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CTL - Q1 2012 CenturyLink, Inc. Earnings Conference Call

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OVERVIEW:

CTL reported 1Q12 consolidated operating revenues of $4.61b and adjusted diluted EPS of $0.68. Expects 2Q12 total operating revenues to be $4.55-4.6b. Anticipates full-year 2012 adjusted diluted EPS to be $2.35-2.55 and 2Q12 adjusted diluted EPS to be $0.59-0.64.

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PRESENTATION

Operator

Good day ladies and gentlemen, and welcome to CenturyLink's first-quarter 2012 earnings conference call. At this time all participants are in a listen-only mode. Later, we will conduct a question and answer session and instructions will be given at that time. (Operator Instructions) As a reminder, this conference call is being recorded. I would now like to turn the conference over to Mr. Tony Davis, Vice President of Investor Relations. Mr. Davis, you may begin.

Tony Davis - *CenturyLink Inc - VP, IR*

Thank you, Sayeed. Good afternoon everyone and welcome to our call today to discuss CenturyLink's first-quarter 2012 results released earlier this afternoon. The slide presentation we will be reviewing during the prepared remarks portion of today's call is available in the Investor Relations section of our corporate website at ir.centurylink.com. At the conclusion of our prepared remarks today, we will open the call for Q&A.

On slide 2 you find our Safe Harbor language. We will be making certain forward-looking statements today, particularly as they pertain to guidance for second quarter and full year 2012, the integration of Qwest and Savvis, other outlooks in our business. We ask that you review our disclosure found on this slide as well as in our press release and in our SEC filings, which describe factors that could cause our actual results to differ materially by those projected by us in our foward-looking statements. We ask that you also note that our earnings release issued earlier this afternoon and the slide presentation and remarks made during this call, contain certain non-GAAP financial measures. Reconciliation between the non-GAAP financial measures and the GAAP financial measures are available in our earnings release and on our website at www.CenturyLink.com.

Now turning to slide 3, your host on today's call is Glen Post, Chief Executive Officer and President of CenturyLink. Joining Glen today will be Stewart Ewing, CenturyLink's Chief Financial Officer, and also available during the question-and-answer period of today's call will be Karen Puckett, CenturyLink's Chief Operating Officer who leads our Region Markets Group; Bill Cheek, President of our Wholesale Markets Group; and Jim Ousley, Chief Executive Officer of Savvis and President of our recently announced Enterprise Markets Group. Our call today will be available for telephone replay through May 16, 2012 and accessible by webcast through May 31, 2012. Anyone listening to a taped or webcast replay or reading a transcript of this call should note that all information presented is current only as of May 9, 2012 and should be considered valid only as of this date regardless of the date heard or reviewed.

As we move to slide 4, I will now turn the call over to your host today, Glen Post. Glen.

Glen Post III - *CenturyLink Inc - Chairman and CEO*

Thank you, Tony. Good afternoon, everyone and thank you for joining us today as we discuss CenturyLink's first-quarter 2012 performance and to review our strategic focus areas for the month ahead. For the past few quarters we have outlined our plan to continue to move toward revenue stability, stable cash flow and further growth. That plan includes investing in key strategic initiatives, broadband expansion and enhancement, Prism TV, fiber-to-the-tower, and managed hosting and cloud computing services. Areas that we believe provide the best opportunities of future revenue growth. We are executing well on this plan and remain focused on continuing this progress in the month ahead.

Turning to slide 5, during the quarter we made good progress in improving our top line revenue trend, we generated over $4.61 billion, a 2.7% year-over-year decline, comparing favorably to the 3.6% decline from the first quarter 2011 and a 3.2% decline from the pro forma 2000 -- pro forma fourth quarter 2011. Full year 2012 we remain on track to reduce our annual revenue rate of decline to between 1.5% to 2.5%. Business customers now drive about 60% of our total operating revenues and our focus on delivering advanced solutions and data hosting services to businesses are key factors in improving our top line revenue trend. Also in the first quarter we achieved further access line loss improvement and strong broadband subscriber growth, and we continue to scale our Prism TV service in the eight markets where it is currently available.

The integrations of Qwest and Savvis remain on track and we will continue to leverage these assets to strengthen our competitive position. Due to better than expected synergy achievement and a better visibility related to the Qwest acquisition, we have raised our annual operating expense synergy target of $650 million from $575 million, an increase of 13%. As of the end of the quarter, we have achieved an annual synergy run rate of $340 million related to the Qwest integration. We expect to end 2012 with an annual synergy run rate of about $465 million. Stewart will provide additional color around the Qwest energy target increase a little later in the call.

To more effectively leverage the strategic assets of paying for the Embarq, Qwest, and Savvis acquisitions, we announced the restructuring of our operating groups in March. Effective April 1, this year we consolidated our organizations focused on business and government customer segments and the two organizations, Enterprise Markets Group, or EMG, and Regional Markets Group, or RMG. EMG is led by Jim Ousley and serves national and international business customers that operate primarily outside our local market areas, along with Savvis' customers and federal government customers. Regional and local business customers that operate primarily in our local market areas and state local government customers are now served by the Regional Markets Group which Karen Puckett continues to lead. The Wholesale Markets Group led by Bill Cheek continues to serve our wholesale international customers, they also now provide sales and support the Savvis wholesale carrier customers. We believe this structure provides a more integrated approach that will allow us to serve our business and government customers more effectively and competitively and it underscores the strategic rationale for the acquisition we have made the past few years.

Moving to slide 6, I will provide a few highlights regarding these four key strategic initiatives. Our first-quarter results reflect the solid progress we make in these key areas. Through the quarter we continued our disciplined investment in broadband expansion enhancement in Prism TV, fiber-to-the-tower, and in managed hosting and cloud services. First we continued to make significant investments in the expansion enhancement of our broadband network. During the first quarter we added over 89,000 high speed internet customers. Our customer retention efforts and the benefits of bundling broadband with products and services resulted in the continued decline in the rate of access line losses in our business, we improved from 7.6% at first quarter 2011 to 6.4% at first quarter 2012.

We also expanded our fiber-to-the-node infrastructure to an additional 175,000 living units during the quarter and now passed nearly 6.3 million living units with fiber-to-the-node and we expect to pass about 7.1 million living units by year-end. Also in late first quarter we rolled out simplified packages for higher speed ethernet, bundled with Voice-over-IP and IT services targeted to our SMB customers. Early indicators are encouraging with positive market feedback that this bundle is simple and compelling and begins to position us for further provisioning of IT services in the SMB market. As a result of our network investment enhancements, broadband speed availability has continued to improve. Nearly 70% of enabled lines receive speeds of 6 megabits or higher now, almost 55% of enabled lines receive 10 megabits or higher, and over 25% have speeds of 20 megabits or higher. We expect to continue to make investments in our networks to deliver competitive broadband product and services across our markets in the months ahead.

Second, our Prism TV service represents a very compelling entertainment alternative to cable TV services in the eight markets where it is currently available. We remain focused on expanding our Prism TV enabled footprint and in driving additional subscriber growth in the months ahead. Our Prism product continues to perform well. We added nearly 15,000 Prism subscribers during the first quarter, 55% of which are new to CenturyLink. We now have a penetration rate of over 8% across eight markets in which the service is available. Prism TV continues to have a positive impact on churn and line loss trends and we experienced greater than 90% broadband pull-through rate with our Prism sales to new customers. We continue to see an annualized 350- to 400-basis point improvement in churn for our customers taking the Prism product. We remain on track to launch Prism TV in our first Legacy Qwest market in the coming months.

Continuing onto slide 7, our third quarter -- our third key strategic initiative is investing in fiber builds to as many towers in our service areas as economically feasible. This initiative supports anticipated long-term growth in data transport, most of which is driven by wireless data traffic, and it expands our addressable customer footprint by enabling fiber access points to other strategic locations where viable along these routes. During the first quarter we completed 650 fiber builds. This is in line with expectations and we continue to anticipate completing 4,000 to 5,000 builds in 2012 as fiber-to-the-tower construction continues to ramp up through the remainder of the year. We believe our fiber-to-the-tower program solidifies our wholesale special access revenue for the long-term and it assists in stabilization of our revenue trend. As we have discussed with you before, we do expect some near-term revenue compression as our wireless wholesale customers transition from copper-based DS1 backhaul facilities to fiber-based ethernet backhaul services. However we believe the continued acceleration in wireless data consumption will drive increases in ethernet service revenues that will offset any revenue compression within a reasonable period of time and provide solid growth over the 7 to 10 years lives of the associated contracts.

And finally we continue to invest in managed hosting and cloud services to increase data center capacity as well as expand our product portfolio to meet customers needs and expand our market opportunity. During the first quarter, Savvis' bookings are strong once again, growing 26% from the year-ago period and comparable to fourth quarter '11 which had the highest bookings level since the first quarter 2008. Additionally to further expand our global presence, we announced a joint venture with Digital Realty Trust to build a data center in the Hong Kong financial district. And we launched Savvis cloud products in both Hong Kong and Japan. We are also adding a data center in Singapore that will enhance our ability to provide service in the Asia region and better meet the needs of our global clients.

Also our Savvis operating group was recently selected by several third-party global IT service providers and financial service companies to provide their cloud and hosting services to help transform their existing IT infrastructure into more agile, cost-effective computing environments. We also gained traction in cross selling opportunities for Savvis product to our existing enterprise customers through our RMG and BMG segments, for example several existing network customers now have signed agreements for Savvis hosting services. We expect further improvement in this key effort in the second quarter and beyond. Finally, we ended the first quarter with 51 data centers in the North America, Europe, and Asia, with total sellable floor space of 1.36 million square feet.

In summary, I am pleased with the first quarter financial results which were supportive of strong customer metrics. We continue to improve our top line revenue trends as we move towards revenue stabilization and eventual growth. Our employees did a very good job of containing costs and we generated strong cash flows during the quarter. We also reduced our access line losses by more than 20% compared to pro forma first quarter 2011, and 6% compared to fourth quarter 2011, and grew our high speed internet customers by nearly 90,000 subscribers. And we made solid progress in our key strategic initiatives that we believe position us well as to continue to improve our top line revenue trends in the months and years ahead. With that I'll turn the call over to Stewart for an in-depth look at our financial results.

Stewart Ewing - *CenturyLink Inc - EVP and CFO*

Thank you, Glen. I'll spend the next few minutes reviewing the financial highlights from the first quarter and then I'll provide a brief liability management update and conclude my remarks with an overview of the second-quarter and full-year 2012 guidance we included on our earnings release issued earlier this afternoon.

Turning to slide 10, first in order to provide more relevant comparisons, I'll be reviewing the financial results on a pro forma basis as if Qwest and Savvis were fully included in the results for all periods. I'll also be reviewing the results excluding special items as outlined in the earnings release and associated financial schedules. Additionally, this quarter we continued to report four operating segments, RMG, BMG, WMG, and Savvis. Next quarter we will continue to report four segments, however they will be realigned to report under the new operating structure we announced in late March, which are the Enterprise Managements Group which will include two segments, network services and data hosting services, and the Regional Markets Group and the Wholesale Markets Group. When we report second-quarter results in early August, we plan to publish historical quarterly segment financial information along the new reporting lines as outlined in more detail in the earrings release.

With that let's turn to the results for the first quarter. As you can see we generated strong operating cash flows and solid cash flows during the first quarter. Operating revenues were $4.61 billion on a consolidated basis, in line with our guidance for the quarter, and represent a 2.7% decline for pro forma first quarter 2011 operating revenues. This also represents a solid improvement from the 3.6% annual decline in the year-ago period. Strategic revenue in the quarter increased to 45% of total revenue from 42% of total revenue in first quarter a year ago. Adjusted diluted earnings per share for first quarter was $0.68, exceeding guidance by $0.05, which was driven by lower than anticipated depreciation, professional services, and operating tax expenses, the timing of certain hardware and software maintenance contracts as well as higher than anticipated capitalized expenses.

Adjusted diluted EPS excludes special items and certain noncash purchase accounting adjustments as we have discussed during prior earnings calls. Total cash operating expenses declined modestly from a pro forma first quarter 2011 to first quarter 2012 with synergy achievement and other cost reductions partially offset by continued investments in our key strategic initiatives. We generated solid operating cash flow over approximately $1.94 billion for the first quarter, about $40 million above the top of our prior guidance, and achieved an operating cash flow margin of 42.2%. Additionally, we generated $1.04 billion of free cash flow during the quarter which is defined as operating cash flow, less cash taxes paid, interest, and capital expenditures and additional adjustments to other income. Our strong cash flows continue to provide us the financial strength and flexibility to meet our business objectives and drive long-term shareholder value.

Now turning to slide 11, I'll begin my operating segments discussion today with our Regional Markets Group. Regional Markets Group generated $2.2 billion in operating revenues, which represents a decrease of 4.1% over pro forma first quarter a year ago. Strategic revenues grew to $764 million in the quarter, up 3.9% pro forma year over year. Legacy services revenues for the segment declined $124 million or 8.1% from pro forma first quarter 2011 due primarily to a continuing decline in revenues related to access lines. However, this 8.1% decline represents a solid improvement over the 9.4% year-over-year decline in Legacy revenues in pro forma first quarter 2011. Our expense reductions for the first quarter compared to the previous year were mainly driven by lower employee-related expenses, professional fees, and marketing and advertising costs, which were partially offset by higher Prism TV expenses.

Moving to slide 12, our Business Markets Group generated $917 million in operating revenues during the first quarter which represented a decrease of 1.3% from pro forma first quarter 2011. That said, excluding data integration revenues, the year-over-year decline in BMG operating revenues for the quarter was only 0.4%. First-quarter strategic revenues for BMG increased by $13 million or 3% to $450 million from pro forma first quarter 2011, driven primarily by strength in high bandwidth services such as ethernet, MPLS, and DWDM. Excluding low-speed private line services which were in decline as customers migrate to higher-bandwidth services, strategic revenue grew nearly 8% from the pro forma year-ago period. Legacy revenue for BMG declined by $16 million from pro forma first quarter 2011, due primarily to declines in local and Legacy WAN services, while data integration revenues decreased $9 million or 7% due to lower equipment sales and professional services revenues. Our total segment expenses in BMG increased by 9.6% to $581 million for first quarter 2012, as we experienced higher expenses related primarily to the expansion of sales resources and increased network allocations from RMG.

Moving to slide 13, our Wholesale Markets Group generated $957 million in operating revenues, a decrease of 4.2% from pro forma first quarter 2011, as access and long distance revenues continued to decline but were partially offset by wireless and other wholesale carrier bandwidth revenue growth during the quarter. Strategic revenues for WMG grew 4.2% to $576 million from pro forma first quarter 2011, primarily driven by continued strong data transport demand from wireless providers. WMG's Legacy revenues declined by 14.6% to $381 million, reflecting the continued decline in access revenues. WMG's operating expenses for the quarter were $278 million, 4.1% below the pro forma period from the prior year. The decline was primarily due to lower professional fees and reduced headcount.

Now turning to slide 14 in our Savvis operating group. Savvis generated $266 million in operating revenues, representing an increase of 3.9% from pro forma first quarter 2011 revenues of $256 million. This growth came primarily from year-over-year increases of 4% in colocation revenues and over 7.5% in managed hosting and cloud services revenues, which were partially offset by a 1.5% decline in network services revenues. Savvis' strong fourth-quarter 2011 bookings, which we discussed last quarter helped drive this revenue growth in first quarter, and we believe the continued strong Savvis bookings in the first quarter provide a solid provisioning funnel to support continuing revenue growth in the second quarter. Savvis' operating expenses were $209 million in the first quarter compared to $190 million in pro forma first quarter 2011. This increase of 10% is driven by the expansion of data center operations and additional sales and marketing staff to support revenue growth.

As shown on slide 15, we continued to make good progress on our $1.5 billion to $2 billion gross debt repayment program. In 2011 we set a target to repay $1.5 billion to $2 billion of gross debt on a pro forma basis over the two-year period ending December 31, 2012. We remain on track to reach this goal as we have accomplished approximately $1 billion of our target through the first quarter. Recent liability management actions have extended the weighted average maturity of our debt by approximately two years and slightly decreased our weighted average interest rate. The chart illustrates the change in annual debt maturities. As you can see, these recent actions position CenturyLink well from a debt maturity standpoint through 2017. As a result of the refinancing and debt reductions over the last several months, we currently expect interest expense to decline modestly each quarter through the remainder of 2012.

Slide 16 addresses our second-quarter and full-year 2012 guidance. For the second quarter 2012, CenturyLink projects total operating revenues of $4.55 billion to $4.6 billion, and operating cash flow between $1.86 billion and $1.91 billion; adjusted diluted EPS is expected to be $0.59 to $0.64. For full year 2012, the previously provided guidance for operating revenues, precash flow, and capital expenditures remains unchanged from the previous guidance we gave when we reported fourth-quarter 2011 earnings. However, primarily as a result of our lower than anticipated first-quarter operating expenses, we now expect operating cash flow to be in the range of $7.45 billion to $7.65 billion, and adjusted diluted EPS to be in the range of $2.35 to $2.55.

Lastly, as Glen mentioned earlier, we have increased our annual run rate operating expense synergy for the Qwest acquisition to $650 million from $575 million. The majority of this $75 million increase is driven by nonpersonnel-related costs primarily in RMG, finance, and network services areas. That concludes our prepared remarks. So at this time I'll ask the operator to provide instructions for the Q&A portion of our call.

QUESTIONS AND ANSWERS

Operator

(Operator instructions)

David Barden, Bank of America.

David Barden - *BofA Merrill Lynch - Analyst*

Congrats on the quarter. Just if I could quickly, Glen, could you go into a little bit more behind the rationale for the restructuring, I guess Chris has left and now Jim I think you're going to be taking over a larger slab of responsibilities. What are the specific benefits that are supposed to come out of that and is that part of the synergy guidance change? And then second, Stewart, could you refresh us or remind us where your net operating loss tax carry forward now stands and as you look out into the future, how many years are you now thinking that you'll be shielded from taxes under the current regime? Thanks.

Glen Post III - *CenturyLink Inc - Chairman and CEO*

David, thank you. And first of all, regarding the rationale for the organization change, first of all, we had -- we have a lot of common customers between our Legacy BMG group and our Savvis Group, number one. Secondly, we are finding that virtually all of our enterprise customers now are asking and talking about -- wanting to talk about cloud and hosting services, and we believe that bringing those sales groups together, managing those groups together, will enhance our ability to bring value to those enterprise to business customers. That's a major factor there and that -- we believe that opportunity will grow in the month ahead. Of course we have a lot of training to do, cross training to do with our BMG sales folks on cloud and some network training in the Savvis Group, but we will get that done over time. And it also consolidates how we approach the enterprise customers with one contact, with coordination, we will have leads and of course experts in different types of services but it makes a lot of sense to us.

Secondly, if you look at the business that we moved to RMG, it's in territory, there's large businesses that -- where we have local presence and we feel like with our regional management system, our general managers, we can bring more personalized, build better relationships in these cities in markets where we have our local operating or [highlight] business. We thinks it makes a lot of sense and really will drive value for us and for our customers over time.

Stewart Ewing - *CenturyLink Inc - EVP and CFO*

And David as of the end of 2011, we had $6.2 billion of NOLs and we would expect to be a full taxpayer probably in 2015.

Jim Ousley - *CenturyLink, Inc. - CEO and President of EMG*

And also on the advantage -- on the synergy question, Dave, we did not include the reorganization synergies as part of the synergy increase we are talking about with Qwest and -- with Qwest transaction.

Operator

Michael McCormack, Nomura Securities.

Michael McCormack - *Nomura Securities Intl - Analyst*

Stewart, can you just address the change in guide. It looks like the benefit on both ETS and OSGF was reached in Q1. Just trying to get a sense for how we should think about margins as the year progresses. It looks like again that the guidance (inaudible) is already captured. Maybe just a quick comment, a little more color on the Qwest upside. You mentioned it was nonpersonnel. Is that access or other things we should be thinking about? Thanks.

Glen Post III - *CenturyLink Inc - Chairman and CEO*

Yes, so Michael, basically the change in the guidance, most of it was captured, we always have a seasonal increase in expenses in the second and third quarters really related to our folks being able to get out and do more maintenance on the network and energy cost increase with heating -- with cooling, rather, in the summer and things like that. So most of it was really captured in the first quarter. With respect to margins, would expect the margin was a little bit over 42% in the first quarter. Would expect to end up somewhere in the 41.5% range or so probably for the full year.

Michael McCormack - *Nomura Securities Intl - Analyst*

Okay. And the Qwest comments? You mentioned there was nonpersonnel. I'm trying to get a sense for what the moving parts were there on the upside.

Glen Post III - *CenturyLink Inc - Chairman and CEO*

Basically in the network side, I think we've basically been able to consolidate, do more from the standpoint of consolidating some of the networks and getting more efficiencies there, getting off of third-party networks. With respect to RMG, I think they were just able to basically reduce some of the expenses associated that are really -- they are not headcount related but they are related to getting out of some buildings and things like that. And then with respect to the finance group, basically we were able to reduce some of our insurance costs more than we thought and just some of the other costs, actually building-related costs too that were related to there. And some contract labor. Contract labor reductions as well both in the finance group and in RMG.

Michael McCormack - *Nomura Securities Intl - Analyst*

Great. That's helpful. Thanks, guys.

Operator

Dave Coleman, RBC Capital Markets.

David Coleman - *RBC Capital Markets - Analyst*

On your revenue guidance for 2012, if I take the midpoint of the 2Q and the full-year revenue guidance, it suggests a material improvement in the rate of decline in the second half of the year, almost to the point of flat revenues existing -- I'm sorry, exiting 2012. So I was wondering what your revenue trend expectations are for the year and when you would anticipate achieving revenue stabilization, and then just on the broadband side, continue to post pretty good broadband subscriber numbers. Just wondering what the source of these new subscribers are, if it's new to category or switchers from cable or another broadband provider. Thanks.

Glen Post III - *CenturyLink Inc - Chairman and CEO*

Yes, so basically on the revenue guidance, we do expect revenue to continue to improve throughout the year and the reasons that it will continue to improve is, one, on the RMG side, basically we'll continue to add customers with our Prism TV service, we also expect to add additional broadband customers. And our folks are doing a good job on the business side as well attracting new customers and data revenues from our business customers. On the -- and we expect Savvis revenues to continue to grow throughout the year, so we believe that will help revenue growth as well during the year or help improve the reduction that we've been seeing in the past. We are not ready to call yet, that we will get to revenue stability in the fourth quarter but hopefully we should see some continued improvement throughout the year.

Karen Puckett - *CenturyLink Inc - EVP, COO*

And on the -- this is Karen Puckett. On the high speed, really there's three categories. One, our local model, general managers, and a local engagement from the team having quota by market has been extremely helpful and visibility into that. Secondly I would just say the continuation of the change in the go to market, so first off our Price Lock, five-year Price Lock as well as our Bundle Your Way, which is something we've had in the market for a couple of quarters now have continued to play extremely well for us. Our call center continues to perform, their sales per 100 continues to go up, especially in the Legacy Qwest centers that we were attempting to get up to the Legacy CenturyLink levels. And then we've initiated quite a few of contact retention strategies that has helped us on the churn side, so all three of those really gave us a great quarter. Relative to second quarter, I would just be mindful that there is seasonality always in second quarter, pretty significantly around snow birds, and so typically that had been Florida for us, now we have Arizona and other areas, as well as college students.

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David Coleman - *RBC Capital Markets - Analyst*

That's great. Thank you.

Operator

Batya Levi, UBS.

Batya Levi - *UBS - Analyst*

For the BMG unit I believe that you mentioned some personnel increases that caused some pressure on expenses and margins on the first quarter. Have you reached the scale that you want now? Can we expect margins for that unit to continue to improve from here? I understand the organizational change is going to change the overall outlook, but would you just for that segment, would you expect margins to improve? Thanks.

Glen Post III - *CenturyLink Inc - Chairman and CEO*

Batya, yes. We believe -- we are going to be changing segments next quarter so it's going to be awfully different and we are going to have to go back to restate what is the BMG segment today, because all the customers that are in for the most part, their customers that are in the Legacy local exchange areas are going to be moving over to the RMG group. So we will have to see what impact that has on margins. But just from the standpoint of where the salesforce is, we think the expense associated with the salesforce is where it needs to be, and yes at this point and don't really expect any continued expansion there, in the BMG.

Batya Levi - *UBS - Analyst*

Okay. Thanks.

Operator

Scott Goldman, Goldman Sachs.

Scott Goldman - *Goldman Sachs - Analyst*

A couple of questions. Maybe Stewart just going back to one of the previous questions and talking in reference to the margin trajectory, but help us think through how some of the costs layer in throughout the year, what would be the timing of that Qwest markets? Are you still planning on doing two Qwest markets throughout the year and what might be the timing of that? And perhaps timing of some of the other initiatives around hosting and cloud to help us think through that. And then secondly, maybe Glen maybe you can help us think about or your latest thoughts on M&A, clearly with the synergy guidance hike today I think that suggests you're more comfortable with the Qwest integration progress, so maybe you could talk a little bit about your appetite for further M&A and what types of assets could be of interest. Thanks.

Stewart Ewing - *CenturyLink Inc - EVP and CFO*

Yes, so cash expenses we would expect to be up marginally in the second quarter over the first quarter, again, just due to mostly seasonality, and then marginally up again in the third quarter, partially due to seasonality there and the utilities and the expectation that we would be increasing costs associated with the Prism TV service. And also Savvis, where we are adding some data center capacity throughout the year. And then hopefully costs would flatten out somewhat between third and fourth quarter as those seasonal increases start declining somewhat as the weather cools off.

Glen Post III - *CenturyLink Inc - Chairman and CEO*

Scott, regarding the Qwest integration, it is going well. We are on target there. We successfully completed the SAP conversion, we have selected all the major systems now, we are going to be converting in the months ahead, so it's going well. We have more visibility than we had. So we are feeling good about it. But there still has to be a lot of focus on that integration. We have to get it right. So we are not letting up there. Also, we have still Savvis coming in and really the reorganization, a lot of focus there.

However, as we see these integrations really come to fruition here like we expect, we will continue to first of all focus on our four key initiatives like we talked about, the broadband expansion, fiber-to-the-tower, our Prism TV, and managed hosting and cloud services. That being said, we will continue to look at opportunities for inorganic growth that can drive shareholder value but more so the further we move down the road with the Qwest integration, so I'm not ready to tip our hand on what our favorites would be there but we will be looking at opportunities that we think can drive long-term shareholder value and that will be our goal as we look at inorganic opportunities.

Stewart Ewing - *CenturyLink Inc - EVP and CFO*

Scott, it's not really cash flow item but we would expect depreciation expense to increase marginally each quarter as well as we continue to make investments for growth in the future.

Scott Goldman - *Goldman Sachs - Analyst*

Great. Thanks and just follow-up on that, Stewart, can you help us or remind us how much incremental IP TV costs you'll see on the OpEx side this year?

Stewart Ewing - *CenturyLink Inc - EVP and CFO*

About $70 million over last year, over 2011.

Scott Goldman - *Goldman Sachs - Analyst*

Okay. Great thanks, guys.

Operator

Frank Louthan, Raymond James.

Frank Louthan - *Raymond James & Associates - Analyst*

Can you talk to us about the Connect America fund money that you've been offered and what your thoughts are there and when we might see some announcement of how much of that you might be able to put to use? And then maybe question for Jim, looking at having all of the EMG and Savvis units together, how differently will you be going to market and how should we think about your approach in the enterprise space with those combined assets as opposed to maybe the way Qwest and Century were operating before?

Stewart Ewing - *CenturyLink Inc - EVP and CFO*

Yes Frank, we were allocated about $90 million of the Connect America fund and very rural areas where we really have the greatest need for support, this amount on a per location basis will not be enough to allow us to really do an economic build-out, so we are still in the process really of evaluating our opportunities with respect to that fund, and we will make the decision within the 90-day period and talk with the FCC.

Jim Ousley - *CenturyLink, Inc. - CEO and President of EMG*

And Frank on the enterprise, the new enterprise approach, clearly we will still keep focus on network because we have a large base to maintain there, but more importantly and the reason we brought these together is a very small percentage of the Qwest and BMG customer base today aren't using any level of Savvis' hosting services or even competitor hosting services, so the opportunity to go to that customer base and leverage our services is very high. So we will have a focus on hosting, we will have a focus on network, we will bring products and services together, in fact we will be announcing some in the next few weeks that combines network capabilities with hosting capabilities and cloud capabilities that we can take to the large Qwest base that we think will afford some significant growth opportunities.

Frank Louthan - *Raymond James & Associates - Analyst*

That's great. One quick follow-up. Do you have the Qwest data center assets, I think those are under Savvis now, what is the outlook for those assets, were they underutilized and when should we expect to see that impact, the Savvis numbers?

Stewart Ewing - *CenturyLink Inc - EVP and CFO*

We do have those data centers and those were relatively high utilization and so we are in the process of one, refocusing those and also in several cases they weren't up to the Savvis' level of data center quality that we need for true enterprise markets so we've been upgrading those. That will probably take until the end of the year and so we will hopefully be able to expand that by the end of the year. And one of the reasons we brought it under Savvis was to be able to get it under the Savvis umbrella and then leverage those assets, so I would say in the second half of the year you'll see some growth from those Qwest assets.

Frank Louthan - *Raymond James & Associates - Analyst*

Great. Thank you very much.

Operator

(inaudible), Morgan Stanley.

Unidentified Participant - - *Analyst*

You guys engaged in a significant amount of debt refinancing in this quarter. What visibility do you have with --

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Stewart Ewing - *CenturyLink Inc - EVP and CFO*

Yes, we are having trouble hearing you. I'm sorry. Could you speak up.

Unidentified Participant - - *Analyst*

I don't have the CenturyLink land line.

Stewart Ewing - *CenturyLink Inc - EVP and CFO*

(laughter) We can resolve that problem.

Unidentified Participant - - *Analyst*

You guys have been engaged in a significant amount of debt refinancing this quarter and just wondering what visibility you have into the rating agencies and how you think about buybacks or dividend increases as we go towards the end of this year and beginning of next.

Glen Post III - *CenturyLink Inc - Chairman and CEO*

Yes, so basically we will have our normal conversations with the rating agencies after today in the next week or two and but we do plan on really fully executing on the $1.5 billion to $2 billion debt payback that we -- that we committed to by the end of the year. And then the Board will talk at the end of the year, early next year about what do with free cash flow in 2013. So we can't really make any commitments there now. It will take the rest of the year really to fulfill the commitment that we have.

Unidentified Participant - - *Analyst*

Appreciate it. Thank you.

Operator

Thank you. Kevin Smithen, Macquarie.

Kevin Smithen - *Macquarie Research Equities - Analyst*

I noticed there was no change to free cash flow guidance despite the upside in Q1. Maybe you could talk about the progression of CapEx and working capital puts and takes over the remainder of the year and how you view that. Are there any things I'm missing aside from the CapEx? Because even if you keep CapEx flat with the upside in Q1, you should see higher free cash flow for the year.

Stewart Ewing - *CenturyLink Inc - EVP and CFO*

Yes, so the range of guidance that we have given for CapEx is $200 million and we were just -- we really wanted to get further into the year before we adjust free cash flow guidance just to see where we think we are going to end up from a CapEx standpoint. If we end up towards the top of the CapEx guidance or from the mid to the top, then basically we wouldn't -- we wouldn't be able to raise our guidance from free cash flow, so we wanted to give ourselves another quarter there to let that flush out a little bit.

Kevin Smithen - *Macquarie Research Equities - Analyst*

So we should think of your CapEx progression as more along the lines of AT&T and Verizon seeing a sequential acceleration versus Frontier who seems like they front loaded more of their CapEx given the warm weather.

Stewart Ewing - *CenturyLink Inc - EVP and CFO*

Yes, we will see, really be pretty -- I would imagine pretty steady for the rest of the year. We added -- we probably -- our CapEx was unusually high first quarter this year the cash CapEx because of really a lot of money that we spent and invested at the end of last year and just the payables didn't get paid until after the first of the year, so that's why the cash CapEx number was higher than it normally is in first quarter and expect it to be pretty flat the next quarter.

Kevin Smithen - *Macquarie Research Equities - Analyst*

Any further thoughts on Prism TV CapEx for 2013? I had in my notes that you were going to get back to us with some more color at some point as to suggest base CapEx for next year.

Stewart Ewing - *CenturyLink Inc - EVP and CFO*

I think we need to get through 2012 or further into 2012 and get one of the Qwest markets turned. To see if we continue to have success that we've experienced in the eight markets that we have today, and also get one of the Qwest markets up, and then I think we will be able to give some guidance on 2013.

Kevin Smithen - *Macquarie Research Equities - Analyst*

Great. Thank you.

Operator

Thank you. This concludes our question-and-answer session for today. I would now like to hand the conference over to Mr. Glen Post for any closing remarks.

Glen Post III - *CenturyLink Inc - Chairman and CEO*

Thank you. CenturyLink's first-quarter financial results and operating metrics reflects a solid start toward achieving our 2012 objectives, improving our top line revenue trend, slowing the rate of line loss and driving further penetration of our broadband services including internet and Prism TV, and high bandwidth services. Our integration of the Qwest and Savvis acquisitions are proceeding well, and as a result we have increased annual synergy run rate to $650 million. Our operating group restructuring announced in late March became effective April 1, which we expect to drive additional benefits in the integration of Qwest and Savvis. And we believe this enhances our ability to leverage our asset portfolio to serve our business and government customers.

We expect to continue to invest in our key strategic initiatives as we believe these investments continued to strengthen CenturyLink's ability to compete on a local, national, and global scale. Finally I'd like to invite all of you in the investment community to our analyst day that we have scheduled for June 12, at the New York Stock Exchange. The invitation and registration information will be sent out this week and we hope you'll be able to attend and meet members of our Executive Team there. Thank you for being on our call today and we look forward to speaking with you in the months ahead.

Operator

Thank you, sir. Ladies and gentlemen, thank you for participating in today's conference. This concludes our program for today. You may all disconnect and have a wonderful day.

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