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CTL - Q4 2012 CenturyLink, Inc. Earnings Conference Call

EVENT DATE/TIME: FEBRUARY 13, 2013 / 10:00PM GMT

OVERVIEW:

CTL reported 4Q12 consolidated operating revenues of $4.58b and adjusted diluted EPS of $0.67. Co. expects 2013 total operating revenue to be $18.1-18.3b and adjusted diluted EPS to be $2.50-2.70.

CORPORATE PARTICIPANTS

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to CenturyLink's fourth 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 call over to Mr. Tony Davis, Vice President of Investor Relations. Mr. Davis, you may begin.

Tony Davis - *CenturyLink, Inc. - VP, IR*

Thank you, Sayed. Good afternoon, everyone, and welcome to our call today to discuss CenturyLink's fourth quarter and full year 2012 results and our capital allocation changes 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.

As you move to slide 2, will you find our Safe Harbor language. We will be making certain forward-looking statements today, particularly as they pertain to guidance for first quarter and full-year 2013, the integration of Qwest and Savvis, our capital allocation changes and other outlooks on our business. We ask that you review our disclosure found on this slide as well as in our press releases and in our SEC filings, which describe factors that could cause our actual results to differ materially from those projected by us in our forward-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 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; Bill Cheek, President of Wholesale Operations; and Jim Ousley, Chief Executive Officer of Savvis.

Our call will be available for telephone replay through February 20, 2013, and accessible by webcast through March 6, 2013. Anyone listening to a taped or webcast replay or reading a written transcript of this call should note that all information presented is current only as of February 13, 2013, and should be considered valid only as of this date regardless of the date heard or viewed.

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

Glen Post - *CenturyLink, Inc. - CEO & President*

Thank you, Tony. Good afternoon, everyone, and thank you for joining us today to discuss CenturyLink's fourth quarter and full year 2012 results. We will also provide guidance for the first quarter and full year 2013, as well as other important updates about our business.

We are pleased with our fourth quarter and full year results and we continue to make good progress on a number of fronts. Starting on slide 5, I would like to highlight the progress CenturyLink made in 2012 toward achieving the goals we set a year ago. Our top line pro forma revenue trend continued to improve in 2012 with an annual revenue decline of 1.7% compared to 3.8% decline in pro forma 2011 and an estimated 5.6% decline in pro forma 2010. This continued improvement is driven by strength in our strategic products including high-speed Internet, Prism TV, high bandwidth data services to enterprise customers and wholesale customers, and our hosting services. For full year 2013, we believe we'll reduce our annual revenue rate of decline to the 0.5% to 1.5% range, and we expect to reach revenue stability in 2014. While we continue to face declines in legacy services, we believe we have the right asset mix in place to stabilize our top line and grow revenue over time.

Continuing on to slide 6, during the year we achieved strong improvement in access line loss and continued subscriber growth in broadband and Prism TV services. We added over 196,000 broadband subscribers and nearly 45,000 Prism TV subscribers during the year. The enterprise market's network segment during 2012, we grew recurring revenue for four consecutive quarters, driven by strength in high bandwidth data services revenue. In addition, we made continued progress on the fiber to the tower initiative, completing over 4,500 fiber builds during 2012, ending the year with approximately 14,700 within our territory.

During 2012 we continued to expand the global reach of our co-location and managed services, adding three new data centers and expanding available space in four existing data centers. Also, in December we launched Savvis Direct, our simplified approach to cloud computing for both small and large businesses. During 2012 we increased operating expense synergy target related to the Qwest acquisition from $575 million to $650 million, and we are pleased with our synergy achievement throughout last year as we ended 2012 with an annual synergy run rate of $480 million.

Moving now to slide 7, I will provide a few highlights from the fourth quarter 2012 regarding our key strategic initiatives. As we have outlined over the past several quarters, we are focused on continued strategic investment in broadband services expansion and enhancement, our Prism TV, fiber to the tower, and hosting and cloud computing services. Our fourth quarter results reflect continued progress we are making in these key initiatives. Starting with broadband expansion enhancement, we continue to make significant investments in this area, and during the fourth quarter, we had over 41,000 high-speed Internet subscribers. With these new subscribers, we now have more than 5.85 million broadband customers.

Our customer retention efforts and the growth benefit of bundling broadband with other products and services contributed to the improvement in the decline of the rate of access line loss, which improved from 6.6% in the fourth quarter 2011 to 5.7% in fourth quarter 2012.

We also expanded our fiber to the node infrastructure to more than 274,000 new living units during the quarter, adding nearly 1 million living units in 2012. We now pass over 7.1 million living units with fiber to the node technology. As a result of our network investment enhancements, broadband speed availability has continued to improve. Over 70% of our enabled access lines receive 6 megabits or higher. Nearly 60% of enabled lines receive 10 megabits or higher; and 31% have speeds of 20 megabits or higher

We've been very focused on expanding our ethernet and MPLS services for our business customers. During the quarter, we continued to expand our ethernet over copper footprint, which has increased over 80% through 2012 to over 700 ethernet-enabled central offices. We expect to continue making investments in our network-enhanced speed capabilities in order to continue delivering competitive broadband product and services across our markets.

Turning to slide 8, our Prism TV service continues to perform well and represents a very compelling entertainment alternative to cable TV service in the markets where it is currently available. We added over 10,000 Prism TV subscribers during the fourth quarter, ending the year with 115,000 subscribers. Of the 45,000 new subscribers we have added over the past 12 months, over 50% of our new subscribers are new customers to CenturyLink. We now have a penetration rate of nearly 11% across eight markets in which the service is available during 2012.

In addition, we continue to enhance our IPTV features by introducing new functionality and applications, including expansion of our TV Everywhere capability, video on demand library, and successful trial of wireless set-top boxes. Prism TV continues to have a positive impact from churn and line loss trends. We experienced greater than 90% broadband pull-through rate with our Prism TV sales to new customers. We continue to expand our Prism TV-enabled footprint and expect to drive additional subscriber growth in the months ahead.

As announced last quarter, Phoenix will be the first legacy Qwest market to receive Prism TV service. The soft launch occurred in late December, and early results and impressions are favorable. We are optimistic about the success in this market. The Phoenix market will be commercially launched in the first half of 2013, and we also expect to enter a second legacy Qwest market in mid-2013.

Continuing on to slide 9, a third key strategic initiative for us is investing in fiber builds to as many towers and service areas as is economically feasible. During the fourth quarter, we completed approximately 1,175 fiber to the tower builds for a total of over 4,500 during 2012. Currently, we have over 14,700 fiber builds complete across our footprint, and we anticipate completing an additional 4,000 to 5,000 builds in 2013. This initiative supports anticipated long-term growth in data transport, much of which is driven by wireless data traffic. It also expands our addressable customer footprint by enabling fiber access points to other strategic locations, where it's viable along these routes. We believe our fiber to the tower program helps solidify our wholesale access revenue for the long-term and assists in the stabilization of our revenue trends.

As we have discussed with you before, we are experiencing some revenue compression as our wireless wholesale customers transition from copper-based DS1 facilities to fiber-based ethernet services. However, we do anticipate that wireless bandwidth growth will result in expansion of ethernet consumption, reversed from the current revenue compression by early 2014. On average, bandwidth capacity of initial fiber-based connection is increasing.

Moving on to slide 10, we continue to invest in managed hosting and cloud services to increase data center capacity as well as expand our product portfolio to meet customer need and expand our market opportunity. We're seeing benefits from investments in this area, and realized the highest quarterly bookings in four years in the fourth quarter as we rebounded from the third quarter.

We continued to expand our facilities and open a data center in Frankfurt, Germany, in the fourth quarter. With this facility, we ended the quarter with 54 data centers in North America, Europe, and Asia; with total salable floor space of about 1.4 million square feet as we continue to expand the global reach of our managed hosting services. We anticipate increasing hosting and cloud revenue expansion opportunities in 2013 as we further train and enable our sales channels for business and wholesale customers.

In October, we announced the beta launch of Savvis Direct, our simplified approach to cloud computing with small and large businesses. The commercial launch occurred in December, and early indications are promising. Finally, on October 15, we closed the acquisition of certain assets of Ciber's global IT outsourcing business. In addition to these assets, we will complement Savvis' existing ITO assets by expanding our capabilities for application management services and help desk support.

Now, turning to slide 11, I want to address our announcement today regarding changes to our capital allocation strategy. We have decided to repurchase up to an aggregate $2 billion of outstanding common stock over the next two-year period ending February 13, 2015; and we've decided to reduce our quarterly dividend to $0.54 a share from $0.725 per share.

Just a little history here as backdrop -- as we were finalizing our budgets for 2013 and working with the rating agencies, it became apparent that, in order to maintain investment grade ratings we needed to reduce investments in the business in our growth -- that is, investments, really in our growth initiatives; and/or we needed to reduce the dividend significantly and use 100% of the free cash flow to repay debt -- again, if we were willing to maintain our investment grade rating. We have decided that it is not in the long-term best interest of the Company and our investors to significantly reduce the dividend or use the proceeds to pay back debt to maintain the investment grade rating. We believe it is important to continue to invest capital in our growth initiatives that will help bring us to revenue and EBITDA growth and to return cash to shareholders as well.

Also, we determined if we were willing to accept the loss of investment grade rating, we could return more cash to shareholders during 2013 and 2014 than we were, even with reducing the current dividend and while implementing a share repurchase program. We decided to take advantage of the opportunity to get more cash to shareholders now and adjust the dividend to a level that would be closer to the payout ratio that we have historically maintained after we have utilized all of our NOLs. We expect to be a full-cash taxpayer in 2015. With this plan, we will be able to continue to invest in our business, our growth initiatives at a strong level. We worked to make our decisions based on our ability to drive long-term shareholder value, and we believe these decisions, these changes will do just that.

On to slide 12. In summary, before handing the call off to Stewart, let me say I'm pleased with our fourth-quarter and full-year 2012 results. We continue to improve our top-line revenue trend and reached the target level of rate decline we set early last year. We reduced our access line losses by 9% compared to the fourth quarter 2011, and we achieved good high-speed Internet subscriber growth as well as a solid increase in the number of Prism TV customers. Also, the focused investments we have made in our key strategic initiatives have positively contributed to strategic revenue growth. They continue to improve our top line -- our revenue trend.

We believe the soft launch of Prism TV into the Phoenix market in December and the subsequent commercial launch in the first half of this year will position us well to grow video subscribers during 2013 and beyond. We are also optimistic about leveraging the acquisition of Savvis to generate organic growth. Our new Savvis Direct product offers the opportunity to gain market share in the fast-growing cloud space across our entire range of customers. Finally, we believe the capital allocation initiatives announced today will further our strategy of investing key drivers to stabilize and grow top-line revenues. In addition to the share repurchase program, our very competitive cash dividend, we will be able to significantly increase the total cash returned to shareholders in the next two years.

With that, I will turn the call over to Stewart for an in-depth look at our financial results. Stewart?

Stewart Ewing - *CenturyLink, Inc. - EVP, CFO and Assistant Secretary*

Thank you, Glen.

I'll spend the next few minutes reviewing the financial highlights from the fourth quarter and then conclude my remarks with an overview of the first-quarter and full-year 2013 guidance we included in our earnings release issued earlier this afternoon. Turning to slide 14, I will be reviewing the results, excluding special items as outlined in the earnings release and associated financial schedules. With that, let's turn to our results for the fourth quarter.

As you can see, we generated solid operating revenues and cash flows. Operating revenues were $4.58 billion on a consolidated basis, which was in line with our guidance for the quarter and represented a 1.5% decline from fourth quarter 2011 operating revenues. This also represents a solid improvement from the 3.2% annual decline in the year-ago period.

Strategic revenue in the quarter increased to 46% of total revenue from 44% in the fourth quarter a year ago, due to growth in strategic products such as high-speed Internet, high bandwidth data services, Prism TV, and managed hosting services. Adjusted diluted earnings per share for fourth quarter was $0.67, meeting our guidance. As we have discussed on prior earnings calls, adjusted diluted EPS excludes special items and certain non-cash purchase accounting adjustments.

Total cash operating expenses decreased from fourth quarter 2011 to fourth quarter 2012. This decline was primarily the result of lower personnel-related costs being partially offset by higher data hosting and network cost. We generated solid operating cash flow of approximately $1.91 billion for the fourth quarter and achieved an operating cash flow margin of 41.7%. Additionally, we generated $610 million of free cash flow during the quarter, which is defined as operating cash flow less cash paid for taxes, interest, and capital expenditures and additional adjustments to other income. Our strong cash flows continue to provide us the financial strength to meet our business objectives and drive long-term shareholder value.

Turning to slide 15, year-over-year revenue declined 1.5% from fourth quarter 2011. The decline was primarily a result of growth in strategic revenue and other revenue being offset by lower legacy revenues due to access line losses and lower minutes of use. Strategic revenue growth was driven by strength in high-speed Internet, high-bandwidth data services, and hosting services.

Now, turning to slide 16, I will discuss each of our operating segments, beginning with our Regional Markets segment. Regional Markets generated $2.45 billion of operating revenues, which represents a decrease of 3.9% over fourth quarter a year ago. Strategic revenues in this segment grew to $914 million in the quarter, up 3.6% over a year ago. Legacy services revenues for the segment declined $120 million, or 7.6% from fourth quarter 2011, due primarily to a continuing decline in access line and long-distance revenues, partially mitigated by implementation of the ARC in July of 2012. Expenses declined $20 million, or 1.9% compared to the previous year, driven mainly by lower employee-related and data integration expenses which were partially offset by higher Prism TV costs.

Moving to slide 17, our Wholesale Market segment generated $908 million in operating revenues, a decline of 5.5% from fourth quarter 2011. Strategic revenues for Wholesale Markets were $572 million, up slightly from fourth quarter 2011, primarily driven by growth of ethernet services, offset by rate compression and special access services as customers transitioned from copper-based to ethernet-based services. Wholesale Markets legacy revenues declined by 14% to $335 million, reflecting the continued decline in access and long-distance minutes of use and the implementation of the cap order rate step-down. Operating expenses for the quarter were $271 million, 13% below the same period from the prior year, driven by lower access and other costs.

Moving to slide 18, Enterprise Markets Network segment generated $671 million in operating revenues during the quarter, which represented an increase of 5.7% from fourth quarter 2011. This marked the fourth consecutive quarter of sequential growth in recurring revenues for the Network Services segment. Fourth quarter strategic revenues for Enterprise Markets Network increased by $25,million, or 8% to $346 million from fourth quarter 2011, driven primarily by strength in high bandwidth services such as MPLS, ethernet, and wavelength. Excluding private line services, strategic revenue was up nearly 13% from a year ago. Legacy revenues were basically flat from a year ago period, while data integration revenues increased $12 million, or 12%, due to higher equipment sales and professional services revenues from government and enterprise customers. Our total segment expenses were flat year-over-year.

Now turning to slide 19, our Enterprise Markets Data Hosting segment, which is primarily legacy Savvis operations. This segment generated $292 million in operating revenues, representing an increase of 13% from fourth quarter 2011 revenues of $259 million. This growth came primarily from year-over-year increases of 9.6% and co-location revenues, 21% in managed hosting and cloud services revenues, and a 3.6% increase in network services revenues. Fourth quarter 2012 EMG Data Hosting revenues include approximately $13 million of revenue contribution from the Ciber IT outsourcing assets acquired in October 2012. Excluding this revenue, Managed Hosting revenue grew about 8% year-over-year. Soft bookings in the third quarter 2012 and higher than normal churn primarily due to customer bankruptcy events pressured fourth quarter 2012 Data Hosting revenue.

Enterprise Markets Data Hosting operating expenses were $235 million in the fourth quarter compared to $202 million in fourth quarter a year ago. This increase of 16% is driven by edit operations and sales and marketing headcount to support revenue growth, including headcount, for the Savvis Direct and enabling sales channels, along with expenses related to the acquisition of the Ciber ITO assets not present in the prior period.

In early January we announced an organizational realignment combining our Network Services business sales and operating teams into one organization which is led by our Chief Operating Officer, Karen Puckett. Slide 20 highlights the revised reporting structure. The reorganization combines business sales and operations functions that previously resided in the Enterprise Markets' Network Services and Regional Markets organizations. We believe this change allows us to better serve our business customers by streamlining our end-to-end service delivery and support and sales of Network Services to our Enterprise customers by creating one cohesive organization.

Beginning with first quarter 2013, the Company will report the following four segments -- Consumer, Business, Wholesale, and Data Hosting services. While the Consumer and Business segments will be different from today's reporting structure, Wholesale and Data Hosting segment will remain unchanged from what was previously known as Wholesale Markets and Enterprise Markets Data Hosting. To assist the investment community in understanding the underlying trends in each segment, we expect to provide historical pro forma segment financial statements when we report first quarter 2013 earnings.

On slide 21 we provide our first-quarter and full-year 2013 guidance. We expect first-quarter 2013 operating revenues and operating cash flow to decrease compared to fourth quarter 2012, primarily due to the decline in legacy and data integration revenues. Similar to last year, we also anticipate a decline in depreciation and amortization expense in the first quarter of 2013, driven primarily by the impact of our annual review and update of depreciation and amortization rates. This anticipated lower level of depreciation and amortization expense, approximately $100 million below the level in the fourth quarter of 2012, is expected to more than offset the decline in operating cash flow and result in an increase in adjusted diluted EPS in the first quarter of 2013 compared to fourth quarter 2012.

For first quarter 2013, CenturyLink projects total operating revenues of $4.46 billion to $4.51 billion, and operating cash flow between $1.83 billion and $1.88 billion. Adjusted diluted EPS is expected to range from $0.67 to $0.72 per share. For the full year 2013, CenturyLink expects total operating revenues of $18.1 to $18.3 billion, reflecting a year-over-year revenue decline of 0.5% to 1.5%. Operating cash flow is expected to be between $7.3 billion and $7.5 billion, and adjusted diluted EPS is expected to be $2.50 to $2.70.

Capital expenditures are expected to range from $2.8 to $3 billion, driven by spending in our key growth areas -- data hosting will spend $325 million to $375 million; HSI expansion and HSI capacity will spend between $350 million and $375 million. In our fiber to the tower, we'll continue to spend about $250 million to $300 million in this area. Our Prism TV, with the launch of the Phoenix and one other market, we expect to spend $100 million to $150 million; and maintenance CapEx is expected to remain around the 20% to 25% of total capital expenditures level.

We anticipate free cash flow for full-year 2013 between $3 billion and $3.2 billion. CenturyLink anticipates full year 2013 operating cash flow and free cash flow to decline from full-year 2012, primarily driven by the impact of the decline in legacy revenue along with a lower level of incremental synergies in 2013 compared to the level of incremental synergies achieved in 2012. The Company also anticipates a decline in depreciation and amortization expense for full year 2013 compared to full year 2012.

That concludes our prepared remarks for the day, so at this time I'll ask the operator to provide instructions for the Q&A portion of the call.

QUESTIONS AND ANSWERS

Operator

Thank you, sir.

(Operator Instructions)

Our first question comes from Mike McCormack from Nomura.

Mike McCormack - *Nomura Securities Intl - Analyst*

Could you just sort of dig in for us on the cash cost? Obviously in '13 we got some pressure on EBITDA, and you mentioned the fact that the Qwest synergies don't recur, and I suspect that one happening 2014 either. But as we look out at EBITDA trajectory, is there anything unusual from '13 from a cash cost perspective, or should we just expect an even level of declining -- potentially declining EBITDA that's tracking revenue, or are there actual levers to pull in the cash cost side to get margins at least stabilized?

Stewart Ewing - *CenturyLink, Inc. - EVP, CFO and Assistant Secretary*

So Mike, basically, the cash expense drivers in '13 over '12, about $165 million or so is associated to lower incremental synergies that we'll have in 2013 than we had in 2012. So, lower incremental synergies of about $165 million. We'll still increase the total run rate synergies from the $480 million that we exited 2012, so about $600 million by the time we exit 2013, but the incremental amount will be less than last year. So, the incremental really, to a certain extent, masked the legacy mix shift that we had from legacy revenues which are very high margin revenues which are very high margin revenues to the strategic revenues, which tend to be lower margin. Additionally, other expense drivers that we have for 2013 are Cyber, there will be about $45 million of incremental expenses there. And then in our IPTV there will be some incremental expenses there as well.

Mike McCormack - *Nomura Securities Intl - Analyst*

Okay, and still, when you think about the buyback, it seems like a fairly low amount of buyback over a fairly long period of time, and stock tomorrow will likely get beaten pretty hard. Is there anyway that you guys could accelerate that?

Stewart Ewing - *CenturyLink, Inc. - EVP, CFO and Assistant Secretary*

Just from the -- we could, depending on what happens to the stock price, Mike. We could be in and potentially buy the shares a little bit sooner or use some financing to purchase the shares a little bit sooner than the 24 month period.

Mike McCormack - *Nomura Securities Intl - Analyst*

Okay, thanks, guys.

Stewart Ewing - *CenturyLink, Inc. - EVP, CFO and Assistant Secretary*

We do plan to buy back about 8% of our total outstanding, though, with the $2 billon.

Mike McCormack - *Nomura Securities Intl - Analyst*

Okay, thanks.

Operator

Thank you. Our next question comes from Batya Levi at UBS.

Batya Levi - *UBS - Analyst*

Thanks. I just want to reconcile some of the prior comments that you had made. I think you had mentioned that if you are comfortable with revenue trends improving, stabilizing, you could even consider maybe a small dividend increase, just to keep in consistent. And I guess I just want to get sense of how you feel about revenue trends going forward. And your 2016 dividend payout guidance of lower than 60%, I think you implied a pretty significant decline to free cash flow per share from the current levels. Can you talk about that as well?

Stewart Ewing - *CenturyLink, Inc. - EVP, CFO and Assistant Secretary*

Yes, so Batya, the decline that you can back into basically by looking at the dividend payout ratio or the approximate payoff ratio in 2015 is really due to the fact that we, in 2014, will utilize all the federal net operating loss carry forwards that we have. And our cash taxes will increase substantially, or we expect them, barring any changes in the tax laws to increase substantially in 2015. So, that's the reason -- that was one of the reasons we had decided to go ahead and take advantage of this at this point in time and be proactive and try to address the dividend and, again, try to return more cash to shareholders over the next two years before we become a full cash taxpayer to allow us to retire 8% or more of our shares, which will reduce the dividend, even at the new rate, by a little over $100 million probably between now and 2015 which, again, allows us to really be a lot more comfortable with the dividend that we're moving to on a going forward basis.

Batya Levi - *UBS - Analyst*

Excluding that increase in the taxes, how do you think about revenue trends from here towards '15 and EBITDA and CapEx, if you could talk a little bit about that too.

Stewart Ewing - *CenturyLink, Inc. - EVP, CFO and Assistant Secretary*

Yes, so Batya, we still expect, as Glen indicated, revenue to flatten out in 2014 compared with 2013, and we'd hopefully we able to grow revenue thereafter, at least -- that's our current thinking. EBITDA may not stable quite as quickly because we'll continue to have some of the revenue mix shift where you continue to lose some of the margin revenue that's replaced with lower margin revenue. But we would hope -- we would be hopeful that we would continue to close the gap in '14 and '15 in terms of flattening out EBITDA and eventually starting to grow EBITDA. And all of that is really without any business as usual, expense cuts in the event we're able to define ways to cut cost to a certain extent over and above the synergies that we expect to get over the next couple of years. It would enable us to be able to hopefully get to EBITDA stability a little quicker.

Batya Levi - *UBS - Analyst*

Okay, thanks.

Operator

Thank you. Our next question comes from David Barden from Bank of America. Pardon me, your line is open. Can you unmute your phone if you have your phone on mute? Our next question comes from Simon Flannery from Morgan Stanley.

Simon Flannery - *Morgan Stanley - Analyst*

Thanks a lot. Can we talk about capital spending? How should we think about the level for 2013? Is that a run rate level, or are some of the projects like IPTV and fiber to the tower peaking this year? If you could give us a little color there. And on the cost side, can you update us on a couple of items, the labor negotiations and any contributions to the pension fund? Thanks.

Stewart Ewing - *CenturyLink, Inc. - EVP, CFO and Assistant Secretary*

So Simon, on contributions to the pension fund, we made a contribution of about $146 million, $147 million in early 2013, and that will suffice, we believe. It will certainly cover all the required contributions that we have to make this year. So I think we've done what we needed to do there for this year. In terms of CapEx levels, Stewart, the $2.9 billion level, that reflects a lot of investments we're making in the new initiatives, Simon, as you pointed out. Excluding our fiber to the tower, about $600 million of that is success-based capital where we have revenues locked in, where we really expect to have them locked in. We make those investments. It includes fiber to the tower where we have the contracts. We have close to $900 million. They're almost on-third of that expand is success-based.

So, to the extent we continue to build out our systems and we have opportunities to grow through hosting, Prism, we'll do it on a success based basis, really. We expect to continue to drive additional revenues if we're successful in these areas. If we have more opportunity, we'll continue to invest in these areas. If we're not, we don't have to. We'll see how this goes, but right now, in 2013 again, we really have one-third of our CapEx in success based type CapEx expenditures.

Simon Flannery - *Morgan Stanley - Analyst*

And on the labor daily, or negotiations?

Stewart Ewing - *CenturyLink, Inc. - EVP, CFO and Assistant Secretary*

Yes, on the labor, we've -- the current contract expired back in October, and we've been working with the union agreed extended her agreements day by day -- or day to day as we continue negotiations. I think everybody's negotiating in good faith. We're making progress, but it's been obviously much slower than we had hoped or expected. But we believe we are making progress. It is our desire to reach agreement that will help the Company better align our costs with a very competitive marketplace while still providing really good competitive wages and benefits for our employees, and we think we will get there. We're hopeful that we'll reach agreement with the union the next several weeks, but it's been much slower than we expected. But we believe we're making progress.

David Barden - *BofA Merrill Lynch - Analyst*

Thank you.

Operator

Thank you. Our next question comes from Frank Louthan from Raymond James.

Frank Louthan - *Raymond James & Associates - Analyst*

Great. Thank you. So, in going through the process, just curious, why wouldn't you consider cutting the dividend further, or if you're -- I applaud standing up to the rating agencies a little bit, but why not leave the you dividend where it is and just buy back less stock? What is the thinking there? And if you are on a path to get to the point where EBITDA is stable, why do we have to necessarily consider cutting the dividend, or is it just taking that much longer than your original plan when you look back at acquiring Savvis and Qwest? Is it just taking longer to get there?

Glen Post, III - *CenturyLink, Inc. - CEO, President*

I will start and let Stewart follow up, Frank. First of all, we didn't think was good to reduce the dividend further. We know that we to -- we believe we need to return cash to shareholders. We believe a 25% cut is certainly not what we want to do in a perfect world, but something we think is important to do now. We do want to maintain the payout ratio we've historically been comfortable with, in that 60%,, below or less than 60% ratio.

We felt like if we pay back -- if we continue the dividend now, there's no real benefit in one sense, because once there is uncertainty about the 2015 payout ratio, then it's really like a one-time dividend or payout to shareholders. We don't think it's the right thing to do.

We decided it was better to buy stock back with that -- with those funds, plus additional -- another 50% of our free cash flow or so and take advantage of those -- that accretion. And with the dividend at a level we are very comfortable with going forward and where we won't see that we think the concern about the level of dividends we'd be paying. So, that's really how we came to our conclusion. Stewart, you want to add anything?

Stewart Ewing - *CenturyLink, Inc. - EVP, CFO and Assistant Secretary*

That's it. It's really, Frank, just thinking through and looking at what the cash taxes would be in 2015 and the impact of that on free cash flow and on the dividend payout ratio. And again, the opportunity to retire 8% or more of the shares between now and then, and really help further -- it's accretive to free cash flow per share, and it will be --reduce the aggregate dividend going forward.

Frank Louthan - *Raymond James & Associates - Analyst*

Okay, and nothing on the operations side that's not trending the way you want -- you had been planning all along that makes you more concerned about in 2015 having to face a bigger dividend crisis?

Glen Post, III - *CenturyLink, Inc. - CEO, President*

No, that was not part of the decision. We made this based on, we believe from a position of strength, frankly, looking to the future of the Company. Also, there's no plans for any -- we don't have any major acquisitions on the radar. That had nothing to do with our decision. It was strictly what we think is best for the long-term growth of this Company.

Frank Louthan - *Raymond James & Associates - Analyst*

Thanks for the color.

Operator

Thank you. Our next question comes from Phil Cusick from JPMorgan.

Phil Cusick - *JPMorgan - Analyst*

Hi, guys. So, with the lower payout ratio, can you help us think about the opportunity that this creates in terms of spending more CapEx or maybe going more aggressively after growth initiatives like the video business, which is going to drive a little more dilution up-front?

Glen Post, III - *CenturyLink, Inc. - CEO, President*

Phil, so with -- I guess, if we buy shares back with the free cash flow, then basically we'll not have the additional capital to invest over and above what we're investing today unless we lever the Company up some. And I guess that's the other thing is part of this, too, we increase the leverage ratio to somewhat less than three times, or no more than three times. But, basically, we plan on using the free cash flow that's he created as a result of the dividend reduction, which is about $450 million a year to repurchase shares, plus we'll add a -- use about $1.1 billion of our free cash flow to repurchase shares as well.

Phil Cusick - *JPMorgan - Analyst*

Okay, and so we should look at CapEx as being essentially flat for the next few year?

Stewart Ewing - *CenturyLink, Inc. - EVP, CFO and Assistant Secretary*

That's our thinking now, Phil, that it'll be pretty flat. We could bring it down some, it could go up a little. It's really based on the success of these new initiatives, what we think we can drive in terms of revenue and margins going forward.

Glen Post, III - *CenturyLink, Inc. - CEO, President*

Fiber to the tower will start winding down, I guess 2014.

Phil Cusick - *JPMorgan - Analyst*

And can you help us think about your thought process on acquisitions here? I would think that given the hit your stock probably takes tomorrow that a stock-based acquisition might be a little tougher, but this buyback pool could leave some room for cash acquisitions instead. How are you thinking of that?

Glen Post, III - *CenturyLink, Inc. - CEO, President*

Right now, we're focused on our key growth initiatives. We believe we have a lot of opportunity of organic growth, with our broadband expansion and the power to the node ethernet and MPLS additions or expansion. We've got fiber to the tower work, that managed hosting cloud service is our Prism TV services. All those, we are very comfortable.

We do not need to make an acquisition in order to grow the Company and to grow revenues and margins. It doesn't mean we won't consider. We will consider opportunities, we always have. But we don't see a need to go out and acquire the right -- we'll look opportunistically at acquisitions that could possibly grow the Company faster, but nothing that we feel like we need to go out and do or have to go out and do.

Phil Cusick - *JPMorgan - Analyst*

Got it. Thanks.

Operator

Thank you. Our next question comes from Tim Horan from Oppenheimer.

Tim Horan - *Oppenheimer & Co. - Analyst*

Thanks, guys. For what it's worth, I think it's a really ingenious, and balance the restructuring here makes a lot of sense. Can you maybe just elaborate on the acquisitions? Are there any areas of divestiture that might make some sense for you? You haven't done in a little while. and maybe any areas of obviously low hanging productivity improvements at this time. Thanks.

Glen Post, III - *CenturyLink, Inc. - CEO, President*

Tim, there's nothing significant. We're -- at least nothing we can talk about right now. There's some, obviously, things on divestitures we've looked at before we could do, but nothing we feel like would really improve our growth rate at this point in time or our margins. So we're not going to expect any divestitures today.

The as far as low hanging fruit, I don't -- Stewart, anything? I don't know if anything that's out there that would drive productivity in the near term. The biggest thing, I think, is improve our growth is just the improvement of the economy. We're still seeing -- although we've had good results in our enterprise business this past year, we're still seeing a long decision making cycle out there. And although we're encouraged somewhat as far as some of the successes we've had in the recent months, we're still concerned about the economy and the concern that our customers -- potential customers have had over the fiscal cliff and the other regulatory issues that are out there, the debt ceiling, those kinds of things. If we can get those out of the way, we're hopeful to make it see this economy turn around and see -- but if that happens, and that's the biggest thing we think could drive faster growth for us.

Tim Horan - *Oppenheimer & Co. - Analyst*

And last, on the rating agencies, are they focused on debt to EBITDA, or is it interest coverage at this point? Where would they like to see you at net debt to EBITDA ratio? Thanks.

Stewart Ewing - *CenturyLink, Inc. - EVP, CFO and Assistant Secretary*

Yes, net debt to EBITDA, and it basically varies from agency to agency. And I know Moody's has their release out, and I think Fitch has their release out now, and S & P's release is probably out by now as well.

Tim Horan - *Oppenheimer & Co. - Analyst*

Thanks.

Operator

Thank you. Our next question comes from Scott Goldman from Goldman Sachs.

Scott Goldman - *Goldman Sachs - Analyst*

Thanks, guys. Appreciate you taking the questions. I guess I will lay off on the buyback and dividend question. Seems like we've hit a lot of that. And just ask about the Savvis side of things -- or the hosting side of things. I notice you mentioned that Savvis was up, or the hosting was up about 8% year-over-year. But if I back out the announced contribution from the Cyber ITO, it looks as though that segment was pretty flat sequentially. Wonder if you could talk a little bit about what you are seeing inside of the data center stuff, [colo] managed hosting side of things, and what you are seeing from the interest in Savvis Direct and what impact that co- have in 2013.

Glen Post, III - *CenturyLink, Inc. - CEO, President*

Yes, Scott, the 8% year other year growth was without Cyber. But if you do -- you're right, if you look sequentially from third to fourth quarter, basically, revenue was flat. And that's really due to the things that we brought up on the call, the bankruptcies that we had during the quarter, and that's really about it. We are hopeful that we had a good quarter in terms of bookings for fourth quarter. Some of the softness that we saw in third quarter -- in fourth quarter, rather, was related to third quarter bookings which were soft. So we're hopeful, again, with a good bookings in fourth quarter, it will take a couple quarters probably to turn that around good. But we had the best bookings in fourth quarter we've had in four years, basically. Jim, did you want to comment on that?

Jim Ousley - *CenturyLink, Inc. - CEO, Savvis and President, Enterprise Markets Group*

I would say that the key issues that affect 2013 is we've done a lot of work on integrating and enabling the CenturyLink network channels and so on. And we'll start to see that have revenue -- positive revenue impact in the second half of the year. You take that, and you take the opportunity's there with Savvis Direct, which Glen mentioned, getting a positive reaction. There again, there's a very large customer base that this appeals to in the CenturyLink base that we believe will start to have some very positive impact in the third and fourth quarter and particularly in 2014 and 2015, it can be a very big increment to the overall hosting revenue.

The colo business is stable. It's kind of a managed business right now, directly related to investment. So we feel good. We had a good colo year, but it was at a controlled level. So, managed hosting is the key. It's the where the margins are at, where the value-add is at, and that's what we really need to drive on in 2013, and we have plans in place to do that.

Scott Goldman - *Goldman Sachs - Analyst*

Great, and if I could just follow up, and I apologize if I missed this earlier, but, Stewart, if you could talk about how much investment on the CapEx front you're spending on the data center side in '13 and how that compared to '12? I know you're pretty active on data center expansions in '12.

Stewart Ewing - *CenturyLink, Inc. - EVP, CFO and Assistant Secretary*

Yes. We've got $325 million to $375 million in '13, and that was probably in '12. Let me grab that right quick. Total cash CapEx was about $318 million in '11.

Scott Goldman - *Goldman Sachs - Analyst*

Great. Thanks, guys.

Stewart Ewing - *CenturyLink, Inc. - EVP, CFO and Assistant Secretary*

'12, I'm sorry, '12.

Scott Goldman - *Goldman Sachs - Analyst*

Understood.

Operator

Thank you. Our next question comes from David Barden from Bank of America.

David Barden - *BofA Merrill Lynch - Analyst*

Hey, guys. Thanks for taking the question. I will go back to the strategy change, I guess. I guess I wanted to give you guys maybe the opportunity. A lot of the questions have been, okay, so Stewart, if nothing has changed in the business from a year ago and we're looking at the same free cash flow in 2015 today that we're looking at before, but what we've done is we've chosen a strategy now that's both led to debt downgrades and a 15% cut in the stock price. But the argument is that we're going create long-term value, but there's nothing on the acquisition table, there's nothing on the Ca[Ex investment front that's going do anything different than what's been happening. So, what is the bull argument now for CenturyLink now that you have done what you have done? How is CenturyLink better for the stockholders now?

Stewart Ewing - *CenturyLink, Inc. - EVP, CFO and Assistant Secretary*

So, David, I think the first is that, basically, we were going to get downgraded anyway, based on the 2013 budgets and plan, short of cutting operating expenses or investment in areas that we think long-term will help us get to revenue and EBITDA stability. If we hadn't cut those, we couldn't have kept the investment grade rating. The other way to keep the investment grade rating would have been to cut the dividend, and use that to pay debt back. Wwe were going to get downgraded anyway. It would have been worse, I think, for us to cut the stock price -- cut the dividend and basically use that to pay debt back at this point.

So, looking at that, I guess, we -- as we focused on 2013, we really started focusing on '15 and working through and trying to look at what taxes, cash taxes, would potentially go in to '15. And that's when we realized as part of that, that basically the dividend payout ratio was going to increase significantly in '15, if we didn't do something. I guess we could have waited and -- 1.5 year or 2 years and see how that worked out, but we decided better to be proactive and really try to bay stock back in the interim and keep investing in the business to try to -- nothing has changed in the business, really. Keep investing in the business to stabilize and grow revenue and EBITDA. So it's just -- we felt like we were better off going ahead and reducing the dividend now, buying shares back with it, which reduces the shares outstanding by the time we get to 2015 which helps us really, again, stabilize and be confident that we can continue with the dividend that we've moved to. Which is more in line with our historical payout ratio in the last two or three years in '15 than we would have been, had we not done this at this point.

Glen Post, III - *CenturyLink, Inc. - CEO, President*

I will just add, David, that first of all, what's changed is better visibility, as Stewart said, into 2015. Secondly, more confidence in our growth initiatives. We're seeing those become real. We could have made the choice to increase the -- keep the dividend or increase the dividend and reduce our investment in the business, which we don't think is right. If we had not done this, we're looking at 2015, we think we'd see pressure on the stock price as we went into -- certainly into '13 and '14 as we came close to being a cash taxpayer. So, we think you take all that into consideration, this is the best strategy for our Company long-term and for our shareholders long-term. That's our view of it.

David Barden - *BofA Merrill Lynch - Analyst*

All right. Thanks, guys.

Operator

Thank you. Our next question comes from Nicole Black from Wells Fargo.

Nicole Black - *Wells Fargo Securities - Analyst*

Hi, guys. Thanks for taking the question. I guess as a fixed income analyst, what I want to ask about is, could you take a minute to discuss your future debt issuance plans now that we are firmly in high yield status? Are you going to continue to use the Qwest Corp entity to refinance Qwest Corp paper, or will all future bonds come out of the CenturyLink parent box?

Stewart Ewing - *CenturyLink, Inc. - EVP, CFO and Assistant Secretary*

Yes, so, Nicole, Qwest Corp and Embarq will remain investment grade at Fitch. Basically that's in their release. Moody's basically indicated in their release that although they just put everything on review for downgrade, that is it was likely that Qwest corp and Embarq would retain their investment grade ratings. So, we really believe we'll retain the investment grade ratings at Embarq and Qwest Corp.

We carry about $7.5 billion of debt of the $20.5 billion that we have outstanding, is carried at Qwest Corp. We will continue to use the Qwest corp entity to refinance borrowings that come due at Qwest Corp. Everything else, our current plans are to, as they are in the past, really, to refinance everything else that comes due up at that time parent company. And of course, that will be non investment grade, BB plus at Fitch, Moody's will come out with their rating, but they indicated strong -- pretty strongly, I think, that the family rating would go down only one notch. So,we'll refinance at the parent company.

If you look at our debt maturities over the next three years, over '12, '13 -- '13, '14, and '15, we only have about $725 million of maturities that will need to be refinanced at the parent company level. The remainder of the maturities that come due are at Qwest Corp. So, we feel real comfortable with our financing plan going forward. We'll carry -- our credit facility is paid down to about 300 -- real close to $300 million now from about $800 million at the end of the year. So, we think -- and it's a $2 billion facility. We don't plan on drawing it down to more than $1 billion so that we keep at least $1 billion capacity on that facility, just so that we'll always have plenty of liquidity. So, those really are our plans going forward.

Nicole Black - *Wells Fargo Securities - Analyst*

Okay. So, if Embarq has a chance of keeping its IG status, would you revise that as a potential issuing entity down the road?

Stewart Ewing - *CenturyLink, Inc. - EVP, CFO and Assistant Secretary*

Nicole, we haven't really talked about that, and we'll need to think through that to see if that's a possibility. I would mean -- it would have to be another reporting entity, and we'll just to have see if it's worth the effort of doing that. We have about $3 billion of debt today, or a little less than $3 billion of debt today at the Embarq level. The first major maturity that comes up at Embarq is in 2016, a little over $1 billion. So, we have some time, I think, to decide if we want to refinance at Embarq as well.

Nicole Black - *Wells Fargo Securities - Analyst*

Okay, and then last question. The covenants that are in place on the bank facility side, because that's good for another four years, the four turns at the parent level and the 285/235 tests on Qwest, are those going to stay unchanged, even with the ratings agencies actions?

Stewart Ewing - *CenturyLink, Inc. - EVP, CFO and Assistant Secretary*

Yes, those stay unchanged, even with the rating agency actions. We do have some -- a couple of covenants on QCII that spring back, but they're not material at all and really don't impact us.

Nicole Black - *Wells Fargo Securities - Analyst*

Okay. Well, it has been delightful covering you guys as long as I have been able to, so good luck.

Stewart Ewing - *CenturyLink, Inc. - EVP, CFO and Assistant Secretary*

Thank you, Nicole.

Operator

Thank you. Our next question comes from Donna Jaegers from D.A. Davidson.

Donna Jaegers - *D.A. Davidson & Co. - Analyst*

Hi, I've got a question for Karen Puckett since she is in the background there. I was just curious, given that enterprise is your growth area, what Century is doing to change or to improve the go to market in the out of region market for CenturyLink.

Karen Puckett - *CenturyLink, Inc. - EVP, COO*

Hey, Donna. In terms of -- the team had a great performance in 2012. We really want to continue to accelerate that. We have opportunities. We're very focused, not only on the sales front, but also on the customer experience, because we believe that's a big different shader for is right now against our competitors. So, we're going to leverage that and get the tools and the resources so our sellers can be more productive in the up front. So, those two book ends are what we plan on doing differently.

Donna Jaegers - *D.A. Davidson & Co. - Analyst*

And given that Comcast is coming at you guys hard in region offering twice the bandwidth to small business customers, what's your response there competitively?

Karen Puckett - *CenturyLink, Inc. - EVP, COO*

Comcast is certainly a competitor, but I would say relative to the amount of fiber that we have in market, and the amount are fiber that we have already to buildings, we feel like we're set up pretty well. We're packaging that, so we have symmetrical capability into those buildings at very high-speed ethernet connections. That with our Savvis Direct product in terms of computing and such, packaging puts us in a really strong position against our competitors, be it Comcast or any of them. Okay, thanks, Karen.

Operator

Thank you. And our final question comes from Tom Nguyen from Jefferies.

Tom Nguyen - *Jefferies & Co. - Analyst*

Thanks. Most of mine have been answered. I guess maybe could I ask for a little bit more color on how you feel like the Savvis Direct product rollout has gone? Can you talk about how you are marketing it now that it is out of beta? Are you systematically hitting your captive customer base, any more white label deals? Just any color you could provide would be great.

Stewart Ewing - *CenturyLink, Inc. - EVP, CFO and Assistant Secretary*

I'll start, and Jim may want to add to this. But up until through this month, through January into February, we have not done any advertising, basically. It's all been just on the web and word of mouth, and put it out in the -- really, and the Internet world. We've been very pleased so far.

We've also marketed it some with our direct sales channels, and they have been successful. Early on with that, we're seeing a lot of demand for the product. Feel really good about it. And again with no advertising. So, we'll begin advertising heavier with direct mail, with more on-net type advertising, and we expect to accelerate going forward. We believe it's going to be a very competitive product, and again, the initial reaction has been very positive.

Jim Ousley - *CenturyLink, Inc. - CEO, Savvis and President, Enterprise Markets Group*

I would just add two other data points. One, we're seeing very positive response on the private label, the white label product that we're looking at. We signed one order, and we've got a lot of interest, so those could be pretty significant in the future. The second is around the dedicated hosting environments, low end dedicated hosting environments that we're promoting. We're seeing very strong information and demand around those. Those take a little longer to sell because they're basically supporting a dedicated environment. But they're bigger ticket items, and so both of those are very positive early on indications.

Tom Nguyen - *Jefferies & Co. - Analyst*

Okay, great. Thanks very much.

Operator

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

Glen Post, III - *CenturyLink, Inc. - CEO, President*

Thank you. Sayed. We'll turn to turn to slide 24 as we conclude today's call. We are pleased with the continued progress we made during the fourth quarter towards stabilizing our top-line revenues and believe our continued investment in key strategic opportunities will help us continue to drive growth, both near-term and long-term. Our strategic revenue growth continues to strengthen CenturyLink's competitive position, and our guidance reflects our expectations that our revenues from these strategic services will continue to grow in the months ahead. Demand from business customers for advanced network and hosted IP solutions remains strong.

Also, the expansion of our Prism TV service and the recent launch of managed hosting and cloud services for small and mid-sized business customers will further strengthen our product portfolio and provide us additional revenue growth opportunities in 2013. Throughout 2012, we made good progress on our key strategic initiatives, and we believe these growth areas continue to strengthen our competitive position going into 2013. And lastly, we believe that capital allocation changes we announced today will allow us to continue to invest in these strategic initiatives. They will help stabilize our top line revenue, and strengthen our Company's position long-term while continuing to return significant cash to shareholders. Thank you for joining our call today, and we look forward to speaking with you in the weeks ahead.

Operator

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