12-Feb-2014

CenturyLink, Inc. (CTL)

Q4 2013 Earnings Call

CORPORATE PARTICIPANTS

Tony Davis
Vice President-Investor Relations, CenturyLink, Inc.

Glen F. Post, III
President, Chief Executive Officer & Director, CenturyLink, Inc.

R. Stewart Ewing, Jr.
Executive Vice President, Chief Financial Officer and Assistant Secretary, CenturyLink, Inc.

Karen A. Puckett
Chief Operating Officer & Executive Vice President, CenturyLink, Inc.

William E. Cheek
President, Wholesale Markets Group, CenturyLink, Inc.

Jeffrey H. Von Deylen
President, Savvis, CenturyLink, Inc.

OTHER PARTICIPANTS

David W. Barden
Analyst, Bank of America Merrill Lynch

Phil A. Cusick
Analyst, JPMorgan Securities LLC

Mike L. McCormack
Analyst, Jefferies LLC

Simon Flannery
Analyst, Morgan Stanley & Co. LLC

Batya Levi
Analyst, UBS Securities LLC

Frank G. Louthan
Analyst, Raymond James & Associates, Inc.

Kevin Smithen
Analyst, Macquarie Capital (USA), Inc.

Michael I. Rollins
Analyst, Citigroup Global Markets Inc. (Broker)

Sergey Dluzhevskiy
Analyst, Gabelli Funds LLC

Jonathan G. Epstein
Analyst, Deutsche Bank Securities, Inc.

Adam T. Ilkowitz
Analyst, Nomura Securities International, Inc.

MANAGEMENT DISCUSSION SECTION

Tony Davis
Vice President-Investor Relations, CenturyLink, Inc.

GAAP AND NON-GAAP FINANCIAL MEASURES

- You'll 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

Glen F. Post, III
President, Chief Executive Officer & Director, CenturyLink, Inc.

BUSINESS HIGHLIGHTS

Revenues

- If you will turn to slide five, I'd like to start off by recapping our performance for 2013
- During the year, we continued to effectively execute our objectives and make investments that we believe will lead to revenue stability
- For the full year 2013, total revenue declined by 1.5% compared to 2012
- In 2013, our core revenues trend continued to improve from a 2.3% annual decline in 2012 to a 1.3% annual decline in 2013
  - This continued revenue improvement was driven by a nearly $400mm increase in strategic revenues, primarily due to growth in broadband, Prism TV and high-bandwidth data services and hosting services
- The annual strategic revenue growth was driven in part by a 13.4% improvement in MPLS, our growth in MPLS, Ethernet and Wavelength revenues
- Additionally the decline of legacy revenue has slowed from 8.4% in 2012 to 7.3% in 2013

HIGH-SPEED INTERNET AND PRISM TV SUBSCRIBERS

- We achieved solid growth in both high-speed Internet and Prism TV subscribers throughout the year, adding 140,000 HSI customers and 69,000 Prism TV subscribers
- We've been pleased with the early growth of Prism TV subscribers in new legacy Qwest markets where we launched Prism in 2013
- Throughout the year, we invested to improve broadband speed availability across our footprint
- We grew the number of enabled access lines receiving 20 megabits and 40 megabits each by approximately 25% over the prior year
- Also, we continued to focus on developing more fiber, deploying more fiber to multi-tenant buildings and expanded the program by approximately 1,000 buildings during the year

Stock Repurchase Program

- We have continued to make excellent progress under our $2B stock repurchase program authorized by our board in mid-February of last year
- During Q4, we repurchased 10.5mm shares for a total investment of $331mm
- From the inception of the program in February 2013 through February 11, 2014, we had completed 86% of the $2B program, having purchased a total of 50.8mm shares for $1.72B.
- We currently expect to complete the remainder of the current $2B stock repurchase program during Q2 2014, well ahead of the original two-year timeframe
- Based on this anticipated early completion of our current stock repurchase program, the current level of our stock price and the strong FCF we believe we will generate during 2014, management expects to recommend to our board that they approve a follow-on stock repurchase authorization at our regularly scheduled meeting later this month
    - This of course would position us to continue to opportunistically repurchase shares and return additional free cash to shareholders once our current stock repurchase program is completed
- Over the last few weeks, our Investor Relations team has heard from the investment community that some investors are stating CenturyLink's dividend is not sustainable
- Obviously that concerns us

Dividend

- So I want to clearly address the sustainability of our dividend before making further comments
- We remain confident that the investment in our key strategic initiatives continue to position us to reach revenue stability in 2015 and establish a revenue growth trend soon thereafter
- Our strong fourth quarter and solid full year 2013 results along with our full year 2014 revenue guidance shows that we have made and that we anticipate continuing to make progress toward reaching our revenue objectives

OPERATING COSTS AND REVENUE TREND

- Additionally, we expect to successfully align our operating costs with our future revenue streams and continue to generate solid, predictable cash flows in the years ahead
- We believe in our growth opportunities and we also know that we must improve our operational efficiency to mitigate the impact of the revenue mix shift on our operational cash flow and FCF over time
- We believe there's an improving revenue trend along with the strategic opportunities in the marketplace, position us well for future revenue growth and cash generation
    - These are the key reasons we believe our dividend is sustainable and that our payout ratio will remain at a reasonable level even as we begin to pay higher cash taxes in the future

Key Strategic Initiatives

- If you'll turn to slide six, I'll provide an update on our key strategic initiatives
- Throughout the year we have diligently executed in the four key strategic initiatives we initially laid out in third quarter 2011
    - We believe our investment in these strategies continues to strengthen our overall product portfolio, which further positions CenturyLink as a leading integrated provider of global network, data hosting, and cloud solutions

BROADBAND EXPANSION AND ENHANCEMENT

- Starting with broadband expansion and enhancement, we continue to make significant investments in this area that we believe will better serve our business and consumer customers
- We ended the quarter with approximately 6mm broadband customers
- We had a strong fourth quarter, adding nearly 49,000 new subscribers
- And we believe our fiber assets, including approximately 240,000 fiber route miles across the U.S., position us well in the business market

MTU PROGRAM

- We continue to grow our advanced multi-tenant unit, or MTU program
- We had 200 fiber-fed buildings in the quarter, increasing the number of fiber-fed buildings by 17% from Q3
  - This program offers broadband capabilities of up to a gigabit of symmetrical service, and it enhances cloud connectivity for these business customers
- We have made very good progress over the past few years in cost effectively deploying broadband services
- We have enabled a total of nearly 8mm homes with Fiber-to-the-Node and have passed a total of approximately 2mm homes with Prism TV capabilities

1 GIGABIT SERVICE

- We have utilized and continued to utilize a balanced capital investment approach, including gigabit fiber, VDSL2, and pair bonding deployments to efficiently enable higher speeds, enhanced services to consumers and businesses in our markets
  - This balanced investment strategy has allowed us to deliver very competitive broadband speeds, including up to 1 gigabit service in a number of areas, in an efficient manner and to continue to drive broadband penetration
- Early results from our 1 gigabit pilots in Omaha and Las Vegas have met or exceeded our expectations, and are good indicators that by coupling GPON technology, gigabit enablement with expansion of Fiber-to-the-Node and Prism TV deployment, we can successfully compete and meet the broadband needs of both consumer and business customers
- Our announcement last week regarding the delivery of up to 1 gigabit service to more than 2,500 Salt Lake City businesses located in multi-tenant unit office buildings for them to use is an example of how we're leveraging our existing fiber to opportunistically expand speed and service capability to high-value business and consumer customers

MTU AND GPON PROGRAMS

- Both the MTU and GPON programs offer upstream speeds and business service level agreements beyond what is normally available with the cable companies
  - These offerings are particularly compelling in the business market where upstream capabilities are critical to enablement of cloud services
- In business areas where we do not offer our advanced MTU or GPON programs, we have extensively deployed Ethernet services
- We currently cover over 2.3mm business locations with Ethernet capability, with nearly half of this footprint capable of 20 megabits and higher symmetrical speeds
- In the months ahead, we expect to continue making investments in our network to enhance speed capabilities required to deliver competitive broadband products and services across our markets

Prism TV Service

- Turning to slide seven, our Prism TV service continues to perform well and represents a very compelling entertainment alternative to cable TV service in the markets where we offer this service
- We added a record 26,000 Prism TV subscribers during Q4, ending with a total of 175,000 subscribers in service
  - Over 50% of these added customers are new to CenturyLink, and they continue to have a very high rate of broadband attachment
- This quarter we experienced an attachment rate of 98%
- But we continue to expand the footprint where Prism service is available
- And in fourth quarter, we added approximately 180,000 addressable homes, of which just over half were in the newly launched markets of:
  - Phoenix
  - Colorado Springs
  - Omaha
  - And Denver

PRISM SUBSCRIBER GROWTH AND IPTV FEATURES

- We are very pleased with the early Prism subscriber growth in these first Qwest markets to provide this video service
- We continue to see our churn rates improve with Prism triple play bundle customers, where the bundle customers are less likely to churn than single-play voice customers
- In addition, we continue to enhance to our IPTV features by introducing new functionality and applications, including expansion of our TV Everywhere capabilities, Video On Demand library, and our recent successful trial of wireless set-top boxes

Fiber-to-the-Tower Builds

- Continuing on to slide eight, during Q4 we completed approximately 930 Fiber-to-the-Tower builds, for a total of 4,100 fiber builds in 2013 and over 18,800 total fiber connected towers across our footprint
- In 2014, we expect to complete a total of 3,000 to 3,500 fiber builds
- As expected, we continue to experience some revenue compression as our wireless wholesale customers transition from copper-based DS1 facilities to fiber-based Ethernet services
  - However, we anticipate that wireless data bandwidth growth will result in expansion of Ethernet consumption, and thereby reverse the current revenue compression during 2014

Managed Hosting and Cloud Services

- Now moving to slide nine, managed hosting and cloud services, we continue to believe we're well positioned to capitalize on long-term growth opportunities in this space where we've developed and are expanding our strong product offerings
- Cross-sell or team-selling opportunities for hosting products across our hosting and network sales teams continued to be strong, with sales and hosting services to business customers steadily growing

SALES AND HOSTING SERVICES

- Sales and hosting services to network business customer base has grown significantly in Q4

- We expect to maintain this momentum as customers seek IT solutions to streamline their operations, increase efficiency, and reduce cost
- We are focused on growing hosting sales to our large base of business network customers and expanding our hosting demand generation across target customer segments
- While we expect to have some churn of larger colocation clients, we expect the new initiatives to continue to drive growth

NEW DATA CENTER

- We continue to invest to increase our data center capacity as well as expand our product portfolio to meet customer needs and expand our market opportunity
- In Q4, we opened a new data center in Hong Kong

ACQUISITION OF TIER 3

- And we announced in late November the acquisition of Tier 3, an innovative provider of public cloud services
- Tier 3's products, roadmap, and vision are now the foundation of CenturyLink's cloud development strategy
- We believe Tier 3's public multi-tenant cloud platform combined with our global network and data center footprint and managed services team will greatly enhance our service capabilities to businesses of all sizes
- Additionally, in January of this year Savvis began operating as CenturyLink Technology Solutions, aligning the brand with CenturyLink and demonstrating deeper ties to the broadband portfolio of IT solutions delivered to businesses

PRIORITIES

High-Speed Internet and Prism TV Subscriber Growth

- Turning to slide ten, I'd like to shift briefly from 2013 achievements to looking ahead at our priorities for 2014
- We were pleased with the strong consumer metrics generated in 2013 as we achieved high-speed Internet and Prism TV subscriber growth
- As we enter 2014, we expect to continue to enable higher broadband speeds and to drive further broadband penetration across our markets
- During 2013, we enabled Prism TV service to approximately 800,000 incremental households. primarily driven by our launch of Phoenix, Colorado Springs and Omaha during the year
- We expect to continue to expand our Prism TV addressable market during 2014 and to drive subscriber growth during the year, driven by the expanded and addressable market improvements in our programming packages and a continued improvement in the customer experience
    - We also will continue to monitor our success in all of our Prism TV markets including Highlands Ranch, Colorado, a suburb of Denver, where we launched service late last year and may consider further expansion of our Prism markets if our results continue to be strong

Customer Retention Programs

- With our customer retention programs, we continue to refine a series of programs targeting the highest-value customers focused on high-speed Internet, VoIP and Prism TV services

- We also extended programs focused on new customer outreach, auto-pay take rates and overall higher quality sales during the year

Business Segment

- In our business segment, we will continue to focus on driving growth in sales on high-bandwidth data services including MPLS, Ethernet and Wavelength to meet strong customer demand
- We believe our targeted marketing approach and sales programs as well as continued enhancements in our product portfolio continued to position us to drive revenue growth
- Based on early sales results associated with our recent launch of Managed Office, we will continue to grow and expand these by-the-seat solutions to meet market demand and gain market share
- We also expect to continue to expand our GPON and fiber deployment to buildings, provided expanded addressable market opportunities to our business sales team

Wholesale Segment

- In our wholesale segment, we will continue to expand our fiber deployment to wireless towers, continue to drive revenue growth from the continued market demand and from wireless carriers for wireless data backhaul
- However we expect our 2014 expected pace to be below that of the last few years
- Utilizing the capabilities of CenturyLink Technology Solutions and the recent acquisition of Tier 3, we also expect to expand our marketing of white label cloud services on a wholesale basis, enabling to us drive further growth in cloud services in the coming year

Data Hosting Segment

- In the data hosting segment, we will migrate it to a single platform at our Tier 3 for all cloud and managed services which will enable new capabilities that further differentiates CenturyLink in the market and enhance customer experience
- Further, we will meet customer needs by selling a full portfolio of colocation, cloud and managed hosting services while retaining existing customers through exceptional service

Key Partners

- Lastly, we expect to identify key partners that will help expand our capabilities beyond our direct sales force and drive additional revenues there as well
- Overall, I'm pleased with the solid results for the quarter and the full year
- We continue to invest to drive growth and we're experiencing good traction in those key areas

R. Stewart Ewing, Jr.

Executive Vice President, Chief Financial Officer and Assistant Secretary, CenturyLink, Inc.

FINANCIAL HIGHLIGHTS

Opening Remarks

- I'll spend the next few minutes reviewing the financial highlights from Q4 and then conclude my remarks with an overview of Q1 and full year 2014 guidance we included in our earnings release issued earlier this afternoon
- Beginning on slide 12, I'd like to review some highlights from our strong fourth quarter results
- I'll be reviewing the results excluding special items as outlined in the earnings release and associated financial schedules

Operating Revenues and Cash Flows

- As you can see, we generated solid operating revenues and cash flows in the quarter
- Operating revenues were $4.54B on a consolidated basis, a 0.9% decline from fourth quarter a year ago
- Core revenues, defined as strategic revenues plus our legacy revenues, were $4.11B for fourth quarter, a decline of 0.4% from the year ago period
- Strategic revenues grew 5.4% y-over-y and represent 50% of our total revenues compared to 47% a year ago
  - Strength in strategic products such as high-speed Internet, high-bandwidth data services, Prism TV and managed hosting services continues to drive this growth

SUBSCRIBER GROWTH

- As Glen mentioned earlier, subscriber growth was strong for both broadband and Prism TV
- From a business market perspective, we experienced strong new sales to business customers for network and hosting services in Q4
- We generated strong operating cash flow of approximately $1.84B for Q4 and achieved an operating cash flow margin of 40.4%

Adjusted Diluted EPS

- As we've discussed on prior earnings calls, adjusted diluted EPS excludes special items and certain non-cash purchase accounting adjustments as outlined in our press release and associated supplemental financial schedules
- Adjusted diluted EPS for Q4 were $0.68, well ahead of the midpoint of our guidance of $0.58
- Results included the benefit of certain favorable year end operating expense adjustments related to employee benefits, operating and income taxes
  - Normalizing for these items, operating expenses would be approximately $60mm higher and adjusted diluted EPS would be $0,59, above the midpoint of our guidance range for both operating cash flow and adjusted diluted EPS

FCF, CapEx and Share Purchase Program

- Additionally, we generated $601mm of FCF during the quarter, which is defined as operating cash flow less cash paid for taxes, interest and CapExs 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

- Also during the quarter, we made strong progress on the share purchase program, buying 10.5mm shares for $331mm

Operating Revenues

- Now turning to slide 13, the 0.9% decline in fourth quarter 2013 operating revenues compared to fourth quarter 2012 was primarily a result of growth in strategic revenues that was more than offset by lower legacy revenues due to access line losses and lower minutes of use
- The growth in our strategic revenues was primarily driven by:
    - Strength in high-speed Internet
    - High-bandwidth business data services
    - Prism TV
    - And data hosting services

Consumer Segment

OPERATING & LEGACY SERVICES REVENUES AND EXPENSES

- Now turning to slide 14, we'll discuss each of our operating segments beginning first with the Consumer segment
- Consumer generated nearly $1.5B in operating revenues, which represents a decrease of 1.7% over fourth quarter a year ago
- Our strategic revenues in this segment grew 7.7% y-over-y to $683mm, driven by growth in high-speed Internet and Prism subscribers and the full quarter impact of price increases
- The long-term growth rate in high-speed Internet is likely to slow over time due to our growth in penetration of households
- Legacy services revenues for the segment declined 8.4% from fourth quarter 2012 due primarily to a continuing decline in access line and long distance revenues
- Expenses were essentially flat compared to the same period a year ago, driven mainly by lower employee related costs which were partially offset by higher Prism TV costs

Business Segment

OPERATING & STRATEGIC REVENUES

- Moving to slide 15, our Business segment generated $1.56B in operating revenues during Q4 which increased $16mm, or 1% from the same period a year ago
- On a sequential basis, total revenues grew $19mm from third quarter 2013, primarily driven by higher CPE revenue
- Fourth quarter strategic revenues for the segment increased by 7.5% to $643mm from fourth quarter 2012, driven primarily by strengthen in high-bandwidth services such as MPLS, Ethernet and Wavelength

Enterprise Customer Segments

- We continue to generate solid growth across the enterprise customer segments and we see an opportunity for further investment in the small and medium sized business space to improv e market share and drive further growth
- Legacy services revenues for the segment declined 3.5% from fourth quarter a year ago due primarily to a continuing decline in access line and long distance revenues

- Total segment expenses increased $39mm, or 4.1%, driven by higher facility costs associated with our MPLS product growth

Wholesale Segment

STRATEGIC & LEGACY REVENUES AND OPERATING EXPENSES

- Now turning to slide 16, our Wholesale segment generated $884mm in operating revenues, a decline of 2.5% from fourth quarter a year ago
- Strategic revenues for Wholesale were $581mm, which grew 1.6% from fourth quarter 2012, as growth in Ethernet services and data bandwidth capacity expansion by wireless carriers and delays in TDM disconnects offset the decline in low speed transport services revenue
- Legacy revenues declined by 9.6% to $303mm, reflecting the continued decline in access and long distance minutes of use and the implementation of lower access rates under the CAF Order rate stepdown
- Operating expenses for the quarter were $290mm, or 3.7% below the same period from prior year, driven primarily by lower VoIP usage costs

Data Hosting Segment

OPERATING REVENUES

- Now moving to slide 17 and our Data Hosting segment, which includes all colocation, managed hosting, cloud and hosting-related network service revenues
- This segment generated $353mm in operating revenues, representing an increase of 3.8% from fourth quarter 2012 revenues of $340mm
- Y-over-y managed hosting revenues including cloud grew 14%
- Colocation growth of 1.4% was weakened by customer churn and price erosion in previous quarters

OPERATING EXPENSES

- Data Hosting operating expenses were $283mm in fourth quarter compared to $264mm in fourth quarter 2012
  - This 7.2% increase is primarily due to increased sales costs, the Tier 3 and AppFog acquisitions and incremental expenses associated with them, and investments in marketing
- Over time, we expect long-term improvement in both revenue and margin trends across the Data Hosting segment and continue to leverage these assets to drive additional revenue through cross-selling opportunities in our other segments

Q1 2014 GUIDANCE

Operating Revenues, Cash Flow and EPS

- On slide 18, we provide our first quarter 2014 guidance
- We expect for Q1 2014, operating revenues and operating cash flow to decrease compared to fourth quarter 2013, primarily due to a decline in legacy and data integration revenues along with favorable employee benefits and operating tax true-ups present in fourth quarter 2013 results that are not expected to reoccur in first quarter 2014

- Similar to last year, we also anticipate a decline in depreciation and amortization expense in Q4 2014, driven primarily by the impact of declining amortization of acquisition related intangible assets and the annual review and update of depreciation rates
- For first quarter 2014, CenturyLink projects total operating revenues of $4.46B to $4.51B, our core revenues of $4.07B to $4.12B and operating cash flow between $1.73B and $1.78B
- Adjusted diluted EPS is expected to range from $0.58 to $0.63

FULL YEAR 2014 GUIDANCE

Operating Revenues

- On slide 19, we provide our full year 2014 guidance
- For the full year 2014, we expect total operating revenues of $17.9B to $18.1B, reflecting a y-over-y revenue change of flat to negative 1.2%, and core revenues of $16.25B to $16.45B

Operating Cash Flow, EPS, CapEx and FCF

- Operating cash flow is expected to between $7.05B and $7.25B, and adjusted diluted EPS is expected to be between $2.40 and $2.60
- Our CapEx are expected to be approximately $3B, as we continue to make investments in key growth areas
- So we anticipate FCF for full year 2014 to be between $2.6B and $2.8B
- The anticipated decline in operating cash flow and FCF, primarily driven by:
  - The decline in legacy revenue
  - Investments to continue to grow strategic revenues
  - As well as a lower level of acquisition related synergies in 2014 compared to the level of incremental synergies that we achieved in 2013

QUESTION AND ANSWER SECTION

David W. Barden
Analyst, Bank of America Merrill Lynch

Q

I want to talk first a little bit about the guidance, Stewart, if I could. So first, the full year midpoint is looking for a margin of around 39.7%, which is a higher margin than you had the in Q4, a higher margin than you're guiding to in first quarter. So if you could step us through where that margin expansion and where the pivot starts to occur, that would be helpful.

I think the second thing that would be helpful is last year, around the middle of the year, there were challenges to the guidance numbers and hitting those numbers. Could you talk a little bit about the process that you went through for setting these expectations here now and some of the base case expectations that you made around the enterprise environment and other things.

And then lastly, if I could, you talk about, as we all know, the falling revenues in legacy have higher margins than the growing revenues in strategic services do. You've also talked about the potential for a pivot in EBITDA around the time about a year following the pivot in revenue growth. Could you put numbers around those margin numbers? If you're having a conversation with someone and they say legacy revenues are X and strategic revenues are Y, at what margin can we have a conversation about that and think about when the EBITDA pivot can occur? Thanks.

R. Stewart Ewing, Jr.
Executive Vice President, Chief Financial Officer and Assistant Secretary, CenturyLink, Inc.

A

So, David, first of all, the full-year guidance midpoint, that basically is 39.7%. The midpoint in Q1 is 39.1%. So obviously, we expect the latter three quarters of the year to be above that. We basically have expense reduction programs that we're working to put in place, which will help reduce our expenses from Q1 expected levels into second, third, and Q4 the year.

Our guidance last year in 2013, if you'll recall, we had a hockey stick basically in revenues. So where we really missed our guidance in 2013 and came back and tweaked it some was really associated with the revenue that we hoped to get out of some of the products such as savvisdirect, which was our cloud product, and another product that just didn't materialize as we had hoped. We feel like we have all that worked through in 2014 and feel much more comfortable with the revenue guidance in 2014, I think looking back on the experience that we had last year. So we feel much better about the guidance there. And again, on the expense side, we think we have the programs in place and about to put in place to get us to the point where we need to be there to hit the guidance.

In terms of EBITDA pivot, basically we will continue to lose legacy revenues, but our strategic revenues grew very strong in Q4 and really full 2013. We expect continued growth in strategic revenues in 2014. What we've said is that we're not ready really to put a peg in when we can stabilize the EBITDA and turn to EBITDA growth. But as Glen indicated in his prepared remarks, we do expect to get to revenue stability in 2015.

David W. Barden
Analyst, Bank of America Merrill Lynch

Q

Okay. And, Stewart, just to be clear, I think you have talked about a 12-month lag between the revenue pivot and EBITDA stability. Are you saying something different now, or am I missing it?

R. Stewart Ewing, Jr.
Executive Vice President, Chief Financial Officer and Assistant Secretary, CenturyLink, Inc.
A

No, really pretty much the same, David. What we've said exactly I think is hopefully we would get to EBITDA stability shortly thereafter, or some time reasonably thereafter, a year or so. We're not really saying anything different than we said before.

Phil A. Cusick
Analyst, JPMorgan Securities LLC
Q

Can you talk about a couple things? One is Q4 employee cost savings. Just help us out and help us understand what was there and I understand is not going to be there in Q1. And then as you think about the buyback from here, what's management thinking about in terms of the size of that recommendation? And how should we think about the max leverage on the business going forward? Thanks.

R. Stewart Ewing, Jr.
Executive Vice President, Chief Financial Officer and Assistant Secretary, CenturyLink, Inc.
A

So from a leverage standpoint, we've said that we would like to stay in the three times debt to EBITDA or so. We're at 2.8 times debt to EBITDA now. I'll let Glen talk to the buyback for a moment, and then I'll come back to the cost savings.

Glen F. Post, III
President, Chief Executive Officer & Director, CenturyLink, Inc.
A

Yes, regarding the buybacks, the size of the buyback, we really have not discussed that with the board yet, so I'm not ready to put a number out there. But we realize it would have to be significant enough to make a difference and give us an opportunity really to buy our stock back at attractive prices, which obviously we believe the current price is very attractive. But we're not ready to give a number yet. We'll announce that after the board meets.

R. Stewart Ewing, Jr.
Executive Vice President, Chief Financial Officer and Assistant Secretary, CenturyLink, Inc.
A

And, Phil, the employee cost savings were really related to employee benefits, and it was really just making adjustments for really all the adjustments related to the full year 2013. They revolved around our medical, dental, and vision accruals basically for current-year cost. They also revolved around some of our post-retirement benefit cost as we've made adjustments to adjust that to the liability that they need to be at. We changed our paid time off policy and had fewer hours carried over from year to year. A lot of our people took a lot of time off the last quarter of the year, so that drove our paid time off expense up. Then in addition to that, we had the remainder of the – that's about $40mm or so. The remainder or the other $20mm or so is really related to a sales transaction tax reserve that we had on an acquired company that is no longer necessary, so we're able to eliminate that reserve, as well as our normal year-end ad valorem tax true-ups for the most part.

Mike L. McCormack
Analyst, Jefferies LLC
Q

Maybe just a quick comment, Stewart, regarding the view here, obviously you're discussing the potential for share repurchase. The competitive landscape for high-speed obviously becomes tougher and tougher, I think, as cable gets more aggressive on pricing or functionality. What's your thought regarding sort of balancing the capital budget when you look at 2014 vs. thinking about a repo? And then if you can give us sort of any color on what you're thinking for cash taxes rolling into the 2014 guide, that would be great. Thanks

R. Stewart Ewing, Jr.
Executive Vice President, Chief Financial Officer and Assistant Secretary, CenturyLink, Inc.
A

Yes, so let me hit the last part first and I will let Karen talk a little bit about competition. Cash tax is somewhere between $50mm and $100mm in 2014. The potential for share repurchase and balancing that with the capital budget, I mean we think we'll have, our capital budget will be about $3B this year and we think that that will give us enough FCF to implement – to complete the share purchase program that we have in place, which we have about $300mm remaining there and implement another program that we would hope to get, expect to get the board to approve at our February meeting in a couple of weeks. Karen, do you want to talk about where we are with respect to high-speed Internet, speed if possible?

Karen A. Puckett
Chief Operating Officer & Executive Vice President, CenturyLink, Inc.
A

Yes, in terms of high-speed Internet, yes, just great quarter. Congratulations to the CenturyLink whole team that made that happen. But I would say that we have ADSL2, Fiber-to-the-Prem, Fiber-to-the-Node capabilities. And we really do a great job with our local model, using the capital and optimizing by market what capability and then how we can market the best capable speed with the cash available. So it really is a balance of the cash, the technology capability on the economics, and then taking that and optimizing that message within each market. So it is very market-specific, and we seem to win that way.

R. Stewart Ewing, Jr.
Executive Vice President, Chief Financial Officer and Assistant Secretary, CenturyLink, Inc.
A

And we consistently upgrade speeds. I think in the talking points that we have, I think there's a 25% increase in the households that could receive 20 meg higher and a 25% increase in the households that could get 40 meg or higher at the end of 2013 vs. the end of 2012. And we'll continue to shorten loops, to put fiber in the network to shorten loops, to bond and just to do whatever is necessary in our markets to be able to compete with the cable companies.

Mike L. McCormack
Analyst, Jefferies LLC
Q

Stewart, when you look at 2014, does the available homes for sale for Prism, is that going to be expanding at the same rate we saw in 2013?

R. Stewart Ewing, Jr.
Executive Vice President, Chief Financial Officer and Assistant Secretary, CenturyLink, Inc.
A

It will not expand at the same rate. We added about 800,000 homes passed in 2014, basically – 2013 rather. For 2014, we have the Phoenix market to complete, and we have, I think Glen mentioned the area in Colorado, Highlands Ranch, and we have incremental expansion in really most of the markets. We'll cover potentially at least an additional 300,000, maybe 400,000 homes in 2014, really without going into any new markets and we'll evaluate new markets through the early part of the year.

Simon Flannery
Analyst, Morgan Stanley & Co. LLC
Q

Glen, you talked in your prepared remarks about the strategic opportunities in the marketplace. I wonder if you could just expand on that a little bit. Does that mean doing more things like Tier 3? And then just a clarification, Stewart. I think I'm right in saying that your Q1 and your 2014 guidance only includes the share count as of December 31; that the buybacks you've done YTD are not in that number. I just want to clarify that. So given what you've already completed in the last six weeks or so, that will help some of the earnings vs. what you printed here, is that right?

R. Stewart Ewing, Jr.
Executive Vice President, Chief Financial Officer and Assistant Secretary, CenturyLink, Inc.

A

Yes, Simon. That's correct. Our guidance only includes this year's purchase through the end of the year.

Simon Flannery
Analyst, Morgan Stanley & Co. LLC

Q

Okay. Thank you.

Glen F. Post, III
President, Chief Executive Officer & Director, CenturyLink, Inc.

A

Yes Simon, regarding my comments about strategic opportunities, I really wasn't talking about potential acquisitions there. I was talking more about the opportunity for to expand our service especially in the cloud hosting space, IT services space where we're seeing more and more demand in that space. And with our Tier 3 acquisition and the other product expansion, product development we're doing, we think there's significant opportunity there in the next couple of years to do something very meaningful.

Simon Flannery
Analyst, Morgan Stanley & Co. LLC

Q

Is there timing on when the Tier 3 integration really kicks into high gear and you can start benefiting from that acquisition?

Glen F. Post, III
President, Chief Executive Officer & Director, CenturyLink, Inc.

A

We're thinking second quarter kicking in really a much higher level. Certainly by midyear is our target. We've already begun selling it and integrating it in some ways, but a full integration, we're thinking second quarter.

Simon Flannery
Analyst, Morgan Stanley & Co. LLC

Q

Great, thank you.

Glen F. Post, III
President, Chief Executive Officer & Director, CenturyLink, Inc.

A

And as regarding acquisitions, we're focused on our key strategic initiatives and we think there's good growth with these and bringing more MPLS, Ethernet, expanding our Prism opportunities, connect the home, the connected office work we're doing along with the cloud hosting. So we think there are significant opportunities there. At the same time, we will consider inorganic opportunities that will help drive growth really. We'll maintain our disciplined approach to these decisions and we'll just look for the right opportunities that can really grow shareholder value. That would be our goal there.

Batya Levi
Analyst, UBS Securities LLC

Q

Strategic wholesale revenues grew for the first time in a while and you had mentioned before that you expect wireless backhaul to begin to grow in 2014. Can you provide more color on the timing of that? Can we see that early on in the year? And also, within your guidance for the year for revenues, which is looking for an improvement in the rate of decline, can you talk about your assumption you have for strategic in there? Thanks.

R. Stewart Ewing, Jr.
Executive Vice President, Chief Financial Officer and Assistant Secretary, CenturyLink, Inc.

A

Okay. Bill's going to address your question on wholesale.

William E. Cheek
President, Wholesale Markets Group, CenturyLink, Inc.

A

Yes, Batya, this is Bill Cheek. Let me just talk to you a little bit about the timing and the growth of backhaul revenues. We are continuing to build out our Fiber-to-the-Tower initiative, and we'll have completed additionally about 18,800 or so towers next year with adding another 3,000 to 3,500. So we are expecting to see the revenue compression start to mitigate. It won't happen early in the year. There are a fairly major reduction in some DS1s when a large carrier turned down the Push to Talk network and that affected everyone in the industry. So we're having to live through that a little bit. But we do expect that will mitigate towards the latter part of the year.

Batya Levi
Analyst, UBS Securities LLC

Q

Okay, and in terms of strategic services growth within your guidance?

R. Stewart Ewing, Jr.
Executive Vice President, Chief Financial Officer and Assistant Secretary, CenturyLink, Inc.

A

Yes, and Batya, we are expecting our strategic revenue growth to improve in 2014 and think it will be led by our broadband, our Prism and our data hosting areas and the success that we continue to have with business customers and in the Business segment.

Batya Levi
Analyst, UBS Securities LLC

Q

It's about 50% of revenues going at 4% to 5%. Should we expect that trend to continue?

R. Stewart Ewing, Jr.
Executive Vice President, Chief Financial Officer and Assistant Secretary, CenturyLink, Inc.

A

Yes.

Frank G. Louthan
Analyst, Raymond James & Associates, Inc.

Q

Looking at some of the IP trials that the SEC has got out, do you see any value of pursuing that yourself? And then can you comment on the Managed Office platform that you recently launched? When do you expect to get traction with that in the SMB segment? Thanks.

R. Stewart Ewing, Jr.
Executive Vice President, Chief Financial Officer and Assistant Secretary, CenturyLink, Inc.

A

So I'll comment on the IP trials and Karen will discuss Managed Office. But yes, we would expect to be involved in the IP trials and alongside the other major carriers there, so that we'll be in a position to move in that direction and get all the learnings that we would get from a trial.

Karen A. Puckett
Chief Operating Officer & Executive Vice President, CenturyLink, Inc.

A

Frank, Karen. In terms of the Managed Office, I mean we really just have begun to roll that out in late fourth quarter. But we are really encouraged by the traction and the funnel that we're seeing. It is a different sale for our sales reps. But, it's very simple for the business owner, right, because it allows them to have their information technology simply on a per-seat basis and it bundles the business grade data network and a hosted VoIP service with cloud-based applications for e-mails and storage really all in one package. And so we're also enabling that with our MTU, Fiber-to-the-Building, and we'll keep you posted but we're very encouraged and the sales team is giving us a lot of good feedback and we think it's going to change the dialogue that they're able to have in front of the customer.

Kevin Smithen
Analyst, Macquarie Capital (USA), Inc.

Q

Just a follow-up on an earlier question. Given your sequential improvement over the past couple quarters in broadband and Prism TV, I guess, why wouldn't you launch new markets and try to pass as many homes as possible this year? And given that rates have fallen, interest rates have fallen, why not take up leverage slightly to fund both the CapEx and a buyback to try to get to revenue and EBITDA breakeven as quickly as possible and retire shares?

R. Stewart Ewing, Jr.
Executive Vice President, Chief Financial Officer and Assistant Secretary, CenturyLink, Inc.

A

Yes, so Kevin, we're certainly looking at new markets and evaluating new markets and the cost of going into them. And we really wanted to see a little bit more success. We really just turned up the Omaha market in September or so, September, October on a commercial basis, and we've done really well there. We've done well in Las Vegas where we have Fiber-to-the-Home. We've done well in Colorado Springs. So I think we want to see a little bit more performance and just make sure it really lasts, which we believe, we certainly believe it will and all indications are that it will. And, but rest assured that we're looking at other potential markets that we could provide Prism service.

Glen F. Post, III
President, Chief Executive Officer & Director, CenturyLink, Inc.

A

And Stewart, I'd like to add to that. When you look at revenue growth opportunity and look at Prism, it's certainly one as Stewart just said, we're looking hard at. That would involve some additional CapEx. I don't think, not a whole lot for this 2014, but it also impacts our start-up expenses or EBITDA. So we would have to take a look at that. But if we did, we'd come back to investors and explain, this is what we were doing this, to accelerate revenue and we're seeing significant success in these markets and this is why we're doing it. But that would be the issue we deal with if we decided to make a move to more aggressively invest in Prism TV in the coming months.

Kevin Smithen
Analyst, Macquarie Capital (USA), Inc.

Q

And what would roughly the CapEx be per market, and OpEx for a startup? I know it's hard to...

R. Stewart Ewing, Jr.
Executive Vice President, Chief Financial Officer and Assistant Secretary, CenturyLink, Inc.

A

Kevin, it's really hard to say. It varies by market and it depends on the quality of the plant that's there today and how much work needs to be done in it. It's really very difficult to generalize. But again, if we continue to have good success in the markets that we're in, we'll keep evaluating other markets and come back to you guys like Glen indicated.

Kevin Smithen
Analyst, Macquarie Capital (USA), Inc.

Q

And just what are the max leverage ratios you'd feel comfortable with exiting 2014?

R. Stewart Ewing, Jr.
Executive Vice President, Chief Financial Officer and Assistant Secretary, CenturyLink, Inc.

A

What we said is that basically three times is really our bogey.

Michael I. Rollins
Analyst, Citigroup Global Markets Inc. (Broker)

Q

I guess the first question is, if you just look out three to five years, is there a sense of what broadband speed a home needs given the evolution of technology and over-the-top type of applications? And then if you have a view there, how the company's working backwards to try to get the portfolio in better shape in the aggregate to get to that goal. And then just secondly, on the consumer side as well, are you seeing any changes to the way customers are using bandwidth, using Internet that you could just give us a sense of whether it's volume growth or usage per household and maybe how it's different in a fiber-fed home or a Fiber-to-the-Node fed home vs. a straight up copper home? Thanks.

Karen A. Puckett
Chief Operating Officer & Executive Vice President, CenturyLink, Inc.

A

Hey, Michael, Karen Puckett. In terms of the broadband, everyone has an opinion. We've made a good investment in our ADSL, VDSL, really VDSL technology as well as our Fiber-to-the-Prem. And depending on, at 30 meg to 50 meg, we believe we can be successful at. With bonding, we can get well beyond that. But really what we're focused on is the functionality and the capability, so Prism and the connected home we're pretty excited about. We continue to push the technology team in getting more efficient, and we're encouraged by some work that we have going on that we'll be talking about in future quarters. So I think from the standpoint of how we're positioned, we feel good about where we're positioned at right now.

R. Stewart Ewing, Jr.
Executive Vice President, Chief Financial Officer and Assistant Secretary, CenturyLink, Inc.

A

Yes, and if you look at it, 65% of our households can get access to 10 meg or higher on an unbonded basis, not bonded. Almost 40% can get access at 20 megs or higher on a non-bonded basis.

Michael I. Rollins
Analyst, Citigroup Global Markets Inc. (Broker)

Q

And just to follow up, if you have some details also on usage for home and the maybe growth in broadband traffic over the last year, that would be great.

R. Stewart Ewing, Jr.
Executive Vice President, Chief Financial Officer and Assistant Secretary, CenturyLink, Inc.

A

Yes, so the growth basically in – the average monthly download was 44 gigabytes, which was an increase of 24% quarter-to-quarter. The median monthly download, however, was 16 gigabytes, which is again about a 25%

increase quarter-to-quarter. So the top 1% of our subscribers downloaded 11% of the total – represented 11% of the total traffic basically. And 20% represented 70% of the total traffic.

Michael I. Rollins
Analyst, Citigroup Global Markets Inc. (Broker)
Q

That's helpful, and then just one final question, if I could. Is there a way to think about your CapEx in terms of what's a general bucket of the network that supports all the segments? And then maybe the CapEx specifically for consumer vs. business vs. – I know you've laid out some bogeys already on Fiber-to-the-Tower. But is there a way to think about how, you have this pool of broad CapEx, but then you can identify maybe some of the pieces for us? Just think through the where you're placing your dollars.

R. Stewart Ewing, Jr.
Executive Vice President, Chief Financial Officer and Assistant Secretary, CenturyLink, Inc.
A

So our dollars are really going, we'll spend $400mm or so on broadband expansion and enhancement this year and another $150mm on our Prism TV product. And then just your, we have a lot of success-based capital with our business customers, but that's all the detail I really want to give you now. Maybe $250mm or so on Fiber-to-the-Tower. I'm sorry, that's 2013.

Karen A. Puckett
Chief Operating Officer & Executive Vice President, CenturyLink, Inc.
A

$160mm.

R. Stewart Ewing, Jr.
Executive Vice President, Chief Financial Officer and Assistant Secretary, CenturyLink, Inc.
A

Yes.

Karen A. Puckett
Chief Operating Officer & Executive Vice President, CenturyLink, Inc.
A

$160mm.

R. Stewart Ewing, Jr.
Executive Vice President, Chief Financial Officer and Assistant Secretary, CenturyLink, Inc.
A

It's going to be slightly less for Fiber-to-the-Tower in 2014. It will be more like $150mm to $200mm depending upon the requirements there.

Sergey Dluzhevskiy
Analyst, Gabelli Funds LLC
Q

Two questions, one for Glen on M&A. Could you update us on your M&A philosophy and potential areas of interest? Obviously, you guys have mentioned in the past that you have the right mix of assets to return to revenue stabilization and eventually to grow. But to the extent that you would look to augment this growth through acquisitions, what areas would be of primary interest to you? And also one question for Karen on 1 gigabit service offerings. Maybe if you could, share with us some initial learnings from Omaha and Las Vegas. And what are your expectations for this market and for 1 gigabit offerings in general as you roll them out?

Glen F. Post, III
President, Chief Executive Officer & Director, CenturyLink, Inc.
A

Yes, Sergey, regarding the acquisition approach we're taking, we don't feel like we are compelled to make an acquisition. But to the extent we can find companies that can accelerate our growth, then we are interested. We'd expect it to be revenue growth accretive, also FCF accretive within, I think we said within 12 months, and it has to drive long-term shareholder value. So those are the three things we look for. And the recent acquisitions we've made, all of those fit this criteria basically. They all especially are poised to help enhance our growth in the months ahead, and we'll continue to look for those. These have all been small ones, but even large ones we'd consider. But those are the primary criteria we'd be looking for in an acquisition target.

Karen A. Puckett
Chief Operating Officer & Executive Vice President, CenturyLink, Inc.
A

This is Karen. Regarding the gig learnings from Omaha and Vegas, still early, but again we are really encouraged by the results there. We are seeing strong pull through just overall, two to three times in terms of HSI. Even outside of the gate footprint as well as an impact on business customers. So we have landed some new business opportunities just because of what we would call a halo effect in these two markets.

Jonathan G. Epstein
Analyst, Deutsche Bank Securities, Inc.
Q

First, on your comments about the dividend. You've previously expressed the desire to keep the 2015 dividend payout ratio under 60% of adjusted FCF. Is that still the foundation of the dividend policy? And if so, is it a litmus test, or is there any wiggle room there especially considering the forthcoming renewal of share repurchases? And then just a follow-up on a previous question. Was the $60mm savings in the quarter originally contemplated in 2013 guidance and can we expect savings of this magnitude in Q4 this year, of course baking in the tax savings that you already mentioned that you expect?

R. Stewart Ewing, Jr.
Executive Vice President, Chief Financial Officer and Assistant Secretary, CenturyLink, Inc.
A

Yes, so last question first. No, this was not in our guidance for Q4 or the full year really and we would not necessarily expect it. I mean, we always have a few adjustments during Q4, more related to property taxes and the true-up of our income tax rate for the year and things like that, minor items. But it just turned out to be much more significant this year because we had a number of employee benefit items that we that have been much smaller in the past. So it was not baked into guidance and we would not expect that to reoccur in 2015, 2014, I'm sorry.

In terms of the dividend, we basically indicated that we thought we could keep the payout ratio around 60% in 2015 when we became a cash taxpayer. It's not really a litmus test and there is certainly wiggle room from there. So it's just where we thought we would be at that time that we indicated that. And so it's not set in stone basically that if we get above 60%, we have to take action. So we're good with the dividend. We're comfortable with the dividend where it is and we're comfortable looking out a few years to the time when we become a full taxpayer that based on our business plans today, we would not have to change the dividend.

Adam T. Ilkowitz
Analyst, Nomura Securities International, Inc.
Q

Quick question on the Data Hosting segment. Can you give a little detail on how much Tier 3 added to the growth rate? I know we're lapping fiber a bit, but I was wondering how much of the managed hosting growth was actually organic. And then a question on cash flow beyond 2014. I know it's a little out there, but think about cash taxes going up and capital spending for some of these initiatives going down. Given that you're having success with GPON and with fiber on the business and consumer side, does this change how you're thinking about CapEx and the speed requirements and moving more to fiber than VDSL and bonding in the future? And how that would impact the CapEx budget going forward? Thanks.

Jeffrey H. Von Deylen
President, Savvis, CenturyLink, Inc.

A

Sure. Yes Adam, this is Jeff Von Deylen. On the first question, for the quarter, the Tier 3 acquisition added about $1.6mm in revenue for the quarter. And then we did get just, full disclosure, we got about $2mm benefit for exchange rate favorability. So, but the rest of the managed hosting cloud growth would have been organic. So we had a good, a very strong quarter sequentially in terms of growth and new business customers that we added and got installed during the quarter.

R. Stewart Ewing, Jr.
Executive Vice President, Chief Financial Officer and Assistant Secretary, CenturyLink, Inc.

A

And on your second question in terms of GPON and Prism impact and how we might think about CapExs and leverage related to that, really we believe we have enough capital built into the budgets in the out years to be able to do what we need to do to adequately serve our customers and compete with the cable companies and other competitors. If we did get to the point to where we felt like we needed to drive more fiber than we're planning on today and expand into many more Prism markets, we would certainly come back and talk with you about that and have the case associated with that to sell that. But basically at this point, I mean, we plan on really using multiple technologies to provide higher speeds to our customers and think we can continue to really have success there. And again, we'll monitor Omaha and the gigabit fiber trial there as well as where we've rolled it out in Las Vegas and see what success we have and make decisions later. But for now, we believe that with other technologies, we can basically be competitive.