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CenturyLink, Inc. (CTL)

Q1 2014 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day, ladies and gentlemen, and welcome to CenturyLink's first quarter 2014 earnings conference call. [Operator Instructions] As a reminder, this conference call is being recorded.

I would now like to turn the conference over to Mr. Tony Davis, Vice President of Investor Relations. Mr. Davis, you may begin.

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

Thank you, Sayyid. Good afternoon, everyone, and welcome to our call today to discuss CenturyLink's first quarter 2014 results released earlier this afternoon.

The slide presentation we will be reviewing during the prepared remarks portion of today's call is available in the Investor Relations section of our corporate website at ir.centurylink.com. At the conclusion of our prepared remarks today, we will open the call for Q&A.

Now turning to slide two, you'll find our Safe Harbor language. We will be making certain forward-looking statements today, particularly as they pertain to guidance for the second quarter 2014 and other outlooks in our business. We ask that you review our disclosure found on this slide as well as in our press release and in our SEC filings which describe factors that could cause our actual results to differ materially from those projected by us in these 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 ir.centurylink.com.

Now turning to slide three, your host for 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 portion of today's call will be: Karen Puckett, CenturyLink's Chief Operating Officer; Bill Cheek, President of Wholesale Operations; and Jeff Von Deylen, President of CenturyLink Technology Solutions, formally Savvis.

Our call today will be available for telephone replay through May 14, 2014, and the webcast replay through May 29, 2014. 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 May 7, 2014, and should be considered valid only as of this date regardless of the date heard or viewed.

Now as we move to slide four, I'll turn the call over to Glen Post. Glen?

Glen F. Post, III

President, Chief Executive Officer & Director, CenturyLink, Inc.

Thank you, Tony. Good afternoon, everyone, and thank you for joining us today.

I am pleased to report that CenturyLink achieved strong financial and operating performance for the first quarter. We continued to effectively execute against our objectives and make investments that we believe will drive an improved revenue trend and profitable growth over time.

Now turning to slide five, we achieved total operating revenues, operating cash flow, and adjusted diluted earnings per share that all exceeded our guidance for the quarter. For the first quarter of 2014, total operating revenues of $4.54 billion increased by $25 million compared to the first quarter 2013. This revenue growth represents a significant improvement from the 2.1% decline in year-over-year revenues in the first quarter 2013 and 2.7% decline in year-over-year revenues in the first quarter 2012. Data integration revenues were approximately $35 million higher in the first quarter 2014 than the first quarter 2013, primarily due to increased CPE or customer premise equipment sales.

Core revenue for the quarter, which represents strategic and legacy revenues combined, was $4.11 billion and was nearly flat from the year-ago period, reflecting the commitment and dedication of our employees to meet the needs of our customers. This comparison also represents a significant improvement from the 2% and 3% declines in year-over-year core revenues in the first quarter 2013 and 2012 respectively.

As anticipated, our Wholesale segment revenues continued to be negatively impacted by the lower access revenues due to the implementation of lower access rates under the CAF order and the declining voice minutes of use. Excluding our Wholesale segment, our core revenue grew approximately 1.2% or $38 million compared to the first quarter 2013. This compares to a decline of 0.9% or $28 million in the first quarter of 2013 compared to the first quarter of 2012.

Now continuing to slide six, I would like to highlight the key drivers of this continued strong improvement in our revenue trends. The improvement in core revenues was driven by the combination of improved rate of growth in strategic revenue and the lower rate of decline in legacy revenue. Business core revenue grew sequentially and year-over-year, driven by business demand for high-bandwidth data services and our bundled service offerings combining network, CPE, software applications, and managed services. We also continue to see good growth in Ethernet services from our fiber-to-the-tower investments in our Wholesale business so we meet the growing data backhaul needs of wireless carriers.

Managed hosting revenue, including cloud, grew nearly 13% year-over-year, while colocation revenue grew 3.3%, resulting in total hosting revenue growth of 6% compared to the first quarter of 2013. Additionally, if you look at our combined Business and Hosting segment revenues, we achieved year-over-year revenue growth for the last seven quarters. Consumer revenue grew sequentially and was nearly flat year-over-year, fueled by continued strength in high-speed Internet and Prism TV customer growth, price increases, and improved churn.

If you turn to slide seven, we're excited about the market opportunities that lie ahead for CenturyLink. Our employees have worked hard to successfully integrate several major acquisitions over the last few years, and we believe we are now well positioned as an industry leader capable of competing more effectively and winning in the marketplace. Over the last couple of years, we have consistently talked about our focus on broadband enhancement, Prism TV expansion, fiber-to-the-tower, and managed hosting and cloud services.

As we continue to transform our company from a provider of traditional network communications to an integrated provider of IP, enhanced network, cloud hosting, and IT services, we're refining our focus and executing on several strategic priorities. These strategic priorities are: first, business network solutions; hosting, cloud, and IT services; consumer broadband and video; and operating efficiency. We believe executing on these strategic priorities are key to our navigating this transformation successfully in 2014 and beyond to drive long-term profitable growth and value for our shareholders.

Now moving to slide eight, I'll provide a little more color on each of these priorities before I turn the call over to Stewart. Over the last several years, we have made significant investments in our ability to provide network and hosting services to our business customers, and we're now in a position where more than 60% of our revenues come from business customers across our Business Hosting and Wholesale segments. But more important than diversification alone, we're also seeing strong pull-through effects of being able to provide business customers with a suite of network, cloud, hosting, colocation, and IT services. More and more, our customers are asking for integrated communications and IT solutions, and we believe we have the strategic assets to provide these services.

With respect to business network solutions, we expect to continue to focus on driving growth in high-bandwidth data services, including MPLS, Ethernet, wavelength, and voice-over-IP by providing reliable, secure connectivity to meet the growing bandwidth needs of our business customers and wireless carrier customers. We believe our targeted marketing approach, sales programs, and continued expansion of our sales team as well as continued enhancements in our product portfolio continue to position us to drive revenue growth. For example, we're seeing strong early sales results associated with our recent launch of Managed Office, a solution that integrates network, VoIP, e-mail, and other key business applications, and we believe we have a good opportunity to grow our business customer base with these services.

We also expect to continue to expand our GPON and fiber deployment to commercial buildings, providing expanded addressable market opportunities for our business sales team, and ultra-fast Ethernet quality speeds to our customers, allowing them to cloud-enable their businesses. Similarly, although slowing somewhat from the level of the last few years, we will continue our fiber deployment to wireless towers to capture the growing demand from wireless carriers for wireless data backhaul.

With respect to our cloud and hosting business, we believe we have the right assets to meet the growing needs for cloud hosting and colocation services we are seeing from businesses ranging from small to global in scale. These assets coupled with our robust network capabilities enable our sales teams to build integrated hosting and network solutions that not only meet the clients' needs but also lower the total cost of ownership and better enable our customers to focus on their core businesses.

We will continue to enhance our hosting cloud service platform and expect to have deployed our advanced CenturyLink cloud nodes to six of our data centers by year end, which along with the Tier 3 cloud nodes operating in nine data centers at the time of acquisition will bring us to 15 advanced nodes by year end. We are further enhancing our ability to compete in the growth of hosting services by building and leveraging our deep IT knowledge base to offer mid to large enterprise customers a complete portfolio of IT and cloud enablement services.

While there are clearly strong competitors in the public cloud services space, we believe we are well positioned to compete in the hybrid cloud market as we offer the full range of network, cloud, managed hosting, colocation, and IT services that we believe our customers want.

In the Consumer segment, we continue to see good results in those markets where we have deployed higher bandwidth and IPTV services. For example, in the last six months since our limited gigabit service deployment in Omaha, the results continue to exceed our expectations in the consumer market, and we have seen good pull-through in the small and medium business space as well.

We expect to continue to invest in our high-speed Internet and Prism TV capabilities, with plans to continue to push fiber deeper into our network and add approximately 300,000 Prism TV addressable homes in 2014. We continue to monitor the success of Prism TV in our current markets and will consider further market expansion in the months ahead. We will of course give careful consideration to the operating cash flow impact of any new market launches.

Finally, we are focused on driving improved operating efficiency through network simplification and rationalization that should improve our end-to-end provisioning time and help drive standardization throughout our company. Additionally, we are focused on process automation improvement through applications and work tools that drive lower operating cost and improved sales efficiency.

Overall, I'm pleased with the strong results for the quarter. We remain focused across all operating segments and offering our customers high-value product and service solutions along with a high-quality customer experience that drives loyalty and improves customer retention. And we continue to invest to drive growth in our business.

With that, I'll turn the call over to Stewart for in-depth look at our financial results and second quarter guidance. Stewart?

R. Stewart Ewing, Jr.

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

Thank you, Glen. I'll spend the next few minutes reviewing the financial highlights from the first quarter and then conclude my remarks with an overview of the second quarter 2014 guidance we included in our earnings release issued earlier this afternoon. Beginning on slide 10, I'd like to review some of the highlights from our strong first quarter results. I'll be reviewing the results excluding special items as outlined in the earnings release and associated financial schedules.

As Glen mentioned earlier, we generated solid operating revenues and cash flows in the quarter. Operating revenues were $4.54 billion on a consolidated basis, a 0.6% increase from first quarter 2013 operating revenues. Core revenue, which we define as our strategic revenue plus legacy revenue, was $4.11 billion for the first quarter, nearly flat from the year-ago period. Our strategic revenues grew 5.4% year-over-year and now represent 50% of our total revenues compared to 48% a year ago. Strength in strategic products, such as high-speed Internet [HSI], high-bandwidth data services, Prism TV, and managed hosting services continues to drive this growth. Additionally, customer growth was strong in the first quarter. We added approximately 66,000 high-speed Internet customers and 24,000 Prism TV customers during the quarter.

In line with our prior experience, we expect HSI net adds to be seasonally weak in the second quarter as certain of our markets will experience increased disconnects from snowbirds and college students. Despite this, we do continue to expect positive HSI customer additions in the back half of the year.

We generated strong consolidated operating cash flow of approximately $1.79 billion for the first quarter and achieved an operating cash flow margin of 39.4%. The year-over-year decline in operating cash flow and operating cash flow margin was primarily driven by higher CPE sales and maintenance costs, employee-related expenses, facility cost, weather-related power cost, and expenses related to the growth of Prism TV. Also contributing to these year-over-year decreases was the impact of certain one-time favorable expense reductions experienced during first quarter of 2013, which resulted in higher operating margins in the year-ago period, and the continued decline in legacy revenues.

Additionally, we generated $860 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 and flexibility to meet our business objectives and drive long-term shareholder value.

We expect our dividend payout ratio for full-year 2014 to be approximately 45%. Adjusted diluted earnings per share for the first quarter was $0.66, well ahead of the $0.61 midpoint of our guidance. As we discussed on prior earnings calls, adjusted diluted EPS excludes certain special items and certain non-cash purchase accounting adjustments, as outlined in our press release and associated supplemental financial schedules.

We have continued to make solid progress under our $2 billion stock repurchase program authorized by our board in mid-February of 2013. During the first quarter, we repurchased 10.4 million shares with an investment of $319 million. From the inception of the program in February a year ago through May 6 of this year, we have almost completed the $2 billion program, having repurchased a total of 58.7 million shares for $1.97 billion, which reduced our aggregate annual dividend requirement by more than $125 million annually. We expect to complete the remainder of the current $2 billion stock repurchase program in the second quarter, well ahead of the original two-year timeframe. And as announced in February, our board approved a $1 billion follow-on stock repurchase authorization, which will commence upon completion of our current program.

Now turning to slide 11, the 0.6% increase in first quarter 2014 operating revenues compared to the first quarter 2013 was primarily a result of growth in strategic and data integration revenues that was partially 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 hosting services. Although legacy revenues continued to decline, the decline in first quarter 2014 was approximately 30% lower than the first quarter a year ago. Data integration revenues were higher year-over-year due to increased CPE sales.

Now turning to slide 12, I'll discuss each of our operating segments, beginning first with the Consumer segment. Consumer generated nearly $1.51 billion in operating revenues, which was nearly flat with first quarter 2013. Strategic revenues in this segment grew 8.8% year-over-year to $702 million, driven by growth in high-speed Internet, Prism customers, price increases, and improved churn. Legacy revenues for the segment declined 6.7% from first quarter a year ago, as access line and long distance revenues continued to decline. The comparable year-over-year decline in first quarter 2013 was 9.7%, so a three percentage point improvement in the rate of decline in legacy revenues period to period. Operating expenses increased 6.2% compared to the same period a year ago, primarily driven by higher Prism TV cost.

Moving to slide 13, our Business segment generated $1.56 billion in operating revenues during the first quarter, which increased $54 million or 3.6% from the same period a year ago. First quarter strategic revenues for the segment increased by 6.7% to $655 million from first quarter 2013, driven primarily by strength in high-bandwidth services such as MPLS, Ethernet, and Wavelength. We continued to generate solid growth across the enterprise customer market, and we see an opportunity for further investment in the small and medium sized business space to improve our market share and drive further growth.

Legacy revenues for the segment declined 2.9% from first quarter a year ago, due primarily to a continuing decline in access lines. Our data integration revenues grew 25% in first quarter 2014 compared to first quarter 2013, driven by higher CPE sales. Total Business segment expenses increased 12.7%, primarily driven by the higher CPE costs associated with those sales and facility costs associated with MPLS product growth along with higher employee-related expenses.

The segment margin of 38% declined from 43.1% a year ago. This decrease was primarily due to the higher costs I just mentioned above along with the impact of certain favorable one-time expenses experienced in first quarter 2013 and the continued decline in Business segment legacy revenue. If you look at our sequential segment decline from the fourth quarter of last year, it's fairly insignificant.

Wholesale, now turning to slide 14, our Wholesale segment generated $862 million in operating revenues, a decrease of 4.9% from first quarter 2013. Strategic revenues for Wholesale were $570 million, nearly flat with first quarter 2013, as growth in Ethernet services and wireless bandwidth expansion was offset by DS1 disconnects. Legacy revenues declined by 12.8% to $292 million, reflecting the continued decline in access and long distance minutes of use and the implementation of lower access rates under the CAF order. Operating expenses for the quarter in the Wholesale segment were approximately flat compared to the same period a year ago.

Now moving to slide 15 and our Hosting segment, which includes all managed hosting, cloud services, colocation, and hosting related network services revenues; before getting into the numbers, I want to note two changes in reporting for this segment that were implemented this quarter and have been retroactively applied through the first quarter of 2012. The first change is that hosting revenue by product category has been restated to allocate Cross-Connect revenue with the associated colocation or managed service, which is more aligned with industry peer reporting. The second change is that hosting expenses have been revised to remove certain administrative expenses in order to conform our Hosting segment reporting to that of our other operating segments.

This segment generated $354 million in operating revenues, representing an increase of 6% from first quarter 2013. Year-over-year managed hosting revenues, including cloud, grew 12.7% while colocation growth of 3.3% was impacted by customer churn and price erosion. Hosting operating expenses increased 10.5%, primarily due to higher employee costs partially related to the AppFog and Tier 3 acquisitions and one-time higher weather-related power costs. Over time, we expect long-term improvement in both revenue and margin trends across the Hosting segment and continue to leverage these assets to drive additional revenue through cross-selling opportunities in our other segments.

Now turning to slide 16 and our second quarter 2014 guidance, for the second quarter of 2014 we project total operating revenues of $4.48 billion to $4.53 billion, core revenues of $4.07 billion to $4.12 billion, and operating cash flow between $1.75 billion and $1.8 billion. Adjusted diluted EPS is expected to range from $0.62 to $0.67. We expect second quarter 2014 operating revenues and operating cash flow to be impacted by lower data integration revenue and the continued decline of our legacy revenue. Our full-year 2014 guidance remains unchanged from that provided on our February earnings call.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And our first question comes from Phil Cusick from JPMorgan. Your line is open. Please go ahead.

Philip A. Cusick
Analyst, JPMorgan Securities LLC
Q

Hey, guys; a couple things I guess. First, as you look at the buyback, you've got some left to go on the original and then the next $1 billion kicks in. Given, one, we're moving on to the next segment, and second that the shares have rebounded quite a bit, do you think that the pace of buyback slows, if not in 2Q, then beyond that? Thanks.

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

First of all, I'll let Stewart answer it later. But as far as the pace, it depends on a lot of things; the stock price, what happens to the stock price. It depends on other alternatives. Plus we're committed to our dividend. We think it's well protected by our free cash flows. We'll look at other opportunities for debt reduction. But right now, we expect to continue to complete the $1 billion stock buyback in the timeframe we talked about, even though the pace may not be quite as fast. Stewart, do you want to add?

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

No, Glen. I think you answered it. As the stock price increases, we spend less and of course buy fewer shares.

Philip A. Cusick
Analyst, JPMorgan Securities LLC
Q

And then, if I can, one on the business. You mentioned the colocation churn and price erosion as being a headwind to revenue. Was there anything notable there or new, or is that just the business running the way it typically does?

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

We had a couple of large businesses that were pure colo companies. We've actually been especially in the legacy Qwest data centers, and that was the biggest impact. I'll let Jeff address this for you.

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

That's right, Glen. There were a couple customers, a couple of large Internet companies, but we did have higher churn in Q1. We have one customer in the same vein for Q2 that will put some pressure. I would say that the Q1 impact, just of that to us from a revenue standpoint, is about $10 million annual, and that was just three customers. So those three were a pretty big impact to us, so there are some headwinds in terms of near-term growth. We're obviously focused on fill rates and filling those customers. The good news is a couple of those customers had very aggressive rates. So as we sell more to the enterprise, we think our yield and margins are going to be in good shape.

Philip A. Cusick
Analyst, JPMorgan Securities LLC
Q

Got it. Thanks, guys.

Operator: Thank you. And our next question comes from Simon Flannery from Morgan Stanley. Your line is open. Please go ahead.

Simon Flannery
Analyst, Morgan Stanley & Co. LLC
Q

Thanks very much. I wonder if you could expand a little bit on the operating efficiency actions. What is the timing on that, and anything you can do in terms of sizing it? And then I think there was a comment in the release around some delays in some fiber-to-the-tower builds by some of the carriers into 2015. Can you just expand on that as well, please?

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

Simon, so the delays in the fiber-to-the-tower builds were really just a customer pushing out certain towers that they had initially expected for us to build fiber to in 2014, and they delayed that out into 2015. So we think they'll ultimately get built by us, but it's just a matter of timing. They decided they wanted to spend capital elsewhere this year.

In terms of the operating efficiency actions, if you look at our guidance for the full year, our operating cash flow margin would be about 39.7% at the midpoint of the guidance. So we really need to keep expenses somewhat flat between now and the end of the year to hit the midpoint of the guidance. And there are just a number of different programs that we're looking at to take cost out of the business as we change our processes and get more efficient. I know Karen has, on the sales side, a lot of work being done to make our salespeople more efficient, to make our back office people, our sales support people more effective. So I think just as some of these programs mature over the next couple years, we'll be able to take some cost out.

Simon Flannery
Analyst, Morgan Stanley & Co. LLC
Q

Great, thank you.

Operator: Thank you. Our next question comes from Batya Levi from UBS. Your line is open. Please go ahead.

Batya Levi
Analyst, UBS Securities LLC

Q

Thanks. Can you talk a little bit about the trends you're seeing in the Business segment? I think you mentioned the sales pipeline is strong for the second quarter. How should we think about the business revenue growth for the remainder of the year?

Also, I believe CPE revenues were higher than expected in the quarter. Can you talk about what drove that, and does that add positive [ph] base-through (29:35) for network services for the remainder of the year? Thank you.

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

A

Yeah. So I'll address the CPE sale, and I think Karen is going to address the first question. The CPE sale was really a sale that we expected to book in the second quarter in our original guidance that we provided, and it just got pulled forward into the first quarter. That was the primary item. And then we had a large enterprise customer that we had a CPE sale to in the first quarter as well. So that really drove – there will not be really much MRR [Monthly Recurring Revenue] pull-through with those two sales. We have MRR associated with the large customer, which was a tech refresh that we did. Their MRR will not change, but we just basically refreshed all of their equipment. The other customer is more of a one-time CPE sale. But there's some network associated with that, but it wouldn't be that significant.

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

A

This is Karen. In terms of the overall Business segment, we have a strong funnel obviously going into second quarter with strong MPLS. Ethernet growth has been the story and continues to be the story. The team has done an extraordinary job of executing on that and really taking from competition. And then you come over to commercial mid-markets, the Managed Office as well as the business GPON is beginning to kick in and make a difference as well as the efficiencies that Stewart talked about in making our reps – giving them back more time for selling. So we're very encouraged about the year in front of us.

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

A

I might just add to that. This is Glen. In spite of a difficult economy that continues for us, our solutions, our go-to-market solutions-based approach we think is really being accepted well by our customers. We are very pleased with the growth we're seeing in our solutions-based approach, of course, MPLS, Ethernet. We're seeing crossover selling in cloud hosting into our network customer base. Managed Services is driving a lot of interest from customers as well. So we were very pleased with the response received to our marketing efforts and sales efforts in the Business segment.

Batya Levi
Analyst, UBS Securities LLC

Q

Great, thank you.

Operator: Thank you. [Operator Instructions] And our next question comes from David Barden from Bank of America. Your line is open. Please go ahead.

David W. Barden
Analyst, Bank of America Merrill Lynch
Q

Hey, guys. Thanks for taking the questions, congrats on a good quarter. I guess two questions, if I could. Just looking at the segments, Consumer flat, Business growing, Hosting growing. Sorry if Bill's there, but it looks like Wholesale really is the piece that we're trying to manage and the piece that's declining there is that last $292 million of it. Could you talk to us about how that Wholesale will trend over the course of the year because obviously we're not going to have that inter-carrier comp reduction like we did for the last two years? So I expect it should smooth out, and that will get us to that stronger end of revenue guide for the year.

And then the second question I had was we had the FCC finish their modeling process on the Connect America Fund, and it's going to mean big things I think for the sector maybe starting next year. Could you talk a little bit about what the model changes mean to CenturyLink and how you think you'll be dealing with these forces as they change over the course of this year and next? Thanks.

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

Yes, David. Unfortunately, Bill is here to hear your question. We'll let him address that.

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

David, you're right. It has been a challenge on the legacy revenue as that's phasing down. That has really been a challenge for us. We had a number of issues that hit us this year when you compare back to 2013 first quarter. We had some one-time items. We of course had the ICC rate changes, intercarrier comp rate changes. They are flattening out, as you said, but we still have a phase down that's coming as we continue to phase that down to effectively zero over time on the terminating side. The good news there is we do have an offset with some access recovery charges on the retail side that we pick up some of those ICC phase-down costs. So it's more of a phase from wholesale over to retail.

And then of course our LD volumes and access volumes have in fact declined. We do expect they will start to mitigate somewhat, but minutes of use obviously will continue to decline along with access line loss and wireless substitution, Internet substitution on the 800 business. And the UNI [User Network Interface] business for us has been pretty flat, and that's in legacy. So the CLECs, while they're not gaining traction and not gaining share, they're not going away at a very rapid rate but they are declining slightly.

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

And, David, on the second part of your question on the CAF 2, as you know, the FCC has decided to modify the CAF 2 proposal and initiate a notice of proposed rulemaking. This will involve several rounds of FCC comments and industry discussion over the next 90 days or so, so there's a lot of work to do here. One of the key changes that they're proposing is the requirement to increase broadband deployment speeds from 4 megabits to 10 megabits. We'll see how that discussion goes. Once we have more time to digest the proposed rulemaking and discuss the issues with the FCC and industry, we'll be able to provide more guidance on this issue.

Previously our projections ranged from $470 million to $500 million of support annually we could obtain from CAF 2. Right now, we don't know what that will be based on the latest changes. But we do think it's important that if we move to the higher bandwidth there's enough support there to justify or to make it practical for us to provide that level of service.

David W. Barden
Analyst, Bank of America Merrill Lynch
Q

Got it, thank you.

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

David, on the strategic revenue side on Wholesale, I think it's important to note we were only down $1 million, $571 million a year ago, $570 million first quarter this year, which really is a reflection of the fiber-to-the-tower builds that we've done over the last two or three years and the Ethernet and growing bandwidth that we're experiencing with those customers. And it's offsetting the disconnects of the DS1s and DS3s that we're seeing that are also included in that strategic revenue line.

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

David, this is Bill again. I just want to add. We are very encouraged by the bandwidth growth we're starting to see. If you look over the last really six months or so, we've seen a 4% migration of bandwidth. And over the last 12 months that's up to 6%. Certain carriers are over 8%. So we're starting to see some improvement in that trend. And just recently, we got a very large order for a number of upgrades from one of the major carriers, so we think that will continue.

David W. Barden
Analyst, Bank of America Merrill Lynch
Q

Great, okay. Thanks for that color, I appreciate it.

Operator: Thank you. And our final question for today comes from Ana Goshko from Bank of America. Your line is open. Please go ahead.

Ana Goshko
Analyst, Bank of America Merrill Lynch
Q

Hi, thanks very much. I wanted to ask on the cash flow items outside of the definition of free cash flow, last year there was a pretty big use of cash. It was about $340 million for retirement benefits. But I noticed that in the first quarter it's really down a lot year-over-year. It looks like it's only a $28 million use of cash versus $178 million in the prior-year period. So I wanted an estimate of what you think that's going be in terms of the use of cash for this year.

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

I'm going to need to get back with on an estimate for the year. But it's really our pension contribution that we made last year. I think our pension contribution was in the neighborhood of $300 million or so. The pension contribution this year will be less than that, in the about $125 million range.

Ana Goshko
Analyst, Bank of America Merrill Lynch
Q

Okay. And then any other items that we should be cognizant of that are outside of the company-defined free cash flow definition in terms of expectations for working capital use or any remaining integration expenditures or anything like that?

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

No, not really. In the first quarter we did make the payment on the litigation that Qwest had, the KPNQwest litigation, which if I recall was about $235 million. It was fully accrued. But that was a cash payment that we made in the first quarter.

Ana Goshko
Analyst, Bank of America Merrill Lynch
Q

Okay. And then on the uses of free cash flow outside of the dividend, it did sound like in the prior question that you may slow the pace of buybacks with a stronger stock price. So I'm wondering what the other uses of the free cash flow would be. I did note that it looks like you had another small revolver draw, and that revolver is probably around $750 million. So barring additional share buybacks, would you look to pay that debt down?

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

We'll just have to see where the stock price goes and really the level at which we repurchase shares and go from there. But our debt level at the end of the first quarter was essentially flat with where we were at the end of 2013.

Ana Goshko
Analyst, Bank of America Merrill Lynch
Q

Okay, great. Thank you very much.

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

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

Thank you, Sayyid. Overall, we are very pleased with our strong first quarter results, both operating and financial, especially the continued improvement in our revenue trend. We believe the investments we are making in our business continue to position us to effectively compete in the marketplace and drive revenue growth from our strategic products and services in the months ahead. 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 participating in today's conference. This concludes our program. You may all disconnect, and have a wonderful day.