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CenturyLink, Inc. (CTL)

Q3 2014 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day, ladies and gentlemen, and welcome to CenturyLink's Third Quarter 2014 Earnings Conference Call. At this time, all participants are in a listen-only mode. Later, we'll conduct a question-and-answer session and instructions will be given at that time. [Operator Instructions] As a reminder, this conference call is being recorded.

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

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

Thank you, Syed, and good afternoon, everyone, and welcome to our call today to discuss CenturyLink's third 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.

As you move 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 fourth 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 those non-GAAP financial measures and the GAAP financial measures are available in our earnings release and on our website at ir.centurylink.com.

Now, if you move 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; and Jeff von Deylen, President of Technology Solutions.

Our call today will be available for telephone replay through November 13, 2014, and the webcast replay of our call will be available through November 27, 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 November 5, 2014, and should be considered valid only as of this date regardless of the date heard or reviewed. As we move to slide four, I'll now turn the call over to Glen Post. Glen?

Glen F. Post, III

President, Chief Executive Officer & Director

Thank you, Tony. Good afternoon, everyone and thank you for joining us today. I'm pleased with our solid financial performance for the third quarter. We continue to effectively execute against our objectives and make investments that we believe will drive increased revenue.

Now turning to slide five, we achieved solid revenue in third quarter. Total operating revenues of $4.514 billion were basically flat, compared to third quarter 2013. This revenue performance represents a significant improvement from the 1.2% decline in year-over-year revenues in third quarter 2013 and a 1.3% decline in pro forma year-over-year revenues in the third quarter 2012. Data integration revenues were $22 million higher in third quarter 2014 than in third quarter of 2013, primarily due to increased CPE or customer premise equipment sales. Core revenue, which represents strategic and legacy revenues combined, was $4.08 billion for the quarter, a decline of only 0.6% from the year ago period. This comparison also represents a strong improvement from the 1% and 1.8% declines in year-over-year core revenues in the third quarter 2013 and 2012 respectively.

Now continuing to slide six, I'd like to highlight the key drivers of this continued and strong improvement in our revenue trend. The improvement in core revenues was driven by the combination of the continued growth in strategic revenue and a lower rate of decline in our legacy revenue. Business core revenue grew sequentially and year-over-year driven by 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 as we meet the growing data transport needs of our wireless carriers.

However, as we mentioned last quarter, wholesale operating revenues continue to be pressured by the migration from low speed data services to fiber-based Ethernet, as well as continued network grooming by wireless carriers. Consumer strategic revenue grew over 6% year-over-year, fueled by continued strength in high-speed Internet and Prism TV customer growth, price increases and improved churn. Managed hosting and cloud revenue grew 14% year-over-year, while colocation revenue grew 4.5%, resulting in total hosting revenue growth of 5.6% compared to third quarter 2013. Additionally, if you look at our combined business and hosting segment revenues, we have achieved year-over-year revenue growth for the last nine quarters.

Turning to slide seven, we continue to transform our company from a provider of traditional network communications to an integrated provider of IP enabled network, cloud hosting and IP services and we are refining our focus and executing on several strategic priorities. We believe these priorities are key to successfully navigating the continued transformation of our company and driving long term profitable growth and value to our shareholders. The first of these is to grow business network solutions. We expect to continue to focus on driving growth from high-bandwidth data services including MPLS, Ethernet, wavelength, business GPON and voice-over IP services, by providing reliable connectivity to meet the growing bandwidth needs of our business customers.

In third quarter, we experienced continued strength in sale of high-bandwidth data services. We announced expansion of our 1-gig service for our business customers to 16 markets in August, which has resulted in strong small and mid-size business sales. This expansion provides increased addressable market opportunities for our business sales team and ultra-fast Ethernet quality speeds to our customers, allowing them to cloud-enable their businesses.

We also believe our targeted marketing approach and the continued expansion of our sales team as well as continued enhancements in our product portfolio position us well to drive revenue growth. For example, we are seeing continued strong sales results associated with our launch of Managed Office, a solution that integrates network, voice-over IP, e-mail and other key business applications. And although slowing somewhat from the level of the last few years, we continued our fiber deployment to wireless towers to capture the growing demand from wireless carriers for data backhaul. During the third quarter, we completed fiber to approximately 1200 towers for a total of nearly 21,000 fiber builds.

With respect to our client and hosting business, we believe we have a strong set of assets that will enable us to meet the growing demand we are seeing from businesses ranging from small to global in size for cloud and hosting services. These assets, coupled with our expansive network capabilities, enable our sales team to deliver integrated hosting and network solutions to meet the customer's needs, lower their operating costs, enable them to focus on their core businesses. We continue to believe we are well positioned to compete and win in the hybrid cloud market as we offer the full range of network, cloud, managed hosting, hosting, colocation and IP services that we believing our customers want.

During third quarter, we launched CenturyLink Private Cloud service, which is available on the same industry recognized platform as our Public Cloud service, enabling new hybrid IT capabilities. This new cloud service delivers the agility and innovation of public cloud but with the physical isolation, dedicated hardware and security standards that many large enterprises require. I believe CenturyLink is well positioned to capture the future growth of enterprise IT workloads that we expect to migrate to the cloud over time, whether these workloads end up in multi-tenant or dedicated cloud infrastructures.

Additionally during the quarter, we announced the roll out of our global managed hosting services in China. This expansion, along with our other Asia-Pacific capabilities, enable us to better serve multinational corporations, conducting business in the world's second largest economy. We continue to enhance our ability to compete in the growth of hosting services by building and leveraging our broad IP capabilities to offer enterprise customers a complete portfolio of IT, cloud enablement and consulting services.

Continuing now to slide eight. In the consumer segment, we continue to see good results in those markets we've deployed higher bandwidth and IPTV services. For example, since our limited gigabit service deployment in Omaha, the results continue to exceed our expectations in the consumer market and we have seen good results in small and medium business space as well.

Along with our gigabit service expansion for businesses, we also announced the availability of gigabit service to residential customers in select locations in ten cities, including some of our larger markets like Minneapolis, St. Paul, Denver, Seattle, Las Vegas and Portland. And we expect to continue to expand the availability of this service in the months ahead. We also have a plan to continue to invest in our Prism TV capabilities and we've added more than 240,000 addressable homes year-to-date, on track to reach a total of 300,000 new Prism TV addressable homes for the full year 2014. We do anticipate expanding Prism TV service to additional households and markets during 2015. However, we are not ready to announce specific markets at this time.

Finally, we are focused on driving improved operating efficiency through a number of methods including network simplification and rationalization that should improve our end to end provisioning time and help drive standardization. We're also focused on improvement in process automation through applications and work tools that drive lower operating cost and that we expect to improve our sales efficiency. We continue to modernize our network replacing ATM with IP technology that enables high broadband speeds while also adding network capacity to serve our growing customer base. Since January, we've added over 3 terabytes to our IP backbone, bringing total capacity to 19 terabytes per second. Also we continue to manage the expenses related to our declining legacy revenue.

Lastly, we have laid the foundation to migrate our internal IT operations for our cloud platform as we continue to invest in IT virtualization. In recent years, we have consolidated our internal IT operations from more than 10 data centers to 4 data centers. We also are using a cloud-first approach to rapidly deploy the same innovative platform, infrastructure and software-as-a-service solutions across our internal IT operations that we're selling through our cloud and IT hosting customers. We're currently on track and our efforts to host the vast majority of our new and strategic internal IT applications, the CenturyLink cloud, instead of our internal data center.

Going to slide 9. Effective November 1, we've implemented and refined our organization structure to better serve our customers and drive incremental growth. We're pleased with the progress we made toward our goal of reaching long-term growth and we believe the structure will accelerate that progress. This change combines marketing, sales, and services delivery for all of our customers under one leader. Additionally, we've created an organization under a single leader who is responsible for operational excellence, the Indian engineering delivery, and management of our network and data centers. We believe that these changes will strengthen our focus on revenue generation and go-to-market strategy and improve our ability to develop and deliver new technologies and solutions while better aligning our cost structure with our revenue strength. This change in our organization structure will likely result in some modification of our segment reporting that will determine in the coming weeks.

Overall, I'm pleased with the solid results for the quarter. We remain focused across all operating segments on offering our customers high-value product and service solutions, along with a high-quality customer experience we believe creates 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 fourth-quarter guidance. Stewart?

R. Stewart Ewing, Jr.

Executive Vice President, Chief Financial Officer & Assistant Secretary

Thank you, Glen. I'll spend the next few minutes reviewing the financial highlights from the third quarter and then conclude my remarks with an overview of the fourth-quarter 2014 guidance, we included in our earnings release issued earlier this afternoon.

Beginning on slide 11, I'd like to review some highlights from our solid third quarter results. I've been reviewing the results excluding special items as outlined in the earnings release and associated financial schedules. As Glen mentioned earlier, we generated strong operating revenues and cash flows in the quarter. Operating revenues were $4.51 billion on a consolidated basis nearly flat from the third quarter 2013 operating revenues. Core revenue defined as strategic revenue plus legacy revenue was $4.08 billion for the third quarter, but decline of only 0.6% from the year ago period. Strategic revenues grew 4.4% year-over-year and that represent 51% of our total revenues compared to 49% 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.

Additionally, we added approximately 14,000 Prism TV customers and 8,400 high-speed Internet customers during the third quarter. We generated strong operating cash flow of approximately $1.75 billion for the third quarter and achieved an operating cash flow margin of 38.7%. The year-over-year decrease in operating cash flow and operating cash flow margin was primarily driven by higher customer premise equipment sales, higher content cost related to the growth of Prism TV and the continued decline in legacy revenues. Additionally, we generated $780 million of free cash flow during the quarter, which is defined as operating cash flow, less cash taxes paid, interest and capital expenditures and additional adjustments to other income.

Our strong cash flows continue to provide us the financial strength and flexibility to meet our business objectives and drive long term shareholder value. Adjusted diluted earnings per share for third quarter was $0.63, the high end of our adjusted diluted EPS guidance for the quarter. As we have discussed on prior earnings calls, adjusted diluted EPS excludes special items and certain non-cash purchase accounting judgments as outlined in our press release and associated supplemental financial schedules. Additionally, under the $1 billion share repurchase program, we repurchased 1.7 million shares for an investment of $64 million during the third quarter. We expect to set up a 10b5-1 program in the next few days to facilitate the purchase of shares through our fourth-quarter earnings release date.

Now turning to slide 12. Third quarter 2014 operating revenues were flat to third quarter 2013 as the growth in strategic data and integration revenues was 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 data business services, Prism TV and hosting services. Although legacy revenues continue to decline, the revenue decline in third quarter 2014 was 9% lower than the third quarter revenue decline a year ago.

Now turning to slide 13, I'll discuss each of our operating segments beginning with the consumer segment. Consumer generated $1.49 billion in total operating revenues which represented a decline of 0.8% from a third quarter a year ago. Strategic revenues in this segment grew 6.4% year-over-year to $712 million, driven by growth in high-speed Internet and Prism TV customers, price increases and improved churn. Legacy revenues for the segment declined 6.6% from third quarter 2013, as access line and long distance revenue declines were partially offset by select price increases. The comparable year-over-year decline in third quarter 2013 was 8.7%. Operating expenses increased 1% compared to the same period a year ago, primarily driven by higher Prism TV costs or content costs.

Moving to slide 14. Our business segment generated $1.57 billion in operating revenues during the third quarter, which increased $25 million or 1.6% from the same period a year ago. Third quarter strategic revenues for the segment increased 6.1% to $677 million from third quarter 2013, driven primarily by strength in high-bandwidth services such as MPLS, Ethernet and wavelength. We continue to generate solid growth across the enterprise customer base and we see an opportunity for further investment in small and mid-size business space to improve our market share and drive further growth. Legacy revenues for the segment declined 4.8% from third quarter 2013, due primarily to the continuing decline in access lines. Our data integration revenues grew 13.6% in third quarter 2014, compared to third quarter 2013, driven by higher CPE sales.

Total business segment expenses increased 7%, driven primarily by higher CPE costs and facility costs associated with MPLS product growth along with higher employee-related expenses related to additional sales resources brought in to drive future revenue growth. Our segment margin of 36.5% declined from 39.6% a year ago; this decrease was primarily due to the higher cost I just mentioned, along with the continued decline in business segment legacy revenue.

Now turning to slide 15. Our wholesale segment generated $843 million in operating revenues, a decrease of 4% from the third quarter 2013. Strategic revenues for wholesale were $560 million, down slightly from third quarter 2013, as growth in Ethernet services and wireless bandwidth expansion was offset by declines in low speed data revenues. Legacy revenues declined 10.2% to $283 million, reflecting the continued decline in access and long distance minutes of use and the annual implementation of lower access rates under the CAF order. Operating expenses for the quarter declined $8.1 million, or 2.7% compared to the same period a year ago, driven by lower employee-related and facility costs.

Now moving to slide 16 and our hosting segment, which includes all managed hosting, cloud services, colocation, and hosting related network services revenues. This segment generated $361 million in operating revenues, representing an increase of 5.6% from third quarter 2013. Year-over-year, managed hosting revenues including cloud grew 14%, while colocation revenues grew 4.5%. Hosting operating expenses increased $9 million or 3.5%, primarily due to higher employee costs related to the revenue growth. Over time, we expect long-term improvement in both revenue and margin trends across the hosting segment and we continue to leverage these assets to drive additional revenue through cross selling opportunities in our other segments.

Now turning to slide 17 and our fourth quarter 2014 guidance. For fourth-quarter 2014, CenturyLink projects total operating revenues of $4.44 billion to $4.49 billion, core revenues of $4.05 billion to $4.10 billion, and operating cash flow between $1.75 billion and $1.8 billion. Adjusted diluted EPS is expected to range from $0.59 to $0.64. We expect fourth quarter 2014 operating revenues to be lower than third quarter 2014, primarily due to lower data integration revenues or our CPE revenues. Core revenues are expected to be approximately in line with third quarter as the declines in legacy services are offset by growth in strategic services. Fourth quarter cash expenses are expected to decrease from third quarter, primarily due to the normal seasonality of outside plant maintenance and utility costs and lower CPE sales related to the anticipated decline in data integration revenues.

Based on our revenue outlook for fourth quarter 2014, we expect total revenue results for 2014 to be approximately $40 million to $80 million above the midpoint of our original 2014 guidance range, which was $18 billion, primarily driven by higher than anticipated non-recurring CPE sales. As we look forward to 2015, we continue to expect operating revenues to be approximately the same as these projected 2014 revenues. However, the increase in the rate of decline in low speed data services revenues, which Glen discussed earlier, driven by the accelerated pace of network grooming by wholesale customers in the second half of 2014, and the higher than anticipated CPE sales in our projected 2014 revenues, as mentioned above, has added risk to this comparison. We also anticipate capital expenditures for full year 2015 to be in line with our expected full year 2014 capital expenditures of approximately $3 billion. We will provide further 2015 guidance in mid-February, when we report our fourth quarter and full year 2014 results.

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, sir. [Operator Instructions] Your first question comes from David Barden from Bank of America. Your line is open, please go ahead.

David W. Barden
Bank of America Merrill Lynch

Q

Hey guys. Thanks for taking the question. So I guess first question is on the fourth quarter revenue guidance, Stewart. I guess I was looking at the data integration revenue line and it's been elevated all year.

I think every quarter you called it out as being surprisingly strong, but it's strong every single quarter and now in fourth quarter is the quarter you're now expecting it to maybe ease off. So are you expecting it to be kind of flat year-over-year growth wise, or really significantly down? And if so, why? And then, this kind of goes into my next question, which was, I mean, we have been looking at 2015 as the revenue inflection year for probably a couple of years now. It's been this goal you guys have really set out. You seem to be now hedging a little bit that maybe it is, maybe it isn't because of all these risk factors, one of which is CPE and the other is the narrow band contraction revenues. So if you could talk a little bit about the driver of the narrow band issue and what was unexpected about it and kind of how you're planning on managing it to get to revenue growth for next year, would be great. Thanks.

R. Stewart Ewing, Jr.
Executive Vice President, Chief Financial Officer & Assistant Secretary

A

Yeah, so first of all, David, I'll try to take it in the order that you indicated. It is forecast lower in the fourth quarter. You know, we had a larger deal that closed in the third quarter. Fourth quarter of 2013 was about $187 million and we are expecting the fourth quarter of this year to be about $144 million. So, we do expect it to be down. We just don't have the same number of large deals in the pipeline that we expect to close in the fourth quarter.

In terms of 2015 being an inflection year, so, basically, when we started talking about -- we still believe, first of all, let me say, we still believe that we can get to the level of revenue, hopefully, that we will have this year in 2014, which will be higher than the midpoint of the original guidance that we gave. So the original guidance we gave was – the midpoint was $18 billion. We are going to end up probably $40 million to $80 million higher than that. So basically, that puts some challenge associated with 2015 just right out the gate, plus our CPE revenues and it really relates to CPE revenues in 2014 being higher than 2013. So, the low speed narrow band issue that we have seen is basically as – and it really started kind of the end of the second quarter or so, where we started seen more disconnects than we saw in actually the first quarter and really second quarter of this year.

And what it is, basically, is it's related to – we are having fewer towers that we are building to, because we are just about through the cycle of building fiber-to-the-towers and we are still seeing disconnects of the low-speed circuits and they really seem to relate to one, a customer that basically shut a network down and secondly, towers that we were not successful in terms of obtaining the fiber to the tower builds from. So we expect this to play out sometime, probably during the first half of 2015 in terms of the rate of decline that we are seeing, but that's really-- and just to quantify for you, it is probably – and it is really lower than what our expectations were. It won't necessarily be lower than – it won't be that much lower than this year's revenue. But, it's somewhere in the range of $50 million to $100 million or so.

But, you know, we have overcome that and think we can overcome that with the improvement that we have been able to see in our business revenue growth and also the lower decline in our consumer revenue growth that we have seen this year. So we've offset some of that decline in effect.

David W. Barden
Bank of America Merrill Lynch
Q

So basically, two parts to that. One is the starting point for the revenue growth kind of inflection is actually higher than what we thought it was going to be when we were talking about it at the beginning of 2014. And then we've got this narrow band issue – we can overcome that with the business and consumer initiatives and the CPE side is probably going to be relatively low margin so at the end of the day, it's not that important a revenue stream?

R. Stewart Ewing, Jr.
Executive Vice President, Chief Financial Officer & Assistant Secretary
A

End of the day, it's not that important and we will be right in the range of our 2014 revenue in 2014, plus or minus a little bit. And, it may depend on how much CPE we sell. But again, you got it characterized exactly correct. The jump off point more or less or the base that we set in 2014 was higher than the midpoint when we started talking about revenue stability. And then towards the latter half of this year, we've seen a little bit of weakness in the low-speed connections on the wholesale side.

David W. Barden
Bank of America Merrill Lynch
Q

Okay, great. Thanks for the clarification.

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

Batya Levi
UBS Securities LLC
Q

Great, thanks. Glen, could you also provide some color on your outlook for margins. I think you've already said that once the revenue trends stabilize, EBITDA stability should be 12 months to 18 months behind that. So, how should we think about margin outlook for 2015 and beyond? And another question on the CapEx. You're maintaining your $3 billion guidance, which suggests a big ramp in 4Q. What will that mainly be spent on? And looking at 2015, wireless backhaul spending probably comes down, what will that be replaced with to maintain a flat level? Thanks.

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

Yeah, so, Batya, the margins, we think they will continue to come down slightly as we continue to lose the higher margin revenue, but again, lose it at a slower rate than we've been losing it in the past. But we would still expect EBITDA to stabilize 18 months, 12 months to 18 months or so afterwards, assuming we can continue the rate of decline in the legacy revenue and assuming we can continue the rate of growth, the growth in our strategic revenue. And I think we haven't really called where the margins will end up, but somewhere in probably the mid-to-upper 30s range. One thing, if you look at our business margins, they were down a pretty good bit quarter-to-quarter. But if you back CPE out of both of the quarters, the third quarter last year and third quarter this year, the margin third quarter last year was 41%. The margin this year was about 39% or so. So, again, outside of the CPE, we're still getting good margins in that business.

CapEx, it is going to be somewhat higher in the fourth quarter. We have some of the network work that we're doing to try to upgrade some of our networks. We also have some data center expenditures that we're going to make as well in the fourth-quarter. So we'll just catch-up a little bit in the fourth quarter with what we had expected to spend for the year.

In terms of wireless backhaul, we really don't have the full 2015, the details of 2015 budget laid out at this point. But we'll probably still have some fiber-to-the-tower builds next year. And any moneys that we don't spend there will probably go in our GPON deployment, as we try to build fiber to more business customers and more buildings to allow our customers to be able to sell higher-speed data services to our customers.

Batya Levi
UBS Securities LLC
Q

Great. Thank you.

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

Simon Flannery
Morgan Stanley & Co. LLC
Q

Great, thanks a lot. Staying on the CapEx side, I think you said Prism would cover 300,000 households this year. You're not ready to choose markets for next year. But have you given thought to accelerating the pace of Prism? I noticed the broadband ads were somewhat light this quarter. Perhaps you could just talk to that. Is there some pressure on DSL outside of your Prism markets and what can you do to get some better growth in that? Thanks.

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

I'll talk about the first part of your question. Simon, it's Glen, and then Karen, can answer on the issue with the units. But, yes, we are considering accelerating some of the Prism investment. Here we – it'll probably be mid-year before we actually initiate service in new markets, but we do expect to expand. And we've identified a number of markets. And we're still working with franchises with some of the cities and we're grooming our plant. Getting it ready for that GPON investment, will also help with that process of bringing Prism to the cities. But we are expecting to move forward, certainly accelerated to what we have been this year.

Simon Flannery
Morgan Stanley & Co. LLC
Q

Okay, good.

Karen A. Puckett
Chief Operating Officer & Executive Vice President
A

Simon, Karen. In terms of HSI, I would first say that we still have historical low churn and we are very proud of that work we have done. In terms of some of the softness, I would categorize it, we had some softness in our ATM markets. We have really taken out some of the marketing that we were doing there for all the right reasons. We had some softness in some alternative channels that we have. And then this quarter we got very focused on just improving our inward ARPU and we accomplished that. It did cost us a bit on the units, but we are still very optimistic where we have fiber-to-the-node and where we have fiber-to-the prem, we're very competitive and can compete with cable. In the ATM markets, though, that has been a bit more challenging.

Simon Flannery
Morgan Stanley & Co. LLC

Q

Thank you.

Operator: Thank you. Our next question comes from Mike McCormack from Jefferies. Your line is open, please go ahead.

Michael McCormack
Jefferies LLC

Q

Hey, guys, thanks. I guess just thinking about a couple of the comments regarding prices, and Karen just mentioned the inwards, but how price sensitive are you finding consumers right now with respect to whether it is broadband or traditional telecom services? And then, secondly, just a thought on Prism TV, I mean, hearing a lot of over-the-top chatter and TV moving in different directions. Has that changed your view on sort of longer term where you want to take Prism TV? Thanks.

Karen A. Puckett
Chief Operating Officer & Executive Vice President

A

In terms of the pricing, how sensitive consumers are, you know, I would say, the market hasn't changed a lot. It really is around the promotional that ebb-and-flows in terms of the amount sometimes per quarter. There is a lot more chatter around speed, as you would guess, especially from cable where they have upped the speed on their entry-level programs to 60 megs in many of our markets. On Prism, I think we are still very optimistic about Prism. Over the top is an opportunity; we continue to follow what is happening. We have the capability, given our Prism foundation and content capability there. And it's just a matter of getting the economics right. So we continue to be focused and look at plans to have some type of over the top offering in the future.

Michael McCormack
Jefferies LLC

Q

And Karen, just sticking on the economics of the consumer market, the 1-gig product you're rolling out, obviously it's relatively limited, but how do you think about the economics, sort of on a per home basis, if you would?

Karen A. Puckett
Chief Operating Officer & Executive Vice President

A

The announcement that we made actually right at last earnings call, we looked at the opportunity, we are focused on the fiber deployment, getting that cost per household deployed down. And so, that range needs to be under $1,000 per household. We have the GPON that we are currently rolling out that we are constructing as we speak, fit into those metrics very easily because it was aerial fiber and short loop. So that works. It is the bigger next step, where we've got to continue to get that fiber deployment down. We have been working on a couple of different approaches and we are making progress there. So that is important for our ability to roll out fiber in a bigger way.

The other thing, I would just mention on the fiber-to-the-business, GPON-to-business, really very optimistic, the sales team there is very excited. Early indicators, and we just started marketing that, are positive. And we think that that will put us in a very competitive position here in the next couple of quarters.

Michael McCormack
Jefferies LLC

Q

Great. Thank you.

Operator: Thank you. Our next question comes from Phil Cusick from JPMorgan. Your line is open, please go ahead.

Philip A. Cusick
JPMorgan Securities LLC

Q

Hey, guys, thanks. You know, given what sounds like a potential revenue decline in 2015, should we still think about EBITDA stability a couple of years beyond revenue? Or with CPE being the difference or a good chunk of the difference in 2015, could that timeframe tighten a bit? Thanks.

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

A

Yeah, Phil, so we still believe we can hit hopefully 2014 revenue in 2015 to where it will be flat, we're just saying that there is some challenges and risks getting there with what we are seeing. But, we still should be able to see EBITDA stability, we think again within the periods that we talked about, the 12 months to 18 months after we get to revenue stability. So hopefully after 2015.

Philip A. Cusick
JPMorgan Securities LLC

Q

Okay, thanks, guys.

Operator: Thank you. And our next question comes from Kevin Smithen from Macquarie. Your line is open. Please go ahead.

Kevin Smithen
Macquarie Capital (USA), Inc.

Q

Yeah, how should we think about cash taxes in 2015 and assuming different scenarios on bonus depreciation. I know you have some amortization that is not deductible. Can you talk a little bit about the different scenarios for cash taxes? And then, as a follow-up to that, can we talk a little bit about priorities for use of cash next year? I saw your share repurchase was a little bit lower this quarter despite the strong-free cash flow. How should we think about use of cash in 2015?

R. Stewart Ewing, Jr.
Executive Vice President, Chief Financial Officer & Assistant Secretary

A

Yeah, So basically in terms of cash taxes, we'll pay $50 million to $100 million of cash taxes in 2014, and really that represents virtually no federal taxes. In 2015, we would expect our cash taxes to increase somewhere in the $600 million to $700 million range on an incremental basis. So $700 million to $800 million or so of cash taxes in 2015. Should bonus depreciation get implemented and extended basically for 2014 and 2015, we would expect our 2015 cash taxes to be about maybe $50 million to $150 million higher than they are in 2014. So maybe $150 million to $175 million next year.

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

A

Kevin, this is Glen. I'll talk about the use of cash for a moment. As far as the stock buyback is concerned, we didn't make much progress this past quarter. We expect to be back on track in the coming quarter. As we've said from the beginning, we buy opportunistically and we'll look at each quarter. But we are committed to stock buybacks. We think they're good. The money we spent on our own stock the last couple of years has really been a good investment for us. So we are pleased with that. We also were committed to our dividend. We think it's well protected by our free cash flow. Our dividend payout ratio this year, we expect to be about 45%. As we feel good about that dividend.

And in addition to our dividend and stock buyback, we are continually weighing, the best opportunities to utilize our cash. We look at additional cap expenditure opportunities where we can drive growth in the business, we look at possible debt reduction, and then acquisition opportunities and organic opportunities that can drive growth for us. But our continual focus is really on the best ways to utilize our cash to drive long term shareholder value. That's the way it's been for years and we'll continue that focus.

Kevin Smithen
Macquarie Capital (USA), Inc.

Q

And any from further development on your REIT exploration process, if you will?

R. Stewart Ewing, Jr.
Executive Vice President, Chief Financial Officer & Assistant Secretary

A

Yeah, no, Kevin. We're basically going to watch Windstream go through their process and just see how that goes, and then we'll make a decision at some point after that.

Operator: Thank you. Our next question comes from Michael Rollins from Citigroup.

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

Q

Hi. Good afternoon and thanks for taking the question. Two if I could. The first is, should we be thinking about the revenue impact of the inter-carrier compensation reform during a quarter in terms of moving some revenue from regulatory to retail and how much that might be in the consumer and business segments? And then the second question I have is, if you look at the slowdown in legacy revenue erosion and you look by market or you look by product, is there a certain secret sauce that you're finding in some markets where you really start to see that slow? Is it maybe the voice customers get to a certain level of market share? Or broadband capabilities get above a certain level? If you could maybe give us your sense of what's happening underneath the hood there, that would be great.

R. Stewart Ewing, Jr.
Executive Vice President, Chief Financial Officer & Assistant Secretary

A

So Mike, the revenue impact of the inter-carrier comp reform really is not that significant. It does reflect, or result in a decline in our wholesale segment revenue. But that decline in the wholesale revenue segment is really pretty much offset as you indicate, by increases that we're able to do in the charge to our consumer and our business customers, [ph] the org chart (44:51), which really virtually offsets the access charge reductions that we're implementing.

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

Q

And how much is that that moves from wholesale to retail? In terms of dollars?

R. Stewart Ewing, Jr.
Executive Vice President, Chief Financial Officer & Assistant Secretary

A

About $5 million a quarter or so.

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

Q

Okay.

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

A

And concerning the secret sauce, we don't know there is really any secret sauce out there. We look at every market individually. As far as the capabilities that we provide in the marketplace. We look at bundles of services, trying to price it competitively, but we have found a level of voice customers or a level of broadband that really says, it is going to slow at any point in time. We think that will happen, we just don't know where that is yet. But, absolutely, we are rolling out new products and bundles of services is where we believe has helped slow the loss of lines in recent quarters.

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

Q

Thank you.

Operator: Thank you. And our final question comes from Tim Horan from Oppenheimer. Your line is open, please go ahead.

Tim K. Horan
Oppenheimer & Co., Inc. (Broker)

Q

Thanks. Karen, can you talk a little bit about the cost trends in the network, where you have kind of seen both deploying fiber more to the nodes and fiber to the home over the last couple of years? Thanks.

Karen A. Puckett
Chief Operating Officer & Executive Vice President

A

Yeah, I think the cost trends, I would say, continue to improve, and a lot of it is just around like I said, the work that we have been doing, and we do need to continue to drive improvement in those each year so that that we can get fiber further out. But it is everything from the approach to the process and also anything around the install improvements that we can get there. So it is really an end-to-end approach.

Tim K. Horan
Oppenheimer & Co., Inc. (Broker)

Q

Have you seen material improvements though? Or can you talk about the trends a little bit on technology that you've seen over the last two or three years?

Karen A. Puckett
Chief Operating Officer & Executive Vice President

A

I can't say that there has been a large increase in technology over the last couple of years. The biggest thing that helped us is really more on the Prism side is the wireless set-top box. That really has changed the game for us. It has improved significantly our ability on a time of install as well as the customers love it. But I think if there is one thing that you would ask us or the team, that would be the number one thing.

Tim K. Horan
Oppenheimer & Co., Inc. (Broker)

Q

Thank you.

Operator: Thank you. This concludes our question-and-answer 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

Thank you, Syed. Overall, we are so pleased with our solid third quarter operating financial results. We're pleased with the continued improvement in our revenue trend. We are confident that the investments in our business continue to position us to effectively compete in the marketplace to drive revenue growth from our strategic products and services in the months and years 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 for today. You may all disconnect and have a wonderful day. Thank you.