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CenturyLink, Inc. (CTL)

Q4 2014 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day ladies and gentlemen and welcome to CenturyLink's fourth 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, Saheed. Good afternoon, everyone, and welcome to our call today to discuss CenturyLink's fourth 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 turn 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 full year and first quarter 2015 and other outlooks on 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 our forward-looking statements.

We ask that you also note that our earnings release issued earlier this afternoon and the slide presentation and remarks made during this call contain certain non-GAAP financial measures. Reconciliation between the non-GAAP financial measures and the GAAP financial measures are available in our earnings release and on our website at www.centurylink.com.

Now turning to slide 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 period of today's call will be Karen Puckett, CenturyLink's President of Global Markets. Our call today will be available for telephone replay through February 19, 2015, and the webcast replay of our call will be available through March 5, 2015. Anyone listening to a taped or webcast replay or reading a written transcript of this call should note that all information presented is current only as of February 11, 2015, and should be considered valid only as of this date regardless of the date heard or viewed.

So 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, and good afternoon, everyone, and thank you for joining us today. Starting on slide five, our fourth quarter results were slightly weaker than our expectations, but we were pleased with our full-year 2014 performance and the progress we made toward reaching revenue stability. And the weakness in the fourth quarter was primarily due to lower hosting revenue growth, resulting from lower installs and nonrecurring revenues, along with higher churn and credits.

Also, we experienced accelerated declines in low bandwidth data revenue and we had a one-time true-up in employee healthcare costs that impacted the quarter. We are taking a number of actions to drive stronger strategic revenue growth in 2015 and we'll discuss some of those with you today. Our recent organizational realignment is expected to result in some initial negative impact on our sales momentum in the first half of 2015, but we are confident this refined operating structure positions us well to drive stronger revenue results, strategic revenue growth and operating efficiency over the long term.

Our global sales and revenue is now led by Karen Puckett. And we expect to accelerate our future growth through a more unified sales and marketing approach and improved customer experience. Additionally, the alignment of our shared global network and data center infrastructure operations under a single senior leader, Maxine Moreau is expected to drive increased efficiency and consistency.

We also completed two strategic acquisitions in December. We acquired DataGardens and Cognilytics which we believe significantly enhance our product and solutions portfolio. The DataGardens acquisition gives us a leading disaster recovery-as-a-service cloud solution which once fully integrated with our current IT solutions should provide an improved end-to-end customer experience.

Acquisition of Cognilytics positions CenturyLink as a leading provider of advanced predictive analytics and Big Data solutions that help mid-sized and large enterprises convert data to decisions. We accomplished this through deep expertise in Big Data deployment, advanced decision sciences and predictive analytics.

CenturyLink can now deliver advanced Big Data analytics solutions across multiple industries including financial services, retail, consumer products, healthcare, oil and gas, among others. Also, we have an outstanding portfolio of network hosting, cloud, IT and managed services capabilities. We have integrated this broad portfolio into solutions for a diverse set of customers from the largest companies in the world to small, locally-focused companies. In addition, we've expanded our distribution capabilities and made additional investments in our product enhancements, and product enhancements we believe will be effective in helping drive growth in the coming year.

Now turning to slide six, I'd like to recap our performance for 2014. During the year, we continued to effectively execute against our objectives and make investments that we believe will lead to revenue stability. For the full-year 2014, we generated total operating revenue of \$18.03 billion, a 0.4% decline compared to 2013. It's an improvement from the 1.5% year-over-year decline in 2013 compared to 2012. In 2014, the core revenue, as strategic and legacy revenues, trend also continue to improve from 1.3% annual decline in 2013 to a 0.6% annual decline in 2014. This continued revenue improvement was driven by a nearly \$380 million increase in strategic revenues, primarily due to growth in high-bandwidth data services, high-speed internet, Prism TV and hosting and cloud revenues.

Revenue growth from high-bandwidth data services, MPLS, Ethernet and Wavelength was a strong 16% year-over-year. Additionally, the decline of legacy revenue slowed from 7.4% in 2013 to 6.3% in 2014. We achieved solid growth in both high-speed Internet and Prism TV subscribers throughout the year, adding 91,000 and 67,000, respectively. We've been pleased with the continued growth of Prism TV subscribers in the existing markets where we further expanded Prism TV service in 2014. Throughout the year, we invested to enhance our network, to improve speed, availability across our footprint. One direct result of this investment is that we grew the number of enabled access lines, receiving 20 megabits and 40 megabits each by more than 45% over the prior year. Additionally, we generated solid free cash flow of \$2.7 billion and returned approximately \$1.9 billion to shareholders through our dividend and share repurchase program.

Now turning to slide seven. During 2014, we continued to transform our company from a provider of traditional network communications to an integrated provider of network, cloud hosting and IT services and we're focused on executing on several strategic priorities. We believe these priorities are key to successfully navigating the continued formation of our company and driving long-term profitable growth. And the first of these is to grow Business Solutions. We continue to drive strong strategic revenue growth from meeting the businesses' and government demand for our MPLS, Ethernet and Wavelength network services during the year.

Additionally, our Managed Office and Managed Enterprise solutions continue to gain traction and are beginning to drive meaningful revenue growth due to increasing customer interest from both small and large business customers. These managed services help free them from day to day management of their network, services and equipment as well as maintenance. We are seeing strong demand for GPON service from businesses and expect to drive additional revenue growth from our continued expansion of GPON availability in the months ahead.

Wholesale revenues have remained under pressure due to lower bandwidth, data service disconnects, along with reductions in intercarrier compensation and declining voice usage. We've had success mitigating our losses by expanding our fiber-based wireless backhaul services. And we now serve over 21,000 towers.

A key focus in 2015 will be helping our Wholesale customers with their collocation and cloud requirements. Growth in our hosting services, including collocation, managed hosting and cloud solutions, was below our expectations. However, we believe the hosting opportunities remain strong as we improve the capability of our highly-automated next-generation CenturyLink cloud platform. Price compression on collocation renewals and technology refreshes, along with some increased churn, driven by a small group of large customers, continue to pressure overall hosting revenue growth.

In addition with our focus on relieving IT capacity issues due to production workloads, we've seen a measured adoption of multitenant cloud-based services, based on how ready the customers' application architecture is for cloud conversion. However, interest in and demand for cloud-based services continues to grow. Also, our sale of collocation services reached record levels in the second half of 2014.

From the standpoint of cloud, we're focused on opportunities that leverage our key strengths in cloud, one example of which is the ability of IT departments to set spending thresholds at the individual or department level and monitor cloud spend on a real-time basis. Although our managed hosting sales are not where we want them to be, we are seeing success in selling our cloud and managed hosting solutions. And during the fourth quarter, we added eight Fortune 500 companies as CenturyLink cloud and managed hosting customers. Finally, our indirect channel partners are beginning to sell our managed hosting solutions, and we expect to have additional partners in 2015.

Going on to slide eight, in the Consumer segment, we continue to see good results in those markets we have deployed higher bandwidth and IPTV services. For example, in Omaha, the results continue to be strong in the consumer market and we are seeing good results in small, 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 at 10 cities, including some of our larger markets like Minneapolis, St. Paul, Denver, Seattle, Las Vegas and Portland. We expanded the gigabit footprint of these markets in 2014 and expect to further expand availability of their service in the months ahead.

We also plan to continue to invest in our Prism TV capabilities, having added approximately 385,000 addressable homes during 2014, which exceeded our full-year 2014 target of 300,000 households. As of year-end, we had more than 240,000 Prism TV customers across addressable homes of nearly 2.4 million. We anticipate expanding Prism TV service to additional households and markets during the second half of 2015. However, we're not ready to announce specific markets at this time.

Finally, we're focused on driving improved operating efficiencies through a number of methods, including network simplification and rationalization that should improve our end-to-end provisioning time and help drive standardization. We continue to modernize our network with replacing ATM with IP technology that enables higher broadband speeds, while also adding network capacity to serve our growing customer base.

For full year of 2014, we added over 4 terabytes to our IP backbone, bringing total capacity now to 20 terabytes per second on that backbone.

Also, we continue to manage expenses related to our declining legacy revenues. And lastly, we have laid the foundation to migrate our internal IT operations to 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 four data centers and we 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. This effort is expected to reduce our IT costs and improve security and other efficiencies for CenturyLink.

In summary, I believe we're well positioned in our markets with a strong portfolio of strategic assets. We've also invested in and expanded our unified distribution capabilities and we have a laser focus on continuing to improve our revenue trend in the months ahead.

Now I'll turn the call over to Stewart for an in-depth look at our financial results and full year and first quarter 2015 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 fourth quarter and then conclude my remarks with an overview of the full year and first quarter 2015 guidance we included in our earnings release issued earlier this afternoon.

Beginning on slide 10, I'd like to review some highlights from our fourth quarter results. I'll be reviewing the results excluding special items as outlined in the earnings release and associated financial schedules. Operating revenues were \$4.44 billion on a consolidated basis, a 2.3% decline from fourth quarter 2013 operating revenues. Core revenue, which is defined as strategic revenue, plus legacy revenue, was \$4.05 billion for the fourth quarter, a decline of 1.5% from the year-ago period. Our strategic revenues grew 2.2% year-over-year and now represent 52% of our total revenues compared to about 50% a year ago.

Strength in strategic products such as high-speed internet, high-bandwidth data and Prism TV continue to drive this growth. We added approximately 12,900 Prism TV customers and 18,600 high-speed internet customers during the fourth quarter. We generated strong operating cash flow of approximately \$1.71 billion for the fourth quarter and achieved an operating cash flow margin of 38.5%. The year-over-year decrease in operating cash flow and operating cash flow margin was primarily driven by the continued decline in legacy and private line revenues and an accounting adjustment of about \$40 million related to employee healthcare costs, offset by one-time reductions in facility costs and operating taxes totaling \$30 million recorded in the current quarter.

Additionally, we generated \$373 million of free cash flow during the quarter, which is defined as operating cash flow, less cash paid for taxes, interest and capital expenditures, along with other income. Our solid cash flows continue to provide us the financial strength and flexibility to meet our business objectives and drive long-term shareholder value. Our adjusted diluted earnings per share for fourth quarter was \$0.60. 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 schedule.

These special items included two larger items worth calling out in the fourth quarter: a \$60 million favorable income tax adjustment and an approximate \$60 million pension settlement charge as a result in a partial termination of a plan.

Additionally, under the \$1 billion share repurchase program, we repurchased 2.3 million shares for an investment of \$91 million during fourth quarter. We expect to continue to be opportunistic in completing this program, within the 24-month period.

Now turning to slide 11. Fourth quarter 2014 operating revenues declined \$104 million or 2.3% compared to fourth quarter a year ago as the growth in strategic revenues was more than offset by the decline in legacy revenues due to access line losses and lower minutes of use and lower data integration revenues. The growth in our strategic revenues was primarily driven by strength in high-speed internet high bandwidth business data services and Prism TV. Although legacy revenues continued to decline, the revenue decline in fourth quarter 2014 was 16% lower than the fourth quarter revenue decline a year ago.

Moving to slide 12, as outlined in our earnings release, beginning with the fourth quarter reporting, we've changed our segment reporting to align with our new organization structure. We will now report two segments, Business and Consumer. The Business segment consists primarily of providing network, IT services, collocation, managed hosting and cloud services to enterprise, wholesale and governmental customers across the U.S. and select international locations.

The Consumer segment consists primarily of providing products and services to residential consumers across our 37 state footprint and remains relatively unchanged from prior reporting. Schedules providing eight-quarter

trended detail of these new segments are provided in the earnings supplement, which is available on our Investor Relations website. Now turning to our Business segment.

In fourth quarter, the Business segment generated \$2.7 billion in operating revenues, which decreased \$102 million or 3.6% from the same period a year ago. Fourth quarter strategic revenues for the segment increased 0.4% to \$1.6 billion from fourth quarter a year ago, driven primarily by strength in high-bandwidth services such as MPLS, Ethernet and Wavelength, which was largely offset by the continued decline of low-bandwidth data services and a one-time true-up related to strategic revenues of approximately \$10 million in the quarter.

We continue to generate solid growth across the enterprise customer growth market and we see an opportunity for further investment in the small-sized and medium-sized business space to provide improved market share and drive further growth. Legacy revenues for the segment declined 6.4% from fourth quarter 2013, due primarily to continued decline in access lines. Total Business segment expenses increased slightly from the year-ago period, driven primarily by higher sales-related expenses. Our segment margin was 43.6%, a decline from 46% a year ago. This decrease was primarily due to the higher costs I just mentioned above, along with the continued decline in Business segment legacy and low-bandwidth data services revenue.

On slide 13, I'll provide a little more detail on the revenue mix within the Business segment. High-bandwidth data services revenue grew 13% year-over-year compared to fourth quarter 2013, driven by continued strength in sales to enterprise and governmental customers. Low-bandwidth data services, including private LAN, continued to decline in fourth quarter. The year-over-year revenue decline of 13% was primarily due to the continued disconnects of TDM circuits by enterprise and wireless customers as they migrate to fiber-based services. In the fourth quarter, data integration revenues decreased approximately \$40 million or 23% compared to fourth quarter 2013, driven by lower CPE sales. If you remember, fourth quarter in 2013, we had – actually had one sale to a large customer that makes up most of that difference.

Now turning to Slide 14. Consumer generated \$1.49 billion in total operating revenues, which was basically flat from fourth quarter 2013. Strategic revenues in this segment grew 6.4% year-over-year to \$727 million, driven by growth in high-speed internet and Prism TV customers, price increases, improved churn and certain favorable revenue settlements in the current quarter. Legacy revenues for the segment declined 5.7% from fourth quarter 2013 as access line and long-distance revenue declines were partially offset by select price increases. The comparable year-over-year decline in fourth quarter 2013 was 8.5%.

Operating expenses increased slightly compared to the same period a year ago, primarily driven by higher Prism TV content costs. Now turning to Slide 15, and our full year and first quarter 2015 guidance. For full year 2015, we anticipate total operating revenues of \$17.9 billion to \$18.1 billion and core revenues of \$16.25 billion to \$16.45 billion, both stable when compared to full year 2014 due to the expected continued increases in the level of strategic revenue growth, offsetting the anticipated legacy revenue declines.

Operating cash flow is expected to range from \$6.8 billion to \$7 billion and free cash flow is expected to range from \$2.5 billion to \$2.7 billion. Operating cash flow and free cash flow are expected to decline from full year 2014, primarily driven by the continued decline in higher margin legacy revenues, the impact of higher expenses associated with the increased growth in strategic revenues and an increase in pension expense of approximately \$90 million due to changes in actuarial assumptions, which really relate to the – our adoption of new mortality tables.

We anticipate a decline in depreciation and amortization expense of approximately \$250 million for full year 2015 compared to full year 2014, primarily driven by the impact of declining amortization of acquisition-related intangible assets and the annual review and update of depreciation rates, which were expected to more than offset

increases in depreciation expense associated with continued capital investment. Included in the full year free cash flow estimate are cash taxes of \$25 million to \$50 million. As a result of bonus depreciation being approved, our cash taxes will now be less than we anticipated earlier.

We also expect to incur capital expenditures of approximately \$3 billion in 2015 and adjusted diluted EPS is expected to range from \$2.50 to \$2.70. Currently, we have not yet decided whether to accept or reject the specific build-out opportunities related to support payments available under CAF 2. We plan to provide an update later this year when it is determined the extent to which the implementation of CAF 2 will impact our future revenues and cash flows.

For first quarter 2015, we expect operating revenues of \$4.45 billion to \$4.5 billion, an increase compared to fourth quarter 2014, primarily due to the projected growth in strategic revenue, offsetting the anticipated decline in legacy revenue, resulted in higher core revenue and also higher data integration revenues in first quarter 2015.

Core revenues are expected to range from \$4.04 billion to \$4.09 billion. Operating cash flow is projected to be between \$1.64 billion to \$1.69 billion, a decrease compared to fourth quarter 2014, primarily due to higher pension cost, payroll taxes and operating taxes, along with the continued decline in higher margin legacy revenue. We also anticipate an approximate \$90 million decline in depreciation and amortization expense in the first quarter 2015 compared to fourth quarter 2014, driven by the reasons previously described.

The anticipated lower level of depreciation and amortization expense is expected to mostly offset the decrease in operating cash flow and the impact of favorable income tax adjustments in fourth quarter 2014, resulting in adjusted diluted EPS expected to range from \$0.56 to \$0.61 per share in first quarter 2015 compared to the \$0.60 in fourth quarter 2014.

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 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 questions. I guess my first question is Stewart, if you could kind of go back and kind of catalog in one list some of these one-timers from the fourth quarter. I think you normalized some out in your EBITDA number, but you didn't normalize some other ones out, which I guess were a \$40 million one-time expense, offset by \$30 million in one-time benefits. There was, I think you said there were some positive revenue settlements in the Consumer segment in the quarter. If you could walk us through that so we can get a sense as to what the earnings power of the company was in the fourth quarter?

And then the second part on the guidance, I guess, Glen, you kind of foreshadowed that the shape of 2015 would be a little stronger in revenue in the second half than the first half as a result of some of the reorganization issues. But looking at the first quarter revenue guidance, it's up sequentially. It's actually flat year-over-year at the midpoint. So I was wondering could you give us a sense as to how much of the expectation for revenue stability do you kind of have in hand right now that you see in your books and your funnels? And then what increment is coming from the hoped-for benefits that will be in the back end of this reorg? Thanks.

R. Stewart Ewing, Jr.

Executive Vice President, Chief Financial Officer & Assistant Secretary

A

Yeah, so, David, in terms of the fourth quarter items that were more or less one-time items, we did have a \$40 million true-up related to group insurance that was an increase in expense. That was basically offset by \$30 million of favorable adjustments that we had. We had about a \$15 million favorable adjustment related to operating taxes, which are primarily property taxes and then \$15 million related to facilities cost. That was a favorable adjustment, that's a one-time adjustment, so really net-net, about \$10 million negative expense in the fourth quarter that would be one-time adjustments.

On the revenue side, basically there are just a couple of offsetting items there. In Business revenue, on the strategic side, we had a \$10 million negative adjustment that I mentioned. That was related to a large customer that we have that the – we needed to book the revenue differently than the way – basically it needed to be accounted for differently based on the contract. So we had a \$10 million negative adjustment there on the Business segment for strategic revenue. We also had a positive settlement that I mentioned as well, of about \$10 million that impacted Consumer revenue on the strategic side. And that was basically related to a couple settlements that we had with parties that we sell products for.

David W. Barden

Bank of America Merrill Lynch

Q

Got it.

Glen F. Post, III

President, Chief Executive Officer & Director

A

Yeah, David, and regarding the revenue in the first half year versus second half, you're right. We do expect more growth in second half of the year. We think we'll have some mild disruption due to this reorganization. We're changing sales plans. We're changing really sales leadership for certain accounts across the country, so there will be some disruption there. Our funnel looks good right now. We have a really good funnel. Also, we're seeing a lot of demand for our combined solutions.

We're selling – as I mentioned, we've sold some big deals with some Fortune 500 companies. We're selling at small/midsize space. We're seeing a lot of demand for our Managed Office products. So we're confident that we're going to see increasing demand second half of the year. And yes we are up in the first quarter, but we expect – we need more acceleration to hit that revenue stability that we expect into the second half of the year. So that's what we believe is going to happen and we believe we have plans in place to help make that happen including the expanded distribution, along with the unified approach, combining our cloud and hosting and network sales teams and leadership.

R. Stewart Ewing, Jr.

Executive Vice President, Chief Financial Officer & Assistant Secretary

A

And, David, the first quarter guidance for revenue is a sequential increase from fourth quarter to first quarter.

David W. Barden

Bank of America Merrill Lynch

Q

Right. And thank you, guys. If I could ask one quick follow-up, Stewart again. It sounded like you're baking in – in the EBITDA guide, you're baking in \$90 million of incremental pension pressure related to assumptions. Is it fair to say that if interest rates start to go back up that we kind of get that back over the course of the year?

R. Stewart Ewing, Jr.

Executive Vice President, Chief Financial Officer & Assistant Secretary

A

Yeah, so, David, that's baked into the EBITDA assumption. But it's really a non-cash charge. It's just completely related to an increase or a change in the mortality tables, adopting new mortality tables that reflect people living longer. Basically with what's – we had actually merged our three pension plans in the fourth quarter and we're funded at about 84% or so. And we actually have no required pension contributions at all from a cash standpoint for the next three years to five years based on what we're looking at today. I mean we had a good year. Our pension assets earned about 12% or so, 12% to 14%, in that range.

And – but basically our liability went up a little over – about \$1.2 billion basically due to \$1 billion of it related to the change in the mortality tables, about \$1.2 billion related to a lower discount rate. We're using the discount rate of 3.9% versus about 4.9% a year ago, and then we had a little over \$1 billion of earnings. So we feel good about where we are with respect to the plans, but that \$90 million incremental pension pressure is really a non-cash expense.

David W. Barden

Bank of America Merrill Lynch

Q

Got it. Thanks guys.

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. Thank you. Couple questions. First, can you give a little bit more color on the slowdown in the hosting revenue growth? Maybe if you could quantify the churn and what you expect for churn to be in that segment for 2015. And you had mentioned before that cross-selling is a big opportunity. Do we still have that as an upside for that segment? And the second question I had is sort of, a lot of M&A activity in the space, and maybe if you could remind us your thoughts on further asset purchases. Is data centers a space that you want to get bigger in? And what are some of the criteria that you would consider? Thanks.

R. Stewart Ewing, Jr.

Executive Vice President, Chief Financial Officer & Assistant Secretary

A

So, Batya, I'll take the first one and let Glen take the second one. Basically, in terms of the churn, the slowdown in hosting, we continue to have bankruptcies hit us from the standpoint of some of the customers that are in our facilities and some customer credits really related to some service issues that we've had. So basically, we think we can really get that worked through. And from a collocation standpoint, we actually had a really good quarter from the standpoint of new sales. And we had a lot of optimism in terms of our ability to be able to sell the colo space. And with the developments that we're making to our cloud product that was part of the Tier 3 acquisition, we're confident in our ability to be able to get that product to where we can – as Glen mentioned, we picked up five Fortune 100 – Fortune 500 companies, and so we have a lot of confidence in our ability to be able to add to that.

It certainly is not up to expectation. It's not up to where we want it to be, but we think with the changes that we've made in the selling organization, we'll have more sellers selling those products and services now. Over time, we'll see improvement in the revenue associated with those businesses.

Glen F. Post, III

President, Chief Executive Officer & Director

A

Yeah. And, Batya, regarding the cross-selling, we're bringing our sales teams together, so we hope there's more and more common knowledge. We've done a lot of training with those folks. We will have centers of expertise for both network and cloud and hosting, but we think the opportunity to bring those together and sell a solution of cloud and network is really a strong potential upside for us.

We were talking with a customer this week, who we just talked with, executive talked with, who really was interested in enabling the hybrid cloud offering with our cloud hosting and network capability, end-to-end type capabilities. So we believe that the opportunity is really strong there, bringing those together.

R. Stewart Ewing, Jr.

Executive Vice President, Chief Financial Officer & Assistant Secretary

A

Batya, there were two other one-time items I might mention. We had lower non-recurring revenue bookings of about \$2 million in the quarter related to hosting. And also we had foreign currency impact that was negative of about \$1.2 million. So we had about \$3.2 million of more or less one-time items that were negative in the quarter.

Glen F. Post, III

President, Chief Executive Officer & Director

A

And then, Batya, regarding the further asset purchases we might be interested in. So first of all, we have assembled a strong set of assets that we believe are aligned with the growth opportunities in our industry. As we've discussed, the majority of our strategic products and services are growing well and moving us toward revenue stability. That being said, we are obviously aware of a lot of the consolidations going on in the industry. We think there will be opportunities for additional asset purchases that could enhance our growth.

Our preference, as I said before, is for inorganic growth or opportunities that really fit well with our strategic priorities, that create unique value for our customers through differentiation. And that's what we've done with the last two acquisitions we bought give us some capabilities that others don't have, and opportunities that can enhance our revenue and cash flow trajectory. We like to see that growth accelerate and not – try and avoid a situation that would really pull our growth down. And that should be our major view. We will consider opportunities that would expand our network capabilities, that would increase our metro fiber access footprint. Those are the types of assets we'd be interested in looking at over time, and/or investments to enhance our data hosting and cloud and IT services capabilities. So we'll – with each of those opportunities, of course, we'll continue our very disciplined approach to these acquisitions.

Batya Levi

UBS Securities LLC

Okay. Thank you.

Q

Operator: Thank you. And our next question comes from Phil Cusick from JPMorgan.

Philip A. Cusick

JPMorgan Securities LLC

Hey, guys. Thanks. I guess first if you can talk about your broadband speed upgrade plan. The FCC's raised the broadband definition to 25 megs. How does that affect your thoughts and any thoughts on CAF?

Q

Glen F. Post, III

President, Chief Executive Officer & Director

First of all, I'll let Karen address. Phil, I'll just say that the new definition of broadband doesn't really impact us in a significant way. We're going to provide our customers with as much broadband as we think we can afford and the needs that they have. Again, we're selling solutions and not just speed. So we'll continue to do that. It will change how we define broadband probably going forward, but it won't impact necessarily our investment in broadband. I'll let Karen talk about upgrade plan.

A

R. Stewart Ewing, Jr.

Executive Vice President, Chief Financial Officer & Assistant Secretary

Yes, Phil, the other thing I might mention is their new broadband speed upgrade plan. It really doesn't affect CAF 2 because CAF 2 is 10 meg down and one meg up. So it's a lot lower than the new speed that they just announced.

A

Glen F. Post, III

President, Chief Executive Officer & Director

Now we'll let Karen talk to that...

A

Karen A. Puckett

Chief Operating Officer & Executive Vice President

I don't think there's much more to add there. I would just say in terms of the broadband speed, we've been talking over many, many of the calls about the importance of GPON and our commitment to continue to get that cost structure down, cost per household task. We continue on with our consumer GPON that we've been talking about, that's the 10 markets. Good response. We like the halo effects that that gives us in new markets. And then the business GPON equally important. But fiber-to-the-node is still an important VDSL2, still a very important

A

technology. And when you're a carrier that has diverse sets of markets with diverse sets of density, you need all the technology planned for you.

Philip A. Cusick

JPMorgan Securities LLC

Q

Okay. And then second, can you expand quickly for me on the realignment of the business and how that is going to slow things down? It doesn't look like 1Q, you're looking for a whole lot of slowdown. Should we look for a sort of weaker middle of the year and then some acceleration in the back half? How you're...?

Karen A. Puckett

Chief Operating Officer & Executive Vice President

A

Yes, so – let me just kind of walk through that just quickly in terms of this is in the Business segment. And we have two segments that were sub-segmenting in going to market. We have a Global segment, which are 1,000 employees and more, and then in Enterprise, less than 1,000. The Enterprise segment is pretty much not impacted here. There's some changes, but the real integration of the former BSD, Business Solutions sellers, which came from the network communication side of the company and the CTS sellers are in the Global space, and that's where the integration is happening. And it really is working through customer portfolios.

We've been very thoughtful about how we build customer modules. Very thoughtful of that, as Glen said, the product specialists that are important behind these sales executives, and from there built the module. So there is module changes. There's compensation changes. We really want sellers hunting more, and we're incenting them to do that. So it's just a transition to new comp structure and some new changes in customer portfolio. The sales, we're hoping, will be flat, but we're saying that we could be down a bit on first quarter, which will impact us further quarters out. But I will tell you that across the board, you talk to one of our Global sellers, they'll say this is the right thing to do. We really needed that one face to the customer and get the technical support behind that. So it's been embraced, but change is always hard for an organization, in particular, sellers.

Philip A. Cusick

JPMorgan Securities LLC

Q

Does this create an opportunity to accelerate the EBITDA for the cost cutting?

Karen A. Puckett

Chief Operating Officer & Executive Vice President

A

You sound like Stewart now. We'll take every opportunity – we do think obviously there's some efficiencies. We got to get the revenue trajectory, the sales trajectory going first. And no, there are some efficiencies because you have more coverage, right? You have better coverage with potentially less headcount. So the answer is yes. We've got to let that all play through.

Philip A. Cusick

JPMorgan Securities LLC

Q

Thanks, guys.

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

Frank G. Louthan

Raymond James & Associates, Inc.

Q

Great. Thank you. With the internal virtualization of your IT systems, how long have you been working on that and what sort of cost savings can you expect to see materialize? And we've been talking for a little bit, for a while about the larger customer churn in the hosting and colo business. At what point do you expect to see that stabilize, maybe see a little bit better growth out of that business?

Glen F. Post, III

President, Chief Executive Officer & Director

A

Yeah, Frank, first of all, the virtualization of IT systems, I don't have a number to give you. We haven't really disclosed that figure. But we are anticipating [indiscernible] (0:43:10) significant ability to control our costs going forward. We're going to reduce costs initially, but we're taking all of our server-based systems, our non-mainframe systems and moving them as we speak to our cloud. And we're closing data centers, we're reducing head count in those areas. We are able to – all of them did a lot of automation there. And that is, we think the opportunities are significant to not – as I said, not just reduce its current cost, but control costs going forward with this virtualization. So we're very confident in it and we are – we believe we – we're going to drink our own bath water here. We're going to do it ourselves. We think that the opportunities are really significant here.

Karen A. Puckett

Chief Operating Officer & Executive Vice President

A

Frank, this is Karen. In terms of the collocation churn, the CTS organization had put in some changes towards the end of last year around compensation and contract – terms of contract. That will have a benefit for us in 2015. We've targeted that churn to come down. We know the customers who are coming out of contract and it really is getting the right churn initiative programs in place to support that. So the fourth quarter, we had a large customer that wasn't with us long who churned on us. And but those are the kinds of profiles, we just have to make sure we have the right profile mix of types of customers. And I think you'll see that continue to improve here in 2015.

Frank G. Louthan

Raymond James & Associates, Inc.

Q

What maybe are you going to do differently to keep a customer that would come in and out that quickly on you?

Karen A. Puckett

Chief Operating Officer & Executive Vice President

A

Well, we'd probably not enable them in the first place. We'd start there because it's – just in terms of the risk of a customer, I think we're reassessing the types of risk of customers. So we're going to start on the front end.

Frank G. Louthan

Raymond James & Associates, Inc.

Q

Got it. That's helpful. Thank you very much.

Operator: Thank you. Our next question comes from Mike McCormack from Jefferies. Your line's open. Please go ahead.

Mike L. McCormack

Jefferies LLC

Q

Hey, guys. Thanks. Stewart, maybe just a quick comment looking at the core revenue. Just looks on paper as though unless there's going to be a significant or a meaningful deceleration in strategic services that you're looking for sort of continued steady losses on the legacy side. I'm just trying to get a sense for what the thought process is

there. And then secondly on the broadband net adds, could you give us a sense whether you're seeing gross adds coming in or better churn? How do we think about the intake on broadband? Thanks.

R. Stewart Ewing, Jr.

Executive Vice President, Chief Financial Officer & Assistant Secretary

A

Yeah, so, Michael, on the core revenues, we believe we've bottomed out in terms of the decline of those revenues. And hopefully we'll see, continue to see, lower declines with the exception of the low-speed data services. And we're hopeful that we're getting to the point there to where we've worked through most of the declines, where we've had large customers grow networks and see the effects of towers that we didn't get the fiber-to-the-tower to. So we're hopeful that that will decline somewhat during 2015 in terms of the rate of decline that we've been seeing.

And from a strategic revenue standpoint, I think the things that Karen has done with respect to the reorganization and the way our sales force is focused now, the fact that we'll have an increased number of sellers on the street, I think we can drive the strategic products and services. I mean, we've proven our ability to sell the large MPLS networks. And I think we just need to continue to focus on doing that and get some big deals in 2015 just like we did in 2014.

Mike L. McCormack

Jefferies LLC

Q

Okay.

Karen A. Puckett

Chief Operating Officer & Executive Vice President

A

In terms of broadband, it really – it's not a churn issue for us. In fact, we've done very well on the churn initiative that we've had in place for over a year. It really is on the inward side. And the inwards are really where we have the lower speed, less dense markets, or the ATM markets. So in our growth markets where we have fiber-to-the-node, GPON, higher speed, where we've got the flow share coming in. But it's more challenging in those less dense markets where we don't have the speed frankly is the inward issue there.

Mike L. McCormack

Jefferies LLC

Q

Karen, you'd mentioned I guess price increases in the Consumer side having a positive impact on revenue. Where will you be able to take price on that? Was it purely inside the Prism markets or can you take price elsewhere?

Karen A. Puckett

Chief Operating Officer & Executive Vice President

A

The price increases in Prism market are – they're passed through the content cost. We have a pretty good methodology that we've used over the years in terms of the life cycle of products and price increases. And so we're just following kind of our process there. But you will see continued price increases in the different categories of really access lines and other places. Prism, for the content cost.

Mike L. McCormack

Jefferies LLC

Q

Great. Thank you, guys.

Operator: Thank you. Our next question comes from Brett Feldman from Goldman Sachs. Your line is open. Please go ahead.

Brett Joseph Feldman

Goldman Sachs & Co.

Q

Thanks for taking the question. I just wanted to go back and understand a little more about the low bandwidth data services. You mentioned that you're hoping the headwinds moderate a little bit this year. What's left in that category? Who are the key customers? What are the services they're buying and why do you think it's going to moderate? And just in general, putting aside the tower part, when that business churns off, how much of it are you typically winning back through other services? And to what extent does some of it just kind of go away?

R. Stewart Ewing, Jr.

Executive Vice President, Chief Financial Officer & Assistant Secretary

A

Yes. So basically, the customers there are the large telecommunications customers for the most part. That's where the most of the revenue is. Again, we believe we'll have some moderation this year in terms of the churn that we've seen in the network grooming and the copper [ph] tipped (0:49:16) towers that we had that we lost. And basically we think – we haven't really shared the amount of revenue in that bucket. But suffice it to say it should come down in terms of the number of losses that we see in 2015.

Brett Joseph Feldman

Goldman Sachs & Co.

Q

And when you lose it, do you tend to just lose it or are you getting it back somewhere else?

R. Stewart Ewing, Jr.

Executive Vice President, Chief Financial Officer & Assistant Secretary

A

Some of it we get back. So basically, it goes to the Ethernet service. And so basically our Ethernet revenues are cannibalizing the copper-based revenues that we have. So there is some decline in revenues there. And it typically takes a few years before the circuits get back to the point to where you overcome the loss that you had in the copper circuit. So it requires a bandwidth increase over the Ethernet circuits over time in order to be able to achieve the same amount of revenue that we effectively were getting for the copper circuit.

Brett Joseph Feldman

Goldman Sachs & Co.

Q

Great. And just, you mentioned the cash taxes for the year. I just didn't quite get it. Could you just repeat that again?

R. Stewart Ewing, Jr.

Executive Vice President, Chief Financial Officer & Assistant Secretary

A

Yes. So about \$25 million to \$50 million, which is lower than what we had previously been stating because of the fact that bonus depreciation was enacted.

Brett Joseph Feldman

Goldman Sachs & Co.

Q

So what happens to next year, then? Does that inflect higher or does everything get pushed out another year?

R. Stewart Ewing, Jr.

Executive Vice President, Chief Financial Officer & Assistant Secretary

A

Yes, it does. So in 2016, our cash taxes would be \$1.2 billion to \$1.3 billion, of which about \$300 million of that are really taxes that relate to 2015. But because of the way that we can make our tax payments, the cash doesn't go out the door for the big part of 2015 until 2016.

Brett Joseph Feldman

Goldman Sachs & Co.

Q

Okay. Thank you very much.

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

Q

Hi. This is [ph] Spencer (0:51:22) for Simon. Two quick questions. So first, the buyback slowed pretty meaningfully in the second half. I know it was up quarter-over-quarter. Should we – is that just a function of the higher stock price? And should we expect that to be down somewhat this year? And then secondly, I know back in 2013, you mentioned expecting a similar inflection in the revenue for the second half of the year. Can you talk about how your expectations for this year are similar or maybe different from that? Thanks.

R. Stewart Ewing, Jr.

Executive Vice President, Chief Financial Officer & Assistant Secretary

A

Yes. So in terms of the buyback, we spent a little over \$90 million in the quarter. We actually spent about \$75 million in the month of January. So our – the amount of money that we spend every day, the cash we spend every day, is based on a matrix that we have under a 10b5-1 plan. And so we still expect to complete that program, that \$1 billion program within the 24-month period from the time that we started that program, which effectively was the end of May of 2014. So basically by the end of May of 2016, we would still expect to be complete with that program.

Glen F. Post, III

President, Chief Executive Officer & Director

A

[ph] Spencer (0:52:33), would you repeat the last part of our question, the last question?

Q

Yes, sure. So I think you guys had made comments previously about expecting an acceleration for 2013. I think it was mostly because of the data hosting business, but I was wondering if there was any analog we can draw for this year in terms of your expectation for a similar acceleration for revenues in the back half.

Glen F. Post, III

President, Chief Executive Officer & Director

A

Well, it's a combination of revenue growth, I think, and all across the strategic revenues. But the reason we believe that – are confident in that is that first of all, we have increased our sales force, our distribution, both direct and indirect. We realigned our sales force we talked about previously under Karen, combining cloud and hosting with

network. We believe we remain under-penetrated in strategic products and services in MPLS and Ethernet. And we believe we're well positioned to really take share back in these areas. Also, we invested in some voice technology with the SIP trunking features that will give us more capability, we believe. We – and although, as you mentioned, our cloud and hosting results have not met our expectations to date, the fact is, the demand for these services is still great and we are, we believe we are making the right investments.

And these platforms, especially in greater automation of our cloud platform that we're rolling out of our Tier 3 acquisition, together with the greater sales efficiencies, we expect that we're going to see the growth in our hosting, cloud and colo sales this year. And then, our recent acquisition of major IT and big analytic services, give us another significant product to combine with our Solution selling we believe can be effective. So we believe our results will ramp up during the course of the year. And we know our plan is ambitious, but we believe it's achievable.



Great. Thank you.

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

Thank you, Saeed. Overall, we are pleased with our solid 2014 operating and financial results and the continued improvement in our revenue trend. While we did experience slightly weaker results in fourth quarter, we believe the reorganization and the investments we're making continue to position us to effectively compete in the marketplace and drive revenue growth from our strategic products and services in the months and years ahead. And we look forward to talking with you again soon. Thank you for joining our call today.

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.

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