

# CenturyLink, Inc. NYSE:CTL

## FQ2 2016 Earnings Call Transcripts

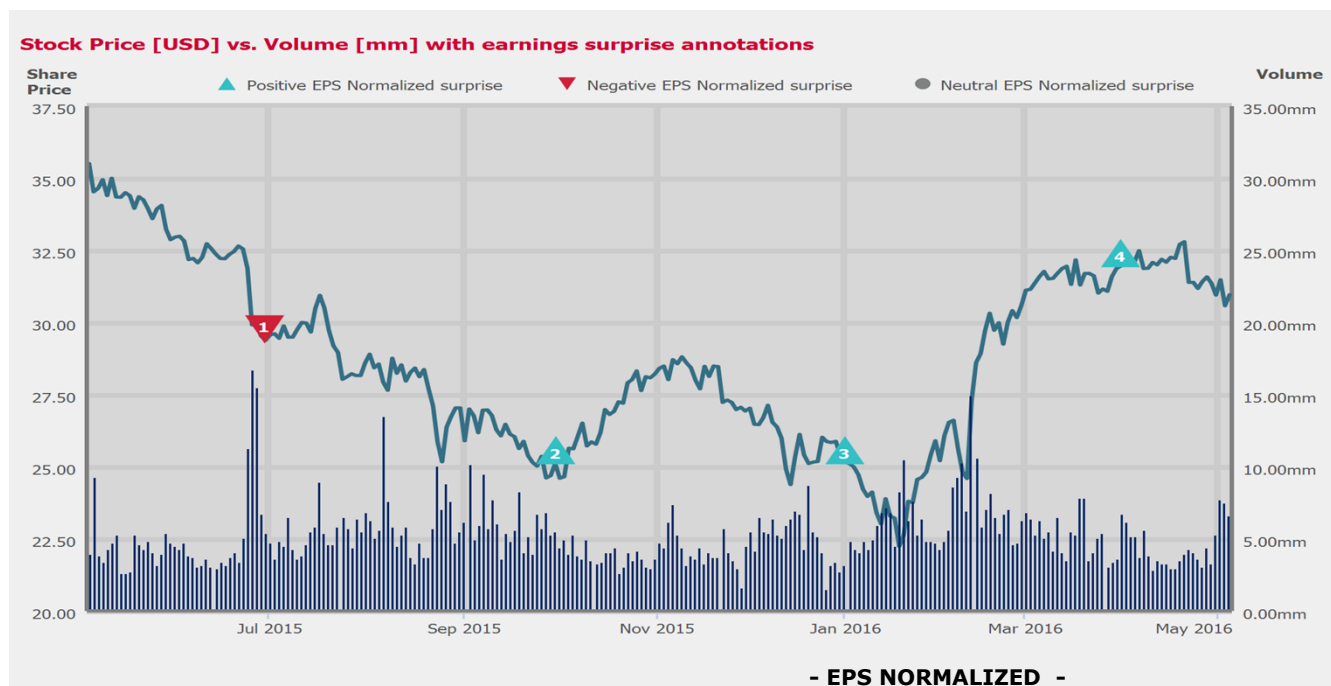
Wednesday, August 03, 2016 9:00 PM GMT

### S&P Capital IQ Estimates

	-FQ2 2016-			-FQ3 2016-	-FY 2016-	-FY 2017-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
<b>EPS Normalized</b>	0.59	0.63	▲6.78	0.62	2.59	2.45
<b>Revenue (mm)</b>	4390.47	4398.00	▲0.17	4391.26	17580.22	17483.04

Currency: USD

Consensus as of Aug-03-2016 7:59 AM GMT



	CONSENSUS	ACTUAL	SURPRISE
<b>FQ2 2015</b>	0.60	0.55	▼ (8.33 %)
<b>FQ3 2015</b>	0.69	0.70	▲ 1.45 %
<b>FQ4 2015</b>	0.65	0.80	▲ 23.08 %
<b>FQ1 2016</b>	0.68	0.71	▲ 4.41 %

## Call Participants

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### EXECUTIVES

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**Dean J. Douglas**

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## Presentation

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### Operator

Good day, ladies and gentlemen, and welcome to CenturyLink's Second Quarter 2016 Earnings Conference Call. [Operator Instructions] As a reminder, this conference call may be 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 of Investor Relations*

Thank you, Sayeed, and good afternoon, everyone, and welcome to our call today to discuss CenturyLink's second quarter 2016 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](http://ir.centurylink.com). At the conclusion of our prepared remarks today, we will open the call for Q&A.

As you move to Slide 2, you'll find our safe harbor language. We will be making certain forward-looking statements today, particularly as they pertain to guidance for third quarter and full year 2016 and other outlooks in our business. We ask that you review our disclosure found on the 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 those forward-looking statements.

As you move to Slide 3, 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 these non-GAAP financial measures in the most comparable GAAP financial measures are available in our earnings release and on our website at [ir.centurylink.com](http://ir.centurylink.com).

And now as you move to Slide 4, 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 Dean Douglas, CenturyLink's President of Sales and Marketing.

Our call today will be available for telephone replay through August 11, 2016, and a webcast replay of our call will be available through August 25, 2016. Anyone listening to a taped or a webcast replay or reading a written transcript of this call should note that all information presented is current only as of August 3, 2016, and should be considered valid only as of this date, regardless of the date heard or viewed.

And now as you move to Slide 5, I'll turn the call over to Glen Post. Glen?

### Glen F. Post

*Chief Executive Officer, President, Director and Member of Special Pricing Committee*

Thank you, Tony, and thank you all for joining our call today as we discuss our second quarter results and provide an update on our key operational initiatives as well as provide guidance for next quarter and discuss our outlook in our business.

As we begin on Slide 6, we had solid second quarter 2016 financial results. Our total revenue and core revenue were in line with our guidance. We also did a good job managing our expenses during the quarter, which resulted in an operating cash flow and adjusted diluted earnings per share that exceeded the top end of our guidance range.

We continue to see good demand for our high-bandwidth data services from our business customers as revenue grew more than 8% year-over-year, and we grew year-over-year consumer strategic service revenue approximately 5.5%. So overall, a very good quarter financially. On the other hand, our subscriber results were below our expectations, which I will discuss in more detail a little later in the call.

One last point before we leave the overview, the strategic review process for our colocation business continues to move forward. And while we have work left to do, we remain optimistic about the level of interest and the prospects for a positive outcome. Now we expect to finalize this process in the late third quarter to early fourth quarter time frame.

As we've said previously, our principal focus is on the sale of all our portion of the data centers, but we also have other alternatives should our process not result in a sale. We believe these are valuable assets, and we are committed to realizing that value for CenturyLink and our shareholders, while continuing to provide a strong colocation service offering for our customers.

Now let's turn to a discussion of our operational focus and financial results. Continuing to Slide 7. As I shared with you last quarter, CenturyLink entered 2016 with a renewed focus on improving the lives of our customers by connecting them to the power of the digital world. This is an important reminder that our principal operational focus is providing our customers the network connections and related services they need to power their lives, their businesses and their communities.

We will continue to provide a range of hosting, cloud, IT and managed services to our business customers and video and other services to our consumer customers. Our success in growing these services, though, is tied to our enabling and delivering excellent network connections. And we are focused on 4 key operational initiatives to drive achievement of that key objective.

So as you move to Slide 8, first, we are focused on driving penetration in the existing network and adjacent capabilities. The network is the foundation of the value we deliver to our customers, and we believe maximizing penetration of enabled network capabilities is critical to our success. This initiative is really about execution. We have enabled a great deal of capability into [ph] our network and we have to drive higher sustained levels of market penetration to earn an attractive return on that investment.

And we're seeing some positive results on this front as both business and consumer data revenues grew during the quarter, and we have achieved over 21% penetration of our year-end 2015 GPON-enabled addressable units. The 8% growth we saw in business high-bandwidth data services was a strong -- was a result of strong growth and Ethernet and MPLS services in the second quarter 2016. We believe these trends validate the value and relevance of our service offering and we are working hard to expand and improve them.

For example, in the Business segment, our new sales and marketing leadership team has refined our customer base into more tightly-targeted customer groups and key verticals and is tailoring the Street product and go-to-market strategies for each group and vertical. We believe this will improve our business customer engagement and drive greater sales execution.

We're also expanding the scope of our partnership channels to drive more sales through partnerships and major software technology companies. On the consumer side, we're continuing to pivot towards the sale of higher speed, higher-value bundle offerings to better credit quality customers. These customers have a higher ARPU, lower churn and a much higher lifetime value than lower speeds, lower credit, standalone broadband customers. We believe this is the right approach for long-term health of our business, even though it does have an impact on broadband units, some of which we saw during the second quarter.

As I referenced earlier during the second quarter, our high-speed data customers declined over 65,000. I'd like to make a couple of comments about those results. These broadband additions for the quarter were below our expectations driven, we believe in part, by our focus on acquiring higher-value bundled customers and less emphasis on standalone broadband customers.

We did expect broadband additions to be affected by the pivot away from the standalone broadband customers, but the impact was greater than we anticipated. From an out [ph] standpoint, about 20% of the decline was driven by a higher-than-expected number of slow and non-paying customer churn.

A significant percentage of the churn is related to standalone broadband customers who are less loyal than our traditional bundled customers. Also, there are underlying indicators of strength in the market as we have seen in the continued increase in the number of net adds with the 40 megabits and higher speeds, which we expect will deliver future benefits to the lower churn and higher ARPU. Now we expect

unit trends to improve in the second half of the year as effects of the changes in our go-to-market and customer retention programs begin to take effect.

Moving now to investing with discipline and a network-first focus. As I said earlier, we believe the best potential to grow our business is to focus on enabling and delivering fast, reliable technologically-advanced broadband access and related services.

And during second quarter 2016, we continue to expand our capabilities. We believe we have enabled one of the largest deployments of software-defined networking, SDN, and network function virtualization, NFV, capabilities in the market. These technologies allow us to provide advanced network functionality and deliver much more efficiently than traditional deployments.

Also, in late June, we announced the launch of our CenturyLink SD-WAN, software-defined wide area networking service. Today, we have dozens of customers and proof-of-concept trials and are working over 100 potential sales opportunities. And we will continue to invest to build this type of intelligence and efficiency into our broadband access network.

From a broadband access standpoint, I want to take a few minutes to discuss our network evolution plan with you. What we think, it takes to be competitive where we are today and our plans to ensure we are keeping pace both with customer demand and competitive market. First, I wanted to make a point about speed enablement.

Our view is that we should always enable the highest speed that technology and market economics allow. We put fiber everywhere it makes sense to do so. But we also believe our access technologies such as vectoring, bonding and G.fast deliver market-competitive speeds when the cost of fiber deployment becomes prohibitive.

Let me walk you through some of those numbers when we move to Slide 9. What you see here is an estimate of the bandwidth requirements of what we would describe as a heavy usage consumer customer: a household streaming 6 streams of HD video, including 2 streams of 4K video; a group HD call; a couple of HD gamers; multiple bit torrent downloads; and multiple music stream.

As you can see, even in this relatively high usage case, which is well beyond the vast majority of user's activity, can be met with speeds of less than 100 megabits and that aligns with our own experience. We see speeds of 40 megabits to 100 megabits as competitive today in virtually all of our markets.

We expect that usage curve to continue to increase over time, moving to the 100 megabits or 200 megabits range over the next several years. Certainly, there will be users who will seek the gigabit connection, but for the vast majority of consumers, we see 100 megabits to 200 megabits is being more than sufficient to meet market demand for a number of years.

With that in mind, let's move to Slide 10 and take a look at where we are today with the broadband speed deployment, where our access enablement plan takes us over the next several years. We're confident we can accomplish these broadband speeds within the confines of our existing capital budget levels, and this is based on currently available compression and access technologies and average cost of deployment, which we hope will improve over time.

By year-end 2018, we expect to enable speeds of greater than 40 megabits to 85% of our top 25 markets, and to reach more than 55% of those markets with more than 100 megabits with a lot of that improvement coming over the next 12 to 18 months. And while not depicted on this chart, across all of our markets, this will represent about 50% of addressable units receiving 40 megabits and higher speeds and more than 30% of addressable units receiving 100 megabits and higher speeds by year-end 2018.

By the time we get to year-end 2019, we'll have almost -- we expect to have almost 11 -- or about 11 million addressable units, representing 42% of total addressable units across all of our markets capable of receiving 100 megabits and higher. And in our top 25 markets, over 70% of addressable units expect to have 100 megabits and higher speeds.

By this time, we also expect to have approximately 3 million addressable units enabled for 1 gigabit and higher speeds across all of our markets. Obviously, the changes in technology, cost of deployment and market factors could cause us to reassess our actual deployments either a little lower or a little higher.

And while the details may vary, the point is we believe we can deploy very competitive speeds within our existing capital plans. And while our investment plans assume capital intensity at current levels, for the next several years, we do anticipate our capital intensity to return to historical averages over time.

Let's move to Slide 11. Our next operational initiative is to exceptional customer experiences. As enabled speeds become more aligned among competitors and are more consistently in excess of the customers' needs, we believe customer experience becomes more relevant to the buying decision.

Under our new sales and marketing leadership, we're intensifying our effort to go-to-market with a customer-focused approach. For example, we're in the process of reducing the many variations of one of our consumer products. This resulted in fewer easy-to-understand and easy-to-provision offerings. This will improve our customer experience and drive efficiencies into our operations.

We've also continued an enhanced effort to accelerate provisioning of our business network services, and we've seen a 25% improvement in Ethernet service intervals since the first of this year and increased order velocity by approximately 60%. Again, this improvement drives a better customer experience, drives efficiencies in their operation and accelerates the order-to-cash cycle.

Finally, we've increased the level of focus in our call centers in first call resolution for our customers. Now this focus on first call resolution is another change we believe may have affected our broadband additions for the quarter as we focus more on the customer issues rather than selling, but we believe the improved customer experience will improve customer retention and improve revenue over time.

Finally, our fourth operational initiative is to optimize operating capital and capital efficiencies. We know we have to continue to realign our legacy cost structure. I think, our operating expenses for the second quarter show that we are focused on operating efficiencies. However, realizing the level of efficiencies we require will take more than just good cost management, we have several initiatives underway to drive even greater efficiencies.

We simplified our product offerings. We are also in the process of simplifying our billing platforms. This is a complex multiyear project that we believe will simplify our systems and infrastructure, improve our customer experience and deliver operating efficiencies. We're energized with this focus we're driving into our business, and we believe we have a clear strategic direction. And by delivering on our key operational initiatives, we will successfully build on CenturyLink's history of delivering value for both our customers and our shareholders.

Now I will turn the call over to Stewart for a discussion of our financial results and guidance. Stewart?

**R. Stewart Ewing**

*Chief Financial Officer, Executive Vice President and Assistant Secretary*

Thank you, Glen. Over the next few minutes, I'll review the financial results for the second quarter and provide an overview of the third quarter 2016 guidance we included in our earnings release issued earlier this afternoon.

Now moving to Slide 13. I'll review the -- a few highlights from our second quarter results. Please note that I will be reviewing some of the results, excluding special items, as outlined in our earnings release and associated financial schedules.

As Glen mentioned earlier, we achieved solid financial results for the second quarter and operating revenues were \$4.4 billion on a consolidated basis, a 0.5% decrease from second quarter 2015 operating revenues. This decrease was primarily driven by lower legacy revenues, offsetting an approximate \$50 million increase in higher cost support revenues due to CAF Phase II support, higher consumer strategic services and increased business high-bandwidth data services.

I might point out here that as indicated in our release, this quarter, we moved private line from strategic to legacy revenue. Prior quarters have been restated to reflect this change.

Core revenue, defined as strategic revenue plus legacy revenue, was \$3.97 billion for the second quarter, a decrease of only 1.2% from the year-ago period. Our strategic revenues grew 5.2% year-over-year, primarily driven by strength in high-bandwidth data services and higher consumers future growth in use.

Operating income was \$650 million, an increase of \$101 million from second quarter of 2015. We generated operating cash flow of approximately \$1.65 billion for the second quarter and achieved an operating cash flow margin of 37.5%.

Cash expenses for the second quarter declined \$48 million year-over-year, primarily due to lower employee-related costs. Free cash flow, defined as operating cash flow less cash paid for taxes, interest and capital expenditures, along with the cash impact of pension and OPEB costs, stock-based compensation and other income was \$617 million for the quarter.

Diluted earnings per share for the quarter -- second quarter of 2016 was \$0.36, an increase from \$0.26 in the year-ago period. Adjusted diluted earnings per share for the second quarter of 2016 was \$0.63, an increase from \$0.55 in the second quarter of 2015.

Moving to Slide 14 and our Business segment. In the second quarter, the Business segment generated \$2.6 billion of operating revenues, which decreased \$61 million or 2.3% from the same period a year ago. Second quarter strategic revenues for the segment was \$1.23 billion, an increase of 5% compared to second quarter 2015 and was driven primarily by the continued growth in high-bandwidth data services, partially offset by the decline in hosting revenues. In addition, we had a onetime favorable settlement of approximately \$10 million.

Legacy revenues for the segment declined 7.4% from second quarter 2015 due primarily to a continuing decline in voice and low-bandwidth data services. Our data integration revenues declined \$20 million from second quarter 2015 due primarily to lower CPE sales. Total Business segment expenses decreased \$17 million or 1.1% from the year-ago period, driven primarily by lower employee-related and network expenses, partially offset by higher facilities cost.

Now turning to Slide 15. The Consumer segment generated \$1.49 billion in total operating revenues, a decrease of \$9 million or 0.6% from second quarter 2015. Strategic revenues in this segment grew 5.5% year-over-year to \$800 million, driven by year-over-year growth in, broadband and Prism TV revenues. Legacy revenues for the Consumer segment declined 6.8% from second quarter a year ago as access line declines were partially offset by select price increases.

Operating expenses increased \$18 million or 2.8% compared to the same period a year ago due to higher Prism TV costs, commissions and marketing expenses, partially offset by reductions in employee costs from lower headcount.

Now turning to Slide 16. For the third quarter 2016, we expect operating revenues of \$4.35 billion to \$4.4 billion, core revenues of \$3.9 billion to \$3.95 billion and operating cash flow between \$1.56 billion and \$1.61 billion. Adjusted diluted EPS is expected to range from \$0.52 to \$0.57. Third quarter 2016 operating revenues are expected to be lower than second quarter 2016 operating revenues, primarily due to anticipated growth in data integration, high-bandwidth data services, broadband and Prism TV revenues being offset by the expected decline in legacy revenues.

Our anticipated sequential decrease in third quarter operating cash flow compared to second quarter is primarily due to the decline in revenues and expected higher normal seasonal cost. In addition, we expect to have higher than originally anticipated network sales and marketing cost related to our customer growth plans for the back half of the year.

Although we do not provide free cash flow guidance on a quarterly basis, I want to point one additional item as you're thinking about first half versus second half trends. As you're all probably aware about the news media earlier this year, we experienced record flooding in Louisiana. And as a result, many parishes in the state were declared as federal disaster areas ineligible for federal relief. As part of this relief, federal

and certain state cash taxes related to our first and second quarter tax estimates were delayed until the third quarter of 2016.

For full year 2016, we slightly narrowed our cash taxes estimate to be \$400 million to \$500 million and, again, most of this will be paid in the last 6 months of the year. For full year 2016, we remain comfortable with our previous guidance, although due to the higher expenses outlined earlier, operating cash flow will likely come in towards the lower portion of our range for the year. We continue to expect our dividend payout ratio, however, to be in the low to mid-60% range for 2016.

This concludes our prepared remarks for today. So at this time, I'll ask the operator to provide instructions for the question-and-answer portion of our call.



## Question and Answer

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### Operator

[Operator Instructions] And our first question comes from David Barden from Bank of America.

### David William Barden

*BofA Merrill Lynch, Research Division*

I guess, first question for you, Stewart, is obviously the math of the EBITDA guidance. Even if we look at the very low end of the EBITDA number and do the math for the first 3 quarters including the midpoint of 3Q guide, it would imply like a 6% increase in 4Q versus 3Q EBITDA. You did have about \$178 million of sequential cost cuts last year in the fourth quarter, but you had a very specific program that you were implementing in the second half of the year. Could you kind of talk about why we can get comfortable with that mathematics? And then, again, just on the kind of -- I know you don't give the free cash flow guidance, Stewart, but you've generated about \$1.4 billion to date. The midpoint of the guidance is \$1.9 billion. Is the entire difference really the cash tax payment's timing? Or does it seem to be kind of steering to the higher end of the range for whatever reason?

### R. Stewart Ewing

*Chief Financial Officer, Executive Vice President and Assistant Secretary*

Yes. So David, the last question first. Basically, it's partially cash taxes in the last half of the year, but it's also CapEx because we'll spend more CapEx in the last half of the year than we did in the first half of this year as well as our operating income -- our operating cash flow will be expected to decline somewhat in the second half of the year as well. With regard to the first question, you're correct that last year, as you pointed out, we cut expenses about \$125 million between the third and fourth quarter. We feel comfortable that with -- coming off seasonality from the third quarter, we'll have a normal reduction in expenses in the fourth quarter, plus we will have programs in place to allow us to be able to cut operating expenses to come in within the guidance range that we're staying with.

### David William Barden

*BofA Merrill Lynch, Research Division*

All right. And can you kind of map out some of the specific plans that you have that were going to get you there?

### R. Stewart Ewing

*Chief Financial Officer, Executive Vice President and Assistant Secretary*

I guess -- I mean, we're still working on a few other things, David. But normally, I mean, just from a seasonality standpoint, there is probably \$60 million to \$80 million that comes out -- that will come out in the fourth quarter this year related to seasonality between what we expect in the third quarter versus what we would expect in the fourth quarter. So the fourth quarter programs don't have to be quite as robust as they were last year to get us to the \$125 million or so that we experienced last year. Also, we'll have somewhat of a decline in marketing expenses in the fourth quarter because we are ramping up some marketing expenses in the third quarter and we expect that to come back down a little bit in fourth quarter as well.

### David William Barden

*BofA Merrill Lynch, Research Division*

And I apologize, Stewart, one last one, just a clarification. So last quarter, when you guided down from 1Q to 2Q, you kind of sighted seasonal cost pressures, which didn't materialize and you ended up above the high end of the range. Is there like -- are we actually seeing the seasonal expenses coming through now that are more likely? Or are you expecting these kind of seasonal costs to come down the pike?

### R. Stewart Ewing

*Chief Financial Officer, Executive Vice President and Assistant Secretary*

Yes. So about \$20 million in the second quarter and about \$30 million or so in the third quarter.

**Operator**

Our next question comes from Amir Rozwadowski from Barclays.

**Amir Rozwadowski**

*Barclays PLC, Research Division*

I wanted to follow-up on the commentary around the capital intensity. It sounds like the way we should think about it is based on your investment plans, you do expect capital intensity to be up for the next several years. How should we think about it in terms of magnitude? And at what point do you expect capital intensity to return to historical averages over time?

**Glen F. Post**

*Chief Executive Officer, President, Director and Member of Special Pricing Committee*

Yes, Amir, that -- I was not saying that capital intensity would be up. It just won't come down for a couple of years, 2 or 3 years. So we as get -- we spend -- we've had our capital intensity to be a little higher than the industry for a couple of years, so we expect that level to continue. We do not -- we believe we can hit these objectives in terms of broadband speed, improving the network and enhancing the network with SDN and the other services that we're putting into the network, other technologies within the current capital budget, which is about \$3 billion today.

**Amir Rozwadowski**

*Barclays PLC, Research Division*

Got it, that's very helpful. And then I was wondering if we could talk a bit more on the subscriber trends on the high-speed data customers. It sounds like there's a shift in terms of focus on the more -- the bundled offering in terms of those types of subscribers. But I'd seem to recall in your last call, you did mention that there was a deferral in certain price increases that you had hoped to get out of the high-speed broadband. Just trying to put two and two together there, is there any color that you can provide us in terms of the competitive landscape or what you're seeing from that front that gives you confidence that you can still return to targeting those higher-value bundled customers?

**Glen F. Post**

*Chief Executive Officer, President, Director and Member of Special Pricing Committee*

You want to take that one? Well, I'll let Dean Douglas.

**Dean J. Douglas**

*President of Sales and Marketing*

So actually, there are 2 issues here. So the first issue is with regard to the trend towards our shift that we're going to make and -- or making towards bundled customers. So that's an initiative we've started and continued to pivot our customers from a pure or single-focused high-speed Internet type of customer towards one, which is bundled. That is something that drives better ARPU as well as a longer lifetime revenue base for that customer. The second piece, though, is with regard to the price increases. Price increases, we saw some of the price increases take us back in the first half, and we're continuing to drive some of those price increases into the second half. And we'll see those manifest themselves in the second half as well.

**Operator**

Our next question comes from Phil Cusick from JPMorgan.

**Philip Cusick**

*JP Morgan Chase & Co, Research Division*

Just to fundle [ph] up -- follow up, excuse me. Bundled customers, what does that mean? What are you bundling? Because your video reach just isn't that wide. Are you looking to bundle with voice? What should we be thinking about here?

**Dean J. Douglas**

*President of Sales and Marketing*

Sure. Phil, we're primarily looking at double and triple play, so it includes voice and other services that we would bundle with our high-speed Internet. And as I mentioned, those customers tend to stay with us much longer than those that are just -- than pure-play.

**Philip Cusick**

*JP Morgan Chase & Co, Research Division*

Okay, I -- okay. And then it looks like the managed hosting business continues to decline here. Can you talk about any color around that as well as the sort of data center sale process? Any update there, either in terms of the process or thoughts on how to use the proceeds?

**R. Stewart Ewing**

*Chief Financial Officer, Executive Vice President and Assistant Secretary*

First of all, the process is going well. We have narrowed down the group of final contestants for the property and we have ongoing discussions, negotiations with that group. We feel good about where we're headed there, and we think we'll be successful in getting the transaction done. Again, as I said before, it will be third quarter, maybe early fourth quarter before we finalize a transaction. We have not yet made final decisions regarding the use of proceeds from that. We'll address this as we get closer to a transaction. We'll obviously consider a number of alternatives, stock buybacks, debt reduction, investment in strategic services and other possible areas. We just haven't -- we're waiting till we get a little closer to the -- to a close to really decide how to best spend those funds. So our primary goal, of course, will be to utilize the cash in the very most effective way we can to drive long-term shareholder value. That will be our objective.

**Operator**

Our next question comes from Simon Flannery from Morgan Stanley.

**Spencer S. Gantsoudes**

*Morgan Stanley, Research Division*

It's Spencer for Simon. Just 2, if I may. Can you update us on what you're hearing in terms of the latest in special access? And then second, what's the latest outlook for returning to revenue breakeven?

**Glen F. Post**

*Chief Executive Officer, President, Director and Member of Special Pricing Committee*

Well, special access, we would be working with the FCC. It's a complex issue and deals with the provisioning of wholesale special access service to wireless providers and to carrier, CLECs. In our discussion with the FCC, and we've been in continuous discussions with them, we believe that they intend to move on an order to move it to resolution this year. They obviously have a limited amount of time to do so. They're trying to move quickly. We're in conversation with almost all of the industry stakeholders, including the cable companies, CLECs and other industry players and hopes [ph] with our negotiating a workable solution that we can bring to the FCC, to the Chief a balanced reform. The FCC order will likely address the definition of competitive and noncompetitive markets as well as prospective rates charged to carriers and CLECs and wireless providers. We are on record and in direct conversations with Chairman Wheeler and the other commissioners that the vast majority of our markets are fully competitive and that those rates should not be regulated. That's been a major position of ours, and we think we have -- we can show that. And we believe the commission is using data from cable TV companies that's 3 years old, and the cable companies have actually said this data is not really correct. So we're encouraging the commission, really, to step back and use the most recent data that's available out there to make these decisions. Because we've [indiscernible] that the special access really could take, we're not ready to

provide a range of possible outcomes. It's just too complex. And we do expect it [ph] more than a few weeks. We are cautiously optimistic that some form of compromise can be reached that the FCC can work with to achieve some of their objectives and make this powerful for all of the players. We know change has to take place, but we believe there are ways to do without being punitive to a specific group of players here.

**Spencer S. Gantsoudes**

*Morgan Stanley, Research Division*

Then in just terms of updating your comments in terms of, I think, at the end of 2015, you're talking about revenue breakeven in 12 to 18 months. Is that still part of the plan?

**R. Stewart Ewing**

*Chief Financial Officer, Executive Vice President and Assistant Secretary*

Yes, Spencer. So we still think that there's a possibility that by the last quarter of the year, we could get to potentially revenue stability. And we still expect EBITDA stability to come 18 months or so, probably after that. It's as we stated before, our results won't be perfectly linear, but we're confident that we're all going to pass to get through revenue stability and growth and EBITDA stability and growth as well. I'll add one comment related to a product question on the bundling. We are bundling our services with DIRECTV services, video services, where we don't have Prism TV service available. We're also about to trial an over-the-top product, and we had one trial and going to have another more robust trial of over-the-top product that we expect to be able to the bundle. And we're bundling voice as well.

**Operator**

Our next question comes from Frank Louthan from Raymond James.

**Frank G. Louthan**

*Raymond James & Associates, Inc., Research Division*

First, can you talk to us a little bit about the consumer products that you say you're rationalizing? What exactly is going out there? And then Stewart, I'd like to follow up on what you said about the OTT product. What would that look like? Will that be a similar OT taking Prism as an OTT and [indiscernible] a set-top box or something like that or a smaller, skinnier package? Give us a little more color on that.

**Dean J. Douglas**

*President of Sales and Marketing*

So first of all, with regard to product consolidation rationalization. We're going to take 40 speed products, as an example, down to 7. So that's the extent to the level of the rationalization that we're going to go forward with in our consumer products. You can imagine the complexity when you've got 40 different product offerings to speeds and so we really do need to rationalize. With regard to the OTT or the over-the-top products, we are going to be going forward with skinny bundles. And so as was mentioned just a moment ago, we've piloted this in one market and we expect to go forward with a broader pilot towards the end of the year and really test the market in terms of pricing as well as the ability to penetrate the marketplace with this OTT offering to complement what we have in the Prism markets.

**Glen F. Post**

*Chief Executive Officer, President, Director and Member of Special Pricing Committee*

I might add to that, Dean. With the skinny bundle, we'll also offer the broadcast network channels with that, which is a little different from all of the offerings that out there today. So we think that will be a differentiator if we bring those local channels with the over-the-top cable channels.

**R. Stewart Ewing**

*Chief Financial Officer, Executive Vice President and Assistant Secretary*

And that will be an app-based product, right, so that you can access it through an app of the smart TV.

**Frank G. Louthan**

*Raymond James & Associates, Inc., Research Division*

Got it. Too bad, they won't let you do that kind of rationalization with some of the regulated voice products.

**Operator**

And our next question comes from Matthew Niknam from Deutsche Bank.

**Matthew Niknam**

*Deutsche Bank AG, Research Division*

Just 2, if I could. One, you mentioned refining your go-to-market strategy in both consumer and business. Maybe if you can give us some more color on what's actually going on there and when you expect these efforts to produce results and improve volumes and revenue growth. And then just on broadband, if you can help us think through the pressure this quarter, whether it was more of a growth fad or a churn issue. And then I have one more follow-up. Just in terms of trying to figure out the impact from the deferral of rate hikes that was discussed, whether that actually has come through yet or not?

**Dean J. Douglas**

*President of Sales and Marketing*

Okay. So with regard to refining the go-to-market, what we've done is we've transitioned from a go-to-market that is really driven by product to a go-to-market that is more market sensitive and market focused. So customer groups much more than product group. And so for example, we've got 7 routes to market in our new go-to-market construction. And so they've got large accounts, SMB and so on. It allows us to differentiate not only the product offerings we take to those market segments but also how we bundle or create product groupings solutions that we're going to take to the marketplace as well. And so when we think about the markets in the large accounts space, what we call global markets, it's one that really is driven by vertical market penetration. So we've got a couple of vertical markets that we're going forward with today. We'll be adding more as we go forward. Those vertical markets, especially for large accounts, are absolutely essential in order to create credibility and relationships, strong relationships with the customer base. So that's where we are with regard to the go-to-market in the business space and how we're going to address those market opportunities. We are starting to see some traction in the marketplace, and I believe that the market structure that we implemented today is something that our customers have [indiscernible] forth not only in our business but in our competitors. And I think that we're seeing that benefit in the way in which we're interacting with our customers and the opportunities that we're seeing in the marketplace with those new solutions.

**Glen F. Post**

*Chief Executive Officer, President, Director and Member of Special Pricing Committee*

And then regarding the pricing increase we've talked about, almost very, very low first half of the year. We saw almost none come in. But second half of the year, we expect probably less than \$10 million in the second half of the year in price increases. That's about 20% of the increase we're putting in place. We should see the rest of that in 2017.

**Matthew Niknam**

*Deutsche Bank AG, Research Division*

Okay. And then on the broadband activity for the quarter, whether parsing through growth adds versus churn. If you can just give us any more color there?

**Dean J. Douglas**

*President of Sales and Marketing*

So with regard to the ins and outs, so we had a pretty significant number of ins on our business we continue to sell, especially in the -- as most mentioned earlier, the 40 megabyte space -- megabit space. And so our customers are really looking for greater speed and bandwidth as we go forward. We also saw that the purer customers continue to churn and we've talk about that. The churn level for our pure

customers or standalone high-speed customers is double that what we were seeing in those bundled customers. So very, very significant churn rate in those customers. So we saw a significant number of outs in that pure space.

**Glen F. Post**

*Chief Executive Officer, President, Director and Member of Special Pricing Committee*

Matt, if you look at the overall broadband losses, it was about 50% due to the lower end and about 50% due to increased churn. So it's about 50% of both -- pretty well balanced as for the impact.

**Operator**

Our next question comes from Amy Yong from Macquarie.

**Amy Yong**

*Macquarie Research*

Two questions. So first on just operational efficiencies. And as you upgrade, I guess, business and consumer segments, what kind of margin expansion should we expect in '17 and '18? And my second question is on the data centers, [indiscernible] churn this. What types of considerations -- that will I guess an outright sale and point you to perhaps staying in the colocation business?

**Glen F. Post**

*Chief Executive Officer, President, Director and Member of Special Pricing Committee*

First of all, with respect to margins, I mean, we're going to continue to see some margin decline in the consumer business -- segment because basically, we will still be losing the legacy revenue that's higher margin and the revenue that we're adding will be more strategic revenue in nature to the extent that's video, the margin on that is substantially lower. To the extent it's high-speed Internet, that margin is better. So overall, the margin will continue to come down. So the important thing, I think, is that over time, we intend to be able to grow revenue and stabilize EBITDA and really start growing both revenue and EBITDA on a consolidated basis. And regarding the data center business, [indiscernible], we expect to right now that there will be a sale. However, we're not limiting ourselves to that. The colo business continue to be an important part of our future, and we will be in the managed services business. We have big data capabilities. We're in managed hosting, so all those [indiscernible] having data centers having capabilities, colo capabilities. So we'll continue to be in this business. However, we think there are opportunities to approach it differently if we don't have a sale. We think there are partnership opportunities that would reduce the load for the capital requirements on CenturyLink. And we can do partners with other companies for [ph] ways to share our overheads with other companies. So we have a couple of partnership opportunities we think are legitimate and real, that could be beneficial for shareholders if we don't get the valuation of sale that we expect that we require.

**Operator**

Our next question comes from Mike McCormack from Jefferies.

**Michael McCormack**

*Jefferies LLC, Research Division*

I guess, Glen, just thinking about the high-speed database that currently exists. You talked about the single play and the higher churn in, I guess, nonpaid discos. When you think about your overall subscriber base, is there a percentage of that base that you think could be at risk as we think about progressing over the next few quarters? And then, I guess, just on the speed offered by cable competition or others in that top 25 market, how does that stack up against the way you guys are thinking about CenturyLink for the future?

**Glen F. Post**

*Chief Executive Officer, President, Director and Member of Special Pricing Committee*

Mike. First of all, on the -- as far as the base of risk, we still have a lot of pure-play customers out -- pure-play standalone Internet customers out there that we expect to impact us going forward. We think by early second half of the year, we should filter through those to a great degree, and we'll see that churn rate [indiscernible] come down. We'll see more stabilization and accretion to ARPU at that point. So there's some still out there, but early second half of the year, we should see that subside quite a bit, the impact of that. As far as the speeds that we are projecting, certainly, in some markets, the cable companies have roll out higher speeds. However, we have a lot of -- more GPON assets than anybody -- than anyone has, any one of the cable competitors have. We have 40 megabits in over 30% of our markets today. That's going up significantly. We expect to have close to 4 million homes with access to 100 megabits or more by year end on the businesses. So we believe we're going to be very competitive. Especially we don't feel we have to compete on the speed, but on service, on the services from our products that we're selling. And that's the chart I showed you. We showed earlier that if you can get the same service level with lower investment, lower speeds, and we think that's the right thing to do. We don't think we just go out and invest for the sake of investing where it doesn't make sense in low-density markets. Again, as I said, if here [ph] we could take fiber economically, we're going to do with. But that's not going to be in all of our markets by any means.

### **Operator**

Our next question comes from Tim Horan from Oppenheimer.

### **Forrest Wilson**

*JP Morgan Chase & Co, Research Division*

Two questions. Where do you think the low-end broadband subscribers are going? I would think you would have prices at the lower end that are quite a bit below cable. Is it the wireless? And maybe just at a high level, how do your broadband prices compare to cable at this point? And then secondly, could you give us some more color on SDN? It sounds like you're deploying it very aggressively. What your experience has been to date? Maybe what kind of suppliers you're using or where you've seen the most OpEx and CapEx savings with SDN and NFV?

### **Dean J. Douglas**

*President of Sales and Marketing*

So with regard to the first part of your question, where do we think the low-end broadband subscribers are going, we think they're increasing their speeds. They're moving up speed in the marketplace. There probably are some corner cutters, but we don't see that as being very, very significant at this juncture. We really do see them increasing their speeds. With regard to SDN, NFV and the approach that we're taking, we've got several pilots in place today. We're looking at broader market or geographies for those customers. And we're really thinking about the reach that we get from the SDN, NFV implementations versus the way in which we're traditionally going after the MPLS and Ethernet marketplaces. And that ability to take our network and provide significant services beyond just what's offered today in MPLS and the Ethernet marketplace across a broader geography is what's compelling for our customer base at this juncture.

### **Timothy K. Horan**

*Oppenheimer & Co. Inc., Research Division*

And how do you think your base broadband prices compared to cable prices at this point?

### **Dean J. Douglas**

*President of Sales and Marketing*

We believe that our prices are lower than the cable offerings at this juncture. Of course, that's during the promotional period.

### **Operator**

Our next question comes from Brett Feldman from Goldman Sachs.

**Brett Feldman***Goldman Sachs Group Inc., Research Division*

Just 2 questions. First, on the skinny bundles that you're going to be rolling out, I'm curious whether there are any taps on your programming agreements? Sometimes, that's key tradeoff that you get with the programmers [indiscernible] have a more limited bundle. And then second, on the third quarter marketing initiatives that you're planning that's going to put a little upward pressure on spending. Just want to come back to that. What is the outcome you're looking to achieve? And why are you containing that to the third quarter?

**R. Stewart Ewing***Chief Financial Officer, Executive Vice President and Assistant Secretary*

We'll let Aamir Hussain, our CTO, answer the first question about skinny bundles.

**Aamir Hussain***Chief Technology Officer and Executive Vice President*

Thanks, Stewart. The key for getting the skinny bundles to work is having the right level of programming agreement in place. Today, on Prism TV service, we buy 2 NCTC. When we launch our TV over-the-top offering, that offering, we are negotiating brand-new agreements with the broadcasters. And those agreements are not bound by any caps or by franchise agreements, so these are non-franchise type agreements that allow us to pretty much have a nationwide reach. And the top 4 or 5 here, the ones [indiscernible] very well in those agreements and we very, very feel very comfortable with the time line that we have provided. I would also add that skinny bundles are not just about skinny. We are offering -- we will be offering multiple genre packages on top of that. And that will have a very, very positive effect on our overall ARPU at a the cost point which makes sense for the consumer.

**Dean J. Douglas***President of Sales and Marketing*

Regarding the marketing efforts and the greater intensity of the marketing spend in the third quarter, actually, we're looking to not just drive that in the third quarter but going forward, and so we are going to have a marketing -- a set of marketing programs that are going to get to continue to drive our high-speed broadband businesses. But it's not all incremental. The fact is that we are taking some funds from other marketing programs that are no longer justified and moving them to this increased spend as we go forward, and it allows us to continue to drive our broadband services, especially for those higher-end customers.

**Brett Feldman***Goldman Sachs Group Inc., Research Division*

And what's the metric that's going to tell us it's working? Is it as simple looking like at an improvement in the broadband net adds?

**Dean J. Douglas***President of Sales and Marketing*

It will be improvement in the broadband net adds, and obviously, that's the primary metric in the consumer space. And that, by the way, when we talk about improvement in the net ad, it's traditional, where the bundled approach as opposed to those pure plays.

**Brett Feldman***Goldman Sachs Group Inc., Research Division*

Do you anticipate that in aggregate, your broadband sub-base will be growing sequentially in the back end of the year? Or do you still have a little bit you have to work out in the system?

**Dean J. Douglas***President of Sales and Marketing*



We still have to work some out of the system with regard to the churn that occurs in our pure standalone plays. We'll see that play out through the third quarter. And then we expect that we'll start to see an improvement in the subsequent quarters.

**Operator**

Our next question comes from Batya Levi from UBS.

**Batya Levi**

*UBS Investment Bank, Research Division*

A couple of follow-ups. First, on the guidance for revenues. You have guided to the low end of the guidance range partly because you have decided not to increase prices. Now that you're taking some selected price increases, can we expect a little bit of a move on the annual revenues? And maybe within that, can you talk about what you're seeing in the wholesale business, both from a wireless backhaul perspective and other wireless contracts? Some of your peers saw some pressure there. What are you seeing in the market? And third question, on CapEx. You said that you expect capital intensity to remain at current levels for a few years, which is about 17% of sales. And then what is the more normalized level that you can get back to?

**R. Stewart Ewing**

*Chief Financial Officer, Executive Vice President and Assistant Secretary*

So Batya, with respect to the revenue guidance, we still believe we'll be at the lower half of the range that we gave for the full year, the price increases that we expect to do. And by the way, we did price increases in the first half of the year. I just want to make that clear. The \$40 million is what we effectively deferred and decided not to do that we had previously planned when we originally gave our 2016 guidance. Some of that will implement now, but the impact of that on the last half of the year is going to really be pretty immaterial. We hope to have some increases in our sales of CPE, which would help improve our revenue somewhat in the back half of the year.

**Glen F. Post**

*Chief Executive Officer, President, Director and Member of Special Pricing Committee*

And then on the wholesale business, pressure on wireless backhaul, there continues to be pressure on wireless backhaul. It's very competitive. A lot of players out there. The wireless companies have alternatives, so it is continual negotiation going on. Of course, we had a major reduction last year that we talked about this time last year in terms of wireless backhaul agreements, but it's an ongoing issue. We think we can be competitive. We don't expect any major impact this year, but these negotiations are continual with the wireless carriers and it is very competitive. As for the more normal level of CapEx we can get to, we think there's \$300 million or \$400 million that will come out easily out of the \$3 billion. So we think \$2.5 billion level is certainly achievable, maybe less. It depends on what -- where the opportunities are in terms of driving or investing in technology can drives revenue and margins. But right now, we think a more normal level would be closer to the \$2.5 billion mark.

**Operator**

And our next question comes from Michael Rollins from Citi.

**Michael Ian Rollins**

*Citigroup Inc, Research Division*

Just wondering if I could follow back up on some of the CapEx points that you're making. The first thing is when you talked about the use of proceeds or possible proceeds for the possible data center sale, you mentioned, I think, reinvestment as a category. And I don't think you mentioned that in some of the past calls. So can you talk us through if you did have more capital available where you might want to put it? How much you think you can invest and have impact on the revenue line and the operations longer term? And then just finally, on data speeds. How much of your customers make decisions based on what they feel they need in terms of speed versus what they're marketed do and what they feel is better for them? And then can you talk us through your strategy to address the way customers are buying these services?

**Glen F. Post***Chief Executive Officer, President, Director and Member of Special Pricing Committee*

Mike, first of all, the mention of the reinvestment. We consider that in every -- we look at cash flow of any kind as part of the consideration. So I wasn't trying to say, well, that's a change. We look at, as I said, we look at stock buybacks, debt reduction, investment fees and services and others -- acquisitions. We put the whole opportunities in there. But the focus, again, is driving long-term shareholder value. So for that, Mike, just to give you an example, there might be an opportunity to invest in a certain type of technology we believe can drive short of near-term returns, drive real value for us, offset some capital expenses, offset some from the cash investment in CapEx. So that's the kind of thing we look at. But there's no change in what we said before.

**Michael Ian Rollins***Citigroup Inc, Research Division*

And if you did have a few more capital or just cash coming in, is there a certain amount that you feel like you can deploy in the business that would be catalytic for better performance?

**Glen F. Post***Chief Executive Officer, President, Director and Member of Special Pricing Committee*

We really haven't made a decision. Certainly, there are opportunities there to invest in the business, so there's no question about that. We have not made any decisions as far as should we invest back into the business with some of the funding that comes from the sale of the data centers. We just haven't made those decisions yet. But those opportunities are certainly there.

**Michael Ian Rollins***Citigroup Inc, Research Division*

And then just lastly, back to my question on how your customers buy services. And in terms of how you feel they're making the decisions, do you think they're making decisions on what they actually need? Or do you think it's more of a marketing situation where they might be captivated by the advertisement of better speeds and how your marketing to your customers based on how you see the decision-making process working?

**Dean J. Douglas***President of Sales and Marketing*

So as you would expect in the marketplace, there's an overemphasis on speed. And even though speeds may be well above what the customer's requirements are, there's still that desire to get as much speed as possible. But we have an advantage that, for example, our cable competitors do not have in that we're not shared, and our cable competitors are. So what we really focus on is being real speed that the customers is going to get and what they really need going forward from a broadband standpoint. And that seems to be very, very effective in communicating to our customers what their real needs are versus what the advertised speed might be in the best of circumstances. And then, of course, the other piece of the whole speed equation that we try to educate our customers about is the symmetry of speed. So we've got upload and download speeds that are similar and we're not seeing that in our cable competition. So we talked about that upload and download speeds with our customers and the fact that it's symmetrical.

**R. Stewart Ewing***Chief Financial Officer, Executive Vice President and Assistant Secretary*

And Mike, one thing I might point out on that as well is that we've always competed with the cable companies at a speed disadvantage [ph], and we've always been successful adding customers over the years. And with the network expansion and the emphasis on the network and improving the broadband speeds from a relative standpoint, we will be competing at a much better position than we've been at in the past. And again, we've been successful in the past, so there's no reason to think we shouldn't be successful in the future with the focus and the emphasis that we're putting on investing in the network to increase our speeds.

**Operator**

I'm showing no further questions at this time. I would like to hand the conference back over to Mr. Glen Post for closing remarks.

**Glen F. Post**

*Chief Executive Officer, President, Director and Member of Special Pricing Committee*

Great. And I believe CenturyLink is well positioned to help our customers realize the promise of the power of the digital economy that we've talked about. And we'll continue to invest in our broadband network and expand our broadband capabilities that we discussed today that we believe will help meet our customers' needs, help them improve their lives, grow their businesses. We continue to see excellent opportunity to meet business customer demand for high bandwidth data, hosting and IT and managed services, and we think that we're going to see that demand grow in the months and years ahead. Additionally, we are focused on meeting the broadband and video demand we see for consumer customers and are investing to deliver those services that they want and need, as we've also discussed today. We have a strong set of assets. We have the financial strength that we believe positions us well to invest in our future and to grow our business.

Thank you for being an our call today. We look forward to speaking with you in the weeks and months ahead. Thank you.

**Operator**

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

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