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CenturyLink, Inc. NYSE:CTL

FQ4 2017 Earnings Call Transcripts

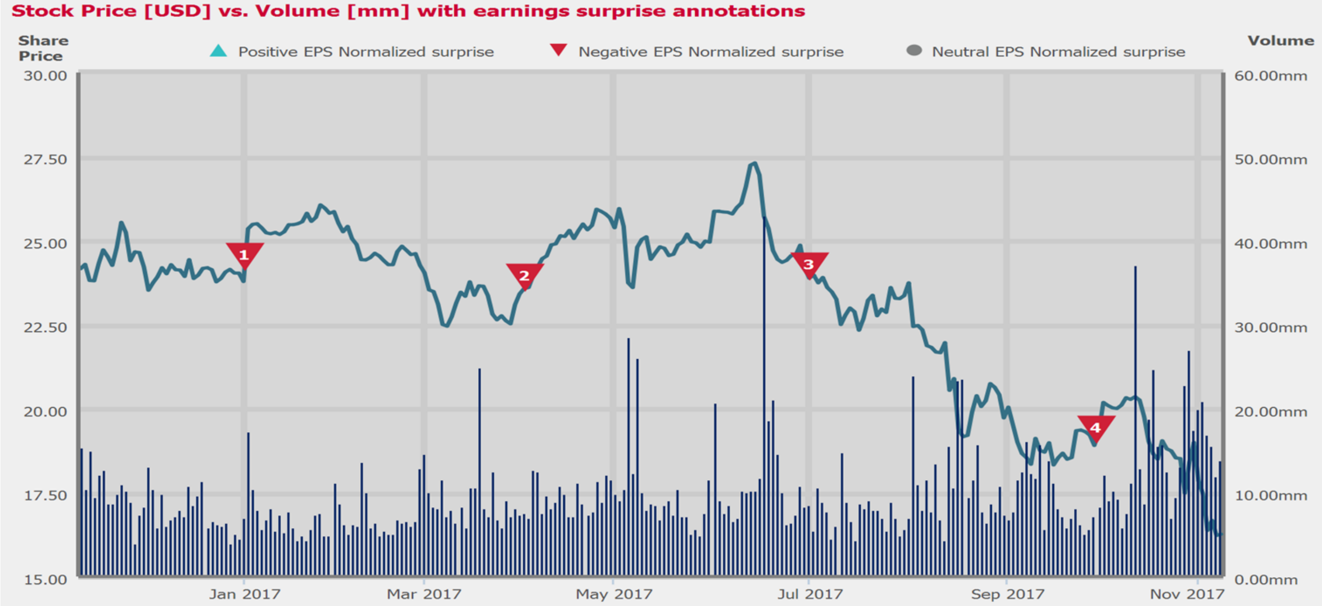
Wednesday, February 14, 2018 10:00 PM GMT

S&P Capital IQ Estimates

	-FQ4 2017-			-FQ1 2018-	-FY 2017-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL
EPS Normalized	0.33	0.18	(45.45 %)	0.34	1.67	1.58
Revenue (mm)	5400.31	5323.00	(1.43 %)	6033.71	17712.65	17656.00

Currency: USD
Consensus as of Feb-12-2018 6:10 AM GMT

Stock Price [USD] vs. Volume [mm] with earnings surprise annotations



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FQ4 2016	0.56	0.54	(3.57 %)
FQ1 2017	0.53	0.52	(1.89 %)
FQ2 2017	0.49	0.46	(6.12 %)
FQ3 2017	0.45	0.42	(6.67 %)

Call Participants

EXECUTIVES

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CEO & Director

Jeffrey K. Storey
President, COO & Director

Sunit S. Patel
Executive VP & CFO

Tony Davis
Former Vice President of Investor Relations

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Presentation

Operator

Ladies and gentlemen, thank you for standing by, and welcome to CenturyLink's Fourth Quarter 2017 Earnings Call. [Operator Instructions] As a reminder, this conference is being recorded Wednesday, February 14, 2018. I would now like to turn the call over to Mr. Tony Davis, Vice President of Investor Relations with CenturyLink. Please go ahead.

Tony Davis
Former Vice President of Investor Relations

Thank you, Ash, and good afternoon, everyone, and welcome to our call today to discuss CenturyLink's fourth quarter 2017 earning results released earlier this afternoon. The slide presentation we will be reviewing during the prepared remarks portion of today's call is available in the Investor Relations section of our corporate website at ir.centurylink.com. At the conclusion of our prepared remarks today, we will open the call for Q&A.

As you move to Slide 2, you will find our safe harbor language. We will be making certain forward-looking statements today, particularly as they pertain to guidance for full year 2018 and other outlooks in our business. Unless otherwise noted, prior periods are provided on a year-over-year basis.

Metrics discussed today on the call exclude acquisition-related expenses associated with the Level 3 transaction. Those metrics are adjusted EBITDA, capital expenditures, free cash flow and net leverage, and we have footnoted the details in our press release and earnings presentation. Pro forma results discussed today exclude the May 1, 2017, sale of the data centers and colocation business and reflect purchase accounting adjustments and intercompany eliminations related to the November 1, 2017, acquisition of Level 3 by CenturyLink. We also ask that you review our disclosures 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.

Now moving 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. Reconciliations between these non-GAAP financial measures and the most comparable GAAP financial measures are available on our earnings release and on our website at ir.centurylink.com.

And now as we move to Slide 4, your host for today's call is Glen Post, CenturyLink's Chief Executive Officer. Joining Glen on today's call are Jeff Storey, CenturyLink President and Chief Operating Officer; and Sunit Patel, CenturyLink's Executive Vice President and Chief Financial Officer. Our call today will be available for telephone replay and webcast replay through May 8, 2018. Anyone listening to a telephone or a webcast replay or reading a written transcript of this call should note that all information presented is current only as of today, February 14, 2018, and should be considered valid only as of this date regardless of the date heard or viewed.

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

Glen F. Post
CEO & Director

Thank you, Tony, and thank you all for joining our call today as we discuss CenturyLink's fourth quarter 2017 results, our progress and the integration of CenturyLink and Level 3 and the 2018 outlook for our business. For the next few minutes, I will discuss CenturyLink's continued transformation to one of the world's leading network providers and will also make a few remarks about fourth quarter results and some of our plans for 2018. I will then hand the call over to Sunit to review fourth quarter results in more detail and discuss our 2018 business outlook. And following Sunit, Jeff will provide an operations review of our business, including an update on our sales and operations integration and alignment to date and the opportunities and challenges he sees in the months ahead for our business.

As we move into our first full year of the combined operations of CenturyLink and Level 3, we'll talk for a minute about -- a look back basically. If you look into late 2016, we announced the sale of our data center and colocation businesses and the acquisition of Level 3, 2 milestone transactions that helped sharpen our focus on Core Network Services. As you know, we successfully completed the sale of the data centers and colocation business effective May 1, 2017, and of course, the acquisition of Level 3 effective November 1 of last year. Both of these transactions represented significant steps forward in CenturyLink's -- CenturyLink becoming one of the leading network services providers in the world. Upon closing the Level 3 transaction, we immediately began implementing our integration plan to successfully bring the 2 companies together. I am very pleased with how this integration is progressing, and given our ability to gain additional insights since closing, we're even more confident in our ability to achieve our annual run rate operating capital expense synergy targets of $850 million and $125 million, respectively. Jeff will talk in more detail about our integration efforts a little later.

We entered 2018 a much different company than only a year ago, and I want to talk briefly about our operational focus as we head into 2018. Our principal operational focus is to drive long-term profitable revenue growth and free cash flow generation so that we can both continue to invest in our business and sustain our strong dividend. We are prioritizing our investments and operational initiatives that we believe will help support that outcome. First, we are focused on creating great customer experiences. We are simplifying and automating products, processes and systems. We're increasing digitization of end-to-end service delivery platforms, allowing more efficient customer-friendly interactions. And we're improving our managed service delivery and service models to enable us to better meet our customers' needs.

Second, we are focused on investing with discipline to expand key network capabilities and to take fiber deeper into the network. And while we invest for future growth, we have significant opportunities to increase market penetration in areas where we have enabled strong broadband capabilities and related services in recent years.

Third, we know we must optimize operating capital efficiencies while successfully integrating people, processes and systems throughout our company. We expect to drive efficiencies through product portfolio and processes simplification as well as through greater automation. And we are increasing the discipline and rigor of our capital allocation process to ensure our investments are focused on network customer experience and efficiency realizations.

Finally, we will continue our focus on stabilizing and improving sales and revenue effectiveness and productivity as we solidify our new organization structure and continue the successful integration of CenturyLink and Level 3. Over the last several years, we have positioned CenturyLink from a legacy-focused telco with limited prospects for growth to a fiber-focused provider of advanced data services and global networking and customer base. We have a lot of work ahead of us, but we're excited about our future and look forward to updating you on the progress toward making ourselves the world's best network provider.

Before turning the call over to Sunit, I just want to point out that our fourth quarter results as a combined company largely met our expectations. Our pro forma consolidated revenue was $6 billion, and adjusted EBITDA, excluding acquisition-related costs, was over $2.2 billion. Our 450,000 route mile fiber network, the more than 350 connected metro markets and 100,000 fiber-enabled, on-net buildings along with the network connections in over 60 countries provide us the scale and scope to compete globally with our enterprise products and services. I am confident in our 2018 business outlook and in our leadership team's ability to successfully integrate our companies and meet the needs of our customers.

And with that, I will turn the call over to Sunit for a review of our financial results.

Sunit S. Patel
Executive VP & CFO

Thank you, Glen, and thank you, everyone, for joining today. I'll provide a brief overview of each company's stand-alone results followed by a review of our combined company pro forma results for the fourth quarter. After that, I'll discuss how we will be reporting our go-forward results, and I'll wrap up with a discussion of our financial outlook for 2018.

I'd like to start with Slide 7. We expect adjusted EBITDA to increase year-over-year. We also expect to be free cash flow positive after dividends in 2018, and we remain confident in our ability to achieve our targeted adjusted EBITDA synergies of $850 million and CapEx synergies of $125 million.

Turning now to Slide 8 for an overview of CenturyLink stand-alone fourth quarter results. Total operating revenue in the fourth quarter declined 7.6% to $3.964 billion primarily due to a decline in legacy revenue and the Colocation Sale in May of 2017. Core revenues declined 8.4%, and strategic revenues declined 6.1% in the fourth quarter. Adjusting for the Colocation Sale, core revenue declined 4.7% and strategic revenue grew 1.4%.

Fourth quarter adjusted EBITDA was $1.471 billion. This is a $74 million sequential improvement compared to $1.397 billion in third quarter 2017. This improvement was driven by lower seasonal labor and utility costs combined with approximately $20 million of onetime favorable items in the fourth quarter.

In addition, we had expected to recognize a $25 million to $30 million favorable carrier settlement in the fourth quarter, but as part of our network optimization integration work for the combined company, we determined it was not in our best long-term interest to enter into this settlement.

Capital expenditures for the fourth quarter 2017 were $528 million. This compares to $749 million in the third quarter of 2017 and $963 million from the year-ago quarter. Full year 2017 capital expenditures were $2.886 billion, which were a bit higher than we expected. We are aligning capital spending with revenue performance and increasing our focus and investments on projects with predictable returns.

Moving to Slide 9. CenturyLink enterprise strategic revenue increased 1.9%. In the quarter, we saw continued strength from our MPLS offering, which was partially offset by declines in broadband data services.

Turning to Slide 10. Consumer revenue decreased 5.6%. Consumer strategic revenue was essentially flat. We saw a net loss of about 90,000 broadband subscribers this quarter, which were made up of losses of about 140,000 at speeds under 20 meg and gains of approximately 50,000 in higher-speed offerings with a higher average ARPU. We are continuing to see success with our simplified Price for Life offering.

For Level 3 standalone, we met the outlook we set at the beginning of 2017. For the full year 2017, we delivered adjusted EBITDA of $2.979 billion compared to our outlook of $2.94 billion to $3 billion and free cash flow of $1.141 billion compared to our outlook of $1.1 billion to $1.16 billion. Capital expenditures for the full year 2017 were $1.326 billion or 16% of total revenue.

Turning to Slide 11 of our presentation. Total revenue grew 3.3%, and CNS revenue grew 3.8% in the fourth quarter of 2017. Total wholesale CNS revenue declined 1.8%, and total enterprise CNS revenue, excluding U.K. government, grew 6% in the fourth quarter 2017. Enterprise CNS revenue was strong in all regions. In particular, North America enterprise CNS revenue grew 5.6% year-over-year and 4.4% sequentially driven by strong growth in government revenue, which was from onetime low-margin professional services revenue. Excluding that onetime revenue, we grew North American CNS -- North America enterprise CNS revenue more than 2% sequentially.

Turning now to Slide 12. Adjusted EBITDA was $758 million for the fourth quarter 2017 compared to $724 million in the fourth quarter of 2016. Adjusted EBITDA margin was 35.9% in the fourth quarter of 2017 and 35.6% in the fourth quarter of 2016. Level 3 generated free cash flow of $353 million in the fourth quarter of 2017 compared to $266 million in the fourth quarter of 2016.

I'd like to move to some highlights for the combined company. These results are on a pro forma basis assuming the merger was completed in the beginning of 2016 and include the effects of purchase price accounting and the elimination of both intercompany revenue and expenses and revenue and expenses related to the sale of the data center and colocation business. Going forward, we'll report revenue in the following categories: business, consumer and regulatory, which includes CAF and other support funds.

As you can see from the chart on Slide 13, business revenues represent 74%, consumer revenue represents 23% and regulatory revenue represents about 3% of total revenue. We will also report revenue by our 5 customer-facing business units: consumer, small and medium enterprise, strategic enterprise, international and global accounts, and wholesale and indirect. Additionally, we'll report revenue by 5 product categories: IP and data services, transport and infrastructure, voice and collaboration, IT and managed services, and regulatory. Historical pro forma results for our business units dating back to the fourth quarter of 2016 can be found in today's earnings release.

Turning to adjusted EBITDA on Slide 14. We are defining adjusted EBITDA to exclude stock-based compensation expense, integration and transaction costs and revenue and expenses associated with the sale of the data center and colocation business. Pro forma adjusted EBITDA was $2.211 billion for the fourth quarter 2017 and was seasonally higher due to lower labor expenses and utility costs. Our full year 2017 pro forma adjusted EBITDA was $8.698 billion. Pro forma adjusted EBITDA margin was 36.8% for the fourth quarter 2017, and our full year 2017 pro forma adjusted EBITDA margin was 36.1%.

Moving to synergies on Slide 15. We have achieved approximately $75 million of annualized run rate adjusted EBITDA synergies. As most of you are aware, we are targeting $975 million of annualized run rate synergies, which are comprised of $850 million in operating expense synergies and $125 million in capital expense synergies. We are confident that we can capture the majority of the targeted run rate adjusted EBITDA savings over the next 3 years. Additionally, we expect to achieve the $125 million of CapEx energies this year.

At the time of the acquisition announcement, we said we expect to incur a total of approximately $685 million in integration-related expenses. Please note, transaction-related expenses were not part of our estimate of our total integration-related expenses. Integration-related expenses for the fourth quarter were $62 million. In total, we have incurred approximately $170 million in integration-related expenses at the adjusted EBITDA line. Additionally, we have incurred approximately $250 million in transaction-related expenses since we announced the merger in the fourth quarter 2016.

Our trailing 12-month net debt to adjusted EBITDA ratio at the end of the fourth quarter was 4.3x on a pro forma basis, excluding acquisition-related expenses. Our target leverage range is 3 to 4x. We remain confident that we will be able to drive down our leverage ratio every year as we grow adjusted EBITDA.

I'll also note, our weighted average cost of debt is currently about 5.7% with 65% being fixed rate and 75% -- 35% being variable rate debt.

In the fourth quarter, we recorded a tax benefit of $1.1 billion as a result of the tax reform. This was driven by the lower 21% rate versus a 35% rate applied against the net deferred tax liability of CenturyLink, resulting in a benefit of $1.28 billion partially offset by a chain charge from the reduced net deferred tax asset of Level 3 adjusting for purchase price accounting treatment of about $180 million. As we mentioned last quarter, we will not be providing revenue or quarterly outlooks going forward.

Turning to Slide 16 and our outlook for full year 2018. Please note all outlook measures exclude integration expenses. For the full year 2018, we expect adjusted EBITDA to grow from the pro forma $8.698 billion in 2017. We're defining free cash flow as cash flow from operations minus capital expenditures. We are providing 2 measures of free cash flow: before the dividend and after. Excluding integration-related expenses for the full year 2018, we expect free cash flow before the dividend of $3.15 billion to $3.35 billion. In addition, we expect free cash flow after the dividend of $850 million to $1.05 billion. Given our confidence in our cash flow profile over the next few years, we remain committed to the dividend. Please note, our free cash flow outlook assumes a $100 million pension contribution in 2018 in line with our contribution level in 2017. Additionally, our cash flow outlook in 2018 benefits from income tax refunds, timing of incentive-based compensation and tighter management of accounts receivables and payables. In 2018, we expect to spend roughly 16% of total revenue on capital expenditures.

I wanted to take a moment to comment on tax reform and how it will benefit our business. We are pleased with this new legislation and see it as a positive to our business, both in the short term and long term. As you are aware, we have NOLs, which total approximately $9 billion. So in the short term, we expect the ability to expense most capital expenditures, and all of our interest expense will initially slow down the utilization of our NOLs. In the first 5 years under the new tax law, we will see significantly reduced cash taxes. For the longer term, moving from a federal rate of 35% to 21% will add additional value even as the benefits of expensing the capital expenditures began to reverse.

For the full year 2018, we expect our effective tax rate to be approximately 25%. We expect first quarter 2018 adjusted EBITDA to be lower than the fourth quarter of 2017 due to the $20 million in onetime credits I discussed earlier combined with an increase in payroll taxes and other compensation expense items of about $40 million. For the year, we expect integration costs at the adjusted EBITDA line to be higher than the $170 million in integration costs we have incurred through the end of 2017.

I'll summarize by saying we are confident in our business outlook for the year. We expect adjusted EBITDA and adjusted EBITDA margins to increase nicely over the next few years.

With that, I'd like to turn the call over to Jeff.

Jeffrey K. Storey
President, COO & Director

Thank you, Sunit. Good evening, everyone, and thank you for joining us. Sunit discussed the stand-alone results for Level 3 and CenturyLink, so I won't go into much detail about the former companies in my comments. I would like to start by saying Level 3 had strong results in the fourth quarter, and I'd like to thank the employees for staying focused and finishing strong. I'd also like to thank the former CenturyLink team. Their commitment to the success of our business even during a time of significant change has not wavered. From this point forward, my remarks will concentrate on the combined CenturyLink. It's been an exciting few months since we closed the acquisition in November, and we've made a lot of progress with integration in a relatively short period of time.

I'm frequently asked if there are any big surprises, either good or bad. The answer is generally no. We had a year of integration planning, and the team did a very good job evaluating what we need to do. But I have been pleasantly surprised with the eagerness of our employees. Since the close, I visited a number of our offices across the country, large and small, and you can see the excitement from our people regarding the opportunity ahead. They recognize and appreciate the tremendous challenges ahead as we transform the way we provide services and interact with our customers. However, they're excited about the company we're building. While we are actively simplifying and harmonizing our product offerings, among the advantages of the -- bringing the 2 companies together is a more robust product portfolio our sales team can take to the business market, and our expanded on-net footprint is already creating opportunities.

As many of you know, I believe the driver of long-term value is growth in free cash flow per share. Our strategy for improving free cash flow starts with enhancing the customer experience. The better our products meet the needs of the customers and the better we perform operationally, the higher the customer experience. One thing we know for sure is satisfied customers turn less and buy more.

Although capital efficiency is certainly a component of free cash flow, we don't intend to limit capital in an effort to generate free cash flow. We actually do just the opposite. We invest our capital to drive profitable revenue growth by enhancing our products, expanding our on-net footprint, simplifying our operating environment for employees and improving the way we interact with our customers. With -- we are implementing initiatives across all 5 of our business units.

As we discussed during our third quarter earnings call, we have organized each of the business units around specific customer groups. By focusing each business unit on a unique attribute of their particular customers, we can drive operational excellence and fine tune our efforts by customer group to provide a differentiated experience.

Talking about digital transformation is not a new topic, but we are certainly undergoing a digital transformation at CenturyLink. Over the past few years, we have heavily invested in utilizing technologies like software-defined networking and network function virtualization to reduce our costs, enhance our own performance and deliver new capabilities to our customers. Expanding our product portfolio to couple services like SD-WAN with MPLS with wave transport or our cloud connect infrastructure and new products like Cloud Application Manager, we are using these same technologies to enable the hybrid networking capabilities our customers demand.

Across the company, there are concerted efforts underway to ensure we pursue profitable revenue growth. For example, we target customers that are either already in on-net buildings or in near-net buildings where we can expand our footprint. As a reminder, there are hundreds of thousands of buildings within 500 feet of our network.

Domestically and internationally, we have relatively low market share, and we believe we have significant opportunity to drive revenue growth over time. The key to our success is ensuring we have the appropriate relationship with each customer. In some cases, that may mean having a large sales team supporting a single customer and interacting on a daily basis. In other cases, it may be an entirely digital experience where the customers buy and utilize our service in a touchless way. We want to provide our services in the way our customers want to purchase and consume them.

I'd like to take a minute to walk you through each of our customer-facing business units, our go-to-markets approach and how we're thinking about future growth. I'll start with the wholesale and indirect group. Our wholesale customers are very important part of our business, and they give us scale in capabilities that we can deliver to them and our direct enterprise customers. With the broader footprint and enhanced product set we have as a combined company, we believe we are positioned to continue to serve our wholesale customers well. However, as I've said for a long time, given continued industry consolidation, we expect revenue from wholesale to be flat to slightly down over the long term.

We have combined our indirect partners with our wholesale business. They tend to order through integrated interfaces and operate much like wholesale customers. The biggest difference is we view our indirect partners as a force multiplier of our sales team. We are able to leverage a large external sales force to sell our services to customers we would not be able to address directly. We expect to see continued growth through the indirect channel.

Moving to our global accounts or our GAM and international group and starting with our international opportunity. Putting the 2 companies together has increased our scale and scope, and we serve customers in more than 60 countries on 5 continents, conducting business in 25 languages. Looking back, our LatAm business has shown strong growth in the enterprise channel and we expect that to continue.

In EMEA, we've seen improving sales and revenue performance. We've also mitigated U.K. government decline, and it is now a small percentage of revenue. From a GAM perspective, we've expanded the number of customers we serve with this team. These customers tend to have the most complex networking needs, which aligns well with CenturyLink's global scalable capabilities. We have 250 or so customers in GAM, and I'd say, historically, both companies did an excellent job covering maybe the top 10% of these accounts. With better focus on the entire set of accounts and improved engagement model and by differentiating the customer experience we provide globally, I'm optimistic about the opportunity to grow revenue with our GAM customers.

Next is our North America strategic enterprise and federal government team, which we call [GEAR] internally. This team covers 3 primary customer groups, and we tailor our approach for each. For regional enterprise, we plan to optimize growth through a defined, repeatable, low-touch and increasingly digital model. For large enterprise, we have customized global solutions in a high-touch model similar to GAM. The federal government group is very high touch and serves the unique requirements of the government with a highly customized approach.

We believe we have room to expand our current market share and can grow revenue across all 3 groups. We also remain firmly committed to our general manager model to expand our network, optimize our local presence and increase our profitability.

Next is our small and medium enterprise group, which we call [GEM]. We have a great team in place here. While we want to continue to sell services within the legacy CenturyLink territory, we also see the opportunities to sell to small and medium enterprises in on-net buildings outside of legacy CenturyLink network. I'm very excited to now have the sales organization and processes in place to attack those buildings within the former Level 3 footprint.

If we look across all of our enterprise groups, we believe [GEMs] can benefit the most from an increasingly digital environment, and we're focused on various initiatives to simplify the customer experience.

Rounding out the 5 customer-facing groups is our consumer business, which is roughly 25% of our revenue. We are looking across the business to ensure we offer our customers the services they want and in the way they want to receive them. The short-term opportunity here is to maximize the investments we have already made. We have a significant number of homes that are enabled with speeds between 100 megabits and a gigabit. Even though most customers don't see the need for or use more than 40 megabits, we know we are more successful in selling when they have an upgrade path for the future.

We have also implemented a number of changes to stabilize revenue and improve the customer experience. For example, we introduced a single price that won't change as long as the customer has the service called Price for Life. Prior to this approach, we had various promotions and discounts that would roll off over time. This was not a very customer-friendly approach as customers viewed the loss of discounts as rate increases. Our new approach improves the customer perception, reduces the need for calling CenturyLink, which also reduces our costs and enhances the overall customer experience.

We believe that just as important as our efforts in driving profitable revenue growth is improving operational efficiency and effectiveness across our business. It's more important than just synergies. Don't get me wrong. Reaching our synergy targets is very important, and we're on track to do so. But it's also important we support our customers as efficiently as possible going forward.

Many of you have heard me say that taking cost out of the business not only improves the bottom line. It also improves the customer experience. If we can handle a customer's concern in a single call or better yet with a single online interaction, our costs will be lower. However, if we -- if the customer has to call us back a second, third or even a fourth time, not only can that add 4x the cost providing the service. It creates a very bad experience for the customer. Driving cost out of our business also drives the customer experience up.

Another example is moving a customer from off-net provider onto the CenturyLink network. When we do this, we reduce what we pay to our competitors, improve our profitability and provide a better end-to-end experience for our customer.

I'll now shift and provide a brief update on integration. Starting with the sales force integration. I'm pleased to say that we are substantially complete with integrating the 2 sales teams. All sellers are now aligned to their go-forward business unit and organizational structure. Where we were previously operating with a dual accounting structure with both companies supporting a customer, account transitions have been largely completed and we now have a single account team in place.

We are on a single instance of our customer relationship management system, which goes a long way to help the overall management of the sales team and standardization in our go-to-market approach. Sales is obviously the most critical function and often an area that erodes for a few quarters after an acquisition closes. Teams are learning new products, new systems and in some cases, new customers. We have implemented a sales support center as a resource for sales teams to call as they come up the learning curve on the combined company.

Some other highlights. The company's network backbones were interconnected early in the process. Customer migrations to on-net have begun and will be completed over the next several years. We'll be deliberate about the migration process and are looking at it from a customer impacting perspective rather than a geographic or a CenturyLink-oriented view. We believe this approach minimizes disruption for our customers and provides a better customer experience.

The teams have developed the IT systems integration road map and are beginning to execute on that road map. We expect to complete the initial enterprise resource planning or ERP system integration in the second quarter and consolidate major customer portals, allowing customers to sign into the portal with a single password. Similarly, we have identified our in-state product road map, and execution is in progress. As within the integration, this along with IT systems are long-term but critical efforts.

In addition to these specific integration accomplishments, we are remaining disciplined across our business. We've introduced capital governance and enterprise governance processes to ensure we prioritize and maximize our investments and resources.

In summary, our goal is to focus on products and services where we can win in the market and where winning means something significant to us. We are being disciplined about the opportunities we'll pursue and our focus on cost transformation in managing the business efficiently through an integrated digital experience.
I'll now turn the call over to the operator for your questions. Operator, can you explain the process?

Question and Answer

Operator

[Operator Instructions] The first question comes from the line of Philip Cusick with JPMorgan.

Philip A. Cusick
JP Morgan Chase & Co, Research Division

A couple if I can. Jeff, what are you seeing from customers who Glen had talked about? And I think you as well had been talking about holding back from signing contracts earlier in the year before the deal. What kind of progress have you seen there? And then second on the consumer side, broadband losses continue. What are your thoughts on the consumer broadband strategy going forward?

Jeffrey K. Storey
President, COO & Director

Sure. Thank you, Phil. Holding back, that's one of those things that we see periodically. And if you look at the sales from customers during 2017, we saw increasing sales through the first quarter, the second quarter, third quarter. Sales were a little bit lighter in the fourth quarter versus the prior quarter, but we're stronger year-over-year versus the first -- fourth quarter of '16. So we're starting to see customers recognizing how to work with the combined company. And so I wouldn't say that there are particularly any big deals being held back. Most of that concern from customers is behind us, and we should start seeing deals continue to close. From a consumer perspective and a broadband perspective, we have a significant footprint that has been activated with high speed. We need to focus on selling what we've got. We have opportunities to sell more high speed -- or very high speed, 100 megabit and above, 40 megabit and above. We need to make sure that we're doing that. We have plenty of footprint out there that we can go and sell. We'll continue to deploy more fiber into our network, getting it closer and closer to enterprise customers -- or, excuse me, consumer customers and making that higher speed available to a larger footprint. Now we have the benefit of being able to spread that fiber deployment across not only our consumer customers but our small and medium enterprise customers, our larger enterprise customers, passing more buildings and going into more buildings. And so we believe fiber is good, and we'll continue to build that closer and closer to customers. But the primary effort right now for us in our consumer business, especially with high-speed IP, is to make sure that we provide a great customer experience, we reduce churn by providing a great customer experience and we sell in the footprint where we think we really have a very competitive product.

Glen F. Post
CEO & Director

And Philip, let me just add one thing to that. Our major loss is on broadband and where we have below 20 megabits of spectrum available -- speed available. And last year, early last year, we made a decision to really focus more on the higher-value customers. We went to our price -- simplified Price for Life plan and really trying to drive the higher ARPU, which we've done. And as Jeff said, the good news is we've got a lot of households of 9.8 million households available with 40 megabits or higher and 4.4 million available at the 100 megabits or more at the year-end. So we have a lot of capacity to sell into, and that'll be our focus as Jeff said.

Operator

Our next question comes from the line of Amir Rozwadowski with Barclays.

Amir Rozwadowski
Barclays PLC, Research Division

Two if I may. I was wondering if you could discuss your thoughts around the enterprise spending environment at this point. One other provider of services had discussed the potential opportunity for improved spending trends on the back of some of the tax reform we've seen. Are you folks seeing any sort of leading indicators as to where demand trends could go? And then perhaps secondly, you mentioned focusing on product and services to win and where winning means something to the company. How should we think about sort of the focus or trajectory of revenues within that context? I recognize that you're not providing revenue guidance, but if we can think about the different moving pieces as to how you can get and achieve that EBITDA and cash flow guidance that you've set, I think that would be helpful.

Sunit S. Patel
Executive VP & CFO

Okay. So I think I'll take a stab at both, and Jeff or Glen might want to add. So on the enterprise spending environment, yes, we -- while we believe that tax reform is a positive, you heard other people talk about it. At the end of the day, I think we look at the backdrop in terms of the demand environment for the kind of services we are offering and what customers are trying to evolve to new hybrid infrastructures for both cloud and bandwidth requirements on their own premises, including how they interact with their customers. So I think that, in general, we continue to see bit growth, which is why Jeff made the comment about on-net and driving our fiber footprint deeper across to serve all our customer segments. On the second question, I think the key here is, certainly on the enterprise side, I mean, we -- anyone on the consumer price -- side for that matter, but most certainly on the enterprise side, our goal is to improve our revenue performance over time in line with the comments that Jeff and Glen made. And I certainly think our position from a network footprint and the comprehensive products and portfolios we have in the on-net buildings we have and the continued investments we make, we think we should be able to drive a little better performance over time on the revenue side.

Jeffrey K. Storey
President, COO & Director

And just to add on the enterprise spending comment. We see our customers needing the products and services that we have. So hopefully, the ability to capitalize infrastructure -- to expense capitalized infrastructure and other things will help customers invest. But whether there's a good economy or a bad economy, our customers need the types of products and services we provide, and we've seen that over time that in a bad economy, they want to move to more cost-effective infrastructures, and so they move to newer technologies and move to the capabilities that we have. In a good economy, they're trying to accelerate their growth and make sure that they're able to meet their customers' needs. And so they want our expandable services and our capabilities. And so for a fairly long time, we see customers moving to us because they need our products and services kind of independent of the economy. But we do think and are hopeful that the tax environment will make them purchase more and invest more.

Amir Rozwadowski
Barclays PLC, Research Division

So just a quick follow-up though. It doesn't seem like that expectation is embedded into your outlook currently. Is that a correct way to think about things?

Sunit S. Patel
Executive VP & CFO

That's correct.

Operator

Our next question comes from the line of Simon Flannery with Morgan Stanley.

Simon William Flannery
Morgan Stanley, Research Division

Sunit, on the '18 EBITDA guidance, what are you assuming for synergy realization going through the year? Is it fair -- you mentioned the 3-year target. Is it fair to take that fairly linearly? Or is that going to be more in years 2 or 3? And then I think you mentioned recently about a 500 to 700 basis point margin opportunity. Can you just sort of review that for us? And should we take '17 or '18 as the kind of the base year for that target?

Sunit S. Patel
Executive VP & CFO

Thanks, Simon. So I think on the synergy realization, I mean, typically, what we see is the first year is the steepest part of the curve and then you get the full run rate benefit in the second year. And then after that, it starts tailing off. So usually, we get a lot of the benefit over the -- we should see a lot of the benefit in terms of reported benefit that you will see this year and next year; the run rate benefit, a little more this year, some next year and then it tails off in the third year. So in general, that's the pattern we see. On the EBITDA margin, to your question, I think, in general, we continue to expect to see the EBITDA margin expand nicely over the next 3 to 5 years. I think we said even at the time of the announcement that with synergies and everything pro forma, we should be north of 40% plus EBITDA margins over the next few years and we continue to feel quite confident and comfortable with that. So I think you will see the margin expansion in terms of the basis points that you described.

Operator

Our next question comes from the line of David Barden with Bank of America Merrill Lynch.

David William Barden
BofA Merrill Lynch, Research Division

So Sunit, a couple more questions on the guide. So there's about a $550 million delta between kind of looking at EBITDA minus interest minus pension minus tax minus CapEx and the free cash flow guide. And you kind of highlighted, I think, working capital, which would be kind of recurring potential benefit; tax refunds, which aren't recurring. So if you could kind of bridge us to kind of what that $550 million breaks down into, be super helpful. And then just second, I think you kind of called out some kind of onetime items that are going to weigh on 1Q. So I guess, people are going to look at the fourth quarter number, kind of take that down, and I guess, we're then expecting the kind of EBITDA cadence to be kind of as synergies compound kind of ramping, I guess, over the course of the year. I just kind of -- some cadence guidance on the EBITDA will be helpful, too.

Sunit S. Patel
Executive VP & CFO

Sure. So with your first question, that number, the biggest portion is tax refund, which we expect from -- for taxes from 2017. So that's why it flows to the working capital -- I mean, through that working capital line. And then secondly, the second item that I mentioned in my comments was the timing of incentive-related compensations. So for example -- one example, but there are a couple of things. Typically, for the case of Level 3, we paid bonuses the year following year-end. So 2017 bonuses were typically paid in 2018 in this case, but with the timing of the close, some of those were paid through the end of the first 10 months -- or those were paid through the first 10 months in 2017. And so we won't be paying them in '18, so that's a benefit. And then the third thing I mentioned is just working capital management on receivables and payables, so that's the third component in order of magnitude. And we think they'll continue to be opportunities to improve that even next year when you look at the DSOs for example. So those are the components. I think when you see through that and you go in subsequent years, in general, we expect the working capital line to be a slight of a negative. And by slight, I mean, in the scheme of things, small compared to our cash flow generation. So I think that, that helps you get you a sense of as we look longer term, so it'll be a little bit of use of cash but -- and that has to do more with the pension funds and other forced retirement benefit expenses. But some of that will be offset at least over the next year by continued improvement in receivables and payables. And then on the question on transitioning from the fourth quarter to the first quarter, I think, in simple terms, yes, I mean, we'll see about the kind of magnitude change. I talked about $20 million on the onetime credits that I explained and then $40 million, which really has to do with the change in incentive-based compensation and typically higher payroll taxes in the first quarter. So when you add that together, it's $20 million and $40 million. It's about $60 million. So I think that, hopefully, helps people calibrate to the starting point in the first quarter, and then given the guide for the year, I think that helps interpolate that pretty well.

David William Barden

BofA Merrill Lynch, Research Division

And if I can just do one quick follow-up. I mean, I think, over the last couple of years, CenturyLink has proven to be apparently pretty notoriously difficult to guide for. And could you kind of give us a sense -- and you've expressed this conviction that you feel good about the numbers. But with your fresh set of eyes looking at an old set of books, where does that conviction really come from? What process did you go through that makes you think that you've kind of got it nailed down where, for the last few years, it really hasn't been?

Sunit S. Patel
Executive VP & CFO

Yes. So I think there are a couple of elements. We've had a year of integration planning, and all the various organizations were announced from the summer months onwards. And as I mentioned -- as we mentioned even last quarter, everyone had their budgets and targets for 2018 by the end of October. And as Jeff also mentioned and Glen alluded to, we have taken a much harder look at capital governance processes, capital allocation processes, return investment criteria. We have spent a lot of time as we worked on integration planning on the synergy plan with respect to things like non-headcount expenses and RFPs. We run with suppliers both for capital expenditures and non-headcount expenses on the operating expense side. We have spent a fair bit of time very specifically looking at our plans for network expense reductions and the capital expenditures it takes to do that. So I think, on the whole multitude of efforts across the whole organization and the fact that everyone's executing on the plans, I think we -- and also, we hope we've taken a fairly realistic appraisal of the revenue trends looking at more historical trends. Recently, I feel -- we feel, having looked at all of that and considered it with some marginal safety, we are very confident of the guide that we've provided for 2018.

Jeffrey K. Storey
President, COO & Director

And I'd just like to add. We're also using our organizational structure differently. We've organized around the customer and our business units to give us greater focus, greater intensity, greater visibility into each of those customer segments and greater visibility into the profitability of those customer segments. And so we have organized around profitability. We have organized around driving success with our customers and feel fairly confident about our visibility into the business at this point.

Sunit S. Patel
Executive VP & CFO

And the only final point I would add is I think we've hopefully tried to improve the elasticity or the responsiveness of the organization so we can manage and adjust levers as we see how we are performing every month. So hopefully, it can be more flexible in how we adjust more quicker. So I think, hopefully, that should also -- that also gives us some more confidence.

Operator

Our next question comes from the line of Scott Goldman with Jefferies.

Scott Goldman
Jefferies LLC, Research Division

I guess, just want to follow up to David's question on free cash flow and make sure I understand, Sunit. Sounds as though you're saying there's a decent working capital benefit that rolls through in 2017 on the back of tax refund and the timing and other working cap stuff that you just laid out. So as we think about sort of exiting '18 into '19, is it fair to sort of back out those and say that's sort of starting point and then you'll have initiatives around DSOs and that type of thing going into '19? Just want to make sure I understood that properly. And then secondly, just on the broadband side of the equation, seems like a sort of a tale of 2 cohorts there with, obviously, the lower-speed guys churning off and showing success on the high-speed guy. Wonder if you could help give us a sense for where that base is today. I'm trying to just size what the potential risk is within that base on the low or the opportunity to move them up into the high speed would be going forward.

Sunit S. Patel
Executive VP & CFO

Okay. So I'll answer the first question, and Jeff maybe can do the consumer one. But in essence, I think as I said, the biggest component is the tax refund from last year's taxes followed by the incentive-based comp I talked about. And I think I just summarized it best by saying when you go forward, generally, working capital should be neutral to a slight use of capital going forward as you look in future periods. And that includes the pension expense funding that we talked about or takes that into consideration.

Jeffrey K. Storey
President, COO & Director

And Scott, I don't have an exact mix of how many customers are below 20 and above 40, but it's a fairly large number below 20 that are turning. But our opportunity is to continue -- those are customers that have been around for a very long time, and there are opportunities to continue to improve our network, improve the speeds that we offer to those low-speed customers. And they're moving from that low-speed onto the high-speed capabilities. And so we'll continue to focus on that. And as Glen said, we have a significant number of households passed that are addressable with very high speeds, and we will continue to sell to those customers and position our products and services with those customers and continue to upgrade for the very low end.

Sunit S. Patel
Executive VP & CFO

And one other point on the guide, remember, we said that outlook does not include integration expenses, and we give you a sense of that. And there'll be some in the capital expenditures side. But those expenses will be more onetime in nature, and then, obviously, there will be a benefit in future periods when you look at your forecast after [could] take into consideration integration costs.

Scott Goldman
Jefferies LLC, Research Division

And just one quick follow-up on the consumer broadband side. As you think about the non-Price for Life customers, what's the thoughts or strategy around pricing as you go into 2018, Jeff?

Jeffrey K. Storey
President, COO & Director

Well, the strategy has moved to Price for Life. One of the things that we saw was we -- in 2016, we put in a lot of promotions and discounts. And what that feels like to the customer is these promotions and discounts roll off 6 months after they've signed them. They don't feel like now the discount's gone. They feel like we gave them a rate increase. And so it's not a very customer-friendly way to do it. But it also drives activity within our business, drives calls, drives dissatisfaction from the customer. And so we will move -- continue to move to Price for Life for those customers and for making it simpler for them to buy and consume our products.

Glen F. Post
CEO & Director

And I'll just add to that, that even for our 20 meg and below customers moving more toward the Price for Life simple pricing, [favorable for the] lower price speed customers, of course, at lower price plans. So we are seeing some success in those markets where we've rolled that out.

Jeffrey K. Storey
President, COO & Director

And we have over 1 million customers. We've rolled Price for Life, I don't know, less than 6 months ago or so, maybe a little longer. And we have over 1 million customers on it already, so it's been very successful.

Our customers have reacted well to that, and it makes the experience they have with us feel better for them.

Operator

Our next question comes from the line of Brett Feldman with Goldman Sachs.

Brett Feldman
Goldman Sachs Group Inc., Research Division

Just one, hopefully, last clarification on the cash taxes. Your guidance does say you'll be paying cash taxes of $100 million. I think you're sort of saying that the refund and that payment are 2 distinct things. Is that the right way to interpret it?

Sunit S. Patel
Executive VP & CFO

The right way to think about it because the cash income taxes pertains to taxes that we expect to pay for 2018 income. The refund was refund from taxes for 2017, so the refund would not show up to the income tax line. It shows up to the working capital line, so that is correct.

Brett Feldman
Goldman Sachs Group Inc., Research Division

So then I know you're not giving formal revenue guidance, but we can kind of infer what you're expecting based on the CapEx range you gave in the reconciliation and the CapEx intensity. And if you sort of do math on that, it sort of suggests you guys think you're going to have a pretty stable top line on a pro forma basis in 2018. So I was hoping you can maybe just provide a little more context around where you see things firming that gave you that conviction. And then, Jeff, hopefully as a component of that answer, you can maybe just address MPLS because I feel like that's a big mystery for investors. They're not really sure how to assess the extent to which there's still demand or which there may be risks to that business as we go ahead. I'm not sure people really even understand how much of your business comes from MPLS. So sorry, a lot in there, but it will be helpful to get that color.

Sunit S. Patel
Executive VP & CFO

Let me start with revenue. As I said, I mean, I think we think that we should be able to drive slightly better revenue performance over time. And the story, as you mentioned, is a little different in various -- each of these customer-facing areas. So won't go through that in detail other than just say that I think that given our position as the second largest wireline carrier serving enterprises in a fiber network, in our footprint, in our products and services, we should be able to do a better job over time gaining share from our competitors who are principally more focused in other segments like wireless and content. So -- and I think we've tried to be realistic with that. So I think that's all I'll say on the revenue side. And I'll turn it over to Jeff for the other question.

Jeffrey K. Storey
President, COO & Director

On MPLS, MPLS is an important product for us because our customers want it. They need it. They need secure communications between large branch offices. It's scalable. It meets their needs. We can put multiple applications over the top of it. But we're also very excited about things like SD-WAN. We have a great capability that we've been working on in CenturyLink for a couple of years, and we think that's going to be a huge product for us. Our customers have networking challenges that are not solved by one size fits all or one product fits all. We will sell MPLS where that makes sense. We will sell waves where that makes sense. We will go to our customers with SD-WAN where that makes sense. One of the things that we've become very good at, at CenturyLink is the migration off other old technologies and onto new technologies. Now I don't think it's an either or between SD-WAN and MPLS. I think it's both. But we have -- are very good at making sure that we sell the right product to the right customer for the right application. And we think MPLS is important in that. We think other products are important in that. And so

I don't know if that fully answers the question, Brett, but we think it's going to continue to be part of our product portfolio that's significant for us.

Operator

Our last question comes from the line of Batya Levi with UBS.

Batya Levi
UBS Investment Bank, Research Division

Can you provide a little bit more color on your comment about aligning CapEx with revenue performance this year? You mentioned on-net focus. Should we expect any significant changes versus where CapEx was spent last year? And maybe also if you could update plans to how many consumer locations you plan to reach with fiber. I think CenturyLink had plans to do about 3 million homes by '19.

Sunit S. Patel
Executive VP & CFO

All right. So I think on the capital question, I think just a quick thing. We are seeing the benefit of the synergies in the CapEx. We think the guide we provide on CapEx addresses revenue growth and other needs. We have to keep driving profitable growth. So most of it will be success based. The allocation of capital, I think as we've talked -- as I talked about, we're going to shift harder on making sure it's for return profiles that are higher, more -- take advantage of our on-net footprint, predictable, whether it's cost reductions or driving profitable margin growth, and we've changed our governance process. So from an allocation perspective, as we've also said, we aim to continue to invest in the consumer business but it being more directed towards where we can extend our fiber footprint and enable -- both enable more higher-speed broadband households plus work on penetrating the ones we've already enabled. So I think that's really the summary on capital. And then, Jeff, I don't think you [indiscernible] you think the same thing.

Jeffrey K. Storey
President, COO & Director

Yes, I don't know if I have anything to add to that.

Sunit S. Patel
Executive VP & CFO

Yes. I mean, we have double opportunity. We've got to do well with the households we've enabled with higher speeds, which has increased quite significantly over the last couple of years with the money that CenturyLink spent on -- whether it's vectoring or bonding or just pushing the fiber footprint deeper. And two, we continue to believe both with CAF funding and other more specific market opportunities, we have got the ability to invest money to push the fiber deeper and both enable more households and succeed better with them.

Glen F. Post
CEO & Director

[I'll add to that]. I'd say, really, the very disciplined approach to capital allocation and that's where we're headed. And we can drive returns to profitability, we'll certainly do that. But we have a lot of previously built capacity to build into or sell into this year.

Operator

I will now turn the call over to Mr. Post for any concluding remarks.

Glen F. Post
CEO & Director

Thank you, Ash. CenturyLink is now the second largest domestic communications provider serving global enterprise customers, and we believe we are well positioned to deliver a great customer experience and a wide array of communications products and services to gain market share over time. We are confident in our ability to successfully integrate CenturyLink and Level 3, and we're excited about opportunities that lie before us. We do expect to drive long-term shareholder value through free cash flow growth, return of cash to shareholders via the dividend and most importantly, by providing our customers with the products and services they need to operate effectively in a digital world. Thank you for joining our call today, and we look forward to working with you in the months ahead. Thank you.

Operator
Thank you, Mr. Post. We would like to thank everyone for your participation and for using the CenturyLink conferencing service today. This does conclude the conference call. We ask that you please disconnect your lines. Have a great day, everyone.