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CTL - Q2 2012 CenturyLink, Inc. Earnings Conference Call

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OVERVIEW:

CTL reported 2Q12 consolidated operating revenues of $4.6b and adjusted diluted EPS of $0.65. Expects full-year 2012 operating revenues to be $18.3-18.4b and adjusted diluted EPS to be $2.45-2.55. Co. expects 3Q12 operating revenues to be $4.54-4.59b and adjusted diluted EPS to be $0.54-0.59.

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Stewart Ewing *CenturyLink, Inc. - CFO*

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to CenturyLink's second-quarter 2012 earnings conference call. At this time, all participants are in a listen-only mode. Later, we'll conduct a question-and-answer session and instructions will be given at that time.

(Operator Instructions)

As a reminder, this call is being recorded.

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

Tony Davis - *CenturyLink, Inc. - VP of IR*

Thank you, Saeed. Good afternoon, everyone, and welcome to our call today to discuss CenturyLink's second-quarter 2012 results released earlier this afternoon. Let me begin by saying I apologize, we got the release out a little later than we had planned, had a little glitch in the release process. We'll certainly strive to get it out sooner next quarter. Thank you for your patience and understanding in that. The slide presentation we'll 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.

On 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 2012, the integration of Qwest and Savvis, and other outlooks in our business. We ask that you review our disclosure found on this slide, as well as in our press release and in our SEC filings, which describe factors that could cause our actual results to differ materially from those projected by us in our forward-looking statements.

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

As you turn to slide 3, your host on today's call is Glen Post, Chief Executive Officer and President of CenturyLink. Joining Glen will be Stewart Ewing, CenturyLink's Chief Financial Officer. And also available during the question-and-answer period of today's call will be Karen Puckett, CenturyLink's Chief Operating Officer, who leads our Region Markets Group; Bill Cheek, President of our Wholesale Markets Group; and Jim Ousley, Chief Executive Officer of Savvis and President of our Enterprise Markets Group. Our call today will be available for telephone replay through August 15, 2012 and accessible by Webcast through August 30, 2012. Anyone listening to a taped or Webcast replay, or reading a written transcript of this call, should note that all information presented is current only as of August 8, 2012, and should be considered valid only as of this date, regardless of the date heard or viewed.

As you move to slide 4, I'll now turn the call over to your host today, Glen Post. Glen?

Glen Post - *CenturyLink, Inc. - CEO and President*

Thank you, Tony. Good afternoon, everyone, and thank you for joining us today as we discuss CenturyLink's second-quarter 2012 results and guidance for the third quarter and full year 2012, as we provide other updates, as well, about our business. During the second quarter, CenturyLink achieved solid results and we continue to make good progress on a number of fronts.

As announced previously, we restructured our operating groups during the second quarter. We completed the reorganization successfully, with minimal disruption of our business operations. We're pleased with the results of that restructuring. Our national and international legacy Business Markets Group, BMG customers, Savvis customers, and federal government customers are now served by our new Enterprise Markets Group, or EMG. And our in-region large business customers, and state and local government customers, are now served by our Regional Markets Group, RMG. We believe this restructuring strengthens our ability to better serve our business and government customers locally, nationally and internationally.

We also continue to make good progress with our integration of Qwest and Savvis and remain on track to meet our synergy targets for these transactions. Our operating group restructuring is just one example of how we continue to further integrate these acquisitions into CenturyLink. Additionally, we continue to see solid bookings in our Enterprise Business segment. And with continued demand for integrated network, co-location, managed hosting and cloud services. And we continue to invest in additional data center capacity to position us to drive further growth from these services in the months ahead. With our fiber-to-the-tower initiative, we continue to make excellent progress in completing fiber builds and enabling high bandwidth ethernet data services to support the growing demand for wireless data backhaul capacity.

As we have previously discussed, while this transition from traditional copper-based data services to fiber-based data connectivity creates some near-term revenue pressure, we are confident our investments in fiber-to-the-tower will generate good returns and provide solid revenue growth over the 7 to 10 years lives of these agreements. Finally, we remain on schedule to launch Prism TV service in our first legacy Qwest market later this year. And are also on schedule to launch our click-to-buy managed hosting and cloud services platform for businesses in the fourth quarter of this year.

Now turning to slide 5. During the quarter we made good progress in improving our top-line revenue trend. We generated revenue of $4.61 billion, or 1.2% year-over-year decline. Comparing favorably to the 3.8% decline and the 2.7% decline for pro forma second quarter 2011 and first quarter 2012, respectively. Excluding data integration revenues, which widely fluctuate from quarter to quarter, the annual revenue decline in second quarter was 1.7%. For full year 2012, we remain on track to reduce our annual revenue rate of decline to the 1.5% to 2.5% range. The integrations of Qwest and Savvis remain on track. And we will continue to leverage these assets to strengthen our competitive position throughout our operating areas. As of the end of the second quarter, we achieved an annual synergy run rate in excess of $380 million, related to the Qwest integration. We continue to expect to end 2012 with an annual synergy run rate of $465 million related to Qwest.

Also in the second quarter, we delivered further access line loss improvement and subscriber growth in broadband and Prism TV services. We continue to scale our Prism TV service in the eight markets where it is available today. And are progressing on our plans to roll Prism out in the first legacy Qwest market later this year. We remain focused on delivering advanced communication solutions and data hosting services to businesses as key factors in improving our top-line revenue trend. As of the second quarter, business customers drive more than 60% of our total operating revenues. During the quarter we generated strong strategic data growth from our business customers in both RMG and EMG.

Moving to slide 6. I'll provide a few highlights regarding our key strategic initiatives. As we have outlined, we are focused on continued investment in broadband expansion and enhancement, Prism TV, fiber-to-the-tower and managed hosting and cloud computing services. Our second-quarter results reflect the solid progress we're making in these key initiatives. Starting with broadband expansion enhancement, we continue to make significant investments. And during the second quarter we had over 18,000 high-speed Internet subscribers. We saw some weakness in demand, but second quarter is a seasonally weak quarter as we have significant presence in two snow bird states, Florida and Arizona. Our customer retention efforts, and the growth benefits of bundling broadband with other products and services, resulted in the continued decline of the rate of access line loss in our business, improving 7.4% in second quarter 2011 to 6.1% at second quarter 2012.

We expanded our fiber-to-the-node infrastructure to an additional 215,000 living units during the quarter. And now passed nearly 6.6 million living units with fiber-to-the-node. And we expect to pass approximately 7 million living units by the end of this year. As a result of our network investment enhancements, broadband speed availability has also continued to improve. Nearly 70% of enabled access lines now receive speeds of 6 megabits or higher. And more than 55% of our enabled lines receive 10 megabits, or higher. And 27% have speeds of 20 megabits or higher. We expect to continue to make investments in our network to deliver competitive broadband products and services across our markets.

Turning to slide 7. Our Prism TV service represents a very compelling entertainment alternative to cable TV service in the eight markets where it's currently available. And it continues to perform well for us. We added over 9,000 Prism TV subscribers during the second quarter, ending the period with over 94,000 subscribers. Of the new customers we've added over the past 12 months, approximately 50% were new customers to CenturyLink. We now have a penetration rate of over 9% across the eight markets in which the service is now available.

In addition, we continue to enhance our IPTV experience by introducing new functionality and applications. This quarter we launched our Mosaic application, allowing our customers to aggregate multiple channels on one stream. And new TV applications, as well, including Facebook, Picasso, Weather Channel, Yahoo Sports, and others that we've enabled this quarter. Prism TV continues to have a positive impact on churn and line loss trends. And we experienced greater than 90% broadband pull-through rate with our Prism TV sales to new customers. Approximately 65% of Prism customers have a triple play bundle with CenturyLink.

ARPU, by the way, is between $165 and $170. So really strong average revenue per customer with our Prism bundles. We continue to see an annualized 350 to 400 basis point improvement in churn for customers taking our Prism product. We remain focused on expanding our Prism TV-enabled footprint and driving additional subscriber growth. And we're on track to launch Prism TV again in our first Qwest market in the coming months.

Continuing on to slide 8. Our third key strategic initiative is investing in fiber builds to as many towers in our service area as economically feasible. This initiative supports anticipated long-term growth in data transport, much of which is driven by wireless data traffic. And expands our addressable customer footprint by enabling fiber access points to other strategic locations where viable, along these routes. During second quarter, we completed approximately 1,350 fiber builds. This is in line with expectations. And we continue to anticipate completing 4,000 to 5,000 builds in 2012, as fiber-to-the-tower construction continues to ramp up through the remainder of the year. We believe our fiber-to-the-tower program helps solidify our wholesale special access revenue for the long-term and assists in stabilizing our revenue trend. As we discussed with you before, we do expect some near-term revenue compression as our wireless wholesale customers transition from copper-based DS1s for backhaul facilities to fiber-based ethernet services. However, we believe the continued acceleration in wireless data consumption will drive increases in ethernet service revenues that will offset any revenue compression within a reasonable period of time and provide solid growth over the 7-to 10-year lives of the associated contracts.

Moving on to slide 9. We continue to invest in managed hosting and cloud service to increase data center capacity, as well as expand our product portfolio to meet customer needs and expand our market opportunity. During the quarter, we announced our 2012 planned data center expansions in seven markets, four of which were online in the second quarter. We also launched our Savvis Symphony, a virtual private data center product cloud solution in Toronto, and now offer this service in five locations across three continents. We continue to focus on leveraging multiple sales channels to drive further growth in data hosting services. And at the end of the second quarter we're seeing significant growth and potential sales of hosting products within the EMG, network, and RMG segments. In the months ahead we will focus on aligning hosting product offerings and solutions bundles with existing RMG and EMG network clients, as we see that demand continuing to grow.

We ended the second quarter with 50 data centers in North America, Europe and Asia, with total sellable floor space of about 1.4 million square feet. And finally, on July 31 we announced the acquisition of certain assets of Ciber's global IT outsourcing, or ITO business. The addition of these assets will complement Savvis' existing ITO assets by expanding our capabilities for application management services and help desk support.

Now on to slide 10. And in summary, I am pleased with our second-quarter financial results. We continue to improve our top-line revenue trend. Our employees did a good job of containing cost. We generated solid cash flows during the quarter. We reduced our access line losses by 22% compared to pro forma second quarter 2011. We grew our high-speed Internet and Prism customer bases during the quarter. We also made solid progress in our key strategic initiatives that we believe position us well to continue to improve our top-line revenue trend in the months ahead.

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

Stewart Ewing - *CenturyLink, Inc. - CFO*

Thank you, Glen. I'll spend the next few minutes reviewing the financial highlights from the second quarter. And then I'll provide a brief liability management update. And then conclude my remarks with an overview of the third-quarter and full-year 2012 guidance we have included in our earnings release issued earlier this afternoon.

Now turning to slide 12. First, in order to provide more relevant comparisons, I'll be reviewing the financial results on a pro forma basis as if Savvis was fully included in the results for all periods. I'll also be reviewing the results excluding special items, as outlined in the earnings release and associated financial schedules.

With that, let's turn to our results for the second quarter. As you can see, we generated strong operating revenues and solid cash flows. Operating revenues were $4.6 billion on a consolidated basis, exceeding our guidance for the quarter. And represent a 1.2% decline from pro forma second-quarter 2011 operating revenues. This also represents a solid improvement from the 3.8% annual decline in the year-ago period.

Excluding data integration revenue, the year-over-year decline in revenue is 1.7%. Strategic revenue in the quarter increased to 45% of total revenue, from 43% in the pro forma second quarter a year ago, due to growth in strategic products such as high-speed Internet, high-bandwidth data services, Prism TV and managed hosting services. Adjusted diluted earnings per share for the second quarter was $0.65, exceeding guidance by $0.01, driven primarily by higher growth in strategic revenue than anticipated, and a one-time adjustment to depreciation expense.

As we've discussed on prior earnings' calls, adjusted diluted EPS excludes special items and certain non-cash purchase accounting adjustments. Total cash operating expenses increased modestly from pro forma second quarter a year ago to second quarter 2012. With synergy achievement and other cost reductions, partially offset by continued investments in our key strategic initiatives, as well as other related revenue growth. We generated solid operating cash flow of approximately $1.9 billion for the second quarter and achieved an operating cash flow margin of 41.2%. Additionally, we generated $779 million of free cash flow during the quarter, which is defined as operating cash flow, less cash taxes paid, interest, cash interest, as well as capital expenditures and additional adjustments to other income.

Our strong cash flows continued to provide us the financial strength and flexibility to meet our business objectives and drive long-term shareholder value. As a result, our operating group restructuring, that Glen discussed earlier, the segment financial information has been realigned this quarter to support this new operating structure. We've also provided a supplemental financial schedule this quarter that provides restated historical quarterly segment financial information, retroactive to first quarter 2011.

The four segments are defined as follows. Regional Markets Group is reported as one segment and includes Region Market Group's financial information as previously reported. Along with revenues and the related direct and allocated costs associated with the in-region large business customers, and state and local government customers transferred through the Region Markets Group from legacy Business Markets Group.

Enterprise Markets Group is operated and reported as two segments. First, the Network Services Segment includes the Network Services revenues and the related direct and allocated costs associated with the national and international Business Markets Group customers, and federal government customers transferred to EMG from BMG, along with the Savvis operating group's network services customers. Second, the Data Hosting Services segment includes co-location managed hosting, and cloud services revenues. And the related direct and allocated costs associated with the national and international Business Markets Group customers and federal government customers transferred to the EMG group from the legacy BMG group, along with Savvis operating group's data hosting services customers.

Wholesale Markets Group is reported as one segment. It includes the Wholesale Market Group's financial information, as previously provided, along with revenues and the related direct and allocated costs associated with this Savvis operating group wholesale customers that we transferred from Savvis.

Now turning to slide 13. I'll begin the operating segments' discussion today with our Regional Markets Group. The Regional Markets Group generated $2.48 billion in operating revenues, which represents a decrease of 2.6% over pro forma second quarter a year ago. Strategic revenues grew to $894 million in the quarter, up 5.8% pro forma year-over-year. Excluding the impact of private line revenues, strategic revenues grew approximately 7%. Legacy services revenues for the segment declined $122 million, or 7.5% from pro forma second quarter 2011, due primarily to a continuing decline in revenues related to access lines. Our expense reductions for the second quarter compared to the previous year were mainly driven by lower employee-related costs, professional fees, and marketing and advertising costs, which were partially offset by higher Prism TV and data integration expenses.

Moving to slide 14. Our Wholesale Markets Group generated $944 million in operating revenue. A decrease of 4.1% from pro forma second quarter 2011. This decline was a result of wireless and other wholesale carrier bandwidth revenue growth being more than offset by the continued decline in access and long-distance revenues. Strategic revenues for WMG grew 2.1% to $572 million from pro forma second quarter 2011, primarily driven by continued strong data transport demand from wireless providers. WMG's legacy revenues declined by 12.3% to $372 million, reflecting the continued decline in access and long-distance revenues. WMG's operating expenses for the quarter were $286 million, or 6.8% below the pro forma period from a year ago.

Moving to slide 15. EMG Network Services segment generated $648 million in operating revenues during the second quarter, which represented an increase of 2% from pro forma second quarter 2011. The second quarter represented the second consecutive quarter of sequential growth in recurring revenues for the Network Services segment. Second-quarter strategic revenues for EMG Network Services increased by $9 million, or 2.8%, to $333 million from pro forma second quarter 2011, driven primarily by strength in high bandwidth services such as MPLS, ethernet and DWDM.

Excluding private-line services, strategic revenue grew nearly 7% from the pro forma year-ago period. Legacy revenue for EMG Network Services declined by $8 million from pro forma second quarter 2011, due primarily to declines in local and legacy WAN services. While data integration revenues increased $12 million or 14%, due to higher equipment sales and professional services revenues from government and enterprise customers. Our total segment expenses in EMG Network Services were virtually flat from the same period a year ago.

Now turning to slide 16 and our EMG Data Hosting Services segment, which is primarily legacy Savvis operations. This segment generated $277 million in operating revenues, representing an increase of 6.5% from pro forma second quarter 2011 revenues of $260 million. There are additional $45 million of Data Hosting revenues reflected in our other segments. We expect to provide a schedule that will reflect total Data Hosting revenues across the Company on our website early next week. This growth came primarily from year-over-year increases of 4.7% in co-location revenues, and 11.5% in managed hosting and cloud services revenues. And a modest increase in Network Services revenues. Strong bookings in Data Hosting Services in the prior two quarters helped drive this revenue growth in the second quarter. A solid pipeline and additional capacity will support continued revenue growth in the second half of 2012. EMG Data Hosting operating expenses were $211 million in the second quarter, compared to $196 million in pro forma second quarter 2011. This increase of 7.7% is driven by added headcount in operations, and sales and marketing staff to support revenue growth.

As reflected in slide 17, we continued to make good progress on our liability management plans. In 2011, we set a target to repay $1.5 billion to $2 billion of gross debt on a pro forma basis as of December 31, 2010, over the two-year period ending December 31, 2012. We remain on track to reach this goal, as we've accomplished approximately $1.5 billion of our target, excluding debt refinancings year-to-date through July. If you consider year-to-date refinancings, including the associated premiums incurred to call debt associated with the refinancings, we've accomplished about $1.1 billion of our target. Recent liability management actions have extended the weighted average maturity of our debt by approximately two years. And slightly decreased our weighted average interest rate. The chart reflects the change in annual debt maturities, as you can see. These recent actions position CenturyLink well from a debt maturity standpoint through 2017. Maturities over the five-year period, 2013 through 2017, have declined over 35% from $9 billion to $5.6 billion, making the annual maturities over that period very manageable.

As a result of the refinancing and debt reductions over the last several months, we currently expect interest expense to decline modestly each quarter through the remainder of 2012. The Pension Relief Act, passed as part of the highway bill in June, reduced our required pension contributions by approximately $1 billion over the next three years. We currently expect our required contribution to be $100 million in 2013. This compares with an expected contribution of about $500 million in 2013, prior to the passage of the legislation.

Slide 18 addresses our third-quarter and full-year 2012 guidance. CenturyLink expects growth in strategic revenue in the third quarter. However, we also expect third-quarter 2012 revenues to be negatively impacted by the decline in access revenues as a result of the implementation of the FCC's USF/ICC transformational order. And the reduction effective July 1, 2012 in monthly universal service contribution rate assessed to end users, which will be partially offset by the implementation of access recovery charges in accordance with the order. The total negative revenue impact of these three items on the third quarter, compared with the second quarter, will be about $25 million.

Operating expenses are also anticipated to increase in the third quarter 2012, as compared to second quarter 2012, due to the normal seasonality of outside plant maintenance and utility cost, which we believe approximates an additional $50 million. Increased data center operating costs as a result of some of the expansions that we've done at our data hosting area. And higher depreciation and amortization of approximately $20 million, which will be partially offset by other operating efficiencies. For the third quarter 2012, CenturyLink projects total operating revenues of $4.54 billion to $4.59 billion. And operating cash flow between $1.82 billion and $1.86 billion. Adjusted diluted EPS is expected to be $0.54 to $0.59. The Company expects fourth-quarter 2012 operating revenues and operating cash flow to increase compared to third quarter 2012, due to anticipated continued growth in strategic revenues and lower outside plant maintenance and utility and marketing costs.

Slide 19 reflects our full-year 2012 guidance. Our operating revenue, we expect to be $18.3 billion to $18.4 billion, which is consistent with the guidance we gave last quarter. Or actually it's up $100 million on the lower end. Our operating cash flow from $7.5 billion to $7.65 billion. Adjusted diluted EPS from $2.45 billion to $2.55 billion(sic-see press release "$2.45 to $2.55"). Capital expenditures from $2.7 billion to $2.8 billion. And free cash flow from $3.25 billion to $3.4 billion. In essence, we've tightened our ranges and increased the midpoints of our guidance by moving the bottom of our ranges up to reflect our year-to-date performance.

Turning to slide 20. In summary, we are investing to drive growth in our strategic initiatives that we believe will result in continued improvement of our top-line revenue trend. We continue to believe a solid balance sheet is important to our financial flexibility, and feel confident about our cash flow generating ability, which allows CenturyLink to return meaningful cash to our shareholders.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Simon Flannery.

Simon Flannery - *Morgan Stanley - Analyst*

You mentioned the pension impact. Can you give us an update on the labor negotiations with the contract up in October, and what you're hoping to achieve from those? Also I noted that you were doing some metro fiber builds in Charlotte. Perhaps you can provide a little bit more color on how extensive those metro deployments are. And if we're going to see more of those over time. And what's the payback on some of those projects? Thanks.

Glen Post - *CenturyLink, Inc. - CEO and President*

Yes, Simon. Regarding the union negotiations, we're not going to really discuss any specifics at this time. But we're looking for ways to really better align our costs with the revenue sources. That will be our primary objective. The Qwest contract expires October 6. We'll be well prepared for the possibility of a strike. But I remain really cautiously optimistic that we'll be able to reach agreement with the CWA and IBW. We'll negotiate in good faith and expect the CWA and IBW leaders to do the same. However, you just never know until the negotiations are over, as we've seen this past week with AT&T, some things happening there. But we're cautiously optimistic and have begun preliminary discussions with them.

Simon Flannery - *Morgan Stanley - Analyst*

Okay, thank you.

Stewart Ewing - *CenturyLink, Inc. - CFO*

And Simon, on the metro fiber build in Charlotte, I'm not familiar with that one. I know that we're building to customers, as we pick up additional customers and it makes sense from an economic standpoint.

Simon Flannery - *Morgan Stanley - Analyst*

So there's no real change in your mix of CapEx?

Stewart Ewing - *CenturyLink, Inc. - CFO*

No, there's no real change. We are doing some data center builds, building into some data centers that we've not been built into previously. We're also, in conjunction with Savvis, doing some work there to basically integrate their network with our network, and give some redundancy to some of the data centers that Savvis has. We're doing some things like that, but there's no real specific change in our CapEx budget or philosophy there.

Simon Flannery - *Morgan Stanley - Analyst*

Great. Thank you.

Operator

Frank Louthan.

Frank Louthan - *Raymond James & Associates - Analyst*

Great. Thank you. Can you give us an idea on the enterprise side, what percentage of new RFPs and things are incorporating more of the Savvis type products versus the more traditional voice and data products? And looking at your fiber-to-the-tower expansion there, are there any fiber-to-the-tower builds that you're seeing that are uneconomic that you're walking away from? Or are you pretty much going after everything that comes up?

Stewart Ewing - *CenturyLink, Inc. - CFO*

Frank, I'll get the last one first. With respect to fiber-to-the-tower, we are walking away from some of the builds that aren't economic for us. It's really very insignificant, I think. Generally, if we can't build to a tower, no one else can either. We're not seeing a lot of people build in our markets, that we're aware of, from the standpoint of the towers that we wouldn't be willing to build to. So with the agreements that we have with major carriers, and some of the smaller carriers as well, we feel very good about our ability to be able to capture the revenue that would otherwise be cannibalized from the wireless providers.

Glen Post - *CenturyLink, Inc. - CEO and President*

Frank, I'll make a brief comment, and ask Jim Ousley to talk more about your question about the RFPs. I don't have the RFP percentages. But I just know in our dealing with customers, and the requests we're receiving from our large customers, I would say the vast majority are talking about the Savvis type or the cloud-hosting products, that I talk with. And as I talk with our sales folks around the country, they're very interested. Some long sales cycles here but a lot of interest. And Jim, do you want to --?

Jim Ousley - *CenturyLink, Inc. - CEO of Savvis and President of Enterprise Markets Group*

Hi, Frank. I would just reinforce that. Now with the combination of the old BMG enterprise sales force working together, virtually every one of our major enterprise CenturyLink customers are now interested in talking about Savvis products. So we aren't seeing a big change in the RFP type alignment. But clearly every major customer is now talking about Savvis products. And vice versa. The Savvis enterprise customers are requesting information on CenturyLink capabilities. So we're going to see leverage from it, no question about it.

Frank Louthan - *Raymond James & Associates - Analyst*

Great. That's helpful. Thank you.

Operator

David Barden.

Julia Senior - *BofA Merrill Lynch - Analyst*

This is Julia Senior for Dave. Just on synergies and where they're coming in this year, is it more fourth quarter-weighted or are we going to see some in the third quarter? Maybe just some detail on exactly where those synergies are coming from. And then just a side note, you guys put in the supplementals a breakdown of Savvis. Are you going to continue to give that going forward? Thanks.

Glen Post - *CenturyLink, Inc. - CEO and President*

Yes, Julie. We ended the quarter with a run rate of about $380 million or so. We still expect to end the year at about $465 million or so. We'll see incremental synergies in the third quarter. And then we'll see some other incremental synergies in the fourth quarter, as well. So I would say if you're doing a model basically spread them evenly and you'll be in pretty good shape.

Stewart Ewing - *CenturyLink, Inc. - CFO*

Also, we will continue to break out Savvis as we did this quarter in the rest of the year, Julie. And we're probably going to do more than just break Savvis out. I think we're going to provides you with a schedule. We have data hosting. Our segments are really more by customers. So we have customers of the Wholesale Group and the RMG group that also have hosting services. And we're basically going to provide you a schedule of all of the hosting revenue across the Company. So we'll get that out hopefully on the website in the next week or so.

Julia Senior - *BofA Merrill Lynch - Analyst*

Okay. Great. Thank you.

Operator

Nicole Black.

Nicole Black - *- Analyst*

Stewart, I was hoping you could clarify the comment you made about the $1.5 billion debt reduction excluding debt refinancing. So, are we to take it that that does not net out the $2 billion of bond issuance that CenturyLink did in March over the $900 million of bond issuance that Qwest Corp. has done this year?

Stewart Ewing - *CenturyLink, Inc. - CFO*

Basically, when we first looked at the debt paydowns that we would do, we didn't know what refinancings we would do. So we basically looked at the maturities that were coming up, as well as the other debt that was going to be coming due. The debt was going to be coming due close to other debt that we might be able to call. And we were going to get to $1.5 billion to $2 billion. The $1.5 billion really includes everything that we have paid off to date that was a scheduled maturity or something that we could call early. The remainder, the other, the $1.1 billion, really takes into consideration all the refinancings that we did and the associated premiums that we had to pay, as well. So we paid about $350 million or so, $350 million to $400 million of premiums associated with the debt that we called, associated with the refinancings, that allowed us to really get our maturity towers to where we needed to get them for the next five years.

Nicole Black - *- Analyst*

Okay. So does that mean $1.1 billion is how much you've accomplished against the $1.5 billion to $2 billion goal?

Stewart Ewing - *CenturyLink, Inc. - CFO*

The way that we were looking -- if you look at it that way, then basically we'll probably get towards the lower end of the range. Maybe $1.4 billion to $1.5 billion or so, because we've got a $318 million maturity that comes up August 15 that we expect to pay off and put on a credit facility. But then we'll ultimately pay that off, if not by the end of fourth quarter, sometime during the first quarter. If you count the premiums that we had to pay in effect, then we'll get closer to the $2 billion. So that's the way to look at it. The way to look at it really is, we'll get towards the bottom end if you look at debt -- net debt, more or less. If you look at the debt including the premiums that we had to pay, then basically we'll be closer to the top end of the range.

Nicole Black - - *Analyst*

Okay. And then at your Analyst Day I believe you cited your leverage target of the 2 to 2.5 range. Do you have a time frame associated with that?

Stewart Ewing - *CenturyLink, Inc. - CFO*

We really don't. Our leverage with leases was about 2.8 times trailing 12 months ending the third quarter. Probably about 2.7 times or so if you exclude leases. Our target is more or less in that range, but not any specified period of time to get to there.

Nicole Black - - *Analyst*

And the ratings agencies do count the leases in their calculation, correct?

Stewart Ewing - *CenturyLink, Inc. - CFO*

Yes, they do. And, of course, Moody's has their calculation. Their target for us is to get down to 3 times and we're a little bit over 3 times now, based on the target that they have for our rating.

Nicole Black - - *Analyst*

That is very helpful. Thank you.

Operator

Chris King.

Chris King - *Stifel Nicolaus - Analyst*

Just wanted to follow up a little bit on the regulatory issues that are impacting you in the third quarter to the tune of $25 million or so. And realizing there's a lot that's yet to be decided at the SEC level in terms of timing of stepdowns and subsequent recovery mechanisms. Just was wondering if we could get your quick thoughts on how you see that, at least at this stage, playing out over 2013? Right now are you guys expecting to see another $25 million stepdown in the middle of 2013? Is that in your internal plans for right now? And then, secondly, just wanted to get any of your latest thoughts regarding special access, re-regulation at the SEC, and where that currently stands in your mind. Thanks.

Stewart Ewing - *CenturyLink, Inc. - CFO*

Yes. Chris, the $25 million includes about $15 million stepdown in the USF contribution rate. That will result in reduced revenue but it also results in reduced expense for us, as well, the way we account for it. The access reform on a net basis, if you take the access charges reduction, which is, if I remember right, about $30 million -- $27 million to $30 million -- and you net that with the increase that we can flow through to our customers, it nets to about a $10 million negative in the third quarter. And of course that will recur -- it will be flat in the fourth quarter. So next July we'll see another stepdown. Really don't know how much at this point. And we're in the process of building our 2013 pro formas to go over with the Board. We'll have that by the mid-September or so time line. But wouldn't expect anything more significant than the stepdown that we saw this year.

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Chris King - *Stifel Nicolaus - Analyst*

Thanks. Then on the special access?

Stewart Ewing - *CenturyLink, Inc. - CFO*

Yes. Basically, we've provided additional information to the FCC. We know that this is something that's on their agenda to look at over time. It's been on there for a long time. At this time, there's plenty of competition in the special access market. So we don't really foresee any re-regulation of special access. We think that that would really be a long shot if that were to happen. Not in the near term.

Chris King - *Stifel Nicolaus - Analyst*

Thank you.

Operator

Scott [Coleman].

Scott Goldman - *Goldman Sachs - Analyst*

It's Scott Goldman here. Wondering if you could maybe talk a little bit about the revenue trajectory. You guys highlighted a $25 million impact in the third quarter. But it looks as though the trajectory would suggest that second half should be about on par with a 1.2% decline, or maybe even a little bit worse. Presumably in part due to the $25 million, but with potential, possibly even sequential step-up in the fourth quarter. So just wondering if you guys could just lay out the trajectory for revenue and what some of the drivers there. And then I have a follow-up, as well.

Stewart Ewing - *CenturyLink, Inc. - CFO*

So if you look at fourth to fourth quarter, probably there would be about a 1.6% decline, from a year ago.

Scott Goldman - *Goldman Sachs - Analyst*

1.6%?

Stewart Ewing - *CenturyLink, Inc. - CFO*

Yes, about 1.6%, probably.

Scott Goldman - *Goldman Sachs - Analyst*

And I assume part of that is just a tougher comp from the year-ago quarter?

Stewart Ewing - *CenturyLink, Inc. - CFO*

Yes.

Scott Goldman - *Goldman Sachs - Analyst*

So, if you're sitting, say, at 1.2% now, obviously you have a tougher comp, how do you think about the trajectory of revenue going into 2013 and your ability to possibly even grow revenue on a sequential basis?

Glen Post - *CenturyLink, Inc. - CEO and President*

Yes. We're getting closer to the point. And if you take our last six or eight quarters and just plot them out, you can see that we've made really good progress in terms of hopefully flattening out revenue and starting to grow revenue. We mentioned in our EMG Network segment, if you exclude the CPE type revenue that fluctuates, we've seen our second quarter of sequential growth. So we're getting close. We're not ready to put a stake in the ground and say it's 2013, or some time in 2013 or 2014. But we're definitely moving closer. And we would expect our revenue decline in '13 to be lower than decline that we end up with in 2012. Because we expect continued growth in the network area. We're having good success with the local model that we have put in place in the markets, where we're the primary telephone company. And we're seeing improved growth, we think, in the second half of this year with respect to the data hosting revenues. So we think things are setting up pretty well.

Scott Goldman - *Goldman Sachs - Analyst*

Then just to follow up on your commentary about the Network segment. I was looking at the pro forma information you put out. It looked like a nice stepup on the year-over-year improvement in strategic services. But an equally good stepdown, actually, in the rate of decline in the legacy services. So maybe you can talk a little bit about what's driving that. And just what your expectations are for data integration for the back half of the year.

Glen Post - *CenturyLink, Inc. - CEO and President*

Data integration is hard to say. We've got a number of deals in the pipeline but it's hard to say when they might close. That gets pushed from time to time, quarter to quarter. In terms of the strategic revenue, we are seeing good growth there. We're seeing good opportunities with larger business customers that have asked us to take a look at being a participant in providing services to them. Or taking over one of the other larger carriers. So our MPLS and Ethernet growth is really strong. And we expect it to continue to be strong during the rest of the year. Some of that revenue growth is actually cannibalizing some of the other revenues that we have, some of the legacy revenues that we have.

Scott Goldman - *Goldman Sachs - Analyst*

Great. Thanks, guys.

Operator

Michael Hodel.

Michael Hodel - *Morningstar, Inc. - Analyst*

Just looking at the Prism TV adds in the quarter, they were maybe a little bit lighter than I would have expected, given how new you guys are in that business. I was just wondering if you could talk about anything in the competitive environment that you're seeing. Or if there are any changes you guys are anticipating making in terms of maybe promoting the service or anything else you might be thinking about planning, to jump start growth in Prism adds as you go forward.

Karen Puckett - *CenturyLink, Inc. - COO*

Michael, Karen Puckett. In terms of the Prism TV, in general, second quarter is just weak seasonality in high speed and in Prism. When I look at overall, we're happy with our inwards. From a competitive standpoint, we continue to get really good comments from our customers. Depending on which market, at least 50% of our customers are new to our Company. And so it is a big inward driver for us. As we expand we'll continue to work on just distribution, the inwards. But not any competitive issues. In fact, we're very pleased with the performance of Prism right now.

Glen Post - *CenturyLink, Inc. - CEO and President*

And we do expect to increase some of the advertising in some of these markets in the last half of the year as well, Michael.

Michael Hodel - *Morningstar, Inc. - Analyst*

Great. Thank you.

Operator

Brian Turner.

Brian Turner - - *Analyst*

Just one quick one from me. Can you give us any color on potential conversations you've had with the rating agencies as you look forward towards the end of the year into '13? Specifically, have they provided any granularity around a criteria they might be looking for in order to maintain or stabilize the current ratings?

Stewart Ewing - *CenturyLink, Inc. - CFO*

Yes, Brian. Of course, we're not investment graded S&P. We're fine there in terms of the rating that we have today. And wouldn't expect to get an upgrade there until we can show that we can stabilize revenue and start growing cash flow again. With respect to Moody's and Fitch, on Moody's we've had conversations with them. Their target more or less, to take the negative outlook off the parent company, is basically for them to be able to see that we can get down to 3 times debt to EBITDA based on their calculation. And they're willing to give us some time to do that and they understand where we are. We have a conversation with them each quarter and we have face-to-face visits a couple times a year. Expect to be able to give them our 2013 projections probably sometime after we meet with our Board in September.

And again, I think they want to be able to see clear that we can get down to 3 times coverage leverage on their basis in order to remove the negative outlook. With Fitch, the dividend payout ratio is more what they look at. And it's about 55%, which is in line with where we are. And I think they're willing to potentially give us a little flexibility if we need to make other investments that they can see are strategic investments from the standpoint driving revenue in the future, or preserving revenue. An example of that is fiber-to-the-tower. So that's where we are with the agencies.

Brian Turner - - *Analyst*

Excellent. Thank you.

Operator

This does conclude our question-and-answer session for today. I would now like to turn the conference back over to Mr. Glen Post for any closing remarks.

Glen Post - *CenturyLink, Inc. - CEO and President*

Thank you, Said. We are pleased with the continued progress we made during the second quarter towards stabilizing top-line revenues in our business. And we believe our continued investment in what we see as key strategic opportunities will help us continue to drive growth, both near term and long term. Our strategic revenues continue to grow nicely. And our guidance reflects our expectation that our revenues from strategic services will continue to grow in the months ahead. We also remain focused in ensuring that our operating costs align with our revenue mix. And on achieving our operating expense synergy targets for the successful completion of the Qwest and Savvis integrations. Additionally, the expansion of our Prism TV service and launch of managed hosting and cloud services for small- and medium-sized business customers later this year will further strengthen our product portfolio, and provide us additional revenue growth opportunity as we look into 2013. Thank you for joining our call today and we look forward to speaking with you in the weeks ahead.

Operator

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