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CenturyLink, Inc. (CTL)

Q3 2013 Earnings Call

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MANAGEMENT DISCUSSION SECTION

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

FINANCIAL MEASURES

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

Glen F. Post, III
President, Chief Executive Officer and Independent Director, CenturyLink, Inc.

OPENING COMMENTS

- First, I'd like to take a moment to acknowledge the hard work and dedication of our employees in the Northern Colorado region
- During the worst of the flooding that occurred there in September, we had thousands of customers experience service outages among, of course, other hardships

- Our local field operations team worked around the clock to manage unprecedented workloads for several weeks and we brought resources from around the state and country into the front range area to support our local teams
    - And they all did an amazing job restoring service to our customers there
- So our thoughts and prayers go out to all those affected, including our employees, who have been partially impacted by that event

OVERVIEW

- Turning to slide 5, we are pleased with our financial results for Q3 as we continue to make good progress on a number of fronts
- We believe our investments in our key strategic growth initiatives continue to strengthen our overall product portfolio, which further positions CenturyLink as a leading integrated provider of global network, data hosting and cloud solutions

Non-Cash Goodwill Impairment

- I'd like to address a couple of significant special items that affected our financial results for the quarter
- First, as you saw in the press release, we booked $1.1B non-cash goodwill impairment during the quarter
- The impairment was related to goodwill assigned to the Data Hosting segment and it was primarily due to our recent performance being factored into the development of growth projections used for calculating impairment
- We are not satisfied with our recent results in this segment of our business and we will be taking aggressive steps to drive the revenue growth and margins in this segment to be more in line with industry growth rates going forward

Settlement of KPNQwest Bankruptcy Litigation

- Secondly, we have reached a tentative agreement on the principal financial terms of a potential settlement of the KPNQwest bankruptcy litigation in the Netherlands
- The oral agreement was reached following confidential mediation between CenturyLink, KPN and KPNQwest trustees
- As a result, we have reported €172mm or $233mm based on September 30, 2013 exchange rates pre-tax charge this quarter
    - This proposed settlement amount of €172mm is significantly below the €4.2B litigation claim
- We're hopeful this settlement will be finalized and look forward to putting this issue behind us

Q3 HIGHLIGHTS

- Beginning on slide 6, I'd like to review some highlights from Q3
- We generated solid financial results with annual strategic revenue growth of 4.2%
- Excluding low-speed, private-line data services, our strategic revenue grew by 12% for the quarter
- Strength in revenues from high-speed Internet, high-bandwidth data products, Data Hosting and Prism TV were the primary drivers of this growth
- We generated strong subscriber growth in the quarter, adding 33,000 broadband customers and 17,000 Prism TV customers

Business Market Perspective

- From a business market perspective, we experienced strong new sales to business customers for network and hosting services during the quarter
- And also in the quarter, we made strong progress on the share repurchase program we announced in February
- Through November 5 of this year, we repurchased 38mm shares or 6.1% of our outstanding common stock for a total of approximately $1.3B
- We have repurchased shares aggressively since the start of the program, and we expect to opportunistically buy back additional shares going forward
- Through the combination of dividends and share repurchases, we returned over $2.2B to shareholders through the first three quarters of the year
    - That's a 63% increase compared to approximately $1.4B during Q1 2012

KEY STRATEGIC INITIATIVES

Broadband Expansion Enhancements

- If you turn to slide 7, I'll provide an update on our key strategic initiatives starting with broadband expansion enhancements
- We continue to make significant investments in this area that we believe will better serve our customers – our business and consumer customers
- We ended the quarter with approximately 5.94mm broadband customers
- As I said earlier, we added 33,000 new subscribers in the quarter, which was a strong improvement from the seasonally weak second quarter
- We believe our fiber assets including nearly 240,000 fiber route miles across the U.S. have positioned us well in the business market

MTU PROGRAM

- We continue to grow our advanced multi-tenant unit, MTU, program
- We added 400 fiber-fed buildings in third quarter, increasing the number of fiber-fed buildings by 40%
- This program offers broadband capabilities of up to 500 megabits of symmetrical service and enhances cloud connectivity for these business customers
- In addition, we plan to leverage our existing fiber to opportunistically expand speed and service capabilities to higher value business and consumer customers

GPON Technology

- We are focusing on GPON technology in certain high-density business districts offering broadband speeds of up to 1 gigabit
- Both the MTU and GPON programs offer upstream speeds and business service level agreements, or SLAs, beyond what is normally available with cable companies
    - These offerings are particularly compelling in the business market where upstream capabilities are critical to the enablement of cloud services

ETHERNET SERVICES

- In business areas where we do not offer advanced MTU or GPON programs, we've extensively deployed Ethernet services
- We currently cover over 2mm business locations with Ethernet capability with nearly half of this footprint capable of 20 megabits and higher symmetrical speeds
- In Omaha, which is our first GPON 1 gigabit trial market, we have deployed 1 gig service capability to over 40,000 homes, and we expect to reach nearly 50,000 homes in the trial area during Q4
- We are very encouraged with these early results in Omaha, and we additionally – we announced recently in October that we will expand our fiber network pilot to Las Vegas, enabling Internet speeds of up to 1 gig to consumers and small businesses in select neighborhoods in that market
- In the months ahead, we expect to continue making investments in our network to enhance speed capabilities required to deliver competitive broadband products and services across our markets

Prism TV Service

- Turning now to slide 8, our Prism TV service continues to perform well and represents a very compelling entertainment alternative to cable TV service in the markets where we offer this service
- We added a record 17,000 Prism TV subscribers during Q3, ending with a total of 149,000 subscribers in service
    - Over 50% of these added customers are new to CenturyLink, and they continue to have a high rate of broadband attachment
- This quarter, we expect a record level 98% attachment rate
- We continue to expand the footprint where Prism service is available, and in third quarter, we added approximately 285,000 addressable homes of which just over half were in the newly launched market of Phoenix, Colorado Springs and Omaha

SUBSCRIBER GROWTH

- We are very pleased with the early Prism subscriber growth in our first legacy Qwest markets to provide this video service in Phoenix, Colorado Springs and Omaha
- Prism triple-play bundled customers are significantly less likely to churn than single-play voice customers
- And in Q3, the churn rate for Prism triple-play customers was over 600 BPS lower than single-play voice customers
- In addition, we continue to enhance our IPTV features by introducing new functionality and applications, including:
    - Expansion of our TV Everywhere capabilities
    - Our video-on-demand library
    - And a recent successful trial of wireless set-top boxes

Investing in Fiber Builds

- And taking you on now to slide 9, a third key strategic initiative is investing in fiber builds to as many towers and service areas as economically feasible
- During Q3, we completed approximately 1,200 fiber to tower builds for a total of over 17,900 across our footprint
- We currently expect to complete a total of 3,500 to 4,000 builds in 2013

- That is slightly below our previous expectation of 4,000 to 5,000 primarily due to construction delays by wireless carriers
- As expected, we continue to experience some revenue compression as our wireless wholesale customers transition from copper-based DS1 facility to fiber based Ethernet services
- However, we anticipate that wireless data bandwidth growth will result in expansion of Ethernet consumption and thereby reverse the current revenue compression during 2014

Managed Hosting and Cloud Services

- Moving on to slide 10 in managed hosting and cloud services, we continue to believe we are well-positioned to capitalize on long-term growth opportunities in this space where we developed and are expanding our strong product offerings
- We experienced weaker than expected sequential Data Hosting revenues primarily due to one-time credits and legacy Qwest hosting churn in Q3
- Despite weaker third quarter revenue, we continue to expect revenue growth in H2 2013 compared to H1 2013

SALES MOMENTUM

- We continue to build upon the sales momentum of the past few quarters with solid new sales again this quarter
- Cross-sell or team-selling opportunities for hosting products across our hosting and network sales teams continues to be strong with sales of hosting services to business customers steadily growing
- We expect this momentum to continue as customers continue indicating strong demand for managed hosting and cloud solutions to streamline their operations and increase efficiency and reduce cost
- As we work through the exiting of a few major colocation customers from the legacy Qwest data centers, it will more thoroughly enable the selling of hosting products to our large base of business network subscribers and expand our on-boarding process, we expect to see significantly better growth in our hosting operations

DATA CENTER CAPACITY

- We continue to invest to increase our data center capacity as well as expand our product portfolio to meet customer needs and expand our market opportunity
- We currently have 55 data centers globally
- In Q3, we added approximately 20,000 square feet of sellable floor space through the expansion of existing facilities in three markets
    - And YTD, we've added approximately 80,000 sellable square feet
- Lastly, we recently expanded our partnership with VMware allowing Savvis and VMware to offer enterprise services on VMware's hybrid cloud powered by Savvis collocation services, and we're pleased with that partnership development

Agreement with CWA and IBEW

- Finally, before I turn the call over to Stewart, I am pleased the tentative agreement with the CWA and IBEW was ratified in late October
- The contract covers 12,000 employees and will be effective through October 7, 2017

- Our focus in these negotiations has been to align the cost structure and work rules under this agreement with the rest of our organization and the competitive dynamics in the markets where we operate
    - I believe we've made progress towards these objectives
- Overall, I am pleased with the solid results for Q3
- We continue to advance to drive growth and are experiencing good traction in these key areas

R. Stewart Ewing

Chief Financial Officer, EVP & Assistant Secretary, CenturyLink, Inc.

FINANCIAL HIGHLIGHTS

- I'll spend the next few minutes reviewing the financial highlights from Q3 and then conclude my remarks with an overview of Q4 guidance we included in our earnings release issued earlier this afternoon

GAAP Net Loss

- Turning to slide 12, on a GAAP basis, we reported a net loss of $1.05B and a loss per share of $1.76, primarily driven by the two special items Glen mentioned earlier that were disclosed in our press release
- For the remainder of my comments, I'll be reviewing the results excluding special items as outlined in the earnings release and associated financial schedules

Operating Revenues

- As you can see, we generated solid operating revenues and cash flows in the quarter
- Operating revenues were $4.52B on a consolidated basis, a 1.2% decline from third quarter 2012 operating revenues
- Our core revenues, defined as strategic revenues plus legacy revenues, were $4.1B for Q3, a decline of 1% from the year ago period
- Our strategic revenues grew 4.2% y-over-y and now represent 49% of our total revenues
- Strength in strategic products such as high-speed Internet, high-bandwidth data services, Prism TV and managed hosting services continues to drive this growth

Cash Expenses

- Third quarter 2013 cash expenses increased 1.4% from the year ago period, driven primarily by higher professional fees and non-employee cost, which offset lower personnel-related costs
- Included in Q3 expense was less than $5mm related to the Colorado floods Glen mentioned earlier
- We've also incurred less than $10mm of flood-related expense during the month of October

Operating Cash Flow

- We generated strong operating cash flow of approximately $1.81B for Q3 and achieved an operating cash flow margin of 40%
- As we move toward revenue stability, we do expect continued pressure on operating cash flow as the revenue mix shifts to lower margin products
- We near the full achievement of operating expense synergies related to the Qwest acquisition

STRATEGIC INVESTMENTS AREAS

Adjusted Diluted EPS and FCF

- And lastly, we continue to make investments in strategic areas to drive future growth
- Adjusted diluted EPS for third quarter was $0.63
- As we've discussed on prior earnings calls, adjusted diluted EPS excludes special items and certain non-cash purchase accounting adjustments as outlined in our press release and associated supplemental financial schedules
- Additionally, we generated $761mm of FCF during the quarter, which is defined as operating cash flow less cash paid for taxes, interest and CapExs, and additional adjustments to other income
- Our strong cash flows continue to provide us with the financial strength and flexibility to meet our business objectives and drive long-term shareholder value

Operating Revenues

- Now turning to slide 13, the 1.2% decline in third quarter 2013 operating revenues compared to third quarter a year ago was primarily the result of growth in strategic revenues that was more than offset by lower legacy revenues due to access line losses and lower minutes of use
- The growth in our strategic revenues was primarily driven by strength in high-speed Internet, high-bandwidth business data services, Prism TV and Data Hosting services

OPERATING SEGMENTS

Consumer Segment

- Now, turning to slide 14, I'll discuss each of our operating segments, beginning first with the Consumer segment
- Consumer generated $1.5B in operating revenues, which represents a decrease of 2.1% over third quarter a year ago
- Our strategic revenues in this segment grew 6.8% y-over-y to $644mm, driven by growth in high-speed Internet and Prism customers and price increases
- The long-term growth rate in high-speed Internet is likely to slow over time due to our growth in penetration of households

LEGACY SERVICES REVENUES AND EXPENSES

- Legacy services revenues for the segment declined 8% from third quarter 2012, due primarily to a continuing decline in access line and long-distance revenues partially mitigated by an increase in the access recovery charge
- Expenses in this segment declined $5mm or approximately 1% during Q3 compared to the same period a year ago, driven primarily by lower employee-related costs, which were partially offset by higher Prism TV costs

Business Segment

- Moving to slide 15, our Business segment generated $1.54B in operating revenues during Q3, which were flat with the same period a year ago
- On a sequential basis, total revenues grew 1.2% from second quarter 2013

- Our third quarter strategic revenues for the segment increased by 6.3% to $640mm from third quarter a year ago, driven primarily by strength in high-bandwidth services such as MPLS, Ethernet and Wavelength
- Excluding low-bandwidth services, strategic revenue grew nearly 9% from a year ago
- We continue to generate solid growth across the enterprise customer segments and we see an opportunity for further investment in the small and mid-sized business customer space to improve our market share and drive further growth

LEGACY SERVICES REVENUES AND EXPENSES

- Legacy services revenues for the segment declined 3.8% from third quarter 2012, due primarily to a continuing decline in access line and long-distance revenues, partially mitigated by an increase in the access recovery charge
- Our total segment expenses increased $22mm or 2.4%, driven by higher facility costs, partially offset by lower employee-related and CPE expenses

Wholesale Segment

- Now, turning to slide 16, our Wholesale segment generated $878mm in operating revenues, a decline of 3.5% from third quarter 2012
- Strategic revenues for Wholesale were $563mm, down 1.1% from third quarter 2012 as declining low speed transport services revenue offset growth in Ethernet services and data bandwidth capacity expansion by wireless carriers

LEGACY REVENUES AND EXPENSES

- Our legacy revenues in this segment declined by 7.6% to $315mm, reflecting the continued decline in access and long distance minutes of use and the implementation of lower access rates under the CAF order rate step-down
- Our operating expenses for the quarter were $293mm, 3.6% below the same period from a year ago driven primarily by lower personnel related and facilities costs

Data Hosting Segment

- Moving to slide 17 and our Data Hosting segment, which includes all colocation, managed hosting, cloud services and hosting related network services revenues
    - This segment generated $342mm in operating revenues, representing an increase of 4.6% from third quarter 2012 revenues of $327mm
- Third quarter 2013 revenues include approximately $14mm of revenue contribution from the Ciber IT outsourcing assets we acquired in October 2012
- Data Hosting y-over-y revenue growth was weakened by the impact of large client bankruptcy related churn and price erosion in previous quarters
- Data Hosting operating expenses were $274mm in Q3 compared to $246mm in third quarter a year ago
    - This 11% increase is driven primarily by higher employee costs related to the Ciber and AppFog acquisitions that were not present in the prior period
- Despite recent weakness, we expect long-term improvement in both revenue and margin trends across the Data Hosting segment and continue to leverage these assets to drive additional revenue through cross-selling and opportunities in our other segments

Q4 2013 GUIDANCE

- Turning to slide 18, we provide our fourth quarter 2013 guidance
- For Q4 this year, we expect total operating revenues of $4.5B to $4.55B
- Our core revenues of $4.07B to $4.12B and operating cash flow between $1.75B and $1.8B
- Adjusted diluted EPS is expected to range from $0.55 to $0.60
- Our fourth quarter expenses are expected to increase from third quarter 2013 primarily due to higher data integration costs related to increased CPE sales

QUESTION AND ANSWER SECTION

David W. Barden
Analyst, Bank of America Merrill Lynch

Q

I guess my first question is if you could go into, as you might imagine, lots more detail about what's going on in the data center business, I think two things. One is on the write-down. Clearly, there's some amount of growth rate in the future that you don't think you're going to achieve that you thought you're going to achieve. So if you kind of address what the difference in that growth rate is. And then second, on the kind of quarter-to-quarter performance, it looks like the managed hosting business went down $5mm. If you could talk about some of these credits and other things that occurred and I think, Glen, you mentioned that the Data Hosting business should grow half over half. But it could still go down next quarter and grow half over half. So if you guys could give us a little bit more sense as to what the expectation here is. Last quarter, we were still expecting this business to grow high single digits, so seems like something kind of really went off the rails in the quarter. I think on the other side of the coin, Stewart, the midpoint of the revenue guidance is actually the highest revenue that you guys would have had pretty much for the whole year. And you guys have been talking down revenue growth expectations, I think, in terms of 2014. But it feels like we're finding some kind of level. So could you talk about, even with the data center business not performing, it does feel like we're flattening out in the revenue curve and could you kind of revisit what the puts and takes are for getting to revenue growth in 2014?

Glen F. Post, III
President, Chief Executive Officer and Independent Director, CenturyLink, Inc.

A

And I'll take a few of those and I'll get Jeff to come in on a couple of items, but I'll get to your question about the quarter. In Q4, we do expect growth. It won't be negative is our expectations anyway. We expect to see growth in Q4, sequential growth in probably – in the 2.5% to 3% range is our targets for Q4. But if you look at this past quarter, we have a number of one-time items. First, we have currency issue of a little under $2mm, we had right at $2mm. We had a couple of prior year adjustments in there, $3mm. And the big item really was the churn of the old Qwest center. So we had some very large customers who were pure colo customers, some very large – and you know the names well, I won't call them, who took their business to their internal data centers. These are very large folks who have a huge amount of data out there. That's a big – they weren't buying any cloud and managed services from us, pure colo. So that's where a lot of that churn came from, plus we had the bankruptcy of Kodak impacted us by about $3mm. So it was a combination of things in the quarter. We do expect to turn that growth around. I am confident that we can drive growth in the hosting business. We're seeing significant success in our cross-selling efforts. We're changing our go-to-market with our network customers, seeing very strong demand in our sales. As we've talked about, it continues strong into Q4, the last three quarters in a row we've had strong bookings. And these Data Hosting assets are really important to our future growth. They support – supported by analysts, of course, industry analysts regarding the trends toward IT outsourcing. We believe those are real. We have some work to do. We're making some changes in some of our go-to-market work and our focus on certain verticals. And so strategically, these are very important assets for us and we see that's where the marketplace is going over time and I'm confident we can grow this business. I'll let Jeff make a few comments on his view here.

Jeffrey H. Von Deylen
President-Savvis, CenturyLink, Inc.

A

Sure David. Jeff. As we went into the quarter, we kind of expected Q3 would be flat to Q2. We had Q2, there was some non-recurring revenue. But anyway, we kind of got surprised by the $5mm. I think Glen talked about that. From a new sales perspective, we were in line with new sales, really. We had the same level of new sales in Q3 as we did in Q2. And as Glen mentioned, probably the biggest success we're having is selling into some of the CenturyLink network customers who don't buy hosting today, so they're not part of that legacy Qwest hosting base but they're buying the new products. So we really think the combination of some of these one-time items getting behind us after Q3 is why we think the 2.5% to 3% total hosting growth is reasonable and that's a result of the sales. I will say the quarter's impact has also negatively impacted our network. Our other network, as we call it, or the wide area, the VPN network, was negative y-over-y. If you sort of take that out, you just focus on the hosting revenue kind of y-over-y without the credits, we're about 8.6% growth. So a little better than kind of that reported 4%, and we feel like going forward, some of these one-time credits are out of the way and we're poised to grow sequentially. Again, the question on the goodwill write-down and sort of how we think about that. Stewart, if you want to take that one?

R. Stewart Ewing
Chief Financial Officer, EVP & Assistant Secretary, CenturyLink, Inc.

A

Yeah.

Jeffrey H. Von Deylen
President-Savvis, CenturyLink, Inc.

A

Because it was about future growth rates.

R. Stewart Ewing
Chief Financial Officer, EVP & Assistant Secretary, CenturyLink, Inc.

A

So in terms of the goodwill write-down, David, I mean we just basically because of our past performance, we decided we needed to take down the – just from an accounting standpoint, take down the assumed growth rates that we were using going forward for purposes of calculating the value of the business and comparing that with the amount that's reflected on the books and just decided that we needed to go ahead and write it down. I mean we certainly believe, as Glen pointed out, in the value of this business going forward, we believe that we can get to growth rates that will, and if you look at market comps basically, there's more value there than we wrote it down to really. So we feel comfortable with that. I mean, I think we're conservative in the write-down that we took and hopefully we're conservative in the projections that we used to calculate that. Your question concerning the revenue guidance and feels like we're finding some level of flattening revenue curve. So basically, yes, we are continuing to get towards and move towards flat revenue. It's a little slower than we thought it would be a few quarters ago. And that's why we said last quarter we didn't think we'd get to flat revenue in 2014. But basically it's dependent on the continued growth in strategic revenue. And the Data Hosting business is a big part of that. Our IPTV revenue and success there that we're seeing is a big part of that and continued success in our business sector with the MPLS revenue that we're driving there and the new customer growth we're driving there. We're having some really good success there. And if we can bring the success that we're seeing in the large customer segment, large and enterprise customer segment, down to the small and mid-size segment, it will certainly help us get there quicker. The other place is basically just our high-speed internet. We need to continue to do well from the standpoint of adding customers and hopefully increasing rates a little bit over time as we were able to do in Q3.

David W. Barden
Analyst, Bank of America Merrill Lynch

Q

Okay. And just a follow-up quick, when you're looking for the data center 2.5% to 3% growth, is that y-over-y or sequential?

R. Stewart Ewing
Chief Financial Officer, EVP & Assistant Secretary, CenturyLink, Inc.

A

Sequential.

Jeffrey H. Von Deylen
President-Savvis, CenturyLink, Inc.

A

Sequential.

Simon Flannery
Analyst, Morgan Stanley & Co. LLC

Q

Could you dig a little bit more into the broadband numbers? It was a very nice snapback. Obviously, some of that was seasonality. But did you change your go-to-market? Was that driven by promotions? Is this the sort of level that we think is sustainable over the next couple of quarters? And capital intensity continues to move up into the mid to high-teens. As the fiber to the tower build slows, when do you think we sort of see a peak in that capital intensity? Or are we seeing it right now? Or are we going to maintain it for another year or so?

Karen A. Puckett
Chief Operating Officer & Executive Vice President, CenturyLink, Inc.

A

In terms of the broadband bounce-back, we are pleased about that obviously. I would say no new go-to-market. We continue to execute. We do this well, and so the seasonality helps. Also, we were able to overcome the indirect partner we spoke about last time with some digital partners that we had helping them increase their business. And our call center channel performed very well, as well as just getting very focused on our go-to-market in terms of our prospect leads and making sure that those were all optimized. So the things that we normally do, we continued to do well and had a good quarter from that.

R. Stewart Ewing
Chief Financial Officer, EVP & Assistant Secretary, CenturyLink, Inc.

A

Simon, regarding the capital budget, we expect CapEx, even though we do expect the fiber-to-the-tower spend to go down, we believe our budget will stay in the range, in this $3B range that we've been talking about. You can be a little +/- to either side of that, but that's the range we expect it to be in. Because of the opportunities we think we have in broadband expansion driving additional revenue opportunities, also a lot of success-based – about a third of our budget will be success-based capital. So if we continue to be successful in Ethernet, MPLS work and the Savvis sales data center expansion, then a lot of that will be success based. We expect to be in this range, in this $3B range at least through 2014.

Batya Levi
Analyst, UBS Securities LLC

Q

First a follow-up question on the data hosting business. I think a couple months ago you had mentioned that we will see some pick-up in churn in Q1 2014. Would the churn that we saw in the quarter, was that pulled forward? Or do you expect another pick-up in churn in the beginning of the year? And the second question is on the business revenues. We saw some slight improvement to y-over-y growth in that business. Do you expect that to continue?

Jeffrey H. Von Deylen
President-Savvis, CenturyLink, Inc.

A

Yes. It's Jeff. Regarding the churn, the $2mm that we referenced on legacy Qwest, that was a surprise, so that was sort of over and above what we had forecasted. And we don't have in our kind of current view of Q1 – or Q4, Q1 any more large churn, any higher than kind of where we currently run. So that $2mm that we referenced or that Glen referenced in this quarter was over and above what we expected. But then as we go forward to Q4, Q1, we sort of expect to have sort of that – a normal level of churn, which we currently run in the 1.3% to 1.5% of revenue.

Glen F. Post, III
President, Chief Executive Officer and Independent Director, CenturyLink, Inc.

A

And, Batya, on the business revenue growth, I mean we do hope to continue to improve our business revenue growth. Some of it in Q3 related to some price increases that we did, some small amount of it, but we're again seeing good success on the large multi-node MPLS networks and strategic data revenue growth that we're seeing in our business sector.

Scott J. Goldman
Analyst, Goldman Sachs & Co.

Q

I guess I want to follow up on David's question earlier and just looking at Q4 guide that you've laid out for – really for both revenue and for EBITDA. If you kind of look where you came in Q3, fairly close to the midpoint of your guide there but it looks as though you're bringing down full year guide by about $50mm or so at the midpoint for both revenue and EBITDA if we take your Q4 numbers there? So wonder if you can just talk a little bit about the puts and takes that we should be thinking about. I know you highlighted CPE, but anything else we should be thinking about, Stewart, as we go forward on that? And then secondly, obviously seeing good results on Prism IPTV and market expansion and the quality churn implications in HSI attach rates that you get there, just wondering how you think about the opportunity to maybe accelerate that either within existing CapEx budget or even a willingness to move CapEx a little bit higher just given the benefits of that product?

R. Stewart Ewing
Chief Financial Officer, EVP & Assistant Secretary, CenturyLink, Inc.

A

Yeah. So, Scott, in terms of fourth quarter guidance, I mean, yes, considering the guidance that we have for full year and the performance in Q3 and our guidance that we gave in fourth quarter, we'll probably be somewhere around the midpoint to the lower end of the guidance that we gave for revenue and operating cash flow for the full year. So, yeah, we'll be to the midpoint or slightly below. So – and we feel good about that. There are some – we do expect an increase in our CPE sales in Q4 and the associated costs with that since that's a low margin product. In terms of Prism?

Glen F. Post, III
President, Chief Executive Officer and Independent Director, CenturyLink, Inc.

A

Yeah, I'll just talk about Prism for a minute. We continue to build out in markets where we are. So we still have some other phases going in Phoenix and in Colorado Springs as well as in Omaha. And other areas where we're building out – continuing to build out in those markets. As we continue to see success there, if we – if this growth continues, we will consider expanding in other markets. That will be part of our 2014 budget process that we're in the process of going through now and we'll be considering those expansions. As far as increasing the budget, we don't expect significant increases in the budget, capital budget to build out Prism at least in 2014. But that is an opportunity for us as we look – if we continue to see success here, it is an opportunity to really consider acceleration of the build out in the months and years ahead.

Scott J. Goldman
Analyst, Goldman Sachs & Co.

Q

Stewart, just one follow-up to the guidance. Anything we should be thinking about in terms of the new union contract? How that layers in, in Q4 and into 2014 that would impact or benefit you on the EBITDA side come Q4?

R. Stewart Ewing
Chief Financial Officer, EVP & Assistant Secretary, CenturyLink, Inc.

A

Yeah, not much impact in Q4. We should see some positive benefits in Q1 and full year 2014.

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

Q

Thanks, guys. Two questions. Where do you think your pricing is on the data center side vs. market and vs. legacy? And are you seeing kind of much overbuild in the markets that you're in? Or is it more just the Internet companies kind of going to their own facilities? And then secondly, on the GPON strategy, could you maybe just give a little bit more detail on how it compares and contrasts to what Verizon did with FiOS and maybe a little bit of color on the cost structure on that? It seems like a very large opportunity and I know Omaha you had lost a – they had lost a lot of market share historically. Maybe if you could give some color on what kind of uptick you're getting in your trials there? Thanks.

Jeffrey H. Von Deylen
President-Savvis, CenturyLink, Inc.

A

Sure. On the first one, on the data center side, specifically as it relates to colocation, I think our legacy base, certainly I think pricing over the last few years has probably declined in the 10% to 15% range. So some of those clients that are coming up for renewal on just pure colocation, we have to – we see that in price erosion. You're right for the larger, big [ph] i-content (41:14) kind of guys who've built their own data centers and look at choices of where to put their environment. And we've had that certainly in our numbers negatively impacted. I will say there's probably a couple markets that we think maybe are more competitive or price competitive than not in terms of D.C., Santa Clara and Dallas. But those are markets that we're – the good news is we're pretty well distributed and where we're adding footprint is probably away from those markets where we see some of the wholesalers and other demand going. So – and then the last point is we're really trying to take advantage of this embedded base of customers who, that Karen really has in her channel and our ability to sell data center and even simple colocation racks and bundles to those customers that they've never had that offer before. And we think that's going to really help us kind of de-emphasize some of the larger one megawatt and above kind of deals to really add enterprise and smaller opportunities.

Karen A. Puckett
Chief Operating Officer & Executive Vice President, CenturyLink, Inc.

A

And, Tim, Karen. On the GPON question, yeah, I would say in terms of just Omaha, let's think about that, we had fiber deployed in that core of the network, so it made sense to do GPON. And what we're attempting to do here is really understand the market with the GPON message take rates and such as well as harden our process because it is somewhat of a new process for our systems and our organization. I will tell you that we're very pleased. We have not officially even hard launched. We're still in the soft launch at Omaha. So very pleased with the results both from a consumer and a business standpoint. So encouraged in every operating metric. Vegas, we have some fiber to the curb technology. We had the fiber, and we decided to use the most recent GPON capability to enable that again, to trial to further harden our process in the legacy seed side in terms of those systems and processes. Our focus is very targeted in terms of going after the high addressable market and consumer, so the premium kind of customers, but very focused on the business side too. And you'll hear more of that here in the coming quarters as our focus on GPON with business.

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

Q

Was wondering if you can talk a little bit about what's going on in the cost space and especially relative to revenue? So it seems like the segments that grew in the quarter – y-over-y they grew like the business segment, the Data Hosting segment. That's where you actually saw segment income decline y-over-y, and in aggregate, if you just look at just the segment income where you can take it to the larger consolidated EBITDA level, it looks like EBITDA was down by more than a dollar y-over-y for every dollar of revenue loss. I was just wondering if you could talk to us about how to think about the change in revenue relative to the change in EBITDA and whether that can get better over time and if there are any specific issues that were impacting this quarter more so than usual? Thanks.

R. Stewart Ewing
Chief Financial Officer, EVP & Assistant Secretary, CenturyLink, Inc.

A

Yeah, Mike. So what you're seeing is a combination of really two major things that are going on. One, we're cycling through or have pretty much cycled through the synergies related to Qwest. So we're not seeing the offsets to expense increases that we've been having really all along related to higher network services really and charges related to business customer growth. And some of that was offset in the past related to synergies that we were achieving from Qwest. Also, secondly, in Q3, we do have some seasonality from a cost standpoint. So we get a chance to do maintenance on our networks and things like that. So that really drives our cost up some, and our power costs are higher in Q3 simply because of the heat and the cooling required, things like that. The other is that basically we have new initiatives where we're rolling out new products and there are costs associated with that really that aren't really the – there's not a lot of revenue benefit there in the early stages in rolling out new products. So I think that you're seeing some of that too. We would expect for other than the Qwest synergies for the other expenses to be more in line with the revenue growth in the future though.

Glen F. Post, III
President, Chief Executive Officer and Independent Director, CenturyLink, Inc.

CLOSING REMARKS

- Please turn to slide 21 as we close today's call
- Overall, we are well pleased with our results for Q3
- We believe our continued investment in key strategic opportunities will help us drive revenue growth and strong financial results over time
- We are seeing strong demand from business customers for our advanced network and hosting IT solutions
- And we're also seeing improved sales success through increased collaboration among our business and data hosting sales leaders around the joint development of targeted innovative solutions
- Our new bundled offers have positioned us to capture additional spend in the IT services space of our customers' portfolios

  - We – for example, our managed products is a simple, fully managed bundle solution that was created specifically for small and commercial businesses and integrate all elements of our communications network, managed data, hosted managed voice and managed applications
- We believe that these types of products and bundles that we're developing can be very effective in driving future revenue streams and develop a lot of customer loyalty
- Overall, we believe we are well-positioned to effectively compete and drive revenue growth from our strategic products and services in the months and years ahead