Windstream Holdings (WIN) Earnings Report: Q3 2014 Conference Call Transcript

The following Windstream Holdings conference call took place on November 7, 2014, 08:30 AM ET. This is a transcript of that earnings call:

Company Participants

- Bob Gunderman; Windstream; Interim CFO, Treasurer
- Jeff Gardner; Windstream; President, CEO
- Tony Thomas; Windstream; President - Real Estate Investment Trust Operations

Other Participants

- Barry McCarver; Stephens; Analyst
- Simon Flannery; Morgan Stanley; Analyst
- Batya Levi; UBS; Analyst
- Phil Cusick; JPMorgan; Analyst
- David Barden; BofA Merrill Lynch; Analyst
- Frank Louthan; Raymond James; Analyst
- Tim Horan; Oppenheimer; Analyst
- Michael Rollins; Citigroup; Analyst

MANAGEMENT DISCUSSION SECTION

Operator:

Good day, ladies and gentlemen, and welcome to the Windstream Q3 2014 earnings conference call. (Operator Instructions) As a reminder, this conference call is being recorded.

I would now like to turn the call over to Bob Gunderman. Sir, you may begin.

Bob Gunderman (Interim CFO, Treasurer):

Good morning and thank you for joining Windstream's third-quarter earnings call. My name is Bob Gunderman and I am the interim CFO and Treasurer at Windstream . Joining me today are Jeff Gardner, our Chief Executive Officer, and Tony Thomas, Windstream's former CFO, who is now President of Real Estate Investment Trust Operations for Windstream . Tony will participate in the Q&A portion of this call.

To accompany today's call we have posted the presentation slides, earnings release, and supplemental results on our Investor Relations website. I would like to draw your attention to our Safe Harbor statement on slide 2.

Today's discussion will include statements about expected future events and financial results that are forward-looking and subject to risks and uncertainties. A discussion of factors that may affect future results is contained in Windstream's filings with the SEC, which are available on our website.

The presentation also includes certain non-GAAP financial measures. Reconciliations of these non-GAAP measures to the most directly comparable GAAP measure are available on the Investor Relations section of our website. The quarterly growth rates discussed on this call are on a year-over-year basis, unless otherwise noted as sequential.

Turning to slide 4, for the third quarter we reported earnings of $0.01 per share on a GAAP basis, which include certain one-time items. Specifically, our GAAP results included approximately $0.02 per share in after-tax merger and integration and restructuring expense. Excluding these items, adjusted EPS would have been $0.03 per share for the third quarter.

Now I would like to turn the call over to Jeff Gardner, who will provide a strategic update. Then I will review the third-quarter financial results. At the end of the presentation we will take your questions.

With that, here is Jeff Gardner.

Jeff Gardner (President, CEO):

Good morning and thank you for joining today's earnings call. First I would like to thank Bob for taking on additional responsibility in serving as our Interim CFO. I would also like to thank Tony for his help in completing our third-quarter financial reporting. Tony has now turned his attention to establishing the new REIT, which I will discuss in more detail shortly.

Let's turn to slide 5 and I'll review some of the highlights from the third quarter. 2014 has been a very productive year both strategically and operationally. Enterprise and SMB revenue grew sequentially, and the year-over-year growth rate improved by 30 basis points, driven by solid enterprise sales and price increases.

Our team has grown new business sales by 5% year-to-date as our advanced capabilities, customized solutions, and focus on midsize enterprise customers has gained traction. In addition, we continue to see positive trends supporting our efforts to move upmarket, evidenced by a 70 basis point acceleration in enterprise customer growth and a 10% increase in average revenue per customer.

The consumer channel delivered another strong quarter, improving the year-over-year revenue trends by 250 basis points through lower churn and pricing initiatives implemented during the second quarter. Last, we generated $253 million in adjusted free cash flow, of which we returned $151 million to our shareholders.

Telecom continues to be a dynamic industry driven by technology migrations, increasing data consumption, and changing customer preferences. Our third-quarter results were somewhat pressured by declines in legacy carrier transport services and lower product sales, which muted some of the progress we anticipated.

In addition, we continue to experience competitive pressures within the SMB space. We are taking proactive steps to increase profitability, improve our cost structure, and drive operating efficiencies in this business.

Specifically, we are seeing sales success with SMB customers within our ILEC footprint and have refocused our strategy in these markets to place greater emphasis on capturing profitable opportunities. In addition, we continue to target higher-margin business sales opportunities through the combination of network services, data center, and managed services.

We are moving closer to completing the PAETEC integration and becoming one Windstream from a systems perspective, driving over $15 million in targeted synergies in 2015.

Turning to our strategic initiatives on slide 6, as we announced in July, Windstream is separating its business into two companies by spinning off certain network assets into an independent publicly traded REIT. We are very excited about this opportunity and believe we will drive additional value for our shareholders as two companies.

Windstream's strategy remains focused on providing advanced communication services to business, and this transaction better positions Windstream to improve its competitive position and accelerate its growth. The REIT will produce strong, stable cash flows supportive of an attractive dividend, while providing the opportunity to grow and diversify over time.

We are making progress on all necessary steps to complete the REIT spinoff. As a reminder, we received the necessary Private Letter Ruling from the Internal Revenue Service prior to our announcement in July.

We are working with the public utility commissions to obtain state approvals where necessary, and this process is going very well. Given the compelling consumer benefits resulting from increased network investment, combined with a meaningful decrease in Windstream's outstanding debt, we are confident that we will receive all necessary approvals.

In addition, we recently filed a preliminary Form 10 to register the REIT's equity securities with the SEC and are on track to close the transaction during the first quarter of 2015.

We announced the acquisition of an innovative company called Business Only Broadband, which operates high-bandwidth fixed wireless network providing business-class Internet, private ethernet, and managed services over microwave spectrum. The company serves SMB and enterprise customers in four large metropolitan markets.

The acquisition enhances Windstream's enterprise capability and provides diverse last-mile access away from the traditional telco infrastructure, enabling reduced installation times and network diversity. While small, this acquisition provides capabilities and expertise which are extendable into additional Windstream markets over time.

In the consumer channel, we are rolling out an IPTV service called Kinetic in certain markets. Kinetic is a complete video entertainment offering with a wide variety of features that will be available to more than 50,000 homes in Lincoln, Nebraska, in mid-2015.

We plan to launch Kinetic in a small number of select markets over the next few years, targeting upgraded fiber markets that leverage the existing infrastructure to generate incremental returns. This, combined with declining hardware costs, results in immaterial CapEx requirements. Importantly, Kinetic will provide Windstream with an innovative new customer offering to drive higher bundled sales and improve customer retention.

In closing, we are encouraged about the prospects of these strategic initiatives and expect to achieve our financial targets in 2014. I will now hand the call over to Bob for the financial update on the third quarter.

Bob Gunderman (Interim CFO, Treasurer):

Thank you, Jeff. Turning to slide 7, total revenue in the third quarter was $1.5 billion. Total service revenue was $1.4 billion, down 2.3%, as strong consumer performance combined with improving enterprise trends enabled us to offset some of the pressure related to Intercarrier Compensation reform, carrier declines, and SMB losses.

Lower-margin product sales were $46 million, down roughly $10 million year-over-year, driven by evolving purchasing behavior as more businesses consider cloud-based products.

Moving to our business channel results on slide 8, enterprise and SMB service revenue was $752 million, up slightly. We continue to see healthy demand for our broad suite of enterprise services, and we implemented modest price increases late in the second quarter which aided performance.

Partially offsetting this was a decrease in usage-based long-distance revenue and legacy voice declines. Specifically, data and integrated services grew by about 4%, led by growth in IP-based solutions and next-generation data.

We continue to see strong growth in data center and managed services revenues, which totaled roughly $32 million in the third quarter and increased 21% year-over-year. This growth was offset by declines in voice and long-distance revenue driven by lower usage-based revenue, migrations from traditional voice to IP services, and declines in small business customers.

Enterprise locations grew by 3.6% and average revenue per business customer grew by 10%. We are successfully moving upmarket by focusing on solutions that combine our data and voice transport and networking capabilities with higher-value offerings such as managed and hosted services.

The breadth of our enterprise services portfolio enables Windstream to design solutions that meet the specific needs of our customers through highly skilled teams of sales professionals and solution architects. This underpins our brand promise of smart solutions and personalized service.

Carrier revenue was $151 million, down 10%, primarily related to wireless carrier migrations from legacy TDM circuits to newer ethernet technology, as well as some nonrecurring items. We are seeing solid growth in ethernet services from our fiber-to-the-tower investments, which we expect to continue, based on the increasing data transport needs of wireless carriers.

Turning to slide 9, consumer service revenue was $321 million, essentially flat year-over-year, which is an improvement of 250 basis points versus the second quarter due to lower churn and price increases we implemented in the second quarter. We are making solid progress in the consumer channel with continued focus on selling our bundled services combined with growth in broadband speeds and vertical services, which resulted in a 5% increase in consumer broadband ARPU.

In addition, we are making progress on fiber backhaul upgrades within our ILEC footprint, which enable enhanced services and provide for an improved customer experience. Sequentially, consumer revenue grew by $4 million.

Wholesale revenue was $132 million, down 11%, primarily due to terminating switched access rate stepdowns and lower support from the Access Recovery Mechanism, both related to ICC reform. These declines were consistent with our guidance for expected total revenue declines of 8% to 9% in 2014.

On slide 10, cash expenses increased by $7 million due to higher cost of services from seasonally higher expenses in operations related to increased outside plant activity. This was partially offset by other cost initiatives within SG&A.

The seasonal operations expense peaked in the third quarter, resulting in roughly $8 million in incremental expenses that are expected to fall away in the fourth quarter. Adjusted OIBDA for the quarter was $525 million.

Turning to slide 11, we spent $194 million on capital expenditures. Over 60% of our CapEx is directed toward growth projects including fiber deployment, broadband expansion, and success-based opportunities. We have ongoing programs in place to enhance our broadband capabilities including shortening loop lengths and expanding our fiber network to increase our enterprise opportunities and improve our cost structure.

In addition, we have completed the first phase of the expansion of our 100-gig long-haul network in order to significantly increase network capacity, which will enable incremental carrier transport revenue and improve enterprise opportunities. We also deployed fiber to 85 towers during the quarter, bringing the total number of towers completed to date to almost 4,800 with another 525 under construction.

On slide 12, we generated adjusted free cash flow of $253 million during the third quarter. Year-to-date adjusted free cash flow was $693 million, which is up 2% due to cash interest savings and lower CapEx. We returned over $450 million to our shareholders in the form of dividends during this period.

Taking a closer look at the balance sheet, cash interest is down year-to-date due to our 2013 refinancing activities, which will enable us to achieve $40 million in annual savings this year. We ended the quarter with ample liquidity comprised of $640 million in revolver availability and $111 million in cash.

Net leverage was 3.9 times adjusted OIBDA. As part of the spinoff transaction, Windstream expects to reduce debt by approximately $3.2 billion.

We continue to affirm our previously provided guidance on revenue, adjusted free cash flow, and payoff ratio shown on slide 13. We expect revenue to be at the low end of the range provided. In addition, we now expect CapEx of around $775 million, modestly better than the original range provided; and cash taxes are now expected to be less than $10 million.

In closing, we remain focused on executing our plans to grow revenues, stabilize adjusted OIBDA trends, and deliver a quality customer experience. Thank you for your time this morning. We will now take your questions.

Operator, please review the instructions and open the call to questions.

QUESTIONS & ANSWERS

Operator:

(Operator Instructions) Barry McCarver, Stephens.

Barry McCarver (Analyst - Stephens):

Hey, good morning, guys, and thanks for taking my question. I guess, Bob, first off on the margins -- I'm sorry, on guidance, you didn't make any mention specifically OIBDA margins. I know Tony in the past has suggested that you would end the year at about 37%. Do you still feel comfortable with that number?

Bob Gunderman (Interim CFO, Treasurer):

Yes, Barry, I think we are likely to end up between 36% and 37% for the year. We have seen some margin compression this year related to the loss of our high-margin carrier and switched access revenues and investments that we have made related to our business channel.

Given that pressure in the third quarter and coupling that with a bit of a higher expense outcome on operations within the quarter, which resulted in about $8 million in incremental expense there, even though we expect that to fall away in fourth quarter we think the combination of all those things together will cause us to be between 36% and 37%. We are taking proactive steps to focus on ways to increase profitability and improve our cost structure.

And as Jeff mentioned in his prepared remarks, the PAETEC integration activities are on track, and we do think that in the near term those will give us some nice opportunities to improve the cost structure through the realization of the incremental synergies from that transaction.

Barry McCarver (Analyst - Stephens):

Then on the revenue guidance, we did see in the quarter a lot of improvement in various consumer and business subsegments. It looks like you're going to have to have another step-up in order to get to the low end of the revenue guidance for the year.

Are there certain segments that you can point to that you are seeing that strength, that we can think about in our modeling?

Bob Gunderman (Interim CFO, Treasurer):

Yes. Barry, in the quarter, we did feel a bit of incremental pressure in a few areas. The carrier wireless TDM pressure, that's been sustained and that continues certainly into the quarter; so that was an influence for us.

But I think the other areas of increased pressure that we saw in the quarter that we don't think are recurring pressures really came in the form of our usage-based revenues. We did feel some pressure on the retail long-distance usage revenues being a bit lighter. We would expect that to improve in fourth quarter.

We also felt a little bit more usage pressures within switched access. We expect some of that usage to come back.

And then our product sales were modestly down in third quarter. We've seen some pressure there, but we do think that those trends can improve in fourth quarter as well.

As you think about consumer and business, the enterprise and SMB business improved sequentially. We did get better year-over-year trends there as we are seeing some nice improvements on the enterprise side to offset the competitive pressures of SMB.

And then the consumer business quite frankly improved quite nicely sequentially. We are really seeing some nice trends and improvements, and we would expect that to continue as well.

Barry McCarver (Analyst - Stephens):

Okay. Thanks, Bob. That's really helpful.

Operator:

Simon Flannery, Morgan Stanley.

Simon Flannery (Analyst - Morgan Stanley):

Great. Thanks very much. Good morning. Tony, wanted to just touch base with you, if you could give us an update from your perspective on your progress in setting up the new company, and in particular a couple of areas.

One, what is the progress in terms of conversations with other telcos or others in terms of doing rollups and using the vehicle to continue to do M&A down the road?

And secondly, conversations with the REIT community in terms of their receptivity to the story. Thanks.

Tony Thomas (President - Real Estate Investment Trust Operations):

Good morning, Simon. As you can imagine, I have been on the road talking to other telecommunication companies, and I would describe -- there has been a high level of interest from those companies in the transaction. This transaction is fairly unique in its ability to inject cash into a business to help restructure the balance sheet, invest more capital to improve the underlying network performance, or simply return cash to shareholders.

So those conversations are progressing well and I expect those to continue. And frankly reaffirms my view that there is going to be significant opportunities for this REIT vehicle to be an acquisition or potential partner in acquisitions on a prospective basis, be that with Windstream or with other companies. So that is progressing very nicely.

In terms of the outreach to the REIT investors, matter fact I am at NAREIT, the annual convention of REIT investors and REIT companies today, beginning that dialog. But it's a journey.

I think there is the introduction of telecom. I believe the REIT community has liked the strong, stable cash flows associated with the REIT; so we are beginning that dialog and we will continue to work on that prospectively.

I am optimistic, but I do expect it to take some time for the REIT community fully to adopt the company. But in the interim, we think the yield will be very attractive to a broad base of investors.

Simon Flannery (Analyst - Morgan Stanley):

Thank you. Just one clarification maybe; this is also for Jeff. There is a $50 million CapEx option in terms of you funding that for the operating company. Can you just explain how that might work?

Jeff Gardner (President, CEO):

Sure, Simon. How are you doing? It's really at our election. We will have the opportunity to use the REIT, depending on if it makes sense from a cost of capital perspective, to help with our own capital program. So it offers some flexibility.

I think it is very likely that over the course of time that we will be making additional investments using the REIT in around that amount on an annual basis. So of course, Tony will have other opportunities to diversify, but we do have that option, that I think is helpful to us, to invest with them over time.

And we really believe that they should have a cost of capital that makes that attractive.

Simon Flannery (Analyst - Morgan Stanley):

Great, thank you.

Operator:

Batya Levi, UBS.

Batya Levi (Analyst - UBS):

Great, thanks. Just to follow up on your comments on the business segment, can you update us on your outlook for business revenue growth? I think you had been looking about 1% to 2% growth in 2014 and 2% to 4% longer term.

We are seeing some incremental pressure on the special circuits. Where do you think you will end the year in business, and what is your expectation for longer term? Thanks.

Bob Gunderman (Interim CFO, Treasurer):

Yes, thanks, Batya; this is Bob, I will take that one. You're right. Given the increasing pressure that we've seen in the carrier business, we now expect our business service revenue to decline just over 1% in 2014.

Having said that, we are encouraged by the momentum that we are getting from our sales and marketing initiatives. Jeff mentioned the sales progress that we've seen this year; that's been, I think, good.

We think our enterprise and SMB revenues combined, that should result in flat revenues on that front. But the carrier pressure will pull us down a bit relative to our prior discussions.

We are encouraged by the sequential progress that we saw in enterprise and SMB, and we think those improving trends will continue. We still have a lot of opportunity, we think, to gain market share and obviously continue to work very hard to do that.

Longer term, the business we feel comfortable can grow in that 2% to 4% range, and we think that is obviously going to be led by the enterprise progress. As you could see in the quarter, we did have some nice momentum by adding a sizable number of enterprise customers and also increasing our ARPU for those customers within the enterprise space.

Batya Levi (Analyst - UBS):

Have those trends continued into October? And with 4Q maybe having fewer business days, do you think that sequentially you can still grow that business?

Bob Gunderman (Interim CFO, Treasurer):

Yes, I think the trends are still very solid in that piece of the business. I think it is likely to be flattish looking ahead on that piece of the business into fourth quarter.

But again, that is really combined. The combination of the enterprise trends continued to be improving, but the SMB competitive pressures hold back the combination of both of those revenues a bit.

Batya Levi (Analyst - UBS):

Thank you.

Operator:

Phil Cusick, JPMorgan.

Phil Cusick (Analyst - JPMorgan):

Hey, guys. I guess two things. First if you can talk about the deceleration in CapEx versus what we expected to be at increase, at least next year, what are you doing so far? And when can we expect that to ramp up?

Then second, if you can talk about the revenue trends, which have been weakening through the year rather than strengthening, how should we start to think about 2015? Thanks.

Jeff Gardner (President, CEO):

Great, thanks, Phil; this is Jeff. On the CapEx side, the biggest factor this year has been slower fiber-to-the-tower activity than we had estimated at the beginning of the year. It's the biggest driver of the update that we gave to guidance this year. Going forward, we expect -- and even with that we are still in that 11% to 13% range that we forecasted for the year.

For next year, we talked about some of the things that we plan to do with the new structure, with the REIT. And that, those plans, continue to stay on track -- which would be to invest more; to bring our broadband penetration up to 80% receiving 12 meg or higher in the consumer business; and then also focusing on accelerating our transition to IP on the enterprise side; and really focusing more on facilities builds next year.

So all three of those initiatives are what we plan to invest in next year. And again we still are expecting that to come in, in that 13% to 15% range.

Phil Cusick (Analyst - JPMorgan):

When should we look for that to start to pick up? Is that something that probably doesn't happen this year, more next year?

Jeff Gardner (President, CEO):

I think you should expect that in 2015, coincident with our REIT announcement or spin-off.

And then the second question was on revenue as it relates to the business trends. Could you just repeat that, Phil?

Phil Cusick (Analyst - JPMorgan):

We've seen a year-over-year decline in revenue trends, low 2%s to high 2%s in the second half. As we think about 2015, should that weakening on a year-over-year basis continue, or do you think we could start to see better numbers?

Jeff Gardner (President, CEO):

Yes. I definitely think that we expect to see both revenue and OIBDA improvement in 2015. Really, when you think about some of the things that are causing us a lot of pressure this year, probably the biggest factor on the revenue side has been our carrier business. That's very high-margin business.

We've seen very aggressive grooming activities on behalf of the largest wireless carriers in the country. We expect that to slow down in 2015. There has been so much activity in terms of accelerated TDM disconnects as they move to fiber-to-the-tower that naturally that will slow down, because there's fewer of those circuits out there.

We still see -- when I look at our enterprise business and

what gives us confidence, I know we have had more pressure this year than we realized, but long-term we still feel good about our ability to grow that enterprise business in the 2% to 4% range. And why? Because this focus that we have in the marketplace on these customers between 5,000 and 100,000, bringing a bundled set of solutions to them is really resonating.

And we are competing against some of the large carriers. As you know, we have low penetration in some of these markets, and we are continuing to see good wins in the marketplace.

When you peel away or some of these headwinds fall away, then the business will be more driven just on that: that organic growth that demonstrates that we are having success in that midsized segment.

Phil Cusick (Analyst - JPMorgan):

Got it. Thanks, Jeff.

Operator:

David Barden, Bank of America.

David Barden (Analyst - BofA Merrill Lynch):

Hey, guys. Thanks for taking the questions. Maybe just three quick ones if I could.

First, Jeff or Bob, could you talk about the mix of the revenue health in the enterprise segment sequentially, as it relates to the price initiatives that you talked about last quarter versus volume, and which the primary driver of the sequential revenue growth was?

Then second, I think, Bob, you mentioned that there were about $8 million of costs that should drop out from 3Q to 4Q. I was wondering if those are going to be recurring cost saves and so that would be a good baseline for looking into 2015.

Then last, Tony, just on the regulatory process, could you single out one long pole in the tent that maybe we would want to look at, just to keep an eye on how the process is evolving as we progress towards the separation of the two companies? Thanks.

Bob Gunderman (Interim CFO, Treasurer):

Thanks, David. I will take the first couple and Jeff can chime in as needed. On the enterprise momentum sequentially, you're right; we did have price increases in later second quarter. That helped the trends a bit, but they were pretty modest.

I think about these types of price increases as occasionally just making sure we are priced at market, and we felt the opportunity to raise in certain areas. So it was a modest action and one that we take occasionally.

So the progress on the rest of the business I think was encouraging. We have seen improvements in our installation activity as we have foreshadowed from the first part of this year, and that helped drive some sequential progress there as well.

As I mentioned, the SMB churn pressure has been pretty consistent. So really we were just able to outrun that churn and get some sequential growth.

Turning to the cost of services question, which I think is what you are referring to, we did have what I would say is higher than normal activity within the quarter just due to some outside plant activity. We had floods and such in Oklahoma and Arkansas that caused us to have a lot of overtime and staff off for some repairs out there. But those are things that come occasionally, and we don't expect that to obviously recur.

Then the other thing I would say, David, is just third quarter is seasonally always a higher cost of services quarter for us. There's just better weather for our teams to be working in the field on the operations and engineering front. So the combination of both of those things will I think cause us to have lower costs in that area in fourth quarter.

The real longer-term benefits on costs I think that you may be after on the synergy front is we do think we have those opportunities on the PAETEC synergy front to take out at least $15 million, looking ahead, once we get through those conversions.

David Barden (Analyst - BofA Merrill Lynch):

Right.

Tony Thomas (President - Real Estate Investment Trust Operations):

David, this is Tony. To your last question, the Form 10 is expected to be the long pole in the transaction timeline. As Jeff mentioned, we filed the preliminary Form 10 in late October with the Securities and Exchange Commission, and we are going through the normal process with them. And we expect to execute the spin-off in the first quarter of 2015.

David Barden (Analyst - BofA Merrill Lynch):

So there is no particular state or body, like the unions or anyone else, that you are negotiating with that represents the nexus point of the debate around should we or shouldn't we allow this sort of thing to happen, or what kind of concessions are we trying to extract? It is really just the mechanical process of getting through the SEC?

Tony Thomas (President - Real Estate Investment Trust Operations):

Yes, that is definitely the longest pole in the tent. We are still -- we still have three ILEC states pending approval. But given, as we talked about before, the strong consumer benefits associated with the transaction, we are making good progress in terms of those approvals and we expect to receive those well in advance of the spin-off in the first quarter.

David Barden (Analyst - BofA Merrill Lynch):

Perfect. All right. Thanks, Tony.

Operator:

Frank Louthan, Raymond James.

Frank Louthan (Analyst - Raymond James):

Great, thank you. A couple quick questions.

On the video, what drove the ARPU upside in the quarter? Was there any additional charges or things you've added? And is that sustainable?

Then secondly, looking at the filing you filed last week on the REIT, at what point did you determine to put Talk America and the consumer UNEP business in that?

And within the filing, you mentioned you plan to try and grow that business from the declines it's been showing. What kind of additional marketing expense do you think will be associated with trying to revive or stem the losses on that business?

Jeff Gardner (President, CEO):

Yes, great. Thanks, Frank, for the question. On the video side, we announced that we are going to rollout Kinetic and that it's not going to have a huge impact on CapEx. Really as you think about Kinetic, we have got -- you guys know our footprint: largely sparsely populated towns. Lexington and Lincoln are two of our biggest towns.

Some of our larger towns where we have seen aggressive competition, those are the places where we are focused on Kinetic, and that will just be in a small number of towns. Not a big impact.

As we look at that business case now compared to just 2 years ago, the pricing on set-top boxes has gone down considerably. Our networks have improved a lot. And so I think at the end of the day it is really going to help us in some of these most competitive markets to gain back some broadband share and to really be a better competitor in those markets going forward. And as we mentioned, that will take place in 2015.

The ARPU uplift in the consumer business -- and I'm really pleased with what is going on in the consumer business. We've seen steady improvements. We've got very high attachment rate in terms of broadband.

We still have a lot of upside. We have made many improvements to our network through our continued investment. As you know, we've been aggressive with Stimulus and CAF 1. We are getting to some very rural customers and seeing the opportunity to sell higher speeds, and that has really been driving some of our ARPU.

We did have -- where we have made improvements in the network and have been able to offer higher speeds, we have also taken some pricing actions in the second quarter. It's really the combination of those things that has helped drive that.

And then the last part of your question, remind me.

Frank Louthan (Analyst - Raymond James):

Yes, in the filing you mentioned -- that you put out last week -- about Talk America, and how do you plan to -- what sort of costs do you think you will have to incur to remarket and stem some of the losses in that business?

Jeff Gardner (President, CEO):

Sure. Yes, I will start with that and then I will ask Tony to chime in, because he's spent more time on the specific tactics around that early on as we start the REIT.

First of all, that was contemplated from the very beginning. This is a consumer CLEC business that's pretty small. It's resell residential CLEC, and so it's been under a lot of pressure.

As I said, it's not a big business. Tony is going to take that with the REIT. And Tony, maybe you can comment on what impact you think that additional marketing spend may have.

Tony Thomas (President - Real Estate Investment Trust Operations):

It will be very immaterial, Frank. The consumer CLEC business will generate OIBDA somewhere between $5 million to $10 million per year, and we are not expecting significant investments in marketing.

It will have to be a very entrepreneurial effort that is quite cost-effective given, as Jeff alluded to, the sometimes difficult economics in the consumer CLEC business. It was a fairly modest business, very small business relative to the overall transaction.

As a reminder, the REIT is going to be anchored by a $650 million rent payment from Windstream . And when you think about the OIBDA, there is roughly $20 million of overhead at the REIT; so you are talking about $630 million of OIBDA. So the consumer CLEC business is just a very modest piece that was really required as part of our spin-off process.

Frank Louthan (Analyst - Raymond James):

Okay, great. Thank you very much.

Operator:

Tim Horan, Oppenheimer.

Tim Horan (Analyst - Oppenheimer):

Thanks. Just two high-level questions. Tony, it looks like you are trading anywhere 8%, 9%, 10% dividend yield here. The triple-net guys are generally below a 7% yield.

What is the major pushback you are getting from the REIT investors? And how do you explain those concerns? We are hearing some ourselves; just curious what your arguments are.

Then, Jeff, at a high level, revenue has been declining 2% per year the last 3 years. How do you explain to investors what the big seachange is going to be for revenue to start to grow 1% per year over maybe the next 4, 5 years? What do you think the biggest change is? Thanks.

Jeff Gardner (President, CEO):

Great; thanks. Tony, would you take the first part?

Tony Thomas (President - Real Estate Investment Trust Operations):

Certainly. As I have been talking to investors, a lot of this has been requisite education around the transaction and around the telecommunications industry. I think the more conversations we have about the REIT structure -- its fairly straightforward and simple structure -- I think the more comfort investors are going to see. I think ultimately as we get closer to the transaction we will see where the ultimate valuation shakes out.

I think the other pushback we have gotten -- I think this is just important to help educate investors -- is: Ultimately, what is the aggregate opportunity after the spin-off? When you think about the acquisition opportunities, you can segregate those between midsize companies and small companies, small cable and telecommunications companies. There is roughly 2,000 of those across the domestic United States.

So there is a significant opportunity for growth on the small end, and there is a large, well-known universe of midsize companies. So I think once we have a chance to articulate the opportunity from a sale/leaseback transaction or the ability to acquire networks, that is quite compelling.

The second thing I always talk to the REIT investors around is the ongoing need for fiber investment especially by telcos. Jeff alluded to that as part of the reason for the Windstream REIT distribution.

But that is another reason I think there's going to be a lot of capital being invested, and ultimately the operators have an opportunity to work with this REIT to help finance it. So I think once those opportunities for growth are better understood, I believe both REIT investors as well as technology, media, and telecom investors will get more comfort about the growth prospects of the REIT.

We are quite comfortable that we are going to find significant opportunities and be able to grow the free cash flow on a per-share basis prospectively and hence increase our dividend distributions over time. We think that is the right way to create shareholder value, and we think there is lots of acquisition opportunities out there and ways to partner with companies to achieve those goals.

Jeff Gardner (President, CEO):

Great; thank you, Tony. And Tim, on your second part of your question was -- how do we expect investors to think about 2015 and our ability to improve the revenue trend? There's really a few things I would just like to mention.

First is we anticipate that as our strategic revenues continue to become a greater percentage of the revenue mix, we will see improving revenue trends. We expect continued improvement in our revenue trends driven by a couple of things.

Business sales momentum: I talked today about the fact that we are up 5% year-over-year. We really invested this year in marketing and sales enablement on the front end with our salesforce.com application, demand generation. Those processes continue to work well, and we feel good about our ability to win in the marketplace.

We have had some real headwinds with carrier revenue as TDM disconnects have been very heavy this year. We expect those to slow in 2015. They won't totally stop, but we will see a much better trend that will allow us to grow our aggregate revenue as well.

Importantly, the consumer business is showing a lot of improvement. So as you look at overall with Windstream , we feel very good about our ability to sustain that improvement that we've seen in consumer this year.

As I said, we are making significant investments in the network. As I look at our capability to offer higher speeds versus where customers are at today, we have a great opportunity to sell into that space and drive better ARPU -- even better ARPU in the consumer business.

So as you take all those factors into account, which is mostly just, as I said earlier, our revenue trends being more focused on a very stable consumer business and our ability to win in that midsize enterprise space, you are going to see improving revenue trends. We can't give specific timing, but I think we have the right assets in place to grow, as you said, modestly in the future.

Tim Horan (Analyst - Oppenheimer):

One of your larger peers talks about a 12- to 18-month lag in terms of EBITDA margin stabilization. Do you think you will see that same type of lag, or will margins stabilize and improve right alongside revenue growth?

Jeff Gardner (President, CEO):

As I said earlier, I think we will see improvement in both. And I think it is fair to say just because of the nature of our business and the way we are scaling that, similar to one of our peers, that OIBDAs will follow about 12 months later.

Tim Horan (Analyst - Oppenheimer):

Thank you.

Bob Gunderman (Interim CFO, Treasurer):

Operator, we have time for one more call, please.

Operator:

Michael Rollins, Citi Investment Research.

Michael Rollins (Analyst - Citigroup):

Hi, good morning. Thanks for taking the questions. Two, if I could.

One is, as you look at your higher capital intensity guidance next year, how does that break down between consumer and business and some of the strategic investments that you've made in the past?

Then secondly, as you look at the strategy to go after the midsize enterprise, you have competitors that are willing to deploy fiber or have fiber already deployed to those facilities. Can you contrast that with your strategy and how you look to be better positioned to win share, maybe versus some of those who are just putting in or have those fiber facilities? Thanks.

Jeff Gardner (President, CEO):

Okay, great. Thanks, Michael. Bob, would you take the first part and I'll jump on (technical difficulty) second?

Bob Gunderman (Interim CFO, Treasurer):

Yes, sure. Michael, as we said before, we do expect our CapEx intensity range to go from roughly 11% to 13% this year, up to 13% to 15% longer term. So it's roughly -- think about it as $125 million or so, just around that midpoint of that range.

The three places that we really see making those investments, I think, really helping all three of our core businesses. On the enterprise fund, we certainly think there is opportunity to invest more for success-based opportunities around more fiber deployment, more on-net opportunities with higher incremental margins, if you will.

We do think that -- I think that directly speaks to your second question about how that can improve our enterprise strategy and results over time. So I think that is a focus area for us.

The consumer business certainly has benefited from organic investment over the last several years as we have continued to improve our speed profile, add more fiber backhaul capacity to improve our customer experience. I think that is, frankly, showing up in our results right now.

But we think we have an ability to modestly invest in those areas as well. As we mentioned before, we think we can bring more speed profile to those markets; and that will also complement our small business segment. So you will see some investments continue there.

On the carrier side, I think that what we have started to do this year around what we call our [winter stay], which is our carrier network extensions to really give ourselves the ability to serve more of our carrier partner needs, I think we have good opportunities to extend those routes. We made some recent gains this year that I think are going to be impactful for us.

So I can't tell you the exact percentage that we will spend in each, but I think there is going to be multiple opportunities to invest in really all those core businesses.

Jeff Gardner (President, CEO):

Right. We are really excited about the enterprise side, and it goes to the second part of your question in terms of -- today, as you know, we compete a little bit differently. More reliant on last-mile access from third-party carriers.

We are a large buyer of services from some of the largest carriers in the country. We have really opened up the options. There are many other competitive access providers out there that allow us access to lower-cost last-mile connections.

I think importantly, from our customers' perspective, you've got to remember -- your question really deals more with margins and how are we going to manage margins over time. We take a lot of pride in -- whether it is all on Windstream's facilities or we are partnering with another carrier -- to really take care of our customers end-to-end.

So when we focus on that segment that I mentioned earlier, we are able to come in, in a very consultative way, and sell them solutions regardless of where they are across the country, that really deal with some real big business problems that they have. So we are bringing a lot of value; it is resonating in the marketplace.

We are competing against those carriers today and winning a fair bit of the time. It's definitely competitive, and we have got to continue to improve.

But as Bob mentioned, what makes me feel better about our ability both to manage our network going forward and, importantly, to manage our cost structure is the REIT structure. The increased capital intensity is going to allow us to place more of our facilities into our network, which is going to improve our ability to serve the customers, of course, but also improve our margins. And it's going to be important to us as we continue to work hard to scale this business over time.

Michael Rollins (Analyst - Citigroup):

Since you just brought up the REIT structure, can I just ask you and Tony to remind us why you chose the structure of spinning it off and separating the ownership structure completely, instead of trying to keep some sort of stake to strategically keep all the assets under one roof? If you could just maybe remind us of some of the things that drove the decision for the proposed structure, thanks.

Jeff Gardner (President, CEO):

I will say two things and I will ask Tony to chime in. First, you've got to remember that we are not giving up any control of our network with this transaction. We are running our network; we are engineering our network the very same way that we do today.

So in terms of -- it is not going to be any -- it is not going to factor into our strategy about how we run our business or serve our customers. Our technicians are going to continue to run that network, and there will be no change from our customers' perspective.

Why we chose to do it as a spin-off was more about shareholders and the ability to provide shareholders the full access to realize value creation from that. And I will let Tony follow up on that.

Tony Thomas (President - Real Estate Investment Trust Operations):

Yes, Michael, when you look at some of the alternatives -- for example, the stapled REIT, it didn't have near the financial benefits that you get from the complete separation. Under the separation you get two independent companies; you get the full benefits of the valuation differential between triple-net REITs and diversified telecommunications.

You get the ability to have more leverage consistent with triple-net REITs. And ultimately the tax savings are only 49%. You're limited under a stapled REIT structure to simply 49% ownership, so by definition, you're leaving a lot on the table in terms of value creation.

So as we evaluated the structures, this is clearly the optimal structure. And frankly, we discuss this a little bit out at our website, WindstreamREIT.com, as well, where we have several thoughts on this question as well.

Michael Rollins (Analyst - Citigroup):

Thanks so much for taking those questions.

Jeff Gardner (President, CEO):

Thank you for joining our call this morning. We continue to see healthy demand for our broad suite of enterprise services and are well positioned in growth areas such as IP, next-generation data, MPLS, unified communications, data center, and cloud services, with well-established offerings in each area.

In addition, we are seeing solid and improving results in our consumer channel. We believe that this progress, in combination with the REIT spin-off and other strategic initiatives that we are pursuing, will continue to increase shareholder value over time. And again thank you for your time this morning.