



Rating
Hold

North America
United States

TMT
Telecom Services

Company
CenturyLink, Inc.

Reuters
CTL.N

Bloomberg
CTL US

Exchange
NYS

Ticker
CTL

Date
8 August 2018

Results

Price at 8 Aug 2018 (USD)	18.54
Price target	17.00
52-week range	21.96 - 13.62

Guidance hike yields more support for 2018: 2Q First Take

Revenues were lighter, but better Adj. EBITDA/lower capex bolster FCF outlook
Bottom line, we view CTL's 2Q results as an **incremental (near-term) positive**, given **increases to both its 2018 Adj. EBITDA and FCF outlooks (+3%/+14% at the midpoint, respectively)**. With that said, we believe **bears will continue pointing to lighter revenue growth trends, elevated leverage (4.2x net debt/LTM Adj. EBITDA) and a rising forward dividend payout ratio (in 2019)** as reasons to stay on the sidelines.

2Q18 results: Revenue of \$5.90bn was just shy of DBE/street, and -2.1% yoy ex-accounting changes (vs. -1.5% last quarter). **Adj. EBITDA** of \$2.27bn was +3% vs. DBE/consensus (margins were +280bp yoy); CTL noted it **exited the quarter with \$675mn in annualized run-rate Adj. EBITDA synergies** (vs. \$215mn last quarter, and as compared to its \$850mn target).

Walking through the FCF guidance increase - CTL increased the midpoint of its **2018 FCF guide by \$450mn** (+14% vs. prior), owing to: **(1) Higher Adj. EBITDA**, +\$225mn vs. prior (at the midpoint) owing to faster synergy realization, **(2) Lowered capex**, -\$150mn vs. prior (at the midpoint), and **(3) +\$75mn** in what we believe is tied to working capital/other.

Notes from the call Business

* **Medium & Small Business** revenues were -2.6% yoy ex-ASC 606 (given declines in legacy voice) – CTL is seeing improved productivity from sales teams

* **Enterprise** – growth was flat yoy. CTL noted it terminated an unprofitable government contract during the quarter.

* **International & Global Accounts** revenues were -1.3% yoy, ex-ASC 606, as CTL cited efforts to focus on more profitable revenue. The company renegotiated a contract with a large European customer that it expects will likely negatively impact revenues in 3Q as well, but will improve Adj. EBITDA. 70% of this segment's revenue is denominated in USD.

* **Wholesale** – CTL had a favorable settlement with a carrier during the quarter

Valuation & Risks

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Consumer

* 60% of CTL's broadband customers are at speeds below 20Mbps, 40% are above that

* Consumer revenue growth was -4.0% yoy ex-ASC 606

* Of the -80k broadband net adds this quarter, -134k were customers at speeds 20Mbps and below, vs. +54k net adds for customers at 20Mbps+ (and of the latter, +22k of this gain was at speeds 100Mbps+)

* CTL will increase residential broadband investment in targeted areas

* 40% of CTL's broadband base is on "Price-for-Life" plans. The simplicity around these plans drives lower churn, and reduces customer service costs (via fewer inbound calls).

Financials

* **Outlook** - The increased outlook for Adj. EBITDA this quarter was "primarily" driven by accelerated synergy capture.

* **Adj. EBITDA margins** - The company remains comfortable around its target for 5-7% of margin improvement over time (on top of the initial ~35% margin pre-deal). We note that at 38.5% today, this implies CTL's margins have room to improve to reach the ~40-42% range implied by this target. Management is re-focusing attention on more profitable revenue streams, and away from products like linear/OTT video, as well as certain (unprofitable) Business contracts; this could boost margins over time.

* **Capex** - Capex should trend higher in 2H18, after tracking at only ~13% of revenues in 1H (vs. guidance for 16% of revenue). These increased investments will be focused on "success-based" items such as converting on the sales funnel, funding the CAF build-out, more targeted spend in residential broadband, connecting key locations on-net, and to capture incremental deal synergies.

* **FCF** - FCF was impacted by various tax refund benefits and pension contributions. In 2Q18, CTL saw a \$314mn tax refund benefit, and contributed \$100mn to its pension plan (for a net \$214mn FCF impact). Since the start of 3Q, management noted that the company has received a +\$392mn tax refund (tied to tax reform treatment of 2016 income taxes), but will use this to fund a +\$400mn contribution (for a minimal FCF impact). Post-these contributions, CTL's pension plan is now 90% funded.

* **Leverage** - The company ended the quarter at 4.2x leverage, and remains focused on getting to the low end of the 3-4x target range. This path to de-leveraging is going to hinge on growth in Adj. EBITDA over time.



Cost synergies

- * Integration is pacing ahead of plan to achieve synergies
- * CTL expects to achieve more savings tied to digital transformation efforts

F/X

- * 95% of total CTL revenue denominated in USD (ie: less exposure to F/X swings)



Figure 1: CTL 2Q18 Actuals vs. Estimates (\$ mns, except per share/operating items)

	C2Q18				
	Actuals	Estimates	\$ Diff	% Diff	Consensus
Income Statement					
Medium & Small Business	\$884	\$851	\$33	3.9%	\$853
Enterprise	\$1,295	\$1,322	(\$27)	-2.0%	\$1,320
International & Global Accounts	\$903	\$949	(\$46)	-4.8%	\$942
Wholesale & Indirect	\$1,283	\$1,256	\$27	2.1%	\$1,250
Total Business	\$4,365	\$4,378	(\$13)	-0.3%	\$4,380
Consumer	\$1,352	\$1,363	(\$11)	-0.8%	\$1,360
Regulatory	\$185	\$187	(\$2)	-1.1%	\$184
Total Revenue	\$5,902	\$5,928	(\$26)	-0.4%	\$5,923
Non-GAAP Cost of Revenue	\$2,730	\$2,788	(\$58)	-2.1%	
Non-GAAP SG&A	\$955	\$990	(\$35)	-3.6%	
Adj. EBITDA	\$2,271	\$2,201	\$70	3.2%	\$2,208
% of Revenue	38.5%	37.1%		3.6%	37.3%
D&A	\$1,290	\$1,291	(\$1)	-0.1%	
Operating Income	\$767	\$794	(\$27)	-3.4%	\$818
% of Revenue	13.0%	13.4%			
Interest Expense	\$546	\$549	(\$3)	-0.5%	
Adjusted Net Income	\$282	\$233	\$49	21.2%	
Adjusted Diluted EPS	\$0.26	\$0.21	\$0.05	22.8%	\$0.24
Diluted Shares Outstanding	1,069	1,082	(13)	-1.2%	
Cash Flow					
Operating Cash Flow	\$1,582	\$1,980	(\$398)	-20.1%	
Capital Expenditures	\$771	\$936	(\$165)	-17.6%	
Free Cash Flow (reported)	\$811	\$1,044	(\$233)	-22.3%	\$849
FCF/Share	\$0.76	\$0.96	(\$0.21)	-21.3%	
Operating Metrics					
Consumer Broadband Subscribers	4,906	4,898	8	0.2%	
Broadband Net Adds	(80)	(88)	8	NM	(60)
Consumer ARPU	\$91.12	\$91.94	(\$0.82)	-0.9%	

Source: Deutsche Bank estimates, company information, FactSet, StreetAccount.



Appendix 1

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CenturyLink, Inc.	CTL.N	18.54 (USD) 8 Aug 2018	2, 8, 14, 15

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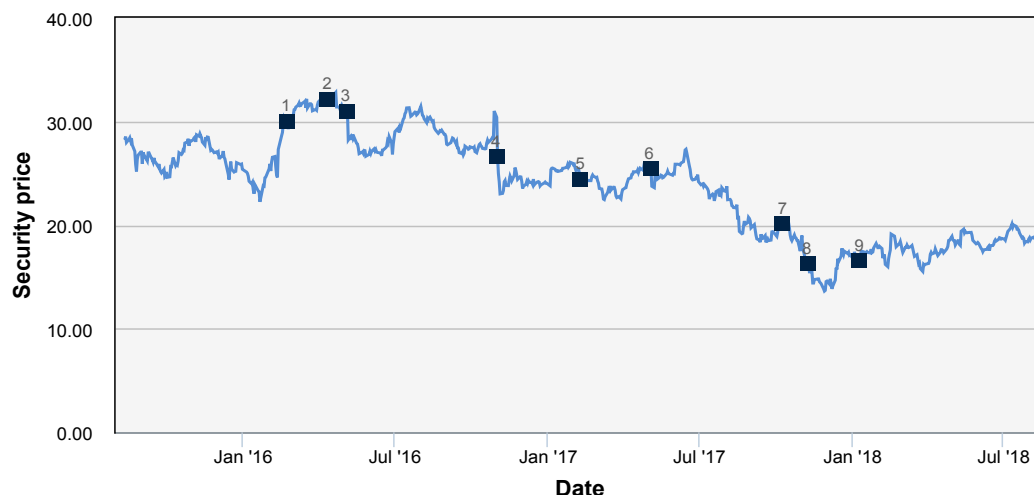
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Historical recommendations and target price. CenturyLink, Inc. (CTL.N)

(as of 08/08/2018)



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4.	11/01/2016	Hold, Target Price Change USD 26.00 Matthew Niknam	9.	01/10/2018	Hold, Target Price Change USD 17.00 Matthew Niknam
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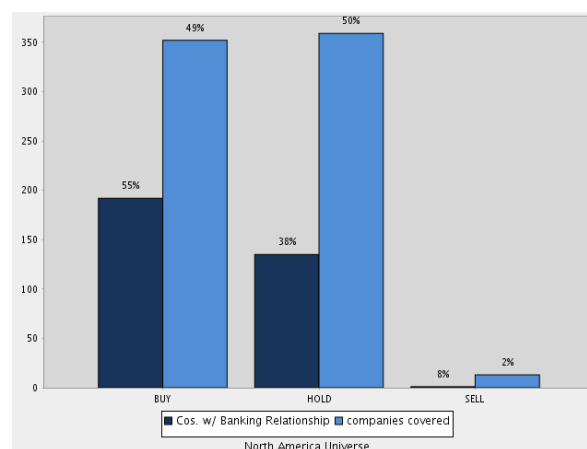
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