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Lumos Networks Corp. *(LMOS)*

Q3 2012 Earnings Call

CORPORATE PARTICIPANTS

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President, Chief Executive Officer & Director, Lumos Networks Corp.

Joseph Mccourt
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OTHER PARTICIPANTS

Ric Prentiss
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MANAGEMENT DISCUSSION SECTION

Operator: Good morning and welcome to the Lumos Networks' Third Quarter 2012 Earnings Conference Call and Webcast. All participants will be in listen-only mode. [Operator Instructions] After today's presentation there will be an opportunity to ask questions. [Operator Instructions] Please note this event is being recorded.

I would now like to turn the conference over to Mr. Hal Covert, CFO. Please go ahead sir.

Harold L. Covert
Chief Financial Officer, Treasurer & Executive VP, Lumos Networks Corp.

Good morning. This is Hal Covert, Chief Financial Officer of Lumos Networks Corporation. Welcome to Lumos Networks' Q3 2012 earnings conference call. The topics for today's call include remarks by Tim Biltz, our CEO, and Joe McCourt, our Chief Revenue Officer. Additionally I will provide a review of our financial results for the third quarter of 2012 and selected financial guidance. We will take questions at the end of our commentary. We ask that questions on this call be from current investors or analysts and any media questions will be directed to Jim Nester, Lumos Networks' Director of Public Relations.

Before we continue, I would like to point out that certain of the statements made on this conference call are forward-looking statements that are subject to risks and uncertainties that could cause actual results to differ materially from those described. Please refer to the special note from the company regarding forward-looking statements in our third quarter 2012 earnings press release issued late yesterday.

In an effort to provide useful information to investors, our comments today include non-GAAP financial measures. For details on these measures including reconciliations to the most comparable GAAP measures, please refer to our third quarter earnings press release and to information posted on the company's Investor Relations website.

Just before turning the call over to Tim, I would like to introduce [ph] Will Davis (02:20), our new Director of Investor Relations. [ph] Will (02:21) has great experience on Wall Street as well as in industry. During our upcoming trips to Boston and New York in November, hopefully, you will get a chance to meet [ph] Will (02:32) and visit with him. [ph] Will (02:35)?

Unverified Participant

Thanks, Hal. And I'm very excited to be a part of Lumos and I look forward to working with all of you. My mobile phone is going to remain the same. It's 917-519-6994. That's 917-519-6994 and please feel free to reach out at any time. Thank you.

Harold L. Covert

Chief Financial Officer, Treasurer & Executive VP, Lumos Networks Corp.

With that, I'll now turn the call over to Tim.

Timothy G. Biltz

President, Chief Executive Officer & Director, Lumos Networks Corp.

Thanks, Hal, and good morning, everyone and thank you for joining our call today. During our call today, I will highlight our strategic and operational goals, many of which we have discussed in earlier earnings calls. However, before starting that discussion, I want to say we are happy to report that our financial results for Q3 2012 for revenue and EBITDA were in line with our internal plan and financial guidance.

For the quarter, we generated $52 million in revenue and $22.3 million in EBITDA. And just as important, we are on track with our targeted sequential strategic data growth trajectory of 5%. And as we move forward through the fourth quarter of 2012, we're on that same trajectory and are prepared to enter 2013 with strong momentum. Shortly, Hal will cover our financial results for Q3 in detail as we – as well as our financial outlook for the fourth quarter of 2012.

As we discussed last quarter, our revenue growth and margin expansion opportunities are firmly embedded in our strategic data product lines. For the first time in the third quarter of 2012, strategic data revenue represented more than 50% of our total revenue. And we expect to end the full year of 2012, with strategic data revenue in the 50% range of total compared to approximately 43% last year.

Our enterprise and carrier data product lines represent approximately 80% of our strategic data revenue, split fairly evenly, and both customer segments have strong growth outlook as we look towards 2013.

The marketplace balance between these two important customer segments is extremely important from a number of standpoints. First, to meet our goal of achieving overall annual year-over-year revenue growth beginning in 2013, it is critical that we have two customer segments that are growing by more than 15% in 2012 when compared to 2011, and which we expect to continue along the same trajectory into 2013. This revenue growth momentum is projected to more than offset the ongoing projected declines in our legacy voice and access revenue streams.

Next, our strategic data adjusted EBITDA margin growth in 2013 and beyond is projected to more than offset the combined decline in adjusted EBITDA margin loss for our legacy voice and access product lines in terms of both absolute dollars as well as a percentage of revenue.

Finally, with the breadth and strong competitive profile of our strategic data product lines, we are in good position to leverage our advanced fiber optics network from both a customer satisfaction and a capital efficiency standpoint. In addition, we are in an excellent position to leverage our operational infrastructure to drive efficiencies throughout our organization especially installation and customer service.

Before getting into more detail about our enterprise and carrier data product lines, I'd like to provide some insight on how we plan to manage our legacy voice and access product lines. Within our legacy voice revenue streams, we believe that our CLEC revenue will continue to decline at an annual rate of approximately 15%. For 2012, we project that this revenue stream will be approximately $45 million. Our goal for this revenue stream is to retain higher margin customers and to upsell lower margin customers or to help them transition to other service providers in a graceful manner.

Legacy voice revenue from our RLEC product lines is projected to be approximately $18 million in 2012. This revenue stream will likely continue to decline at an annual rate of approximately 10% due to technology changes primarily related to the proliferation of wireless devices and other IP-based technologies. Our goal for this revenue stream is to continue to provide good customer service while maximizing cash flow.

Turning to our access revenue, our CLEC access revenue is projected to be approximately $10 million in 2012 and will likely continue to decline at an annual rate of approximately 20%. Our goal for this revenue stream is to continue to provide good customer care while maximizing cash flow.

Access revenue for our RLEC product line is projected to be $30 million in 2012 and decline at an annual rate of approximately 5% for the next several years. The 5% decline is based on our current understanding of the FCC's Access Reform Act.

Now, turning back to our growth story. Our strategic data product line, as I highlighted earlier, are future growth in both revenue and margin expansion. It's embedded in these two products. As we move forward and enhance our strategic data product offering we're pursuing three key themes, first, revenue growth; second, margin expansion; and third, capital efficiency.

From a revenue growth standpoint, we have upgraded and expanded our sales organization, implemented sales productivity tools and are continuing to implement our agile market strategy. Over the last several months in particular since Joe McCourt joined Lumos as our Chief Revenue Officer, we've made meaningful and significant progress on all three tracks.

For 2013, we believe we have – we currently have the product lineup and sales organization that is needed to achieve our revenue goal. Shortly, I will ask Joe to provide you with more insight into our efforts here. But let me first say how very excited we are to have the energy and the talent that Joe and his organization have brought and are bringing to the company.

Next, margin expansion. We are pursuing margin expansion from two primary aspects, as our strategic data revenue grows as a percent of our total revenue, we believe that our margins will improve as a result of this product mix.

As I indicated earlier in my discussions, our strategic data product margins as a percent of revenue are beginning to and are projected to continue to more than offset the combined losses of our legacy voice and access product lines. Therefore with its revenue growth profile, strategic data revenue will drive up our margins and improve our bottom line.

We are highly focused on ensuring that we fund our strategic growth data products while reducing expenses related to our declining product lines. Taking our continuous improvement productivity programs into consideration, as well as our efforts to manage expenses on a product line basis, we believe we can hold the cost of revenues and operating expenses relatively flat through 2013 as compared to 2012. Our continuous productivity in programs include workflow efficiency, partner management and back-office automation.

And finally, I'd like to discuss capital efficiency. Our capital efficiency initiatives have two key elements. First, network design and utilization. By successfully addressing this goal, we have the opportunity to lower our capital expenditures and to lower our cost of revenue for each dollar of revenue we generate.

With our engineering and operations organizations, we have dedicated cross-functional teams that are addressing this opportunity and are making meaningful progress. The second key part of our capital efficiency initiatives includes the selection process for success-based capital. We had cross-functional teams that include sales, engineering, operations, and finance that review all potential success-based capital projects before proposed deals are accepted. Hal will provide additional detail on this regard shortly.

In summary, I'd like to highlight two of our strategic products that we believe have all the right attributes both near and long-term revenue growth potential, targeted margin growth, and capital efficiency. These product lines include our fiber to the cell and Metro E products. In regard to our fiber to the cell product line, we exited the third quarter of 2012 with 261 towers installed, an increase of 83 towers for the quarter. 10 times more than we installed in the first quarter of 2012. And we expect to end the year with more than 300 towers installed.

All the major wireless carriers and broadband providers are our current customers and have purchased our carrier data product line and in most cases they represent meaningful revenue streams.

In regard to our enterprise Metro E product line, our top 10 customers alone represent nearly $10 million in annual revenue or approximately 20% of our 12 projected enterprise data revenue. We believe that as we enter 2013, we have the opportunity to improve on this profile as we continue to become more – a strategic partner for our largest enterprise customers.

And in closing, it is our goal to enter 2013 with strong momentum and to improve all aspects of our marketplace and financial performance. We look forward to providing more details in this regard during our next earnings call.

And now I'll turn the call over to Joe.

Joseph Mccourt

Chief Revenue Officer & Executive Vice President, Lumos Networks Corp.

Thank you, Tim. I will now provide some detail related to key initiatives that we have put in place in the last quarter. First, we have adapted tools that provide a sharp review of our sales team activity and productivity. We are benchmarking their progress each month and we're starting to see that our bookings are trending up.

Further, we have a better view of what our funnel looks like for the next few quarters. This intelligence should help all facets of the business for planning and staffing, as well as capital needs. Equally important, it will help us project our aggregate product line profitability going forward.

Secondly, we have crafted and communicated a clear and focused game plan for strategic data to continue to be the cornerstone of our product and service offering as we develop solutions for our prospects and customers.

In concert with that strategy, we have been gathering market intelligence into the prospect population that is adjacent to our metro networks. Additional data shows an aggregate that our market penetration is below 15%. We are optimistic that we have ample headroom to continue to drive our profitable products into more customers as we move forward. This includes the edge-out strategy as we opportunistically expand our footprint.

The initial boot camp training that I referenced in the last earnings call has now been delivered in the entire sales organization. The feedback has been overwhelmingly positive and we will continue to reinforce training as part of our journey.

Our customer sales engineering team has been leveraged to cover the increase in customer appointment activities. Sales engineers are on final part of our sales initiative including regular training on solution-based data products. We will continue to clearly strive to differentiate our company and this process starts with the first contact. Our goal is to earn the role of trusted advisor. Increasing technical knowledge across our team is a major step in the path to achieve this goal.

We have also brought in accomplished leadership for our field organization with a proven successful track record in the past. I am confident that the new additions in field management will further drive needed consistency across the entire sales team. We are continuing to grow our account management productivity and are focusing on attracting top talent.

Additionally, to support the increasing productivity, we have created an order entry team from the customer care organization. This allows for our sales representatives to spend more time prospecting for new business.

As Tim mentioned earlier, we've been busy closing out fiber to the cell towers in our carrier segment. We have a good backlog and expect to close more business this quarter. We continue to see robust activity in the fiber to the tower space and expect to have a seat at the table as the wireless carriers continue with their 4G roll-out program in our addressed markets.

In the last quarter, we contracted with a respected third party to undertake a brand study of Lumos Networks. The finding of the study will be useful to help us understand the relevance and recognition of our brand in the market with existing customers as well as prospects. With this feedback, we can develop an enhanced marketing focus as we strive to be well-known for trusted high-quality communication infrastructure solutions.

Lastly, the recent press release about our collaborative efforts to secure a redundant path between Atlanta and Ashburn has driven additional increase over the last few weeks. There are many carriers that share the common I-95 route. Carrier and enterprise customers looking for diversity from that segment for this essential data center connections are quickly seem to value of the non-commodity route. We believe the pending completion of the second path and future capability to deliver 100-gig waves will foster additional interest.

So, in summary, the team has been very busy setting the table for sequential growth at our enterprise and carrier data market segments. I am optimistic about the potential in front of us as we continue to pursue a high level of success each month and quarter. Our goal is to win customers by designing network solutions, not selling circuits. We are seeing positive results and expect that to continue as we prepare to enter 2013 with momentum.

Thank you for your time today. I will now turn the call over to Hal.

Harold L. Covert

Chief Financial Officer, Treasurer & Executive VP, Lumos Networks Corp.

Thank you, Joe. I'd like to cover three topics with you today. First, our unaudited financial results for Q3 2012; next, our capital expenditures program; and finally financial guidance for Q4 2012. Revenue for Q3 2012 was $52 million compared to $50.8 million for Q2 2012 and $51.6 million for Q3 2011.

Q3 2012 represents the first quarter in seven quarters that we expect to continue to achieve consistent year-over-year quarterly revenue growth going forward. Our projected growth is based on the outlook for continuing strong demand for our strategic data products.

Q3 2012's strategic data revenue was $26.1 million versus $24.9 million in Q2 2012 and $22.4 million in the same quarter last year. This represents a sequential increase of 4.8% and year-over-year increase of 16.5%. These increases were driven by good performance across all of our strategic data products, in particular, our enterprise and carrier data market segments. Overall, strategic data revenue represented 50.3% of our total revenue in Q3 2012 versus 49.1% in Q2 2012 and 43.4% in Q3 2011.

With our Q3 2012 run rate, strategic data revenue is continuing to increase as a percent of our overall revenue and is more than $100 million annual business, and for the first time in the company's history, represents more than 50% of our total revenue.

Q3 2012 legacy voice revenue was $16.1 million versus $16.2 million in Q2 2012 and $18.3 million in the same quarter last year. This represents a sequential decline of 0.6% and a year-over-year decline of 12%. The year-over-year decline which is in line with industry trends is due to the continuing commoditization of legacy voice revenue, the increase in use of wireless devices, and our shifting focus to VoIP and other strategic data products.

Overall, legacy voice revenue represent a 31% of our total revenue in Q3 2012, 31.9% in Q2 2012 and 35.5% in Q3 2011. Q3 2012 network access revenue was $9.7 million versus $9.7 million in Q2 2012 and $10.9 million in the same quarter of last year.

Going forward, we expect that network access revenue will continue to decline but be moderated to some degree as the FCC's Access Reform Act continues to be implemented while the year-over-year decline of 11% reflects for the most part carrier network grooming that took place in the last two quarters of 2011. Overall, network access revenue represented 18.7% of our total revenue in Q3 2012, 19% in Q2 2012, and 21.1% in Q3 2011.

Adjusted EBITDA for Q3 2012 was $22.3 million, compared to $21.1 million for Q2 2012 and $24.6 million for Q3 2011. This represents sequential increase primarily relates to higher revenue while the year-over-year decrease relates to expanding our sales and installation capacity ahead of expected sales and new expenses as a result of our separation from NTELOS on October 31, 2011.

To summarize, revenue and adjusted EBITDA for Q3 2012 were in line with our operating plan and financial guidance. In particular, our Q3 2012 revenue and adjusted EBITDA run rate reflects the influence of a higher concentration of strategic data products offsetting the combined impact of a loss of legacy voice and network access revenue and related adjusted EBITDA.

Now, I'd like to discuss the billing disputes. In our recent SEC filings we have discussed a number of customer billing disputes primarily related to RLEC business. As of September 30, 2012, we are happy to report that all major billing disputes have been resolved. Throughout 2012, we have been working diligently to settle these disputes in the most cost-effective manner possible. In Q3 2012, we settled the two largest disputes along with several smaller disputes.

During our Q4 2011 earnings call in February of this year, we indicated that we have approximately $22 million of billing disputes and approximately a $5 million reserve against these disputes as of December 31, 2011. The following is a summary of the cost of several billing disputes and the impact in our 2012 financial statements as of September 30, 2012.

First, the $5 million accrual just mentioned was eliminated and did not have an impact on our income statement in 2012. Second, a charge including legal expenses for negotiated settlements that were not in litigation reduced adjusted EBITDA by $2.5 million as of September 30, 2012. Approximately $0.6 million of this charge was reported in Q3 and just under $1 million was recorded in each of the first two quarters of 2012.

Third, a $3 million charge for negotiated settlement of a billing dispute that was in litigation was included in our Q3 financial results below the adjusted EBITDA level. During Q3 2012, we also settled a dispute related to our prior acquisition that resulted in a gain of $5.3 million. This gain was included in our Q3 financial results below the adjusted EBITDA level. All inclusive, the aforementioned transactions resulted in a cash outflow during the first three quarters of 2012 of approximately $2 million.

Turning to our capital expenditures program. Capital expenditures for Q3 2012 were $14.9 million, compared to $11.6 million in Q2 2012 and $17.4 million in Q1 2012 for a total of $43.9 million. For the same timeframe in 2011 capital expenditures were $48.8 million.

Our goal is to invest approximately 75% of our capital expenditures for success-based projects that are tied to near-term revenue opportunities for our strategic data products. Near-term is defined as approximately six months after a capital project is approved and the installation process has began. By comparison, the same data point for 2011 related to less than half of our capital expenditures for that year.

In particular in 2010 and 2011 we made significant investments to expand the footprint and capacity of our fiber-based network. As a result of these investments, we are now in a position to leverage our network and continue to accelerate the growth rate of our fiber-based data products and services.

To expand upon this point if you take our projected capital expenditures of $60 million for 2012, $45 million will be spent on success-based strategic data revenue growth opportunities. The remaining $15 million will be spent on maintenance IT and facilities.

We analyze and select our success-based capital projects based on achieving our targeted capital efficiency ratios, which include payback, return on investment, and EBITDA margin, and our targeted revenue growth rate. We believe that our success-based capital expenditures will be equally split between enterprise and carrier customers during 2012.

By focusing on success-based projects that are tied to our data, product revenue streams and leveraging the density and expanding footprint of our fiber-based network with on-net or near-net opportunities, we are in the position to improve upon our capital efficiency, as well as EBITDA margins.

The level of capital expenditures that we plan and incur has a direct correlation with our targeted revenue growth rate. Given this equation, we are in a position to manage the rate of our success-based capital expenditures that we make based on market conditions and targeted growth.

Moving on, adjusted EBITDA less capital expenditures for Q3 2012 was $7.3 million, compared to $9.5 million for Q2 2012 and $9.6 million in Q3 2011. Our net credit line balance after subtracting cash on hand was $4.7 million as of September 30, 2012, $5.7 million as of June 30, 2012 and $4.5 million as of December 31, 2011. We have a credit line of $60 million which is currently – with current availability of approximately $55 million.

Now turning to financial guidance for Q4 2012. Our financial guidance is as follows: revenue, approximately $52 million; adjusted EBITDA, approximately $22 million; capital expenditures, approximately $16 million. Including our actual financial results for Q1 through Q3 2012, together with our Q4 guidance, our 2012 financial guidance is as follows: Revenue approximately $206 million; adjusted EBITDA approximately $88 million; capital expenditure is approximately $60 million. Our initial annual financial guidance for 2012 that was provided in – on February 27, 2012 was for a revenue of $200 million to $205 million, adjusted EBITDA of $85 million to $90 million and capital expenditures of $52 million to $60 million.

With our current operating performance profile, the company should be in a position to achieve annual year-over-year revenue growth starting in 2013 as well as margin expansion. We look forward to providing you with our financial performance goals for 2013 during our Q4 2012 earnings conference call.

Please review our business outlook schedule which is attached to our Q3 2012 financial results press release that was issued late last night for a more complete summary of our most recent financial outlook for 2012. We have also posted a new company presentation to our website www.lumosnetworks.com that you may find of interest.

Now, we will open the call for questions. Operator, we'll take the first question.

QUESTION AND ANSWER SECTION

Operator: Thank you. We will now begin the question-and-answer session. [Operator Instructions] Our first question is Ric Prentiss, Raymond James. Please go ahead.

Ric Prentiss
Analyst, Raymond James & Associates

Q

Thanks. Good morning, guys.

Timothy G. Biltz
President, Chief Executive Officer & Director, Lumos Networks Corp.

A

Good morning, Ric.

Harold L. Covert
Chief Financial Officer, Treasurer & Executive VP, Lumos Networks Corp.

A

Good morning.

Ric Prentiss
Analyst, Raymond James & Associates

Q

Hey. First, good work in those disputes settled in out of the way.

Harold L. Covert
Chief Financial Officer, Treasurer & Executive VP, Lumos Networks Corp.

A

Thank you.

Ric Prentiss
Analyst, Raymond James & Associates
Q

I noticed also that on the cash statement the debt payments in 2012 now are $1 million higher. Was that partly related to settling the acquisition item or why would debt prepayments in 2012 or debt payments in 2012 go up?

Harold L. Covert
Chief Financial Officer, Treasurer & Executive VP, Lumos Networks Corp.
A

No, it was just mostly rounding in interest payments related to other things. So, it did not change from our original estimates.

Ric Prentiss
Analyst, Raymond James & Associates
Q

Okay,

Harold L. Covert
Chief Financial Officer, Treasurer & Executive VP, Lumos Networks Corp.
A

The primary difference in cash – if you remember last quarter I think we had forecasted right around $3 million of positive cash flow.

Ric Prentiss
Analyst, Raymond James & Associates
Q

Yes.

Harold L. Covert
Chief Financial Officer, Treasurer & Executive VP, Lumos Networks Corp.
A

And this year, it was essentially zero. The majority of that related to the billing disputes.

Ric Prentiss
Analyst, Raymond James & Associates
Q

Right. Right, okay. And obviously then, you're looking at kind of breakeven this year. As you think about CapEx success-based projects, Tim you're talking about how you prioritize them and select them and the dividend. Are you turning down projects this year? Is the dividend 100% safe? Just trying to think of how you look at cash spending now that you got the disputes out of the way.

Timothy G. Biltz
President, Chief Executive Officer & Director, Lumos Networks Corp.
A

Yes, I'll reiterate our position from the last two calls, which is the dividend we think is very important. It's an absolute number. Not a dividend play. So, we think about it as an absolute dollar amount. And to answer your question, no. It has not inhibited our growth. And we'll continue to push, our current financings allow us to have good runway to hit the targets we've been talking about and thinking about. And the – even though the RLEC business is in decline we have a very high profitable access revenues that come out of that business that can support that dividend. So, at this point, we – capital is not inhibiting our growth, nor at this point is the dividend.

Ric Prentiss
Analyst, Raymond James & Associates
Q

Great. Always like to hear that. In today's environment, you always want to make sure how secure the dividend feels.

Timothy G. Biltz
President, Chief Executive Officer & Director, Lumos Networks Corp. A

Okay.

Ric Prentiss
Analyst, Raymond James & Associates Q

When you think about margin expansion, the new slide deck that's out there, slide 22 is a very interesting slide with a financial model. It mentions margins going from kind of the 42 range that we've seen this year and returning at some point to the 47% plus range. Can you walk us through – I'm sure the mix obviously helps a lot with that, but can you just walk us through your thoughts about how you get back to that margin number and how long it might take and what might be involved?

Harold L. Covert
Chief Financial Officer, Treasurer & Executive VP, Lumos Networks Corp. A

Yes. So, I think the key on that – on the margin is two things, number one is, as we indicated earlier, we believe that we can take expenses out of our legacy businesses, and I think Tim indicated in his comments that we believe we can hold expenses relatively flat heading into next year.

The second key part of that, Ric, is what you just touched on, is the mix. And actually, if you look at that over a five-year period which is our strategic time period that we're working through right now, we see continued margin expansion throughout that period driven by good cost alignment with our product lines, as well as the mix change that's happening right now.

Joseph Mccourt
Chief Revenue Officer & Executive Vice President, Lumos Networks Corp. A

Yes, I think, Ric, you'll see – we indicated on the last call that we're picking a culture of product line profitability management. The Q this period will show more of how we're viewing the business. By the time we get to the K, you'll see a lot more information and analysis of each of our product lines and their margins. And as we start to project growth on each of those product lines, you'll be able to run that mix.

It started this quarter, and turned not only on absolute dollars but return on a margin basis. And even if you normalize for the billing dispute, slight turns. So, this was a very important quarter for the company. As, Hal said, we have a ton of initiatives to make us more efficient.

And – I'll leave it at that.

Harold L. Covert
Chief Financial Officer, Treasurer & Executive VP, Lumos Networks Corp. A

One of the things that we've been doing, Ric, to really understand and manage our business effectively is a strong focus on product line management now, and we have EBITDA goals for each one of our product lines and that's really driving a lot of the behavior that both Tim and I and Joe have talked about.

Ric Prentiss
Analyst, Raymond James & Associates Q

Great, thanks. I'll come back in if there's more time at the end.

Joseph Mccourt
Chief Revenue Officer & Executive Vice President, Lumos Networks Corp.

A

You got to ask me about towers.

Ric Prentiss
Analyst, Raymond James & Associates

Q

Well, of course. Fiber to the cell, nice – I mean obviously a great improvement there as far as the – getting from 178 to 261 in the quarter as far as fiber to the tower and obviously we both have a lot of background in the tower space. Can you talk a little bit about the ramping effort there and I was really intrigued starting to hear that some of the new RFPs are for second tenants and obviously our experience from the tower industry about that beautiful incremental margin business of the tower business probably some good incremental margins here too. So, maybe talk a little bit about how you've ramped it up and how's it continuing to ramp and what that opportunity for second tenants looks like?

Timothy G. Biltz
President, Chief Executive Officer & Director, Lumos Networks Corp.

A

All right. Yes, couple things. First of all, I've got to give credit to our deployment teams, our service delivery teams, they put great focus and work with customers in the timelines and have built an organization that can deliver like Joe sells, and that was proven this quarter. So, we have the capability to ramp that business and Joe has expectations of ramping it from a sales perspective. You could not be more correct.

The conversation we were just having about margin expansion – there is no greater – almost -improvements to our margins than adding a second tenant to our fiber to cell business or for that matter selling additional services anywhere on that, and Joe's got a significant focus on that. We did put a slide in the company presentation that talks about the leverage that we believe and the returns that can be generated on the fiber business to the cell based on various tenancies.

We will begin to look at that business on a normalized basis. We didn't put it out this quarter, but we'll talk about it certainly going into next year on a normalized [ph] BBE (36:12) basis. So, you can see what were kind of revenue generating form each asset. So, we're very excited about it. Not only that we can sell them but then we can install them and we can do both and – with a good trajectory.

Ric Prentiss
Analyst, Raymond James & Associates

Q

Great, thanks.

Operator: Our next question is from Donna Jaegers, D.A. Davidson. Please go ahead.

Donna A. Jaegers
Analyst, D. A. Davidson & Co.

Q

Hi, guys. Congratulations on a good quarter.

A

Thank you.

Donna A. Jaegers
Analyst, D. A. Davidson & Co.

Q

Can you – since Hurricane Sandy is so much in everyone's mind – I know you guys got hit by a huge snowstorm certainly in the West Virginia territory. Can you talk about any sort of network damage that you guys have suffered? On the construction plan for fiber to the towers, luckily you don't have a whole lot left to finish up in the fourth quarter, are those mostly in easy to get to locations? And then any sort of read on the competitive damage or on the damage that maybe some of your competitors might have suffered that would you give you guys more of an opportunity.

Harold L. Covert
Chief Financial Officer, Treasurer & Executive VP, Lumos Networks Corp.

A

Yes, a couple of things. Obviously Sandy will go down as one of the most historic storms that's hit this country. We, within our region, did not feel the full effect of Sandy. We did suffer the derecho that hit in late June, early July, which was much more devastating to Lumos from a network perspective. Having said that, you're absolutely right. West Virginia suffered a substantial blizzard, snowstorm, power outages. Our network, even at the peak of our outages, were still single digits versus during the height of the derecho we were down almost 50%.

Our teams learned a lot from the derecho, put a lot of those programs in place, and we actually have a little more time to prepare for it. So I wouldn't say – from an overall company perspective, it was severe but not – but small in percentage.

On the competitive side, that I really can't speak to. I know there's been some outages, but most of the damage in West Virginia has been to the south in the high mountains, Logan area, although there are some populations who are affected in Charleston, not as severe. Certainly not severe as the derecho and certainly nothing to the scale that others are facing along the coast due to Sandy's wrath. We're fortunate this way, on this one.

Donna A. Jaegers
Analyst, D. A. Davidson & Co.

Q

Good. And then a question, I guess, for Joe McCourt. Can you talk a little – you mentioned that bookings were up. I don't know if you can give any sort of quantification around that. And then also can you explore the data center opportunity a little more? Obviously, Ashland or – I think I'm saying it right, Ashland or Ashburn, has a lot of data centers there. What product – when will the fiber be finished to that, linking Atlanta and Ashburn and what sort of revenue opportunity could we be talking about?

Joseph Mccourt
Chief Revenue Officer & Executive Vice President, Lumos Networks Corp.

A

Okay. So on your first question with regard to bookings, I'm not going to go into specific numbers other than to say that we're trending upwards. And we feel very confident about where we are heading for the quarter and as we're heading to 2013.

With respect to the data centers, you've got one of the biggest destinations of the East Coast in Ashburn. A lot of people wanted to get to Equinix. The diversity that we provide on the network that we've established here is designed for lower latency, high capacity capabilities. There's a second leg that we're building, a small – a piece of fiber to connect back up to the other nodes so we'll have an east and west connection if you will.

The data center – the data center connectivity continues to drive, you think, few things like cloud services and just the pure demand for these large data centers that need to communicate back and forth. Atlanta being an area where a lot of the connections go south and west and the one in Ashburn going north and east. Having that diversity is really critical to a lot of companies and the carriers as well.

Specific revenue , I don't know that I'll get in to that on this call but to say, there's a good pent-up demand and we're seeing a lot of positive momentum.

Donna A. Jaegers
Analyst, D. A. Davidson & Co. Q

Okay, thanks.

Joseph Mccourt
Chief Revenue Officer & Executive Vice President, Lumos Networks Corp. A

Yes, thank you.

Operator: [Operator Instructions] We have additional questions from Ric Prentiss, Raymond James. Please go ahead. Mr. Prentiss?

Ric Prentiss
Analyst, Raymond James & Associates Q

Yes, I'm here.

Operator: Thank you.

Ric Prentiss
Analyst, Raymond James & Associates Q

Just wanted to go back to the RLEC erosion a little bit. Obviously the grooming affected second half 2011, we've seen some erosion this year but not as bad as thought. Can you walk us just through your visibility on the rules and the step downs and anything going on as far as the Connect America side also. Just kind of help us get a little more comfort as we start looking into 2013 and 2014 that there's good visibility on the erosion path.

Harold L. Covert
Chief Financial Officer, Treasurer & Executive VP, Lumos Networks Corp. A

Yes, Ric just before doing that though, back on the debt for a minute.

Ric Prentiss
Analyst, Raymond James & Associates Q

Yes,

Harold L. Covert
Chief Financial Officer, Treasurer & Executive VP, Lumos Networks Corp. A

As I indicated, the debt payment essentially stayed the same right around $2 million. So, and then we have some lease payments that caused the number to round the $2 million that we have in there in the past to $3 million.

So, in regard to the RLEC, we have a lot more visibility now. We have a good view of what the Connect America Fund is going provide to us. We've done a fairly extensive analysis on it. And that's why as we indicated earlier, we believe that going forward, the plan is going to be moderate. And we think it's going to be in the 5% range.

And if you look out over the longer period of time, 2013, 2014, and 2015, we believe that that payment is going to about the same. Now, of course there could be changes and we'll update when we get those changes. But we, at this point in time, have very good visibility. We have a person that's fully dedicated to watching that model along with our product line profitability. So, we spend a lot of time making sure that we do understand that. So, that reflects our comments earlier today.

Ric Prentiss
Analyst, Raymond James & Associates

Q

Okay. And then maybe a little bit of thought about M&A environment out there. On my other side of my hat, the tower side and the wireless side, my gosh, there's certainly been a flurry of activity in the space. What are you guys seeing on the CLEC, RLEC side as far as M&A, both appetite to buy stuff, appetite to sell stuff? Just kind of what's the environment looking like out there?

Harold L. Covert
Chief Financial Officer, Treasurer & Executive VP, Lumos Networks Corp.

A

Well, we're so focused on organic growth, I hadn't really – around that arena. Look, there has been activity. There's been both private transactions. The rules have changed and allowed the MFOs to get into the space. It's driving some values up. We – so I think those are the two fundamental change. Right? There's been some private transactions that are continuing to go on and some of the values of those companies that are clearly positioned us broadband providers and supplying services to enterprise. Those values are going up.

We're very, very focused on turning this company into a data company, a broadband provider and we – I could say, officially we are now with over 50% and growing. So, you haven't seen a lot of big transactions. I think everyone's just kind of talking and looking and analyzing, but clearly where there's demand and growth and leverage, a few transactions, probably pretty good environment for that. So, it's built, we're – not have to – not going have to buy anybody [indiscernible] (44:28).

Ric Prentiss
Analyst, Raymond James & Associates

Q

Yes. Back to slide 22 from your financial deck that was – or from your company deck It mentions "annual long-term goals". It talks about the strategic data revenue, legacy voice revenue. You talked a little bit on the conference call about that too. But should we think of those as both annual and long-term goals? I was kind of a little confused by the column heading.

Harold L. Covert
Chief Financial Officer, Treasurer & Executive VP, Lumos Networks Corp.

A

Yes. I think that's the right way to think about it. It's annual and it's kind of a long-term view of where it's going.

Ric Prentiss
Analyst, Raymond James & Associates

Q

Okay. And capital expenditures on that slide 22 also were talking about kind of keeping it in the under 30% of revenue range. Is that kind of – do you think there is the runway for not just 2013 but 2014 and 2015 to spend that much of revenue on these growth initiatives?

Harold L. Covert
Chief Financial Officer, Treasurer & Executive VP, Lumos Networks Corp.

A

Yes, give the importance of our two market segments, carrier, and enterprise, we believe that there's a growth opportunity. We want to be in a position to take advantage of that. Now, we are all watching our capital efficiency very carefully and we think as we indicated earlier, we can make some improvements there. And I think if you look at the performance that we have this year, we've done this very right. That we're on that track. But we're going to continue to invest for growth.

Timothy G. Biltz
President, Chief Executive Officer & Director, Lumos Networks Corp.

A

And I want to say, Ric, my experience is that the company is doing an excellent job of performing and growing organically and putting capital to work. Access to capital is generally not the problem. And – so we're focused.

Our current model lives and works within the numbers on that page but we're not restraining ourselves to that. We see good opportunities to grow.

Ric Prentiss
Analyst, Raymond James & Associates

Q

Okay. And final question from me, I think Hal maybe just remind us, there's a higher amount of debt repayments in 2013 just to the way the A and B term loans are structured, right? And how much is that?

Harold L. Covert
Chief Financial Officer, Treasurer & Executive VP, Lumos Networks Corp.

A

$5.5 million in 2013 and then it goes up in 2014. And again, we've factored that into our consideration on it from the planning standpoint.

Ric Prentiss
Analyst, Raymond James & Associates

Q

Sure. Okay. Thanks, guys.

Timothy G. Biltz
President, Chief Executive Officer & Director, Lumos Networks Corp.

A

Thank you, Ric.

Harold L. Covert
Chief Financial Officer, Treasurer & Executive VP, Lumos Networks Corp.

A

Thank you.

Operator: Our next question is Bob Bridges, Sterling Capital Management. Please go ahead.

Bob W. Bridges
Analyst, Sterling Capital Management LLC

Q

Good morning. Can you please comment on – maybe some internal sales metrics that you're looking for in terms of productivity as you've expanded yourselves for us as you've given additional training? What would be important for investors to understand as far as your expectation on the sales productivity growing in the next year or so.

Timothy G. Biltz
President, Chief Executive Officer & Director, Lumos Networks Corp.

A

From our productivity standpoint, what we're doing is measuring actual results by month and by quarter and then benchmarking the team. And then looking at what their continued funnel growth is and looking at what the productivity will net out as we grow, we're putting more focus on going that market into the solution selling that I referenced in my comments and getting away from that – the low-end transactional two and three-line type accounts.

By nature of that and the training that we're doing to enhance our team, we're really fine tuning it. The goal is to attract top talent, of people that understands solution selling and not chasing the small accounts. The absolute focus and discipline that we've implemented in solution selling is netting a continued climb.

I think I can say we have seen a good, solid percentage of growth productivity in – when you compare Q3 in aggregate to Q1 and Q2. We're seeing an upper trend and all indications for Q4 state that that's going to continue.

Harold L. Covert
Chief Financial Officer, Treasurer & Executive VP, Lumos Networks Corp.

A

I think the best indicator is the sequential growth that we talked about even – again, in Q3 we have 5% sequential growth for our data products and we expect that kind of range to continue going forward. So, that's the ultimate measurement.

Joseph Mccourt
Chief Revenue Officer & Executive Vice President, Lumos Networks Corp.

A

Yes.

Timothy G. Biltz
President, Chief Executive Officer & Director, Lumos Networks Corp.

A

And the only thing I would add, it may not have been to say like a real specific crisp answer is because there is. But one of the things that I love that Joe has done is he has bifurcated the sales force by responsibility. And we have orders that range from $15,000 a month or higher to $4,000 and $3,000 depending on what they're trying to sell.

And when I first got here, we have several people that have a thousand dollars in a month or less, so we are selling a different set of products, different sales cycle, larger solutions, and so it's not as easy and crisp. We'll try to do a better job to refine that after we have a little track record. But what I'm very comfortable with is he is driving bookings that are leading to sequential data growth. So, and even on my first call I said we probably had in the year with fewer sales people than we have. We're probably pretty close to where we were. But the productivity is up and the quarters are up.

Bob W. Bridges
Analyst, Sterling Capital Management LLC

Q

And from an incentive perspective, is there anything material that you all had to restructure in the incentive package when you arrive? Do you think you have to buy incentives in place for your sales team today?

Timothy G. Biltz
President, Chief Executive Officer & Director, Lumos Networks Corp.

A

We might make a few tweaks to the comp plan as we move into 2013. Since I have been in sales many, many years, I've always realized that you want to reward performance and we're going to pay the people that do the job. There will be incentives for people to overachieve above and beyond. And the focus is obviously driving the value with more and more on that bookings. So, we're going to pay people to – and incent them to continue to drive the enterprise data growth on that. That's really the focus.

Bob W. Bridges
Analyst, Sterling Capital Management LLC
Q

Maybe the last question would be one of – in your businesses you got an interesting position given the rate of decline on the legacy side of the house and the great growth opportunity, because in return potentially you've got on the strategic data side. Going forward what level of disclosure should we be looking to in terms of you've got these kind of six month windows? Should we be certain to get any more granular disclosure in terms of, oh gosh, return hurdles backlog, your changes to the CapEx or the EBITDA going forward or to the current reporting package, what we should be counting on?

Timothy G. Biltz
President, Chief Executive Officer & Director, Lumos Networks Corp.
A

Yes, I think that the first step in that was if you take a look at our company presentation, I think there's a lot more information in the previous company presentation. And as we wrap up our planning process for 2013 and get more oriented towards product line, profitability and goals, we will probably provide some additional metrics and we'll get back to you with those.

Bob W. Bridges
Analyst, Sterling Capital Management LLC
Q

Yes, but the level of disclosures is great and anything more on the success CapEx and the payout would be really helpful for the announcement. Thanks a lot.

Timothy G. Biltz
President, Chief Executive Officer & Director, Lumos Networks Corp.
A

Now, we got it and we'll look into it. Thank you.

Bob W. Bridges
Analyst, Sterling Capital Management LLC
Q

Thank you.

Operator: Next we have some additional question from Donna Jaegers, D.A. Davidson. Please go ahead.

Donna A. Jaegers
Analyst, D. A. Davidson & Co.
Q

Hey, just two quick follow ups. The timing of the construction of the diverse path from Atlanta to Ashburn, when does that come in so we can sort of fine tune our 2013 estimates?

Timothy G. Biltz
President, Chief Executive Officer & Director, Lumos Networks Corp.
A

I think we'll see that up and operational by the end of Q1, Donna.

Donna A. Jaegers
Analyst, D. A. Davidson & Co.
Q

Great. And can you remind us, I don't think you guys have a whole lot of vulnerability on Universal Service Fund but can you remind us what the dollar amount that you've received from Universal Service Fund is?

Harold L. Covert
Chief Financial Officer, Treasurer & Executive VP, Lumos Networks Corp.

A

Yes, approximately $10 million in total.

Donna A. Jaegers
Analyst, D. A. Davidson & Co.

Q

And how much of – on the connect – on the FCC rules, I think there's still influx. When do you expect to hear more as far as how the Universal Service Fund will be dealt with going forward?

Harold L. Covert
Chief Financial Officer, Treasurer & Executive VP, Lumos Networks Corp.

A

Yes, I think there's activity going in that on a routine basis. So, we think probably in the next few months, we'll have more visibility on some of the changes that are coming in 2013.

Joseph Mccourt
Chief Revenue Officer & Executive Vice President, Lumos Networks Corp.

A

But we're getting our share today. We're measuring the rules as we understand them and – that is still an ongoing process but we think that we are getting what we deserve under the current rules.

Donna A. Jaegers
Analyst, D. A. Davidson & Co.

Q

Okay, great. Thanks a lot guys.

Harold L. Covert
Chief Financial Officer, Treasurer & Executive VP, Lumos Networks Corp.

A

Thank you.

Timothy G. Biltz
President, Chief Executive Officer & Director, Lumos Networks Corp.

A

Thank you, Donna.

Operator: Having no further questions. This concludes our question-and-answer session. I would like to turn the conference back over to Hal Covert for any closing remarks.

Harold L. Covert
Chief Financial Officer, Treasurer & Executive VP, Lumos Networks Corp.

As a reminder a replay of this call and an archive of this audio webcast will be available. Please refer to our Investor Relations website for details. Thank you again for joining us this morning. This concludes our call.

Operator: The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.