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Lumos Networks Corp. *(LMOS)*

Q4 2012 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning. And welcome to the Lumos Networks' Fourth 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. Will Davis, Director of Investor Relations. Please go ahead.

Will Davis
Director of Investor Relations, Lumos Networks Corp.

Good morning. This is Will Davis, Director of Investor Relations, for Lumos Networks Corporation. Welcome to Lumos Networks fourth quarter 2012 earnings conference call. The topics for today's call include remarks by Tim Biltz, our CEO; and a financial results update by Hal Covert, our CFO. We ask that questions on this call be from current investors or analysts and that any media questions be directed to Jim Nester, Lumos Networks' Director of Marketing Operations (sic) [Public Affairs] (01:00).

Before we continue, I'd 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 fourth quarter 2012 earnings press release issued earlier this morning.

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 fourth quarter earnings press release and to information posted on the company's Investor Relations website.

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

Timothy G. Biltz

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

Thanks, Will, and good morning. And thank you for joining our call today. During my discussion today, I will cover key achievements that Lumos Networks experienced in 2012, the building momentum that these achievements generated as we move through the year and into 2013, and cover our key goals for 2013. However, before I start that discussion, I want to say that we are happy to report that our financial results for Q4 2012 and for the year 2012 for both revenue and EBITDA were in line with our internal plan and above our financial guidance.

During Q4 2012, we generated $52.7 million in revenue and $23.2 million in EBITDA. And for the full year 2012, we achieved revenue of $206.9 million and $88.9 million in EBITDA. Shortly, Hal will cover our financial results for 2012 in more detail, as well as our financial outlook for the first quarter of 2013 and for the full year of 2013.

Throughout 2012, we made major enhancements in each of the areas that I will highlight and, in aggregate, achieved meaningful progress as we strive to strengthen our position as a leader in providing next-generation communications solutions over our ever-expanding advanced fiber optic network. First and most importantly, we validated our winning strategy of being a broadband, fiber-based facility service provider, focused on data solutions and mobility.

For our Strategic Data products, during each quarter of 2012, we averaged sequential revenue growth of approximately 4%, achieved year-over-year revenue growth of 16%, and generated 53% of our total revenue from this category. In 2011, we generated 45% of our revenue from Strategic Data and 38% in 2010. Our goal for 2013 is to generate approximately 60% of our total revenue from Strategic Data and to exit the year with a run rate well north of 60%, so that we can continue to build this momentum into 2014.

With our focus on Strategic Data products, we expect to achieve year-over-year revenue growth in 2013, as well as sequential revenue growth for each quarter in 2013. We believe that our current addressed marketplace, as well as our edge out marketplace opportunities in Eastern Virginia and Western Pennsylvania offer sufficient opportunities for us to achieve our revenue growth targets.

From an EBITDA standpoint, as our total revenue mix becomes more and more influenced by our Strategic Data products, we have the opportunity to expand our EBITDA margins in 2013 and over the next several years. During the second half of 2012, we improved our EBITDA margin sequentially in the third and fourth quarter and with our 44.1% margin in the fourth quarter of 2012, achieved a favorable year-over-year comparison as well.

As we head into 2013, we expect to continue a positive trend pattern sequentially and year-over-year. Hal will provide an overview of our product families, including targeted growth rates and EBITDA margins, shortly.

We believe that we have a strong Strategic Data product offering from a customer value proposition and sustainable competitive advantage standpoint. This belief has been validated over the last several years with the growth rates that we have achieved and our outlook for 2013.

Now, I'd like to discuss our management team. Throughout 2012, we have formed an experienced, capable and motivated management team. Every functional area of the company has focused on strengthening their management team members. Starting in June, when Joe McCourt joined the company, we have added senior leadership in our sales and marketing team in every region of the company.

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In fact, in January of 2013, Joti Balani joined the company as Vice President of Marketing, reporting to Joe. Joti most recently was with Zayo. However, prior to the acquisition, she spent six years in product marketing with AboveNet. Her extensive experience in our industry, her proactive leadership style and direct experience in marketing will make her a tremendous addition to the team.

In operations, we've added senior managers in our service delivery and installation teams, as we focused on accelerating our revenue cycle and improving customer satisfaction. These teams proved their capabilities by completing 222 fiber to the cell installations in 2012, with 192 of these in the second half of the year, including 109 in the fourth quarter.

By doing this, Lumos ended the year with 370 fiber to the cell installations. And we are well positioned to achieve our goal of exiting 2013 with approximately 550 to 600 fiber to the cell installations. Just as important, this would put us on a path to reach our goal of 1,000 fiber to the cell installations over the next three to four years. Other functional areas of the company such as finance, IT, product, engineering and network development have also meaningfully enhanced their capabilities of their management teams.

Finally, in 2012, we received positive and differentiating feedback from our customers regarding our evergreen product offering and our end market service programs. While in each of our addressed marketplaces we have competitors and we generally expect competition to intensify, typically our competition is the incumbent and the MSO. However, our new customers and continuing customers and prospective customers continue to prove that we're well-positioned from a competitive standpoint with our product offering and leading edge end market service programs.

To summarize 2012, we validated our strategy, strengthened our management team, improved our addressed marketplace penetration, continued to pursue near-term edge out marketplace opportunities, and achieve continuous financial performance improvement. With these attributes and our momentum, we believe that the path to success in 2013 is now all about operational excellence.

With that as a lead – and I'd like to highlight our primary strategic and operational imperatives for 2013. First, to achieve total year-over-year revenue growth in 2013 for the first time in three years, while continuing to achieve Strategic Data revenue growth at a faster rate than our addressed marketplace is growing. Next, to continue to focus on high-margin differentiated Strategic Data products, by providing highly competitive products and services at all entry points of our addressed marketplace.

With our mix of Enterprise Data products, Carrier Data products and IP Services, we believe that we are well positioned to achieve this goal. Our Enterprise Data products include leading-edge differentiated products and services such as enhanced Metro E, robust high capacity private line offerings.

Our IP Services include leading-edge voice over IP, broadband and video services. The combination of these product groups represent nearly 50% of our Strategic Data revenue and provide us with a highly competitive product offering, which we can address to all enterprise needs over our dense and rapidly expanding fiber infrastructure.

Our Carrier product group includes transport and fiber to the cell product lines. With the density and reach of our network, we are well positioned as a leading provider of these fiber-based broadband products and services. The combination of these products represent approximately 50% of our total Strategic Data revenue. Our customers in this category include all major wireless carriers and most of the major broadband service providers.

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Moving on to capital expenditure efficiency. Our goal is to optimize our capital efficiency by pursuing on-net and near-net opportunities and maintaining a balanced mix of enterprise and carrier business. By pursuing these attributes, we believe we will continue to achieve our capital efficiency goals. And with our long-term customer contracts that are now typically signed at more than four years, these goals were achieved in 2012 and we believe will continue to be achieved in 2013.

In addition, we will continue to pursue our goal of deploying capital with a success-based orientation. In 2012, more than 75% of our capital expenditures of $60 million were for near-term revenue projects.

Finally, we continue to enhance our management team in terms of skill set and execution capability. Many members of our management team have only worked together for six months or less. Therefore, we believe that we have a tremendous opportunity to enhance our productivity throughout the year.

A key data point in this regard is our goal to grow revenue in 2013, while holding expenses relatively flat when compared to 2012. We believe that we can achieve this goal by focusing on three action items: first, by continuing to maintain our EBITDA margins as a percent of revenue for our declining product families such as legacy voice and access; next, to increase the rate at which we streamline and automate our business processes; and finally, to continue to focus on cross-functional organizational alignment, accountability and communications, therefore, maximizing our execution efficiency and timing.

You noticed in the fourth quarter, we shifted expenses from our legacy products to fund our growth products. This was notable when we implemented an early retirement program, in which 90% of the participants had been focused on legacy products. In summary, we believe that 2013 is all about continuing our momentum through operational excellence.

Just before turning the call over to Hal, I would like to wrap up my discussion by highlighting a couple points. First, we have passed through a critical inflection point at Lumos. We are now a growth company, with the opportunity to expand margins and take full advantage of our marketplace opportunities. Look forward in 2013 to year-over-year revenue growth, year-over-year EBITDA growth, margin expansion, and exiting the year with Strategic Data exceeding 60% of our total revenue.

We look forward to visiting with the investment community to discuss our plans for 2013, but I want to first thank our team for all the accomplishments in 2012. And we look forward to providing an environment where employees can excel and be rewarded for exceptional team and individual performance.

Thank you. We'll now turn the call over to Hal.

Harold L. Covert Jr.

Executive Vice President, Chief Financial Officer, Chief Accounting Officer and Treasurer, Lumos Networks Corp.

Thank you, Tim. I would like to cover three topics with you today; first, our unaudited financial results for Q4 2012 and for the year 2012; next, an overview of our three product families; and finally, financial guidance for Q1 2013 and the year of 2013.

Please note that as of the end of 2012, the company went through an extensive process of ensuring that we classify revenue in the most descriptive manner possible from a product family standpoint. Revenue numbers that I discuss today will reflect some differences in reported revenue from a product family standpoint in 2011 and 2012.

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Total revenue did not change. The reclassification of selected product family revenue was an important step in the process of moving to product line reporting in 2013. You will find a comparative schedule posted on our website, www.lumosnetworks.com, for 2011 and 2012 that reflects revenue as reclassified and reported. Revenue for 2013 will be reported in the same manner consistent with the reclassified revenue in the schedule.

Revenue for Q4 2012 was $52.7 million compared to $52 million for Q3 2012 and $51.1 million for Q4 2011. For the year of 2012, revenue was $206.9 million compared to $207.4 million in 2011. Q4 Strategic Data revenue was $29 million versus $27.4 million in Q3 2012 and $25 million in the same quarter last year. This represents a sequential increase of 6% and a year-over-year increase of 15.8%. These increases were driven by good performance across our entire Strategic Data product family, in particular Enterprise and Carrier Data product lines.

Overall, Strategic Data revenue represented 55% of our total revenue in Q4 2012 versus 52.6% in Q3 2012 and 49% in Q4 2011. With our Q4 2012 run rate, Strategic Data revenue is continuing to increase as a percent of overall revenue, continues patterning a meaningful sequential growth, and is more than $115 million annual business.

Q4 2012, legacy voice revenue was $15.4 million versus $16.1 million in Q3 2012 and $17.8 million in the same quarter last year. This represents a sequential decline of 4.2% and a year-over-year decline of 13.4%. The year-over-year decline is due to the continuing commoditization of legacy voice revenue, the increase in use of wireless devices, and our shift in focus to VoIP and other Strategic Data products. Overall, legacy voice revenue represented 29.9% of our total revenue in Q4 2012, 30.9% in Q3 2012, and 34.8% in Q4 2011.

Q4 2012 access revenue was $8.3 million versus $8.6 million in Q3 2012 and $8.3 million in the same quarter last year. Going forward, although there are still some uncertainties, we expect that our access revenue will decline at a moderate rate due to the FCC access reform order. Overall, access revenue represented 15.7% of our total revenue in Q4 2012, 16.5% in Q3 2012, and 16.2% in Q4 2011.

In 2012, Strategic Data revenue represented 52.6% of total revenue and grew 16.2% year-over-year. Legacy voice revenue was 31.1% of total revenue in 2012 and declined 49% year-over-year, while access revenue was 16.3% and declined 11.7% year-over-year. Shortly, I will provide more details about these product families.

Adjusted EBITDA for Q4 2012 was $23.2 million compared to $22.3 million for Q3 2012 and $23 million for Q4 2011. The sequential increase in EBITDA is primarily due to higher revenue, while holding expenses relatively flat.

In Q4 2012, we recorded a $3 million restructuring charge that was related to a reduction in force of approximately 60 people or 10% of our workforce and for real estate consolidation charges. The reduction in force accounted for $2.4 million of the $3 million. Approximately 50% of the $3 million will be paid in Q1 2013, with the remainder spread throughout the year. The restructuring charge, which was announced in December 2012, was not included in the aforementioned adjusted EBITDA.

To summarize, revenue and adjusted EBITDA for Q4 2012 were in line with our internal plan and above our financial guidance. In particular, our Q4 2012 revenue and adjusted EBITDA run rate reflects the influence of a higher concentration of Strategic Data products, somewhat offset by lower legacy voice and access revenue.

Adjusted EBITDA for 2012 was $88.9 million compared to $96.9 million in 2011. The adjusted EBITDA decline of $8 million relates to the $3.2 million for the settlement of billing disputes in 2012 and $4.8 million for increased expenses due to our spin-off from NTELOS in October of 2011.

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Turning to capital expenditures. In 2012, capital expenditures were $59.9 million compared to $61.5 million in 2011. Approximately 75% of our capital expenditures in 2012 were for success-based projects. By focusing on success-based projects that are tied to our Strategic Data products and leveraging the density and expanding footprint of our fiber-based network with on-net or near-net revenue opportunities, we are in a position to continue to enhance our capital efficiency ratios, as well as EBITDA margins.

Moving on, adjusted EBITDA less capital expenditures for Q4 2012 was $7.3 million compared to $7.3 million for Q3 2012 and $10.3 million in Q4 2011. The primary reason for the year-over-year decline relates to capital expenditures of $16 million in Q4 2012 versus $12.7 million in Q4 2011.

Our net credit line balance after subtracting cash on hand was $3.5 million as of December 31, 2012, $4.7 million on September 30, 2012, and $4.5 million as of December 31, 2011. During Q1 2013, our net credit line balance is projected to increase to approximately $12 million due to paying for capital expenditures that were incurred in Q4 2012, a higher level of debt principal amortization starting in 2013, and payment of a meaningful amount of the restructuring charges previously discussed. We have a credit line of $60 million with a projected availability of approximately $50 million as of 2/28/2013.

Now, I'd like to discuss our three product families. First, our goal is to generate approximately 80% of our Strategic Data revenue from on-net customers. Achieving this goal will result in the optical – optimal mix for capital expenditures, efficiency, and adjusted EBITDA margins. Our current level of achievement for this data point is 70%.

As in 2012 and going forward, the majority of our capital expenditures will be for on-net or near-net customers and to pursue our edge out marketplace strategy for success-based Strategic Data products. Our RLEC revenue is essentially all on-net, while a little less than half of our CLEC voice revenue is on-net.

Our Strategic Data product family consists of three product groups: Enterprise Data, Carrier Data and IP Services. Our goals for this product family are; drive sequential and year-over-year revenue growth, maximize network efficiency by generating approximately half our revenue from Enterprise Data and IP Services and the other half from Carrier Data, and expand aggregate adjusted EBITDA margins.

Each of the aforementioned product groups has a number of associated product lines. For example, Enterprise Data, Metro E and robust high capacity private lines; Carrier Data, transport and fiber to the cell; IP Services, voice over IP, video and broadband. We expect that our Strategic Data product family will continue to grow in the range of 15% to 20% annually and achieve adjusted EBITDA margin in the 45% to 50% range over the next several years. In 2012, Strategic Data revenue represented approximately 53% of total revenue compared to 45% in 2011. In 2013, our target is 60% for the full year with a year-end annual exit rate of approximately 63%.

Our legacy voice product family consists of two product groups: CLEC voice that represents approximately 70% of total legacy voice revenue; and RLEC voice revenue, approximately 30%. In 2012, legacy voice revenue accounted for 31% of total revenue. Overall, we expect our legacy voice product family revenue to decline at 10% to 15% annually, with CLEC voice revenue declining faster than RLEC voice revenue. Adjusted EBITDA margin for this product family is projected to be in the 20% to 25% range.

Our access product family consists of two product groups: CLEC access revenue that represents approximately 30% of total access revenue; and RLEC access revenue, 70%. In 2012, access revenue represented 16% of total revenue. Overall, we expect our access product family of revenue to decline at 10% to 15% annually, with CLEC access revenue declining faster than RLEC access revenue.

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Adjusted EBITDA margin for this product group is projected to be in the 70% to 75% range. We believe that our RLEC access revenue will decline approximately 5% annually over the next several years, now that a large part of the network grooming that we experienced during the second half of 2011 is behind us and we started recognizing earned CAF reimbursement revenue in line with our expectations.

Going forward, in 2013, our goal is to continue to provide meaningful financial and marketplace information about our product lines and addressed marketplace. We have posted a new company presentation on our website that you may find informative, as well as comparative financial information for 2011 and 2012.

Finally, we would like to discuss financial guidance for Q1 2013 and the full year of 2013. Our financial guidance for Q1 2013 is as follows: revenue approximately $52 million, adjusted EBITDA approximately $23 million, capital expenditures approximately $16 million, line of credit balance approximately $12 million.

Our financial guidance for 2013 is as follows: revenue $208 million to $212 million, adjusted EBITDA $94 million to $97 million, capital expenditures $65 million to $70 million, line of credit balance $10 million to $16 million.

In the first half of 2013, we will explore refinancing options. Our goal is to have cash on hand and credit line availability that will accommodate our success-based Strategic Data growth plans over the next several years. Given our Q4 2012 EBITDA run rate annualized and our EBITDA projection for 2013, we believe that we have the necessary EBITDA profile to achieve our goal, in particular if the current business environment remains consistent.

Please review our business outlook schedule, which is attached to our Q4 2012 financial results press release that was issued earlier today for a more complete summary of our financial performance estimates for Q1 2013 and for the year of 2013.

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

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QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] The first question comes from Ric Prentiss with Raymond James.

Charlie Castillo
Analyst, Raymond James & Associates, Inc.

Q

Hey, guys. It's Charlie Castillo sitting in for Ric.

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

A

Hey, Charlie. How are you?

Harold L. Covert Jr.
Executive Vice President, Chief Financial Officer, Chief Accounting Officer and Treasurer, Lumos Networks Corp.

A

Hi, Charlie.

Charlie Castillo
Analyst, Raymond James & Associates, Inc.

Q

Doing good. You guys gave for 2012 CapEx that was 75% success-based. Can you kind of give us some color on 2013 for the guidance range you're giving, like how much is success-based versus maintenance?

Harold L. Covert Jr.
Executive Vice President, Chief Financial Officer, Chief Accounting Officer and Treasurer, Lumos Networks Corp.

A

Yeah. Going forward, Charlie, we expect to continue to maintain our 75% profile. The remaining 25% is maintenance, IT and other things that it fundamentally takes to run the business. And you may recall that back in 2011 that ratio was under 50%. So we hit this 75% ratio in 2012 and we're going to continue that going forward.

Charlie Castillo
Analyst, Raymond James & Associates, Inc.

Q

Great. And kind of like what will it really take for you guys to get to the high end of the CapEx guidance?

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

A

A larger bookings profile than we expect, so success could drive that to the higher end. And there are opportunities – I think I mentioned in my script, to look to add efficiencies for 2014 by installing systems and enhancements to our OSS and various system platforms. So I think it's a combination of systems investment and higher than expected bookings would drive our CapEx to the northern part.

Harold L. Covert Jr.
Executive Vice President, Chief Financial Officer, Chief Accounting Officer and Treasurer, Lumos Networks Corp.

A

Yeah. And even if we're at the high end of our capital expenditure range, what the guidance that we provided, we'd still be will within all of our capital efficiency goals that we set out to. So we're on track.

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Charlie Castillo
Analyst, Raymond James & Associates, Inc.

Q

Right, okay. And looking at the cash flow guidance table, can you go over the components for the $7 million in other? I'm guessing $3 million is the restructuring. What's the balance of that?

Harold L. Covert Jr.
Executive Vice President, Chief Financial Officer, Chief Accounting Officer and Treasurer, Lumos Networks Corp.

A

Yes, the balances is actually – as you said, it's – about half relating to the restructuring and the other half is a reduction in working capital.

Charlie Castillo
Analyst, Raymond James & Associates, Inc.

Q

Okay. And is there no opportunities to receive any Fed stimulus money in 2013?

Harold L. Covert Jr.
Executive Vice President, Chief Financial Officer, Chief Accounting Officer and Treasurer, Lumos Networks Corp.

A

There is, but it's not a meaningful enough amount for us to have called out.

Charlie Castillo
Analyst, Raymond James & Associates, Inc.

Q

Okay. Got it.

Harold L. Covert Jr.
Executive Vice President, Chief Financial Officer, Chief Accounting Officer and Treasurer, Lumos Networks Corp.

A

It's part of our program, but, again, we don't have a lot of activity going on in that arena right at the moment.

Charlie Castillo
Analyst, Raymond James & Associates, Inc.

Q

Okay. And the final question, what's the – what's driving the increase in cash taxes year-over-year?

Harold L. Covert Jr.
Executive Vice President, Chief Financial Officer, Chief Accounting Officer and Treasurer, Lumos Networks Corp.

A

Well, it's simply the rate of reduction from 100% to 50% for accelerated depreciation. And that's it.

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

A

It would have been higher had...

Charlie Castillo
Analyst, Raymond James & Associates, Inc.

Q

Right, right. Got it. Okay, guys. That's it for me. I appreciate it.

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

A

Thanks Charlie.

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Operator: Your next question comes from Donna Jaegers with D.A. Davidson.

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

Hey, guys. Congratulations on a good quarter and thanks for taking my questions. I have a few, if you don't mind, because I know you're busy after this and I'm busy. So on the RLEC operations, it looked like access revenues were higher than we were looking for in the quarter. Were there any one-time settlements there?

Harold L. Covert Jr.
Executive Vice President, Chief Financial Officer, Chief Accounting Officer and Treasurer, Lumos Networks Corp.
A

Yeah, Donna. There was – we actually in effect got a buy off from the FCC on our estimates for the CAF refund. And it was a little bit higher than we had originally planned on, so that was the reason for the uptick in Q4.

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

So it looks like that might have been roughly $0.4 million. Is that a good guesstimate? I'm just trying to get a good going forward rate.

Harold L. Covert Jr.
Executive Vice President, Chief Financial Officer, Chief Accounting Officer and Treasurer, Lumos Networks Corp.
A

Yeah, maybe just a little slightly higher, maybe I'd say more towards the $0.6 million.

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

Okay, great. And then on the Fiber-to-the-Tower, obviously that was where your carrier revenues were very strong in the fourth quarter and congrats on good execution of getting those installed. Can you talk a little about order trends? I know Shentel has been putting an LTE, so I'm assuming that maybe you got part of that. And I know you guys bid on the AT&T RFP. When might we expect some news on that?

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

Well, a couple things. Our guidance for the end of the year between – to have 550 to 600 on-air anchor sites, we feel comfortable with, given the orders that we've signed. And we don't like to project a lot into what we may or may not win, but we are active with not only AT&T, but NTELOS is actively building, so is T-Mobile, Sprint in parts of our carrier area and Verizon. So, all the carriers are active. Shentel would be just in that same category. So, I'd hate to get too specific on any one carrier, but I would say what's good in our markets, the entire group of carriers are actively pursuing 4G.

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

Great, yeah. Then on the cost trends going forward, obviously the early retirement is going to help you hold those costs flattish. What – should we expect most of those early retirement costs to come out of corporate operations or how will they be spread across the line items?

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

No. It – I think it's pretty universal. There are a lot of operational costs. As we start to deemphasize the growth of our legacy voice products, especially in the large CLEC territory footprint, there were folks that were migrating from that category of product line up to Strategic Data. But I'd say it's about half and half, half operations, half administration. But, again, while we had a downsizing or early retirement, we will be adding back staff to grow our business and, again, to try to keep our overall expenses flat year-over-year.

Harold L. Covert Jr.
Executive Vice President, Chief Financial Officer, Chief Accounting Officer and Treasurer, Lumos Networks Corp.
A

Yes. It's all above the EBITDA -

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

Line.

Harold L. Covert Jr.
Executive Vice President, Chief Financial Officer, Chief Accounting Officer and Treasurer, Lumos Networks Corp.
A

Line and it's roughly about $1 million dollar savings over where we were at in 2012 heading into 2013.

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

Great.

Harold L. Covert Jr.
Executive Vice President, Chief Financial Officer, Chief Accounting Officer and Treasurer, Lumos Networks Corp.
A

And it's simply across pretty much all of the categories.

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

Okay. And you said about $1 million savings going forward?

Harold L. Covert Jr.
Executive Vice President, Chief Financial Officer, Chief Accounting Officer and Treasurer, Lumos Networks Corp.
A

Roughly about $1 million savings heading into 2013.

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

Okay. And that's – okay, for an annual basis?

Harold L. Covert Jr.
Executive Vice President, Chief Financial Officer, Chief Accounting Officer and Treasurer, Lumos Networks Corp.
A

That's right.

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

Okay, great. Thanks, Hal. And then, Tim, can you remind me of the trigger points on your performance options? I think it was 15 and 22.

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

[ph] 17.50 and 22.50 (34:07), I don't know.

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

[ph] 17.50 (34:12) is the key one obviously.

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

When we get closer I'll look that up. And I'll get it.

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

That's okay. And then one last question. As far as sustaining the dividend, obviously you guys are being successful with the carriers on the Fiber-to-the-Tower. If you would see – how do you weigh – how do you balance your dividend payments versus – if you got in strong orders for broad – for strategic broadband, how would you balance out those capital needs?

Harold L. Covert Jr.
Executive Vice President, Chief Financial Officer, Chief Accounting Officer and Treasurer, Lumos Networks Corp.
A

Let me start and then I'll turn it over to Tim. So, I made the point that, in effect, we're looking into refinancing in 2013, in the first half of the year. And our goal as part of that refinancing exercise is to bring cash on the balance sheet, as well as have an available line. And when we achieve that goal, we believe that we'll be in a situation going forward over the next two or three years where we effectively will not have to use our credit lines and we'll have enough cash on the balance sheet to accommodate our overall growth, as well as continuing to pay the annual $12 million dividend that we have today. So, Tim?

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

Yeah, no. Hal, I think you said it exactly right. To just to reiterate the point, we've been consistent all along that we see the dividend as a fixed expense, not a yield play. And so when we do our modeling, we think about it as a fixed dollar amount, the $12 million. We believe the dividend's important. It's important to management. It's important to the shareholders that we know today. And we think that we can have growth and pay that dividend, but that dividend, we expect the yield to decline as we create equity value in the company.

If it came to the point where we would have to give up growth versus dividend, I just don't see it now. With the financing markets the way they are, the growth profile of the company, the conversion that we're making in our success-based capital, the lift that we're getting in EBITDA, and the margin expansion, it just had – it's not in the forefront.

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Harold L. Covert Jr.
Executive Vice President, Chief Financial Officer, Chief Accounting Officer and Treasurer, Lumos Networks Corp.

A

Just to stress on our refinancing activity. We are going to bring cash on to the balance sheet. We think we'll be in a very solid position to continue to pay the dividend.

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

Q

Great. And then just one last housekeeping question. On depreciation, that shot up about $1.6 million quarter-over-quarter. Is that a good run rate going forward? I'm assuming that was a lot of the Fiber-to-the-Tower projects that got – that came in and were completed.

Harold L. Covert Jr.
Executive Vice President, Chief Financial Officer, Chief Accounting Officer and Treasurer, Lumos Networks Corp.

A

That's right, Donna. And it probably is a good run rate going forward.

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

Q

Great. Thanks a lot, guys. Have a safe travels today.

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

A

Thanks, Donna.

Operator: The next question comes from Colby Synesael with Cowen & Company.

Colby A. Synesael
Analyst, Cowen & Co. LLC

Q

Great, thank you. Two questions, if I may. First one, as you go about the refinancing, I was wondering if you could talk to us about target leverage ratios. I think one of the things that restricts your investments right now is your current debt instruments and I think the covenants that are on the leverage. And then the second thing is, just curious what your views are on dark fiber. We've been hearing that it seems like more carriers are going to be interested in purchasing dark fiber as a solution for Fiber-to-the-Tower backhaul longer term. And I'm just curious what your thoughts are on that? Thanks.

Harold L. Covert Jr.
Executive Vice President, Chief Financial Officer, Chief Accounting Officer and Treasurer, Lumos Networks Corp.

A

So I'll take the first part and give Tim the second part. Yeah, on the first part, we're – as I say, we're exploring refinancing opportunities. And we believe that given the current market environment that we can achieve a leverage ratio that fits with our overall plan, as well as not having a major increase in interest expense related to the new financing. So, we don't anticipate any issues with leverage, going forward, as it relates to our overall plan that we highlighted a few minutes ago.

Colby A. Synesael
Analyst, Cowen & Co. LLC

Q

Is there a target leverage ratio that you have?

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Harold L. Covert Jr.
Executive Vice President, Chief Financial Officer, Chief Accounting Officer and Treasurer, Lumos Networks Corp. A

Yeah. The target is above where we're at right now. And so we're still working that as part of our overall game plan.

Colby A. Synesael
Analyst, Cowen & Co. LLC Q

Okay.

Harold L. Covert Jr.
Executive Vice President, Chief Financial Officer, Chief Accounting Officer and Treasurer, Lumos Networks Corp. A

So, it's – right now it's four in 2013, and again we – and it drops to 3.75 in 2014. So we believe that we can improve that. Tim?

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

Yeah. Colby, on the dark fiber, as you know, it's not part of our go-to-market strategy. And to this point it has not been restrictive in our ability to build our fiber and carrier business. Again, each marketplace around the country has different dynamics. We have a territory that we have a very dense network. At the same time, in many cases, the sites are still well off-network. And we don't win every site that we go up against but we win a fair amount. And our model is to build long-term lit services to our carrier partners. And so far that seems to work. And dark fiber today is not part of our strategy.

Colby A. Synesael
Analyst, Cowen & Co. LLC Q

Okay. Thank you.

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

Yeah.

Operator: The next question comes from Barry Sine with Drexel Hamilton.

Barry M. Sine
Analyst, Drexel Hamilton LLC Q

Good morning, gentlemen. I wanted to delve in a little bit more on what you're doing on the sales and marketing side. Obviously last year you brought in a new Chief Revenue Officer and you brought in Joti Balani this year. And we're seeing good success in sales of Strategic Products. What are they doing? What's working right? Have you changed the composition of the sales force, their compensation? And what changes should we expect next year as the sales force tries to drive these revenue goals?

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

This is Tim. I'll give a little bit of an answer and then I'll turn the call over to Joe. He's sitting right here and he'll give you some of the best answers. But look, I said in my call, we're thrilled to have Joe and now Joti join the team. But Joe brought in years of experience of running an enterprise and carrier business. He rebuilt his senior

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leadership team. We had some that were promoted within and we brought in some new talent. And we begin to evolve our sales force from a circuit selling CLEC focus to a solution-based enterprise network sales organization.

At the heart of that is building a sales engineering team that works hand in hand with our network design team and product team. It's very integrated strategy. We've made big investments in building our product engineering, sales engineering and AE team. So, it's not really just sales. It's building a product and building a solution and designing networks. It takes experience. It takes – and it takes a fair amount of overhead. We've got it build into our plan.

And I'd say we're halfway home of implementing that throughout our footprint. We're happy with the success at this point. And I think bringing Joti into complement the go-to-market strategy with marketing effort on top of our sales and service effort is going to be icing on the cake. So we're excited about that. And, Joe, if you have any other comments?

Joseph E. McCourt Jr.
Chief Revenue Officer & Executive Vice President, Lumos Networks Corp.

A

Barry, just to add on that. A lot of it was in the base – it was basic blocking and tackling, establishing accountability and discipline within the organization. And then, as Tim mentioned, as a layer on top of that, we're building tools now. We're going to have analytics from a marketing perspective, building our CRM to be really strong to take us to a whole another level and to really understand a lot more about our customers than just going out and selling a circuit. We want to understand, first and foremost, what problem can we solve and sit down with the client and design a network instead of selling them – just selling the circuit or selling some lines. That makes sense?

Barry M. Sine
Analyst, Drexel Hamilton LLC

Q

Yeah. How many quota-bearing sales reps you have now? Has that increased over the last year? Do you have plans to increase that going forward?

Joseph E. McCourt Jr.
Chief Revenue Officer & Executive Vice President, Lumos Networks Corp.

A

So right now the number is plus or minus 50. We will probably increase it by a few heads this year going in. But by and large, it's been about the same number for the last several months.

Barry M. Sine
Analyst, Drexel Hamilton LLC

Q

And could you talk about some of the marketing initiatives you guys might do? That sounds like a new step for you guys, haven't been active on the marketing side in the past. What would you do from a marketing standpoint?

Joseph E. McCourt Jr.
Chief Revenue Officer & Executive Vice President, Lumos Networks Corp.

A

So, we're actually currently in the early stages of developing that. I think on the next call I could probably put a little bit more color around where we're going specifically because we're still kind of building that now.

Barry M. Sine
Analyst, Drexel Hamilton LLC

Q

Okay. Thank you very much.

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Operator: [Operator Instructions] With no further questions, this concludes our question-and-answer session. I would like to turn the conference back over to Mr. Will Davis for any closing remarks.

Will Davis

Director of Investor Relations, Lumos Networks Corp.

As a reminder, a replay of this call and archive of the 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.

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