

Lumen Technologies, Inc. NYSE:LUMN

FQ4 2024 Earnings Call Transcripts

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S&P Global Market Intelligence Estimates

	-FQ4 2024-			-FQ1 2025-	-FY 2024-			-FY 2025-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS
EPS Normalized	(0.05)	0.09	NM	(0.18)	(0.35)	(0.21)	NM	(0.68)
Revenue (mm)	3202.32	3329.00	▲3.96	3135.41	12974.40	13108.00	▲1.03	12307.71

Currency: USD
Consensus as of Feb-03-2025 10:42 AM GMT

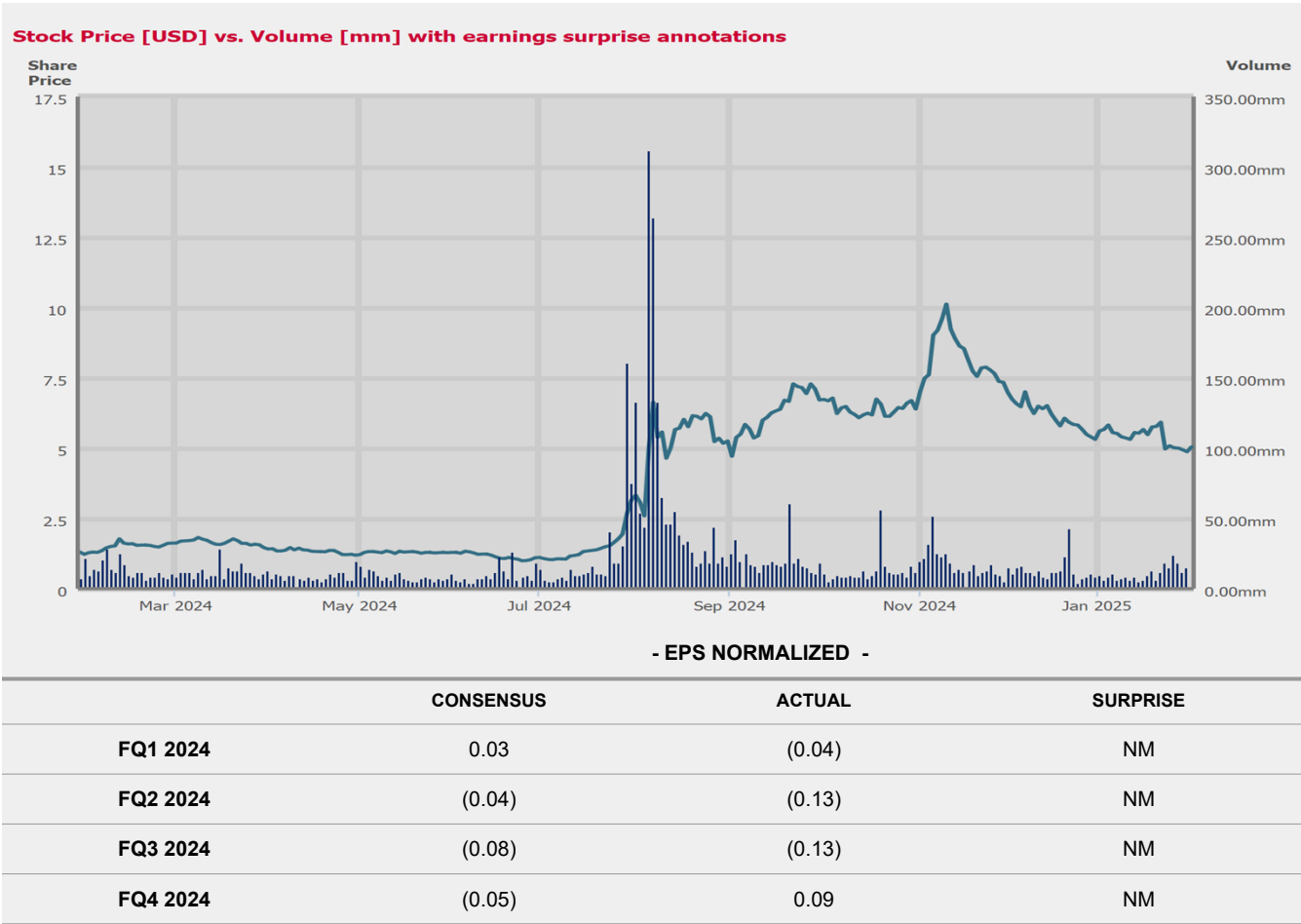


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Presentation

Operator

Greetings, everyone, and welcome to Lumen Technologies Fourth Quarter and Full Year 2024 Earnings Call. [Operator Instructions]. As a reminder, this call is being recorded today, Tuesday, February 1, 2025. Your speakers for today are Kate Johnson, CEO; and Chris Stansbury, CFO.

I would now like to turn the conference over to Jim Breen, Senior Vice President, Investor Relations. Please go ahead, sir.

Jim Breen

Good afternoon, everyone, and thank you for joining Lumen Technologies Fourth Quarter 2024 Earnings Call. On the call today are Kate Johnson, President and Chief Executive Officer; and Chris Stansbury, Executive Vice President and Chief Financial Officer.

Before we begin, I need to call your attention to our safe harbor statement on Slide 1 of our fourth quarter 2024 presentation. Please note that this conference call may include forward-looking statements subject to certain risks and uncertainties. All forward-looking statements should be considered in conjunction with the cautionary statements and the risk factors in our SEC filings.

We'll be referring to certain non-GAAP financial measures reconciled to the most comparable GAAP measures, which can be found in our earnings press release. In addition, certain metrics discussed today exclude costs for special items as detailed in our earnings materials, which can be found on our Investor Relations section of the Lumen website. With that, I'll turn the call over to Kate.

Kathleen E. Johnson *President, CEO & Director*

Thanks, Jim, and thanks, everybody, for joining the call today. I'll focus my remarks with a quick look back on 2024, and then I'll set the vision for 2025 and beyond. In short, 2024 was a remarkable year for Lumen Technologies. We accomplished so much way too much to share on this call, so I'll just focus on a few of the big things. We strengthened our financial position and restore market confidence in Lumen and then starting with the debt restructuring that gives us ample time to execute our transformation.

We lowered our debt load by \$1.6 billion in '24 and recently sent redemption notices for another \$200 million. And importantly, we drove material improvement in both our equity and debt trading values. Next, we established Lumen as the trusted network for AI, inking \$8.5 billion in closed sales with big tech companies like Microsoft, AWS, Google and Meta, among others. These deals helped us strengthen our free cash flow and enable us to self-fund our transformation. We continue to be in deep discussions with several customers to build new routes, and we're going to provide more detail on those deals as it makes sense to do so.

Throughout '24, we also made material progress transforming our corporate functions and some quick highlights include: in service operations and Assurance, we delivered materially better year-over-year customer SAT scores in all 4 enterprise segments, all 4 quarters in a row. And we built an engine to deliver large, complex private network projects on budget and on time with the delivery of the State of California's digital inclusion program as the latest proof point.

Our enterprise sales and customer success teams built a robust engine that delivered over 15% year-over-year sales growth in our North American enterprise channels with more than 13% sales growth in IP and ways and drove more than 500 new customers to adopt the Lumen digital NaaS platform.

Our marketing team built new storytelling muscle, standing side-by-side on stage with big tech and great companies like Intelsat, VSP Vision Care, Churchill Downs and the Pac-12 to evangelize the criticality of fiber networking and reposition Lumen as a trusted network for AI. Our network engineering, IT and product teams delivered dozens of mission-critical programs for us. And one breakthrough program is the delivery of Lumen's unified network architecture, enabling 85% of new Ethernet and IP data service sales in major metro markets. This is the long overdue integration of our 4 network architectures and has already started delivering benefits. The unified network not only enables NaaS and other more advanced digital services. But in some cases, it reduces our average time to deliver by more than 12 days and reduces implementation costs by as much as 50%.

What's more, our HR team successfully embedded our play-to-win culture in every aspect of the company. We can feel every day in the work that we do. And of course, we're proud of the external recognition we've received with more than 15 culture awards so far. But most importantly, we're excited to see major improvements in our employee engagement scores born out of this work because it really matters to our overall mission.

And finally, our mass markets Quantum Fiber team delivered more than 500,000 enablements with greater than 90% year-over-year growth in fiber net adds, while simultaneously reducing expenses year-over-year. In summary, our progress in '24 did a few things. It validated our mission, our vision, our strategy, our culture and especially the strength of our team, and it showed that we have great execution muscle and set a strong foundation for accelerating our transformation work.

Okay. Let's shift gears and look at 2025. We have 3 clear priorities: driving operational excellence, building the backbone for AI and cloudifying telecom. And each of these priorities has detailed plans to deliver more customer, shareholder and employee value in '25 and beyond. Starting with Lumen's financial goals. Our 2025 guidance for EBITDA is between \$3.2 billion and \$3.4 billion, and free cash flow is between \$700 million and \$900 million. But the big takeaway is this, with a combination of improved revenue mix and cost takeout, we see Lumen returning to full year EBITDA growth in 2026. I'm going to let Chris provide more detail on this shortly.

Next, we continue to drive operational excellence in everything we do, ensuring continuous improvement in sales execution and churn mitigation, simplifying our core business processes, and leveraging modernized ERP, CRM, ops platforms and artificial intelligence to deliver improved employee, customer and partner experiences. We've already identified more than \$1 billion of OpEx and a big chunk of network expense that we plan to eliminate by year-end '27 with this work. and we expect to exit 2025 with over \$250 million of run rate cost benefit delivered.

Okay. Before I dig into our big 2 growth levers, I want to provide our view on the market given last week's events in the world of Today, enterprise CIOs are faced expectation that they will continue to deliver work speed innovation at an efficient cost, and they have to push lots of data to the right users at the right places at the right time for the right cost. And the architectural landscape has never been more complex with apps and data sprinkled all over the place, on-prem, at the edge and in multiple clouds. High-speed, low-latency connectivity is table stakes, but it's not the end game. CIOs need digitally controlled higher bandwidth, higher performing, higher reliability and higher security networks to navigate this complexity. And that's exactly what we're building at Lumen, a digital platform on top of a rapidly expanding fiber network to help CIOs design, control, configure and consume network services in a multi-cloud AI first world.

So when the new global player in AI announces a disruptive breakthrough, we see that as a great thing. Competition increases velocity and decreases cost and basically accelerates the democratization of technology. So in short, the disruption we saw in the market last week will likely make AI more accessible to companies, and that just means that our total available market for network fabric just got a lot bigger. That's why we're confident in our two big bets.

So let me crack into them. Starting with the first one, building the backbone for the AI economy, we've begun construction on the backlog of work generated from the \$8.5 billion in PCF sales, and it's going really well. I want to share more on our thinking about how we leverage our network for maximum shareholder returns. We are increasing the variables at the same time, capacity and utilization. You should be able to see a high-level model on this chart in the webcast right now and I'll start with capacity on the left side of the page. Because we see a significant increase in demand for our network infrastructure across both the hyperseller and enterprise market segments, we're driving network expansion in several ways.

We're building new routes funded by our customers, often multi-tenant with great economics. We're partnering with Corning to use their latest fiber innovations, allowing us to get as much as 4x more capacity from existing and new routes, and we're leveraging photonics innovation for up to 2x greater fiber efficiency. If you add all that up, our total network capacity has the potential to go from 12 million total intercity fiber miles in '22 to 47 million miles by '28 giving us unmatched room for growth for network services. And I'm not even including our 22 million metro miles in that number. The second aspect of our plan to drive improved shareholder return is all about utilization of our assets. On the right side of the chart, you'll see that from '22 to '28, we simultaneously increase overall network capacity, as I just described. but we're also going to increase the overall utilization of our network from 57% to 70%. This is because the hyperscalers are leasing once empty conduit and they're funding new builds.

While enterprises are upgrading their networks dramatically. In fact, we saw a nearly 50% increase in 100 and 400 gig wave sales across large enterprise and mid-markets in 2024 alone. We're closely monitoring customer demand signals, and we'll continue to make important capital investments in key major metros to capture this traffic growth. Additionally, we'll continue to examine our utilization and capacity planning business rules for maximum shareholder return, adjusting as market dynamics dictate.

In summary, the growth lever of building the backbone for AI represents a huge accretive opportunity for this company. We're not only driving the strongest utilization of our network assets in the history of the company, we have unmatched capacity for growth at exactly the right time. Moving on to our second growth vector, disrupting the market by cloudifying telecom. Simply put, we're building a digital layer on top of our physical network to help us deliver friction-free, high-performing digital network experiences. So long done pipes hello intelligent digital network fabric that enables CIOs to be successful in a multi-cloud AI first world.

As I shared earlier, enterprise CIOs need to move workloads between locations, on-prem, at the edge and multi-cloud, and it needs to be cost efficient and friction-free, but it's not -- and it's not for two reasons. First, legacy networks were not built for a multi-cloud world. So enterprises were forced to use carrier-neutral facilities to access the cloud connectivity market driving growth and costly and inefficient cross-connects. Second, most traditional telecom companies aren't building a platform for digital dynamic frictionless customer experiences.

Now Lumen is fixing all of that using ourselves as customer on. I'll share a specific example with a supporting graphic on the webcast that you should see right now. To enable our Quantum Fiber quote-to-cash process, for example, we utilize multiple cloud and SaaS providers. Order processing workloads are hosted on one public cloud leveraging its native capabilities for seamless flow-through provisioning. But once it's processed, that data required for business operations and financial reporting is then transferred to our corporate data warehouse, which is hosted in a completely different public cloud.

Using our own Lumen network fabric, which is now directly connected to three big public clouds, in a virtual networking ecosystem. Our Quantum Fiber quote-to-cash network architecture bypasses carrier-neutral facilities and eliminates physical cross-connects and their fees as well as reduces overall port usage. The outcome is a modern multi-cloud network architecture at lower cost than traditional architectures with improved network speed, security and reliability. We plan to bring this lower cost, higher-performing architecture to our customers in late 2025.

And look, the point is this, how we cloudify ourselves to operate efficiently in a multi-cloud hybrid architecture world is informing how we innovate and commercialize our product and services portfolio for our customers. We're creating an innovative networking ecosystem that will bring new value to enterprise CIOs in today's multi-cloud AI first world. And this will give Lumen access to a net new total available market that we estimate to be at least \$15 billion. We have the right assets, the right vision, the right team at exactly the right time, and that's why we're bullish on our pivot to growth. And with that, I'll turn it over to Chris.

Christopher David Stansbury
Executive VP & CFO

Thanks, Kate. Lumen had a transformative year on many fronts. We completed the TSA in the first quarter, extending debt maturities to 2029 and beyond, providing over \$1 billion in cash and access to a \$1 billion revolver. Last earnings call, we announced \$8.5 billion in PCF deals, solidifying Lumen's place as the partner of choice in building the trusted networks for AI. We successfully executed a debt exchange terming out over \$800 million in 2026 through '29 maturities to 2032 and reduced overall debt by \$1.6 billion in 2024 and recently sent redemption notices for another \$200 million. Given our confidence in free cash flow generation, we contributed \$170 million to our pension plans.

We continued to make progress in our selling motion with 2024 North American enterprise sales up over 15%. And finally, mass markets had a record year with over 0.5 million new fiber homes passed and 161,000 net fiber adds, all while reducing our expenses. Looking forward, 2025 will be a year of investment to reach our future goals.

As Kate discussed, the PCS sales we signed in 2024 provide flexibility and liquidity to reduce our debt further, enhance our growth products, and invest in our simplification and modernization efforts. Additionally, with the progress we've made to date, we estimate our run rate cost savings exiting 2025 to be approximately \$250 million, a strong start towards our \$1 billion goal exiting '27.

With our 2025 investments and further execution on our modernization and simplification goals, we have confidence in margin expansion and total EBITDA returning to full year growth in 2026 and growing thereafter. We believe the value creation path for Lumen is clear through additional sales balance sheet improvements and cost structure optimization, all as we continue to execute on our core strategic goals to drive operational excellence, build the backbone for AI and clarify telecom. Now let's move to the discussion of financial results for the fourth quarter. Total reported revenue declined 5.3% to \$3.329 billion. This percentage of decline was due to the impact of divestitures, commercial agreements and the sale of the CDN business.

Business segment revenue declined 5.1% to \$2.659 billion and approximately 33% of that decline was due to the impact of divestitures, commercial agreements and the sale of the CDN business. Mass Markets segment revenue declined 6.3% to \$670 million and adjusted EBITDA was \$1.052 billion with a 31.6% margin and free cash flow was negative \$174 million. Now next, I'll review our detailed revenue results for the quarter on a year-over-year basis. And within our North American enterprise channels, which is our business segment, excluding wholesale, international and other, revenue declined 2.2%. And North American enterprise Bro revenue increased 15.3% year-over-year, driven by public sector growth with continued pressure in nurture and harvest product revenue.

Overall, the North American business declined 2.8%. On a year-over-year basis, large enterprise revenue declined 5.5% in the fourth quarter and mid-market revenue declined approximately 9.8% and both businesses positive grow revenue, 3.5% for large enterprise

and 34% for mid-markets was offset by nurture and harvest. Public sector revenue grew 11.5% year-over-year. For the full year 2024, Public sector revenue grew 3.4%.

As we said in the past, public sector revenue can be lumpy quarter-to-quarter, but we continue to see traction with large bookings in this space, which take time to ramp to revenue. With respect to 2025 and as a result of significant rerating in the wholesale TDM space from select smaller off-net connectivity providers, we are working with our customers to either migrate or disconnect some services.

While these actions will be a drag on public sector revenue in the first half of the year, we believe they are healthy for the overall business as we're making decisions that are margin accretive. Wholesale revenue declined approximately 4.5% year-over-year. The harvest a portion of the wholesale portfolio, which is comprised of products like TDM, voice and private line, saw revenue contraction by 5.2% year-over-year in the fourth quarter.

This is primarily driven by telco partners that are selling legacy services. Our harvest product revenue will likely continue to decline over time and is an area that we will manage for cash. Nurture revenue was down 11% in the fourth quarter on VPN and Ethernet declines. And wholesale grow revenue was positive 1.9%. International and other revenue declined 42.5% and driven primarily by the divestiture of our EMEA business and the sale of select CDN contracts in the fourth quarter of last year.

As a reminder, the EMEA transaction closed on November 23, 2023. Moving to our business product life cycle reporting, I'll reference the results based on our North America enterprise channels. 2.2% year-over-year decrease was due to declines in return harvest. Offset by strength in growth, particularly enterprise broadband, dark fiber and IP. While results can vary in any quarter, we expect sustained growth in grow product revenue as we execute on our core turnaround. Within North American enterprise channels, grow products revenue increased 15.3% year-over-year, up from 4% year-over-year in the prior quarter.

Importantly, Grow represents over 47% of our North America enterprise revenue, further reducing our reliance on legacy revenue. Grow products carried in approximately 80% direct margin this quarter. Nurture Products revenue decreased 16.2% year-over-year, largely impacted by declines in VPN. Nurture represents approximately 26% of our North America enterprise revenue and for our total business segment carried an approximate 67% direct margin this quarter. Harvest products revenue decreased 7.3% year-over-year and continues to be negatively impacted by declines in TDM-based voice. Harvest represented approximately 16% of our North America enterprise revenue in the fourth quarter.

For our total business segment, it carried an approximate 77% direct margin this quarter. Other product revenue declined 16.7% year-over-year. As a reminder, other product revenue tends to experience fluctuations due to the variable nature of these products. Now moving on to mass markets. Our fiber broadband revenue grew 18.9% year-over-year and represents 42% of mass markets broadband revenue.

During the quarter, Lumen 105,000 fiber homes passed bringing our total to over \$4.16 million as of December 31, achieving our full year 2024 target of 0.5 million homes passed. We also added 42,000 Quantum Fiber customers, bringing fiber subs to nearly 1.1 million. Fiber ARPU was \$61, and I would note that mass markets revenue declines improved year-over-year in 2024.

At the end of the fourth quarter, our penetration of legacy copper broadband was approximately 8%, and our Quantum Fiber penetration stood to probably 26%. Now turning to adjusted EBITDA. For the fourth quarter of 2024, adjusted EBITDA was \$1.052 billion compared to \$1.099 billion in the year ago quarter. For the fourth quarter of 2024, our adjusted EBITDA margin was 31.6%. The EBITDA margin declined 40 basis points year-over-year compared to a 90 basis point year-over-year decline in the third quarter. Special items impacting EBITDA totaled \$132 million. The majority of special items this quarter were related to transaction, separation and real estate transaction costs.

And lastly, capital expenditures were \$915 million. Free cash flow, excluding special items, was negative \$174 million, mainly due to timing of cash from PCF deals. We would expect free cash flow to be lumpy quarter-to-quarter as we move through the large PCF builds. Now moving on to our financial outlook for the full year 2025. We expect adjusted EBITDA to be in the range of \$3.2 billion to \$3.4 billion. Our EBITDA guidance includes organic declines similar to 2024 and roughly \$200 million in incremental costs, including the annualized spend associated with building the team to expand and deliver on the PCF partnerships, to proactive disconnects of uneconomical legacy services and additional investments in cloud infrastructure to reduce future CapEx associated with utilizing our own data center assets. Excluded from the guidance above is roughly \$300 million in transformation costs to begin the multiyear task of reducing expenses by \$1 billion.

As we've stated on prior calls, we'd also like to give some preliminary thoughts on 2026 EBITDA. Given anticipated improvements in sales performance, lower absolute declines in the legacy products and the approximately \$250 million in run rate savings exiting 2025, we see 2026 EBITDA being greater than \$3.5 billion with growth in future years.

Moving to capital spending and our other outlook metrics. For the full year 2025, we expect total capital expenditures in the range of \$4.1 billion to \$4.3 billion. The majority of the increase in CapEx from 2024 to 2025 is associated with the cost to execute against our signed PCF contracts. We continue to see maintenance CapEx between \$400 million and \$600 million and Quantum Fiber CapEx at approximately \$1 billion similar to 2024 as our homes past target for 2025 is also \$500,000.

The majority of the remaining CapEx is associated with our core enterprise business. We expect to generate free cash flow in the range of \$700 million to \$900 million for the full year 2025. Additionally, we estimate net cash interest to be \$1.2 billion to \$1.3 billion and cash taxes to be \$100 million to \$200 million in 2025, given a prepayment in 2024. In terms of other special items for 2025, we continue to expect dedicated third-party costs to support transition services for the divestitures. The reimbursement for these services will be in other income with no material net impact to our cash flows.

Additionally, special items include costs associated with Lumen's \$1 billion in cost takeout by year-end 2027. Before we move to Q&A, just a couple of housekeeping items. First, please remember that the first quarter typically has a higher -- seasonally higher expenses related to the timing of bonus payments and other prepaid expenses. Additionally, as noted in our financial trending schedule, fourth quarter '24 was positively impacted by the timing of public sector revenue and EBITDA, which tends to fluctuate quarter-to-quarter. Following the great strides forward in 2024, Lumen's transfer is on track. The progress we've made around our core strategic goals has resulted in a stronger balance sheet, improvements in sales, a decreased reliance on legacy products stronger free cash flow generation and progress on modernization and simplification, giving us increased confidence in an inflection to EBITDA growth in 2026 and beyond. We'll now take your questions.

Question and Answer

Operator

[Operator Instructions]. We will take the first question today from Michael Rollins, Citi.

Michael Ian Rollins
Citigroup Inc., Research Division

A couple of questions, if I could. First, if you look just in total in terms of what's happening with sales that you mentioned in the business, I think, in North America, up 15%. How is that translating to progress in the verticals like large enterprise and mid-market. And then secondly, just looking at the schedule that you provide, it was like the customer verticals and product verticals. As you mentioned, grow was up sequentially, and it looks like maybe about \$82 million sequentially and wholesale, I think it was wholesale harvest was also a significant number in the quarter. How much of that might have been recurring, and it's a bouncing off point for 1Q 25 versus onetime in nature?

Christopher David Stansbury
Executive VP & CFO

Yes. I'll start with the end of the question first. So we're pleased with the grow product revenue broadly, and I'll get into that in a little more detail. The quarter was positively impacted by our state of California initiative around PCF that was announced, gosh, about a year ago, I guess. And a lot was delivered in the quarter -- quarters. So revenue started to get turned up. But I think what's really interesting when you look at the impact overall in the portfolio as I touched on it in my prepared remarks, but the Grow bucket is now almost half of what we sell.

And I think when you look at our overall growth rates vis-a-vis our minor competitors who had very different performance than us, it really relates to the customer experience that we're driving and the focus on those growth products as we go forward. And you can actually see that in our wholesale results, right, where legacy declines were significant, but the grow product sales were actually pretty low. The competition is just not focused on it.

We are -- and so that's without the clarification of telecom. And ultimately, to your point, sales obviously perceive revenue. 2024 was challenged with disconnects. We talked about some forced disconnects we're going to do in the first half of this year. But as it relates to things like renewals and the things that are, I would say, manageable and margin accretive to us, we've got motions in place to drive improvements on those as we move into '20.

Operator

Next up, we'll hear from Sebastiano Petti, JPMorgan.

Sebastiano Carmine Petti
JPMorgan Chase & Co, Research Division

Sorry about that. Thank you for the 2025 EBITDA outlook. But I wanted to see how you can maybe help us think about, Chris, the top line dynamics there, particularly in light of the public sector comments. But as AI fabric revenue come online in the next several years, what's the inflection or the growth to -- what gets you to top line growth, I guess, in the business? Or what's the expectation around that? And public sector did grow in 2024, but it sounds like there's going to be some onetime items that weigh on it in the first half of the year. Is the expectation that public sector growth continues from here?

Christopher David Stansbury
Executive VP & CFO

Yes. So a couple of things. On the overall revenue trends, we obviously don't guide revenue, but I'll provide some color. When we said that our revenue trends will look largely similar to what we saw in 2024. There's a lot of activity in there like the disconnects that I talked about that impact that -- and then you've got underlying improvements in things like sales and other disconnects that are more manageable that kind of net out. I think when we move into we should see continued improvement there because we'll be lapping things like the force disconnects. We're going to start to turn on some of that PCF revenue.

There's going to be very little this year. That's really more 267 ramping fully. And we've also got new product announcements that we'll be making that ultimately benefit as we go forward. The way we can get there though, really big picture, if you just forecast market declines against our nurture and harvest buckets. And you put us at growing at market rates on things like IT and Wave.

And quite frankly, I think we do better than market and Kate alluded to that. We get to growth in the 28, 29 window on revenue. That's really where we inflect. So there's no heroic assumptions being made here. And importantly, the platform layer that is so critical to differentiating Lumen is not really included in that math. So our ability to really disrupt the space is a tremendous opportunity for us. As it relates specifically to public sector, tough to call.

I would say in itself, it's challenging because of the disconnects that were going to take place in the first half, but the team is very focused on -- aside from that trying to grow this year. So more to come as we move through the year, a little early to call.

Operator

Batya Levi has the next question.

Batya Levi

UBS Investment Bank, Research Division

Great. A couple of questions. First, on your network utilization chart, what kind of enterprise needs growth are you assuming that drives your assumption for lower utilization for the enterprise segment by 28%. Is that just a function of revenue mix, meaning much higher growth from the hyperscaler side versus the enterprise? Or is there anything else that's in there?

And then the second question if you don't mind helping out with the cadence of incremental cost we should expect for I believe you mentioned \$200 million included in the EBITDA guide, and there's an incremental \$300 million that's not included. And within free cash flow, are you assuming any incremental deferred revenue.

Kathleen E. Johnson

President, CEO & Director

I'll let Chris hit the last part of your question first, and then I'll hit the utilization capacity chart.

Christopher David Stansbury

Executive VP & CFO

Yes. We're not assuming any new PCF deals in either the EBITDA or the free cash flow. So that was your last question, I think.

But we continue to be deep in those conversations. And as those deals are confirmed, we will obviously be updating guidance, which is very consistent with, obviously, what we've done to date. Yes. So within EBITDA, there's a \$200 million headwind, which really relates to three things: it's the ramp-up that we've talked about last year and the team required to do these big PCF builds. It's a shift in our strategy to move from on-prem data centers to cloud, as Kate said, we're customer #1, but that's a shift from CapEx to OpEx. And we're basically avoiding quite frankly, about a \$0.5 billion investment in data centers in the coming years by that shift.

And then it's the TDM disconnects from those smaller off-net providers that we're driving. So that's the \$200 million in EBITDA. The \$300 million in special items really relates to dedicated expenses associated with getting the \$1 billion of cost out and they're onetime in nature and they will go away.

Kathleen E. Johnson

President, CEO & Director

Okay. And then the first part of your question about utilization, it's really important to note that the utilization chart is really about fiber miles. And so it's the total fiber in our entire network and how each of these major segments, enterprise, consisting of commercial public sector and wholesale customers as well as our own use of the network through services, and then the hyperscalers in a different category. And so we're increasing both the capacity with innovation, putting net new fiber solutions in there, which allow for up to 4x the capacity, better photonics, et cetera. Greater density, greater efficiency in the same stretch of conduit.

And then, of course, we're adding new routes. I think the big piece here is there was a lot of unused conduit. It was empty for 25 years, and we were able to lease it to the hyperscalers to connect to their data centers. And so that's why the chart looks so dramatic in terms of the increase of the hyperscaler utilization. But it's not taking away from enterprise. And in fact, we have more enterprise growth capacity that we've ever had before with these innovations.

Operator

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David Barden, Bank of America. Next.

David William Barden
BofA Securities, Research Division

So I guess just maybe for Chris, two questions. The first would be with respect to the free cash flow guidance this year and maybe as it translates into 2026, it would be, how much money is coming in from the construction contract customers versus how much is going out. And so if we excluded that, what would the cash flow actually look like? That's question one.

And then the second question would be, I think, Chris, you also kind of alluded to this, is that as we look at 2026 and then even more in '27 and beyond, the accounting of how we put the cash flow we're getting today into the income statement down the road when we've built it and then we can start accounting for it, what kind of contribution is that making to the 2026 better than \$3.5 billion EBITDA expectation?

Christopher David Stansbury
Executive VP & CFO

Yes. So a couple of things. The -- on the 2026, we -- while PCF starts to roll in, it's actually going to be pretty small. So we're not -- because we're still at the very early stages of it. So I would say that the \$3.5 billion, the increase that you see is largely driven by the modernization and simplification efforts. And that is more than offsetting kind of legacy declines. And again, keep in mind, I mean, we have now been disclosing kind of the grow nurture harvest buckets. And I think that will evolve to more disclosures in time.

But we've been doing that now for almost 3 years, David, and the mix has substantially changed in our favor because of the focus that the company has had. So Don't forget to model every quarter, mix improvements as legacy continues to become a smaller and smaller piece of what we do. And sorry, remind me, what was the first question?

David William Barden
BofA Securities, Research Division

Just on the [indiscernible].

Christopher David Stansbury
Executive VP & CFO

Cash. Yes, yes. So I want to be really clear before I tell you, I'm not going to give you that detail. We said, and I want to be really transparent about this. We had a funding gap before we had the PCF deals. And that remains to be true. And the PCF deals, not only fill that funding gap, it's allowed us to lean in far more heavily into our transformation efforts, and that all remains to be true. We're not going to give '26 guidance on that yet because here's what I can tell you for certain. There's meaningful things that we can and will do over time as it relates to more PCF contracts, debt refinancings, a number of levers that we can pull that are improved free cash flow as we move through the year.

So, more to come as we go through the year. This doesn't assume any of those refinancings. This guidance doesn't assume any PCF deals, that doesn't assume any major transactions. Any and all of those things could happen, and we'll continue to give you updates. But I think there's far more tailwinds to our cash flow story than there are headwinds.

David William Barden
BofA Securities, Research Division

And Jim, before you cut me off if it's possible, I would love to -- Chris, one more question, which is, we've seen some pretty successful fiber securitization deals out of Unity, out of Zayo, you guys obviously have redone your whole balance sheet and I'm not smart enough to figure out how much opportunity is there for you to kind of take advantage of what's happening in the market right now for fiber financing?

Christopher David Stansbury
Executive VP & CFO

Yes. It's a good question, David. It is an opportunity. But I think that is on the list of priorities versus the list of priorities. There's a number of things that we can and will be in around the debt structure that I think really get to putting the company in more of what I would call a normal capital structure. And at that point, then we can start to look at those things that are on the list, but more to come.

Operator

Jim Schneider from Goldman Sachs.

James Edward Schneider
Goldman Sachs Group, Inc., Research Division

First of all, I was wondering if you could maybe contextualize your view on the recent Deepseek announcement. I realize it's still very early days. But directionally, how do you think this changes the connectivity market going forward? Do you think this is likely to result in because of the lower cost, more inference or more training? Or could we actually get less training and more inference. And what do you think that means, if anything, for the content demand needs you're seeing from hyperscalers? Do you think there's a chance that we could actually exceed less? Or is it more likely that we actually see the market stimulated by lower cost?

Kathleen E. Johnson
President, CEO & Director

Yes, it's a great question. So I think as I noted in my prepared remarks, this is going to accelerate the democratization of AI, okay? So deep Seek is putting pressure on everybody to go faster to innovate and to take cost down and to make the technology more accessible. And when you've got more companies that have to navigate in the multi-cloud AI-first world, as I described, that's more total available market for us to sell our connectivity fabric into. So we see this as an increase in the total available market and a huge opportunity for us. And we have a pretty good head start in this space, and we're investing heavily in a platform to differentiate, and we think it's going to allow us to capture share.

James Edward Schneider
Goldman Sachs Group, Inc., Research Division

And then maybe as a follow-up. Can I maybe just sort of ask about the sort of competitive dynamics you're expecting to see in the PCF market going forward? I mean, clearly, you've talked about all the reasons why you believe you have a privileged advantaged market position today. One of those, I believe, is because of the empty or available conduits you have to fill right now. But I'm sort of curious, as you go into the next couple of years, do you see more competition for these kinds of deals? And do you see your sort of your lead extending yourself? Or do you think more incremental competition is likely to come in?

Kathleen E. Johnson
President, CEO & Director

Yes, of course, Jim. So first of all, we're grateful for the lead. It was nice to get \$8.5 billion in there before anybody else realized that this was a market, but we're paranoid, and we're going to maintain focus on building out the competitive moat. Our network has unmatched coverage. It has unique routes. And -- we've invested heavily in the fiber solutions that, frankly, our competition hasn't -- so we're in the right places with the amount of capacity and the performance that everybody expects, but that's just the infrastructure talking.

I think what's differentiating is the platform on top, and that's becoming more and more interesting to, frankly, all of our customer segments as we're able to present them with a network fabric that gives them access to all the capabilities no matter where they are, we're pretty pumped about our position. We think we're going to continue to be able to execute well and the future is pretty bright. Chris, do you have anything to add to that?

Operator

Jonathan Chaplin from New Street Research is up next.

Jonathan Chaplin
New Street Research LLP

I'm wondering if you could give us an update on how things are progressing with the fiber sales. And then in the context of the fiber cell, it seems to me that the ultimate owners of these assets are probably one of the three big national wireless carriers. And I would have thought they would value copper assets in addition to fiber assets. And I'm wondering if there's a way you can structure the sale of fiber that gives the buyer of that asset, the ability to use your copper infrastructure to build more fiber? And then looking at the progress that AT&T has made with opening I'm wondering if there's an opportunity for you guys in pursuing that or whether that's an opportunity you might hand off to somebody else as well?

Christopher David Stansbury
Executive VP & CFO

Yes, it's a good question. And I'm going to stick to things that we said publicly. So first of all, the -- it's interesting because there are two schools of thought, right? One could be sell the whole thing, but there's been a lot of work that has said yes, but you also give up a lot of EBITDA on that? And is it really a delevering transaction -- the comment that we've made is think about it as 2 businesses, right? You have a fiber business that today is doing just tremendously in terms of its build-outs, but isn't yet in a position where it's generating much EBITDA. There's a lot of that it goes into driving customer penetration. And at the same time, it's consuming \$1 billion a year in CapEx.

The bulk of the EBITDA sits on copper today, which doesn't have a huge CapEx burden, basically some maintenance. So could somebody be interested in all that? Yes. Could somebody be interested in pieces? Yes. We're open to any and all of those discussions, and we'll see where it takes us. But ultimately, we've said this for years, it comes down to valuation. And at the right time, we'll make that decision. And as that decision in that moment comes, we'll obviously share it with you. So that's how we think about it. As it relates to copper decom specifically, think about copper decom being largely market-driven, not consumer-driven.

Because copper e-com is really both an enterprise and a consumer motion. And so I think like a lot of our competitors, that's how we think about it. We have been very aggressive about -- in the consumer space, converting copper to fiber where we do have fiber passing because it's a better outcome for the customer and it's a better outcome for us, and that will continue. But the copper decom process, there's a playbook that we've developed. Frankly, it's part of our modernization and simplification. There's a lot of unlock there. And we think there's even more EBITDA to be generated in the coming years through those activities.

Kathleen E. Johnson
President, CEO & Director

Yes. It's a major tenant of driving operational excellence is wire center by wire center across the country. We have a P&L view so we can see it all now, and it makes for great decision-making, and it's a huge vector, as Chris said, of our cost takeout.

Jonathan Chaplin
New Street Research LLP

Is that export \$1 billion?

Christopher David Stansbury
Executive VP & CFO

Yes. Yes.

Operator

And the next question comes from Nick Del Deo, MoffettNathanson.

Nicholas Ralph Del Deo
MoffettNathanson LLC

First, I guess what happened in the public vector in the quarter, it's not still entirely clear to me. Chris, you said it was driven by a lot of sales or turn up services to the state of California. Is that revenue largely recurring? Or were there onetime delivery or performance fees limped in there? I'm just trying to get a sense as to the right baseline. And then you're looking at your -- sorry, go ahead, sorry.

Christopher David Stansbury
Executive VP & CFO

Yes, just I'll answer that real quick. So the pieces of the PCF for the state of California that got turned on. or onetime in nature as that got lit up. There are other things that happen in the pulp sector, which are more ongoing. We haven't split that out. We don't intend on doing that. And I think the color we gave around some of the headwinds that, that channel faces in 2025 with the disconnect is really what we want to say about that at this point. Sorry, what was your second question?

Nicholas Ralph Del Deo
MoffettNathanson LLC

Okay. I guess looking at the fiber deployment utilization table, if my math is right, the fiber miles used by enterprise channels was roughly flat from '22 to '25, but then you're expecting it to double from '25 to '28. So I'm just wondering what products are driving that doubling?

Christopher David Stansbury

Executive VP & CFO

Well, I think to start with in Kate's prepared remarks, we're seeing 100 gig and 400 gig ways growing at 50% in 2024. And we talked about that and get color around that during the year because we shifted CapEx to support that. So we're at the very -- again, think about it back to the phases of AI that we've talked about. And the first phase is inference, which is where -- sorry, where the hyperscalers are building these networks for their own consumption to train the AI modes.

The second phase is inference, which is where large enterprise starts to use those models to run workloads. And so we're at the very beginnings of that, and we can see it in IP and ways. But I think you'll see more consumption of large enterprise connectivity because of the platform layer that Kate talked about because ultimately, the value that we can bring to enterprise in the form of cost reduction isn't us reducing prices for dumb pipes. It's us providing newer, cheaper, faster, more efficient and flexible ways of reaching their data.

Operator

We'll take the next question from Greg Williams TD Cowen.

Gregory Bradford Williams
TD Cowen, Research Division

Actually, Chris, your last answer is a good segue into my question is. In your deep conversations you're having above and beyond the \$8.5 billion pipeline, are you seeing any of the inference days starting to materialize? Or are we still too early there? Second question is on deep sea kicking. I get the democratization of AI, which you see a larger TAM. But is there a near-term risk with massive scalable AI that would drive a temporary pause of the hyperscalers to rethink some of their plans.

Kathleen E. Johnson
President, CEO & Director

We haven't seen a pause. In fact, are still in deep conversations. We've talked about the pipeline that we're pursuing is predominantly comprised of new routes connecting data centers and we're deep in those conversations. And it's complex to design these kinds of networks, so it takes a bit more time, but they're still progressing with no sign of slowdown. In fact, we have been asked by every single one of the major cloud companies that we've done a deal with no exception. If there's a possibility to accelerate the implementation of what they've purchased so far.

With respect to the second phase in inference, I would say that it's early to start calling the ball on trends of exactly what's going to happen here. If anybody tells you they know, they don't -- what we are seeing is in some of the major industries, financial services, retail, health care, they're starting to -- they're the ones that are asking for the network upgrades. And they're starting to use inference to transform their companies and they are recognizing the fact that they need something fundamentally different. And so that's kind of the trends that we can shine a light on so far. As we learn more, we'll bring it to you. I think it's really important. The discussion that I give you an overview on the multi-cloud AI-ready network architecture.

Every single one of these companies is moving data and workloads back and forth between clouds. And today, it's too complicated. It's too slow. It's too expensive, and it's not secure. And our fabric now that we're connected to all three clouds allows you to do that in a cost-effective, high-performance secure way. And this is a net new capability that we're bringing through our platform and our fabric that no other company is doing. So we're really excited, and we think we'll continue to have a good view on what's happening during inference, and we'll keep you posted.

Operator

Next question comes from Frank Louthan, Raymond James.

Frank Garrett Louthan
Raymond James & Associates, Inc., Research Division

Great. Can you give us a little bit more color, I think, on the public sector for next year, I think you said it was going to pull back a bit. Is any of that related to federal government cost cutting. And does that add any additional risk? And can you give us an update on the billing system collapsed and the other system changes that you're working on? Where are you as far as completing those projects?

Christopher David Stansbury
Executive VP & CFO

Sure. So as it relates to public sector, our sales rates aren't declining. What's impacting revenue in 2025 is yes, I'll use the word, egregious rerate activity a select few. I mean we're talking thousands of percents really over the last few years, where customers, largely in the federal space and unfortunately, some customers who rely critically on that technology for running their businesses are being forced to migrate or turn off those switches. And it's the right call for the customer, it's the right call for us. So really, the big headwind there is that.

As it relates to the IT work, we're making good progress. Our first phase of our ERP should be complete I would say, probably early in the second quarter, and we're expecting the second phase, which first phase is really quote to cash, second phase of procure to pay is later in the year. Now remember, what we're not doing, I want to be really clear about this. We are not doing a big consolidation of order entry or billing systems. What we're doing is as we consolidate networks and we turn on we will, over time, roll off of old systems that support existing revenue. As that revenue kind of retires up and all of the new revenue will be put into a new modernized system. So as that growth bucket continues to grow, more and more of the product is on the future state. We're not doing any kind of a conversion.

Operator

Sam McHugh from BNP Paribas has the next question.

Samuel McHugh

BNP Paribas Exane, Research Division

On your intercity fiber mile vision, I think the 2028, 47 million-mile or 47 miles. Is that based on the announced PTF deals? Or would that require additional PCF deals and CapEx to kind of get to that vision, part one? And then secondly, on the investment in new fiber routes. Does that change your view on how many fiber homes in the mass market business you might be able to reach. And is that helping you in discussions with partners on basically being able to provide more backhaul for that only ventures?

Kathleen E. Johnson

President, CEO & Director

So the 47 million miles just based on the business that we've already inked, it doesn't include any new deals. So as we potentially do that, we might be updating the chart for you, hopefully sooner rather than later. And I -- did I miss your fiber-to-the-home question again, please?

Samuel McHugh

BNP Paribas Exane, Research Division

Yes. Sorry, I was just saying, as you build out more of the conduit and build new conduits. Is that changing your view of kind of the terminal kind of build in mass market? I think you talked to 6 million to 8 million locations in the past. So can you do more with fiber miles?

Kathleen E. Johnson

President, CEO & Director

We think about them separately.

Jim Breen

Operator, we have time for one more question.

Operator

And everyone, at this time, there are no further questions in the queue. That does conclude the conference call for today. We thank you for your participation and ask that you please disconnect your lines. Have a great day, everyone.

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