

Lumen Technologies at the TD Cowen 53rd Annual Technology, Media & Telecom Conference (TMT)

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Company Participants

Chris Stansbury - Executive Vice President and Chief Financial Officer

Conference Call Participants

Gregory Williams - TD Cowen

Gregory Williams

Good afternoon. Welcome to Day One of our 53rd Annual TMT TD Cowen Conference. My name is Greg Williams. I cover cable, wireless, and telco here at TD Cowen. I'm joined in this session by Chris Stansbury, the CFO of Lumen Technologies. Chris, thanks for joining us.

Chris Stansbury

Yes. Great to be here.

Question-and-Answer Session**Q - Gregory Williams**

I want to start off with the AT&T deal that was announced last week. This deal structure is very unique. It's a first of a kind, potentially last of a kind. Help us understand why the deal was structured this way. I understand you're going to keep a lot of these wire centers for the enterprise business, and you're going to direct connect to the cloud. But why do you need 1,700 data centers, to do this?

Chris Stansbury

Yes. So the reason that the deal was structured the way it was really for a few reasons. The value on the consumer side is really in the fiber. That's the go forward strategy. That's the asset that people were most interested in, and we built a great business. And that business can be taken much further. And so from a buyer standpoint, that's why the focus was there. From our standpoint, that footprint generates a lot of enterprise EBITDA in addition to some very healthy consumer copper EBITDA that is in very rural areas that will take years to go away. Fiber is very unlikely to be built to those locations. And then from a strategic standpoint, as we go forward, the real value in the enterprise offering that we're bringing is the marrying of the underlying footprint of our network with the digitization of the services that we offer. So rather than the typical legacy telecom motion, which is every service having its own infrastructure layer, which is very, asset intensive, very expensive, very slow to scale, and ultimately drives very little innovation over time. It's one infrastructure layer, that is digitally enabled where services can be dropped on top of ports by the many. And so the physical locations, while all 1,700 we may not need, the reality is there's a customer base off of those wire centers and there's capabilities we can choose to build in individual wire centers that allow us to really untap the value that exists as we go forward on the enterprise side. So that's why we kept what we kept.

Gregory Williams

Got it. And I want to talk about a few of those things. But I also want to discuss AT&T. They suggested to us on their follow-up call on that day. It was they could build to another 5 million homes possibly in your territory. Trying to understand how that works. Is there additional service agreements that need to happen or do they kind of have carte blanche or free reign to overbuild in that area? And can others do the same?

Chris Stansbury

Yes. So our initial thinking was that, we would build to about 8 million enablements. Their messaging is really going to be closer to the 10 million enablement level, which makes sense, I think, with the wireless offering, the brand recognition that they have, their ability to drive, greater penetration and reach is higher. Now their ability to do that, the fiber assets that they're acquiring sit in 427 of those 1,700 or so wire centers, and they can build wherever they want out of that 427 and I think that's going to be their primary focus. Now if in time as markets grow, there's the ability to go to 428 or 429 then we can have a separate discussion around those additional facilities. But I think their core focus will be building out the enablements and penetration around those 427 wire centers.

Gregory Williams

Got it. And when it comes to the copper sun setting, which sounds like a really good opportunity for all the telcos, you've told us before, you have a seven-year glide path roughly with the remaining CSL subscribers and the remaining business in the COs. Is there fear that maybe you just told an overbuilder right now to come into that territory and cannibalize that business or you're worried that AT&T will cannibalize it faster? Does it accelerate your seven-year sunset horizon?

Chris Stansbury

No. I think that the seven, we call it seven to ten-year horizon, I think is a conservative look. The vast majority of the remaining penetration and again, just to put context around this, 18 million households passed with copper. We got 1.4 or so million DSL customers and a little over a million voice customers. Those are primarily in very rural areas that economically are very unlikely to see fiber. So that's why we have confidence in that rundown. And candidly, to the extent that any of those customers are in more, metro markets where fiber could be, that's actually good for us because it allows us to turn off those networks. So, yes, we're not concerned about that.

Gregory Williams

Got it. So the 1.4 million DSL subs are so rural that there's probably no overbuilding whether it's AT&T or somebody else?

Chris Stansbury

Right. Exactly.

Gregory Williams

Okay. I want to talk about the opportunity that you could have in terms of AT&T backhaul. AT&T is going to own the fiber from the node to the home and then they're going to have IRUs from the central office to the node. But that fiber behind the central office to get to the Internet, shouldn't there be additional commercial services from AT&T? Because now they're going to see 4 million homes to go and get that to use maybe your network with. So it could be an upside opportunity.

Chris Stansbury

Look, I think there's a possibility there. I mean, the reality is today, we all buy and sell from and to each other, right? Because none of us have the network coverage to get to every endpoint that we need to get to. And so there's very healthy wholesale relationships that exist with amongst all the major players. And so those agreements exist and obviously as AT&T grows this business, we'll be able to support whatever needs they have. And they frankly they may choose to use their own network in certain locations to do some of this backhaul as well. So we'll see how that plays out, but, yes, there could be some more there. We'll have to see.

Gregory Williams

Got it. Also in the slide deck on that present -- on that day we announced the transaction. You said the deal was going to be used to pay 4.8 billion in super priority debt, but you're only seeing 4.2 in after tax proceeds from this deal. So like help us reconcile the 600 million gap from selling at 4.2, paying down 4.8. Isn't that cash coming from the hyperscalers that's supposed to be used for dark fiber build outs?

Chris Stansbury

So a few things. I think the 4.2 is conservative. We may be able to do a little better on the tax side. We'll have to see. There's obviously a lot of complexity in that. The other parts of this though are -- we're very clear when we signed the PCF deals that we had a cash contribution margin that approximated our EBITDA margin. So there is margin there. We're driving a lot of EBITDA and cash savings from our modernization and simplification program. So, again, a billion dollars out by the end of 2027, that's going to be contributing. So I wouldn't point to any one thing as the source of cash. The reality is the business is turning around. We're performing really well. We had a great first quarter. And we will hit a point of inflection on our EBITDA this year. We'll call that when we see it. But the business is getting healthier and our ability to drive further cash flow improvements through debt reduction and interest rate deduction or interest payment as we go forward is going to kind of snowball in our favor. So all of that kind of fuels the cash flow that we can use to reduce that 4.8.

Gregory Williams

And with the cost savings initiative, you have \$1 billion cost savings initiative, supposed to be realized by year end '27.

Chris Stansbury

Correct.

Gregory Williams

Can you help us understand how this deal fits into that \$1 billion cost savings? Does it help speed it up or in some ways, could it help potentially slow it down because you're going to need to maintain or retain some central offices that otherwise might have been shut down?

Chris Stansbury

No. I don't think it slows us down at all. The program itself is off to a great start. We're really pleased. We have to -- we're still doing work to determine if that's just a timing thing or whether it's actually a scaling faster thing, in which case, maybe we can do better. But we're very confident in the \$1 billion outside of this transaction. And we'll make adjustments as we go forward. But if anything, we're cautiously optimistic that might be able to creep a little higher.

Gregory Williams

Got it. And you're consolidating central offices or at least you've messaged consolidating central offices. A lot of telcos are excited about the copper decommissioning. But does AT&T have a say in this? Because if they're going to want to expand out to additional 5 million homes, they might say, hey, don't be shutting down some of these central offices. We're going to need them. I think you alluded to it. They have 427 wire centers and if they want to grow a few just help us with that dynamic.

Chris Stansbury

Yes. So, I mean, again, whatever we do outside of that footprint, we can do outside of that footprint. And even within that footprint, if we choose to consolidate, we would obviously make sure there's no disruption of service, but there may be efficiency plays that we can drive and still provide the connectivity that they need, right? So we'll continue to modernize the footprint to meet the needs of today, including the needs of AT&T as a customer in this case. So the future of that business and its success, that consumer fiber business is really important to us. We've got a lot of people that have worked really hard to get it where it is. We want them to succeed. We want that business to succeed. And we'll be very supportive as we go forward.

Gregory Williams

And as you consolidate central offices, one thing AT&T tried was it early last year in California saying, hey, we can offer fixed wireless as a proxy, and then we could shut it down. Well, you don't have a fixed wireless offer. So what would you do? Would you be white labeling like AT&T or T-Mobile or Verizon's fixed wireless and saying offering.

Chris Stansbury

We have the opportunity with this transaction to use AT&T's product where it will work. But we can also use other services as needed. I mean, again, what it really comes down to is how many customers remain on those networks, particularly in those more remote areas. And when we get to a point where it just doesn't make sense to keep powering those networks, we can convert the customers to other services. We do have wholesale relationships. The bigger piece of it though is the regulatory environment is getting easier, where we have to be allowed to do that. And a number of states have already eliminated their carrier of last resort, burdens and requirements. And I think more will follow. So there's a lot of energy around that.

Gregory Williams

Great. Another element of the cost savings initiative is the network integration, turning essentially four networks into one. It was Time Warner Telecom, Global Crossing, CenturyLink, Level 3. Help us understand, like what inking we're in on flattening out that network. What else needs to happen to achieve this? Just anything in terms of what goes into it and when do we realize the benefits?

Chris Stansbury

Yes. So the -- we will, on a go forward basis, be almost entirely on one network by the end of this year. And so think of that as all future services will be sold on that one single network. We won't be selling on the four old networks anymore. The part that we will do though is that any legacy revenue that exists on those other four networks will maintain as those businesses slowly decline over time. And as we convert customers to newer services, they'll sit on the new network. So we're not going to try to consolidate a bunch of old legacy revenue to a new system, a new IT stacks that would be at the --

Gregory Williams

Okay. So care systems, billing systems, they'll still stay separate until you sunset them out of the year.

Chris Stansbury

Exactly. So that's how that's going to work, but we're making great progress. We'll be substantially there by the end of the year. And again, the vision as we go forward, and we've talked a lot about it on earnings calls is, as I said earlier, it's really one network infrastructure with digitally enabled ports. We call them fabric ports. And so you will be able to layer a voice service, a connectivity service, a security service, whatever it is on top of that port. So it's a very scalable and frankly very customer-friendly way to deliver services and for the customer to be able to self-provision. So fewer truck roles. More immediacy, more flexibility in how customers want to consume networking today.

Gregory Williams

Right. So it's not just cost savings, which are obvious, but it's this revenue opportunity to build on so much on these ports by doing this. When can we start to see this both on the cost side or even the revenue? So when does it -- when does this happen? Is it gradual? Is it a flash cut or and when does this?

Chris Stansbury

Yes. We've -- so let's talk about this in a few different ways. We've talked about revenue inflecting kind of late '28, early '29 and the underlying assumption underneath that was everything that we sell today either grows or declines with market rates. And the only two exceptions are as the PCF deals ramp, that revenue will start to amortize in. So that's one. And the second is, in that outer year, that '28 window, we had a few hundred million of digital revenue. That's it. That gets you to a point of inflection. We're already seeing even though the business is in decline, a much better trajectory than our competition because we've been focused on this for years. And our dependency on kind of those bigger, older legacy buckets of VPN, Ethernet, and voice are smaller than what our competitors see. Now what we're looking at, and we're going to give far more color on, in September, we're going to have Analyst Day is really around which services we see scaling first because these are going to be kind of J-curve, deployments. And is there a way to pull in that point of revenue inflection sooner? So that's what we're hard at work on right now. But the biggest, two that are out there right now are really around cloud voice, and our ability to retain and move a lot of our legacy kind of copper based voice customers to a cloud product that we own. And then the other is our ability to rapidly deploy cloud on ramps, which in an AI first multi-cloud world are absolutely critical to enterprise. It's much lower latency than the alternate today and also more effective from a cost standpoint. So the value to enterprise is there. And the more that we share this with our enterprise customers, they're asking us, can I get it faster? It's not why are you doing this. It's kind of get this faster? This is exactly what we need.

Gregory Williams

Great. So I definitely want to talk about the cloud on ramp opportunity as well. Before I do just to maybe reiterate. So what you're saying is the revenue inflection's not really Herculean. It's algebra. You're saying what's the growth rate of your growth products? Put that on a market level. What's the legacy product shrinking at? Put that at a market rate. But you're outperforming on both those ends. Possibly layer on cloud voice, layer on some sort of cloud on ramp opportunity and so you can come in actually a little bit sooner. Is that the right way to think about that?

Chris Stansbury

That's what we're really modeling out right now, right.

Gregory Williams

I wanted to talk about AI. Obviously, the external opportunities with PCF are there. But I mean before we get there just talk about internally. Any updates on what you're doing in AI inside your house?

Chris Stansbury

Yes. We're being very aggressive with it. So if I think about my own function in finance, there's a lot that we have to touch physically because of old IT systems and whatnot. We're moving to one update one ERP with SAP that will go live in a few months. That'll unlock more capability, but we're also using services like Palantir to help us navigate the legacy systems that we have today to get to things like customer, dispute resolution in minutes rather than hours or days. And it's making us far more efficient. So, more to come on that, but we're leaning into AI hard and we're starting to see some real benefits.

Gregory Williams

Got it. Let's pivot to the external opportunities, the PCF wins that you've had in the pipeline. Glad to hear that the business remains on time and on budget. Anything you want to call out here? Is your build engine fully ramped at this point? Is that going to take a few more months?

Chris Stansbury

It's fully ramped. Teams are doing really well. We actually two weeks ago delivered our first complete segment to a customer and it was ahead of schedule. We actually got a bonus payment for that. And the teams and I mean not just Lumen. These are our partners that are helping us with the construction are doing fantastic work. And we're very pleased with where that sits.

Gregory Williams

And you mentioned a bonus payment. So my next question is, can you get an update on your cash cadence? Because you've got a lot coming in from milestones you hit. Then you have a lot going out from the CapEx, and then you eventually got to pay taxes on it. So not a large lumpiness. Anything you can provide in terms of update?

Chris Stansbury

I'd say like really kind of through '27, we're going to receive, I think, just under \$8 billion or so.

Gregory Williams

From the August announcement of last year through '27?

Chris Stansbury

Yes. And then we'll have CapEx and taxes that trail for a year after that. So all other things being equal, if that was our only business, you'd have a negative outflow, obviously in that 2028 time frame. Obviously with the cash benefits of the sale of consumer fiber, just the underlying improvements in the business, the modernization, simplification savings. I think those all bode well on the cash side.

Gregory Williams

Got it. And then on the 3.5 billion PCF funnel, I know you don't talk about updating your funnels anymore, but just a general characteristics. What you've said in the past, it might require more greenfield and sort of more build out, if you will. Any particular verticals or use cases as you think of this 3.5 billion funnel that's different than the 8 billion funnel, which is seems like it's more training.

Chris Stansbury

This still is really around the training. But, again, there's a really important tell in this. And if you think about our network coverage today, we can get from pretty much anywhere to anywhere in terms of the major metros where, those training environments exist, but we may have to go through an extra node or two in our network to get from A to B. And what the hyperscalers are saying is latency is bad for AI. I need a direct city to city pairing between A and B. So these are big complex and really challenging builds that we've got to get really good cost estimation on. We've done a lot of work around that. Hopefully, we'll have an update soon on a piece of that. But the conversations continue. But the reason I emphasize the driving down latency is because that's exactly where large enterprise is going. Latency is bad for AI and it matters. And so what we're doing with things like direct cloud on ramps are to help enable that latency reduction.

Gregory Williams

Definitely you want to talk about the direct cloud on ramps next. But I just want to talk about you mentioned most of this is the training phase or phase one. It doesn't sound just sort of discreet anymore. I came back from ConnectX not too long ago. We're talking about some of these deals are a little bit more nebulous. It's training with clearly some inference in there, whether it's waves to availability zones. Are you seeing that at the RFP table where the deals are?

Chris Stansbury

We are starting to see more around inference. Companies are talking about it and it really does matter because what they're really starting to push for is inference at the edge. Okay. Because again it's about --

Gregory Williams

I'm going to stop you there. What's the definition of edge? Are the availability zones?

Chris Stansbury

So I would -- what really edge means that you don't have to bring it all back to your own on prem data center to do the data manipulation you need to do. So keep the data kind of further away from home so that you're not dealing with latency. Again, we've got what we're -- what the demands of the network today are to take a server that sits 2,000 miles away from another server and make them behave like they're two feet apart from each other, right? That's where AI is pushing this. And so we already have an edge of network compute environment that's built. It covers 96% of US businesses within four milliseconds. And that sits in our largely in our metro rings that already exist in our central offices. And so when you pair that with our ability to get to cloud faster, that's enormously powerful. And that is all about inference and there was an announcement a few weeks ago with IBM and Watson and Inference at the Edge and that's really what that was about.

Gregory Williams

Got it. And on the Direct Connect to the cloud, it's an interesting concept because typically you'd have to go to an interconnect facility. It's in one of those cloud on ramps two dozen or so in the US. So it doesn't sound like you're doing some sort of like parasitic tethering going into those interconnected cells. You're actually bypassing completely because your fiber is going to the CO and then your CO will connect to say a Google Cloud directly. That's right. So you bypass it. Curious how the interconnect data center companies would respond to this. Could you see some retaliatory response? Meaning they'll price you up anytime you're in their facilities. So they'll price you one of your customers that's riding on you to do this because they can see this as a threat.

Chris Stansbury

Look, I'm sure there will be a competitive reaction. What is really exciting to us is there's finally innovation in this space, right? If you think about the world of compute and networking and AI and cloud, there's been enormous innovation in everything except the network. And if you were sitting at a table today with a bunch of really smart, engineers and you were designing the network to support an AI first multi cloud world, you would not draw what we have today, right? And what exists today exists because legacy, telecom has not innovated. And we've all been competing we call them dumb pipes. It's really the commoditization of just simple connectivity. And carrier neutral facilities have become the de facto network for cloud because there's been a lack of innovation. So there's a real need for those carrier neutral facilities in the future, but there's also a real need for innovation and a better way that slays latency. And that's what we're bringing. So we love competition. We'd love to see more competition. But I think this is an environment where everybody wins. It just so happens though that in those applications, in those born in the cloud companies that are being born there because they can't have latency, the way that it works today is untenable. It just doesn't work for what their needs are today and what their future needs will definitely be. So I think the reality is this is new TAM. This is meeting a need that no one else can meet today.

Gregory Williams

So it's not only lower price because the interconnect facilities charge high interconnect fees. So you could bypass those, but it's also a latency thing.

Chris Stansbury

Latency is the main thing, right? I would say that the cost piece, while important, is secondary. It's latency that kills AI. AI, again, you've got machines talking to machines and if there's a delay that kills that dialogue, right? You cannot have that. And so again, we're all about innovation. We're going to bring our part piece of it and we hope others do as well.

Gregory Williams

Right. And you're working with Google on this Direct Connect cloud onboarding. That begs the question, is it safe to assume you're looking to strike deals with AWS and Microsoft?

Chris Stansbury

I think you'll see that continue to expand, but stay tuned.

Gregory Williams

Okay. Will do. And you do have an Analyst Day in September.

Chris Stansbury

Exactly.

Gregory Williams

One of the big margins and economics with the whole network as a service, that you're providing here. How does it compare to your legacy business? Are there revenue shares with this sort of model, partnerships? So are margins higher or lower?

Chris Stansbury

So I think we could see all of that. So the margins will be very high because, again, it's digitally delivered. And frankly, in many cases, will be self-provisioned by the customer. So fewer truck rolls we'll still have a need for obviously the network maintenance, but the ability to drop multiple services on one port is a very scalable motion. So that's very margin friendly. And frankly, over time, while we haven't proven this out, we would also expect it to be less capital intensive per dollar sold.

Gregory Williams

That sounds interesting to me because if you need to connect from a central office to a Google Cloud, point-to-point, that's a brand new connection. How is the CapEx?

Chris Stansbury

Well, it's largely leveraging connections that already exist. In some cases we are expanding the capacity of those connections. And that's already in our capital budget. But again if you think about a legacy world where every service had its own infrastructure and a new world where multiple services share the same infrastructure, it's just much more scalable. So we would expect the capital intensity to be somewhat lower as we go forward.

Gregory Williams

Okay. Wanted to move to the waves business. Cogent was here earlier today and they're off to a slower start, but they're ramping the wave business. And not to speak to them specifically, but, they do say they can provision waves in 30 days or less. Are you doing the same? How do you differentiate? How do you defend share? Is that a real competitive advantage or?

Chris Stansbury

Yes. So we're growing our waves business with market and we're pleased with that. I would say that some of our competitors actually do a better job than we do today in terms of speed to quote and that's something that we continue to focus on and will. But bigger picture, we're not going to play the game the same way that our competitors are. Our competitors are still very focused on price as the selling vehicle. And, again, great. If you want to buy cheap waves to get into a carrier neutral facility, which is going to have much higher latency and a higher cost because of cross connect fees, then great, do that. We may or may not participate in that, but that's not what we see as a winning formula. We see the winning formula really being to put services in the hands of the customer that they can self-provision and to provide them with faster, more secure, and lower cost connectivity in total, than they have today. And I think we're very confident in that strategy. I think we've got a winning strategy and everybody else is a long way behind us right now. So but we'll see how that plays out over time.

Gregory Williams

With about a minute left, the last topic I want to mention is just the balance sheet management. You've got some large longer dated maturity walls. What's the idea to solve those? Is it that you'll have your revenue and EBITDA inflected ahead of time? So then thereby the capital markets open up, and then you'll refinance that debt. Is that the idea here? And you do securitization on some of these PCF wins?

Chris Stansbury

So a couple of things. We would never securitize PCF because we already have the cash, right? So, yes, that one doesn't make sense for us. But the transaction with AT&T allows us to wipe out our most restrictive, most expensive debt. It will put our leverage down below four. And with the cash savings in the coming, next few years, we'll be a lot closer to three. So that will unlock what we believe is more ratings improvements, the ability to refinance what's there and get to a much more normalized maturity curve. So I think the balance sheet is very soon to be a thing of our past, and it's all about execution as we go forward.

Gregory Williams

Great. Thankfully. And with that we're about out of time. So thank you, Chris.

Chris Stansbury

Yes. Thanks a lot, Greg. Thanks.