FINAL TRANSCRIPT

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WIN - Q1 2008 Windstream Communications Earnings Conference Call

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PRESENTATION

Operator

Good morning, welcome to the first quarter 2008 Windstream Communications earnings call. All lines are placed on mute.

We would now like to introduce our speaker, Rob Clancy, Senior Vice President and Treasurer.

Rob Clancy - *Windstream Communications - SVP, Treasurer*

Thank you, Danielle, and good morning everyone and we appreciate you joining us this morning. Today's conference call was preceded by our first quarter 2008 earnings release, which has been distributed on the news wires and is available from the Investor Relations section of our website. Today's conference call should be considered together with our earnings release and related financial information.

Today's discussion includes statements about expected future events and future financial results, that are forward-looking statements within the meaning of Private Securities Litigation Reform Act of 1995. Forward-looking statements are subject to uncertainties that could cause actual future events or results to differ materially from those expressed in such statements. Other factors that could cause actual results of Windstream to differ materially, many of which are beyond the control of Windstream, include but are not limited to the items listed in the Safe Harbor statement contained in our first quarter 2008 earnings press release. Today's discussion will also include certain non-GAAP financial measures, including the term OIBDA, which is defined as operating income before depreciation and amortization. We refer to you the IR section of our website, where we have posted our earnings release and supplemental materials which contain information and reconciliations for any non-GAAP financial measures.

We have provided pro forma results from current businesses that include our results as if the VALOR and CT acquisition had occurred on January 1st, 2006 and exclude one-time transaction related fees. We will make references to these pro forma results from current businesses including the year-over-year comparisons during our call. Before we proceed, let me also mention that we made several minor changes to our revenue and expense classifications which have been reflected in our GAAP and pro forma results from current businesses in both current and historical periods. These changes are not material and better align our reporting structure with both our price gap election and the completion of the CT billing system conversion.

Participating in our call this morning are Jeff Gardner, Windstream's President and Chief Executive Officer, and Brent Whittington, Windstream's Executive Vice President and Chief Financial Officer. At the end of the call, we will take a few questions. So with that, here is Jeff Gardner.

Jeff Gardner - *Windstream Communications - CEO, President*

Thank you, Rob. Good morning, everyone.

Before I get into the details, let me first say that I am very pleased with our results for the first quarter. We are continuing to deliver solid operational metrics and more importantly, cash flow. In fact, with the accelerated depreciation tax benefit, complements of the federal stimulus package, coupled with our share repurchases and the consistent cash generation from our business, we now expect our payout ratio to be between 60% and 65% in 2008. We have been successful in replacing the residential voice revenue streams we are losing with growth in data, special access, and long distance. Our business channel is showing growth year-over-year, and our team is doing a very nice job managing both operating expenses and capital expenditures. To date, the broader challenges in the U.S. economy do not appear to have much effect on our business. And the Windstream team is executing at a high level.

Let me turn to the details. During the first quarter, we repurchased roughly 8.4 million shares at an average price of $11.99, completing $100 million of our $400 million share repurchase authorization. As a reminder, when completed, this repurchase program will result in lowering our payout ratio by 300 to 400 basis points, without significantly increasing the leverage on our balance sheet. The Windstream team has worked very hard integrating CT Communications. And I am pleased to report that we completed the billing system conversion in March. The integration went very smoothly and going forward, we expect to realize the full synergy run rate of $30 million annually. Although most of the synergy savings are reflected in our current expense run rate.

Turning to our pro forma operational results, we added almost 40,000 new broadband customers during the quarter, bringing our total broadband customer base to 911,000, an increase of 22% year-over-year. Broadband penetration is now at 29% of total access lines. We also launched ADSL 2+ across our markets in late April, allowing us essentially to double our broadband download speeds across most of our footprint and offer a 10 to 12 meg speed in certain markets. With this technology, virtually all of our broadband customers can now receive at least 3 Meg service. Faster speeds will increase our competitiveness and revenue opportunities by providing a platform to sell additional products and services, which is an important part of our strategy to transform this business to a broadband-centric model.

We also added 15,000 digital TV customers in the quarter, bringing our total customer base to approximately 210,000, or 11% penetration of primary residential lines. During the quarter, we lost roughly 42,000 access lines, a 4.9% decline in total access lines year-over-year. Our gross adds increased year-over-year, assisted by our sales and marketing efforts. But we also experienced higher disconnects, resulting in an incremental 10,000 lines lost year-over-year. Although cable competitors continue to launch new voice services, much of the year-over-year increase came from our CLEC and business channel, where a significant amount of incremental lines lost migrated to higher capacity circuits, which contributed to the revenue growth in our business channel year-over-year. Non-pay disconnects also increased by 2,000 units year-over-year, although the sequential increase was only 1,000, thus supporting the view that Windstream's rural telecom markets appear to be more insulated from difficulties in the economy.

Our business channel continues to perform well. Next generation data services, such as virtual private network services or VPN, broadband, and long distance sales are contributing to revenue growth year-over-year, and we are seeing a nice lift in the number of special circuits in service. We have also been proactive in extending contract and strengthening our existing business relationships. On the regulatory front, the FCC approved our petition to migrate the balance of our ILEC properties from rate of return to price cap regulation at the federal level, effective July 1st, 2008. This will enable Windstream to maintain competitive prices as we continue to improve the cost structure of our business.

Price cap conversion will allow Windstream to deregulate broadband services, removing the federal universal service fund surcharge currently assessed to customers, thus providing Windstream with improved competitive parity. We expect this change to have little effect financially in the near term, but to provide future benefits as we continue improving our cost structure, while competing aggressively for new wholesale business. At the state level, the Texas PUC concluded their universal service high cost reform effort, which will result in a decrease in Windstream's USF revenue of roughly $5 million annually, beginning in 2009. Subject to competitive conditions, we expect to make modest rate increases to offset this amount.

In summary, we are off to a great start in 2008. We remain confident in our ability to sustain cash flows over a long period of time, and as we have stated before, we will pursue strategic opportunities that are free cash flow accretive. We believe that consolidation is healthy for this industry, because transactions can generate significant operating efficiencies and increased cash flow. We will stay focused on improving sales and service levels, delivering industry-leading operational metrics, and achieving our financial goals so that we are well-positioned for any strategic opportunities that are in the best interest of our stakeholders. Now, let me turn the call over to Brent to discuss the financial results.

Brent Whittington - *Windstream Communications - EVP, CFO*

Thank you, Jeff and good morning everyone. For the first quarter, on a GAAP basis, Windstream achieved consolidated revenue of $812 million. Operating income of $299 million and $0.27 of diluted earnings per share. Our GAAP results include $1.6 million of merger and integration expenses related primarily to the CT system conversion.

Let me now turn to our pro forma results from current businesses, which exclude the $1.6 million of merger and integration expenses, and include the VALOR and CT results for all periods. For the quarter, Windstream achieved consolidated revenues of $812 million, an increase of 1% year-over-year. Consolidated OIBDA of $423 million, an increase of 4% year-over-year, and operating income of $300 million, an increase of 11% year-over-year. The increase in operating income is related to the OIBDA increase, which I will cover shortly, and lower depreciation expense caused by lengthening the lives of various assets, based upon depreciation studies we completed last year.

Turning to our wire line segment, revenues were $788 million, an increase of 1% year-over-year. Collectively, long distance, broadband and special access revenues grew at 12% year-over-year, and continue to replace the declines we've seen in voice revenues. We're experiencing solid growth in business data services and special access circuits, as well as broadband revenue, due to the continued growth in penetration. And our increase in long distance revenues was a result of strong growth and sales of long distance packages, combined with price increases implemented late in the fourth quarter of 2007. Finally, we experienced 4% year-over-year growth in switched access and USF revenues, attributable to a variety of factors, including an increase in regulatory related expense and new federal and state subsidies that we did not receive last year.

Turning to wire line expenses, in total, cash expenses declined by $8 million or 2% year-over-year. This consisted of a $2.5 million decline in restructuring charges and a $5 million reduction in operating cash expenses. Turning to specific expense categories, cost of services increased by approximately $4 million or 2% year-over-year, related primarily to increased fuel and utility costs, increased business taxes, and USF fees. In addition, bad debt expense is slightly higher year-over-year in part due to the sale of certain receivables we had in the first quarter of 2007. These expense increases were partially offset by lower pension and benefit expenses. Within SG&A, expenses decreased by $11 million or 10% year-over-year, largely from cost efficiencies related to our IT optimization activities we worked on throughout 2007. The realization of synergies from the acquired CT business as well as lower advertising spend this quarter, although we plan to ramp up our advertising in the second quarter. And sequentially, total cash expenses were essentially flat.

For the first quarter, wireline OIBDA was $420 million, a 4% increase year-over-year, driven by combination of revenue increases and lower expenses. Our OIBDA margin increased to 53.3%, up from 51.9% in the first quarter of last year. Looking forward, we expect a seasonal increase in payroll of roughly $3 million per quarter, and we plan on making incremental investments in advertising for the remainder of the year, to promote our faster broadband speeds enabled by our recent ADSL 2+ deployment and to expand our sales and distribution efforts.

In our other operations, which include our product distribution business and our wireless business, revenues were $78 million, down approximately 17% year-over-year. This decline is entirely attributable to our supply business and because the majority of sales are internal, the revenue closely tracks our capital expenditures. OIBDA for our other operations was $3 million with the year-over-year increase driven entirely by improvements in the wireless business. We spent $56 million in capital expenditures during the first quarter, down year-over-year, due to improved capital management initiatives by our network team, resulting in fewer carry-over projects from 2007, as well as lower routine service fund spend and slowing subdivision development that we've seen in some areas. Nonetheless, we expect our quarterly CapEx spend to increase from the first quarter level, but we will continue to manage CapEx aggressively. From a balance sheet perspective, we ended the quarter with $54 million of cash and a revolver balance of $115 million, which is up slightly from year-end. At the end of the quarter, our leverage ratio was 3.2 times.

During the first quarter, we completed several asset dispositions, including the sale of the former CT headquarters building, a wireless partnership interest we acquired in the VALOR transaction, and wireless spectrum acquired in the CT transaction, resulting in pretax cash receipts of roughly $25 million. Because the significant cash flow was generated by the business, along with the asset sales and cash on hand, we were able to repurchase $100 million of our stock and retire approximately 8.4 million shares of Windstream common stock with only a slight increase in our revolver. This is quite an accomplishment, given the fact that the first and third quarters of each year include interest payments on our notes. Since our fourth quarter call, the stimulus package was passed by Congress, allowing companies to benefit from lower cash taxes, related to accelerating depreciation. We now expect our cash tax rate to be in the mid--20s, which is down from the low 30s. With this reduction in cash taxes, coupled with the benefits of our share repurchase plans, we now expect our payout ratio to be 60 to 65% in 2008, a significant reduction from the 70 to 75% range we originally provided.

In summary, we are very pleased with our first quarter results. The Windstream team has done an exceptional job executing on our initiatives, including completing the CT billing system conversion, deploying ADSL 2+, managing operating and capital expenses, and executing our operational initiatives, all of which continue to strengthen our position in this industry. With that, we will now take a few of your questions. Operator, please review your instructions and open the call to questions, and thank you for your time.

QUESTIONS AND ANSWERS

Operator

(OPERATOR INSTRUCTIONS). We'll pause for just a moment to compile the Q&A roster. Your first question comes from the line of Jonathan Levine from Jefferies.

Jonathan Levine - *Jefferies - Analyst*

Thanks. I just wanted to see if I could get a little more color in regards to your deactivations. How many of them were really second lines and to the extent that you know, you know, where they went, whether it's wireless, cable, so if you could give a little color on that, that would be great. Thanks.

Jeff Gardner - *Windstream Communications - CEO, President*

Hi, Jonathan. Yes, this is Jeff. Our second line penetration has not changed significantly and so what we looked at, I don't know if we reported that number, but it's something -- it's pretty low compared to our peer group in terms of the number of second lines. So our competition is mainly coming from the voice over IP competitor, mostly on the cable side and then followed closely by wireless substitution. So we did see some slight increase in voice competition across our base, but again, I think we continue to battle that very aggressively. What I wanted just to reemphasize during the call is a lot of our access line losses, year-over-year increase, were driven by some activity in our business and CLEC channel, which if you look at that, if you step back and look at that, basically what you're doing is you're selling additional products and services to those customers that are generating more revenue, but when you look at actual access lines, the number is under some pressure. We didn't see a lot of change in our residential access line run rate.

Jonathan Levine - *Jefferies - Analyst*

Okay. Thanks.

Jeff Gardner - *Windstream Communications - CEO, President*

You're welcome.

Operator

Your next question comes from the line of Jonathan Chaplin from JPMorgan.

Jonathan Chaplin - *JPMorgan - Analyst*

Hi, thanks. Two quick questions, if I may. Firstly, on the economic stimulus package, I'm wondering if you can sort of break out how the stimulus package unwinds in subsequent quarters. You clearly get a big cash tax benefit this year. Do you get an equal cash tax hit next year or does the cash tax drag, unwind over a number of years. And then I'm wondering where DSL ARPU came in this quarter and what the impact from higher speeds has been on your ability to take ARPU up to upsell customers, if you've seen any impact from that so far. Thank you.

Brent Whittington - *Windstream Communications - EVP, CFO*

Jonathan, this is Brent. I'll start with the stimulus package. Really, the way that works is we do get, as we kind of indicated, a significant increase in depreciation deductions this year that help lower our cash taxes to that mid-20s rate that I indicated before. You will see that accelerate in future years, not future quarters, but in future years, but at a slower rate. That kind of give-back from a depreciation standpoint really occurs over the remaining life of those assets. As you know in the wireless business, that's a very long time. So that's kind of the way that's going to work out. With regard to DSL ARPU, we've seen no major change in the quarter for us, really. It's continued to hover right around the $30 point as we've indicated in the past. Our promotions in the marketplace right now are really focused on a consistent price point of around $20 on average for any speed because what we're really trying to do, especially with our ADSL 2+ roll-out, is ramp-up significantly the number of customers we have subscribing to higher speeds and then after a six month time frame, that price point begins to escalate and we believe that's going to lift arrest new the back half of the year.

Jeff Gardner - *Windstream Communications - CEO, President*

Right. I'll just add that our marketing campaign to kind of drive this up speeding was kind of tailored to coincide with the ADSL 2+ components. We're hopeful we'll see good things going forward in that respect.

Jonathan Chaplin - *JPMorgan - Analyst*

Great. Thanks, guys.

Jeff Gardner - *Windstream Communications - CEO, President*

You're welcome.

Operator

Your next question comes from the line of Patrick Ryan from Lehman Brothers.

Patrick Ryan - *Lehman Brothers - Analyst*

Good morning. Thanks for taking the question. Brent, I think you mentioned that there was some state and federal USF receipts in this quarter that were not there last year. Could you tell us what that was and then another question, could you guys remind us, I think there was some restrictions from the spend in terms of your ability to issue equity. Could you remind us, I think there were some restrictions from the Alltel spin in terms of your ability to issue equity. Could you remind us what those restrictions were and when they expire. Thank you.

Brent Whittington - *Windstream Communications - EVP, CFO*

I'll start with the subsidies. As I indicated, there were two subsidies that we began receiving this year. That's not just a Q1 event. That's something we'll see throughout 2008. Specifically one state where we did not receive any USF receipts in prior year, because of higher regulatory expenses as I indicated, we became eligible for receipts in this year and that's something we expect to see throughout '08. Specific to the federal side, it was kind of a niche part of the broader high cost fund for which we became eligible this year that we weren't in previous years, called the safety net fund, effectively, and some very precise markets that we saw.

Patrick Ryan - *Lehman Brothers - Analyst*

Do you have an amount for those?

Brent Whittington - *Windstream Communications - EVP, CFO*

All in all, probably just round about $2 million this quarter, somewhere in that range.

Jeff Gardner - *Windstream Communications - CEO, President*

Patrick, on the -- when we separated in Alltel in July 2006, we had a tax sharing agreement that limited the amount of equity we could issue related to a transaction and that tax sharing agreement is effective until July 18th, 2008. So 70 or 80 days, I guess.

Patrick Ryan - *Lehman Brothers - Analyst*

Great. Thank you.

Jeff Gardner - *Windstream Communications - CEO, President*

You're welcome.

Brent Whittington - *Windstream Communications - EVP, CFO*

Thank you.

Operator

Your next question comes from the line of Jason Moser from Raymond James.

Jason Moser - *Raymond James - Analyst*

Good morning. What's your expectation on an annual level for the pressure for universal service going forward? And also just talk a little bit about what you're seeing on the S and E markets in your territories, that would be great. Thanks.

Brent Whittington - *Windstream Communications - EVP, CFO*

I'll take the first one, expectation on an annual level. As we've indicated, we're not seeing any major pressure in that revenue line item. What I would expect to see consistently going forward with regard to switched access and USF for us is the continued decline in some of our switched access revenues. No major pressure from a USF standpoint that we expect this year.

Jeff Gardner - *Windstream Communications - CEO, President*

And the second part of the question?

Brent Whittington - *Windstream Communications - EVP, CFO*

Small business.

Jeff Gardner - *Windstream Communications - CEO, President*

Oh, in our small business market, again, when we started out 2008, a major focus of ours was to make some investments, put a greater emphasis on harvesting the small business opportunity. We continue to do very well in that channel. We've got a really strong sales force, talking to these customers every day. We've really improved our service levels and selling with a dedicated call center for our business customers as well. So we're seeing growth in that channel. We think there's a lot of opportunity.

We're focused on selling them data, just like we are in the residential side. But again, we've done very well and have seen very little cable competition on the enterprise side, especially in the small business area in the markets today.

Jason Moser - *Raymond James - Analyst*

Great. Thank you.

Jeff Gardner - *Windstream Communications - CEO, President*

You're welcome.

Operator

Your next question comes from the line of Chris King from Stifel Nicolaus.

Chris King - *Stifel Nicolaus - Analyst*

Good morning. Two quick questions for you. First of all, just wanted a possible update on your CapEx guidance for the year, given your numbers in the first quarter. Looks like that CapEx would have to pretty much come close to doubling on a quarterly basis for the rest of the year to kind of get to the low end of your CapEx guidance and just was wondering if that's a pretty decent way to think about it at this point. And secondly, with respect to your share buyback, just wanted to confirm kind of the pace of the buyback as you see it for the remainder of the year and also just to confirm that you guys had a shorter window, at least by a couple of weeks, in the first quarter in terms of the buyback than you will for the rest of the year. Thanks.

Brent Whittington - *Windstream Communications - EVP, CFO*

Okay. Chris, this is Brent. I'll take that. With regard to CapEx, I mean, number one, there is a couple things going on there. First off, we made some significant investments to improve our broadband infrastructure in 2007. Those were big, discrete projects. They really had been substantive sheriff completed at the substantially completed at the end of the year. That did have an impact on CapEx. Secondly, our engineering team has really just done a phenomenal job, making smart decisions on long-term investments we need to make in this business. There's no question, that's driving some improvement in our results. With regard our annual number, just to refresh on guidance, we had a number, 340 to $370 million. So to your point of doubling in the next quarter to get to that run rate, I think that's the right way to kind of think about it. We have seen, as I mentioned in my comments before too, some slowdown in just housing starts in our markets that we're really not sure what the impact of that's going to be on us this year just yet but we do expect CapEx to ramp up substantially in the next three quarters. With regard to the buyback, really I think our actions in the first quarter speak to what you would expect us to do in subsequent quarters. We used really the free cash flow that the business generated in addition to some asset sales to buy back our stock. We'll continue to look for opportunities like that that are free cash flow accretive. Being mindful of other opportunities but that's kind of what our thoughts are at this point.

Jason Moser - *Raymond James - Analyst*

Thank you very much.

Brent Whittington - *Windstream Communications - EVP, CFO*

There is a shorter window but not much. And you're welcome.

Operator

Your next question comes from the line of Michael Rollins from Citi Investment.

Michael Rollins - *Citigroup - Analyst*

Hi, good morning. Just a quick question on where we are with the merger synergies in terms of how much is realized in the quarter versus where you are in terms of I guess a medium term expectation of where that can get to. Thanks.

Jeff Gardner - *Windstream Communications - CEO, President*

Great. So I think in Brent's comments or I guess in my comments we talked about really the last thing we needed to do with the last material thing we needed to do at CT Communications was the billing system conversion. And so that's going to unlock the last bit of synergies there. We were realizing most of those before the billing system conversion. Incrementally, it won't be huge. Expectation going forward is we'll realize the full $30 million impact.

Michael Rollins - *Citigroup - Analyst*

On the long distance side, how much did the long distance pricing changes help you in the quarter or is that something that can help revenue additionally in the next few quarters? Thanks.

Brent Whittington - *Windstream Communications - EVP, CFO*

Michael, this is Brent. A couple things. The pricing increases were really about half of the sequential increase we saw from Q4 to Q1. Some of the packaged plans that I mentioned were the other half and that's something our team throughout this past year has remained focused on, a core voice product that there's demand for in the marketplace and selling not only unlimited bundles, but as we mentioned a couple of times last year, really having a lot of success with some flex bundles, some smaller packaged bundles, better suited to our customer base. That's really helping to drive results that we've seen in the first quarter and I continue to be very pleased with what our team's done with regard to LD revenues.

Michael Rollins - *Citigroup - Analyst*

Thank you very much.

Rob Clancy - *Windstream Communications - SVP, Treasurer*

Danielle, we have time for one more question.

Operator

Your final question comes from the line of Gaurav Jaitly from UBS.

Gaurav Jaitly - *UBS - Analyst*

Just a couple questions. First on the access lines, I was kind of surprised to hear you say gross adds were actually better year-over-year, especially given your comments, Brent, on weaker housing starts. Just wondering what was driving that? And then secondly, you've obviously had a lot of success realizing synergies from the CT acquisition, just wondering what you're seeing out there from an M&A perspective and if you see anything that looks interesting.

Jeff Gardner - *Windstream Communications - CEO, President*

I'll take that. This is Jeff. And so I think, yeah, on the gross side, I'm real pleased with what you saw there and I think it has to do with the fact that we're managing this business very aggressively. We are not a plain old telephone company. We've spent a lot of time in our marketing and sales team has done a really nice job making investments and developing new sales channels, getting aggressive with direct mail campaigns. I think we're doing more precise targeting of our customer base. If you look across the opportunity, despite the slowdown in new housing, we're seeing very good things from a retail channel. We're working hard with things like MDU in the indirect channel. I would attribute that to just hard work on the marketing and sales side, something that we're committed to doing is to continually to reinvent this sales and marketing model here so that we can improve the flow share and we've made progress even in our most competitive markets. And hopefully we will continue to do that. On the M&A side, we won't talk about specific opportunities. I will tell you that as I look across the results in this industry, I'm encouraged.

For the most part, all the RLECs, despite mixed results, what was true across the industry is they demonstrated time and again, these businesses generate cash on a consistent basis. So they're good, solid businesses. They've been resilient to some of the effects of the broader economy and we like our position. We're the largest RLEC in the pace. Our business is running very well, we've got experience on the M&A side. We've integrated VALOR. The team did a great job on that. I'm very pleased with the way the CT integration went. So without talking about some specifics, we still think M&A makes great sense in this business, tremendous synergies can be generated. You can continue to build stronger companies, improve positioning from a scale and scope perspective. We're hopeful there will be opportunities for us to really leverage those things in the near to medium term.

Michael Rollins - *Citigroup - Analyst*

Thanks, Jeff. Just a follow-up. Do you think the credit markets are an impediment right now to do anything in the near term, or do you think you have sufficient access to the capital markets?

Jeff Gardner - *Windstream Communications - CEO, President*

I think our balance sheet is in great shape. We've got great relationships with our banks. The credit markets have probably forever changed in terms of the kinds of commitments that you would get. Two years ago or one year ago even are not going to be there going forward but I think there is definitely access to credit markets. You're talking about, at what price and I think that for the right kind of deals there's going to be financing available, especially if you can do good, strategic transactions. And so -- and we've seen some, although be it minor improvement in the high yield market over the last couple of months, I think generally that the environment is such that you'll see that improve slowly over time. So we'll just continue to monitor that. That obviously will have an impact because credit plays a big role, but I don't think it's a huge impediment.

Gaurav Jaitly - *UBS - Analyst*

Great, thanks. Good luck guys.

Jeff Gardner - *Windstream Communications - CEO, President*

Thanks for joining us this morning. We appreciate your interest and support. Mary Michaels, who is -- and I'm very fortunate to have back from maternity leave, she and I will be available for additional questions throughout the day. Thanks.

Operator

This conclude's today's first quarter 2008 Windstream Communications earnings call. You may now disconnect.