

Embarq CORP  
Form 10-Q  
July 30, 2008  
Table of Contents

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2008

OR

.. **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934**

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 001-32732

**Embarq Corporation**

(Exact name of registrant as specified in its charter)

Edgar Filing: Embarq CORP - Form 10-Q

**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**5454 W. 110<sup>th</sup> Street**

**Overland Park, Kansas**  
(Address of principal executive offices)

**Registrant's telephone number, including area code (913) 323-4637**

(Former name, former address and former fiscal year, if changed since last report)

**20-2923630**  
(IRS Employer  
Identification No.)

**66211**  
(Zip Code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file these reports), and (2) has been subject to these filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act (check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined by Rule 12b-2 of the Exchange Act). Yes  No

COMMON SHARES OUTSTANDING AT JULY 25, 2008:

COMMON STOCK: 142,506,790

**Table of Contents**

***EMBARQ CORPORATION***

***TABLE OF CONTENTS***

	<b>Page Reference</b>
<u>Part I – Financial Information</u>	
Item 1.	
<u>Financial Statements</u>	1
<u>Consolidated Balance Sheets</u>	1
<u>Consolidated Statements of Operations and Comprehensive Income (Unaudited)</u>	2
<u>Consolidated Statements of Cash Flows (Unaudited)</u>	3
<u>Consolidated Statement of Stockholders’ Equity (Unaudited)</u>	4
<u>Condensed Notes to Consolidated Financial Statements (Unaudited)</u>	5
<u>Report of Independent Registered Public Accounting Firm</u>	11
Item 2.	
<u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	12
Item 3.	
<u>Quantitative and Qualitative Disclosures About Market Risk</u>	22
Item 4.	
<u>Controls and Procedures</u>	22
<u>Part II – Other Information</u>	
Item 1.	
<u>Legal Proceedings</u>	23
Item 1A.	
<u>Risk Factors</u>	23
Item 2.	
<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	23
Item 3.	
<u>Defaults Upon Senior Securities</u>	23
Item 4.	
<u>Submission of Matters to a Vote of Security Holders</u>	24
Item 5.	24
Table of Contents	3

Edgar Filing: Embarq CORP - Form 10-Q

Other Information

Item 6.

Exhibits

25

Signatures

27

**Table of Contents****PART I FINANCIAL INFORMATION****Item 1. Financial Statements****EMBARQ CORPORATION****CONSOLIDATED BALANCE SHEETS***(millions, except per share data)*

	As of June 30, 2008 (Unaudited)	As of December 31, 2007
<b>Assets</b>		
Current assets		
Cash and equivalents	\$ 50	\$ 69
Accounts receivable, net of allowance for doubtful accounts of \$57 and \$60	581	616
Inventories, net	119	138
Deferred tax assets	78	76
Prepaid expenses and other current assets	87	87
Total current assets	915	986
Gross property, plant and equipment	20,949	20,802
Accumulated depreciation	(13,360)	(13,054)
Net property, plant and equipment	7,589	7,748
Goodwill	27	27
Prepaid pension asset	130	108
Other assets	45	32
Total	\$ 8,706	\$ 8,901
<b>Liabilities and Stockholders Equity</b>		
Current liabilities		
Current maturities of long-term debt	\$ 82	\$ 99
Accounts payable	337	387
Payroll and employee benefits	146	208
Accrued income taxes	68	27
Accrued operating taxes	105	97
Deferred revenue	189	202
Accrued interest	59	56
Other current liabilities	94	122
Total current liabilities	1,080	1,198
Noncurrent liabilities		
Long-term debt	5,888	5,779
Deferred income taxes	1,114	1,130
Benefit plan obligations	318	320
Other noncurrent liabilities	217	210
Total noncurrent liabilities	7,537	7,439
Stockholders equity		
Preferred stock, \$.01 par value; 200 shares authorized; no shares issued	2	2

## Edgar Filing: Embarq CORP - Form 10-Q

Common stock, \$.01 par value; 1,250 shares authorized; 153.8 and 153.1 shares issued; 144.2 and 153.1 shares outstanding		
Paid-in capital	(214)	(231)
Retained earnings	832	623
Accumulated other comprehensive income (loss)	(130)	(130)
Treasury stock, 9.6 and no shares held in treasury	(401)	
Total stockholders' equity	89	264
Total	\$ 8,706	\$ 8,901

*See accompanying Condensed Notes to Consolidated Financial Statements (Unaudited)*

**Table of Contents****EMBARQ CORPORATION****CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (UNAUDITED)***(millions, except per share data)*

	Quarters Ended June 30,		Year to Date June 30,	
	2008	2007	2008	2007
<b>Net Operating Revenues</b>				
Service revenues	\$ 1,407	\$ 1,454	\$ 2,840	\$ 2,912
Product revenues	142	151	280	282
Total net operating revenues	1,549	1,605	3,120	3,194
<b>Operating Expenses</b>				
Cost of services	381	404	771	821
Cost of products	132	142	270	269
Selling, general and administrative	361	395	719	799
Depreciation	247	264	498	534
Total operating expenses	1,121	1,205	2,258	2,423
<b>Operating Income</b>	428	400	862	771
Interest expense	100	111	204	220
Other (income) expense, net	(1)		(2)	
<b>Income Before Income Taxes</b>	329	289	660	551
Income tax expense	123	113	242	215
<b>Net Income</b>	\$ 206	\$ 176	\$ 418	\$ 336
Amendments to and remeasurement of employee benefit plans, net of tax		(196)		(196)
Amortization of employee benefit plans prior service cost and actuarial losses, net of tax		(4)	(1)	(6)
Amortization of cash flow derivatives, net of tax		1	1	2
<b>Comprehensive Income, Net of Tax</b>	\$ 206	\$ 375	\$ 418	\$ 536
<b>Earnings per Common Share</b>				
Basic	\$ 1.40	\$ 1.16	\$ 2.79	\$ 2.23
Diluted	\$ 1.38	\$ 1.15	\$ 2.76	\$ 2.20
<b>Weighted Average Common Shares Outstanding</b>				
Basic	146.8	151.8	149.7	151.0
Potentially dilutive shares under equity incentive plans	2.0	1.8	1.7	2.0
Diluted	148.8	153.6	151.4	153.0

*See accompanying Condensed Notes to Consolidated Financial Statements (Unaudited)*





**Table of Contents****EMBARQ CORPORATION****CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)***(millions)*

	<b>Year to Date June 30,</b>	
	<b>2008</b>	<b>2007</b>
<b><i>Operating Activities</i></b>		
Net income	\$ 418	\$ 336
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	498	534
Provision for losses on accounts receivable	49	37
Deferred and noncurrent income taxes	(21)	(52)
Stock-based compensation expense	22	30
Net losses (gains) on sales of assets	(9)	(7)
Other, net	26	22
Changes in assets and liabilities:		
Accounts receivable	(14)	(26)
Inventories and other current assets	(4)	(30)
Accounts payable and other current liabilities	(98)	(146)
Noncurrent assets and liabilities, net	(24)	7
<b>Net cash provided by operating activities</b>	<b>843</b>	<b>705</b>
<b><i>Investing Activities</i></b>		
Capital expenditures	(360)	(371)
Proceeds from construction reimbursements	4	5
Proceeds from sales of assets	2	18
<b>Net cash used by investing activities</b>	<b>(354)</b>	<b>(348)</b>
<b><i>Financing Activities</i></b>		
Principal payments on long-term debt	(19)	(462)
Borrowings under revolving credit agreement	790	585
Repayments under revolving credit agreement	(680)	(455)
Proceeds from common stock issued	10	98
Repurchase of common stock	(390)	(2)
Dividends paid to stockholders	(208)	(174)
Tax effects of stock-based compensation		21
Other, net	(11)	(7)
<b>Net cash used by financing activities</b>	<b>(508)</b>	<b>(396)</b>
<b><i>Decrease in Cash and Equivalents</i></b>	<b>(19)</b>	<b>(39)</b>
<b><i>Cash and Equivalents at Beginning of Period</i></b>	<b>69</b>	<b>53</b>
<b><i>Cash and Equivalents at End of Period</i></b>	<b>\$ 50</b>	<b>\$ 14</b>

See accompanying Condensed Notes to Consolidated Financial Statements (Unaudited)



**Table of Contents****EMBARQ CORPORATION****CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY (UNAUDITED)***(millions, except per share data)*

	Preferred Stock	Common Stock	Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total Stockholders Equity
<b>January 1, 2008 Balance</b>	\$	\$ 2	\$ (231)	\$ 623	\$ (130)	\$	\$ 264
Net income				418			418
Dividends to shareholders (\$1.375 per share)				(209)			(209)
Common stock issued			10				10
Stock-based compensation expense			22				22
Restricted stock units surrendered for tax withholding			(15)				(15)
Amortization of (net of tax):							
Employee benefit plans prior service cost and actuarial losses					1		1
Cash flow derivative					(1)		(1)
Repurchase of common stock						(401)	(401)
<b>June 30, 2008 Balance</b>	\$	\$ 2	\$ (214)	\$ 832	\$ (130)	\$ (401)	\$ 89

*See accompanying Condensed Notes to Consolidated Financial Statements (Unaudited)*

**Table of Contents*****EMBARQ CORPORATION******CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS******(Unaudited)***

The information in this Form 10-Q has been prepared according to Securities and Exchange Commission (SEC) rules and regulations. The consolidated interim financial statements of Embarq Corporation (Embarq) reflect all adjustments, consisting only of normal recurring accruals needed to fairly present Embarq's consolidated financial position, results of operations and cash flows.

Certain information and footnote disclosures normally included in consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States were condensed or omitted. As a result, these consolidated financial statements should be read along with Embarq's Annual Report on Form 10-K for the year ended December 31, 2007. Operating results for the 2008 year to date period do not necessarily represent the results that may be expected for the year ending December 31, 2008.

**Note 1. Background and Basis of Presentation*****Background***

Embarq was incorporated in 2005 under the laws of Delaware and was formerly a wholly owned subsidiary of Sprint Nextel Corporation (Sprint Nextel). On May 17, 2006, Sprint Nextel spun-off its local communications business and product distribution operations, thereby establishing Embarq as a separate, stand-alone company.

Embarq provides a suite of integrated communications services including local and long distance voice, data, high-speed Internet, satellite video, professional services and communications equipment to consumer and business customers primarily in local service territories in 18 states. Embarq also provides access to its local network and other wholesale communications services primarily to other carriers, wireless providers and correctional institutions. Through its Logistics segment, Embarq engages in wholesale product distribution, logistics and configuration services.

As of June 30, 2008, Embarq had approximately 18 thousand active employees. Approximately 34% of these employees were represented by unions subject to collective bargaining agreements. Of the union-represented employees, approximately 48% have collective bargaining agreements that will expire within one year. There were no material changes related to employee collective bargaining agreements during the year to date period ended June 30, 2008.

***Basis of Presentation***

The accompanying consolidated financial statements reflect all the accounts of Embarq and its wholly owned subsidiaries. All intercompany transactions have been eliminated.

The consolidated financial statements were prepared using accounting principles generally accepted in the United States. These principles require management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities and the reported amounts of revenues and expenses. Actual results could differ from those estimates.

Certain prior year amounts have been reclassified to conform to the current year presentation. These reclassifications had no effect on the results of operations or stockholders' equity as previously reported.

***Universal Service Fund***

Embarq records federal and state Universal Service Fund (USF) surcharges on a gross basis. The total amount of surcharges recorded in net operating revenue for the quarter and year to date periods ended June 30, 2008 and 2007, were as follows:

Quarter Ended June 30,		Year to Date June 30,	
2008	2007	2008	2007

Edgar Filing: Embarq CORP - Form 10-Q

			<i>(millions)</i>	
Federal and state USF surcharges	\$ 21	\$ 24	\$ 42	\$ 46

**Table of Contents***Workforce Actions*

In order to better align organizational resources with Embarq's business needs as well as to improve its overall cost structure, Embarq has taken various steps, including both voluntary and involuntary reductions in its workforce. Related to these reductions, Embarq recognized the following severance charges (credits):

	Quarter Ended		Year to Date	
	June 30, 2008	June 30, 2007	June 30, 2008	June 30, 2007
	<i>(millions)</i>			
Cost of services				
Telecommunications segment	\$ (2)	\$ 1	\$ (1)	\$ 3
Selling, general and administrative				
Telecommunications segment	4	1	6	12
Logistics segment				1
Subtotal	4	1	6	13
Total severance charges	\$ 2	\$ 2	\$ 5	\$ 16

*Depreciation Rate Adjustments*

On an annual basis, Embarq performs an analysis of the remaining life depreciation rates. Depreciation rates for various digital switching equipment, digital loop carrier equipment and high-speed Internet equipment were adjusted during 2008 and 2007, which resulted in depreciation expense being reduced by the following:

	Quarters Ended		Year to Date	
	June 30, 2008	June 30, 2007	June 30, 2008	June 30, 2007
Depreciation expense reduction (millions)	\$ 12	\$ 11	\$ 24	\$ 23
Basic and diluted earning per share	\$ 0.05	\$ 0.04	\$ 0.10	\$ 0.09

*Treasury Stock*

Shares of common stock repurchased by Embarq are reflected as treasury stock on the trade date and are carried at cost, including any direct third-party fees. Embarq uses the weighted average cost method for the issue of common stock from treasury. In the event shares are not retired and subsequently issued from treasury, paid-in capital will increase for any gains and paid-in capital, or retained earnings in the event of a deficit in paid-in capital, will decrease for any losses.

*Spin-Off Related Expenses*

Embarq replicated or otherwise arranged for replacement of certain facilities, systems, infrastructure and personnel related to functions historically performed by Sprint Nextel and successfully completed the exit of all remaining transitional agreements in May 2008.

No significant spin-off expenditures were incurred during the year to date period ended June 30, 2008. Embarq incurred the following spin-off related charges and capital expenditures for the quarter and year to date period ended June 30, 2007:

	Quarter	Year to Date
	<i>(millions)</i>	
Spin-off related charges	\$ 8	\$ 17

Capital expenditures  
*Adoption of SFAS 157*

2

6

On January 1, 2008, Embarq adopted Statement of Financial Accounting Standards (SFAS) No. 157, *Fair Value Measurements*, for its financial assets and liabilities. Embarq's adoption of SFAS No. 157 did not impact its financial position, results of operations, liquidity or disclosures as there are no financial assets or liabilities that are measured at fair value on a recurring basis. In accordance with FASB Staff Position (FSP) No. 157-2, *Effective Date of FASB Statement No. 157*, Embarq elected to defer until January 1, 2009, the adoption of SFAS No. 157 for all nonfinancial assets and liabilities that are not recognized or disclosed at fair value in the financial statements on a recurring basis. This includes goodwill and nonfinancial long-lived assets that are measured at fair value in impairment testing and asset retirement obligations initially measured at fair value. The adoption of SFAS No. 157 for those nonfinancial assets and liabilities within the scope of FSP 157-2 is not expected to have a material impact on Embarq's financial position, results of operations or liquidity.

6

---

## **Table of Contents**

### *Recently Issued Accounting Pronouncements*

Emerging Issues Task Force (EITF), 03-6-1, *Determining Whether Instruments Granted in Share-based Payment Transactions are Participating Securities*. This standard concluded that unvested share-based payment awards that contain a nonforfeitable right to receive dividends, whether paid or unpaid, are participating securities and should be included in the computation of earnings per share pursuant to the two-class method prescribed under SFAS No. 128, *Earnings per Share*. This standard is effective for fiscal years beginning after December 15, 2008 with early adoption prohibited. Embarq is evaluating the impact of this standard but does not believe it will have a material impact on basic or diluted earnings per share.

## **Note 2. Commitments and Contingencies**

### *Litigation, Claims and Assessments*

Seven former manufactured gas plant sites have been identified that may have been owned or operated by entities acquired by Embarq's subsidiary, Centel Corporation (Centel), before that company was acquired by Sprint Nextel. These sites are not currently owned or operated by either Sprint Nextel or Embarq. On three sites, Embarq and the current landowners are working with the EPA pursuant to administrative consent orders. Expenditures pursuant to the orders are not expected to be material. On five sites, including the three sites where the EPA is involved, Centel has entered into agreements with other potentially responsible parties to share costs. Further, Sprint Nextel has agreed to indemnify Embarq for most of any eventual liability arising from all seven of these sites.

In December 2007, a group of retirees filed a putative class action lawsuit in the United States District Court for the District of Kansas, challenging the decision to make certain modifications to Embarq's retiree benefits programs generally effective January 1, 2008. See Note 5, Employee Benefit Plans. Defendants include Embarq Corporation, certain of its benefits plans, its Employee Benefits Committee and its plan administrator. Additional defendants include Sprint Nextel and certain of its benefits plans. In addition, a complaint in arbitration has been filed by 15 former Centel executives, similarly challenging the benefits changes. Embarq and other defendants intend to vigorously contest these claims and charges.

In addition, Embarq is subject to various other lawsuits, regulatory proceedings against Embarq and other claims typical for a business enterprise. While it is not possible to determine the ultimate disposition of each of these proceedings and whether they will be resolved consistent with Embarq's expectations, Embarq expects that the outcome of these proceedings, individually or in the aggregate, will not have a material adverse effect on its financial condition, results of operations or liquidity.

### *Purchase Commitments: Network Operations Center*

During the second quarter 2008, Embarq entered into a seven year outsourcing agreement for traffic monitoring services and technical support for its voice network operations. Certain Embarq employees are expected to become employees of the vendor during the third quarter when the arrangement is expected to become effective. Embarq's contractual obligation, based on expected call traffic volume, is estimated to be approximately \$27 million annually, which will also be reflected as cost of services in the Consolidated Statements of Operations and Comprehensive Income (Unaudited).

## **Note 3. Debt and Financial Instruments**

During 2008, Embarq increased outstanding borrowings under its credit agreement by \$110 million, entirely through net advances on the revolving credit facility. Additionally, Embarq made \$19 million in scheduled principal payments.

As of June 30, 2008, Embarq's long-term debt had a carrying value of approximately \$6.0 billion and a fair value of approximately \$5.7 billion. This fair value was computed based on observable market transactions and through discounted cash flow analysis using market-based credit spreads.

## **Note 4. Income Taxes**

Embarq records deferred income taxes based on temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and their tax basis.





**Table of Contents**

The differences that caused Embarq's effective income tax rates to vary from the 35% federal statutory rate for income taxes related to continuing operations were as follows:

	Year to Date June 30,	
	2008	2007
	<i>(millions)</i>	
Income tax expense at the federal statutory rate	\$ 231	\$ 193
Effect of:		
State income taxes, net of federal income tax effect	9	22
Other, net	2	
<b>Income tax expense</b>	<b>\$ 242</b>	<b>\$ 215</b>
Effective income tax rate	36.7%	39.0%

In the fourth quarter of 2007, Embarq modified its legal entity structure, which resulted in a reduction of state income tax expense. Also, a favorable negotiated state income tax settlement in the first quarter of 2008 reduced state income tax expense for 2008 by \$5 million.

**Note 5. Employee Benefit Plans**

The components of net periodic benefit cost were as follows:

	Quarter Ended June 30, 2008		Quarter Ended June 30, 2007	
	Pension Benefits	Other Post- retirement Benefits	Pension Benefits	Other Post- retirement Benefits
	<i>(millions)</i>			
Service cost	\$ 14	\$ 2	\$ 14	\$ 2
Interest cost	50	4	49	9
Expected return on plan assets	(68)	(1)	(66)	(1)
Amortization of prior service cost (benefit)	3	(13)	4	(15)
Amortization of actuarial losses	8	3	10	4
Net cost (benefit)	\$ 7	\$ (5)	\$ 11	\$ (1)

	Year to Date June 30, 2008		Year to Date June 30, 2007	
	Pension Benefits	Other Post- retirement Benefits	Pension Benefits	Other Post- retirement Benefits
	<i>(millions)</i>			
Service cost	\$ 28	\$ 4	\$ 28	\$ 4
Interest cost	101	8	97	18
Expected return on plan assets	(137)	(2)	(131)	(2)
Amortization of prior service cost (benefit)	6	(26)	8	(29)
Amortization of actuarial losses	17	6	20	8
Net cost (benefit)	\$ 15	\$ (10)	\$ 22	\$ (1)

## Edgar Filing: Embarq CORP - Form 10-Q

During the second quarter of 2007, Embarq amended its other postretirement medical and life insurance plans to eliminate medical coverage and Medicare premium subsidies for Medicare-eligible retirees and Medicare-eligible beneficiaries and cap the maximum amount of life insurance benefits through the company-sponsored plan for qualified retirees at \$10 thousand, effective January 1, 2008. In addition, effective September 1, 2007, Embarq eliminated company-provided life insurance coverage for retirees who also have benefits through a separate subsidiary company-sponsored plan.

In March 2008, Embarq became aware of transactions that involved the inadvertent receipt of funds by the plan sponsors from the assets of the defined benefit pension plans in which Embarq's employees and retirees currently participate, and in which they participated before the spin-off. These transactions, which began in 2002 and continued through March 2008, require payments to the plans' trusts. With respect to the period following the spin-off, Embarq paid all amounts owed to its plan's trust. For the period before the spin-off, the Embarq plan's trust may receive additional funds from the pre-spin-off plan or pre-spin-off plan sponsor related to these transactions. While it is not possible for Embarq to determine the ultimate disposition of the pre-spin-off amount and whether it will be resolved consistent with current expectations, the eventual outcome is not expected to have a material adverse effect on Embarq's financial condition, results of operations or liquidity.

**Table of Contents****Note 6. Stock-based Compensation***Second Quarter 2008*

On May 1, 2008, approximately 20 thousand restricted stock units were granted to non-employee members of the board of directors as part of their annual compensation program. These awards had a fair value of \$43.08 per restricted stock unit resulting in approximately \$1 million in compensation expense that will be recognized over the one year vesting term.

*First Quarter 2008*

On February 27, 2008, approximately 0.4 million restricted stock units were granted to certain non-executive employees as part of Embarq's 2007 short-term incentive program. The total award was based on the achievement of performance objectives under the 2007 short-term incentive program. These awards had a fair value of \$42.91 per restricted stock unit and will vest in full on December 1, 2008.

On March 2, 2008, approximately 0.9 million stock options and 0.4 million restricted stock units were granted to executive officers and other executive level employees as part of Embarq's 2008 long-term incentive program. The stock options will vest 34% on March 2, 2009, and 33% will vest on each of March 2, 2010 and 2011. The restricted stock units contain market and performance provisions and will vest on March 2, 2011. The restricted stock units ultimately issued could increase up to 200% of the initial number of awards granted or be reduced to zero depending on Embarq's performance. The fair value was \$6.24 per stock option and \$41.94 per restricted stock unit.

The significant assumptions used to calculate the fair value for the 2008 annual stock option grant were as follows:

	<b>2008 Annual Grant</b>
Underlying stock price	\$ 41.94
Exercise price	\$ 41.94
Expected volatility	30.8%
Risk-free interest rate	2.9%
Expected dividend yield	6.6%
Expected term (years)	6.0

Total compensation expense related to all of the awards noted above was \$40.8 million, which is expected to be recognized over a weighted average vesting period of 2.0 years.

**Note 7. Business Segment Information**

Embarq has two segments, Telecommunications and Logistics. The Telecommunications segment provides a suite of integrated communication services including local and long distance voice, data, high-speed Internet, satellite video, professional services and communications equipment to consumer and business customers primarily within Embarq's local service territories in 18 states. The Telecommunications segment also provides access to Embarq's local network and other wholesale communications services primarily to other carriers, wireless providers and correctional institutions. The Logistics segment engages in wholesale product distribution, logistics and configuration services.

Embarq manages its segments to the operating income level. Items, such as interest, other income and expense and income taxes are managed at the consolidated level. The reconciliation of operating income to net income is shown in the accompanying Consolidated Statements of Operations and Comprehensive Income (Unaudited).

The financial information by operating segment was as follows:

	Quarter Ended June 30, 2008			Quarter Ended June 30, 2007		
	Telecommunications	Logistics	Consolidated	Telecommunications	Logistics	Consolidated
	<i>(millions)</i>					
Voice	\$ 994	\$	\$ 994	\$ 1,071	\$	\$ 1,071
Data	199		199	188		188

Edgar Filing: Embarq CORP - Form 10-Q

High-speed Internet	137		137	121		121
Other	77		77	74		74
Service revenues	1,407		1,407	1,454		1,454
Product revenues	32	110	142	28	123	151
Total net operating revenues	\$ 1,439	\$ 110	\$ 1,549	\$ 1,482	\$ 123	\$ 1,605
Operating income	\$ 424	\$ 4	\$ 428	\$ 396	\$ 4	\$ 400

**Table of Contents**

	Year to Date June 30, 2008			Year to Date June 30, 2007		
	Telecommunications	Logistics	Consolidated	Telecommunications	Logistics	Consolidated
	<i>(millions)</i>					
Voice	\$ 2,018	\$	\$ 2,018	\$ 2,155	\$	\$ 2,155
Data	397		397	377		377
High-speed Internet	270		270	237		237
Other	155		155	143		143
Service revenues	2,840		2,840	2,912		2,912
Product revenues	55	225	280	50	232	282
Total net operating revenues	\$ 2,895	\$ 225	\$ 3,120	\$ 2,962	\$ 232	\$ 3,194
Operating income	\$ 860	\$ 2	\$ 862	\$ 770	\$ 1	\$ 771

**Note 8. Supplemental Cash Flow Information and Non-Cash Activities**

Embarq's supplemental cash flow information and non-cash activities were as follows:

	Year to Date June 30,	
	2008	2007
	<i>(millions)</i>	
<b>Supplemental Cash Flow Information</b>		
Cash paid for interest, net of amounts capitalized	\$ 201	\$ 221
Cash paid for income taxes	209	290
<b>Non-Cash Activities</b>		
Capital expenditure accrual	\$ (16)	\$ 15
Cash held in escrow from the sale of assets	10	5
Pending settlement of repurchases of common stock	11	
Dividends accrued	1	
Extinguishment of debt		3
Issuance of treasury stock to the Employee Stock Purchase Plan		2

**Note 9. Subsequent Events**

From July 1 through July 25, 2008, Embarq repurchased 1.7 million shares of common stock for a total of \$78 million, representing an average price of \$44.65 per share.

---

**Table of Contents**

**Report of Independent Registered Public Accounting Firm**

The Board of Directors and Stockholders

Embarq Corporation:

We have reviewed the accompanying consolidated balance sheet of Embarq Corporation and subsidiaries (the Company) as of June 30, 2008, the related consolidated statements of operations and comprehensive income for the three-month and six-month periods ended June 30, 2008 and 2007, the related consolidated statements of cash flows for the six-month periods ended June 30, 2008 and 2007, and the related consolidated statement of stockholders' equity for the six-month period ended June 30, 2008. These consolidated financial statements are the responsibility of the Company's management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the consolidated financial statements referred to above for them to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of Embarq Corporation and subsidiaries (the Company) as of December 31, 2007, and the related consolidated statements of operations and comprehensive income, cash flows and stockholders' equity for the year then ended (not presented herein); and in our report dated February 28, 2008, we expressed an unqualified opinion on those consolidated financial statements. Our report on the consolidated financial statements and the related financial statement schedule refers to the adoption of the provisions of FASB Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations*, as of December 31, 2005. Also, as discussed in Note 6 to the consolidated financial statements, the Company adopted the provisions of Statement of Financial Accounting Standards No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106 and 132(R)*, as of December 31, 2006. Lastly, as discussed in Note 5 to the consolidated financial statements, the Company adopted the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes- an Interpretation of FASB Statement No. 109*, as of January 1, 2007. In our opinion, the information set forth in the accompanying consolidated balance sheet as of December 31, 2007, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ KPMG LLP

Kansas City, Missouri

July 30, 2008

**Table of Contents**

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**  
**CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS**

We make forward-looking statements in this document. These forward-looking statements relate to our outlook or expectations for earnings, revenues, expenses, asset quality or other future financial or business performance, strategies or expectations, or the impact of legal, regulatory or supervisory matters on our business, results of operations or financial condition. Specifically, forward-looking statements may include:

statements relating to our plans, intentions, expectations, objectives or goals;

statements relating to our future economic performance, business prospects, revenue, income and financial condition, and any underlying assumptions relating to those statements; and

statements preceded by, followed by or that include the words estimate, plan, project, forecast, intend, expect, anticipate, seek, target or similar expressions.

These statements reflect our management's judgment based on currently available information and involve a number of risks and uncertainties that could cause actual results to differ materially from those in the forward-looking statements. With respect to these forward-looking statements, our management has made assumptions regarding, among other things, customer growth and retention, pricing, operating costs, network usage, technology and the economic and regulatory environment.

Future performance cannot be ensured. Actual results may differ materially from those in the forward-looking statements. Some factors that could cause our actual results to differ include, but are not limited to:

the effects of vigorous competition in the markets in which we operate, including access line loss to cable operators and wireless providers;

the impact of new, emerging and competing technologies on our business;

the effect of changes in the legal and regulatory environment and the impact of compliance with regulatory mandates;

potential fluctuations in our financial performance, including revenues, capital expenditures and operating expenses;

the impact of any adverse change in the ratings assigned to our debt by ratings agencies on the cost of financing or the ability to raise additional financing if needed;

the effects of mergers, consolidations or other unexpected developments in the industries relevant to our operations;

the failure to realize expected improvement in operating efficiencies;

the costs and business risks associated with the development of new products and services;



## Edgar Filing: Embarq CORP - Form 10-Q

the uncertainties related to our investments in networks, systems and other businesses;

the uncertainties related to the implementation of our business strategies;

the inability of third parties to perform to our requirements under agreements related to our business operations;

our ownership of or ability to license technology that may be necessary to expand our business offerings;

restrictions in our patent agreement with Sprint Nextel;

unexpected adverse results of legal proceedings involving our company;

the impact of equipment failure or other breaches of network or information technology security;

potential work stoppages;

a determination by the IRS that the spin-off from Sprint Nextel should be treated as a taxable transaction;

the volatility in the equity market;

the effects of changes in both general and local economic conditions on the markets we serve, which can impact demand for our products and services; customer purchasing decisions; collectability of revenue; and required levels of capital expenditures related to new construction of residences and businesses;

the possible impact of adverse changes in political or other external factors over which we have no control, including hurricanes and other severe weather; and

other risks referenced in our Annual Report on Form 10-K, including in Part I, Item 1A, Risk Factors , and from time to time in other filings of ours with the SEC.

**Table of Contents**

You are cautioned not to place undue reliance on any forward-looking statements, which speak only as of the date of this document. Except as required by law, we undertake no obligation to publicly update or release any revisions to these forward-looking statements to reflect any events or circumstances after the date of this document or to reflect the occurrence of unanticipated events.

**OVERVIEW***Operations*

We provide a suite of integrated communications services to consumer and business customers primarily in our local service territories in 18 states. Our service and product offerings include local and long distance voice, data, high-speed Internet, satellite video, professional services and communications equipment. In addition, we continue to serve existing wireless customers acquired under our mobile virtual network operator arrangement with Sprint Nextel; however, as part of our orderly transition away from providing these services, we have curtailed most sales activities.

We also provide wholesale services primarily to other carriers, wireless providers and correctional institutions. Services offered include switched access, special access, intelligent network database, collocation, resale switched access lines, pay telephone, unbundled network elements, high speed data services and billing and collection services.

Through our Logistics segment, we engage in wholesale product distribution, logistics and configuration services.

Our mission is to profitably serve targeted customers through simple solutions and a customer experience that satisfies their personal and business needs. Our strategy for success in the marketplace has five key elements: 1) innovate in everything we do, 2) drive productivity and cost efficiency, 3) win and retain targeted customers, 4) drive value through the delivery of broadband services and 5) explore and pursue growth opportunities complementary to our core business.

Consistent with the past several years, we have continued to experience overall declines in telecommunications net operating revenue during 2008. Historically, these overall declines have resulted from voice revenue reductions driven by switched access line losses, somewhat offset by growth in data and high-speed Internet revenue. In recent quarters, voice revenue declines and line loss trends have been comparatively worse. We believe these recent trends are partially the result of general and local economic conditions in the markets we serve. The partial offset of voice revenue declines from growth in data services and high-speed Internet revenue is expected to continue based on recent results and trends; however, the amount of offset may decline in the future due to expected reduced rates of growth for these products and services.

The following table reflects information about our switched access lines:

	Lines Served		Quarterly Line Loss				Annual Line Loss			
	June 30, 2008	June 30, 2007	June 30, 2008	June 30, 2007	June 30, 2008	June 30, 2007	June 30, 2008	June 30, 2007		
			<i>(thousands)</i>							
Primary	3,755	(128)	(3.3)%	(109)	(2.6)%	(370)	(9.0)%	(300)	(6.8)%	
Additional	274	(15)	(5.2)%	(18)	(5.1)%	(62)	(18.5)%	(74)	(18.0)%	
<b>Total Consumer</b>	<b>4,029</b>	<b>(143)</b>	<b>(3.4)%</b>	<b>(127)</b>	<b>(2.8)%</b>	<b>(432)</b>	<b>(9.7)%</b>	<b>(374)</b>	<b>(7.7)%</b>	
Business	1,841	(20)	(1.1)%	(13)	(0.7)%	(55)	(2.9)%	(28)	(1.5)%	
Wholesale	152	(7)	(4.4)%	(8)	(4.3)%	(24)	(13.6)%	(32)	(15.4)%	
<b>Total</b>	<b>6,022</b>	<b>(170)</b>	<b>(2.7)%</b>	<b>(148)</b>	<b>(2.2)%</b>	<b>(511)</b>	<b>(7.8)%</b>	<b>(434)</b>	<b>(6.2)%</b>	

Beginning in 2008, we no longer include in our business switched access line counts those lines that support our internal administrative and operational activities. Accordingly, the business access line counts at June 30, 2007, were adjusted by 158 thousand access lines to reflect this change.

Consumer switched access line losses represent the most significant portion of our losses. These losses were primarily attributed to an increasing overlap of cable operators within our local service territories offering VoIP, as well as an increasing number of customers choosing to discontinue traditional wireline phone service to rely solely on wireless services.

## Edgar Filing: Embarq CORP - Form 10-Q

Product substitution among our offerings also contributes to our access line losses. Certain of our business access line losses result from the conversion to our data services. These substitutions result in a reduction in the number of switched access lines we serve, but do not represent a loss of the customer relationship.

For the year to date period ended June 30, 2008, our high-speed Internet subscribers increased to approximately 1.4 million subscribers, which is an increase of 18% as compared to the same period in 2007, while associated revenue increased 14%.

Demand during the quarter for data services continued to be strong. Our data services consist mainly of dedicated circuits connecting other carriers' networks to their customers' locations, wireless carriers' cell towers to mobile switching centers or business customers to our network. Revenue associated with these services increased 5% for the year to date period ended June 30, 2008, compared to the same period in 2007.

**Table of Contents**

Satellite video service is also a growing element of our bundled service offers that we currently offer through sales agency relationships with various satellite video service providers. As of June 30, 2008, we had 239 thousand satellite video service subscribers, compared to 178 thousand as of June 30, 2007.

To measure our success in our consumer bundling initiatives as well as attracting and retaining high value customers, average monthly revenue per household (ARPH) is a measure that we closely monitor. This measure is calculated by dividing one sixth of year to date consumer revenue by average primary consumer access lines.

	Year to Date June 30,		Difference	
	2008	2007	Amount	%
Consumer revenue (millions)	\$ 1,297	\$ 1,345	\$ (48)	(3.6)%
Average primary consumer access lines (thousands)	3,862	4,207	(345)	(8.2)%
ARPH	\$ 55.97	\$ 53.28	\$ 2.69	5.0%

**Spin-Off Related Expenditures**

We replicated or otherwise arranged for replacement of certain facilities, systems, infrastructure and personnel related to functions historically performed by Sprint Nextel and successfully completed the exit of all remaining transitional agreements in May 2008.

No significant spin-off expenditures were incurred during the year to date period ended June 30, 2008. We incurred the following spin spin-off related charges and capital expenditures for the quarter and year to date periods ended June 30, 2007:

	Quarter	Year to Date (millions)
Spin-off related charges	\$ 8	\$ 17
Capital expenditures	2	6

**Industry Environment**

We operate in an industry that has been and continues to be subject to intense competition in conjunction with regulatory and legislative change. Given these factors, as well as the trend toward consolidation in the industry, we routinely assess the implications of these industry factors on our operations. These assessments, along with regulatory and legislative developments, may impact the future valuation of our long-lived assets and could have a material effect on our business, results of operations, financial condition and liquidity.

**Adoption of SFAS 157**

On January 1, 2008, we adopted Statement of Financial Accounting Standards (SFAS) No. 157, *Fair Value Measurements*, for our financial assets and liabilities. Our adoption of SFAS No. 157 did not impact our financial position, results of operations, liquidity or disclosures as there are no financial assets or liabilities that are measured at fair value on a recurring basis. In accordance with FASB Staff Position (FSP) No. 157-2, *Effective Date of FASB Statement No. 157*, we elected to defer until January 1, 2009, the adoption of SFAS No. 157 for all nonfinancial assets and liabilities that are not recognized or disclosed at fair value in the financial statements on a recurring basis. This includes goodwill and nonfinancial long-lived assets that are measured at fair value in impairment testing and asset retirement obligations initially measured at fair value. The adoption of SFAS No. 157 for those nonfinancial assets and liabilities within the scope of FSP 157-2 is not expected to have a material impact on our financial position, results of operations or liquidity.

**Recently Issued Accounting Pronouncements**

EITF 03-6-1, *Determining Whether Instruments Granted in Share-based Payment Transactions are Participating Securities*. This standard concluded that unvested share-based payment awards that contain a nonforfeitable right to receive dividends, whether paid or unpaid, are participating securities and should be included in the computation of earnings per share pursuant to the two-class method prescribed under SFAS No. 128. This standard is effective for fiscal years beginning after December 15, 2008 with early adoption prohibited. We are evaluating the

impact of this standard but do not believe it will have a material impact on basic or diluted earnings per share.

**Table of Contents****RESULTS OF OPERATIONS**

	Quarters Ended June 30, Year to Date June 30,			
	2008	2007	2008	2007
	(millions)			
<b>Net Operating Revenues</b>				
Telecommunications segment	\$ 1,439	\$ 1,482	\$ 2,895	\$ 2,962
Logistics segment	110	123	225	232
Total net operating revenues	\$ 1,549	\$ 1,605	\$ 3,120	\$ 3,194
<b>Operating Income</b>				
Telecommunications segment	\$ 424	\$ 396	\$ 860	\$ 770
Logistics segment	4	4	2	1
Total operating income	\$ 428	\$ 400	\$ 862	\$ 771
<b>Net Income</b>	<b>\$ 206</b>	<b>\$ 176</b>	<b>\$ 418</b>	<b>\$ 336</b>

**Segmental Results of Operations - Telecommunications**

Our Telecommunications segment consists of regulated local phone companies serving approximately 6 million access lines primarily in 18 states as of June 30, 2008. We provide a suite of integrated communication services including local and long distance voice, data, high-speed Internet, satellite video, professional services and communications equipment to consumer and business customers primarily in our local service territories. We also provide access to our local network and other wholesale communications services primarily to other carriers, wireless providers and correctional institutions.

(millions)	Quarters Ended June 30,				Difference	
	2008	% of Revenues	2007	% of Revenues	\$/ Percent	
<b>Net operating revenues</b>						
Voice	\$ 994	69%	\$ 1,071	72%	\$ (77)	(7)%
Data	199	14%	188	13%	11	6%
High-speed Internet	137	10%	121	8%	16	13%
Other	77	5%	74	5%	3	4%
Service revenues	1,407	98%	1,454	98%	(47)	(3)%
Product revenues	32	2%	28	2%	4	14%
Total net operating revenues	1,439	100%	1,482	100%	\$ (43)	(3)%
<b>Operating expenses</b>						
Costs of services	381	27%	404	27%	(23)	(6)%
Costs of products	33	2%	33	2%		%
Selling, general and administrative	355	25%	387	26%	(32)	(8)%
Depreciation	246	17%	262	18%	(16)	(6)%
Total operating expenses	1,015	71%	1,086	73%	(71)	(7)%
Operating income	\$ 424	29%	\$ 396	27%	\$ 28	7%
Capital expenditures	\$ 181		\$ 188		\$ (7)	(4)%

## Edgar Filing: Embarq CORP - Form 10-Q

Switched access lines (thousands)	6,022	6,533	(511)	(7.8)%
Switched access minutes of use (millions)	6,370	7,066	(696)	(10)%
High-speed Internet subscribers (thousands)	1,364	1,156	208	18%

**Table of Contents**

(millions)	Year to Date June 30,		%		Difference	
	2008	% of Revenues	2007	% of Revenues	\$ /	Percent
Net operating revenues						
Voice	\$ 2,018	70%	\$ 2,155	73%	\$ (137)	(6)%
Data	397	14%	377	13%	20	5%
High-speed Internet	270	9%	237	8%	33	14%
Other	155	5%	143	4%	12	8%
Service revenues	2,840	98%	2,912	98%	(72)	(2)%
Product revenues	55	2%	50	2%	5	10%
Total net operating revenues	2,895	100%	2,962	100%	(67)	(2)%
Operating expenses						
Costs of services	770	27%	821	28%	(51)	(6)%
Costs of products	66	2%	63	2%	3	5%
Selling, general and administrative	703	24%	779	26%	(76)	(10)%
Depreciation	496	17%	529	18%	(33)	(6)%
Total operating expenses	2,035	70%	2,192	74%	(157)	(7)%
Operating income	\$ 860	30%	\$ 770	26%	\$ 90	12%
Capital expenditures	\$ 360		\$ 370		\$ (10)	(3)%
Switched access minutes of use (millions)	13,253		14,642		(1,389)	(9)%

**Net Operating Revenues**

Net operating revenues decreased \$43 million for the quarter and decreased \$67 million for the year to date period ended June 30, 2008, compared to the same periods in 2007. Variances in individual categories of revenue are discussed below.

*Voice*

Voice revenues include monthly recurring fees for local service, enhanced calling features and long distance. Additionally, voice revenues include access and other wholesale services to other carriers to enable connectivity to our network as well as USF receipts and customer surcharges. Voice revenues declined \$77 million for the quarter and decreased \$137 million for the year to date period ended June 30, 2008, compared to the same periods in 2007.

The following table lists the major drivers of these changes:

	Increase (Decrease)	
	Quarter	Year to Date
	(millions)	
Decline in local voice revenues primarily due to access line losses	\$ (54)	\$ (102)
Decline in long-distance voice revenues primarily due to access line losses and yield declines	(6)	(13)
Decline in access revenues primarily associated with lower access minutes of use	(9)	(14)
Other	(8)	(8)
Total decrease	\$ (77)	\$ (137)





**Table of Contents***Data*

Data revenues represent data network services sold to business customers and special access services sold to other carriers. Data revenues increased \$11 million for the quarter and increased \$20 million for the year to date period ended June 30, 2008, compared to the same periods in 2007. The following table lists the major drivers of these changes:

	Increase (Decrease)	
	Quarter	Year to Date
	<i>(millions)</i>	
Special access revenue	\$ 7	\$ 15
Other	4	5
<b>Total increase</b>	<b>\$ 11</b>	<b>\$ 20</b>

*High-speed Internet*

High-speed Internet revenues increased \$16 million for the quarter and increased \$33 million for the year to date period ended June 30, 2008, compared to the same periods in 2007. These increases are due to an 18% increase in subscribers at June 30, 2008, compared to June 30, 2007.

*Other Service*

Other service revenues mainly includes professional services, intelligent network database services, billing and collection services, wireless and sales of services through various sales agency relationships, including our satellite video service offering. Other service revenues increased \$3 million for the quarter and increased \$12 million for the year to date period ended June 30, 2008, compared to the same periods in 2007. These increases were primarily related to wireless and professional services revenue.

*Product Revenues*

Product revenues are derived mainly from sales of customer premises equipment, or CPE, which is communications equipment that resides at a business customer's location for the management of voice and data networks and applications. Sales of high-speed Internet equipment to our customers also are reflected in product revenues. Product revenues increased \$4 million for the quarter and increased \$5 million for the year to date period ended June 30, 2008, compared to the same periods in 2007.

**Costs of Services**

Costs of services include costs to operate and maintain the local network including employee-related costs directly supporting our network, costs directly associated with various service offerings, intercarrier compensation (such as access payments and reciprocal compensation), federal and state USF assessments and various operating taxes. Cost of services decreased \$23 million for the quarter and decreased \$51 million for the year to date period ended June 30, 2008, compared to the same periods in 2007. The following table lists the major drivers of these changes:

	Increase (Decrease)	
	Quarter	Year to Date
	<i>(millions)</i>	
Network labor, benefits and severance charges	\$ (5)	\$ (24)
High-speed Internet service costs, primarily due to web hosting	(3)	(9)
Long-distance costs primarily related to purchased minutes of use	(7)	(8)
Intercarrier compensation	(4)	(7)
Other costs	(4)	(3)
<b>Total decrease</b>	<b>\$ (23)</b>	<b>\$ (51)</b>

**Costs of Products**

Costs of products was comparable for the quarter and increased \$3 million for the year to date period ended June 30, 2008, compared to the same periods in 2007. The 2008 cost increase is primarily related to the product revenue increases noted above as well as adjustments to the carrying value of wireless handsets in 2008.

**Table of Contents****Selling, General and Administrative**

Selling, general and administrative (SGA) costs, includes costs associated with selling and marketing, customer service, information technology, bad debt expense, general corporate costs and all other employee-related costs. These costs decreased \$32 million for the quarter and decreased \$76 million for the year to date period ended June 30, 2008, compared to the same periods in 2007. The following table lists the major drivers of these changes:

	Increase (Decrease)	
	Quarter	Year to Date
		( <i>millions</i> )
Labor and benefits costs	\$ (16)	\$ (41)
Severance charges	3	(6)
Spin-off related charges	(8)	(17)
Systems and process improvement initiatives	(10)	(19)
Other	(1)	7
Total decrease	\$ (32)	\$ (76)

SGA costs include charges for estimated bad debt expense. The reserve for bad debt requires management's judgment and is based on many factors. Bad debt expense increased to approximately 1.7% of net operating revenues in the year to date period ended June 30, 2008, compared to 1.2% for the same period in 2007. The increase is partially due to additional expense associated with our wireless offering and current economic factors.

**Depreciation**

Depreciation expense decreased \$16 million for the quarter and decreased \$33 million for the year to date period ended June 30, 2008, compared to the same periods in 2007. The following table lists the major drivers of these changes:

	Increase (Decrease)	
	Quarter	Year to Date
		( <i>millions</i> )
2008 depreciation rate reductions	\$ (12)	\$ (24)
2007 depreciation adjustments resulting from prior year sales and use tax assessments	(2)	(8)
Lower net additions to property, plant and equipment		(4)
Other	(2)	3
Total decrease	\$ (16)	\$ (33)

**Segmental Results of Operations - Logistics**

Through our Logistics segment, we procure, configure, service and distribute equipment, materials and supplies to the communications industry. The products that we offer include outside plant, business communication systems, telephones and accessories and network access equipment from leading manufacturers.

(millions)	Quarters Ended June 30,				Difference	
	2008	% of Revenues	2007	% of Revenues	\$ /	Percent
Net operating revenues	\$ 110	100%	\$ 123	100%	(13)	(11)%
Operating expenses						

## Edgar Filing: Embarq CORP - Form 10-Q

Costs of products and services	99	90%	109	89%	(10)	(9)%
Selling, general and administrative	6	5%	8	6%	(2)	(25)%
Depreciation and amortization	1	1%	2	2%	(1)	(50)%
Total operating expenses	106	96%	119	97%	(13)	(11)%
Operating income	\$ 4	4%	\$ 4	3%	\$	%

**Table of Contents**

(millions)	Year to Date June 30,				Difference	
	2008	% of Revenues	2007	% of Revenues	\$ /	Percent
Net operating revenues	\$ 225	100%	\$ 232	100%	(7)	(3)%
Operating expenses						
Costs of products and services	205	91%	206	89%	(1)	%
Selling, general and administrative	16	7%	20	9%	(4)	(20)%
Depreciation and amortization	2	1%	5	2%	(3)	(60)%
Total operating expenses	223	99%	231	100%	(8)	(3)%
Operating income	\$ 2	1%	\$ 1	%	\$ 1	100%
Capital expenditures	\$		\$ 1		\$ (1)	(100)%

**Net Operating Revenues**

Revenues from the Logistics segment decreased \$13 million for the quarter and decreased \$7 million for the year to date period ended June 30, 2008, compared to the same periods in 2007. These declines were primarily related to reductions in customer spending resulting from general economic factors partially offset by revenue related to a supply contract that originated in the third quarter of 2007.

**Cost of Products and Services**

Cost of products and services includes costs of equipment sold and other operating taxes. These costs decreased \$10 million for the quarter and decreased \$1 million for the year to date period ended June 30, 2008, compared to the same periods in 2007. The drivers of these changes are directly associated with the revenue factors noted above.

**Selling, General and Administrative**

Selling, general and administrative expense decreased \$2 million for the quarter and decreased \$4 million for the year to date period ended June 30, 2008, compared to the same periods in 2007. This decrease was primarily related to a decrease in severance charges and ongoing labor and benefits costs, as well as a gain related to the sale of a distribution facility.

**Consolidated Non-operating Items**

	Quarters Ended June 30,		Year to Date June 30,	
	2008	2007	2008	2007
	(millions)			
Interest expense	\$ 100	\$ 111	\$ 204	\$ 220
Other (income) expense, net	(1)		(2)	
Income tax expense	123	113	242	215
<i>Interest Expense</i>				

Interest expense decreased \$11 million for the quarter and decreased \$16 million for the year to date period ended June 30, 2008, compared to the same periods in 2007. This decrease is primarily due to the reduction of debt outstanding under our credit agreement as well as declines of interest rates related to these borrowings. Our effective interest rate on long-term debt decreased to 7.0% for the year to date period ended June 30, 2008 as compared to 7.2% for the same period in 2007. See Liquidity and Capital Resources below for more information about our financing activities.

**Table of Contents***Income Tax Expense*

Income tax expense increased \$10 million for the quarter and increased \$27 million for the year to date period ended June 30, 2008, compared to the same periods in 2007. This increase was primarily the result of income before income taxes increasing \$40 million for the quarter and \$109 million for the year to date period ended June 30, 2008, compared to the same periods in 2007. This increase was a result of the various factors discussed in the sections above, partially offset by reduced state income taxes resulting from a favorable negotiated settlement in 2008 and the modification of our legal entity structure in the fourth quarter of 2007.

**LIQUIDITY AND CAPITAL RESOURCES**

We manage our liquidity and capital resource needs primarily through managing the capital allocation of internally generated funds.

*Cash Flows*

The following table summarizes our decrease in cash and equivalents for the year to date periods ended June 30, 2008 and 2007:

	<b>Year to Date June 30,</b>	
	<b>2008</b>	<b>2007</b>
	<i>(millions)</i>	
Operating activities	\$ 843	\$ 705
Investing activities	(354)	(348)
Financing activities	(508)	(396)
Decrease in cash and equivalents	\$ (19)	\$ (39)

*Operating Activities*

Net cash provided by operating activities increased \$138 million in the year to date period ended June 30, 2008, compared to the same period in 2007, based on the following:

	<b>Increase (Decrease)</b>
	<i>(millions)</i>
Collections from customers	\$ (62)
Payments to employees and suppliers	99
Interest payments	20
Income tax payments, net	81
Total increase in cash provided by operating activities	\$ 138

The changes in cash from operations as detailed in the table above were impacted by the drivers discussed in Results of Operations, as well as the timing of certain working capital and income tax requirements.

*Investing Activities*

Net cash used by investing activities increased \$6 million in the year to date period ended June 30, 2008, compared to the same period in 2007.

Capital expenditures account for the majority of our investing activities. Our capital expenditures primarily fund new service addresses, increased network capacity and regulatory mandates; internal infrastructure; new capabilities; and sales success based expenditures primarily related to growth in high-speed Internet and data services. Capital expenditures of \$360 million in the year to date period ended June 30, 2008, decreased \$11 million from the same period in 2007. The following table shows the major drivers of these changes:

Edgar Filing: Embarq CORP - Form 10-Q

	<b>Increase (Decrease)</b> <i>(millions)</i>
Network expansion and mandates	\$ (46)
Internal infrastructure	7
New capabilities	11
Sales success based	17
<b>Total decrease in capital expenditures</b>	<b>\$ (11)</b>



**Table of Contents**

Proceeds from sales of assets decreased \$16 million in the year to date period ended June 30, 2008, compared to the same period in 2007. This decrease was primarily related to proceeds received in the first quarter of 2007 related to the sales of rural telephone exchanges in the fourth quarter of 2006.

**Financing Activities**

Net cash used by financing activities increased \$112 million in the year to date period ended June 30, 2008, compared to the same period in 2007. The following table shows the major drivers of this change:

	<b>Increase (Decrease)</b> <i>(millions)</i>
Net changes in long-term debt	\$ (423)
Dividends paid to stockholders	34
Repurchase of common shares	388
Common stock issued	88
Other	25
 Total increase in cash used by financing activities	 \$ 112

**Capital Requirements**

We currently expect capital expenditures, net of proceeds from construction reimbursements, for 2008 to be approximately \$740 million. We continue to review capital expenditure requirements and will adjust spending and capital investment in response to operational needs, customer demand and changes in the levels of new construction activity in the markets we serve.

**Liquidity**

Since our spin-off in 2006, cash provided by operating activities has been more than sufficient to fund our ongoing capital investment requirements, repay scheduled maturities on outstanding debt and pay regular quarterly dividends to stockholders. As a result, we have been able to increase our dividend payouts, make discretionary payments on outstanding debt and initiate the stock repurchase program approved by our board of directors in early 2008. For 2008 and the next few years, despite the impact of continuing access line losses and increased competition, we believe cash provided by operating activities will be sufficient to fund our capital investment requirements, dividend payouts at current levels, the approved stock repurchase program and scheduled maturities on debt for the remainder of 2008 and subsequent years (which are \$80 million in 2008 and \$2 million in both 2009 and 2010).

Our total indebtedness at June 30, 2008, was approximately \$6.0 billion, consisting of \$4.5 billion in senior notes, \$880 million in direct borrowings under our credit agreement and \$605 million of other debt. As of June 30, 2008, we had approximately \$0.9 billion of availability under our \$1.5 billion revolving credit facility, which reflects direct borrowings of \$520 million and issued letters of credit of \$32 million. The credit agreement expires in 2011, and the initial tranches of our notes mature in 2013. We are in compliance with all applicable financial covenants associated with our borrowings.

We may also incur additional indebtedness from time to time for general corporate purposes, including working capital requirements and capital expenditures. Regulatory restrictions and the terms of our indebtedness, however, limit our ability to incur additional indebtedness, raise capital through our subsidiaries, pledge the stock of our subsidiaries, encumber our assets or the assets of our subsidiaries, or cause our subsidiaries to guarantee our indebtedness.

We expect to pay regular quarterly dividends. Thus far, in 2008 we have paid two quarterly dividends of \$0.6875 per common share each. Our ability to fund a regular quarterly dividend will be impacted by our ability to generate cash from operations. The declaration, amount and timing of future dividends will be at the discretion of our board of directors, and will depend upon many factors, including our financial condition, results of operations, growth prospects, funding requirements, applicable law and other factors our board of directors deems relevant.

On January 9, 2008, our board of directors authorized a program for the repurchase of our common stock for an aggregate purchase price of up to \$500 million until June 30, 2009. We anticipate purchasing shares either in the open market or through private transactions, depending on market conditions and other factors, in accordance with applicable securities laws. As of July 25, 2008, we have repurchased 11.3 million shares

## Edgar Filing: Embarq CORP - Form 10-Q

of common stock (representing approximately 7% of our outstanding shares) for a total of \$479 million, representing an average price of \$42.31 per share.

---

## **Table of Contents**

In connection with the spin-off, we established our own pension and other postretirement benefit plans. Our pension plans are funded in excess of current federal minimum requirements. Contributions during 2008 are currently expected to be approximately \$75 million; however, the final determination of contribution levels will be made during the third quarter, based on projected plan assets, liabilities and other relevant information. See Note 5, Employee Benefit Plans, of the Condensed Notes to the Consolidated Financial Statements (Unaudited), for additional information. Contributions to our other postretirement benefit plans, including medical and life insurance benefits, are expected to be approximately \$30 million in 2008.

In December 2007, a group of retirees filed a putative class action lawsuit in the United States District Court for the District of Kansas, challenging certain modifications to our retiree benefit programs. See Note 2, Commitments and Contingencies, of the Condensed Notes to the Consolidated Financial Statements (Unaudited), for additional information.

### ***Purchase Commitments***

Our total purchase obligations and other items as disclosed in our Annual Report on Form 10-K for the year ended December 31, 2007, has increased by approximately \$195 million as of June 30, 2008. This increase is primarily related to a seven year outsourcing agreement for traffic monitoring services and technical support for our voice network operations; beginning in the third quarter 2008, we expect to incur expenses totaling approximately \$27 million annually during the term of this arrangement, which will be reflected as cost of services in the Consolidated Statements of Operations and Comprehensive Income (Unaudited).

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

We are susceptible to market risks related to changes in interest rates and do not purchase or hold any market risk sensitive financial instruments for trading purposes.

We are subject to interest rate risk primarily associated with our borrowings under our credit agreement. From time to time, we may consider entering into swap and other agreements to manage our exposure to interest rate changes on our debt.

Approximately 85% of our outstanding debt at June 30, 2008, is fixed-rate debt. While changes in interest rates impact the fair value of this debt, there is no impact on earnings and cash flows.

We perform interest rate sensitivity analyses on our variable-rate debt. These analyses indicate that a 1% change in interest rates would have an annual pre-tax impact of \$9 million on the Consolidated Statements of Operations and Comprehensive Income (Unaudited) and Consolidated Statements of Cash Flows (Unaudited) at June 30, 2008. While earnings and cash flows are impacted as interest rates change, our variable-rate debt is not subject to changes in fair values.

We also perform a sensitivity analysis on the fair market value of our outstanding debt. A 10% decrease in market interest rates would cause an increase of approximately \$55 million in fair market value of our outstanding debt at June 30, 2008.

### **Item 4. Controls and Procedures**

#### **(a) Evaluation of Disclosure Controls and Procedures**

As required by Rule 13a-15(b) under the Securities Exchange Act, and in connection with the preparation of this quarterly report on Form 10-Q, our management, including the Chief Executive Officer and Chief Financial Officer, carried out an evaluation of the design and operation of our disclosure controls and procedures. Based on this evaluation, the Chief Executive Officer and Chief Financial Officer each concluded that the design and operation of the disclosure controls and procedures were effective as of June 30, 2008, in providing assurance that information required to be disclosed in reports we file or submit is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure and in providing reasonable assurance that the information is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

During the second quarter of 2008, there have been no changes that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.



**Table of Contents****PART II. OTHER INFORMATION****Item 1. Legal Proceedings**

In December 2007, a group of retirees filed a putative class action lawsuit in the United States District Court for the District of Kansas, challenging the decision to make certain modifications to Embarq's retiree benefits programs generally effective January 1, 2008. See Note 5, Employee Benefit Plans of the Condensed Notes to Consolidated Financial Statements (Unaudited). Defendants include Embarq Corporation, certain of its benefits plans, its Employee Benefits Committee and its plan administrator. Additional defendants include Sprint Nextel and certain of its benefits plans. In addition, a complaint in arbitration has been filed by 15 former Centel Corporation executives, similarly challenging the benefits changes. Embarq and other defendants intend to vigorously contest these claims and charges.

In addition, Embarq is subject to various other lawsuits, regulatory proceedings against Embarq and other claims typical for a business enterprise. While it is not possible to determine the ultimate disposition of each of these proceedings and whether they will be resolved consistent with Embarq's expectations, Embarq expects that the outcome of these proceedings, individually or in the aggregate, will not have a material adverse effect on its financial condition, results of operations or liquidity.

**Item 1A. Risk Factors**

There have been no material changes to the risk factors, disclosed in Item 1A to Part I in our Annual Report on Form 10-K for the year ended December 31, 2007.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds****Issuer Purchases of Equity Securities**

Quarter Ended June 30, 2008	Total Number of Shares Purchased (1)	Average Price Paid per Share (2)	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (3)	Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plan or Program
April 1 through April 30	2,982,942	\$ 39.55	2,982,942	\$ 246,662,136
May 1 through May 31	1,639,768	45.12	1,639,768	172,679,789
June 1 through June 30	1,600,655	45.89	1,600,655	99,233,210
Total	6,223,365	\$ 42.64	6,223,365	\$ 99,233,210

(1) Repurchases were made pursuant to an automatic trading plan executed pursuant to Rule 10b5-1 of the Securities Exchange Act of 1934, as amended (the Exchange Act) and were executed in accordance with the provisions of Rule 10b-18 of the Exchange Act.

(2) Average Price Paid per Share does not include transaction costs.

(3) On January 9, 2008, the Company announced a program to repurchase shares of its common stock in an aggregate amount of up to \$500 million. This share repurchase program will terminate on June 30, 2009, unless extended by Embarq's Board of Directors.

**Item 3. Defaults Upon Senior Securities**

Edgar Filing: Embarq CORP - Form 10-Q

There were no reportable events during the quarter ended June 30, 2008.

**Table of Contents****Item 4. Submission of Matters to a Vote of Security Holders**

Our annual meeting of shareholders was held on May 1, 2008 in Overland Park, Kansas. Shareholders of record as of March 4, 2008 were entitled to vote at the annual meeting. At the close of business on the record date, there were 153,116,035 shares of our common stock outstanding and entitled to vote at the meeting. There were 138,626,085 shares represented at the annual meeting of shareholders.

At the annual meeting, nine directors were elected to serve a term of one year, the appointment of KPMG LLP as our independent registered public accounting firm for 2008 was ratified and the Embarq Corporation 2008 Equity Incentive Plan, the Embarq Corporation 2008 Employee Stock Purchase Plan and the material terms of performance goals for qualified performance-based compensation were approved. A shareholder proposal to require an advisory vote on compensation did not receive a majority vote and was not approved.

The following votes were cast for the election of each director to serve on our board for a term of one year until the 2009 annual meeting or until a successor has been elected and qualified:

	<b>For</b>	<b>Withheld</b>
Peter C. Brown	131,736,584	6,889,501
Steven A. Davis	137,409,712	1,216,373
Richard A. Gephardt	134,385,480	4,240,605
Thomas A. Gerke	137,392,496	1,233,589
John P. Mullen	137,421,602	1,204,483
William A. Owens	135,187,668	3,438,417
Dinesh C. Paliwal	136,617,202	2,008,883
Stephanie M. Shern	136,636,267	1,989,818
Laurie A. Siegel	136,627,515	1,998,570

The following votes were cast with respect to the proposal to ratify the appointment of KPMG LLP as our independent registered public accounting firm for the 2008 fiscal year:

<b>For</b>	<b>Against</b>	<b>Abstain</b>
136,728,668	867,048	1,030,367

The following votes were cast with respect to the approval of the Embarq Corporation 2008 Equity Incentive Plan:

<b>For</b>	<b>Against</b>	<b>Abstain</b>
97,273,806	27,554,735	1,027,924

The following votes were cast with respect to the approval of the Embarq Corporation 2008 Employee Stock Purchase Plan:

<b>For</b>	<b>Against</b>	<b>Abstain</b>
124,435,070	402,325	1,009,069

The following votes were cast with respect to the approval of the material terms of performance goals for qualified performance-based compensation:

<b>For</b>	<b>Against</b>	<b>Abstain</b>
122,226,479	2,581,015	1,038,970

The following votes were cast with respect to the consideration of a shareholder proposal to require an advisory vote on compensation:

Edgar Filing: Embarq CORP - Form 10-Q

	For	Against	Abstain
	48,978,654	72,568,505	4,299,305
<b>Item 5.</b> Other Information			

There were no reportable events during the quarter ended June 30, 2008.



**Table of Contents**

**Item 6. Exhibits**

<b>Exhibit</b>	<b>Description</b>
2.1*	Separation and Distribution Agreement (Incorporated by reference to Exhibit 2.1 to Amendment No. 4 to the Registration Statement on Form 10 (File No. 001-32732), filed with the Securities and Exchange Commission on May 2, 2006).
2.2*	Transition Services Agreement between Embarq Corporation (receiver) and Sprint Nextel Corporation (provider) dated as of January 20, 2006 (Incorporated by reference to Exhibit 2.2 to Amendment No. 3 to the Registration Statement on Form 10 (File No. 001-32732), filed with the Securities and Exchange Commission on April 28, 2006).
2.3*	Transition Services Agreement between Embarq Corporation (provider) and Sprint Nextel Corporation (receiver) dated as of January 20, 2006 (Incorporated by reference to Exhibit 2.3 to Amendment No. 3 to the Registration Statement on Form 10 (File No. 0001-32732), filed with the Securities and Exchange Commission on April 28, 2006).
2.4*	Tax Sharing Agreement dated as of May 17, 2006 by and among Sprint Nextel Corporation, Embarq Corporation and certain Embarq subsidiaries (Incorporated by reference to Exhibit 2.1 to the Current Report on Form 8-K (File No. 001-32732), filed with the Securities and Exchange Commission on May 18, 2006).
2.5*	Employee Matters Agreement dated as of May 17, 2006 between Sprint Nextel Corporation and Embarq Corporation (Incorporated by reference to Exhibit 2.2 to the Current Report on Form 8-K (File No. 001-32732), filed with the Securities and Exchange Commission on May 18, 2006).
2.6*	Patent Agreement dated as of May 17, 2006 by and between Sprint Nextel Corporation and Embarq Corporation (Incorporated by reference to Exhibit 2.5 to the Current Report on Form 8-K (File No. 001-32732), filed with the Securities and Exchange Commission on May 18, 2006).
2.7*	Trademark Assignment and License Agreement dated as of May 17, 2006, by and among Sprint Nextel Corporation, Embarq Corporation and certain Embarq subsidiaries (Incorporated by reference to Exhibit 2.3 to the Current Report on Form 8-K (File No. 001-32732), filed with the Securities and Exchange Commission on May 18, 2006).
2.8*	Software and Proprietary Information Agreement dated as of May 17, 2006 by and between Embarq Corporation and Sprint Nextel Corporation (Incorporated by reference to Exhibit 2.4 to the Current Report on Form 8-K (File No. 001-32732), filed with the Securities and Exchange Commission on May 18, 2006).
3.1	Amended and Restated Certificate of Incorporation (Incorporated by reference to Exhibit 3.1 to Amendment No. 4 to the Registration Statement on Form 10 (File No. 001-32732), filed with the Securities and Exchange Commission on May 2, 2006).
3.2	Amended and Restated Bylaws, as amended (Incorporated by reference to Exhibit 3.1 to the Current Report on Form 8-K (File No. 001-32732), filed with the Securities and Exchange Commission on July 25, 2006).
4.1	Indenture, dated as of May 17, 2006, by and between Embarq Corporation and J.P. Morgan Trust Company, National Association, a national banking association, as trustee (Incorporated by reference to Exhibit 4.1 to the Current Report on Form 8-K (File No. 001-32732), filed with the Securities and Exchange Commission on May 18, 2006).
4.2	6.738% Global Note due 2013 (Incorporated by reference to Exhibit 4.2 to the Registrant's Annual Report on Form 10-K (File No. 001-32372), filed with the Securities and Exchange Commission on March 9, 2007).
4.3	7.082% Global Note due 2016 (Incorporated by reference to Exhibit 4.3 to the Registrant's Annual Report on Form 10-K (File No. 001-32372), filed with the Securities and Exchange Commission on March 9, 2007).
4.4	7.995% Global Note due 2036 (Incorporated by reference to Exhibit 4.4 to the Registrant's Annual Report on Form 10-K (File No. 001-32372), filed with the Securities and Exchange Commission on March 9, 2007).
4.5	

## Edgar Filing: Embarq CORP - Form 10-Q

Credit Agreement, dated May 10, 2006, by and among Embarq Corporation (borrower), the banks, financial institutions and other institutional lenders (initial lenders) and issuers of letters of credit (initial issuing banks) and Citibank, N.A., as administrative agent (Incorporated by reference to Exhibit 4.1 to the Current Report on Form 8-K (File No.

001-32732), filed with the Securities and Exchange Commission on May 11, 2006).

- 10.1 Embarq Corporation 2008 Equity Incentive Plan (Incorporated by reference to Exhibit 10.1 to the registrant's Current Report on Form 8-K (File No. 001-32732), filed with the Securities and Exchange Commission on May 2, 2008).
- 15.1 Letter Re Unaudited Interim Financial Information
- 31.1 Certification of Chief Executive Officer Pursuant to Securities Exchange Act of 1934 Rule 13a-14(a).
- 31.2 Certification of Chief Financial Officer Pursuant to Securities Exchange Act of 1934 Rule 13a-14(a).

**Table of Contents**

**Exhibit      Description**

32.1      Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2      Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Our company will furnish to the SEC, upon request, a copy of the instruments defining the rights of holders of long-term debt that does not exceed 10% of the total assets of our company.

\* Schedules and/or exhibits not filed will be furnished supplementally to the SEC upon request.

**Table of Contents**

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

EMBARQ CORPORATION

(Registrant)

/s/ Gene M. Betts  
Gene M. Betts  
Chief Financial Officer  
(Principal Financial Officer)

/s/ Richard B. Green  
Richard B. Green  
Vice President and Controller  
(Chief Accounting Officer)

Dated: July 30, 2008