

Embarq CORP
Form 10-Q
May 01, 2008
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 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)

20-2923630
(IRS Employer
Identification No.)

5454 W. 110th Street

Overland Park, Kansas
(Address of principal executive offices)

66211
(Zip Code)

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

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

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, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act (check one):

Large accelerated filer Accelerated filer Non-accelerated filer

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 APRIL 25, 2008:

COMMON STOCK: 147,543,364

Table of Contents

EMBARQ CORPORATION

TABLE OF CONTENTS

| | Page Reference |
|---|---------------------------|
| <u>Part I – Financial Information</u> | |
| Item 1. | |
| <u>Financial Statements</u> | |
| <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 |
| Item 2. | |
| <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 10 |
| Item 3. | |
| <u>Quantitative and Qualitative Disclosures About Market Risk</u> | 19 |
| Item 4. | |
| <u>Controls and Procedures</u> | 19 |
| <u>Part II – Other Information</u> | |
| Item 1. | |
| <u>Legal Proceedings</u> | 20 |
| Item 1A. | |
| <u>Risk Factors</u> | 20 |
| Item 2. | |
| <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | 20 |
| Item 3. | |
| <u>Defaults Upon Senior Securities</u> | 20 |
| Item 4. | |
| <u>Submission of Matters to a Vote of Security Holders</u> | 20 |
| Item 5. | |
| <u>Other Information</u> | 20 |
| Item 6. | 21 |
| Table of Contents | 3 |

Exhibits

Signatures

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

| | As of March 31, 2008 (Unaudited) | As of December 31, 2007 |
|--|--|----------------------------|
| Assets | | |
| Current assets | | |
| Cash and equivalents | \$ 52 | \$ 69 |
| Accounts receivable, net of allowance for doubtful accounts of \$58 and \$60 | 579 | 616 |
| Inventories, net | 128 | 138 |
| Deferred tax assets | 80 | 76 |
| Prepaid expenses and other current assets | 102 | 87 |
| Total current assets | 941 | 986 |
| Gross property, plant and equipment | 20,886 | 20,802 |
| Accumulated depreciation | (13,227) | (13,054) |
| Net property, plant and equipment | 7,659 | 7,748 |
| Goodwill | 27 | 27 |
| Prepaid pension asset | 126 | 108 |
| Other assets | 35 | 32 |
| Total | \$ 8,788 | \$ 8,901 |
| Liabilities and Stockholders Equity | | |
| Current liabilities | | |
| Current maturities of long-term debt | \$ 99 | \$ 99 |
| Accounts payable | 404 | 387 |
| Payroll and employee benefits | 140 | 208 |
| Accrued income taxes | 153 | 27 |
| Accrued operating taxes | 90 | 97 |
| Deferred revenue | 200 | 202 |
| Accrued interest | 136 | 56 |
| Other current liabilities | 107 | 122 |
| Total current liabilities | 1,329 | 1,198 |
| Noncurrent liabilities | | |
| Long-term debt | 5,575 | 5,779 |
| Deferred income taxes | 1,124 | 1,130 |
| Benefit plan obligations | 320 | 320 |
| Other noncurrent liabilities | 207 | 210 |
| Total noncurrent liabilities | 7,226 | 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; 153.5 and 153.1 shares issued; 150.2 and 153.1 shares outstanding | | |
| Paid-in capital | (232) | (231) |
| Retained earnings | 728 | 623 |
| Accumulated other comprehensive income (loss) | (130) | (130) |
| Treasury stock, 3.3 and no shares held in treasury | (135) | |
| Total stockholders' equity | 233 | 264 |
| Total | \$ 8,788 | \$ 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)*

| | Year to Date March 31, | |
|--|-------------------------------|-------------|
| | 2008 | 2007 |
| Net Operating Revenues | | |
| Service revenues | \$ 1,433 | \$ 1,458 |
| Product revenues | 138 | 131 |
| Total net operating revenue | 1,571 | 1,589 |
| Operating Expenses | | |
| Cost of services | 390 | 417 |
| Cost of products | 138 | 127 |
| Selling, general and administrative | 358 | 404 |
| Depreciation | 251 | 270 |
| Total operating expenses | 1,137 | 1,218 |
| Operating Income | 434 | 371 |
| Interest expense | 104 | 109 |
| Other (income) expense, net | (1) | |
| Income Before Income Taxes | 331 | 262 |
| Income tax expense | 119 | 102 |
| Net Income | \$ 212 | \$ 160 |
| Amortization of employee benefit plans prior service cost and actuarial losses, net of tax | (1) | (2) |
| Amortization of cash flow derivatives, net of tax | 1 | 1 |
| Comprehensive Income, Net of Tax | \$ 212 | \$ 161 |
| Earnings per common share | | |
| Basic | \$ 1.39 | \$ 1.07 |
| Diluted | \$ 1.38 | \$ 1.05 |
| Weighted average common shares outstanding | | |
| Basic | 152.7 | 150.2 |
| Potentially dilutive shares under equity incentive plans | 1.4 | 2.2 |
| Diluted | 154.1 | 152.4 |

See accompanying Condensed Notes to Consolidated Financial Statements (Unaudited)

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

| | Year to Date March 31, | |
|---|-----------------------------------|--------------|
| | 2008 | 2007 |
| Operating Activities | | |
| Net income | \$ 212 | \$ 160 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation | 251 | 270 |
| Provision for losses on accounts receivable | 21 | 17 |
| Deferred and noncurrent income taxes | (20) | (36) |
| Stock-based compensation expense | 9 | 14 |
| Net losses (gains) on sales of assets | | (3) |
| Other, net | 11 | 11 |
| Changes in assets and liabilities: | | |
| Accounts receivable | 16 | 14 |
| Inventories and other current assets | (15) | (28) |
| Accounts payable and other current liabilities | 133 | 75 |
| Noncurrent assets and liabilities, net | (25) | (14) |
| Net cash provided by operating activities | 593 | 480 |
| Investing Activities | | |
| Capital expenditures | (179) | (183) |
| Proceeds from construction reimbursements | 2 | 3 |
| Proceeds from sales of assets | 2 | 17 |
| Net cash used by investing activities | (175) | (163) |
| Financing Activities | | |
| Principal payments on long-term debt | | (210) |
| Borrowings under revolving credit agreement | 230 | 50 |
| Repayments under revolving credit agreement | (435) | (200) |
| Proceeds from common stock issued | 4 | 35 |
| Repurchase of common stock | (115) | (2) |
| Dividends paid to stockholders | (107) | (4) |
| Tax effects of stock-based compensation | (3) | 5 |
| Other, net | (9) | 2 |
| Net cash used by financing activities | (435) | (324) |
| Decrease in Cash and Equivalents | (17) | (7) |
| Cash and Equivalents at Beginning of Period | 69 | 53 |
| Cash and Equivalents at End of Period | \$ 52 | \$ 46 |

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 |
|---|--------------------|-----------------|--------------------|----------------------|---|-------------------|---------------------------------|
| January 1, 2008 Balance | \$ | \$ 2 | \$ (231) | \$ 623 | \$ (130) | \$ | \$ 264 |
| Net income | | | | 212 | | | 212 |
| Dividends to shareholders (\$0.6875 per share) | | | | (107) | | | (107) |
| Common stock issued | | | 4 | | | | 4 |
| Stock-based compensation expense | | | 9 | | | | 9 |
| Tax effects of stock-based compensation | | | (3) | | | | (3) |
| Restricted stock units surrendered for tax withholding | | | (11) | | | | (11) |
| 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 | | | | | | (135) | (135) |
| March 31, 2008 Balance | \$ | \$ 2 | \$ (232) | \$ 728 | \$ (130) | \$ (135) | \$ 233 |

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, both directly and through its wholesale and sales agency relationships, a suite of communications services, including local and long distance voice, data, high-speed Internet and satellite video 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 for customers, including other carriers. Through its Logistics segment, Embarq engages in wholesale product distribution, logistics and configuration services.

As of March 31, 2008, Embarq had approximately 18 thousand active employees. Approximately 35% of these employees were represented by unions subject to collective bargaining agreements. Of the union-represented employees, approximately 45% have collective bargaining agreements that will expire within one year. Approximately 3% of Embarq's employees were subject to a collective bargaining agreement that expired prior to March 31, 2008. Embarq successfully renegotiated this contract in April 2008. There were no material changes related to employee collective bargaining agreements during the year to date period ended March 31, 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 USF surcharges on a gross basis. The total amount of surcharges recorded in net operating revenue was \$22 million for the year to date periods ended March 31, 2008 and 2007.

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:

| | Year to Date March 31, 2008 2007 (millions) | |
|-------------------------------------|--|--------------|
| Cost of services | | |
| Telecommunications segment | \$ 1 | \$ 2 |
| Selling, general and administrative | | |
| Telecommunications segment | 2 | 11 |
| Logistics segment | | 1 |
| Subtotal | 2 | 12 |
| Total severance charges | \$ 3 | \$ 14 |

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 \$12 million and basic and diluted earning per share being increased by \$0.05 per share for the year to date periods ended March 31, 2008 and 2007.

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 reissuance of treasury stock. In the event shares are sold, Embarq will increase paid-in capital for any gains on sale or will decrease paid-in capital, or retained earnings in the event of a deficit in paid-in capital, for any losses on sale.

Spin-Off from Sprint Nextel

In anticipation of the termination of various transitional agreements in May 2008, Embarq has replicated or otherwise arranged for replacement of certain facilities, systems, infrastructure and personnel related to functions historically performed by Sprint Nextel.

No significant spin-off expenditures were incurred during the year to date period ended March 31, 2008. Embarq incurred \$9 million in total spin-off related charges and \$4 million in capital expenditures for the year to date period ended March 31, 2007.

Adoption of SFAS 157

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.

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.

Table of Contents

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, complaints have been filed with the Equal Employment Opportunity Commission asserting that the benefits plan changes are discriminatory. Embarq and other defendants intend to vigorously contest these claims and charges.

In addition, various other lawsuits, including putative class actions, regulatory proceedings against Embarq and other claims typical for a business enterprise are pending against or would otherwise impact the entities comprising Embarq. 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 or results of operations.

Note 3. Debt and Financial Instruments

During 2008, Embarq reduced outstanding borrowings under its credit agreement by \$205 million, entirely through net repayments on the revolving credit facility.

As of March 31, 2008, Embarq's long-term debt had a carrying value of approximately \$5.7 billion and a fair value of approximately \$5.4 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.

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 March 31, | |
|--|-----------------------------------|---------------|
| | 2008 | 2007 |
| | <i>(millions)</i> | |
| Income tax expense at the federal statutory rate | \$ 116 | \$ 92 |
| Effect of: | | |
| State income taxes, net of federal income tax effect | 2 | 10 |
| Other, net | 1 | |
| Income tax expense | \$ 119 | \$ 102 |
| Effective income tax rate | 36.0% | 38.9% |

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 settlement in 2008 related to a consolidated state income tax return filing election resulted in state income tax expense for the first quarter of 2008 being reduced by \$5 million.

Note 5. Employee Benefit Plans

The components of net periodic benefit cost were as follows:

Edgar Filing: Embarq CORP - Form 10-Q

| | Year to Date March 31, 2008 | | Year to Date March 31, 2007 | |
|--|--------------------------------|---------------------------------------|--------------------------------|---------------------------------------|
| | Pension Benefits | Other Post- retirement Benefits | Pension Benefits | Other Post- retirement Benefits |
| | <i>(millions)</i> | | | |
| Service cost | \$ 14 | \$ 2 | \$ 14 | \$ 2 |
| Interest cost | 51 | 4 | 48 | 9 |
| Expected return on plan assets | (69) | (1) | (65) | (1) |
| Amortization of prior service cost (benefit) | 3 | (13) | 4 | (14) |
| Amortization of actuarial losses | 9 | 3 | 10 | 4 |
| Net cost (benefit) | \$ 8 | \$ (5) | \$ 11 | \$ |

During the second quarter of 2007, Embarq amended its other postretirement medical and life insurance plans. Effective January 1, 2008, Embarq eliminated medical coverage and Medicare premium subsidies for Medicare-eligible retirees and Medicare-eligible beneficiaries and capped the maximum amount of life insurance benefits through the company-

Table of Contents

sponsored plan for qualified retirees at \$10 thousand. 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 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, will require repayments to the plans' master trusts. For the period following the spin-off, the amount Embarq estimates it will be required to repay to its master trust has been accrued in the Consolidated Balance Sheets as of March 31, 2008. For the period before the spin-off, Embarq's master trust may receive additional funds from the pre-spin-off master trust 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 or results of operations.

Note 6. Stock-based Compensation

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:

| | 2008 Annual Grant |
|-------------------------|--------------------------|
| 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, both directly and through wholesale and sales agency relationships, local and long distance voice, data, high-speed Internet and satellite video 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 to customers, including other carriers. The Logistics segment engages in wholesale product distribution, logistics and configuration services to third parties.

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 on the face of the accompanying Consolidated Statements of Operations and Comprehensive Income (Unaudited).

The financial information by operating segment was as follows:

| Telecommunications | Logistics | Consolidated |
|--------------------|-----------|--------------|
|--------------------|-----------|--------------|

Edgar Filing: Embarq CORP - Form 10-Q

| | | <i>(millions)</i> | | |
|------------------------------------|--|-------------------|--------|----------|
| Year to Date March 31, 2008 | | | | |
| Voice | | \$ 1,024 | \$ | \$ 1,024 |
| Data | | 198 | | 198 |
| High-speed Internet | | 133 | | 133 |
| Other | | 78 | | 78 |
| Service revenues | | 1,433 | | 1,433 |
| Product revenues | | 23 | 115 | 138 |
| Total net operating revenues | | \$ 1,456 | \$ 115 | \$ 1,571 |

Table of Contents

| | Telecommunications | Logistics (millions) | Consolidated |
|------------------------------------|--------------------|-------------------------|--------------|
| Operating income (loss) | \$ 436 | \$ (2) | \$ 434 |
| Year to Date March 31, 2007 | | | |
| Voice | \$ 1,084 | \$ | \$ 1,084 |
| Data | 189 | | 189 |
| High-speed Internet | 116 | | 116 |
| Other | 69 | | 69 |
| Service revenues | 1,458 | | 1,458 |
| Product revenues | 22 | 109 | 131 |
| Total net operating revenues | \$ 1,480 | \$ 109 | \$ 1,589 |
| Operating income (loss) | \$ 374 | \$ (3) | \$ 371 |

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 March 31, 2008 2007 (millions) | |
|--|---|-------|
| Supplemental Cash Flow Information | | |
| Cash paid for interest, net of amounts capitalized | \$ 25 | \$ 37 |
| Cash paid for income taxes | 4 | 49 |
| Non-Cash Activities | | |
| Capital expenditure accrual | \$ (14) | \$ 10 |
| Pending settlement of repurchases of common stock | 20 | |
| Dividends accrued | | 74 |
| Extinguishment of debt | | 3 |
| Issuance of treasury stock to the Employee Stock Purchase Plan | | 2 |
| Note 9. Subsequent Events | | |

Pursuant to its stock repurchase program, from April 1 through April 25, 2008, Embarq repurchased an additional 2.6 million shares of common stock for a total of \$103 million, representing an average price of \$39.49 per share.

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

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

Table of Contents

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, both directly and through wholesale and sales agency relationships, a suite of communications services, including local and long distance voice, data, high-speed Internet and satellite video to consumer and business customers primarily in our local service territories in 18 states. We also provide access to our local network and wholesale communications services for customers, including other carriers. Through our Logistics segment, we engage in wholesale product distribution, logistics and configuration services. As part of our orderly transition away from our prior approach to wireless services, we have recently curtailed most sales activities while continuing to serve existing customers.

Our consumer and business strategy is to maximize profitable communications services revenue per customer by providing bundled and integrated voice, data and video products and services that meet the needs of our consumer and business customers within our local territories. This strategy has four key elements: 1) provide useful products and solutions to attract and retain customers by marketing integrated service offerings, 2) improve the customer experience and perception of service and product offerings, 3) manage our costs and 4) maintain a customer-focused culture that promotes high performance and employee satisfaction.

Our wholesale business strategy is structured around increasing the utilization and achieved return of our core network investment by providing a full set of wholesale services primarily to other carriers, wireless providers and correctional institutions. Services offered include switched access, special access, intelligent network database, collocation, resale, public pay telephone, unbundled network elements, high speed data services and billing and collection services.

In the 2008 first quarter, we experienced a continuation of certain revenue trends experienced over the past several years. More specifically, switched access lines declined driving a reduction in voice revenues, which was somewhat offset with continued growth in high-speed Internet and special access data services. We expect these trends will continue through 2008.

The following table reflects information about our switched access lines:

| | As of | | Difference | |
|----------------|--------------------|-------|------------|---------|
| | March 31, 2008 | 2007 | Amount | % |
| | <i>(thousands)</i> | | | |
| Primary | 3,883 | 4,234 | (351) | (8.3)% |
| Additional | 289 | 354 | (65) | (18.4)% |
| Total Consumer | 4,172 | 4,588 | (416) | (9.1)% |
| Business | 1,861 | 1,909 | (48) | (2.5)% |
| Wholesale | 159 | 184 | (25) | (13.6)% |
| Total | 6,192 | 6,681 | (489) | (7.3)% |

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 March 31, 2007, were adjusted by 156 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.

Product substitution among our offerings also contributes to our access line losses. Certain additional consumer access lines have been replaced with our high-speed Internet service and 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.

Edgar Filing: Embarq CORP - Form 10-Q

During 2007, we lost 442 thousand access lines. In first quarter 2008, we lost 120 thousand access lines, which was 47 thousand more than in first quarter 2007. For the remaining quarters of 2008, we expect the year-over-year comparisons of absolute line losses to be better than was experienced in the first quarter.

Growth in other services that we generally provide on a bundled basis such as high-speed Internet, various data services and video have continued to offset a substantial portion of the voice revenue declines associated with the access line losses discussed above.

Table of Contents

For the year to date period ended March 31, 2008, we increased our high-speed Internet subscribers to approximately 1.3 million subscribers, which is an increase of 21% as compared to the same period in 2007. Simplified base and more attractive pricing plans have continued to be successful.

Demand for data services has also 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. Revenues associated with these services increased 5% for the year to date period ended March 31, 2008 compared to the same period in 2007.

Video service is also a growing element of our bundled service offers. We currently offer video and pay per view service through sales agency relationships with various satellite providers. As of March 31, 2008, we had 217 thousand video service subscribers, compared to 170 thousand as of March 31, 2007.

To measure our success in our bundling initiatives as well as attracting and retaining high value customers, average monthly revenue per household (ARPH) is a measure that we closely monitor. In the first quarter, this measure is calculated by dividing one third of year to date consumer revenue by average households served.

| | Year to Date March 31, | | Difference | |
|---------------------------------------|------------------------|----------|------------|--------|
| | 2008 | 2007 | Amount | % |
| Consumer revenue (millions) | \$ 656 | \$ 676 | \$ (20) | (3.0)% |
| Average households served (thousands) | 3,926 | 4,261 | (335) | (7.9)% |
| ARPH | \$ 55.70 | \$ 52.88 | \$ 2.82 | 5.3% |

Spin-Off from Sprint Nextel

In anticipation of the termination of various transitional agreements in May 2008, we have replicated or otherwise arranged for replacement of certain facilities, systems, infrastructure and personnel related to functions historically performed by Sprint Nextel.

No significant spin-off expenditures were incurred during the year to date period ended March 31, 2008. We incurred \$9 million in total spin-off related charges and \$4 million in capital expenditures for the year to date period ended March 31, 2007.

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.

Table of Contents**RESULTS OF OPERATIONS**

| | Year to Date March 31, 2008 2007 (millions) | |
|--------------------------------|--|----------|
| Net Operating Revenues | | |
| Telecommunications segment | \$ 1,456 | \$ 1,480 |
| Logistics segment | 115 | 109 |
| Total net operating revenues | \$ 1,571 | \$ 1,589 |
| Operating Income (Loss) | | |
| Telecommunications segment | \$ 436 | \$ 374 |
| Logistics segment | (2) | (3) |
| Total operating income | \$ 434 | \$ 371 |
| Net Income | \$ 212 | \$ 160 |

Segmental Results of Operations - Telecommunications

Our Telecommunications segment consists of regulated local phone companies serving approximately 6.2 million access lines primarily in 18 states as of March 31, 2008. We provide, both directly and through wholesale and sales agency relationships, local and long distance voice, data, high-speed Internet and satellite video to consumer and business customers primarily in our local service territories. We also provide access to our local network and other wholesale communications services for customers, including other carriers.

| (millions) | Year to Date March 31, % of | | % of | | Difference | |
|-------------------------------------|--------------------------------|----------|----------|----------|------------|---------|
| | 2008 | Revenues | 2007 | Revenues | \$ / | Percent |
| Net operating revenues | | | | | | |
| Voice | \$ 1,024 | 70% | \$ 1,084 | 73% | \$ (60) | (6)% |
| Data | 198 | 14% | 189 | 13% | 9 | 5% |
| High-speed Internet | 133 | 9% | 116 | 8% | 17 | 15% |
| Other | 78 | 5% | 69 | 5% | 9 | 13% |
| Service revenues | 1,433 | 98% | 1,458 | 99% | (25) | (2)% |
| Product revenues | 23 | 2% | 22 | 1% | 1 | 5% |
| Total net operating revenues | \$ 1,456 | 100% | \$ 1,480 | 100% | \$ (24) | (2)% |
| Operating expenses | | | | | | |
| Costs of services | 389 | 27% | 417 | 28% | (28) | (7)% |
| Costs of products | 33 | 2% | 30 | 2% | 3 | 10% |
| Selling, general and administrative | 348 | 24% | 392 | 27% | (44) | (11)% |
| Depreciation | 250 | 17% | 267 | 18% | (17) | (6)% |
| Total operating expenses | 1,020 | 70% | 1,106 | 75% | (86) | (8)% |
| Operating income | \$ 436 | 30% | \$ 374 | 25% | \$ 62 | 17% |
| Capital expenditures | \$ 179 | | \$ 182 | | \$ (3) | (2)% |

Edgar Filing: Embarq CORP - Form 10-Q

| | | | | |
|---|-------|-------|-------|--------|
| Switched access lines (thousands) | 6,192 | 6,681 | (489) | (7.3)% |
| Switched access minutes of use (millions) | 6,883 | 7,576 | (693) | (9)% |
| High-speed Internet subscribers (thousands) | 1,340 | 1,104 | 236 | 21% |

Table of Contents**Net Operating Revenues**

Net operating revenues decreased \$24 million, or 2%, for the year to date period ended March 31, 2008, compared to the same period 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 \$60 million for the year to date period ended March 31, 2008, compared to the same period in 2007.

The following table lists the major drivers of these changes:

| | Increase (Decrease) 2008 vs. 2007 (millions) |
|--|---|
| Decline in local voice revenues primarily due to access line losses | \$ (44) |
| Decline in long-distance voice revenues primarily due to access line losses and yield declines | (7) |
| Decline in access revenues primarily associated with lower access minutes of use | (9) |
| Total decrease | \$ (60) |

Data

Data revenues represent data network services sold to business customers and special access services sold to other carriers. Data revenues increased \$9 million for the year to date period ended March 31, 2008, compared to the same period in 2007. The following table lists the major drivers of these changes:

| | Increase (Decrease) 2008 vs. 2007 (millions) |
|------------------------|---|
| Special access revenue | \$ 8 |
| Other | 1 |
| Total increase | \$ 9 |

High-speed Internet

High-speed Internet revenues increased \$17 million for the year to date period ended March 31, 2008, compared to the same period in 2007. These increases are due to a 21% increase in subscribers in the year to date period ended March 31, 2008, compared to the same period in 2007. We expect that high-speed Internet revenue will continue to increase for the remainder of 2008, but at a declining rate primarily reflecting the growth of our subscriber base.

Other Service

Other service revenues mainly includes professional services, intelligent network database services, billing and collection services, wireless and sales of products and services through various sales agency relationships, including our video service offering. Other service revenues increased \$9 million in the period ended March 31, 2008, compared to the same period in 2007, 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 and wireless handsets to our customers also are reflected in product revenues. Product revenues increased \$1 million in the year to date period ended March 31, 2008, compared to the same period in 2007.

Table of Contents**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 \$28 million in the year to date period ended March 31, 2008, compared to the same period in 2007. The following table lists the major drivers of these changes:

| | Increase (Decrease) 2008 vs. 2007 (millions) |
|---|---|
| Network severance, labor and benefits | \$ (13) |
| High-speed Internet service costs, primarily due to web hosting | (6) |
| Long-distance related costs | (5) |
| Other costs | (4) |
| Total decrease | \$ (28) |

Costs of Products

Costs of products increased \$3 million in the year to date period ended March 31, 2008, compared to the same period in 2007. The 2008 cost increase is primarily related to adjustments to the inventory carrying value of wireless handsets.

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 \$44 million in the year to date period ended March 31, 2008, compared to the same period in 2007. The following table lists the major drivers of these changes:

| | Increase (Decrease) 2008 vs. 2007 (millions) |
|---|---|
| Labor and benefits cost | \$ (21) |
| Severance charges | (9) |
| Spin-off related charges | (9) |
| Systems and process improvement initiatives | (9) |
| Other | 4 |
| Total decrease | \$ (44) |

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 1.4% of net operating revenues in the year to date period ended March 31, 2008, compared to 1.1% 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 \$17 million in the year to date period ended March 31, 2008, compared to the same period in 2007. The following table lists the major drivers of these changes:

| | Increase (Decrease) 2008 vs. 2007 (millions) |
|---|---|
| 2008 depreciation rate reductions | \$ (12) |
| 2007 depreciation resulting from the capitalization of prior year sales and use tax assessments | (6) |
| Plant growth | 1 |
| Total decrease | \$ (17) |

Table of Contents**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) | Year to Date March 31, | | | | Difference | |
|-------------------------------------|------------------------|---------------|--------|---------------|------------|--------|
| | 2008 | % of Revenues | 2007 | % of Revenues | \$/Percent | |
| Net operating revenues | \$ 115 | 100% | \$ 109 | 100% | \$ 6 | 6% |
| Operating expenses | | | | | | |
| Costs of products and services | 106 | 92% | 97 | 89% | 9 | 9% |
| Selling, general and administrative | 10 | 9% | 12 | 11% | (2) | (17)% |
| Depreciation and amortization | 1 | 1% | 3 | 3% | (2) | (67)% |
| Total operating expenses | 117 | 102% | 112 | 103% | 5 | 4% |
| Operating loss | \$ (2) | (2)% | \$ (3) | (3)% | \$ 1 | (33)% |
| Capital expenditures | \$ | | \$ 1 | | \$ (1) | (100)% |

Net Operating Revenues

Revenues from the Logistics segment increased \$6 million in the year to date period ended March 31, 2008, compared to the same period in 2007. The following table lists the major drivers of these changes:

| | Increase (Decrease) 2008 vs. 2007 (millions) |
|------------------------------------|--|
| Significant new supply contract | \$ 13 |
| Other customer spending reductions | (7) |
| Total increase | \$ 6 |

Cost of Products and Services

Cost of products and services includes costs of equipment sold and other operating taxes. These costs increased \$9 million in the year to date period ended March 31, 2008, compared to the same period 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 in the year to date period ended March 31, 2008, compared to the same period in 2007 primarily related to a decrease in severance charges and ongoing labor and benefits costs.

Consolidated Non-operating Items

Year to Date March 31,

Edgar Filing: Embarq CORP - Form 10-Q

| | 2008 | 2007 |
|-----------------------------|-------------------|--------|
| | <i>(millions)</i> | |
| Interest expense | \$ 104 | \$ 109 |
| Other (income) expense, net | (1) | |
| Income tax expense | 119 | 102 |

Interest Expense

Interest expense decreased \$5 million in the year to date period ended March 31, 2008, compared to the same period in 2007. This decrease is primarily due to the reduction of debt outstanding under our credit agreement.

Our effective interest rate on long-term debt was 7.2% for the year to date period ended March 31, 2008 and 7.1% for the same period in 2007. See [Liquidity and Capital Resources](#) below for more information on our financing activities.

Table of Contents*Income Tax Expense*

Income tax expense increased \$17 million in the year to date period ended March 31, 2008, compared to the same period in 2007. This increase was primarily the result of income before income taxes increasing \$69 million as a result of the various factors discussed above, partially offset by reductions in our state income taxes due to a favorable negotiated settlement in 2008 related to a consolidated state income tax return filing election 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 use of capital and the timing and amount of capital expenditures.

Cash Flows

The following table summarizes our decrease in cash and equivalents for the year to date periods ended March 31, 2008 and 2007:

| | Year to Date March 31, | |
|----------------------------------|-------------------------------|-------------|
| | 2008 | 2007 |
| | <i>(millions)</i> | |
| Operating activities | \$ 593 | \$ 480 |
| Investing activities | (175) | (163) |
| Financing activities | (435) | (324) |
| Decrease in cash and equivalents | \$ (17) | \$ (7) |

Operating Activities

Net cash provided by operating activities increased \$113 million in the year to date period ended March 31, 2008, from the same period in 2007 as a result of the following:

| | Increase (Decrease) |
|---|----------------------------|
| | 2008 vs. 2007 |
| | <i>(millions)</i> |
| Collections from customers | \$ (16) |
| Payments to employees and suppliers | 72 |
| Interest payments | 12 |
| Income tax payments, net | 45 |
| Total increase in cash provided by operating activities | \$ 113 |

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 \$12 million in the year to date period ended March 31, 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 \$179 million in the year to date period ended March 31, 2008,

Edgar Filing: Embarq CORP - Form 10-Q

decreased \$4 million from \$183 million in the same period in 2007. The following table shows the major drivers of these changes:

| | Increase (Decrease) 2008 vs. 2007 <i>(millions)</i> |
|--|---|
| Network buildout and mandates | \$ (25) |
| Internal infrastructure | 7 |
| Sales success based | 14 |
| Total decrease in capital expenditures | \$ (4) |

Table of Contents

Proceeds from sales of assets decreased \$15 million in the year to date period ended March 31, 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 \$111 million in the year to date period ended March 31, 2008, compared to the same period in 2007. The following table shows the major drivers of this change:

| | Increase (Decrease) 2008 vs. 2007 <i>(millions)</i> |
|---|---|
| Net cash payment on long-term debt | \$ (155) |
| Dividends paid to shareholders | 103 |
| Repurchase of common shares | 113 |
| Common stock issued | 31 |
| Other | 19 |
| Total increase in cash used by financing activities | \$ 111 |

First quarter 2007 dividends approximating \$75 million were not paid in full until April 2, 2007, therefore first quarter 2007 did not reflect cash dividend payments comparable to the first quarter of 2008.

Capital Requirements

We currently expect capital expenditures for 2008 to be approximately \$780 million. We continue to review capital expenditure requirements and will adjust spending and capital investment in response to operational needs and customer demand.

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, scheduled maturities on debt (which are \$99 million, \$2 million and \$2 million in 2008, 2009 and 2010, respectively), dividend payouts at current levels and the approved stock repurchase program.

Our total indebtedness at March 31, 2008, was \$5.7 billion, consisting of \$4.5 billion in senior notes, \$565 million in direct borrowings under our credit agreement and \$623 million of other debt. As of March 31, 2008, we had approximately \$1.3 billion of availability under our \$1.5 billion revolving credit facility, which reflects direct borrowings of \$205 million and issued letters of credit of \$29 million. The credit agreement expires in 2011, and the initial tranches of our senior notes do not mature until 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. Our first quarter 2008 quarterly dividend was \$0.6875 per common share. 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.

Edgar Filing: Embarq CORP - Form 10-Q

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 March 31, 2008, we had repurchased 3.3 million shares of common stock for an aggregate purchase price of \$135 million.

Pursuant to our stock repurchase program, from April 1 through April 25, 2008, we repurchased an additional 2.6 million shares of common stock for a total of \$103 million, representing an average price of \$39.49 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 based on projected plan asset and liability levels. 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 Kansas federal court, 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.

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 90% of our outstanding debt at March 31, 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 because we do not intend to prepay these obligations.

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 \$6 million on the Consolidated Statements of Operations and Comprehensive Income (Unaudited) and Consolidated Statements of Cash Flows (Unaudited) at March 31, 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 \$118 million in fair market value of our outstanding debt at March 31, 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 March 31, 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 first 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, complaints have been filed with the Equal Employment Opportunity Commission asserting that the benefits plan changes are discriminatory. Embarq and other defendants intend to vigorously contest these claims and charges.

In addition, various other lawsuits, including putative class actions, regulatory proceedings against Embarq and other claims typical for a business enterprise are pending against or would otherwise impact the entities comprising Embarq. 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 or results of operations.

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 March 31, 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 |
|--------------------------------|--------------------------------------|----------------------------------|--|--|
| January 1 through January 31 | | \$ | | \$ 500,000,000 |
| February 1 through February 29 | 469,001 | 43.10 | 469,001 | 479,787,450 |
| March 1 through March 31 | 2,880,989 | 39.97 | 2,880,989 | 364,626,547 |
| Total | 3,349,990 | \$ 40.41 | 3,349,990 | \$ 364,626,547 |

(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

There were no reportable events during the quarter ended March 31, 2008.

Item 4. Submission of Matters to a Vote of Security Holders

There were no reportable events during the quarter ended March 31, 2008.

Item 5. Other Information

There were no reportable events during the quarter ended March 31, 2008.

Table of Contents**Item 6. Exhibits****Exhibit**

| Number | Description |
|---------------|--|
| 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). |

Table of Contents

Exhibit

| Number | Description |
|---------------|--|
| 4.5 | 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 | Employment Agreement dated as of March 3, 2008, between Thomas A. Gerke and Embarq Corporation (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 March 4, 2008). |
| 10.2 | Form of 2008 Restricted Stock Unit Award Agreement (Incorporated by reference to Exhibit 10.2 to the registrant's Current Report on Form 8-K (File No. 001-32732), filed with the Securities and Exchange Commission on March 4, 2008). |
| 10.3 | Form of Stock Option Award Agreement (Incorporated by reference to Exhibit 10.3 to the registrant's Current Report on Form 8-K (File No. 001-32732), filed with the Securities and Exchange Commission on March 4, 2008). |
| 10.4 | Summary of Embarq Corporation 2008 Short-Term Incentive Program. |
| 10.5 | Summary of Embarq Corporation Non-Employee Director Compensation Program. |
| 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). |
| 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: April 30, 2008