

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549**

FORM 8-K

CURRENT REPORT

Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Date of Report (Date of earliest event reported): July 1, 2009

CenturyTel, Inc .

(Exact name of registrant as specified in its charter)

Louisiana
(State or other jurisdiction
of incorporation)

1-7784
(Commission
File Number)

72-0651161
(IRS Employer
Identification No.)

100 CenturyTel Drive
Monroe, Louisiana
(Address of principal executive offices)

71203
(Zip Code)

(318) 388-9000
(Registrant's telephone number, including area code)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligations of the registrant under any of the following provisions:

- ☐ Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)
- ☐ Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)
- ☐ Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))
- ☐ Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

In this current report on Form 8-K, references to “CenturyTel,” “we,” “us” and “our” refer to CenturyTel, Inc.

Item 2.01. Completion of Acquisition or Disposition of Assets.

On July 1, 2009, pursuant to the terms and conditions of the Agreement and Plan of Merger, dated as of October 26, 2008 (the “Merger Agreement”), among Embarq Corporation (“Embarq”), CenturyTel and Cajun Acquisition Company, a wholly owned subsidiary of CenturyTel (“Merger Sub”), Merger Sub merged with and into Embarq, with Embarq continuing as the surviving corporation and as a wholly owned subsidiary of CenturyTel (the “Merger”).

As a result of the Merger, each outstanding share of Embarq common stock was converted into the right to receive 1.37 shares of our common stock (“CTL common stock”), with cash paid in lieu of fractional shares. As a result of the Merger, we will deliver approximately \$6.0 billion in CTL common stock to Embarq stockholders, based on the number of Embarq shares outstanding as of June 30, 2009 and the closing price of the CTL common stock on June 30, 2009.

As previously announced, we plan to begin conducting business under the brand name CenturyLink in conjunction with consummating the Merger. We plan to formally change our name to “CenturyLink, Inc.” upon receipt of shareholder approval, which we expect to solicit in May 2010.

The foregoing description does not purport to be complete and is qualified in its entirety by reference to the Merger Agreement, which is incorporated by reference as Exhibit 2.1 to this current report on Form 8-K and is incorporated by reference herein. Copies of press releases announcing the receipt of the final required regulatory approval and the completion of the Merger are attached as Exhibit 99.1 and Exhibit 99.2, respectively, to this current report on Form 8-K and are incorporated by reference herein.

The Merger Agreement contains representations and warranties made by and to the parties thereto as of specific dates. The statements embodied in those representations and warranties were made for purposes of that contract between the parties and are subject to qualifications and limitations agreed upon by the parties, which are not necessarily reflected in the Merger Agreement, in connection with negotiating the terms of that contract. In addition, certain representations and warranties were made as of a specified date, may be subject to a contractual standard of materiality different from those generally applicable to investors, or may have been used for the purpose of allocating risk between the parties rather than establishing matters as facts.

Item 3.03. Material Modifications to Rights of Security Holders.

The information described under Item 5.03 below is incorporated by reference herein.

Item 5.01. Changes in Control of the Registrant.

As a result of the Merger, former Embarq stockholders held approximately 66% of the outstanding CTL common stock immediately following the Merger.

Item 5.02. Departure of Directors or Certain Officers; Election of Directors; Appointment of Certain Officers; Compensatory Arrangements of Certain Officers.

Appointment of New Directors. Effective upon completion of the Merger, we expanded the size of our Board of Directors from 12 to 15 members. At such time, pursuant to the Merger Agreement, our Board appointed the individuals set forth below (each of whom served as a director of Embarq prior to the effective time of the Merger) to the respective classes and principal committees of the Board specified below:

Name	Class	Principal Committee(s)	Term Expires
William A. Owens	I	Nominating	2010
Stephanie M. Shern	I	Audit, Compensation	2010

Peter C. Brown	II	Audit, Risk Evaluation	2011
Richard A. Gephardt	II	Nominating	2011
Thomas A. Gerke	II	--	2011
Steven A. Davis	III	Risk Evaluation	2012
Laurie A. Siegel	III	Compensation (Chair)	2012

In connection with their appointments as outside directors, each of the new directors listed above will receive a grant of 3,161 restricted shares of our common stock on July 2, 2009. With respect to each such restricted share award, the shares of restricted stock will vest upon the earlier of (i) one-third per year on each of May 15, 2010, May 15, 2011 and May 15, 2012, (ii) the date the director dies or becomes disabled, or (iii) the occurrence of a change of control, all as described further in our directors stock plan. In addition, these shares of restricted stock will have such other terms as are set forth in our directors stock plan and in the form of restricted stock agreement to be entered into with each director.

In connection with being appointed Chairman of the Board in accordance with the Merger Agreement, William A. Owens will receive an additional grant of 6,321 restricted shares of our common stock on July 2, 2009. These shares of restricted stock granted to Mr. Owens have the same terms as the above-described grants of restricted stock to the new outside directors, except that all of his shares of restricted stock will vest upon the earlier of (i) May 15, 2010, (ii) the date he dies or becomes disabled, or (iii) the occurrence of a change of control, all as described further in our directors stock plan.

In connection with consummating the Merger, our Board authorized a new form of indemnification agreement for our directors and officers. These agreements are intended to supersede the existing indemnity agreements between us and each of our directors and officers. Our new form of indemnification agreement is attached hereto as Exhibit 99.3 to this current report on Form 8-K and is incorporated by reference herein.

Members of our Board are subject to our Corporate Governance Guidelines, which, among other things, prohibit a director from serving on more than two additional unaffiliated public company boards. In addition to serving on our Board, Richard A. Gephardt, William A. Owens and Stephanie M. Shern serve on the board of directors of more than two unaffiliated public companies. In connection with appointing each of them to the Board, the Board waived compliance by each such individual with the above-described service limitation, subject to the understanding that this waiver permits such individuals to serve only on the boards of the unaffiliated companies on which they are currently serving, unless and until the individual is permitted to accept a new directorship under our Corporate Governance Guidelines then in effect due to any future reductions in the number of the individual's directorships, any future changes in such guidelines, or any future additional waivers granted by the Board.

Resignation of Directors. Effective immediately prior to the completion of the Merger, each of William R. Boles, Jr., Calvin Czeschin, James B. Gardner and Jim D. Reppond retired from our Board of Directors.

Other Changes in Management. For information on additional changes in management made in connection with the Merger, see Item 8.01 below.

Item 5.03. Amendments to Articles of Incorporation or Bylaws; Change in Fiscal Year.

On July 1, 2009, in connection with the Merger Agreement and as approved by our shareholders on January 27, 2009, we filed Amended and Restated Articles of Incorporation to (i) eliminate our time-phase voting structure, which previously entitled persons who beneficially owned shares of our common stock continuously since May 30, 1987 to ten votes per share, and (ii) increase the authorized number of shares of our common stock from 350 million to 800 million. As so amended and restated, our Articles of Incorporation provide that each share of CTL common stock is entitled to one vote per share with respect to each matter properly submitted to shareholders for their vote, consent, waiver, release or other action, and authorize the issuance of up to 800 million shares of CTL common stock. These amendments reflect changes contemplated or necessitated by the Merger Agreement and are described in detail in our joint proxy statement-prospectus dated December 22, 2008.

Effective July 1, 2009, we amended our bylaws to effect a variety of changes, including the following:

- We amended Sections 1.1, 1.2 and 2.2 of Article I of our bylaws to (i) clarify the management positions that we are required or permitted to maintain, (ii) eliminate various references to succession planning, (iii) provide for the possibility of electing more than one vice chairman and electing non-executive chairman or vice chairman, (iv) revise the scope of the powers of the Chairman and the Vice Chairmen, (v) authorize the Board to periodically designate certain officers as our executive officers, (vi) authorize multiple assistant secretaries and (vii) make clarifying changes to the powers and responsibilities of certain officers.
- Pursuant to our obligations under the Merger Agreement, we added Article I, Section 3, of our bylaws to provide that William A. Owens will serve as our Chairman, and to provide that if he ceases to be Chairman at any time before July 1, 2010, his replacement will be chosen from among Peter C. Brown, Steven A. Davis, Richard A. Gephardt, Thomas A. Gerke, Stephanie M. Shern or Laurie A. Siegel.
- We amended Sections 3.1 and 3.2 of Article II of our bylaws to (i) provide that special board meetings may be called by the Chief Executive Officer, as well as the Chairman, and (ii) shorten the notice periods for calling special board meetings.
- We amended Article II, Section 10, of our bylaws to conform our indemnification bylaw to the terms of the form of indemnification agreement described above under Item 5.02.
- We amended Article III, Section 1, of our bylaws to eliminate the Executive Committee of the Board.
- We amended Article III, Section 5, of our bylaws to eliminate the power of the Chairman to fill committee vacancies when the Board is not in session, and instead empowered the Nominating and Corporate Governance Committee to fill any committee vacancy that is not filled by the Board within 30 days (subject to a provision that requires, for a one-year period ending on July 1, 2010, any vacancy relating to a committee position previously held by a director who served CenturyTel or Embarq immediately prior to the Merger to be filled by another director who previously served CenturyTel or Embarq, respectively).
- We amended Article IV, Section 3, of our bylaws to provide that special shareholder meetings may be called only by the Board or, as previously provided, the holders of a majority of the total voting power.
- We amended Article IV, Section 6.1, of our bylaws to reduce the quorum required to organize our shareholder meetings.
- We amended Article V of our bylaws to authorize us to issue uncertificated shares of stock.
- We amended Article VIII of our bylaws to authorize executive officers, as well as the Board, to designate officers with authority to sign checks, drafts and notes on our behalf.

Our Amended and Restated Articles of Incorporation and Amended and Restated Bylaws are incorporated by reference as Exhibits 3.1 and 3.2, respectively, to this current report on Form 8-K and are incorporated by reference herein.

Item 8.01. Other Events.

Change in Committee Responsibilities of Continuing Directors. In connection with the Merger, eight of our incumbent directors will continue to serve as directors, each in the same class of directorship to which they were allocated immediately prior to the Merger. Listed below are the new principal committee positions of these eight incumbent directors:

Name	Principal Committee(s)
Virginia Boulet	Compensation, Nominating (Chair)
W. Bruce Hanks	Audit (Chair), Risk Evaluation
Gregory J. McCray	Nominating, Risk Evaluation
C. G. Melville, Jr.	Nominating, Risk Evaluation (Chair)

Fred R. Nichols
Harvey P. Perry
Glen F. Post, III
Joseph R. Zimmer

Audit, Compensation
Compensation
—
Audit

Change in Responsibilities of Executive Officers. Glen F. Post, III and Karen A. Puckett continue to serve as our principal executive officer and principal operating officer, respectively. Effective upon completion of the Merger, Mr. Post now serves as our Chief Executive Officer and President, and Ms. Puckett now serves as our Executive Vice President and Chief Operating Officer.

Mike Maslowski, age 61, has announced his intention to retire later this year. Prior to then, Mr. Maslowski will assist our management team with merger integration activities. Mr. Maslowski served as one of our executive officers between 1999 and the effective date of the Merger.

R. Stewart Ewing, Jr., Stacey W. Goff and David D. Cole continue to serve as executive officers with titles and responsibilities substantially similar to their titles and responsibilities prior to the effective date of the Merger.

Appointment of New Executive Officers. Effective upon completion of the Merger, we appointed three former executives of Embarq as executive officers of CenturyTel.

We have appointed Thomas A. Gerke as Executive Vice Chairman with supervisory responsibility for all of our human resource functions and all of our state and federal regulatory activities. From March 3, 2008 until the effective time of the Merger, Mr. Gerke served as President and Chief Executive Officer of Embarq, after serving in the same role in an interim capacity since December 2007. Mr. Gerke previously served as General Counsel – Law and External Affairs for Embarq from May 2006 until December 2007, and had additional responsibility for Embarq’s Wholesale Markets business unit from January 2007 to December 2007. Prior to then, Mr. Gerke served from August 2005 until May 2006 as General Counsel – Law and External Affairs for the local telecommunications division of Sprint Nextel Corporation, Embarq’s former parent company. From May 2003 until August 2005, Mr. Gerke served as Executive Vice President–General Counsel and External Affairs of Sprint Corporation. Mr. Gerke is 53 years of age.

We have also appointed Dennis G. Huber as Executive Vice President – Network and Information Technology. From July 2008 until the effective time of the Merger, Mr. Huber served as Chief Technology Officer of Embarq. Mr. Huber served as Senior Vice President, Corporate Strategy and Development for Embarq from December 2007 through June 2008 and as Senior Vice President of Product Development for Embarq from October 2006 until December 2007. Mr. Huber served as Senior Vice President of Wireless Solutions for Embarq from August 2006 until October 2006. From January 2003 to August 2005, Mr. Huber served as President of Sprint North Supply Company, an affiliate of Embarq’s former parent company. Mr. Huber is 49 years of age.

In addition, we have appointed William E. Cheek as President – Wholesale Operations. From May 2006 until the effective time of the Merger, Mr. Cheek served as President, Wholesale Markets for Embarq. Mr. Cheek served in this role at the local telecommunications division of Sprint Nextel Corporation from August 2005 until May 2006 and as Assistant Vice President, Strategic Sales and Account Management in Sprint Business Solutions from January 2004 until July 2005. Mr. Cheek is 53 years of age.

Announcement of Completion of Merger. On June 25, 2009, we issued a press release announcing the receipt of the final regulatory approval required to complete the Merger, and on July 1, 2009, we issued a press release announcing the completion of the Merger and related events. Copies of these press releases are attached as Exhibit 99.1 and Exhibit 99.2, respectively, to this current report on Form 8-K and are incorporated by reference herein.

Item 9.01. Financial Statements and Exhibits.

- (a) Financial statements of business acquired.

The consolidated financial statements of Embarq Corporation for the quarterly periods ended March 31, 2009 and 2008 and the years

ended December 31, 2008, 2007 and 2006 are attached as Exhibit 99.4 to this current report on Form 8-K.

(b) Pro forma financial information.

CenturyTel intends to file unaudited pro forma combined condensed financial information reflecting the Merger no later than 71 calendar days after the date that this current report on Form 8-K is required to be filed.

(d) Exhibits

The exhibits to this current report on Form 8-K are listed in the Exhibit Index, which appears at the end of this report and is incorporated by reference herein.

SIGNATURES

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

CENTURYTEL, INC.

:

By: /s/ Neil A. Sweasy

Neil A. Sweasy

Vice President and Controller

Dated: July 1, 2009

EXHIBIT INDEX *

Exhibit No. Description

- 2.1 Agreement and Plan of Merger, dated as of October 26, 2008, among CenturyTel, Inc., Embarq Corporation and Cajun Acquisition Company (incorporated by reference to Exhibit 99.1 of our Current Report on Form 8-K filed on October 30, 2008).
- 3.1 Amended and Restated Articles of Incorporation of CenturyTel, Inc. (incorporated by reference to Exhibit 3.1 of Amendment No. 3 to our Registration Statement on Form 8-A filed on July 1, 2009).
- 3.2 Amended and Restated Bylaws of CenturyTel, Inc. (incorporated by reference to Exhibit 3.2 of Amendment No. 3 to our Registration Statement on Form 8-A filed on July 1, 2009).
- 23.1 Consent of KPMG LLP, independent registered public accounting firm for Embarq Corporation.
- 99.1 Press release dated June 25, 2009, announcing the receipt of the final regulatory approval required to complete the Merger.
- 99.2 Press release dated July 1, 2009, announcing the completion of the Merger.
- 99.3 Form of Indemnification Agreement entered into by CenturyTel, Inc. and its directors.
- 99.4 For the quarterly periods ended March 31, 2009 and 2008, the following consolidated financial statements of Embarq Corporation are filed herewith:
- a). Consolidated Balance Sheets as of March 31, 2009 and December 31, 2008 (Unaudited)
 - b). Consolidated Statements of Operations and Comprehensive Income for the Quarterly Periods Ended March 31, 2009 and 2008 (Unaudited)
 - c). Consolidated Statements of Cash Flows for the Quarterly Periods Ended March 31, 2009 and 2008 (Unaudited)
 - d). Consolidated Statement of Stockholders' Equity for the Quarterly Period Ended March 31, 2009 (Unaudited)
 - e). Condensed Notes to Consolidated Financial Statements (Unaudited)
- For the years ended December 31, 2008, 2007 and 2006, the following consolidated financial statements of Embarq Corporation (retrospectively reclassified for all periods and dates to report the financial results of Embarq's logistics business as discontinued operations) are filed herewith:
- a). Report of KPMG LLP, Independent Registered Public Accounting Firm
 - b). Consolidated Balance Sheets as of December 31, 2008 and 2007
 - c). Consolidated Statements of Operations and Comprehensive Income (Loss) for the Years Ended December 31, 2008, 2007 and 2006
 - d). Consolidated Statements of Cash Flows for the Years Ended December 31, 2008, 2007 and 2006

e). Consolidated Statements of Stockholders' Equity for the Years Ended December 31, 2008, 2007 and 2006

f). Notes to Consolidated Financial Statements.

* Each exhibit listed above is filed herewith, except for Exhibits 2.1, 3.1 and 3.2.

Consent of Independent Registered Public Accounting Firm

The Board of Directors
CenturyTel, Inc.

We consent to the incorporation by reference in the Registration Statements (No. 333-91361 and No. 333-157188) on Form S-3, the Registration Statements (No. 33-60061, No. 333-37148, No. 333-60806, No. 333-150157, No. 333-124854 and No. 333-150188) on Form S-8, and the Registration Statements (No. 33-48956, No. 333-17015 and No. 333-155521) on Form S-4 of CenturyTel, Inc. of our report dated February 12, 2009, except for Note 1B, as to which the date is June 17, 2009, with respect to the consolidated balance sheets of Embarq Corporation as of December 31, 2008 and 2007, and the related consolidated statements of operations and comprehensive income (loss), stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2008, which report is incorporated by reference in the Form 8-K of CenturyTel, Inc. expected to be filed on or about July 1, 2009. Our report on the consolidated financial statements refers to the adoption of the provisions of Statement of Financial Accounting Standards No. 157, *Fair Value Measurements*, for its financial assets and liabilities as of January 1, 2008, FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes- an interpretation of FASB Statement No. 109*, as of January 1, 2007, and 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.

/s/ KPMG LLP

Kansas City, Missouri

June 30, 2009

For Immediate Release**Contacts:****For CenturyTel****Analysts & Investors**

Tony Davis

318-388-9525

tony.davis@centurytel.com

Media

Annmarie Sartor

318-388-9671

annmarie.sartor @centurytel.com

For EMBARQ**Analysts & Investors**

Kevin Olin

866-591-1964

investorrelations@embarq.com

Media

Debra Peterson

913-323-4881

Debra.D.Peterson@embarq.com

FCC APPROVES CENTURYTEL AND EMBARQ MERGER**Transaction Has Now Received All Necessary Approvals**

MONROE, La. and OVERLAND PARK, Kan., June 25, 2009 -- CenturyTel, Inc. (NYSE: CTL) and Embarq Corporation (NYSE: EQ) today announced that CenturyTel's pending acquisition of EMBARQ has received approval from the Federal Communications Commission (FCC). The merger now has received all necessary approvals, and the companies expect the merger to be effective on July 1, 2009.

"The FCC's approval is a significant and exciting milestone toward completing the merger," said Glen F. Post III, CenturyTel's chairman and chief executive officer. "It has been a rigorous review process and we are pleased to have the FCC's approval and recognition that the combination of CenturyTel and EMBARQ offers many benefits to our customers and the communities we serve."

"We have committed to the FCC that we will remain focused on infrastructure development and broadband deployment after completion of the merger," said Tom Gerke, EMBARQ's chief executive officer. "Our combined company is committed to investing in our communities and providing our customers high-quality, reliable communications and expanded broadband services."

The FCC memorandum and order approving the merger can be found on the FCC website at: http://hraunfoss.fcc.gov/edocs_public/attachmatch/FCC-09-54A1.doc. CenturyTel and EMBARQ have already received all necessary approvals from the states in which CenturyTel and EMBARQ provide local service, as well as that of their respective shareholders, who overwhelmingly approved all proposals related to the merger on Jan. 27, 2009. On Nov. 24, 2008, the companies also received early termination of the waiting period required under the Hart-Scott-Rodino Antitrust Improvements Act of 1976.

About CenturyTel

CenturyTel (NYSE: CTL) is a leading provider of communications, high-speed Internet and entertainment services in small-to-mid-size cities through our broadband and fiber transport networks. Included in the S&P 500 Index, CenturyTel delivers advanced communications with a personal touch to customers in 25 states. Visit us at www.centurytel.com.

About EMBARQ

Embarq Corporation (NYSE: EQ), headquartered in Overland Park, Kansas, offers a complete suite of communications services. EMBARQ has operations in 18 states and is in the Fortune 500(R) list of America's largest corporations. For consumers, EMBARQ offers an innovative

portfolio of services that includes reliable local and long distance home phone service, high-speed Internet, wireless, and satellite TV from DISH Network(R) -- all on one monthly bill. For businesses, EMBARQ has a comprehensive range of flexible and integrated services designed to help businesses of all sizes be more productive and communicate with their customers. This service portfolio includes local voice and data services, long distance, Business Class High Speed Internet, wireless, satellite TV from DIRECTV(R), enhanced data network services, voice and data communication equipment and managed network services. For more information, visit embarq.com.

Forward Looking Statements

Except for the historical and factual information contained herein, the matters set forth in this press release, including statements as to the expected benefits of the acquisition such as efficiencies, cost savings, enhanced revenues, growth potential, market profile and financial strength, and the competitive ability and position of the combined company, and other statements identified by words such as "estimates," "expects," "projects," "plans," and similar expressions are forward-looking statements within the meaning of the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995. These forward-looking statements are subject to risks and uncertainties that may cause actual results to differ materially, including the possibility that the anticipated benefits from the acquisition cannot be fully realized or may take longer to realize than expected, the possibility that costs or difficulties related to the integration of EMBARQ operations into CenturyTel will be greater than expected, the ability of the combined company to retain and hire key personnel, the impact of regulatory, competitive and technological changes and other risk factors relating to our industry as detailed from time to time in each of CenturyTel's and EMBARQ's reports filed with the Securities and Exchange Commission. There can be no assurance regarding the timing or consummation of the merger. You should not place undue reliance on these forward-looking statements, which speak only as of the date hereof. Unless legally required, CenturyTel and EMBARQ undertake no obligation to update publicly any forward-looking statements, whether as a result of new information, future events or otherwise.

For Immediate Release

Contacts:

Analysts & Investors

Tony Davis
318-388-9525
tony.davis@centurytel.com

Media

Annmarie Sartor
318-388-9671
annmarie.sartor@centurytel.com

Media

Debra Peterson
913-323-4881
Debra.D.Peterson@embarq.com

CenturyTel and EMBARQ Complete Merger

Serves Approximately 7.5 Million Customers in 33 States; Expects \$400 Million in Annual Synergies

MONROE, La., July 1, 2009 – CenturyTel, Inc. (NYSE: CTL) and Embarq Corporation (NYSE: EQ) announced today that they have completed their merger. The combined company, which will be known as CenturyLink, serves more than 2.1 million broadband customers, more than 440,000 video subscribers and approximately 7.5 million access lines in 33 states, based on operating results as of March 31, 2009.

“The completion of this merger is a significant event for our customers, communities, investors and employees,” said Glen F. Post III, president and chief executive officer. “CenturyLink has the advanced networks, the people and the financial stability to deliver the reliable and innovative services that our customers want and need. We look forward to this exciting new chapter in our company’s history.”

CenturyLink expects to generate annual full run-rate operating and capital synergies of approximately \$400 million by 2011. Based on this synergy level and operating results of the two companies for the twelve months ended Dec. 31, 2008, CenturyTel would have had combined revenue of more than \$8 billion, combined operating cash flow of over \$4.2 billion and combined free cash flow of approximately \$1.9 billion. The company expects to continue its current annual dividend of \$2.80 per share. The company anticipates the combination to be accretive to free cash flow per share in 2010, the first full year post-closing. All figures and statements in this paragraph exclude the impact of one-time integration costs.

In accordance with the terms of the Merger Agreement, EMBARQ stockholders received 1.37 CenturyTel shares for each share of EMBARQ common stock they owned at closing. The transaction was structured as a tax-free stock-for-stock exchange. Other than assuming EMBARQ’s existing debt, the combined company has incurred neither any incremental debt nor any change to debt maturity schedules.

While the company’s corporate identity will immediately change to CenturyLink, customer-facing operations and communications will continue under the CenturyTel and EMBARQ brand names until a full brand conversion occurs later this year. The company intends to formally change its name to “CenturyLink, Inc.” upon receipt of shareholder approval, which it expects to solicit in May 2010. The company’s stock continues to trade on the New York Stock Exchange under the ticker symbol “CTL.”

The corporate headquarters of the company will remain in Monroe, La. Regional operating headquarters will be located in Las Vegas, Nev., Wentzville, Mo., Orlando, Fla., Wake Forest, N.C., and La Crosse, Wis. The company also maintains a significant presence in the Overland Park, Kan. area, the former location of EMBARQ’s corporate headquarters.

About CenturyLink

CenturyLink is a leading provider of high-quality voice, broadband and video services over its advanced communications networks to consumers

and businesses in 33 states. CenturyLink, headquartered in Monroe, La., is an S&P 500 Company and expects to be listed in the Fortune 500 list of America's largest corporations. For more information on CenturyLink, visit www.centurylink.com.

Forward Looking Statements

Except for the historical and factual information contained herein, the matters set forth in this document, including statements as to the expected benefits of the acquisition such as efficiencies, cost savings, enhanced revenues, cash flow accretion, growth potential, market profile and financial strength, and the competitive ability and position of the combined company, and other statements identified by words such as "estimates," "expects," "projects," "plans," "intends" and similar expressions are forward-looking statements within the meaning of the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995. These forward-looking statements are subject to risks and uncertainties that may cause actual results to differ materially, including the possibility that the anticipated benefits from the acquisition cannot be fully realized or may take longer to realize than expected, the possibility that costs or difficulties related to the integration of EMBARQ operations into CenturyTel will be greater than expected, the ability of the combined company to retain and hire key personnel, the possibility that our brand conversion could take longer than expected, the impact of regulatory, competitive and technological changes and other risk factors relating to our industry as detailed from time to time in our reports filed with the Securities and Exchange Commission. You should not place undue reliance on these forward-looking statements, which speak only as of the date hereof. Unless legally required, we undertake no obligation to update publicly any forward-looking statements, whether as a result of new information, future events or otherwise.

[Form of]
INDEMNIFICATION AGREEMENT
 (with directors)

This Indemnification Agreement (the “**Agreement**”) is made as of the 1st day of July, 2009 (the “**Effective Date**”), by and between CenturyTel, Inc., a Louisiana corporation (the “**Corporation**”), and _____ (“**Indemnatee**”).

In consideration of Indemnatee’s service as a director of the Corporation commencing on or before the date hereof, the Corporation and Indemnatee do hereby agree as follows:

1. Agreement to Serve. Indemnatee agrees to serve or continue to serve as a director of the Corporation for so long as Indemnatee is elected or appointed or until such earlier time as Indemnatee tenders a resignation in writing.

2. Definitions. As used in this Agreement:

(a) The term “**Change of Control**” shall mean (i) an acquisition by any person (within the meaning of Section 13(d)(3) or 14(d)(2) of the Securities Exchange Act of 1934, as amended) of beneficial ownership of 20% or more of the combined voting power of the Corporation's then outstanding voting securities; (ii) during any period of two consecutive years, individuals who at the beginning of such period constitute the Board of Directors of the Corporation and any new director whose election by the Board of Directors or nomination for election by the Corporation's shareholders was approved by a vote of at least two-thirds of the directors then still in office who either were directors at the beginning of the period or whose election or nomination for election was previously so approved, cease for any reason to constitute a majority thereof; or (iii) the consummation of a merger or consolidation involving the Corporation if the shareholders of the Corporation, immediately before such merger or consolidation, do not own, immediately following such merger or consolidation, more than 50% of the combined voting power of the outstanding voting securities of the resulting entity in substantially the same proportion as their ownership of voting securities immediately before such merger or consolidation. Notwithstanding the foregoing, a Change of Control shall not be deemed to occur solely because 20% or more of the Corporation’s then outstanding voting securities is acquired by (1) a trustee or other fiduciary holding securities under one or more employee benefit plans maintained by the Corporation or any of its subsidiaries or (2) any entity that, immediately prior to such acquisition, is owned directly or indirectly by the shareholders of the Corporation in the same proportion as their ownership of shares in the Corporation immediately prior to such acquisition.

(b) The term “**Claim**” shall mean any threatened, pending or completed claim, action, suit, or proceeding, including discovery, whether civil, criminal, administrative, arbitative or investigative and whether made judicially or extra-judicially, or any separate issue or matter therein, as the context requires, but shall not include any action, suit or proceeding initiated by Indemnatee against the Corporation (other than to enforce the terms of this Agreement), or initiated by Indemnatee against any director or officer of the Corporation unless the Corporation has joined in or consented in writing to the initiation of such action, suit or proceeding.

(c) The term “**Determining Body**” shall mean (i) the Board of Directors by a majority vote of a quorum of the entire board consisting of directors who are not named as parties to the Claim for which indemnification is being sought (“**Disinterested Directors**”), or (ii) if such a quorum is not obtainable, independent legal counsel (A) selected by the Disinterested Directors, or (B) if there are fewer than two Disinterested Directors, selected by the Board of Directors (in which selection directors who do not qualify as Disinterested Directors may participate); *provided, however*, that following a Change of Control, with respect to all matters thereafter arising out of acts, omissions or events occurring prior to or after the Change of Control concerning the rights of Indemnatee to seek indemnification, such determination shall be made by independent legal counsel selected by the Board of Directors in the manner described above in this Section 2(c) (which selection shall not be unreasonably delayed or withheld) from a panel of three counsel nominated by Indemnatee. Such counsel shall not have otherwise performed services for the Corporation, Indemnatee or their affiliates (other than services as independent counsel in connection with similar matters) within the five years preceding its engagement (“**Independent Counsel**”). If Indemnatee fails to nominate Independent Counsel within ten business days following written request by the Corporation, the Board of Directors shall select Independent Counsel. Such counsel shall not be a

person who, under the applicable standards of professional conduct then prevailing, would have a conflict of interest in representing either the Corporation or Indemnatee in an action to determine Indemnatee's rights under this Agreement, nor shall Independent Counsel be any person who has been sanctioned or censured for ethical violations of applicable standards of professional conduct. The Corporation agrees to pay the reasonable fees and costs of the Independent Counsel referred to above and to fully indemnify such Independent Counsel against any and all expenses, claims, liabilities and damages arising out of or relating to this Section 2(c) or its engagement pursuant hereto. The Determining Body shall determine in accordance with Section 6 whether and to what extent Indemnatee is entitled to be indemnified under this Agreement and shall render a written opinion to the Corporation and to Indemnatee to such effect.

(d) The term "**Disbursing Officer**" shall mean, with respect to a Claim, the Chief Executive Officer of the Corporation or, if the Chief Executive Officer is a party to the Claim as to which advancement or indemnification is being sought, any officer who is not a party to the Claim and who is designated by the Chief Executive Officer, which designation shall be made promptly after the Corporation's receipt of Indemnatee's initial request for advancement or indemnification and communicated to Indemnatee.

(e) The term "**Expenses**" shall mean any reasonable expenses or costs (including, without limitation, attorney's fees, fees of experts retained by attorneys, judgments, punitive or exemplary damages, fines and amounts paid in settlement) actually and reasonably incurred by Indemnatee with respect to a Claim, except that Expenses shall not include any amount paid in settlement of a Claim against Indemnatee (i) by or in the right of the Corporation, or (ii) that the Corporation has not approved, which approval will not be unreasonably delayed or withheld.

(f) The term "**Standard of Conduct**" shall mean conduct by an Indemnatee with respect to which a Claim is asserted that was in good faith and that Indemnatee reasonably believed to be in, or not opposed to, the best interest of the Corporation, and, in the case of a Claim that is a criminal action or proceeding, conduct that the Indemnatee had no reasonable cause to believe was unlawful. The termination of any Claim by judgment, order, settlement, conviction, or upon a plea of *nolo contendere* or its equivalent, shall not, of itself, create a presumption that Indemnatee did not meet the Standard of Conduct.

3. Limitation of Liability.

To the fullest extent permitted by Article VII of the Articles of Incorporation of the Corporation in effect on the Effective Date and, if and to the extent the Articles of Incorporation are amended to permit further limitations, in effect at any time prior to the determination of liability, Indemnatee shall not be personally liable in damages for breach of Indemnatee's fiduciary duty as a director or officer. The Board of Directors of the Corporation will not take any action to effect any amendment to the Articles of Incorporation the effect of which would be to deny, diminish or encumber Indemnatee's right to exculpation under this Section 3.

4. Maintenance of Insurance.

(a) The Corporation represents that it presently maintains in force and effect directors and officers liability insurance ("**D&O Insurance**") policies that provide primary and excess coverage on behalf of the Corporation's directors and officers on the terms and conditions specified therein (the "**Insurance Policies**"). Subject only to the provisions of Section 4(b) hereof, the Corporation hereby agrees that, so long as Indemnatee shall continue to serve as a director or officer (or shall continue at the request of the Corporation to serve in any capacity referred to in Section 6(a) hereof) and thereafter so long as Indemnatee shall be subject to any possible Claim, the Corporation shall purchase and maintain in effect for the benefit of Indemnatee one or more valid and enforceable policy or policies of D&O Insurance providing, in all respects, coverage reasonably comparable (including Side A) to that currently provided pursuant to the Insurance Policies, provided that the Corporation shall have no obligation to provide primary coverage or excess coverage in excess of the amount of coverage provided on the Effective Date.

(b) The Corporation shall not be required to purchase and maintain the Insurance Policies in effect if D&O Insurance is not reasonably available or if, in the reasonable business judgment of a majority of the directors of the Corporation, either (i) the premium cost for such insurance is excessive in light of the amount of coverage or (ii) the coverage provided by such insurance is so

limited by exclusions, retentions, deductibles or otherwise that there is insufficient benefit from such insurance.

5. Advancement of Expenses.

(a) Subject to Indemnitee's furnishing the Corporation with a written undertaking, in a form reasonably satisfactory to the Corporation, to repay such amount if it is ultimately determined that Indemnitee is not entitled under this Agreement to indemnification therefor, the Corporation shall advance Expenses to Indemnitee in advance of the final disposition of any Claim involving Indemnitee; *provided, however*, that Indemnitee will return, without interest, any such advance that remains unspent at the disposition of the Claim to which the advance related, and *provided further*, that advances of such Expenses by the Corporation's D&O Insurance carrier shall be treated, for purposes of this Section 5(a), as advances by the Corporation. The written undertaking by Indemnitee must be an unlimited general obligation of Indemnitee but need not be secured and will be accepted by the Corporation without reference to the financial ability of Indemnitee to make repayment.

(b) Any request for advancement of Expenses shall be submitted by Indemnitee to the Disbursing Officer in writing and shall be accompanied by a written description of the Expenses for which advancement is requested. The Disbursing Officer shall, within 20 days after receipt of Indemnitee's request for advancement, advance such Expenses unsecured, interest-free and without regard to Indemnitee's ability to make repayment, *provided* that if the Disbursing Officer questions the reasonableness of any such request, that officer shall promptly advance to the Indemnitee the amount deemed by that officer to be reasonable and shall forward immediately to the Determining Body a copy of the Indemnitee's request and of the Disbursing Officer's response, together with a written description of that officer's reasons for questioning the reasonableness of a portion of the advancement sought. The Determining Body shall, within 20 days after receiving such a request from the Disbursing Officer, determine the reasonableness of the disputed Expenses and notify Indemnitee and the Disbursing Officer of its decision, which shall be final, subject to Indemnitee's right under Section 7 to seek a judicial adjudication of Indemnitee's rights.

(c) Indemnitee's right to advancement under this Section 5 shall include the right to advancement of Expenses incurred by Indemnitee in a suit against the Corporation under Section 7 to enforce Indemnitee's rights under this Agreement. Such right of advancement shall, however, be subject to Indemnitee's obligation pursuant to Indemnitee's undertaking described in Section 5(a) to repay such advances, to the extent provided in Section 7, if it is ultimately determined in the enforcement suit that Indemnitee is not entitled to indemnification for a Claim.

6. Indemnification.

(a) The Corporation shall, in the manner provided in this Section 6, indemnify and hold harmless Indemnitee against Expenses incurred in connection with any Claim against Indemnitee (whether as a subject of or party to, or a proposed or threatened subject of or party to, the Claim) or in which Indemnitee is involved solely as a witness or person required to give evidence, by reason of Indemnitee's position:

(A) as a director or officer of the Corporation,

(B) as a director or officer of any subsidiary of the Corporation or as a fiduciary with respect to any employee benefit plan of the Corporation, or

(C) as a director, officer, employee or agent of another corporation, partnership, limited liability company, joint venture, trust, employee benefit plan or other for profit or not for profit entity or enterprise, if such position is or was held at the request of the Corporation,

whether relating to service in such position before or after the Effective Date, if (x) Indemnitee is successful in defense of the Claim on the merits or otherwise, as provided in Section 6(d), or (y) Indemnitee has been found by the Determining Body to have met the Standard of Conduct; *provided* that no indemnification shall be made in respect of any Claim by or in the right of the Corporation as to which Indemnitee shall have been adjudged by a court of competent jurisdiction, after exhaustion of all appeals therefrom, to be liable

to the Corporation unless, and only to the extent, a court shall determine upon application that, despite the adjudication of liability but in view of all the circumstances of the case, Indemnitee is fairly and reasonably entitled to indemnity for such Expenses as the court shall deem proper, and *provided further*, that Expenses incurred in connection with a Claim for which Indemnitee has been reimbursed or indemnified by the Corporation's D&O Insurance carrier shall be credited against the Corporation's obligation under this Section 6(a) with respect to such Claim.

(b) Promptly upon becoming aware of the existence of any Claim with respect to which Indemnitee may seek indemnification hereunder, Indemnitee shall notify the Chief Executive Officer (or, if the Chief Executive Officer is the Indemnitee, the next ranking executive officer who is not an Indemnitee with respect to the Claim) of the existence of the Claim, who shall promptly advise the Board of Directors that establishing the Determining Body will be a matter presented at the next regularly scheduled meeting of the Board of Directors. Delay by Indemnitee in giving such notice shall not excuse performance by the Corporation hereunder unless, and only to the extent that, the Corporation did not otherwise learn of the Claim and such failure results in forfeiture by the Corporation of substantial defenses, rights or insurance coverage. After the Determining Body has been established, the Chief Executive Officer or that officer's delegate shall inform Indemnitee thereof and Indemnitee shall promptly notify the Determining Body, to the extent requested by it, of all facts relevant to the Claim known to Indemnitee.

(c) Indemnitee shall be entitled to conduct the defense of the Claim and to make all decisions with respect thereto, with counsel of Indemnitee's choice, *provided* that in the event the defense of the Claim has been assumed by the Corporation through its D&O Insurance carrier or otherwise, then (i) Indemnitee will be entitled to retain separate counsel from the Corporation's Counsel (but not more than one law firm plus, if applicable, local counsel at the Corporation's expense if, but only if, Indemnitee shall reasonably conclude that one or more legal defenses may be available to Indemnitee that are different from, or in addition to, those available to the Corporation or other defendants represented by the Corporation through its D&O Insurance carrier or otherwise, and (ii) the Corporation will not, without the prior written consent of Indemnitee, effect any settlement of the Claim unless such settlement (x) includes an unconditional release of Indemnitee from all liability that is the subject matter of such Claim, (y) does not impose penalties or post-settlement obligations on Indemnitee (except for customary confidentiality obligations), and (z) does not require payment by Indemnitee of money in settlement.

(d) To the extent Indemnitee is successful on the merits or otherwise in defense of any Claim, Indemnitee shall be indemnified against Expenses incurred by Indemnitee with respect to the Claim, regardless of whether Indemnitee has met the Standard of Conduct, and without the necessity of any determination by the Determining Body as to whether Indemnitee has met the Standard of Conduct. In the event Indemnitee is not entirely successful on the merits or otherwise in defense of any Claim, but is successful on the merits or otherwise in defense of any claim, issue or matter involved in the Claim, Indemnitee shall be indemnified for the portion of Indemnitee's Expenses incurred in such successful defense that is determined by the Determining Body to be reasonably and properly allocable to the claims, issues, or matters as to which Indemnitee was successful.

(e) Except as otherwise provided in Section 6(d), the Corporation shall not indemnify any Indemnitee under Section 6 (a) unless a determination has been made by the Determining Body (or by a court upon application or in a proceeding brought by Indemnitee under Section 7) with respect to a specific Claim that indemnification of Indemnitee is permissible because Indemnitee has met the Standard of Conduct. In the event settlement of a Claim to which Indemnitee is a party has been proposed ("**Proposed Settlement**"), the Determining Body shall, promptly after submission to it but prior to consummation of the Proposed Settlement, make a determination whether Indemnitee shall have met the Standard of Conduct. In the event such determination is adverse to Indemnitee, Indemnitee shall be entitled to reject the Proposed Settlement. In the event of final disposition of a Claim other than by settlement, the Determining Body shall, promptly after but not before such final disposition, make a determination whether Indemnitee has met the Standard of Conduct. In all cases, the determination shall be in writing and shall set forth in reasonable detail the basis and reasons therefor. The Determining Body shall, promptly after making such determination, provide a copy thereof to both the Disbursing Officer and Indemnitee and shall instruct the former to (i) reimburse Indemnitee as soon as practicable for all Expenses, if any, to which Indemnitee has been so determined to be entitled and which have not previously been advanced to Indemnitee under Section 5 (or otherwise recovered by Indemnitee through an insurance or other arrangement provided by the Corporation), and (ii) seek reimbursement from Indemnitee (subject to Indemnitee's rights under Section 7) of all advancements that have been made pursuant to Section 5 as to which it has been so determined that Indemnitee is not entitled to be indemnified.

(f) Indemnatee shall cooperate with the Determining Body at the expense of the Corporation by providing to the Determining Body, upon reasonable advance request, any documentation or information that is not privileged or otherwise protected from disclosure and that is reasonably available to Indemnatee and reasonably necessary to make such determination.

(g) If the Determining Body makes a determination pursuant to Section 6(e) that Indemnatee is entitled to indemnification, the Corporation shall be bound by that determination in any judicial proceeding, absent a determination by a court that such indemnification contravenes applicable law.

(h) In making a determination under Section 6(e), the Determining Body shall presume that the Standard of Conduct has been met unless the contrary shall be shown by a preponderance of the evidence.

(i) The Corporation and Indemnatee shall keep confidential, to the extent permitted by law and their fiduciary obligations, all facts and determinations provided pursuant to or arising out of the operation of this Agreement, and the Corporation and Indemnatee shall instruct their respective agents to do likewise.

7. Enforcement.

(a) The rights provided by this Agreement shall be enforceable by Indemnatee in any court of competent jurisdiction.

(b) If Indemnatee seeks a judicial adjudication of Indemnatee's rights under, or to recover damages for breach of, this Agreement, Indemnatee shall be entitled to recover from the Corporation, and shall be indemnified by the Corporation against, any and all Expenses incurred by Indemnatee in connection with such proceeding, but only if Indemnatee prevails therein. If it shall be determined that Indemnatee is entitled to receive part but not all of the relief sought, then Indemnatee shall be entitled to be reimbursed for all Expenses incurred by Indemnatee in connection with such proceeding if the indemnification amount to which Indemnatee is determined to be entitled exceeds 50% of the amount of Indemnatee's claim. Otherwise, the reimbursement of Expenses incurred by Indemnatee in connection with such judicial adjudication shall be appropriately prorated.

(c) In any judicial proceeding described in this Section 7, the Corporation shall bear the burden of proving that Indemnatee is not entitled to advancement or reimbursement of Expenses sought with respect to any Claim.

8. Saving Clause. If any provision of this Agreement is determined by a court having jurisdiction over the matter to require the Corporation to do or refrain from doing any act that is in violation of applicable law, the court shall be empowered to modify or reform such provision so that, as modified or reformed, such provision provides the maximum indemnification permitted by law and such provision, as so modified or reformed, and the balance of this Agreement, shall be applied in accordance with their terms. Without limiting the generality of the foregoing, if any portion of this Agreement shall be invalidated on any ground, the Corporation shall nevertheless indemnify Indemnatee to the full extent permitted by any applicable portion of this Agreement that shall not have been invalidated and to the full extent permitted by law with respect to that portion that has been invalidated.

9. Non-Exclusivity. The indemnification and payment of Expenses provided by or granted pursuant to this Agreement shall not be deemed exclusive of any other rights to which Indemnatee is or may become entitled under any statute, article of incorporation, by-law, insurance policy, authorization of shareholders or directors, agreement or otherwise, including, without limitation, any rights authorized by the Determining Body in its discretion with respect to matters for which indemnification is permitted under La. R.S. 12:83A. The parties recognize that La. R. S. 12:83E presently provides that no such other indemnification measure shall permit indemnification of any person for the results of such person's willful or intentional misconduct.

10. Subrogation. In the event of any payment under this Agreement, the Corporation shall be subrogated to the extent of such payment to all of the rights of recovery of Indemnatee. Following receipt of indemnification payments hereunder, as further assurance, Indemnatee shall execute all papers reasonably required and, at the expense of the Corporation, take all action reasonably necessary to secure such subrogation rights, including execution of such documents as are reasonably necessary to enable the Corporation to bring suit to enforce

such rights.

- 11. Counterparts.** This Agreement may be executed in any number of counterparts, each of which shall constitute the original.
- 12. Applicable Law.** This Agreement shall be governed by and construed in accordance with the laws of the State of Louisiana.
- 13. Successors and Binding Agreement.**

(a) The Corporation shall require any successor (whether direct or indirect, by purchase, merger, consolidation, reorganization or otherwise) to all or substantially all the business or assets of the Corporation, by agreement in form and substance satisfactory to Indemnatee, expressly to assume and agree to perform this Agreement in the same manner and to the same extent the Corporation would be required to perform if no such succession had taken place.

(b) Indemnatee's right to indemnification and advancement of Expenses pursuant to this Agreement shall continue regardless of the termination of Indemnatee's status as a director or officer of the Corporation, and this Agreement shall inure to the benefit of and be enforceable by Indemnatee's personal or legal representatives, executors, administrators, spouses, heirs, assigns and other successors.

(c) This Agreement is personal in nature and neither of the parties hereto shall, without the prior written consent of the other, assign or delegate this Agreement or any rights or obligations hereunder except as expressly provided in Sections 13(a) and 13 (b).

(d) This Agreement shall be binding upon and inure to the benefit of and be enforceable by the parties hereto and their respective successors (including any direct or indirect successor by purchase, merger, consolidation, reorganization or otherwise to all or substantially all of the business or assets of the Corporation), permitted assigns, spouses, heirs, executors, administrators and personal and legal representatives.

14. Amendment. No amendment, modification, termination or cancellation of this Agreement shall be effective unless made in writing signed by the Corporation and Indemnatee. Notwithstanding any amendment or modification to or termination or cancellation of this Agreement or any portion hereof, Indemnatee shall be entitled to indemnification in accordance with the provisions hereof with respect to any acts or omissions of Indemnatee which occur prior to such amendment, modification, termination or cancellation.

15. Effective Date. This Agreement is effective as of the Effective Date, supersedes in its entirety any prior indemnity or indemnification agreements between the Corporation and Indemnatee, and covers Claims based on acts, occurrences and omissions occurring at any time prior to, on or after the Effective Date.

IN WITNESS WHEREOF , the parties hereto have caused this Agreement to be duly executed and signed as of the date and year first above written.

[Signature lines intentionally omitted]

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS OF EMBARQ CORPORATION
FOR THE YEAR TO DATE PERIODS ENDED MARCH 31, 2009 AND 2008

	<u>Page Reference</u>
Consolidated Balance Sheets as of March 31, 2009 and December 31, 2008 (Unaudited)	F-2
Consolidated Statements of Operations and Comprehensive Income for the Year to Date Periods Ended March 31, 2009 and 2008 (Unaudited)	F-3
Consolidated Statements of Cash Flows for the Year to Date Periods Ended March 31, 2009 and 2008 (Unaudited)	F-4
Consolidated Statement of Stockholders' Equity for the Year to Date Period Ended March 31, 2009 (Unaudited)	F-5
Condensed Notes to Consolidated Financial Statements (Unaudited)	F-6

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS OF EMBARQ CORPORATION
FOR THE YEARS ENDED DECEMBER 31, 2008, 2007 AND 2006

	<u>Page Reference</u>
Report of KPMG LLP, Independent Registered Public Accounting Firm	F-12
Consolidated Balance Sheets as of December 31, 2008 and 2007	F-13
Consolidated Statements of Operations and Comprehensive Income (Loss) for the Years Ended December 31, 2008, 2007 and 2006	F-14
Consolidated Statements of Cash Flows for the Years Ended December 31, 2008, 2007 and 2006	F-15
Consolidated Statements of Stockholders' Equity for the Years Ended December 31, 2008, 2007 and 2006	F-16
Notes to Consolidated Financial Statements	F-17

EXPLANATORY NOTE

On March 12, 2009, Embarq Corporation (Embarq) completed the sale of its wholly owned subsidiary, Embarq Logistics, Inc., pursuant to an agreement previously entered into on January 29, 2009. Consequently, the consolidated financial statements of Embarq for the three years ended December 31, 2008 have been retrospectively reclassified for all periods to report the financial results of Embarq Logistics' third party wholesale distribution operations, which previously comprised the Logistics business segment, as discontinued operations pursuant to Statement of Financial Accounting Standards (SFAS) No. 144, *Accounting for Impairment or Disposal of Long Lived Assets*. See Note 1B, Discontinued Operations, of the Notes to Consolidated Financial Statements for the years ended December 31, 2008, 2007, and 2006 for additional information.

EMBARQ CORPORATION**CONSOLIDATED BALANCE SHEETS (UNAUDITED)***(millions, except per share data)*

	As of March 31, 2009	As of Dec. 31, 2008
Assets		
Current assets		
Cash and equivalents	\$ 95	107
Accounts receivable, net of allowance for doubtful accounts of \$55 and \$54	444	494
Materials and supplies	51	52
Deferred tax assets	72	89
Prepaid expenses and other current assets	70	81
Current assets of discontinued operations	-	67
Total current assets	732	890
Gross property, plant and equipment	20,960	20,946
Accumulated depreciation	(13,709)	(13,547)
Net property, plant and equipment	7,251	7,399
Goodwill	25	27
Other assets	43	43
Noncurrent assets of discontinued operations	-	12
Total	<u>\$ 8,051</u>	<u>8,371</u>
Liabilities and Stockholders' Equity		
Current liabilities		
Current maturities of long-term debt	\$ 2	2
Accounts payable	245	279
Payroll and employee benefits	196	219
Accrued operating taxes	86	78
Deferred revenue	175	184
Accrued interest	139	58
Other current liabilities	52	42
Current liabilities of discontinued operations	-	34
Total current liabilities	895	896
Noncurrent liabilities		
Long-term debt	5,288	5,743
Deferred income taxes	872	793
Benefit plan obligations	1,332	1,341
Other noncurrent liabilities	191	206
Total noncurrent liabilities	7,683	8,083
Stockholders' equity		
Preferred stock, \$.01 par value; 200 shares authorized; no shares issued	-	-
Common stock, \$.01 par value; 1,250 shares authorized; 154.6 and 154.2 shares issued; 142.8 and 142.4		
shares outstanding	2	2
Paid-in capital	(193)	(193)
Retained earnings	1,062	986
Accumulated other comprehensive loss	(898)	(903)
Treasury stock, 11.8 shares held in treasury	(500)	(500)

Total stockholders' equity	(527)	(608)
Total	<u>\$ 8,051</u>	<u>8,371</u>

See accompanying Condensed Notes to Consolidated Financial Statements (Unaudited)

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

	Year to Date March 31,	
	2009	2008
Net Operating Revenues	\$ 1,346	\$ 1,456
Operating Expenses		
Cost of services and products	363	422
Selling, general and administrative	329	348
Depreciation	244	250
Total operating expenses	936	1,020
Operating Income	410	436
Interest expense	(96)	(104)
Other income (expense), net	1	1
Income From Continuing Operations Before Income Taxes	315	333
Income tax expense	(115)	(119)
Income From Continuing Operations	200	214
Loss from discontinued operations (net of income taxes)	(2)	(2)
Loss on sale of discontinued operations (net of income taxes)	(24)	-
Net Income	\$ 174	\$ 212
Amortization (net of income taxes) of:		
Employee benefit plans prior service cost and actuarial losses	6	1
Cash flow derivative	(1)	(1)
Comprehensive Income, Net of Income Taxes	<u>\$ 179</u>	<u>\$ 212</u>
Basic Earnings per Common Share		
Continuing operations	\$ 1.40	\$ 1.39
Discontinued operations	(0.18)	(0.01)
Total	<u>\$ 1.22</u>	<u>\$ 1.38</u>
Diluted Earnings per Common Share		
Continuing operations	\$ 1.39	\$ 1.38
Discontinued operations	(0.18)	(0.01)
Total	<u>\$ 1.21</u>	<u>\$ 1.37</u>
Weighted Average Common Shares Outstanding		
Basic	143.2	153.8
Potentially dilutive shares under equity incentive plans	0.3	0.5
Diluted	<u>143.5</u>	<u>154.3</u>

See accompanying Condensed Notes to Consolidated Financial Statements (Unaudited)

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

	Year to Date March 31,	
	2009	2008
<i>Operating Activities</i>		
Net income	\$ 174	\$ 212
Adjustments to reconcile net income to net cash provided by operating activities:		
Loss from operations and sale of discontinued operations	26	2
Depreciation	244	250
Provision for losses on accounts receivable	22	21
Deferred and noncurrent income taxes	79	(20)
Stock-based compensation expense	6	9
Other, net	12	11
Changes in assets and liabilities:		
Accounts receivable	28	18
Materials and supplies and other current assets	(3)	(21)
Accounts payable and other current liabilities	60	131
Noncurrent assets and liabilities, net	(14)	(26)
Net cash provided by operating activities - continuing operations	634	587
Discontinued operations	-	6
Net cash provided by operating activities	634	593
<i>Investing Activities</i>		
Capital expenditures	(108)	(179)
Proceeds from construction reimbursements	3	2
Proceeds from sales of assets	7	2
Proceeds from sale of discontinued operations	12	-
Net cash used by investing activities	(86)	(175)
<i>Financing Activities</i>		
Principal payments on long-term debt	(80)	-
Borrowings under revolving credit facility	-	230
Repayments under revolving credit facility	(375)	(435)
Proceeds from common stock issued	1	4
Repurchase of common stock	-	(115)
Dividends paid to stockholders	(100)	(107)
Tax effects of stock-based compensation	(1)	(3)
Other, net	(5)	(9)
Net cash used by financing activities	(560)	(435)
<i>Increase (Decrease) in Cash and Equivalents</i>	(12)	(17)
<i>Cash and Equivalents at Beginning of Period</i>	107	69
<i>Cash and Equivalents at End of Period</i>	\$ 95	\$ 52

See accompanying Condensed Notes to Consolidated Financial Statements (Unaudited)

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

					Accumulated Other Comprehensive	Treasury	Total
	Preferred Stock	Common Stock	Paid-in Capital	Retained Earnings	Loss	Stock	Stockholders' Equity
January 1, 2009 Balance	\$ -	\$ 2	\$ (193)	\$ 986	\$ (903)	\$ (500)	\$ (608)
Net income	-	-	-	174	-	-	174
Dividends to shareholders (\$0.6875 per share)	-	-	-	(98)	-	-	(98)
Common stock issued	-	-	1	-	-	-	1
Stock-based compensation expense	-	-	6	-	-	-	6
Tax effects of stock-based compensation	-	-	(1)	-	-	-	(1)
Restricted stock units surrendered for tax withholding	-	-	(6)	-	-	-	(6)
Amortization (net of income taxes) of:							
Employee benefit plans prior service cost and							
actuarial losses	-	-	-	-	6	-	6
Cash flow derivative	-	-	-	-	(1)	-	(1)
March 31, 2009 Balance	<u>\$ -</u>	<u>\$ 2</u>	<u>\$ (193)</u>	<u>\$ 1,062</u>	<u>\$ (898)</u>	<u>\$ (500)</u>	<u>\$ (527)</u>

See accompanying Condensed Notes to Consolidated Financial Statements (Unaudited)

EMBARQ CORPORATION

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

This information 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 consolidated financial statements for the three years ended December 31, 2008. Operating results for the 2009 year to date period do not necessarily represent the results that may be expected for the year ending December 31, 2009.

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, Embarq was established as a separate, stand-alone company upon its operations being spun off from Sprint Nextel.

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 wholesale access to its local network and other communications services primarily to wireline and wireless service providers.

As of March 31, 2009, Embarq had approximately 15 thousand active employees. Approximately 35% of these employees were represented by unions subject to collective bargaining agreements. Of the union-represented employees, approximately 21% have collective bargaining agreements that will expire within one year. There were no material changes related to any collective bargaining agreements during the year to date period ended March 31, 2009.

Sale of Logistics Business

On March 12, 2009, Embarq completed the sale of its wholly owned subsidiary, Embarq Logistics, Inc., pursuant to an agreement previously entered into on January 29, 2009. Consequently, the financial results of Embarq Logistics' third party wholesale distribution operations, which previously comprised the Logistics business segment, are now reported as discontinued operations for all periods presented pursuant to Statement of Financial Accounting Standards (SFAS) No. 144, *Accounting for Impairment or Disposal of Long Lived Assets*. See Note 2, Discontinued Operations, for additional information.

A commercial agreement was also completed whereby the buyer will provide certain logistics and supply chain services to Embarq's telecommunications operations. While there is no minimum purchase obligation associated with this agreement, Embarq agreed to continue to purchase certain products and services exclusively from the buyer. Based on Embarq's requirements in the 2008 fourth quarter, costs over the four-year term of this agreement may approximate \$450 million.

Pending Merger with CenturyTel

On October 26, 2008, Embarq and CenturyTel Inc. (CenturyTel), a Louisiana corporation, entered into a merger agreement whereby a wholly owned subsidiary of CenturyTel, will merge with and into Embarq. As a result of the merger, Embarq will continue as a wholly owned subsidiary of CenturyTel. At the effective date of the merger, each share of Embarq's common stock, par value \$0.01 per share, will be converted into the right to receive 1.37 shares of CenturyTel common stock, par value \$1.00 per share, plus cash in lieu of fractional shares. It is expected that the merger will qualify as a tax-free reorganization for U.S. Federal income tax purposes. In conjunction with this transaction,

Embarq may incur additional costs including, but not limited to potential asset impairments; employee retention and severance costs; and other merger and integration costs.

On January 23, 2009, Embarq entered into an amendment to modify its existing credit agreement, which will only become effective upon consummation of the merger with CenturyTel and the satisfaction of other customary conditions. Among other matters, the amendment would cause the credit agreement to remain in place after consummation of the merger; reduce the size of the revolving credit facility to \$800 million from \$1.5 billion (and the sub-limit for letters of credit to \$100 million from \$200 million); and require repayment in full of the outstanding term borrowings of \$280 million as of March 31, 2009 on or before the closing date of the merger. See Note 10, Subsequent Events, for additional information.

On January 27, 2009, the Embarq and CenturyTel shareholders approved the matters required to complete the transaction as proposed in the merger agreement. Completion of the merger is now subject to approval by the Federal Communications Commission (FCC) and various state regulatory agencies as well as other customary closing conditions, and is expected to occur during the 2009 second quarter.

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.

Change in Reported Business Segments

As a result of the sale of Embarq Logistics, Embarq's continuing operations are now comprised solely of its telecommunications business. Accordingly, information about this business is now represented by Embarq's consolidated financial position and results from continuing operations.

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 was as follows:

	Year to Date March 31,	
	2009	2008
	<i>(millions)</i>	
Federal and state USF surcharges	\$ 18	\$ 21

Depreciation Rate Adjustments

On an annual basis, Embarq performs an analysis of the remaining life depreciation rates. Depreciation rates were adjusted principally for packet switching equipment in 2009 and for digital switching equipment, digital loop carrier equipment and high-speed Internet equipment in 2008, which resulted in depreciation expense being reduced by the following:

	Year to Date March 31,	
	2009	2008
Depreciation expense reduction (millions)	\$ 7	\$ 12
Basic and diluted earning per common share increase	0.03	0.05

Adoption of New Accounting Pronouncements

Financial Accounting Standards Board Staff Position (FSP) Emerging Issues Task Force (EITF), 03-6-1, *Determining Whether Instruments Granted in Share-based Payment Transactions are Participating Securities* - On January 1, 2009, Embarq adopted this standard, which 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 basic earnings per share. As required by this statement, prior period earnings per share and weighted average common shares outstanding were adjusted to conform to the provisions of this standard.

The impact to basic and diluted earnings per share and weighted average common shares outstanding was as follows:

	Year to Date Period Ended March 31, 2008		
	As Adjusted	Previously Reported	Difference
Total Earnings per Common Share			
Basic	\$ 1.38	\$ 1.39	\$ (0.01)
Diluted	1.37	1.38	(0.01)
Weighted Average Common Shares Outstanding			
Basic (millions)	153.8	152.7	1.1
Diluted (millions)	154.3	154.1	0.2

FSP SFAS No. 132(R)-1, *Employers Disclosures about Postretirement Benefit Plan Assets* - On January 1, 2009, Embarq adopted this standard, which expands the disclosures required by SFAS No. 132(R), *Employers' Disclosures about Pensions and Other Postretirement Benefits*, to discuss the assumptions and risks used to compute fair value of each category of plan assets. As Embarq uses a year end measurement date to value plan assets, all disclosures required by this standard will initially be adopted as of December 31, 2009.

SFAS No. 141(R), *Business Combinations* - On January 1, 2009, Embarq adopted this standard, which maintains the fundamental guidance provided under SFAS No. 141, *Business Combinations*, but requires the acquirer to recognize all acquired assets and liabilities, including goodwill, at fair value at the acquisition date as opposed to the announcement date. In addition, the standard requires most transaction related costs to be expensed as incurred as well as provides expanded disclosure requirements for such transactions in the financial statements. Prior to completion of the pending merger with CenturyTel, Embarq does not expect the adoption of this standard to have a material impact on its financial position, results of operations or liquidity.

FSP SFAS 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 recognized or disclosed at fair value in the financial statements on a nonrecurring 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 SFAS No. 157-2 did not have a material impact on Embarq's financial position, results of operations or liquidity.

Recently Issued Accounting Pronouncements

FSP SFAS No. 107-1 and Accounting Principles Board (APB) 28-1, *Interim Disclosures about Fair Value of Financial Instruments* - This standard amends SFAS No. 107, *Disclosures about Fair Value of Financial Instruments*, and APB Opinion No. 28, *Interim Financial Reporting*, to require disclosures about the fair value of financial instruments for interim periods as well as in annual financial statements. Although Embarq has historically provided most of these disclosures in its interim financial statements, this standard will be formally adopted for periods ending after June 15, 2009.

FSP SFAS No. 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly* - This standard clarifies the application of SFAS No. 157, *Fair Value Measurements*, when the volume and activity of the asset and liability has significantly decreased and reemphasizes that fair value is the price that would be received to sell an asset or pay a liability in an orderly transaction between market participants at the measurement date. In addition, it requires additional disclosures noting the inputs and valuation techniques used for all assets and liabilities measured at fair value and the major security types for any debt or equity securities. Embarq will adopt this standard for periods ending after June 15, 2009. Embarq does not expect the adoption of this standard will have a material impact on its financial position, results of operations or liquidity.

Note 2. Discontinued Operations

On March 12, 2009, Embarq completed the sale of its wholly owned subsidiary, Embarq Logistics, Inc., in exchange for an initial cash payment and future contingent consideration. As a result of the sale, the financial results of Embarq Logistics' third party wholesale distribution operations, which previously comprised the Logistics business segment, are now reported and disclosed as discontinued operations for all periods presented.

The results of operations reclassified to discontinued operations were as follows:

	Year to Date March 31,	
	2009	2008
	<i>(millions)</i>	
Net operating revenues	\$ 58	\$ 115
Operating expenses	62	117
Loss before income taxes	(4)	(2)
Income tax benefit	2	-
Loss from discontinued operations	<u>\$ (2)</u>	<u>\$ (2)</u>

For the year to date period ended March 31, 2009, the loss on the sale of discontinued operations, including severance and benefit plan curtailments associated with the sale, was \$24 million net of an income tax benefit of \$12 million.

Note 3. 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 Environmental Protection Agency (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 early December 2008, an individual shareholder filed suit in Johnson County Kansas District Court against Embarq, each of its directors and CenturyTel, challenging the pending merger with CenturyTel and alleging that the defendants failed to maximize shareholder value, made misleading proxy statements and obtained personal benefits in the form of positions with the combined company. To avoid the expense and uncertainty of litigation, a settlement in principle has been reached between plaintiff and defendants where additional disclosures regarding the transaction were made in a public filing and a limited amount of legal costs will be reimbursed. A definitive settlement agreement will be executed following confirmatory discovery, and the final settlement must be approved by the court.

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. Defendants include Embarq Corporation, certain of its benefit plans, its Employee Benefits Committee and its plan administrator. Additional defendants include Sprint Nextel and certain of its benefit 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.

Note 4. Debt and Financial Instruments

During the year to date period ended March 31, 2009, Embarq repaid the \$375 million balance outstanding under its revolving credit facility. Additionally, Embarq repaid \$80 million of borrowings outstanding under its term credit facility. See Note 10, Subsequent Events, for additional information.

As of March 31, 2009, Embargo's long-term debt had a carrying value of approximately \$5.3 billion and a fair value of approximately \$4.7 billion. This fair value was computed primarily based on quoted market prices.

Note 5. Income Taxes

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,	
	2009	2008
	<i>(millions)</i>	
Income tax expense at the federal statutory rate	\$ 110	\$ 116
Effect of:		
State income taxes, net of federal income tax effect	6	2
Other, net	(1)	1
Income tax expense	<u>\$ 115</u>	<u>\$ 119</u>
Effective income tax rate	<u>36.5%</u>	<u>35.7%</u>

During the year to date period ended March 31, 2009, Embarq received consent from the Internal Revenue Service to modify its accounting method for income tax purposes related to repairs and maintenance expenditures. This change, which became effective on January 1, 2008, will allow certain costs to be deducted immediately rather than capitalized and depreciated. As a result, approximately \$100 million of income tax liabilities were reclassified from other current liabilities to deferred income taxes in the Consolidated Balance Sheets.

Note 6. Employee Benefit Plans

The components of net periodic benefit cost were as follows:

	Year to Date March 31, 2009		Year to Date March 31, 2008	
	Pension Benefits	Other Post-retirement Benefits	Pension Benefits	Other Post-retirement Benefits
	<i>(millions)</i>			
Service cost	\$ 12	\$ 2	\$ 14	\$ 2
Interest cost	53	4	51	4
Expected return on plan assets	(67)	-	(69)	(1)
Amortization of prior service cost (benefit)	3	(14)	3	(13)
Amortization of actuarial losses	14	3	9	3
Contractual retirement benefits	1	-	-	-
Net cost (benefit)	<u>\$ 16</u>	<u>\$ (5)</u>	<u>\$ 8</u>	<u>\$ (5)</u>

For the year to date period ended March 31, 2009, the assets in the plan's trust declined due to negative market conditions by an additional \$157 million, as compared to December 31, 2008. This decline has not been recognized in the consolidated balance sheet as of March 31, 2009, pursuant to the provisions of SFAS No. 87, *Employers' Accounting for Pensions*. Embarq made no contributions to the plan's trust during the year to date period ended March 31, 2009. See Note 10, Subsequent Events, for additional information.

Note 7. Stock-based Compensation

On February 18, 2009, approximately 0.1 million restricted stock units were granted to executive officers and other executive level employees as a result of performance and market adjustments to unvested awards granted under the 2007 long-term incentive program. These restricted stock units vested on February 22, 2009.

On February 27, 2009, approximately 0.3 million restricted stock units were granted to certain non-executive employees as part of Embarq's 2008 short-term incentive program. These awards are scheduled to vest in full on December 1, 2009. In addition, approximately 0.7 million restricted stock units were granted to executive officers and other executive level employees as part of Embarq's 2009 long-term incentive program. These awards will vest 34% on February 27, 2010, and 33% will vest on February 27, 2011 and 2012. The fair value of each of these awards was \$34.97 per restricted stock unit.

Total compensation expense related to all of the awards noted above was \$33 million, which is expected to be recognized over a weighted average vesting period of 1.6 years. Compensation expense for these awards, as well as remaining unvested awards related to previous grants, will be recognized over a shorter period in the event of a change in control related to the pending merger with CenturyTel.

Note 8. Business Segment Information

Embarq provides a suite of integrated communications services to consumer and business customers primarily in local service territories in 18 states. Embarq also provides wholesale access to its local network and other communications services primarily to wireline and wireless service providers. As a result of the sale of Embarq Logistics in March 2009, Embarq's continuing operations are now comprised solely of its telecommunications business.

Embarq's net operating revenues for its services and products were as follows:

	Year to Date March 31,	
	2009	2008
	<i>(millions)</i>	
Voice	\$ 916	\$ 1,024
Data	203	198
High-speed Internet	143	133
Other	84	101
Total net operating revenues	<u>\$ 1,346</u>	<u>\$ 1,456</u>

Voice revenues are principally derived from local and long distance services, switched access charges and USF receipts. Data revenues are principally derived from various data protocol and special access services. Other revenues include professional services, intelligent network database services, billing and collection services, sales agency commissions and sales of customer premise equipment.

Note 9. 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,	
	2009	2008
	(millions)	
Supplemental Cash Flow Information		
Cash paid for interest, net of amounts capitalized	\$ 16	\$ 25
Cash paid (refunded) for income taxes	(7)	4
Non-Cash Activities		
Capital expenditure accrual	\$ (8)	\$ (14)
Pending settlement of repurchases of common stock	-	20

Note 10. Subsequent Events Through May 7, 2009

Pension Trust Contribution

During April 2009, Embarq made a discretionary contribution of \$15 million to its pension plan's trust. Embarq continues to expect total contributions in 2009 to approximate \$150 million.

Term Loan Repayment

In April 2009, Embarq repaid in full the remaining \$280 million balance under its term credit facility, which satisfies the repayment requirement under the January 23, 2009, credit agreement amendment related to the pending merger with CenturyTel.

Dividend Declaration

On May 6, 2009, Embarq announced that its board of directors declared a dividend of \$0.6875 per share payable June 30, 2009 to stockholders of record on June 16, 2009. Payment of this dividend will only occur if the pending merger with CenturyTel has not been consummated by the June 16, 2009 record date.

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
Embarq Corporation:

We have audited the accompanying consolidated balance sheets of Embarq Corporation and subsidiaries (the Company) as of December 31, 2008 and 2007, and the related consolidated statements of operations and comprehensive income (loss), stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2008. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Embarq Corporation and subsidiaries as of December 31, 2008 and 2007, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2008, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1A to the consolidated financial statements, the Company adopted the provisions of Statement of Financial Accounting Standards No. 157, *Fair Value Measurements*, for its financial assets and liabilities as of January 1, 2008. Also, as discussed in Notes 1A and 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. Lastly, 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.

/s/ KPMG LLP

Kansas City, Missouri

February 12, 2009, except for
Note 1B, as to which the date
is June 17, 2009

EMBARQ CORPORATION
CONSOLIDATED BALANCE SHEETS

(millions, except per share data)

	As of December 31,	
	2008	2007
Assets		
Current assets		
Cash and equivalents	\$ 107	\$ 69
Accounts receivable, net of allowance for doubtful accounts of \$54 and \$58	494	582
Materials and supplies	52	73
Deferred tax assets	89	76
Prepaid expenses and other current assets	81	84
Current assets of discontinued operations	67	102
Total current assets	890	986
Gross property, plant and equipment	20,946	20,667
Accumulated depreciation	(13,547)	(12,933)
Net property, plant and equipment	7,399	7,734
Goodwill	27	27
Prepaid pension asset	-	108
Other assets	43	31
Noncurrent assets of discontinued operations	12	15
Total	\$ 8,371	\$ 8,901
Liabilities and Stockholders' Equity		
Current liabilities		
Current maturities of long-term debt	\$ 2	\$ 99
Accounts payable	279	343
Payroll and employee benefits	219	274
Accrued income taxes	-	27
Accrued operating taxes	78	97
Deferred revenue	184	202
Accrued interest	58	56
Other current liabilities	42	46
Current liabilities of discontinued operations	34	54
Total current liabilities	896	1,198
Noncurrent liabilities		
Long-term debt	5,743	5,779
Deferred income taxes	793	1,130
Benefit plan obligations	1,341	320
Other noncurrent liabilities	206	210
Total noncurrent liabilities	8,083	7,439
Stockholders' equity		
Preferred stock, \$.01 par value; 200 shares authorized; no shares issued and outstanding	-	-
Common stock, \$.01 par value; 1,250 shares authorized; 154.2 and 153.1 shares issued; 142.4 and 153.1 shares outstanding	2	2
Paid-in capital	(193)	(231)
Retained earnings	986	623
Accumulated other comprehensive income (loss)	(903)	(130)
Treasury stock, 11.8 and no shares held in treasury	(500)	-

Total stockholders' equity	(608)	264
Total	<u>\$ 8,371</u>	<u>\$ 8,901</u>

See accompanying Notes to Consolidated Financial Statements.

EMBARQ CORPORATION**CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)***(millions, except per share data)*

	For the Years Ended December 31,		
	2008	2007	2006
Net Operating Revenues	\$ 5,689	\$ 5,899	\$ 5,833
Operating Expenses			
Cost of services and products	1,656	1,778	1,709
Selling, general and administrative	1,394	1,567	1,548
Depreciation	1,000	1,048	1,016
Total operating expenses	4,050	4,393	4,273
Operating Income	1,639	1,506	1,560
Interest expense	(404)	(432)	(324)
Other income (expense), net	3	2	15
Income From Continuing Operations Before Income Taxes	1,238	1,076	1,251
Income tax expense	(464)	(391)	(456)
Income From Continuing Operations	774	685	795
Loss from discontinued operations (net of income taxes)	(5)	(2)	(11)
Net Income	\$ 769	\$ 683	\$ 784
Remeasurements of and amendments to employee benefit plans (net of income taxes)	(773)	232	-
Amortization of employee benefit plans prior service cost and actuarial losses (net of income taxes)	3	5	-
Unrealized holding gains on cash flow derivatives (net of income taxes)	-	-	39
Amortization of cash flow derivatives (net of income taxes)	(3)	(4)	(1)
Comprehensive Income (Loss), Net of Income Taxes	\$ (4)	\$ 916	\$ 822
Basic Earnings per Common Share			(Pro forma)
Continuing operations	\$ 5.30	\$ 4.51	\$ 5.33
Discontinued operations	(0.03)	(0.01)	(0.07)
Total	\$ 5.27	\$ 4.50	\$ 5.26
Diluted Earnings per Common Share			
Continuing operations	\$ 5.25	\$ 4.45	\$ 5.28
Discontinued operations	(0.03)	(0.01)	(0.07)
Total	\$ 5.22	\$ 4.44	\$ 5.21
Weighted Average Common Shares Outstanding			
Basic	146.0	151.9	149.2
Potentially dilutive shares under equity incentive plans	1.4	2.0	1.2
Diluted	147.4	153.9	150.4

See accompanying Notes to Consolidated Financial Statements.

EMBARQ CORPORATION**CONSOLIDATED STATEMENTS OF CASH FLOWS**

(millions)

	For the Years Ended December 31,		
	2008	2007	2006
Operating Activities			
Net income	\$ 769	\$ 683	\$ 784
Adjustments to reconcile net income to net cash provided by operating activities:			
Loss from discontinued operations	5	2	11
Depreciation	1,000	1,048	1,016
Provision for losses on accounts receivable	101	95	54
Deferred and noncurrent income taxes	103	(50)	(64)
Stock-based compensation expense	47	50	31
Net losses (gains) on sales of assets	(9)	(7)	(17)
Other, net	53	45	39
Changes in assets and liabilities:			
Accounts receivable	(13)	(94)	(57)
Materials, supplies and other current assets	(24)	(31)	33
Accounts payable and other current liabilities	(168)	(86)	241
Noncurrent assets and liabilities, net	(129)	(78)	(26)
Net cash provided by operating activities – continuing operations	1,735	1,577	2,045
Discontinued operations	13	47	8
Net cash provided by operating activities	1,748	1,624	2,053
Investing Activities			
Capital expenditures	(686)	(829)	(923)
Proceeds from construction reimbursements	11	10	10
Proceeds from sales of assets	11	25	33
Net cash used by investing activities	(664)	(794)	(880)
Financing Activities			
Issuance of long-term debt	-	-	1,600
Principal payments on long-term debt	(99)	(787)	(492)
Borrowings under revolving credit agreement	1,150	1,430	920
Repayments under revolving credit agreement	(1,185)	(1,220)	(720)
Net cash paid to Sprint Nextel associated with the spin-off	-	-	(2,208)
Proceeds from common stock issued	14	116	20
Repurchase of common stock	(500)	(2)	-
Dividends paid to stockholders	(404)	(367)	(150)
Dividends paid to Sprint Nextel	-	-	(194)
Tax effects of stock-based compensation	(1)	25	2
Other, net	(21)	(9)	(1)
Net cash used by financing activities	(1,046)	(814)	(1,223)
Increase (Decrease) in Cash and Equivalents	38	16	(50)
Cash and Equivalents at Beginning of Period	69	53	103
Cash and Equivalents at End of Period	\$ 107	\$ 69	\$ 53

See accompanying Notes to Consolidated Financial Statements.

EMBARQ CORPORATION
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(millions, except per share data)

	Accumulated Other							Total
	Preferred Stock	Common Stock	Paid-in Capital	Retained Earnings	Comprehensive Income (Loss)	Business Equity	Treasury Stock	Stockholders' Equity
January 1, 2006 balance	-	-	-	-	(525)	5,377	-	4,852
Net income	-	-	-	-	-	326	-	326
Dividends paid to Sprint Nextel	-	-	-	-	-	(194)	-	(194)
Cash flow derivatives, net of tax	-	-	-	-	39	-	-	39
Net transfer to Sprint Nextel	-	1	(467)	-	516	(5,509)	-	(5,459)
May 17, 2006 balance	-	1	(467)	-	30	-	-	(436)
Net income	-	-	-	458	-	-	-	458
Dividends paid to shareholders (\$1.00 per share)	-	-	-	(150)	-	-	-	(150)
Common stock issued	-	-	20	-	-	-	-	20
Stock-based compensation expense	-	-	31	-	-	-	-	31
Tax effect of stock-based compensation	-	-	2	-	-	-	-	2
Amortization of cash flow derivative (net of tax)	-	-	-	-	(1)	-	-	(1)
Adoption of SFAS No. 158 (net of tax)	-	-	-	-	(392)	-	-	(392)
December 31, 2006 balance	-	1	(414)	308	(363)	-	-	(468)
Cumulative effect of adoption of FIN 48 (net of tax)	-	-	-	1	-	-	-	1
January 1, 2007 Balance	-	1	(414)	309	(363)	-	-	(467)
Net income	-	-	-	683	-	-	-	683
Dividends to shareholders (\$2.375 per share)	-	-	-	(369)	-	-	-	(369)
Common stock issued	-	1	115	-	-	-	-	116
Stock-based compensation expense	-	-	50	-	-	-	-	50
Tax effect of stock-based compensation	-	-	25	-	-	-	-	25
Restricted stock units surrendered for tax withholding	-	-	(10)	-	-	-	-	(10)
Remeasurements of and amendments to employee benefit plans (net of tax)	-	-	-	-	232	-	-	232
Amortization (net of tax) of:								
Employee benefit plans prior service cost and actuarial losses	-	-	-	-	5	-	-	5
Cash flow derivative	-	-	-	-	(4)	-	-	(4)
Repurchase of common stock	-	-	-	-	-	-	(2)	(2)
Issuance of treasury stock	-	-	-	-	-	-	2	2
Other	-	-	3	-	-	-	-	3
December 31, 2007 Balance	\$ -	\$ 2	\$ (231)	\$ 623	\$ (130)	\$ -	\$ -	\$ 264
Net income	-	-	-	769	-	-	-	769
Dividends to shareholders (\$2.75 per share)	-	-	-	(406)	-	-	-	(406)
Common stock issued	-	-	14	-	-	-	-	14
Stock-based compensation expense	-	-	47	-	-	-	-	47

Tax effect of stock-based compensation	-	-	(1)	-	-	-	-	(1)
Restricted stock units surrendered for tax withholding	-	-	(22)	-	-	-	-	(22)
Remeasurement of employee benefit plans (net of tax)	-	-	-	-	(773)	-	-	(773)
Amortization (net of tax) of:								
Employee benefit plans prior service cost and actuarial losses	-	-	-	-	3	-	-	3
Cash flow derivative	-	-	-	-	(3)	-	-	(3)
Repurchase of common stock	-	-	-	-	-	-	(500)	(500)
December 31, 2008 Balance	\$ -	\$ 2	\$ (193)	\$ 986	\$ (903)	\$ -\$	(500)	\$ (608)

Shares Outstanding	2008	2007	2006
Beginning shares outstanding	153.1	149.7	149.1
Stock issued under equity incentive plans	1.1	3.4	0.6
Repurchase of common stock	(11.8)	-	-
Ending shares outstanding	142.4	153.1	149.7

See accompanying Notes to Consolidated Financial Statements.

EMBARQ CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1A. Background, Basis of Presentation and Significant Accounting Policies

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 wholesale access to its local network and other communications services primarily to wireline and wireless service providers.

As of December 31, 2008, Embarq had approximately 16 thousand active employees. Approximately 34% of these employees were represented by unions subject to collective bargaining agreements. Of the union-represented employees, approximately 27% have collective bargaining agreements that will expire during 2009. There were no material changes related to any employee collective bargaining agreements during 2008.

Pending Merger with CenturyTel

On October 26, 2008, Embarq and CenturyTel, a Louisiana corporation, entered into a merger agreement whereby a wholly owned subsidiary of CenturyTel, will merge with and into Embarq. As a result of the merger, Embarq will continue as a wholly owned subsidiary of CenturyTel. Pursuant to the merger agreement, at the effective date of the merger, each share of Embarq's common stock, par value \$0.01 per share, will be converted into the right to receive 1.37 shares of CenturyTel common stock, par value \$1.00 per share, plus cash in lieu of fractional shares. It is expected that the merger will qualify as a tax-free reorganization for U.S. Federal income tax purposes. In conjunction with this transaction, Embarq may incur additional costs prior to closing including, but not limited to potential impairments of duplicate systems and technology; employee retention and severance costs; and other merger and integration costs .

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.

On March 12, 2009, Embarq completed the sale of its wholly owned subsidiary, Embarq Logistics, Inc. Consequently, the financial results of Embarq Logistics' third party wholesale distribution operations, which previously comprised the Logistics business segment, are now reported as discontinued operations for all periods presented pursuant to Statement of Financial Accounting Standards (SFAS) No. 144, *Accounting for Impairment or Disposal of Long Lived Assets* . See Note 1B, Discontinued Operations, for additional information.

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.

Significant Accounting Policies

Cash and Equivalents

Cash and equivalents include cash and highly liquid investments with original maturities of three months or less.

Revenue Recognition

Embarq recognizes revenue in accordance with SAB No. 104, *Revenue Recognition*. Embarq collects fees for fixed rate services, such as local, unlimited long distance, high-speed Internet and certain data services, in advance and defers revenue recognition until these services are provided to the customer. Variable rate billing services, including minute driven long distance, data and access revenue, are billed in arrears. Embarq has multiple billing cycles spread throughout each month resulting in trade accounts receivables and deferred revenue balances at the end of each reporting period . In the event that the variable rate usage data is not available at the end of a reporting period, Embarq will estimate revenue based on historic and other relevant factors.

Revenue for bundled services is allocated to an individual unit of accounting based on the relative fair value of each individual service when it is regularly sold on a stand-alone basis as prescribed by Emerging Issues Task Force (EITF) Issue No. 00-21, *Revenue Arrangements with Multiple Deliverables*. Cash incentives given to customers are recognized as reductions to revenue ratably over the average life of the customer in accordance with EITF 01-9, *Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor's Products)* and other applicable guidance. Service activation and installation fees are deferred and amortized on a straight-line basis over the average life of the customer.

Embarq records revenue from services offered through various wholesale, sales agency and other professional service arrangements on either a gross or net basis in accordance with EITF Issue No. 99-19, *Reporting Revenue Gross as a Principal versus net as an Agent*.

Embarq records federal and state USF surcharges on a gross basis. The total amount of surcharges recorded in net operating revenue was as follows:

	For the Years Ended December 31,		
	2008	2007	2006
	(millions)		
Federal and state USF surcharges	\$ 86	\$ 92	\$ 98

Net operating revenues include certain revenue reserves for billing disputes and errors and returns on product sales. These reserves require management's judgment and are based on many factors including historical trending, contract and tariff interpretations and developments during the resolution process.

Allowance for Doubtful Accounts

Allowance for doubtful accounts represents the estimate of accounts receivable that are deemed to be uncollectible. This allowance typically reflects Embarq's best estimates based on historic credit losses and aged account receivable balances at the end of the reporting period. These estimates are subject to management's judgment based on payment terms, industry norms and recognition of current economic indicators and may be increased to include the entire accounts receivable balance when specific collection risk exists.

Property, Plant and Equipment

Embarq records property, plant and equipment at historical cost. Repair and maintenance costs are expensed as incurred. Embarq capitalizes software in accordance with American Institute of Certified Public Accountants Statement of Position 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*, and EITF Issue No. 97-13, *Accounting for Costs Incurred in Connection with a Consulting Contract or an Internal Project that Combines Business Process Reengineering and Information Technology Transformation*.

Embarq categorizes its property, plant and equipment into three main categories: network assets; buildings and improvements; and administrative and other. Network assets principally consist of metallic cable and wire facilities, fiber optic cable facilities, switching equipment, conduit, poles and other central office equipment. Buildings and improvements principally consist of owned general office facilities and leasehold improvements. Administrative and other assets principally consist of land, furniture, information technology equipment and vehicles.

The costs of homogeneous units of property, plant and equipment are aggregated to form groups of assets that are depreciated on a straight-line basis over the estimated remaining useful life established for each specific group. Estimates and assumptions used in establishing the depreciation rates associated with each group are based on internal studies of use, industry data on lives, recognition of technological advancements and understanding of business strategy. Assumptions are evaluated annually. Generally, changes in depreciation rates are effected through changes in the remaining depreciable lives of the applicable group assets and are considered an accounting estimate in accordance with SFAS No. 154, *Accounting Changes and Error Corrections*.

Ordinary asset retirements are generally charged against accumulated depreciation with no gain or loss recognized. Ordinary asset retirements totaled \$382 million in 2008 and \$493 million in 2007. Embarq recognizes gains and losses on unusual or unanticipated asset

dispositions. See Note 10, Sale of Properties, for additional information.

Embarq's gross property, plant and equipment and associated range of estimated remaining useful lives by category were as follows:

	Range of Estimated Remaining Useful Lives (years)	As of December 31,	
		2008	2007
		(millions)	
Network assets	3 to 35	\$ 19,351	\$ 18,900
Buildings and improvements	5 to 30	1,031	1,031
Administrative and other assets	3 to 15	564	736
Gross property, plant and equipment		<u>\$ 20,946</u>	<u>\$ 20,667</u>

Embarq evaluates property, plant and equipment for impairment whenever indicators of impairment exist. Accounting standards require that if an impairment indicator is present, Embarq must assess whether the carrying amount of the asset is recoverable by estimating the sum of the future undiscounted cash flows, excluding interest costs, expected to result from the asset. If the carrying amount is more than the recoverable amount, an impairment charge must be recognized based on the fair value of the asset. No such impairments occurred during 2008, 2007 or 2006.

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 in each year, which resulted in depreciation expense being reduced by the following:

	For the Years Ended December 31,		
	2008	2007	2006 ⁽¹⁾
Depreciation expense reduction (millions)	\$ 50	\$ 48	\$ 27
Basic and diluted earnings per share	0.21	0.20	0.11

(1) Pro forma earnings per share information. See Note 1A, *Earnings per Common Share*, for additional information.

Goodwill

Embarq accounts for goodwill in accordance with SFAS No. 142, *Goodwill and Other Intangible Assets*. Goodwill represents the excess of the purchase price over the fair value of the net assets acquired in business combinations accounted for as purchases. The book value of goodwill was \$27 million at December 31, 2008 and 2007 with \$12 million related to United Telephone Southeast LLC and \$11 million related to acquisitions completed by Centel, both subsidiaries of Embarq. The remaining \$4 million was related to various other Embarq businesses.

Embarq evaluates goodwill for impairment on an annual basis and whenever events or circumstances indicate goodwill may be impaired. Embarq determines impairment by comparing net assets of the reporting unit to its respective fair value. In the event the unit's net assets exceed its fair value, an implied fair value of goodwill must be determined by assigning the unit's fair value to each asset and liability of the unit. The excess of the fair value of the reporting unit over the amounts assigned to its assets and liabilities is the implied fair value of goodwill. An impairment loss is measured by the difference between the goodwill carrying value and the implied fair value. No such impairments occurred during 2008, 2007 or 2006.

Derivatives

Embarq recognizes derivative instruments as either assets or liabilities in the Consolidated Balance Sheets and measures those instruments at fair value in accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities as Amended*. Changes in the fair value of derivatives are recorded each period in current earnings or other comprehensive income (loss) depending on the use of the derivative and whether it qualifies for hedge accounting.

Embarq uses derivative instruments only for hedging and risk management purposes. Hedging activity may be done for the purpose of mitigating the risks associated with an asset, liability, committed transaction or probable forecasted transaction. Embarq is primarily exposed to the market risk associated with unfavorable movements in interest rates. Embarq does not enter into derivative transactions for speculative or trading purposes.

At inception and on an on-going basis, Embarq assesses whether each derivative that qualifies for hedge accounting continues to be highly effective in offsetting changes in the cash flows of the hedged item. If and when a derivative instrument is no longer expected to be highly effective, hedge accounting is discontinued. Hedge ineffectiveness, if any, is included in current period earnings.

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 negative paid-in capital, will decrease for any losses.

Workforce Actions

Embarq provides severance benefits for involuntarily terminated employees. Such benefits are recorded in accordance with SFAS No. 112, *Employers' Accounting for Postemployment Benefits* . Voluntary offers for separation or other contractual separation benefits are recorded in accordance with SFAS No. 88, *Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination*. Other one-time benefit arrangements or exit costs that are part of an organized restructuring plan are recorded in accordance with SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities* .

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 charges (including \$13 million of contractual early retirement benefits for the year ended December 31, 2008):

	For the Years Ended December 31,		
	2008	2007	2006
	(millions)		
Cost of services and products	\$ 37	\$ 37	\$ 20
Selling, general and administrative	38	40	10
Total severance expense	<u>\$ 75</u>	<u>\$ 77</u>	<u>\$ 30</u>

Legal and Other Contingent Liabilities

Embarq accrues loss contingencies for legal, environmental and other contingent liabilities in accordance with SFAS No. 5, *Accounting for Contingencies* . See Note 3, Commitment and Contingencies, for additional information.

Leases

Embarq accounts for capital and operating leases in accordance with SFAS No. 13, *Accounting for Leases* . See Note 3, Commitments and Contingencies, for additional information.

Advertising

Embarq recognizes advertising expenses as incurred. This includes production, media and other promotional and sponsorship costs. Total advertising expense was as follows:

	For the Years Ended December 31,		
	2008	2007	2006
	(millions)		
Advertising expense	\$ 91	\$ 93	\$ 102

Income Taxes

Embarq accounts for income taxes in accordance with SFAS No. 109, *Accounting for Income Taxes* . Before spin-off, Embarq's

operations were included in the consolidated federal income tax return and certain combined or consolidated state income tax returns of Sprint Nextel. In accordance with Sprint Nextel's tax sharing arrangement, income tax expense was recorded and charged to Embarq on the basis of filing separate returns in each taxing jurisdiction. After spin-off, Embarq was subject to income taxes as a stand alone entity.

As of January 1, 2007, Embarq adopted FIN 48, *Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109*. This interpretation clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes*. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. As prescribed by the interpretation, the cumulative effect of applying these provisions was reported as an adjustment to the opening balance of retained earnings.

Embarq records interest associated with these liabilities as interest expense. Associated penalties are recorded as income tax expense. The total amount of interest and penalties recognized were as follows:

	Interest		Penalties	
	2008	2007	2008	2007
	(millions)			
Recognized in the Consolidated Balance Sheet	\$ 9	\$ 4	\$ -	\$ 2
Recognized in the Consolidated Statement of Operations and Comprehensive Income (Loss)	5	3	(2)	2

Asset Retirement Obligations

Embarq recognizes Asset Retirement Obligations, or ARO, in accordance with SFAS No. 143, *Accounting for Asset Retirement Obligations* and FIN 47, *Accounting for Conditional Asset Retirement Obligations*.

Embarq has recognized an ARO related to the removal and disposal of the asbestos in company buildings, removal and environmental cleanup of fuel storage tanks used in standby power supply systems and decommissioning of leased building spaces. The fair value of the assets legally restricted to settle the ARO and the corresponding liability was as follows:

	As of December 31,	
	2008	2007
	(millions)	
ARO assets	\$ 4	\$ 4
ARO liability	34	32

In addition, an ARO liability exists, but was not recognized, in situations where Embarq has been granted easements and rights-of-way by the United States government, municipalities and private landowners to route its cable facilities. Most cable facilities are buried, however, some metallic and fiber cable are above-ground on company-owned poles. In addition, Embarq contracts with other utilities to connect cable and wire to their poles. As of December 31, 2008, an estimated settlement date for these obligations was indeterminate.

Stock-based Compensation

Effective January 1, 2006, Sprint Nextel adopted SFAS No. 123R, *Share-Based Payment*, utilizing the modified prospective method. The revised standard requires the recognition of compensation cost of unvested share-based awards granted to employees before January 1, 2003, which were outstanding as of January 1, 2006. The allocated impact of the adoption of this standard was immaterial to Embarq because Sprint Nextel had previously accounted for share-based awards in accordance with SFAS No. 123, *Accounting for Stock Compensation*, as amended by SFAS No. 148, *Accounting for Stock Compensation – Transition and Disclosure* as of January 1, 2003, using the prospective method. Following the spin-off, Embarq implemented the provisions of SFAS No. 123R related to the options, nonvested stock and nonvested stock units held by its employees. As SFAS No. 123R was adopted using the modified prospective method, no retrospective application of net income was required for awards granted prior to January 1, 2003, that were vested in prior years.

Embarq recognizes compensation expense related to share-based awards with graded vesting that only have a service condition on a straight line basis over the requisite service period for the entire award. See Note 7, Stock-Based Compensation, for additional information.

Earnings per Common Share

Embarq calculates basic and diluted earnings per share in accordance with SFAS No. 128, *Earnings per Share*. For purposes of calculating pro forma basic and diluted earnings per share for the year ended December 31, 2006, Embarq assumed that the total common shares issued at spin-off, as well as its related potential dilutive securities, were outstanding for the period from January 1, 2006, through May 17, 2006.

The dilution effect on Embarq’s common stock has been primarily related to outstanding stock options and restricted stock units. The following represents stock options that had an exercise price that was above the average annual market price of Embarq stock and were not included in the computation of diluted earnings per share:

	As of December 31,		
	2008	2007	2006
	(millions)		
Stock options	5.2	2.1	3.3

Adoption of SFAS No. 157

On January 1, 2008, Embarq adopted 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. Embarq does not have financial assets or liabilities that are measured at fair value on a recurring basis. In accordance with Financial Accounting Standards Board Staff Position (FSP) SFAS 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 SFAS No. 157-2 is not expected to have a material impact on Embarq's financial position, results of operations or liquidity.

Recently Issued Accounting Pronouncements

FSP 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 does not expect the adoption of this standard to have a material impact on basic or diluted earnings per share.

FSP SFAS No. 132(R)-1, *Employers Disclosures about Postretirement Benefit Plan Assets* - This standard expands the disclosures required by SFAS No. 132(R), *Employers' Disclosures about Pensions and Other Postretirement Benefits*, to discuss the assumptions and risks used to compute fair value of each category of plan assets. Although early adoption is permitted, Embarq plans to adopt this standard when it becomes effective for fiscal years ending after December 15, 2009. Embarq does not expect the adoption of this standard to have a material impact on the financial position, results of operations or liquidity.

SFAS No. 141(R), *Business Combinations* - This standard maintains the fundamental guidance provided under SFAS No. 141, *Business Combinations*, but requires the acquirer to recognize all acquired assets and liabilities, including goodwill, at fair value at the acquisition date as opposed to the announcement date. In addition, the standard requires all transition related costs to be expensed as incurred as well as provides expanded disclosure requirements for such transactions in the financial statements. This standard is effective for business combinations where the acquisition date is on or after the first annual reporting period beginning after December 15, 2008. Prior to completing the proposed merger with CenturyTel, Embarq does not expect the adoption of this standard to have a material impact on the financial position, results of operations or liquidity.

Note 1B. Discontinued Operations

On March 12, 2009, Embarq completed the sale of its wholly owned subsidiary, Embarq Logistics, Inc., in exchange for an initial cash payment and future contingent consideration. Consequently, the financial results of Embarq Logistics' third party wholesale distribution operations, which previously comprised the Logistics segment, are now reported and disclosed as discontinued operations for all periods presented.

A commercial services agreement was also completed whereby the buyer will provide certain logistics and supply chain services to Embarq's telecommunications operations. While there are no minimum purchase obligations with this agreement, Embarq agreed to continue to purchase certain products and services exclusively from the buyer. Based on Embarq's requirements in the 2008 fourth quarter, costs over the four-year term may approximate \$450 million.

The results of operations presented in discontinued operations were as follows:

	For the Years Ended December 31,		
	2008	2007	2006
	(millions)		
Net operating revenues	\$ 435	\$ 466	\$ 530
Operating expenses	441	468	546
Operating loss	(6)	(2)	(16)
Other income (expense)	-	1	(1)
Loss before income taxes	(6)	(1)	(17)
Income tax benefit (expense)	1	(1)	6
Loss from discontinued operations (net of income taxes)	<u>\$ (5)</u>	<u>\$ (2)</u>	<u>\$ (11)</u>

In the 2009 first quarter, Embarq recognized a loss on the sale of discontinued operations of \$24 million, including severance and benefit plan curtailments associated with the sale and an income tax benefit of \$12 million.

The major classes of assets and liabilities presented in discontinued operations were as follows (in millions):

	As of December 31,	
	2008	2007
Accounts receivable, net of allowance for doubtful accounts of \$3 and \$2	\$ 26	\$ 36
Inventory, net of allowance of \$5 and \$6	41	65
Prepaid expenses and other current assets	-	1
Total current assets of discontinued operations	<u>\$ 67</u>	<u>\$ 102</u>
Gross property, plant and equipment	\$ 135	\$ 135
Accumulated depreciation	(123)	(121)
Other assets	-	1
Total noncurrent assets of discontinued operations	<u>\$ 12</u>	<u>\$ 15</u>
Accounts payable	\$ 29	\$ 45
Payroll and employee benefits	3	4
Other current liabilities	2	5
Total current liabilities of discontinued operations	<u>\$ 34</u>	<u>\$ 54</u>

Note 2. Spin-off from Sprint Nextel

In December 2004, Sprint Nextel announced its intention to spin-off its local communications business and product distribution operations from its other businesses in a tax-free transaction. On May 17, 2006, the date of the spin-off, in exchange for, and as a condition to, the transfer of assets and the assumption of liabilities described below, Embarq (1) issued to Sprint Nextel 149.1 million shares of company common stock and (2) issued to Sprint Nextel \$4.5 billion of Embarq senior notes and (3) transferred to Sprint Nextel \$2.1 billion in cash. In exchange for, and contemporaneously with, the issuance of Embarq's common stock and transfer of debt and cash, Sprint Nextel transferred the Embarq assets, consisting of Sprint Nextel's local communications operations, wholesale product distribution operations and consumer and certain business long distance customers located in its local service territories; and Embarq assumed certain liabilities related to its business. The spin-off was completed through a pro rata distribution to Sprint Nextel shareholders consisting of one share of Embarq common stock for every 20 shares of Sprint Nextel voting and non-voting shares owned by Sprint Nextel's shareholders as of the close of business on May 8, 2006, the record date for the distribution.

The impacts of the spin-off have been reflected in the consolidated financial statements for periods after the spin-off. Accordingly, the revenues and related expenses from the transferred long distance customers and the interest expense associated with the spin-related borrowings are reflected only in periods after the spin-off. Additionally, while management believes these consolidated financial statements include all historical costs; periods before the spin-off do not include all the expenses that would have been incurred had Embarq been a separate, stand-alone entity. Thus, Embarq's results of operations and cash flows before the spin-off are not fully comparable to those after the spin-off.

Relationship with Sprint Nextel

Before the spin-off, Embarq provided to and received from Sprint Nextel a variety of services that were considered related party transactions. Services provided to Sprint Nextel that make up related party revenues, which was \$138 million in 2006 before the spin-off, included, but were not limited to, voice, access, data and sale of telecommunications equipment, as well as billing and collection and lease of network facilities. Services Sprint Nextel provided to Embarq included charges for facilities, information services, marketing and certain corporate and administrative services. Sprint Nextel directly assigned, where possible, related costs based on Embarq's use of these services. Where direct assignment was not possible, or practical, Sprint Nextel used indirect methods, including time studies and headcounts, to allocate shared service costs to Embarq. The services provided by Sprint Nextel were generally accounted for based on fully distributed costs, which Embarq believes approximated fair value. Embarq recognized a total of \$488 million in expenses related to these services in 2006 before the spin-off.

In connection with Embarq's spin-off, Embarq entered into certain agreements with Sprint Nextel. The key terms of the principal agreements that continue to be operative are summarized below:

Tax Sharing Agreement. In connection with the spin-off, Embarq entered into a tax sharing agreement with Sprint Nextel. The tax sharing agreement covers, among other things, Embarq's and Sprint Nextel's rights and obligations with respect to taxes for both the pre- and post-spin-off periods. As of December 31, 2008, settlement of the parties' rights and obligations relating to certain pre-spin-off periods is still pending. Embarq has reflected the estimated amounts that may be due from or to Sprint Nextel, pursuant to this agreement in the Consolidated Balance Sheets. These estimates are based on preliminary calculations, which are still subject to further adjustment based on the agreed-upon processes to resolve these matters, including arbitration.

Embarq has an obligation to indemnify Sprint Nextel for taxes resulting from the spin-off if that tax results from (1) an issuance of our equity securities, a redemption of our equity securities or our involvement in other acquisitions of our equity securities, (2) other actions or failures to act by us (such as those described above) or (3) any of our representations or undertakings referred to in the tax sharing agreement being incorrect or violated.

Intellectual Property Agreements. In connection with the spin-off, Embarq entered into a patent agreement, software and proprietary information agreement and a trademark assignment and license agreement with Sprint Nextel. These agreements govern Embarq's relationship with Sprint Nextel with respect to ownership of and use of intellectual property.

Commercial Service Agreements. Embarq and Sprint Nextel entered into commercial service agreements pursuant to which each company obtains services from one another. The principal agreements are described below:

- Embarq entered into a non-exclusive wholesale agreement, which Embarq refers to as the MVNO agreement, with Sprint Nextel. Under this agreement, for a period of 7 years, Embarq is able to resell certain CDMA-based wireless voice and data services in Embarq's local service territories.
- Under a 5 year wholesale master services agreement with Sprint Nextel, which Embarq refers to as the long distance agreement, Embarq has the ability to market and sell its own branded wireline long distance voice and data services to consumer and small business customers. Under this agreement, Embarq must purchase a minimum of 95% of certain categories of its domestic and international long distance voice and data services from Sprint Nextel.

In addition to the MVNO agreement and long distance agreement, Embarq also entered into a sales agency agreement with Sprint Nextel to sell certain Sprint Nextel-branded wireless and wireline voice and data services to business customers. Embarq also entered into agreements with Sprint Nextel where Embarq is providing certain services to Sprint Nextel, including calling name database services, toll free rehome services and special access services.

Note 3. 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, 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 early December 2008, an individual shareholder filed suit in Johnson County Kansas District Court against Embarq, each of its directors and CenturyTel, challenging the proposed merger with CenturyTel and alleging that the defendants failed to maximize shareholder value, made misleading proxy statements, and obtained personal benefits in the form of positions with the combined company. To avoid the expense and uncertainty of litigation, a settlement in principle has been reached between plaintiff and defendants where additional disclosures regarding the transaction were made in a public filing. A definitive settlement agreement will be executed following confirmatory discovery and the final settlement must be approved by the court.

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 6, Employee Benefit Plans, for additional information. 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

Embarq has minimum purchase commitments with various vendors through 2015. These outstanding commitments represent non-cancelable commitments to purchase goods and services, consisting primarily of network maintenance and equipment, information technology services, customer support provided by third parties and other expenses related to normal business operations. Amounts actually paid will likely be higher due to variable components of certain agreements which include hours contracted, subscribers and other factors. As of December 31, 2008, outstanding minimum fixed purchase commitments to be paid in future years were as follows:

	<i>(millions)</i>
2009	\$ 156
2010	70
2011	65
2012	61
2013	39
Thereafter	47

The total amounts of purchase commitments paid that had an original term in excess of one year were as follows:

	For the Years Ended December 31,		
	2008	2007	2006
	<i>(millions)</i>		
Purchase commitments paid	\$ 75	\$ 51	\$ 17

Leases

Embarq leases various equipment, office facilities, retail outlets, switching facilities, and other network sites. These leases, with few exceptions, provide for automatic renewal options and escalations that are either fixed or based on the consumer price index. Any rent abatements, along with rent escalations, are included in the computation of rent expense calculated on a straight-line basis over the lease term. The lease term for most leases includes the initial non-cancelable term plus at least one renewal period, as the exercise of the related renewal option or options is reasonably assured.

Embarq's gross rental expense was as follows:

	For the Years Ended December 31,		
	2008	2007	2006
	<i>(millions)</i>		
Gross rental expense	\$ 136	\$ 125	\$ 110

As of December 31, 2008, our rental commitments for operating leases were as follows:

	<i>(millions)</i>
2009	\$ 31
2010	23
2011	17
2012	11
2013	4
Thereafter	6

Note 4. Long-term Debt and Financial Instruments

The following table summarizes Embarq's long-term debt:

			As of December 31,	
	Interest Rate	Maturing	2008	2007
(millions)				
Senior notes				
Notes due 2013	6.7%	2013	\$ 1,000	\$ 1,000
Notes due 2016	7.1%	2016	2,000	2,000
Notes due 2036	8.0%	2036	1,485	1,485
	1.0% and			
Term credit facility	5.5%	2011	360	360
	1.6% and			
Revolving credit facility	5.4%	2011	375	410
Other	6.8% to 9.8%	2009 to 2025	525	623
Total debt			\$ 5,745	\$ 5,878
Current maturities			(2)	(99)
Total long-term debt			\$ 5,743	\$ 5,779

In connection with the spin-off, Embarq issued senior notes in an aggregate amount of \$4.5 billion. The senior notes will mature in three tranches, with the earliest maturity in 2013. In addition to the senior notes issued, Embarq entered into a credit agreement with certain financial institutions. The credit agreement expires in May 2011 and originally consisted of a \$1.6 billion term facility and a \$1.5 billion revolving credit facility, with a \$200 million sub-limit for letters of credit. The credit agreement provides for interest rates equal to a base rate or London Interbank Offered Rate (LIBOR), plus an applicable margin. The applicable margin is based on Embarq's non-credit enhanced long-term senior unsecured debt rating. The credit agreement includes customary covenants that, among other things, require Embarq to maintain certain financial ratios and restrict its ability to incur additional indebtedness. See Note 12, Subsequent Events, for additional information.

Various subsidiaries of Embarq have outstanding first mortgage bonds or unsecured debentures. This debt is included in "Other" in the above table. Each issue of first mortgage bonds is secured by substantially all of the property, plant and equipment of the issuing subsidiary. In the aggregate, approximately 50% of Embarq's property, plant and equipment is pledged to secure one or more issues of first mortgage bonds. As of December 31, 2008, approximately \$325 million of first mortgage bonds were outstanding.

Embarq was in compliance with all applicable financial covenants associated with Embarq's borrowings. As of December 31, 2008, Embarq had letters of credit issued under the revolving credit facility of approximately \$42 million.

The following table represents scheduled principal payments of Embarq's long-term debt as of December 31, 2008:

		<u>(millions)</u>
2009	\$	2
2010		2
2011		735
2012		-
2013		1,110
Thereafter		3,896

In anticipation of issuing its senior notes at the time of spin-off, Embarq took steps in the 2005 fourth quarter to limit its interest rate risk by entering into cash flow hedge transactions. On May 12, 2006, the hedge instruments entered into in 2005 were terminated. The accumulated other comprehensive income associated with these hedges was \$51 million, or \$30 million net of tax. This amount is being amortized using the effective interest method and reclassified to interest expense as a yield adjustment of the hedged semi-annual interest payment for ten years as follows:

	For the Years Ended December 31,		
	2008	2007	2006
	(millions)		
Reduction in interest expense	\$ 5	\$ 5	\$ 3

At December 31, 2008, Embarq had no outstanding derivatives.

Fair Value of Financial Instruments

The estimated fair value of long-term debt was \$4.5 billion as of December 31, 2008, and \$6.1 billion as of December 31, 2007. These fair values were primarily based on quoted market prices. The carrying value of Embarq's other financial instruments, primarily cash and equivalents, accounts receivable and accounts payable, approximate fair value as of December 31, 2008 and 2007, due to their short-term nature. Embarq has no significant concentrations of credit risk related to its accounts receivable. See Note 6, Employee Benefit Plans, and Note 7, Stock-based Compensation, for additional information related to fair value.

Note 5. Income Taxes

Embarq's income tax expense (benefit) related to continuing operations consisted of the following:

	For the Years Ended December 31,		
	2008	2007	2006
	(millions)		
Current income tax expense			
Federal	\$ 343	\$ 392	\$ 443
State	18	49	77
Total current	361	441	520
Deferred and non-current income tax expense (benefit)			
Federal	85	(19)	(57)
State	18	(31)	(7)
Total deferred and non-current income tax expense (benefit)	103	(50)	(64)
Total	<u>\$ 464</u>	<u>\$ 391</u>	<u>\$ 456</u>

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:

	For the Years Ended December 31,		
	2008	2007	2006
	(millions)		
Income tax expense at the federal statutory rate	\$ 433	\$ 377	\$ 438
Effect of:			
State income taxes, net of federal income tax effect	28	24	46
Nonrecurring federal and state deferred tax adjustments, net	-	(12)	(16)
Other, net	3	2	(12)
Income tax expense	<u>\$ 464</u>	<u>\$ 391</u>	<u>\$ 456</u>
Effective income tax rate	<u>37.4%</u>	<u>36.3%</u>	<u>36.5%</u>

In 2008, Embarq increased its valuation allowance by \$13 million, resulting primarily from the impact of the decline in the value of pension plan assets on the estimated realization of state net operating loss carryforwards. See Note 6, Employee Benefit Plans, for additional

information regarding the decline in the value of pension plan assets. In 2007, Embarq modified its legal entity structure, which resulted in state income tax expense being reduced by \$14 million and a nonrecurring deferred tax adjustment of \$6 million. Also, a favorable state ruling in 2007 resulted in a nonrecurring deferred tax adjustment of \$6 million. In the 2006 fourth quarter, nonrecurring deferred tax adjustments of approximately \$16 million were required to properly reflect Embarq's deferred income tax liabilities. These adjustments related to periods prior to 2006. In addition, other, net in 2006 included \$7 million in favorable deferred tax adjustments stemming from enacted state legislation.

Income tax expense (benefit) allocated to other items, which have been recorded directly in accumulated other comprehensive income (loss), was as follows:

	For the Years Ended December 31,		
	2008	2007	2006
	(millions)		
Remeasurements of and amendments to employee benefit plans	\$ (477)	\$ 150	\$ -
Amortization of employee benefit plans prior service costs and actuarial loss	2	4	-
Additional minimum pension liability	-	-	321
Adoption of SFAS No. 158	-	-	(248)
Unrealized holding gains on cash flow derivatives	-	-	27
Amortization of cash flow derivatives	(1)	(1)	(2)

Embarq recognizes deferred income taxes for the temporary differences between the carrying amounts of its assets and liabilities for financial statement purposes and their tax bases. The sources of the differences that give rise to deferred income tax assets and liabilities, along with the income tax effect of each, were as follows:

	As of December 31,			
	2008		2007	
	Current	Noncurrent	Current	Noncurrent
	(millions)			
Deferred Tax Assets				
Benefit plan obligations	\$ -	\$ 491	\$ -	\$ 79
Accruals and other liabilities	89	12	73	11
Stock based compensation	-	30	-	33
Net operating loss carryforward	-	33	-	35
Intangibles	-	26	-	29
Other, net	-	6	3	16
Total deferred tax assets before valuation allowance	89	598	76	203
Valuation allowance	-	(23)	-	(10)
Total deferred tax assets	89	575	76	193
Deferred Tax Liabilities				
Property, plant and equipment	-	1,368	-	1,323
Total deferred tax liabilities	-	1,368	-	1,323
Current Deferred Tax Asset	\$ 89	\$ -	\$ 76	\$ -
Noncurrent Deferred Tax Liability	\$ -	\$ 793	\$ -	\$ 1,130

In conjunction with the spin-off, Sprint Nextel transferred to Embarq certain assets and liabilities, which resulted in the transfer or establishment of a net deferred tax liability of \$53 million. This amount includes a deferred tax asset of \$268 million related to the transfer from Sprint Nextel of property, plant, and equipment, customer transfers, postretirement obligations and other liabilities, offset by a \$321 million deferred tax liability related to the elimination of the additional minimum pension liability.

As of December 31, 2008, Embarq did not have any federal net operating loss carryforwards. However, Embarq had state net operating loss carryforwards of approximately \$485 million. Related to these loss carryforwards are state tax benefits of \$33 million before consideration of valuation allowance. The loss carryforwards expire in varying amounts through 2028.

Management believes it is more likely than not that these deferred income tax assets, net of the valuation allowance, will be realized based on current income tax laws and expectations of future taxable income stemming from the reversal of existing deferred tax liabilities.

Uncertainties surrounding income tax law changes, shifts in operations between state taxing jurisdictions and future operating income levels may, however, affect the ultimate realization of all or some of these deferred income tax assets. When Embarq evaluated these and other qualitative factors and uncertainties concerning its industry, it was determined that they provide continuing evidence requiring the valuation allowance, which was recognized related to the realization of the tax benefit of the net operating loss carryforwards as of December 31, 2008.

FIN 48

As of January 1, 2007, Embarq adopted FIN 48 by analyzing uncertain tax positions for tax periods prior and subsequent to spin-off. As of December 31, 2008, the total liability for uncertain tax positions was \$89 million. The total amount of unrecognized tax benefit changes during 2008 was as follows:

	<i>(millions)</i>
Unrecognized tax benefits as of January 1, 2008	\$ 340
Increase (decrease) as a result of tax positions taken in prior years	(1)
Increase (decrease) as result of tax positions taken during the current year	(4)
Unrecognized tax benefits as of December 31, 2008	<u>\$ 335</u>

The total amount of unrecognized tax benefits was primarily related to the tax treatment of USF receipts. While the ultimate recognition of USF receipts in taxable income is highly certain, there is uncertainty about the timing and nature of such recognition. As of December 31, 2008, approximately \$38 million represented uncertain tax positions that could result in a potential future obligation. Additionally, approximately \$245 million represents refund claims. Due to the uncertainty of these refund claims, Embarq has not recognized the impact to current or deferred taxes in its consolidated financial statements.

Embarq expects it is reasonably possible the liability for uncertain tax positions related to USF will increase by \$10 million to \$15 million in 2009.

It is reasonably possible that settlements will be made with various tax authorities related to tax positions taken on prior year returns. These positions relate to tax accounting methods. Embarq expects that the negotiated settlement of these matters will result in a \$30 million to \$40 million reduction of the unrecognized tax benefit in 2009.

Additionally, Embarq has unrecognized tax benefits related to various other tax positions that are not individually significant. Embarq believes that it is reasonably possible that these items may be settled during 2009 resulting in a reduction of the unrecognized tax benefit up to \$4 million.

For 2001 and prior years, Embarq is generally no longer subject to examination by U.S. federal, state, and local tax authorities, either as a component of Sprint Nextel's income tax returns or on a stand-alone basis. However, Embarq and the IRS have agreed that Embarq may file amended returns on a specific tax issue relating to years as early as 1990. These amended returns would be subject to IRS examination.

The total amount of unrecognized tax benefit that, if recognized, would impact the effective tax rate was \$23 million for these tax positions.

Note 6. Employee Benefit Plans

Assets and liabilities recognized in the Consolidated Balance Sheets relating to Embarq's various employee benefit plans were as follows:

	As of December 31,	
	2008	2007
	<i>(millions)</i>	
Prepaid pension asset	\$ -	\$ 108
Benefit plan obligations		
Defined benefit pension liability	\$ 1,083	\$ 32

Postretirement benefit liability	222	219
Other benefit obligations	<u>36</u>	<u>69</u>
Total	<u>\$ 1,341</u>	<u>\$ 320</u>

Defined Benefit Pension Plans

Concurrent with the spin-off, Embarq established a noncontributory defined benefit pension plan. Pension benefits for plan participants represented by a collective bargaining agreement are based on negotiated schedules. All other participants' pension benefits are based on each individual participant's years of service and compensation. Embarq also established certain other nonqualified defined benefit plans to provide supplemental benefits to certain executives. Embarq uses a December 31 measurement date for the plans.

Embarq initially measured the plans at May 17, 2006, based on actual plan assets and their respective accrued benefit obligations transferred from Sprint Nextel. Upon the final measurements, an additional \$326 million in pension obligation was transferred to Embarq from Sprint Nextel, which was recognized through paid-in capital.

During the 2008 first quarter, 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 amounts owed to its plan's trust of approximately \$14 million in the 2008 second quarter. For the period before the spin-off, the Embarq plan's trust may receive additional funds from the Sprint Nextel plan's trust related to these transactions. As of February 11, 2009, Sprint Nextel has not confirmed its intentions with respect to the ultimate disposition of the pre-spin-off amount. Accordingly, no amounts have been reflected in the accompanying Consolidated Balance Sheets as of December 31, 2008. The eventual outcome is not expected to have a material adverse effect on Embarq's financial condition, results of operations or liquidity.

The following table presents information related to Embargo's defined benefit pension plans since their initial measurements:

	Projected		Plan	Funded	Unrecognized	Unrecognized	Unamortized	Accumulated
	Benefit	Obligation	Assets	Status	Net Loss ⁽¹⁾	Prior Service	Transition	Other Comp.
(millions)	Expense	Obligation	Assets	Status	Net Loss ⁽¹⁾	Cost ⁽¹⁾	Asset ⁽¹⁾	Income Recognized ⁽¹⁾
May 17, 2006	\$ -	\$ (3,148)	\$ 3,089	\$ (59)	\$ 742	\$ 74	\$ (1)	\$ 815
Service cost	31	(31)	-	(31)	-	-	-	-
Interest cost	121	(121)	-	(121)	-	-	-	-
Expected return on assets	(166)	-	-	-	166	-	-	166
Amortization of actuarial losses	24	-	-	-	(24)	-	-	(24)
Amortization of prior service cost	10	-	-	-	-	(10)	-	(10)
Actuarial losses	-	(84)	-	(84)	84	-	-	84
Plan amendments ⁽²⁾	-	(15)	-	(15)	-	15	-	15
Actual return on assets	-	-	249	249	(249)	-	-	(249)
Benefit payments	-	106	(106)	-	-	-	-	-
Employer contributions	-	-	2	2	-	-	-	-
December 31, 2006 ⁽³⁾	20	(3,293)	3,234	(59)	719	79	(1)	797
Service cost	55	(55)	-	(55)	-	-	-	-
Interest cost	199	(199)	-	(199)	-	-	-	-
Expected return on assets	(263)	-	-	-	263	-	-	263
Amortization of actuarial losses	46	-	-	-	(46)	-	-	(46)
Amortization of prior service cost	16	-	-	-	-	(16)	-	(16)
Actuarial gains	-	10	-	10	(10)	-	-	(10)
Plan amendments ⁽²⁾	-	(12)	-	(12)	-	12	-	12
Actual return on assets	-	-	314	314	(314)	-	-	(314)
Benefit payments	-	207	(207)	-	-	-	-	-
Employer contributions	-	-	77	77	-	-	-	-
December 31, 2007 ⁽⁴⁾	53	(3,342)	3,418	76	612	75	(1)	686
Service cost	53	(53)	-	(53)	-	-	-	-
Interest cost	206	(206)	-	(206)	-	-	-	-
Expected return on assets	(277)	-	-	-	277	-	-	277
Amortization of actuarial losses	35	-	-	-	(35)	-	-	(35)
Amortization of prior service cost	13	-	-	-	-	(13)	-	(13)
Actuarial loss	-	(20)	-	(20)	20	-	-	20
Plan amendments ⁽²⁾	-	(17)	-	(17)	-	17	-	17
Actual return on assets	-	-	(928)	(928)	928	-	-	928
Benefit payments	-	199	(199)	-	-	-	-	-
Contractual retirement benefits ⁽⁵⁾	13	(13)	-	(13)	-	-	-	-
Employer contributions ⁽⁶⁾	-	-	78	78	-	-	-	-

December 31, 2008 ⁽⁷⁾	\$	<u>43</u>	\$	<u>(3,452)</u>	\$	<u>2,369</u>	\$	<u>(1,083)</u>	\$	<u>1,802</u>	\$	<u>79</u>	\$	<u>(1)</u>	\$	<u>1,880</u>
----------------------------------	----	-----------	----	----------------	----	--------------	----	----------------	----	--------------	----	-----------	----	------------	----	--------------

⁽¹⁾ The adoption of SFAS No. 158 on December 31, 2006, required the recognized pension obligation to equal the funded status of the plans as measured by the difference between the projected benefit obligations and the plans asset values. This resulted in an increase in the obligation of \$797 million. In combination with the associated deferred tax impact of \$307 million, this adjustment reduced stockholder’s equity by \$490 million.

⁽²⁾ Plan amendments were a result of collective bargaining agreement renewals, which impacted certain union employee benefit schedules.

⁽³⁾ The accumulated benefit obligation was \$3,179 million at December 31, 2006.

⁽⁴⁾ The accumulated benefit obligation was \$3,228 million at December 31, 2007.

⁽⁵⁾ Additional pension costs related to contractual early retirement benefits for certain participants affected by workforce reductions.

⁽⁶⁾ Total contributions include \$14 million in repayments to the plan’s trusts.

⁽⁷⁾ The accumulated benefit obligation was \$3,356 million at December 31, 2008.

Plan Asset Allocations	Targeted	Actual		Expected Future Benefit Payments	
	2008	2008	2007		(millions)
Equity securities	50% to 65%	52%	57%	2009	\$ 207
Debt securities	15% to 30%	24%	23%	2010	210
Real estate	5% to 15%	11%	10%	2011	215
Other	5% to 15%	13%	10%	2012	222
Total	100%	100%	100%	2013	230
				2014-2018	1,283

Embarq's investment strategy is to maintain a diversified asset portfolio. For 2008, the actual loss in the value of the pension plan's assets was \$928 million. These losses were primarily attributable to 2008 general and economic market conditions affecting the underlying securities.

Contributions to Embarq's defined benefit pension plan are expected to approximate \$150 million in 2009.

Postretirement Benefit Plans

Concurrent with spin-off, Embarq established its own postretirement benefit plans that provide postretirement benefits, principally medical and life insurance, to its eligible former employees. The plans allow eligible employees retiring before certain dates to benefits at no or reduced cost. Employees retiring after certain dates are eligible for benefits on a shared cost basis. Embarq generally funds and expects to continue funding its postretirement obligations as benefits are paid. Embarq uses a December 31 measurement date for the plans.

Embarq initially measured the plans at May 17, 2006, based on actual plan assets and their respective accrued benefit obligations transferred from Sprint Nextel. Upon final measurements, an additional postretirement liability of \$16 million was transferred to Embarq from Sprint Nextel, which was recognized through paid-in capital.

During the 2007 second quarter, 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.

The amendment caused Embarq to remeasure these postretirement benefit plans as of June 30, 2007. The accumulated postretirement benefit obligations were reduced by \$301 million with a corresponding amount of other comprehensive income, net of tax. The reduction in the obligation will be amortized to other postretirement benefit cost over the remaining average life of retirees.

The following table presents information related to the Embarq's postretirement benefit plans since their initial measurements:

	Accumulated Projected Benefit		Plan	Funded	Unrecognized	Unrecognized Prior Service	Unamortized Transition	Accumulated Other Comp. Income Recognized
(millions)	Expense	Obligation	Assets	Status	Net Loss ⁽¹⁾	Cost ⁽¹⁾	Asset ⁽¹⁾	⁽¹⁾
May 17, 2006	\$ -	\$ (601)	\$ 43	\$ (558)	\$ 173	\$ (350)	\$ (6)	\$ (183)
Service cost	5	(5)	-	(5)	-	-	-	-
Interest cost	23	(23)	-	(23)	-	-	-	-
Expected return on assets	(2)	-	-	-	2	-	-	2
Amortization of actuarial losses	11	-	-	-	(11)	-	-	(11)
Amortization of prior service cost	(37)	-	-	-	-	37	-	37
Employer contributions	-	-	27	27	-	-	-	-
Benefit payments	-	28	(28)	-	-	-	-	-
Actual return on assets	-	-	4	4	(4)	-	-	(4)
Actuarial gains or losses	-	(2)	-	(2)	2	-	-	2
December 31, 2006	-	(603)	46	(557)	162	(313)	(6)	(157)
Service cost	8	(8)	-	(8)	-	-	-	-
Interest cost	26	(26)	-	(26)	-	-	-	-
Expected return on assets	(3)	-	-	-	3	-	-	3
Amortization of prior service cost	(68)	-	-	-	-	68	-	68
Amortization of actuarial losses	15	-	-	-	(15)	-	-	(15)
Amortization of transition asset	(1)	-	-	-	-	-	1	1
Employer contributions	-	-	37	37	-	-	-	-
Benefit payments	-	39	(39)	-	-	-	-	-
Plan amendments	-	301	-	301	-	(301)	-	(301)
Actual return on assets	-	-	3	3	(3)	-	-	(3)
Actuarial gains or losses	-	31	-	31	(31)	-	-	(31)
December 31, 2007	\$ (23)	\$ (266)	\$ 47	\$ (219)	\$ 116	\$ (546)	\$ (5)	\$ (435)
Service cost	8	(8)	-	(8)	-	-	-	-
Interest cost	16	(16)	-	(16)	-	-	-	-
Expected return on assets	(3)	-	-	-	3	-	-	3
Amortization of prior service cost	(53)	-	-	-	-	53	-	53
Amortization of actuarial losses	13	-	-	-	(13)	-	-	(13)
Amortization of transition asset	(1)	-	-	-	-	-	1	1
Employer contributions	-	-	26	26	-	-	-	-
Benefit payments	-	28	(28)	-	-	-	-	-
Plan amendments	-	13	-	13	-	(13)	-	(13)
Actual return on assets	-	-	(13)	(13)	13	-	-	13
Actuarial gains or losses	-	(5)	-	(5)	5	-	-	5

December 31, 2008	\$	(20)	\$	(254)	\$	32	\$	(222)	\$	124	\$	(506)	\$	(4)	\$	(386)
-------------------	----	------	----	-------	----	----	----	-------	----	-----	----	-------	----	-----	----	-------

⁽¹⁾The adoption of SFAS No. 158 as of December 31, 2006, required the recognized post-retirement benefit obligation to equal the funded status of the plans as measured by the difference between the accumulated projected benefit obligation and the plan asset value. This resulted in a decrease in the obligation of \$157 million. In combination with the associated deferred tax impact of \$59 million, this adjustment increased stockholder’s equity by \$98 million.

Plan Asset Allocations	Actual		Expected Future Benefit Payments	
	2008	2007		(millions)
Equity securities	55%	67%	2009	\$ 31
Debt securities	45%	33%	2010	30
Total	100%	100%	2011	28
			2012	26
			2013	25
			2014-2018	120

Embarq is expecting to contribute approximately \$30 million to their postretirement benefit plans in 2009.

Assumptions and Other Information

Accounting for long term obligations such as defined benefit pension and postretirement benefit obligations requires the use of the following assumptions:

- Discount rate based on a hypothetical portfolio of bonds rated AA- or better that produce a cash flow matching the projected benefit payments of the plans.
- Expected rate of future pay raises based on a weighted-average of past experience and industry peer group survey data.
- Expected long-term return on plan assets determined by considering both historical and forward-looking estimates of the expected long-term returns for a portfolio invested according to the pension trust's target investment policy. These estimates were developed using independent data and were corroborated by comparison to benchmarks.
- Health care cost increases and assumed health care cost trends based on a review of surveys of employers' expectations of medical cost increases and a spot survey of the retiree medical inflation assumptions expected to be used by other plan sponsors.

The following weighted average assumptions were used to determine the benefit obligation and net benefit costs related to the defined benefit pension plans and postretirement benefit plans:

<i>Benefit Obligation Assumptions</i>	2008	2007
Discount rate	6.4%	6.3%
Rate of compensation increase	3.5%	4.0%
Health care cost increases in the following year	8.0%	7.9%

<i>Net Benefit Cost Assumptions</i>	2008	2007
Discount rate ⁽¹⁾	6.3%	6.1%
Rate of compensation increase	4.0%	4.0%
Long-term expected return on plan assets	8.5%	8.5%
Health care cost increases in the current year	7.9%	8.6%

(1) The June 30, 2007 remeasurement of the other postretirement benefit expense used a discount rate of 6.4%

The ultimate assumed health care trend rate used in calculating the 2008 and 2007 net benefit costs and the 2007 benefit obligation was 5% and is expected to be reached in 2012. The rate used in calculating the 2008 benefit obligation is 5% and is expected to be reached in 2017.

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A 100 basis point change in assumed health care cost trend rates would have the following effects:

	2008	2007
Health Care Cost Trend Rate Sensitivity:	(millions)	
Effect on service and interest cost - 100 basis point increase	\$ -	\$ 1
Effect on service and interest cost - 100 basis point decrease	-	(1)
Effect on APBO - 100 basis point increase	4	4
Effect on APBO - 100 basis point decrease	(4)	(4)

Subsequent to the adoption of SFAS No. 158, the amount recognized in accumulated other comprehensive loss related to Embarq's defined benefit pension plans and postretirement benefit plans was equivalent to the unrecognized net loss, unrecognized prior service cost (credit) and the unamortized transition asset for each respective plan as of December 31, 2008. The total amount of amortization related to these items that are expected to be recognized into net periodic benefit cost in 2009 is as follows:

	Defined Benefit Pension Plan	Postretirement Benefits
	(millions)	
Amortization of net losses	\$ 54	\$ 12
Amortization of prior service cost (credit)	13	(53)
Amortization of net transition asset (credit)	-	(1)

Defined Contribution Plan

Embarq sponsors defined contribution employee savings plans where participants may contribute portions of their eligible pay. Embarq typically matches contributions for non-union employees and union-represented employees in cash. During 2007 and 2006, however, Embarq matched contributions for certain union-represented employees in company stock. Embarq may, at the discretion of the Employee Benefits Committee, and subject to a respective collective bargaining agreement, provide matching contributions based on the performance of Embarq stock compared to the Standards & Poor's Integrated Telecom Index. The matching contribution was equal to 25% of participants' contributions, up to 6% of their pay, in 2008 and 2007 and was equal to 28% of participants' contributions, up to 6% of their pay, in 2006. Embarq recognized \$10 million of expense in both 2008 and 2007 and \$8 million in 2006 related to these plans.

Allocated Benefit Plan Costs

Before spin-off, a substantial number of Embarq employees were covered as part of Sprint Nextel's noncontributory defined benefit pension plan and postretirement benefit plans. Embarq was allocated plan assets, benefit obligations and net periodic benefit costs from Sprint Nextel related to individuals that could be identified as supporting Embarq's operations. For the year ended December 31, 2006, Embarq recognized allocated defined benefit pension cost of \$20 million and allocated postretirement benefit cost of \$2 million.

Before spin-off, certain Embarq employees participated in Sprint Nextel's defined contribution plan, which had similar matching contributions to Embarq's plan. Prior to 2006, Sprint Nextel matched participants' contributions in Sprint Nextel stock. Embarq recognized allocated contribution charges of \$5 million for the pre-spin-off 2006 period.

Other Benefit Obligations

Other benefit obligations recognized in the Consolidated Balance Sheets, mainly represent certain long-term disability obligations recognized in accordance with SFAS No. 112, *Employers' Accounting for Postemployment Benefits*.

During the 2008 fourth quarter, a nonrecurring adjustment of approximately \$26 million was required to reduce certain long-term

disability obligations. This adjustment related to periods prior to 2006 and was reflected as a reduction of selling, general and administrative expense in the Consolidated Statement of Operations and Comprehensive Income (Loss).

Note 7. Stock-based Compensation

Share-based Payment Plans

2008 Equity Incentive Plan

In May 2008, Embarq shareholders approved the 2008 Equity Incentive Plan (the 2008 Plan) which became the sole plan for granting share-based incentive compensation to eligible Embarq employees and non-employee directors. Under this Plan, Embarq can grant a wide range of awards including stock options, nonvested stock and stock units, otherwise referred to as restricted stock and stock units, stock appreciation right awards, performance share awards and performance unit awards. The compensation committee of the board of directors of Embarq may award options to purchase common stock and set all the terms and conditions of the options, except that the option exercise price per share shall be no less than the fair market value of a share of common stock on the date of grant. In addition, the compensation committee has discretion to set the vesting schedule for the options which can have a term not to exceed ten years and may establish the terms and conditions of the awards including the satisfaction of performance and market goals.

Under the 2008 Plan, 15 million shares were reserved for the issuance of Embarq common stock. For the purpose of calculating this aggregated limit, a single stock option or stock appreciation rights will be counted as one share while each restricted stock unit, performance share award or performance unit award will count as three shares. As of December 31, 2008, substantially all 15 million shares remained available under the 2008 Plan.

2006 Equity Incentive Plan

Prior to adoption of the 2008 Plan, Embarq granted share-based payment awards under the 2006 Equity Incentive Plan (the 2006 Plan). The type of awards that could be issued under the 2006 Plan as well as the restrictions for issuing stock options is generally the same as the 2008 Plan. Under the 2006 Plan, 24.5 million common shares were reserved. As of the adoption of the 2008 Plan, no further awards will be granted under the 2006 Plan except for any incremental shares necessary to satisfy the performance and market criteria specified in the 2008 and 2007 long-term incentive program. As of December 31, 2008, approximately 1 million shares remain to satisfy these performance and market criteria.

Employee Stock Purchase Plan

In May 2008, Embarq shareholders approved the adoption of the 2008 Employee Stock Purchase Plan (the 2008 Purchase Plan). The 2008 Purchase Plan allows eligible employees to deduct up to 20% of eligible compensation to purchase common shares of stock at a price equal to 90% of its fair market value on the last business day of each offering period. The aggregate number of shares an employee may purchase cannot exceed 15 thousand shares or the equivalent of \$20 thousand in any calendar year, subject to limitations imposed by Section 423 of the Internal Revenue Code. Under this plan, 0.9 million common shares were reserved for issuance, of which approximately 0.8 million remained available at December 31, 2008.

The 2008 Purchase Plan replaced the Employee Stock Purchase Plan approved in May 2006 (the 2006 Purchase Plan). The 2006 Purchase Plan was substantially the same as the 2008 plan except the aggregate number of shares an employee may purchase cannot exceed the equivalent of \$25 thousand in any calendar year. During 2008, 0.1 million shares had been purchased by eligible employees under the 2006 Purchase Plan.

Stock Options

Embarq uses the Black-Scholes-Merton model to estimate the fair value of stock options. The risk-free interest rate was determined using the yield available on the option grant date for a zero-coupon U.S. Treasury security with a term equivalent to the expected life of the option. The dividend yield was determined based upon estimated annual dividends and the fair value and shares outstanding of Embarq's stock on the option grant date. Due to Embarq's relatively short life as an independent company, the expected volatility was based on a blend of the historic and implied volatility of Embarq's peer group. The expected life for options granted in 2008 was determined by applying the simplified method as described by SAB No. 110, *Share-Based Payment*, and SAB No. 107, *Share-Based Payment*, for awards granted prior to 2008.

The weighted average grant date fair value was \$6.25 in 2008, \$12.02 in 2007 and \$13.62 in 2006 for all options converted or granted. These fair values were based on the following weighted average assumptions:

	2008	2007	2006
Risk-free interest rate	2.9%	4.7%	5.0%
Expected dividend yield	6.6%	3.5%	4.4%
Expected volatility	30.8%	24.4%	22.5%
Expected term (years)	6.0	6.0	4.7

A summary of the activity related to Embarq's stock options for 2008 is presented below:

	Options (millions)	Weighted Average Exercise Price
Beginning balance outstanding	6.4	\$ 56.51

Granted	1.0	41.95
Exercised	0.2	36.22
Forfeited/expired	0.5	61.15
Ending balance outstanding	6.7	\$ 54.74

The total amount of options exercisable and expected to vest, net of expected forfeitures, at December 31, 2008, was:

	Options	Aggregate Intrinsic Value	Weighted Average Remaining Contractual Term	Weighted Average Exercise Price
	(millions)		(years)	
Exercisable	4.9	\$ 4.9	3.2	\$ 57.82
Expected to vest, net of expected forfeitures	1.7	-	8.3	\$ 45.84

The consolidated financial statement impact related to stock options exercised was as follows:

	For the Years Ended December 31,		
	2008	2007	2006
	(millions)		
Cash received	\$ 8	\$ 109	\$ 21
Tax benefit realized	1	22	3
Intrinsic value	2	60	8

The number and weighted average fair value of options vested during the year was as follows:

	For the Years Ended December 31,		
	2008	2007	2006
Weighted average fair value	\$ 11.92	\$ 11.62	\$ 18.93
Number of fully vested options (millions)	1.0	1.0	0.1

As of December 31, 2008, there was \$7 million of total unrecognized compensation cost related to unvested stock options that is expected to be recognized over a weighted-average period of 0.7 years.

Restricted Stock Units

Since 2007, the fair value of restricted stock units where vesting was dependent only on service conditions was calculated using the closing stock price on the day of grant. Prior to 2007, the fair value of these awards was calculated using the average of the high and low price of Embarq stock on the day of grant. Awards granted that contained market and performance conditions that affect factors other than vesting was determined based on their expected outcome as of the grant date.

The weighted average grant date fair value for restricted stock units granted in 2008 was \$42.41, \$55.41 in 2007 and \$43.86 in 2006. A summary of the activity related to the restricted stock units for 2008 was as follows:

	Unit Award	Weighted Average Fair Value
	(millions)	
Beginning balance nonvested	1.6	\$ 46.87
Granted	0.9	42.41
Vested	1.2	43.88
Forfeited	0.1	45.66
Ending balance nonvested	1.2	\$ 46.64

As of December 31, 2008, there was \$18 million of total unrecognized compensation cost related to restricted stock units that is expected to be recognized over a weighted-average period of 1.0 years.

The total intrinsic value of restricted stock units vested during 2008 was \$45 million, \$42 million in 2007 and \$1 million in 2006.

Performance and Market Provisions Awards

In March 2008, Embarq granted approximately 0.4 million restricted stock units that had performance and market provisions, which could result in the initial number of awards granted being increased up to 200% or decreased to zero. The conversion ratios related to these awards are equally weighted to the performance and market conditions for the three year performance period ending December 31, 2011.

In February 2007, Embarq granted 0.5 million restricted stock units that had performance and market provisions which could result in the initial number of awards granted being increased up to 200% or decreased to zero. The conversion ratios related to these awards are equally weighted to the performance and market conditions for the two and three year performance periods ended December 31, 2008 and 2009.

Compensation Expense

After the spin-off, stock-based compensation expense was calculated on the direct method based on each employee's individual grant. Before the spin-off, stock-based compensation expense was allocated to Embarq by Sprint Nextel based on the total Embarq employee headcount as a percentage of Sprint Nextel's total employees.

A summary of the total expense and income tax benefit related to equity plans was as follows:

	For the Years Ended December 31,		
	2008	2007	2006
	(millions)		
Compensation Expense			
Post spin-off direct expense	\$ 47	\$ 50	\$ 31
Pre spin-off allocated expense	-	-	22
Total	<u>\$ 47</u>	<u>\$ 50</u>	<u>\$ 53</u>
Income Tax Benefit			
Post spin-off direct expense	\$ 17	\$ 18	\$ 11
Pre spin-off allocated expense	-	-	8
Total	<u>\$ 17</u>	<u>\$ 18</u>	<u>\$ 19</u>

Resignation of Chief Executive Officer (CEO)

In December 2007, Embarq's CEO resigned, resulting in the forfeiture of 0.6 million stock options and 0.4 million restricted stock units. These forfeitures resulted in the reversal of \$12 million in compensation expense recognized in 2007 and prior years and reduced unearned compensation expense by \$11 million as of December 31, 2007.

Resignation of Chief Operating Officer (COO)

On December 19, 2006, Embarq eliminated the position of COO and as a result recognized \$8 million of stock-based compensation expense associated with this event.

The general release and agreement entered into in connection with the position elimination provided that Embarq will vest those portions of the former COO's equity grants that remain unvested at the end of his 18 month severance period, which included 43,043 stock option awards and 63,045 restricted stock unit awards. This was considered to be a modification of vesting terms requiring a revaluation of the modified awards. The fair value for the modified stock options was \$11.37 per option and \$51.22 per unit for the restricted stock units. Of the total \$8 million stock compensation charge recognized related to this event, approximately \$4 million was the value associated with the modified awards.

Spin-off from Sprint Nextel

The employee matters agreement provided that at spin-off, Sprint Nextel options held by Embarq employees would be converted into options to purchase shares of Embarq common stock. At spin-off, Embarq employees held approximately 15 million Sprint Nextel stock options which were converted into approximately 8 million Embarq stock options. These options had substantially the same terms and conditions as those of the underlying Sprint Nextel options. Additionally, a special equity award of Embarq restricted stock units was granted to Embarq employees who had their Sprint Nextel options converted into Embarq options. These awards vest over a three year service period and were valued at the closing market value of Embarq stock on the first business day following the grant date. No incremental compensation expense resulted from this modification event.

Note 8. Business Segment Information

Embarq provides a suite of integrated communications services to consumer and business customers primarily in local service territories in 18 states. Embarq also provides wholesale access to its local network and other communications services primarily to wireline and wireless service providers. As a result of the sale of Embarq Logisitics in March 2009, Embarq's continuing operations are now comprised solely of its telecommunications business.

Embarq's net operating revenues for each of its services and products were as follows:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
		<i>(millions)</i>	
Voice	\$ 3,915	\$ 4,238	\$ 4,346
Data	801	765	706
High-speed Internet	549	489	393
Other	424	407	388
Total net operating revenues	<u>\$ 5,689</u>	<u>\$ 5,899</u>	<u>\$ 5,833</u>

Voice revenues are principally derived from local and long distance services, switched access charges and USF receipts. Data revenues are principally derived from various data protocol and special access services. Other revenues include professional services, intelligent network database services, billing and collection services, sales agency commissions and sales of customer premise equipment.

Note 9. Supplemental Cash Flow Information and Non-Cash Activities

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

	<u>2008</u>	<u>2007</u>	<u>2006</u>
		<i>(millions)</i>	
Supplemental Cash Flow Information			
Cash paid for interest, net of amounts capitalized	\$ 407	\$ 437	\$ 290
Cash paid for income taxes	383	449	348
Non-Cash Activities			
Capital expenditure accrual	\$ (4)	\$ 1	\$ 3
Dividends accrued	2	2	-
Cash held in escrow from the sale of assets	10	1	
Proceeds due from sale of assets	6	-	-
Extinguishment of debt	-	3	-
Issuance of treasury stock to the Employee Stock Purchase Plan	-	2	-
Transactions with Sprint Nextel associated with spin-off:			
Distribution of senior notes	-	-	(4,485)
Transfer of notes receivable	-	-	460
Transfer and subsequent adjustment of property, plant and equipment, net	-	4	313
Transfer of post-retirement and other benefit obligations	-	-	(358)
Elimination of additional minimum pension liability and pension intangible	-	-	837
Transfer and subsequent adjustment of other assets and liabilities, net	-	(2)	35
Deferred taxes related to assets and liabilities transferred and subsequently adjusted	-	1	(53)

Note 10. Sale of Properties

In the 2008 second quarter, Embarq completed the sale of its distribution center in Dayton, Ohio for \$10 million. This sale resulted in a pre-tax gain of \$9 million that was reflected as a reduction of operating expenses in the Consolidated Statements of Operations and Comprehensive Income (Loss). Of this amount, \$6 million was attributed to continuing operations, with the remaining \$3 million attributable to discontinued operations.

In the 2006 first quarter, Embarq finalized the sale of 13 exchanges including approximately 5,200 access lines in north central Kansas for approximately \$18 million in cash. This sale resulted in a pre-tax gain of approximately \$6 million and was reflected as a reduction of selling, general and administrative expense in the Consolidated Statements of Operations and Comprehensive Income (Loss).

In the 2006 fourth quarter, Embarq finalized the sale of 12 exchanges in north central Kansas, serving approximately 5,400 access lines. Proceeds from this sale were approximately \$17 million, which generated a pre-tax gain of \$6 million. This gain was reflected as a reduction of selling, general and administrative expense in the Consolidated Statements of Operations and Comprehensive Income (Loss).

Note 11. Quarterly Financial Data (Unaudited)

	2008 Quarters			
	1 st	2 nd	3 rd	4 th
	<i>(millions, except per share data)</i>			
Net operating revenue	\$ 1,456	\$ 1,439	\$ 1,408	\$ 1,386
Operating income	436	424	355	424
Income from continuing operations	214	202	162	196
Income (loss) from discontinued operations (net of income taxes)	(2)	4	(2)	(5)
Net income	<u>\$ 212</u>	<u>\$ 206</u>	<u>\$ 160</u>	<u>\$ 191</u>
Basic earnings per share				
Continuing operations	\$ 1.40	\$ 1.37	\$ 1.13	\$ 1.38
Discontinued operations	(0.01)	0.03	(0.01)	(0.04)
Total	<u>1.39</u>	<u>1.40</u>	<u>1.12</u>	<u>1.34</u>
Diluted earnings per share				
Continuing operations	\$ 1.39	\$ 1.35	\$ 1.12	\$ 1.37
Discontinued operations	(0.01)	0.03	(0.01)	(0.03)
Total	<u>1.38</u>	<u>1.38</u>	<u>1.11</u>	<u>1.34</u>

	2007 Quarters			
	1 st	2 nd	3 rd	4 th
	<i>(millions, except per share data)</i>			
Net operating revenue	\$ 1,480	\$ 1,482	\$ 1,473	\$ 1,464
Operating income	374	396	365	371
Income from continuing operations	162	174	158	191
Income (loss) from discontinued operations (net of income taxes)	(2)	2	(1)	(1)
Net income	<u>\$ 160</u>	<u>\$ 176</u>	<u>\$ 157</u>	<u>\$ 190</u>
Basic earnings per share				
Continuing operations	\$ 1.08	\$ 1.15	\$ 1.03	\$ 1.25
Discontinued operations	(0.01)	0.01	(0.01)	(0.01)
Total	<u>1.07</u>	<u>1.16</u>	<u>1.02</u>	<u>1.24</u>
Diluted earnings per share				
Continuing operations	\$ 1.06	\$ 1.14	\$ 1.02	\$ 1.24
Discontinued operations	(0.01)	0.01	(0.01)	(0.01)
Total	<u>1.05</u>	<u>1.15</u>	<u>1.01</u>	<u>1.23</u>

Note 12. Subsequent Events Through February 12, 2009***Amendment to Credit Agreement and Shareholder Approval of the Merger***

On January 23, 2009, Embarq entered into an amendment to modify its existing credit agreement. See Note 4, Long-term Debt and Financial Instruments, for additional information. The amendment will only become effective upon consummation of the merger with CenturyTel and the satisfaction of other customary conditions, and provides for the following:

- the credit agreement will remain in place after consummation of the merger, with scheduled maturity in May 2011;

- the size of the revolving credit facility will be reduced to \$800 million from \$1.5 billion, and the sub-limit for letters of credit will be reduced to \$100 million from \$200 million;
- the outstanding term borrowings of \$360 million as of December 31, 2008 will be repaid in full on or before the closing date of the merger;
- the leverage ratio financial covenant will become more restrictive, along with other covenant modifications; and
- the interest rates and fees payable on outstanding borrowings and commitments will be increased.

The amended credit agreement will replace CenturyTel's previously arranged \$800 million bridge facility. The bridge facility would have been available to refinance outstanding borrowings under Embarq's existing credit agreement, as necessary, upon consummation of the merger.

On January 27, 2009, the Embarq and CenturyTel shareholders approved the matters required to complete the transaction as proposed in the merger agreement. Completion of the merger is now subject to approval by the FCC and various state regulatory agencies as well as other customary closing conditions. Subject to these requirements, the transaction is expected to close during the 2009 second quarter.

