CENTURYTEL INC
Form 10-Q
November 05, 2010

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

# FORM 10-Q

[X] Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended September 30, 2010

or

[ ] Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Commission File Number: 1-7784

CenturyLink, Inc.
(Exact name of registrant as specified in its charter)

| Louisiana<br>(State or other jurisdiction of<br>incorporation or organization) | 72-0651161<br>(I.R.S. Employer<br>Identification No.) |
|---|---|

100 CenturyLink Drive, Monroe, Louisiana 71203
(Address of principal executive offices) (Zip Code)

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes [X] No [ ]

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

Large accelerated filer [X] Accelerated filer [ ] Non-accelerated filer [ ] Smaller reporting company [ ]

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

As of October 29, 2010, there were 303,246,592 shares of common stock outstanding.

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* All references to “Notes” in this quarterly report refer to these Notes to Consolidated Financial Statements.

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements
CenturyLink, Inc.
CONSOLIDATED STATEMENTS OF INCOME
(UNAUDITED)

| | Three months ended September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| | (Dollars, except per share amounts, and shares in thousands) | | | |
| OPERATING REVENUES | $1,747,101 | 1,874,325 | 5,319,557 | 3,145,179 |
| | | | | |
| OPERATING EXPENSES | | | | |
| Cost of services and products (exclusive of depreciation and amortization) | 605,548 | 684,865 | 1,814,073 | 1,155,228 |
| Selling, general and administrative | 278,331 | 448,275 | 862,931 | 678,862 |
| Depreciation and amortization | 357,867 | 362,202 | 1,068,980 | 618,326 |
| Total operating expenses | 1,241,746 | 1,495,342 | 3,745,984 | 2,452,416 |
| | | | | |
| OPERATING INCOME | 505,355 | 378,983 | 1,573,573 | 692,763 |
| | | | | |
| OTHER INCOME (EXPENSE) | | | | |
| Interest expense | (139,594 ) | (140,422 ) | (425,068 ) | (237,391 ) |
| Other income (expense) | 6,911 | 9,362 | 24,719 | 15,179 |
| Total other income (expense) | (132,683 ) | (131,060 ) | (400,349 ) | (222,212 ) |
| | | | | |
| INCOME BEFORE INCOME TAX EXPENSE | 372,672 | 247,923 | 1,173,224 | 470,551 |
| Income tax expense | 141,083 | 99,876 | 449,552 | 185,796 |
| | | | | |
| INCOME BEFORE NONCONTROLLING INTERESTS AND EXTRAORDINARY ITEM | 231,589 | 148,047 | 723,672 | 284,755 |
| Less: Net income attributable to noncontrolling interests | (422 ) | (412 ) | (1,133 ) | (936 ) |
| NET INCOME BEFORE EXTRAORDINARY ITEM | $231,167 | 147,635 | 722,539 | 283,819 |
| Extraordinary item, net of income tax expense and noncontrolling interests (see Note 12) | - | 133,213 | - | 133,213 |
| NET INCOME ATTRIBUTABLE TO CENTURYLINK, INC. | 231,167 | 280,848 | 722,539 | 417,032 |
| | | | | |
| BASIC EARNINGS PER SHARE | | | | |
| Income before extraordinary item | $.76 | .49 | 2.40 | 1.70 |
| Extraordinary item | $- | .44 | - | .80 |
| Basic earnings per share | $.76 | .94 | 2.40 | 2.50 |
| | | | | |
| DILUTED EARNINGS PER SHARE | | | | |
| Income before extraordinary item | $.76 | .49 | 2.39 | 1.70 |
| Extraordinary item | $- | .44 | - | .80 |
| Diluted earnings per share | $.76 | .94 | 2.39 | 2.50 |

| | | | | |
|---|---|---|---|---|
| DIVIDENDS PER COMMON SHARE | $ .725 | .70 | 2.175 | 2.10 |
| AVERAGE BASIC SHARES OUTSTANDING | 300,702 | 298,133 | 300,058 | 165,558 |
| AVERAGE DILUTED SHARES OUTSTANDING | 301,386 | 298,403 | 300,663 | 165,666 |

See accompanying notes to consolidated financial statements.

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CenturyLink, Inc.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(UNAUDITED)

| | Three months ended September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| | (Dollars in thousands) | | | |
| NET INCOME BEFORE NONCONTROLLING INTERESTS | $231,589 | 282,805 | 723,672 | 419,513 |
| OTHER COMPREHENSIVE INCOME, NET OF TAX: | | | | |
| Derivative instruments: | | | | |
| Reclassification adjustment for losses included in net income, net of $67, $67, $200 and $200 tax | 107 | 107 | 321 | 321 |
| Defined benefit pension and postretirement plans, net of $1,510, $1,673, ($10,788) and $7,161 tax | 2,422 | 2,684 | (4,559) | 11,487 |
| Net change in other comprehensive income (loss), net of tax | 2,529 | 2,791 | (4,238) | 11,808 |
| COMPREHENSIVE INCOME | 234,118 | 285,596 | 719,434 | 431,321 |
| Comprehensive income attributable to noncontrolling interests | (422) | (1,957) | (1,133) | (2,481) |
| COMPREHENSIVE INCOME ATTRIBUTABLE TO CENTURYLINK, INC. | $233,696 | 283,639 | 718,301 | 428,840 |

See accompanying notes to consolidated financial statements.

CenturyLink, Inc.
CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

| | September 30, 2010 | December 31, 2009 |
|---|---|---|
| | (Dollars in thousands) | |
| ASSETS | | |
| | | |
| CURRENT ASSETS | | |
| Cash and cash equivalents | $243,061 | 161,807 |
| Accounts receivable, less allowance of $51,722 and $47,450 | 749,653 | 685,589 |
| Income tax receivable | 85,435 | 115,684 |
| Materials and supplies, at average cost | 35,135 | 35,755 |
| Deferred income tax asset | 79,468 | 83,319 |
| Other | 34,355 | 41,437 |
| Total current assets | 1,227,107 | 1,123,591 |
| | | |
| NET PROPERTY, PLANT AND EQUIPMENT | | |
| Property, plant and equipment | 16,101,285 | 15,556,763 |
| Accumulated depreciation | (7,299,542 ) | (6,459,624 ) |
| Net property, plant and equipment | 8,801,743 | 9,097,139 |
| | | |
| GOODWILL AND OTHER ASSETS | | |
| Goodwill | 10,260,640 | 10,251,758 |
| Other | 1,930,720 | 2,090,241 |
| Total goodwill and other assets | 12,191,360 | 12,341,999 |
| | | |
| TOTAL ASSETS | $22,220,210 | 22,562,729 |
| | | |
| LIABILITIES AND EQUITY | | |
| | | |
| CURRENT LIABILITIES | | |
| Current maturities of long-term debt | $496,552 | 500,065 |
| Accounts payable | 292,675 | 394,687 |
| Accrued expenses and other liabilities | | |
| Salaries and benefits | 197,898 | 255,103 |
| Other taxes | 167,233 | 98,743 |
| Interest | 178,348 | 108,020 |
| Other | 139,107 | 168,203 |
| Advance billings and customer deposits | 177,915 | 182,374 |
| Total current liabilities | 1,649,728 | 1,707,195 |
| | | |
| LONG-TERM DEBT | 7,061,744 | 7,253,653 |
| | | |
| DEFERRED CREDITS AND OTHER LIABILITIES | | |
| Deferred income taxes | 2,260,097 | 2,256,579 |
| Benefit plan obligations | 1,242,322 | 1,485,643 |
| Other deferred credits | 400,465 | 392,860 |

| | | |
|---|---|---|
| Total deferred credits and other liabilities | 3,902,884 | 4,135,082 |
| | | |
| STOCKHOLDERS' EQUITY | | |
| CenturyLink, Inc. | | |
| Common stock, $1.00 par value, authorized 800,000,000 shares, issued and outstanding 302,684,801 and 299,189,279 shares | 302,685 | 299,189 |
| Paid-in capital | 6,087,136 | 6,014,051 |
| Accumulated other comprehensive loss, net of tax | (89,544) | (85,306) |
| Retained earnings | 3,298,643 | 3,232,769 |
| Preferred stock - non-redeemable | 236 | 236 |
| Noncontrolling interests | 6,698 | 5,860 |
| Total stockholders’ equity | 9,605,854 | 9,466,799 |
| TOTAL LIABILITIES AND EQUITY | $22,220,210 | 22,562,729 |

See accompanying notes to consolidated financial statements.

CenturyLink, Inc.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

| | Nine months ended September 30, | |
|---|---|---|
| | 2010 | 2009 |
| | (Dollars in thousands) | |
| OPERATING ACTIVITIES | | |
| Net income | $723,672 | 417,968 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 1,068,980 | 618,326 |
| Extraordinary item | - | (133,213) |
| Deferred income taxes | 18,875 | 38,237 |
| Share-based compensation | 27,988 | 39,618 |
| Income from unconsolidated cellular entity | (13,882) | (15,353) |
| Distributions from unconsolidated cellular entity | 13,793 | 14,137 |
| Changes in current assets and current liabilities: | | |
| Receivables | (64,064) | (2,782) |
| Accounts payable | (102,012) | (93,283) |
| Accrued income and other taxes | 94,817 | 36,734 |
| Other current assets and other current liabilities, net | (7,137) | 147,874 |
| Retirement benefits | (261,351) | (100,300) |
| Excess tax benefits from share-based compensation | (6,026) | (1,105) |
| Increase in other noncurrent assets | (17,448) | (547) |
| Increase (decrease) in other noncurrent liabilities | 5,254 | (12,494) |
| Other, net | - | 7,944 |
| Net cash provided by operating activities | 1,481,459 | 961,761 |
| | | |
| INVESTING ACTIVITIES | | |
| Payments for property, plant and equipment | (599,779) | (417,127) |
| Cash acquired from Embarq acquisition | - | 76,906 |
| Other, net | 1,916 | 3,025 |
| Net cash used in investing activities | (597,863) | (337,196) |
| | | |
| FINANCING ACTIVITIES | | |
| Payments of debt | (195,422) | (626,616) |
| Net proceeds from issuance of long-term debt | - | 644,423 |
| Proceeds from issuance of common stock | 54,412 | 12,672 |
| Repurchase of common stock | (14,321) | (8,774) |
| Cash dividends | (656,665) | (350,959) |
| Excess tax benefits from share-based compensation | 6,026 | 1,105 |
| Other, net | 3,628 | (8,554) |
| Net cash used in financing activities | (802,342) | (336,703) |
| | | |
| Net increase in cash and cash equivalents | 81,254 | 287,862 |
| Cash and cash equivalents at beginning of period | 161,807 | 243,327 |
| | | |
| Cash and cash equivalents at end of period | $243,061 | 531,189 |

| | | |
|---|---|---|
| Supplemental cash flow information: | | |
| Income taxes paid | $397,565 | 126,706 |
| Interest paid (net of capitalized interest of $10,034 and $909) | $344,706 | 158,964 |

See accompanying notes to consolidated financial statements.

CenturyLink, Inc.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(UNAUDITED)

| | Nine months ended September 30, | |
|---|---|---|
| | 2010 | 2009 |
| | (Dollars in thousands) | |
| COMMON STOCK | | |
| Balance at beginning of period | $299,189 | 100,277 |
| Issuance of common stock to acquire Embarq Corporation | - | 196,083 |
| Issuance of common stock through dividend reinvestment, incentive and benefit plans | 3,901 | 1,417 |
| Shares withheld to satisfy tax withholdings | (405) | (310) |
| Balance at end of period | 302,685 | 297,467 |
| | | |
| PAID-IN CAPITAL | | |
| Balance at beginning of period | 6,014,051 | 39,961 |
| Issuance of common stock to acquire Embarq Corporation, including portion of share-based compensation awards assumed by CenturyLink | - | 5,873,904 |
| Issuance of common stock through dividend reinvestment, incentive and benefit plans | 50,511 | 11,255 |
| Shares withheld to satisfy tax withholdings | (13,916) | (8,464) |
| Excess tax benefits from share-based compensation | 6,026 | 1,105 |
| Share-based compensation and other | 30,464 | 41,189 |
| Balance at end of period | 6,087,136 | 5,958,950 |
| | | |
| ACCUMULATED OTHER COMPREHENSIVE LOSS, NET OF TAX | | |
| Balance at beginning of period | (85,306) | (123,489) |
| Change in other comprehensive loss (net of reclassification adjustment), net of tax | (4,238) | 11,808 |
| Balance at end of period | (89,544) | (111,681) |
| | | |
| RETAINED EARNINGS | | |
| Balance at beginning of period | 3,232,769 | 3,146,255 |
| Net income attributable to CenturyLink, Inc. | 722,539 | 417,032 |
| Cash dividends declared | | |
| Common stock - $2.175 and $2.10 per share, respectively | (656,656) | (350,950) |
| Preferred stock | (9) | (9) |
| Balance at end of period | 3,298,643 | 3,212,328 |
| | | |
| PREFERRED STOCK - NON-REDEEMABLE | | |
| Balance at beginning and end of period | 236 | 236 |
| | | |
| NONCONTROLLING INTERESTS | | |
| Balance at beginning of period | 5,860 | 4,568 |
| Net income attributable to noncontrolling interests | 1,133 | 936 |
| Extraordinary gain attributable to noncontrolling interests | - | 1,545 |
| Distributions attributable to noncontrolling interests | (295) | (320) |
| Balance at end of period | 6,698 | 6,729 |
| | | |
| TOTAL STOCKHOLDERS' EQUITY | $9,605,854 | 9,364,029 |

See accompanying notes to consolidated financial statements.

CenturyLink, Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2010
(UNAUDITED)

(1) Basis of Financial Reporting

Our consolidated financial statements include the accounts of CenturyLink, Inc. ("CenturyLink", formerly named CenturyTel, Inc.) and its majority-owned subsidiaries. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to rules and regulations of the Securities and Exchange Commission; however, in the opinion of management, the disclosures made are adequate to make the information presented not misleading. The consolidated financial statements and notes included in this Form 10-Q should be read in conjunction with the consolidated financial statements and notes thereto included in our annual report on Form 10-K for the year ended December 31, 2009.

The financial information for the three months and nine months ended September 30, 2010 and 2009 has not been audited by independent certified public accountants; however, in the opinion of management, all adjustments necessary to present fairly the results of operations for the three-month and nine-month periods have been included therein. The results of operations for the first nine months of the year are not necessarily indicative of the results of operations which might be expected for the entire year.

As more fully described in Note 9, we have reclassified subscriber line charge revenues to "Voice" revenues from "Network access" revenues for all periods presented and we have included the revenues from our fiber transport, CLEC and security monitoring operations in "Other" revenues for all periods presented. In addition, certain revenues presented in third quarter 2009 attributable to our Embarq properties (acquired in the transaction described in Note 2) have been reclassified to conform to the current presentation.

Recent accounting pronouncements. In September 2009, the accounting standard update regarding revenue recognition for multiple deliverable arrangements was issued. This update requires the use of the relative selling price method when allocating revenue in these types of arrangements. This method allows a vendor to use its best estimate of selling price if neither vendor specific objective evidence nor third party evidence of selling price exists when evaluating multiple deliverable arrangements. This standard update is effective January 1, 2011 and may be adopted prospectively for revenue arrangements entered into or materially modified after the date of adoption or retrospectively for all revenue arrangements for all periods presented. We are currently evaluating the impact that this standard update will have on our consolidated financial statements.

In January 2010, we adopted the accounting standard update regarding fair value measurements and disclosures, which requires additional disclosures regarding assets and liabilities measured at fair value. The adoption of this accounting standard update did not have a material impact on our condensed consolidated financial statements.

(2) Embarq Acquisition

On July 1, 2009, we acquired Embarq Corporation ("Embarq") through a merger transaction, with Embarq surviving the merger as a wholly-owned subsidiary of CenturyLink. We accounted for such acquisition pursuant to Financial Accounting Standards Board guidance on business combinations, which requires an acquiring entity to recognize all of the assets acquired and liabilities assumed in a transaction at the acquisition date fair value with limited exceptions. Such guidance also changed the accounting treatment for certain specific items, including acquisition costs, acquired contingent liabilities, restructuring costs, deferred tax asset valuation allowances and income tax

uncertainties after the acquisition date and is effective for us for all business combinations with acquisition dates after January 1, 2009.

As a result of the acquisition, each outstanding share of Embarq common stock was converted into the right to receive 1.37 shares of CenturyLink common stock ("CTL common stock"), with cash paid in lieu of fractional shares. Based on the number of CenturyLink common shares issued to consummate the merger (196.1 million), the closing stock price of CTL common stock as of June 30, 2009 ($30.70) and the pre-combination portion of share-based compensation awards assumed by CenturyLink ($50.2 million), the aggregate merger consideration approximated $6.1 billion. The premium paid by us in this transaction is attributable to strategic benefits, including enhanced financial and operational scale, market diversification, leveraged combined networks and improved competitive positioning. None of the goodwill associated with this transaction is deductible for income tax purposes.

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The results of operations of Embarq are included in our consolidated results of operations beginning July 1, 2009. Approximately $3.687 billion of operating revenues of Embarq are included in our consolidated results of operations for the first nine months of 2010. CenturyLink was the accounting acquirer in this transaction. We have recognized Embarq's assets and liabilities at their acquisition date estimated fair values pursuant to business combination accounting rules that are effective for acquisitions consummated on or after January 1, 2009. The assignment of a fair value to the assets acquired and liabilities assumed of Embarq (and the related estimated lives of depreciable tangible and identifiable intangible assets) require a significant amount of judgment. The fair value of Embarq's property, plant and equipment and identifiable intangible assets were determined based upon analysis performed by an independent valuation firm. The fair value of Embarq's pension and postretirement obligations was determined by independent actuaries. The fair value of Embarq's long-term debt was determined by management based on a discounted cash flow analysis, using the rates and maturities of these obligations compared to terms and rates available in the long-term financing markets at the time of acquisition. All other fair value determinations, which consisted primarily of Embarq's current assets, current liabilities and deferred income taxes, were made by management. The following is the assignment of the fair value of the assets acquired and liabilities assumed for the Embarq acquisition.

| | Fair value as of July 1, 2009 (Dollars in thousands) |
|---|---|
| Current assets | $675,720 |
| Net property, plant and equipment | 6,077,672 |
| Identifiable intangible assets | |
| Customer list | 1,098,000 |
| Rights of way | 268,472 |
| Other (trademarks, internally developed software, licenses) | 26,817 |
| Other non-current assets | 24,131 |
| Current liabilities | (837,132 ) |
| Long-term debt, including current maturities | (4,886,708) |
| Other long-term liabilities | (2,621,493) |
| Goodwill | 6,244,966 |
| Total purchase price | $6,070,445 |

The following unaudited pro forma financial information presents the combined results of CenturyLink and Embarq as though the acquisition had been consummated as of January 1, 2009.

| | Nine months ended September 30, 2009 (Dollars in thousands, except per share amounts) |
|---|---|
| Operating revenues | $ 5,816,000 |
| Net income attributable to CenturyLink, Inc. | $ 667,000 |
| Basic earnings per share before extraordinary item | $ 2.24 |
| Diluted earnings per share before extraordinary item | $ 2.24 |

These results include certain adjustments, primarily due to adjustments to depreciation and amortization associated with the property, plant and equipment and identifiable intangible assets, increased retiree benefit costs due to the remeasurement of the benefit obligations, and the related income tax effects.  Pro forma operating revenues for the nine months ended September 30, 2009 include approximately $104 million of revenues that would have been eliminated had our July 1, 2009 discontinuance of the application of regulatory accounting (discussed further in Part I, Item 2 of this report) been effective as of January 1, 2009.  The pro forma information does not necessarily reflect the actual results of operations had the acquisition been consummated at the beginning of the period indicated nor is it necessarily indicative of future operating results.  Other than those actually realized during the quarter ended September 30, 2009, the pro forma information does not give effect to any potential revenue enhancements or cost synergies or other operating efficiencies that could result from the acquisition.

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(3) Pending Acquisition of Qwest

On April 21, 2010, we entered into a definitive agreement under which we propose to acquire Qwest Communications International Inc. ("Qwest") in a tax-free stock-for-stock transaction.  Under the terms of the agreement, Qwest shareholders will receive 0.1664 CenturyLink shares for each share of Qwest common stock they own at closing.  CenturyLink shareholders are expected to own approximately 50.5% and Qwest shareholders are expected to own approximately 49.5% of the combined company at closing.  As of September 30, 2010, Qwest had outstanding approximately (i) 1.742 billion shares of common stock and (ii) $12.979 billion of long-term debt.

Completion of the transaction is subject to the receipt of regulatory approvals, including approvals from the Federal Communications Commission and certain state public service commissions, as well as other customary closing conditions.  Subject to these conditions, we anticipate closing this transaction in the first half of 2011.  If the merger agreement is terminated under certain circumstances, we may be obligated to pay Qwest a termination fee of $350 million or Qwest may be obligated to pay CenturyLink a termination fee of $350 million.

(4) Goodwill and Other Intangible Assets

Goodwill and other intangible assets as of September 30, 2010 and December 31, 2009 were composed of the following:

| | Sept. 30, 2010 | Dec. 31, 2009 |
|---|---|---|
| | (Dollars in thousands) | |
| Goodwill | $10,260,640 | 10,251,758 |
| Intangible assets subject to amortization | | |
| Customer list | | |
| Gross carrying amount | $1,279,308 | 1,279,308 |
| Accumulated amortization | (301,564) | (148,491) |
| Net carrying amount | $977,744 | 1,130,817 |
| Other | | |
| Gross carrying amount | $69,567 | 69,567 |
| Accumulated amortization | (26,514) | (22,466) |
| Net carrying amount | $43,053 | 47,101 |
| Other intangible assets not subject to amortization | $268,500 | 268,500 |

The change in the balance of goodwill from December 31, 2009 is attributable to the finalization of the assignment of fair value to Embarq's assets and liabilities acquired (primarily certain contingent liabilities and deferred income taxes) in connection with our July 1, 2009 acquisition of Embarq.

The vast majority of our goodwill is attributable to our telephone operations, which we internally operate and manage based on five geographic regions. We test for goodwill impairment for our telephone operations at the region level due to the similar economic characteristics of the individual reporting units that comprise each region. Impairment of goodwill is tested by comparing the fair value of the reporting unit to its carrying value (including goodwill). Estimates of the fair value of the reporting unit of our telephone operations are based on valuation models using techniques such as multiples of earnings (before interest, taxes and depreciation and amortization). We also evaluate goodwill impairment of our other operations primarily based on multiples of earnings and revenues. If the fair value of the reporting unit is less than its carrying value, a second calculation is required in which the implied fair value of goodwill is compared to its carrying value. If the implied fair value is less than its carrying value, goodwill must be written down to its implied fair value. As of September 30, 2010, we completed our annual impairment test of goodwill and concluded that our goodwill was not impaired as of September 30, 2010.

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Total amortization expense related to the intangible assets subject to amortization for the first nine months of 2010 was $157.1 million and is expected to be $206.3 million for the full year 2010, $185.6 million in 2011, $164.5 million in 2012, $145.2 million in 2013 and $126.0 million in 2014.

(5) Postretirement Benefits

We sponsor health care plans that provide postretirement benefits to qualified retired employees.

Net periodic postretirement cost for the nine months ended September 30, 2009 only includes the effect of our Embarq acquisition subsequent to July 1, 2009. Net periodic postretirement benefit cost for the three months and nine months ended September 30, 2010 and 2009 included the following components:

| | Three months ended September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| | (Dollars in thousands) | | | |
| Service cost | $3,306 | 3,175 | 9,975 | 5,701 |
| Interest cost | 8,187 | 8,448 | 24,562 | 18,245 |
| Expected return on plan assets | (981) | (847) | (2,943) | (1,540) |
| Amortization of unrecognized prior service cost | (343) | (887) | (1,029) | (2,660) |
| Net periodic postretirement benefit cost | $10,169 | 9,889 | 30,565 | 19,746 |

(6) Defined Benefit Retirement Plans

We sponsor defined benefit pension plans for substantially all employees, including separate plans for legacy CenturyLink employees and legacy Embarq employees. Until such time as we elect to integrate Embarq's benefit plans with ours, we plan to continue to operate these plans independently.

Upon payment of certain lump sum distributions under a supplemental executive retirement plan in early 2009, we recognized a curtailment loss (which is included in selling, general and administrative expense) of approximately $7.7 million in the first quarter of 2009.

Due to change of control provisions that were triggered upon the consummation of the Embarq acquisition on July 1, 2009, certain retirees who were receiving monthly annuity payments under a supplemental executive retirement plan were paid a lump sum distribution calculated in accordance with the provisions of the plan. A settlement expense of approximately $8.9 million was recognized in the third quarter of 2009 as a result of these actions.

The legacy Embarq pension plan contains a provision that grants early retirement benefits for certain participants affected by workforce reductions. During the third quarter of 2009, we recognized approximately $14.7 million of additional pension expense related to these contractual benefits.

Net periodic pension cost for the nine months ended September 30, 2009 only includes the effect of our Embarq acquisition subsequent to July 1, 2009. Net periodic pension expense for the three months and nine months ended September 30, 2010 and 2009 included the following components:



| Three months ended September 30, | | Nine months ended September 30, | |
|---|---|---|---|
| 2010 | 2009 | 2010 | 2009 |

| | (Dollars in thousands) | | | |
|---|---|---|---|---|
| Service cost | $13,974 | 14,373 | 47,075 | 21,360 |
| Interest cost | 62,589 | 60,723 | 184,250 | 73,975 |
| Expected return on plan assets | (70,757) | (56,857) | (212,270) | (70,785) |
| Curtailment loss | - | - | - | 7,711 |
| Settlement loss | - | 8,890 | - | 8,890 |
| Contractual retirement benefits | - | 14,676 | - | 14,676 |
| Net amortization and deferral | 3,803 | 4,101 | 14,027 | 12,453 |
| Net periodic pension expense | $9,609 | 45,906 | 33,082 | 68,280 |

We contributed $300 million to the legacy Embarq pension plan in the first quarter of 2010. Based on current actuarial estimates, we expect to make a contribution of approximately $100 million to the legacy Embarq pension plan in 2011. Based on current circumstances, our minimum required contributions to our other pension plans are immaterial. The actual level of contribution required in future years can change significantly depending on prevailing discount rates and actual returns on plan assets.

## (7) Stock-based Compensation

We recognize as compensation expense our cost of awarding employees with equity instruments by allocating the fair value of the award on the grant date over the period during which the employee is required to provide service in exchange for the award.

We currently maintain programs which allow the Board of Directors (through its Compensation Committee) and the Chief Executive Officer to grant incentives to certain employees and our outside directors in any one or a combination of several forms, including incentive and non-qualified stock options; stock appreciation rights; restricted stock; restricted stock units and performance shares. As of September 30, 2010, we had reserved approximately 27.5 million shares of common stock which may be issued in connection with awards under our current incentive programs. We also offer an Employee Stock Purchase Plan whereby employees can purchase our common stock at a 15% discount based on the lower of the beginning or ending stock price during recurring nine-month periods stipulated in such program.

Our outstanding restricted stock awards generally vest over a three- or five-year period (for employees) or a three-year period (for outside directors). During the first quarter of 2010, we granted 396,753 shares of restricted stock to certain executive-level employees, of which 198,374 were time-vested restricted stock that vests over a three-year period and 198,379 were performance-based restricted stock. The performance-based restricted stock will vest over time only if specific performance measures are met for the applicable periods. One half of the performance based restricted stock will vest in March 2012 based on our two-year total shareholder return for 2010 and 2011 as measured against the total shareholder return of the companies comprising the S&P 500 Index for the same period. The other half will vest in March 2013 based on our three-year total shareholder return for 2010, 2011 and 2012 as measured against the total shareholder return of the companies comprising the S&P 500 Index for the same period. The 198,379 shares of performance-based restricted stock issued represent the target award. Each recipient has the opportunity to ultimately receive between 0% and 200% of the target restricted stock award depending on our total shareholder return in relation to that of the S&P 500 Index. We valued these performance-based awards using Monte-Carlo simulations. In addition, during the first nine months of 2010, we granted 525,377 shares of time-vested restricted stock (which vest over a three-year period) to certain other key employees and our outside directors as part of our normal recurring annual equity compensation programs.

During the third quarter of 2010, we granted 407,236 shares of restricted stock and approximately $15.2 million of deferred cash compensation awards to certain executive officers and other key employees as part of a retention

program in connection with our pending acquisition of Qwest. The shares of restricted stock will vest in equal installments on the first, second and third anniversaries of the closing date. Each employee receiving a deferred cash award will be entitled to receive one-half of the award on the closing date of the Qwest merger and the other half on the first anniversary of the closing date. Both the restricted stock grant and the deferred cash award will accelerate if we terminate the recipient without cause or under certain other conditions, and will be forfeited if the Qwest merger is not consummated. In addition to the above retention awards, 75,000 shares of restricted stock were granted to an incoming executive officer during the third quarter of 2010 (which vests fully at the end of the officer's term of employment).

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As of September 30, 2010, there were 3,054,000 shares of nonvested restricted stock outstanding at an average grant date fair value of $33.60 per share.

The total compensation cost for all share-based payment arrangements for the first nine months of 2010 and 2009 was $28.0 million and $39.6 million, respectively. As of September 30, 2010, there was $71.2 million of total unrecognized compensation cost related to our share-based payment arrangements, which we expect to recognize over a weighted-average period of 2.2 years. The $15.2 million of deferred cash compensation awards mentioned above is also unrecognized as of September 30, 2010.

(8) Income Taxes

Our effective income tax rate was 38.4% and 39.3% for the nine months ended September 30, 2010 and 2009, respectively.

Included in income tax expense is a $4.0 million charge incurred in the first quarter of 2010 related to the change in the tax treatment of the Medicare Part D subsidy as a result of the comprehensive health care reform legislation signed into law by the President in March 2010. In addition, a portion of our transaction costs associated with our pending acquisition of Qwest is considered non-deductible for income tax purposes. The treatment of these costs as non-deductible resulted in the recognition of approximately $1.4 million of higher income tax expense in the first nine months of 2010 than would have been recognized had such costs been deductible for income tax purposes.

The lump sum distributions made to certain executive officers in the first quarter of 2009 in connection with discontinuing the Supplemental Executive Retirement Plan were non-deductible for income tax purposes pursuant to Internal Revenue Code Section 162(m) limitations. Such treatment resulted in the recognition of approximately $6.7 million of income tax expense in the first quarter of 2009 above amounts that would have been recognized had such payments been deductible for income tax purposes. Our 2009 effective tax rate is also higher because a portion of our merger-related transaction costs incurred during the first nine months of 2009 are non-deductible for income tax purposes (with such treatment resulting in a $6.9 million increase to income tax expense). Such increases in income tax expense were partially offset by a $5.8 million reduction in income tax expense caused by a reduction to our deferred tax asset valuation allowance associated with state net operating loss carryforwards due to a state law change that we believe will allow us to utilize net operating loss carryforwards in the future. Prior to the law change, such net operating loss carryforwards were fully offset by a valuation allowance as it was more likely than not that we would not utilize these carryforwards prior to expiration.

(9) Business Segments

We are an integrated communications company engaged primarily in providing an array of communications services to our retail, business and wholesale customers, including local exchange, long distance, Internet access and

broadband services. We strive to maintain our customer relationships by, among other things, bundling our service offerings to provide our customers with a complete offering of integrated communications services. Because of the similar economic characteristics of our operations, we have utilized the aggregation criteria specified in the segment accounting guidance and concluded that we operate as one reportable segment. Our operating revenues for our products and services include the following components:

| | Three months ended September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| | (Dollars in thousands) | | | |
| Voice | $777,367 | 849,357 | 2,380,823 | 1,346,978 |
| Data | 480,111 | 460,213 | 1,420,550 | 743,073 |
| Network access | 264,319 | 317,529 | 825,503 | 620,639 |
| Other | 225,304 | 247,226 | 692,681 | 434,489 |
| Total operating revenues | $1,747,101 | 1,874,325 | 5,319,557 | 3,145,179 |

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Beginning in 2010, we have reclassified revenues generated from subscriber line charges to “Voice” revenues from “Network access” revenues to better align our presentation of such revenues with others in our industry and we have included revenues generated from our fiber transport, CLEC and security monitoring operations in “Other” revenues. In addition, certain third quarter 2009 revenues attributable to our legacy Embarq properties have been reclassified to conform to current presentation. Prior periods have been restated to reflect this new presentation.

We derive our voice revenues by providing local exchange telephone and retail long distance services to our customers in our local exchange service areas.

We derive our data revenues primarily by providing high-speed Internet access services (“DSL”) and data transmission services over special circuits and private lines in our local exchange service areas.

We derive our network access revenues primarily from (i) providing services to various carriers and customers in connection with the use of our facilities to originate and terminate their interstate and intrastate voice transmissions; (ii) receiving universal support funds which allows us to recover a portion of our costs under federal and state cost recovery mechanisms and (iii) receiving reciprocal compensation from competitive local exchange carriers and wireless service providers for terminating their calls.

We derive other revenues primarily by (i) providing fiber transport, CLEC and security monitoring services; (ii) leasing, selling, installing and maintaining customer premise telecommunications equipment and wiring, (iii) providing payphone services primarily within our local service territories and at various correctional facilities around the country, (iv) participating in the publication of local telephone directories, which allows us to share in revenues generated by the sale of yellow page and related advertising to businesses, (v) providing network database services and (vi) providing our video services, as well as other new product and service offerings.

We are required to contribute to several universal service fund programs and generally include a surcharge amount on our customers’ bills which is designed to fully recover our contribution costs. Such amounts are reflected on a gross basis in our statements of income (included in both operating revenues and expenses) and aggregated approximately $88 million for the nine months ended September 30, 2010 and $52 million for the nine months ended September 30, 2009.

(10) Fair Value Disclosure

As of September 30, 2010, we held life insurance contracts with cash surrender value that are required to be measured at fair value on a recurring basis. The following table depicts these assets held and the related tier designation pursuant to the accounting guidance related to fair value disclosure.

| Description | Balance Sept. 30, 2010 | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| | | (Dollars in thousands) | | |
| Cash surrender value of life insurance contracts | $99,751 | 99,751 | - | - |

(11) Commitments and Contingencies

Over 60 years ago, one of our indirect subsidiaries, Centel Corporation, acquired entities that may have owned or operated seven former plant sites that produced "manufactured gas" under a process widely used through the mid-1900s. Centel has been a subsidiary of Embarq since being spun-off in 2006 from Sprint Nextel, which acquired Centel in 1993. None of these plant sites are currently owned or operated by either Sprint Nextel, Embarq or their subsidiaries. On three sites, Embarq and the current landowners are working with the Environmental Protection Agency ("EPA") pursuant to administrative consent orders. Remediation 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 remediation costs. Further, Sprint Nextel has agreed to indemnify Embarq for most of any eventual liability arising from all seven of these sites. Based upon current circumstances, we do not expect this issue to have a material adverse impact on our results of operations or financial condition.

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In William Douglas Fulghum, et al. v. Embarq Corporation, et al., filed on December 28, 2007 in the United States District Court for the District of Kansas (Civil Action No. 07-CV-2602), a group of retirees filed a putative class action lawsuit challenging the decision to make certain modifications to Embarq's retiree benefits programs generally effective January 1, 2008. Defendants include Embarq, certain of its benefit plans, its Employee Benefits Committee and the individual plan administrator of certain of its benefits plans. Additional defendants include Sprint Nextel and certain of its benefit plans. In 2009, a ruling in Embarq's favor was entered in an arbitration proceeding filed by 15 former Centel executives, similarly challenging the benefits changes. Embarq and other defendants continue to vigorously contest these claims and charges. Given that this litigation is still in discovery, it is premature to estimate the impact this lawsuit could have to our results of operation or financial condition.

In April 2010, a series of lawsuits were filed by shareholders of Qwest Communications International Inc. in Colorado state and federal courts and in Delaware federal court, alleging that Qwest's officers and directors breached their fiduciary duties by failing to maximize the value to be received by Qwest's stockholders in connection with CenturyLink's recently announced acquisition of Qwest. CenturyLink was also named as a defendant in most of the lawsuits. On July 16, 2010, the parties entered into a memorandum of understanding reflecting the terms of their

agreement-in-principle for a settlement of all of the claims asserted in these actions. Pursuant to this agreement, defendants included additional disclosures in the final joint proxy statement-prospectus dated July 19, 2010, in response to allegations and claims asserted in certain of the complaints. If the settlement is consummated, all of the actions relating to the proposed transaction will be dismissed, with prejudice. We do not expect the settlement to have a material adverse impact to our results of operations or financial condition.

In December 2009, subsidiaries of CenturyLink filed two lawsuits against subsidiaries of Sprint Nextel to recover terminating access charges for VoIP traffic owed under various interconnection agreements and tariffs which presently approximate $32 million. One lawsuit, filed on behalf of all legacy Embarq operating entities, was tried in federal court in Virginia earlier this year and a ruling is expected in the fourth quarter of 2010. The other lawsuit, filed on behalf of all legacy CenturyLink operating entities, is pending in federal court in Louisiana. The lawsuits allege that Sprint Nextel has breached contracts, violated tariffs, and violated the Federal Communications Act by failing to pay these charges. We have not recorded a reserve related to this issue.

From time to time, we are involved in other proceedings incidental to our business, including administrative hearings of state public utility commissions relating primarily to rate making, actions relating to employee claims, occasional grievance hearings before labor regulatory agencies and miscellaneous third party tort actions. The outcome of these other proceedings is not predictable. However, based on current circumstances, we do not believe that the ultimate resolution of these other proceedings, after considering available insurance coverage, will have a material adverse effect on our financial position, results of operations or cash flows.

(12) Discontinuance of Regulatory Accounting

Through June 30, 2009, we accounted for our regulated telephone operations (except for the properties acquired from Verizon in 2002) in accordance with the provisions of Accounting Standards Codification 980-10 which addresses regulatory accounting under which actions by regulators can provide reasonable assurance of the recognition of an asset, reduce or eliminate the value of an asset and impose a liability on a regulated enterprise. Such regulatory assets and liabilities were required to be recorded and, accordingly, reflected in the balance sheet of an entity subject to regulatory accounting.

On July 1, 2009, we discontinued the accounting requirements of regulatory accounting upon the conversion of substantially all of our rate-of-return study areas to federal price cap regulation (based on the FCC's approval of our petition to convert our study areas to price cap regulation).

Upon the discontinuance of regulatory accounting, we reversed previously established regulatory assets and liabilities. Depreciation rates of certain assets established by regulatory authorities for our telephone operations subject to regulatory accounting have historically included a component for removal costs in excess of the related salvage value. Notwithstanding the adoption of accounting guidance related to the accounting for asset retirement obligations, regulatory accounting required us to continue to reflect this accumulated liability for removal costs in excess of salvage value even though there was no legal obligation to remove the assets. Therefore, we did not adopt the asset retirement obligation provisions for our telephone operations that were subject to regulatory accounting. Upon the discontinuance of regulatory accounting, such accumulated liability for removal costs included in accumulated depreciation was removed and an asset retirement obligation was established. Upon the discontinuance of regulatory accounting, we were required to adjust the carrying amounts of property, plant and equipment only to the extent the assets are impaired, as judged in the same manner applicable to nonregulated enterprises. We did not record an impairment charge related to the carrying value of the property, plant and equipment of our regulated telephone operations as a result of the discontinuance of regulatory accounting.

In the third quarter of 2009, upon the discontinuance of regulatory accounting, we recorded a non-cash extraordinary gain in our consolidated statements of income comprised of the following components (dollars, except per share amounts, in thousands):

| | Gain (loss) |
|---|---|
| Elimination of removal costs embedded in accumulated depreciation | $222,703 |
| Establishment of asset retirement obligation | (1,556) |
| Elimination of other regulatory assets and liabilities | (2,585) |
| Net extraordinary gain before income tax expense and noncontrolling interests | 218,562 |
| Income tax expense associated with extraordinary gain | (83,804) |
| Net extraordinary gain before noncontrolling interests | 134,758 |
| Less: extraordinary gain attributable to noncontrolling interests | (1,545) |
| Extraordinary gain attributable to CenturyLink, Inc. | $133,213 |
| | |
| Basic earnings per share of extraordinary gain | $.44 |
| Diluted earnings per share of extraordinary gain | $.44 |

Upon the discontinuance of regulatory accounting, we revised the lives of our property, plant and equipment to reflect the economic estimated remaining useful lives of the assets. In general, the estimated remaining useful lives of our telephone property were lengthened as compared to the rates used that were established by regulatory authorities.

Upon the discontinuance of regulatory accounting, we eliminated certain intercompany transactions with regulated affiliates that previously were not eliminated under the application of regulatory accounting. This has caused our operating revenues and operating expenses to be lower by equivalent amounts beginning in the third quarter of 2009.

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Item 2.
CenturyLink, Inc.
MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") included herein should be read in conjunction with MD&A and the other information included in our annual report on Form 10-K for the year ended December 31, 2009. The results of operations for the three months and nine months ended September 30, 2010 are not necessarily indicative of the results of operations which might be expected for the entire year.

On July 1, 2009, we acquired Embarq Corporation (“Embarq”) in a transaction that substantially expanded the size and scope of our business. The results of operations of Embarq are included in our consolidated results of operations beginning July 1, 2009. Due to the significant size of Embarq, direct comparisons of our results of operations for the nine months ended September 30, 2010 with the corresponding periods of 2009 are less meaningful than usual since most of the significant period to period variances are caused by the Embarq acquisition. We discuss below certain trends that we believe are significant, even if they are not necessarily material to the combined company.

We are an integrated communications company primarily engaged in providing an array of communications services to customers in 33 states, including local and long distance voice, wholesale network access, high-speed Internet access, other data services, and video services. In certain local and regional markets, we also provide fiber transport, competitive local exchange carrier services, security monitoring, and other communications, professional and business information services. We operate approximately 6.6 million access lines and serve approximately 2.4 million broadband customers, based on operating data as of September 30, 2010. For additional information on our revenue sources, see Note 9. For additional information on our acquisition of Embarq, see Note 2.

During the three months and nine months ended September 30, 2010 and 2009, we incurred a significant amount of one-time expenses, the vast majority of which are directly attributable to our acquisition of Embarq and our pending acquisition of Qwest Communications International Inc. ("Qwest") discussed in Note 3. Such expenses are summarized in the table below.

| Description | Three months ended September 30, 2010 | Three months ended September 30, 2009 | Nine months ended September 30, 2010 | Nine months ended September 30, 2009 |
|---|---|---|---|---|
| | (Dollars in thousands) | | | |
| Integration related costs associated with our acquisition of Embarq | $ 22,719 | 25,055 | 62,175 | 54,482 |
| Severance costs and accelerated recognition of share-based compensation and pension costs due to workforce reductions | 4,213 | 114,417 | 32,357 | 114,417 |
| Transaction and other costs associated with our acquisition of Embarq | - | 47,154 | - | 47,154 |
| Transaction and other costs associated with our pending acquisition of Qwest | 5,134 | - | 15,157 | - |
| Income tax charge due to a change in the treatment of Medicare subsidy receipts | - | - | 3,965 | - |
| Settlement and curtailment loss related to supplemental executive retirement plan | - | 8,900 | - | 16,611 |
| Charge incurred upon termination of our $800 million bridge facility | - | - | - | 8,000 |
| Total | $ 32,066 | 195,526 | 113,654 | 240,664 |

In addition, due to Internal Revenue Code Section 162(m) limitations, a portion of the lump sum distributions related to the termination of an executive retirement plan made in the first quarter of 2009 are reflected as non-deductible for income tax purposes and thus increased our effective income tax rate. Certain merger-related costs incurred during the first nine months of 2010 and 2009 are also non-deductible for income tax purposes and similarly increased our effective income tax rate. Such increase in our effective tax rate was partially offset by a reduction to our deferred tax asset valuation allowance associated with state net operating loss carryforwards during the first nine months of 2009. See Note 8 and "Income Tax Expense" below for additional information.

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Upon the discontinuance of regulatory accounting, during the third quarter of 2009 we recorded a one-time, non-cash extraordinary gain that aggregated approximately $218.6 million before income tax expense and noncontrolling

interests ($133.2 million after-tax and noncontrolling interests). See Note 12 for additional information.

During the last several years (exclusive of acquisitions and certain non-recurring favorable adjustments), we have experienced revenue declines in our voice and network access revenues primarily due to declines in access lines, intrastate access rates, minutes of use, and federal support fund payments. In an attempt to mitigate these declines, we plan to, among other things, (i) promote long-term relationships with our customers through bundling of integrated services, (ii) provide new services, such as video and wireless broadband, and other additional services that may become available in the future due to advances in technology, wireless spectrum sales by the Federal Communications Commission ("FCC") or improvements in our infrastructure, (iii) provide our broadband and premium services to a higher percentage of our customers, (iv) pursue acquisitions of additional communications properties if available at attractive prices, (v) increase usage of our networks and (vi) market our products and services to new customers.

In addition to historical information, this management's discussion and analysis includes certain forward-looking statements that are based on current expectations only, and are subject to a number of risks, uncertainties and assumptions, many of which are beyond our control. Actual events and results may differ materially from those anticipated, estimated or projected if one or more of these risks or uncertainties materialize, or if underlying assumptions prove incorrect. Factors that could affect actual results include but are not limited to: the timing, success and overall effects of competition from a wide variety of competitive providers; the risks inherent in rapid technological change; the effects of ongoing changes in the regulation of the communications industry (including those arising out of the FCC's proposed rules regarding intercarrier compensation and the Universal Service Fund and the FCC's National Broadband Plan released in the first quarter of 2010); our ability to effectively adjust to changes in the communications industry; our ability to successfully integrate Embarq into our operations, including the possibility that the anticipated benefits from the Embarq merger cannot be fully realized in a timely manner or at all, or that integrating Embarq's operations into ours will be more difficult, disruptive or costly than anticipated; our ability to successfully complete our pending acquisition of Qwest, including timely receiving all regulatory approvals and realizing the anticipated benefits of the transaction; our ability to effectively manage our expansion opportunities, including retaining and hiring key personnel; possible changes in the demand for, or pricing of, our products and services; our ability to successfully introduce new product or service offerings on a timely and cost-effective basis; our continued access to credit markets on favorable terms; our ability to collect our receivables from financially troubled communications companies; our ability to pay a $2.90 per common share dividend annually, which may be affected by changes in our cash requirements, capital spending plans, cash flows or financial position; unanticipated increases in our capital expenditures; our ability to successfully negotiate collective bargaining agreements on reasonable terms without work stoppages; the effects of adverse weather; other risks referenced from time to time in this report or other of our filings with the Securities and Exchange Commission, or SEC; and the effects of more general factors such as changes in interest rates, in tax rates, in accounting policies or practices, in operating, medical, pension or administrative costs, in general market, labor or economic conditions, or in legislation, regulation or public policy. These and other uncertainties related to our business, our pending acquisition of Qwest and our July 2009 acquisition of Embarq are described in greater detail in Part II, Item 1A of this report, as updated and supplemented by our subsequent SEC reports. You should be aware that new factors may emerge from time to time and it is not possible for us to identify all such factors nor can we predict the impact of each such factor on the business or the extent to which any one or more factors may cause actual results to differ from those reflected in any forward-looking statements. You are further cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this report. We undertake no obligation to update any of our forward-looking statements for any reason.

RESULTS OF OPERATIONS

Three Months Ended September 30, 2010 Compared
to Three Months Ended September 30, 2009

Net income attributable to CenturyLink, Inc. was $231.2 million and $280.8 million for the third quarter of 2010 and 2009, respectively. Net income before extraordinary item was $231.2 million and $147.6 million for the third quarter of 2010 and 2009, respectively. Diluted earnings per share for the third quarter of 2010 and 2009 was $.76 and $.94, respectively. Diluted earnings per share before extraordinary item for the third quarter of 2009 was $.49. As described in Note 12, upon the discontinuance of regulatory accounting, we recorded an extraordinary gain (net of income tax expense and noncontrolling interests) of approximately $133.2 million in the third quarter of 2009. As mentioned in the "Overview" section above, we incurred a significant amount of one-time expenses in the third quarter of 2010 and 2009, primarily all of which relates to our acquisition of Embarq and our pending acquisition of Qwest.

| | Three months ended September 30, | |
|---|---|---|
| | 2010 | 2009 |
| | (Dollars, except per share amounts, and shares in thousands) | |
| Operating income | $505,355 | 378,983 |
| Interest expense | (139,594) | (140,422) |
| Other income (expense) | 6,911 | 9,362 |
| Income tax expense | (141,083) | (99,876) |
| Income before noncontrolling interests and extraordinary item | 231,589 | 148,047 |
| Noncontrolling interests | (422) | (412) |
| Net income before extraordinary item | 231,167 | 147,635 |
| Extraordinary item, net of income tax expense and noncontrolling interests | - | 133,213 |
| Net income attributable to CenturyLink, Inc. | $231,167 | 280,848 |
| | | |
| Basic earnings per share | | |
| Before extraordinary item | $.76 | .49 |
| Extraordinary item | $- | .44 |
| Basic earnings per share | $.76 | .94 |
| | | |
| Diluted earnings per share | | |
| Before extraordinary item | $.76 | .49 |
| Extraordinary item | $- | .44 |
| Diluted earnings per share | $.76 | .94 |
| | | |
| Average basic shares outstanding | 300,702 | 298,133 |
| | | |
| Average diluted shares outstanding | 301,386 | 298,403 |

Operating income increased $126.4 million as a $127.2 million decrease in operating revenues was more than offset by a $253.6 million decrease in operating expenses.

Operating Revenues

| | Three months ended September 30, | |
|---|---|---|
| | 2010 | 2009 |
| | (Dollars in thousands) | |
| Voice | $777,367 | 849,357 |
| Data | 480,111 | 460,213 |
| Network access | 264,319 | 317,529 |
| Other | 225,304 | 247,226 |
| | $1,747,101 | 1,874,325 |

The $72.0 million decrease in voice revenues is primarily due to (i) a $42.0 million decrease due to a 7.7% decline in the average number of access lines; (ii) a $13.9 million decrease in custom calling feature revenues primarily due to the continued migration of customers to bundled service offerings at a lower effective rate; and (iii) a $9.3 million reduction in non-recurring revenues.

Total access lines declined 140,000 (2.1%) during the third quarter of 2010. We believe the decline in the number of access lines during the third quarter of 2010 is primarily due to the displacement of traditional wireline telephone services by other competitive services and recent economic conditions. Based on our current retention initiatives, we estimate that our access line loss will be between 7.5% and 8.0% in 2010.

Data revenues increased $19.9 million in the third quarter of 2010 due an $11.2 million increase in DSL-related revenues principally due to growth in the number of DSL customers and a $6.0 million increase in special access revenues.

Network access revenues decreased $53.2 million in the third quarter of 2010 primarily due to (i) a $38.4 million decrease due to a reduction in access rates and minutes (principally due to the loss of access lines and the displacement of minutes by wireless, electronic mail and other optional calling services) and (ii) an $11.2 million reduction in revenues from the federal Universal Service Fund primarily due to an increase in the nationwide average cost per loop factor used by the FCC to allocate funds among all recipients. We believe that access rates and minutes will continue to decline. Proceedings filed by interexchange carriers in several of our operating states or state-initiated legislation could, if successful, place further downward pressure on our access revenues.

Other revenues decreased $21.9 million in the third quarter of 2010 primarily due to (i) an $11.5 million reduction in nonregulated revenues; (ii) a $4.5 million decline in revenues from our wireless reseller product offering (which was discontinued in late 2009) and (iii) a $2.6 million reduction in directory revenues.

Operating Expenses

| | Three months ended September 30, | |
|---|---|---|
| | 2010 | 2009 |
| | (Dollars in thousands) | |
| Cost of services and products (exclusive of depreciation and amortization) | $605,548 | 684,865 |

| | | |
|---|---|---|
| Selling, general and administrative | 278,331 | 448,275 |
| Depreciation and amortization | 357,867 | 362,202 |
| | $1,241,746 | 1,495,342 |

Total operating expenses (exclusive of depreciation and amortization) decreased $249.3 million in the third quarter of 2010 compared to the third quarter of 2009. Such decrease was primarily caused by (i) a $119.1 million decrease in severance costs and accelerated recognition of share-based compensation and pension costs due to workforce reductions related to the Embarq acquisition and (ii) $47.2 million of transaction related costs (primarily investment banker and legal costs) that were incurred in the third quarter of 2009 related to the Embarq acquisition. In addition, salaries and benefits (exclusive of the above described severance, share-based compensation and pension costs) decreased approximately $39.5 million in the third quarter of 2010 compared to the third quarter of 2009 primarily due to the impact of workforce reductions, and the cost of providing long distance services decreased $34.0 million due to reduced reliance on third party providers.

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Depreciation and amortization decreased $4.3 million primarily due to a reduction in amortization expense associated with the customer list intangible asset established in connection with our Embarq acquisition (such asset is being amortized over an accelerated method).

Interest Expense

Interest expense increased $828,000 in the third quarter of 2010 compared to the third quarter of 2009.

Other Income (Expense)

Other income (expense) includes the effects of certain items not directly related to our core operations, including gains and losses from nonoperating asset dispositions and impairments, our share of income from our 49% interest in a cellular partnership, interest income and allowance for funds used during construction. Other income (expense) was $6.9 million for the third quarter of 2010 compared to $9.4 million for the third quarter of 2009.

Income Tax Expense

Our effective income tax rate was 37.9% and 39.5% for the third quarter of 2010 and 2009, respectively. During 2009, certain transaction costs incurred in connection with our acquisition of Embarq were treated as non-deductible for income tax purposes.

Extraordinary Item

Upon the discontinuance of regulatory accounting, we recorded a one-time extraordinary gain of approximately $133.2 million (net of income tax expense and noncontrolling interests) in the third quarter of 2009. See Note 12 for additional information related to this extraordinary gain.

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Nine Months Ended September 30, 2010 Compared

to Nine Months Ended September 30, 2009

Net income attributable to CenturyLink, Inc. was $722.5 million and $417.0 million for the first nine months of 2010 and 2009, respectively. Net income before extraordinary item was $722.5 million and $283.8 million for the nine months ended September 30, 2010 and 2009, respectively. Diluted earnings per share for the first nine months of 2010 and 2009 was $2.39 and $2.50, respectively. Diluted earnings per share before extraordinary item for the first nine months of 2009 was $1.70. As described in Note 12, upon the discontinuance of regulatory accounting, we recorded an extraordinary gain (net of income tax expense and noncontrolling interests) of approximately $133.2 million in the third quarter of 2009. As mentioned in the "Overview" section above, we incurred a significant amount of one-time expenses in the first nine months of 2010 and 2009, primarily all of which relate to our acquisition of Embarq and our pending acquisition of Qwest. The increase in the number of average diluted shares outstanding is primarily attributable to the common stock issued in connection with our acquisition of Embarq on July 1, 2009.

| | Nine months ended September 30, | |
|---|---|---|
| | 2010 | 2009 |
| | (Dollars, except per share amounts, and shares in thousands) | |
| Operating income | $1,573,573 | 692,763 |
| Interest expense | (425,068) | (237,391) |
| Other income (expense) | 24,719 | 15,179 |
| Income tax expense | (449,552) | (185,796) |
| Income before noncontrolling interests and extraordinary item | 723,672 | 284,755 |
| Noncontrolling interests | (1,133) | (936) |
| Net income before extraordinary item | 722,539 | 283,819 |
| Extraordinary item, net of income tax expense and noncontrolling interests | - | 133,213 |
| Net income attributable to CenturyLink, Inc. | $722,539 | 417,032 |
| | | |
| Basic earnings per share | | |
| Before extraordinary item | $2.40 | 1.70 |
| Extraordinary item | $- | .80 |
| Basic earnings per share | $2.40 | 2.50 |
| | | |
| Diluted earnings per share | | |
| Before extraordinary item | $2.39 | 1.70 |
| Extraordinary item | $- | .80 |
| Diluted earnings per share | $2.39 | 2.50 |
| | | |
| Average basic shares outstanding | 300,058 | 165,558 |
| | | |
| Average diluted shares outstanding | 300,663 | 165,666 |

Operating income increased $880.8 million due to a $2.174 billion increase in operating revenues and a $1.294 billion increase in operating expenses. Such increases in operating revenues, operating expenses and operating income were substantially due to our July 1, 2009 acquisition of Embarq, which impacted our operating results for the entire nine months ended September 30, 2010 but only a third of the comparable period of 2009.

As a result of the discontinuance of the application of regulatory accounting effective July 1, 2009 (as more fully described in our 2009 Annual Report on Form 10-K and Note 12), we have eliminated all intercompany transactions with regulated affiliates since the third quarter of 2009 that previously were not eliminated under the application of regulatory accounting. This has caused our revenues and operating expenses to be lower by equivalent amounts (approximately $104 million) for the nine months ended September 30, 2010 as compared to the nine months ended September 30, 2009.