

Embarq CORP
Form 424B4
July 19, 2006
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File No. 333-133343

PROSPECTUS

Embarq Corporation

2,500 Restricted Shares of Common Stock

371,500 Restricted Stock Units and

371,500 Shares of Common Stock Issuable in Connection with the Restricted Stock Units

We are currently a subsidiary of Sprint Nextel Corporation. Sprint Nextel has determined to spin off our company by distributing all of our common stock to its stockholders as a dividend.

The restricted shares of our common stock, or restricted stock, and restricted stock units, or RSUs, covered by this prospectus will be issued, in connection with the spin-off and effective as of the distribution date, to current and former Sprint Nextel employees who hold Sprint Nextel restricted stock or RSUs at that time and who will not become Embarq employees at the spin-off. The restricted stock and RSUs will be subject to or issued under our 2006 Equity Incentive Plan. Based on the distribution ratio for the spin-off, the holders of Sprint Nextel restricted stock will receive one share of our restricted stock for every 20 shares of Sprint Nextel restricted stock held on the distribution date. The RSUs represent the right to receive the number of shares of our common stock that would have been received with respect to the number of shares of Sprint Nextel common stock issuable under the corresponding Sprint Nextel RSU at the time of the distribution. The restricted stock and RSUs covered by this prospectus will have substantially the same terms and conditions as the corresponding Sprint Nextel restricted stock and RSUs. We will not receive any proceeds from the issuance of the common stock or RSUs covered by this prospectus.

There is no trading market for our RSUs. Before May 4, 2006, there was no trading market for our common stock. On that date, shares of our common stock began trading on a when issued basis. Our common stock has been authorized for listing on the New York Stock Exchange, under the symbol EQ.

See **Risk Factors** beginning on page 11 for a discussion of certain risks relating to the spin-off, our business and ownership of our common stock.

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Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

The date of this prospectus is May 10, 2006.

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You should not assume that the information contained in this prospectus is accurate as of any date other than the date set forth on the cover. Changes to the information contained in this prospectus may occur after that date, and we undertake no obligation to update the information, except in the normal course of our public disclosure obligations and practices. You should be aware of certain risks relating to the spin-off, our business and ownership of our common stock, which are described under the heading "Risk Factors."

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SUMMARY

This summary highlights selected information contained in this prospectus. We urge you to read carefully this prospectus in its entirety. Except as otherwise indicated, references in this prospectus to Embarq, we, us or our are to Embarq Corporation and its subsidiaries. Effective August 12, 2005, Nextel Communications, Inc., which we refer to as Nextel, merged with and into a subsidiary of Sprint Corporation. Following the merger, which we refer to as the Sprint Nextel merger, Sprint changed its name to Sprint Nextel Corporation, which we refer to as Sprint Nextel. References in this prospectus to Sprint are to Sprint Corporation before the completion of the Sprint Nextel merger.

Our Company

We are a new company that, following the spin-off, will own the incumbent local communications operations conducted by Sprint Nextel and reported as its Local segment in its financial statements. The spin-off is a transaction that involves two general steps. First, Sprint Nextel will transfer to us assets consisting primarily of Sprint Nextel's incumbent local communications operations. In exchange for, and as a condition to, the transfer of assets and assumption by us of certain liabilities, Sprint Nextel will receive (1) shares of common stock of our company and (2) senior notes and the cash proceeds of our new borrowings, in an aggregate amount of approximately \$6.6 billion. Secondly, Sprint Nextel will distribute pro rata to its stockholders shares of our common stock. We refer to this last step as the distribution. The distribution date for the distribution is expected to occur on or about May 17, 2006. As a result of the spin-off, we will become a separate public company, although we will continue to have a number of significant commercial arrangements with Sprint Nextel. Following the spin-off, we expect to be included in the *Fortune* 500 list based on our historic revenues and those of other companies included in the most recent version of that list.

We offer regulated local communications services as an incumbent local exchange carrier, or ILEC, to roughly 5% of U.S. households, with approximately 7.26 million consumer and business access lines, as of March 31, 2006. Following the spin-off, we will provide a suite of communications services, consisting of local and long distance voice and data services, including high-speed Internet access. We also expect to provide access to our local network and other wholesale communications services for other carriers, communications equipment for business markets, and other communications-related services. Following the spin-off, we expect to provide code division multiple access, or CDMA, based wireless voice and data services in most of our local service territories to consumers and small business customers through a non-exclusive wholesale arrangement involving a mobile virtual network operator, or MVNO, relationship, with Sprint Nextel. We also expect to offer certain wireline voice and data, wireless and video services through sales agency and other wholesale agreements.

Following the spin-off, we expect to have total indebtedness of approximately \$7.25 billion. A portion of this debt is currently outstanding, and we will incur the remainder, approximately \$6.6 billion, in connection with the spin-off. We intend to transfer the cash proceeds of the new indebtedness and issue senior notes in partial consideration for the assets to be transferred to us by Sprint Nextel in the spin-off. The transfer of the assets is conditioned on our incurrence of the new indebtedness and making the related transfers to Sprint Nextel.

We will continue to serve our local service territories, which are located in 18 states. We have a significant presence in Florida, North Carolina, Nevada and Ohio (these four states represent nearly two-thirds of all of our access lines). The remaining states (in order of number of access lines) are: Virginia, Pennsylvania, Texas, Indiana, Missouri, Tennessee, New Jersey, Minnesota, Kansas, South Carolina, Washington, Oregon, Nebraska and Wyoming.

Our Strengths

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We believe our strengths will enable us to continue to generate cash flow and to grow new streams of revenue by diversifying our offerings, such as high-speed Internet services, while also allowing us to focus our

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efforts on minimizing the loss of access lines in our traditional local wireline business. Our principal strengths include:

Longstanding customer relationships

As the incumbent provider of communications services in our local service territories, we have developed longstanding customer relationships. Based on our estimates, we provide communications services to approximately 85% of the total potential customers in our local service territories, which we define to include potential customers who purchase local wireline services or wireless services in lieu of wireline. We manage our service offerings at the local level to serve the needs of each community effectively and efficiently.

Pre-existing network infrastructure

As the incumbent provider of communications services in our local service territories, we have a network infrastructure already in place to serve our customers' current needs and that can also serve as the foundation for offering new services to meet our customers' evolving needs.

Ability to offer a wide array of bundled services

We believe that following the spin-off, we will be among the few communications service providers in many of the markets we serve that can provide a suite of services to both consumers and business customers that includes wireline voice services, high-speed data, consumer video entertainment services, and communications equipment for business customers. We plan to expand our service offerings by providing CDMA-based wireless voice and data services to our consumers and business customers in our local service territories through our MVNO and sales agency relationships with Sprint Nextel. We seek to maximize profitable communications services revenue per customer through the convenience and cost savings of using a single provider for a broad suite of services. By offering a bundled package of products and services, we have improved our long distance and high-speed Internet services penetration, resulting in increased revenue and lower customer churn, which have helped to offset revenue decreases driven by continuing declines in access lines and product substitution. Going forward, we expect to go beyond merely bundling services by offering truly integrated or converged services and we believe that, combined with the modernization of our networks (such as by circuit to packet migration) and support systems, this will allow us to be more competitive and thereby achieve a greater market share.

Favorable demographics

The annual growth in number of households in our local service territories has averaged approximately 1.8% over the three years ended December 31, 2005, compared to the national average over that period of approximately 1.3%. Our local service territories cover all or part of six of the 20 fastest growing metropolitan statistical areas, or MSAs, based on the 2000 census. Approximately 29% of our access lines as of December 31, 2005 were in those MSAs.

Service and product expertise

We believe that our strong heritage provides a solid foundation for the continued development and delivery of cost-effective products and services. We intend to build on the core strengths of our business to fulfill our mission of providing high quality, cost-effective products and services and innovations that address our customers' communications needs.

Experienced management team

We have a senior management team with experience managing the expansion of communications companies, including experience at Sprint.

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Business Strategy

Our strategy is to maximize profitable communications services revenue per customer by selling integrated and bundled products and services and meeting the needs of our consumers and business and wholesale customers within our local service territories. Four key goals will support this strategy:

Provide useful products and solutions to attract and retain customers by marketing integrated service offerings including video and wireless services, expanding high speed Internet coverage, developing simplified products that meet our customers' needs and updating our networks to provide Internet Protocol, or IP, based services such as Voice over Internet Protocol, or VoIP;

Improve customer experience and perception of service and product offerings by providing customers with simplified billing, maintaining service quality and reliability, expanding our distribution channels, providing competitively priced services and using our local market knowledge and experience to provide customers with superior service.

Manage costs by implementing process improvements, focusing our network investment in areas that support enhanced services including high-speed network facilities, improving the efficiency and effectiveness of our customer support operations and simplifying our information technology, or IT, support systems.

Maintain a customer-focused culture that encourages high performance and employee satisfaction by maintaining our commitment to the communities we serve, providing innovative and competitive services while providing an exceptional customer experience, making Embarq a great place to work by improving employee communication, and aligning management and employee incentives and compensation plans.

We describe in this prospectus the local communications business to be transferred to us by Sprint Nextel in the spin-off as if it were our business for all historical periods described. However, we are a newly formed entity. References in this document to our historical assets, liabilities, products, business or activities generally refer to the historical assets, liabilities, products, business or activities of the transferred business as it was conducted as part of Sprint Nextel and its subsidiaries before the spin-off. Our historical financial results as part of Sprint Nextel contained in this prospectus may not be indicative of our financial results in the future as an independent company or reflect what our financial results would have been had we been an independent company during the periods presented.

Our principal executive offices are located at 5454 W. 110th Street, Overland Park, Kansas 66211 and our main telephone number is (913) 323-4637. We were incorporated in Delaware in 2005.

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The Spin-off

Assets and Liabilities Transferred to Embarq	<p>We and Sprint Nextel have entered into a separation and distribution agreement that contains the key provisions relating to the separation of our business from Sprint Nextel and the distribution of our shares of common stock. The separation and distribution agreement identifies the assets to be transferred, liabilities to be assumed and contracts to be assigned to us by Sprint Nextel in the spin-off and describes when and how these transfers, assumptions and assignments will occur. See Agreements with Sprint Nextel Separation and Distribution Agreement.</p>
Relationship with Sprint Nextel After the Spin-off	<p>Before the distribution date, we and Sprint Nextel will also enter into agreements to define the initial relationship between Sprint Nextel and us with respect to a number of services that will be provided. We are entering into commercial service agreements with Sprint Nextel pursuant to which we will purchase certain wireless and long distance services from Sprint Nextel to support our business and Sprint Nextel will purchase special access, calling number identification and other services from us. The commercial service agreements that we are entering into with Sprint Nextel have terms that generally extend from two to seven years and, in certain circumstances, may be terminated earlier by us or Sprint Nextel.</p> <p>We have also entered into transition services agreements under which we and Sprint Nextel will provide each other certain services on an interim basis.</p> <p>We and Sprint Nextel will also enter into an agreement providing for the sharing of taxes incurred before and after the distribution, certain indemnification rights with respect to tax matters and certain restrictions to preserve the tax-free status of the distribution to Sprint Nextel.</p> <p>See Risk Factors Risk Factors Relating to the Spin-off The agreements that we are entering into with Sprint Nextel may involve, or may appear to involve, conflicts of interest and Some of the agreements we are entering into with Sprint Nextel contain early termination provisions that, if exercised by Sprint Nextel, could be materially detrimental to our ability to operate our business. See also Agreements with Sprint Nextel.</p>
Management of Embarq	<p>In connection with the spin-off, we have established a board consisting of eight initial directors. After the initial term, directors will be elected each year at our annual meeting of stockholders. See Management Board Structure.</p> <p>Our executive officers will continue to serve in their respective designated capacities after the spin-off. See Management Directors and Executive Officers.</p>
Debt	<p>Effective as of the distribution date, we will enter into a credit facility with certain financial institutions. On the distribution date, we expect to transfer to Sprint Nextel approximately \$6.6 billion in the form of</p>

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cash and senior notes in partial consideration of Sprint Nextel's transfer to us of the local telecommunications division and wholesale product distribution operations and the consumer and certain business long distance customers located in our local service territories. Although the allocation of that consideration paid to Sprint Nextel may be adjusted, we currently expect that we will issue to Sprint Nextel senior notes in an aggregate initial principal amount of approximately \$4.5 billion and transfer to Sprint Nextel approximately \$2.1 billion in cash borrowed under our credit facility. Including these borrowings and existing borrowings of our subsidiaries, we will have approximately \$7.25 billion of indebtedness on the distribution date. Our incurrence of the new indebtedness and the related transfers to Sprint Nextel are conditions to the completion of the spin-off. The credit facility will also provide a revolving credit arrangement to satisfy other financing needs. We anticipate that immediately following the distribution date, we will have combined cash and equivalents and available liquidity under the credit facility of \$1.2 billion. We expect that the terms of our credit facility will include customary covenants that, among other things, will require us to satisfy certain financial tests, maintain certain financial ratios, restrict our ability to create liens, which could limit our ability to incur additional indebtedness, and restrict the ability of our subsidiaries to incur additional indebtedness. To the extent permitted, we may also incur additional indebtedness from time to time for general corporate purposes, including working capital requirements, capital expenditures and future acquisitions. See

Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources Liquidity. See also Risk Factors Risk Factors Relating to the Spin-off Following the spin-off, we will have substantial indebtedness, which could restrict our ability to pay dividends and have a negative impact on our financing options and liquidity position. Our financing arrangements will subject us to various restrictions that could limit our operating flexibility and Risk Factors Relating to our Business Our capital raising may adversely affect holders of our common stock by increasing our leverage and reducing our credit ratings.

Timeline of Key Events Related to the Spin-off *Before the Distribution Date:*

We will receive all required regulatory approvals.

The Sprint Nextel board of directors will determine the record date for the dividend of our common stock to Sprint Nextel stockholders, declare that dividend and determine the distribution ratio.

Our common stock began trading on a when issued basis on the second trading day before the record date for the spin-off.

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Sprint Nextel, as our sole stockholder, will:

elect our board of directors;

approve our adoption of certain benefit plans; and

approve various actions related to the spin-off.

Our board of directors will approve:

the adoption of certain benefit plans;

our corporate governance documents and policies; and

various actions related to the spin-off.

The Securities and Exchange Commission, or the SEC, will declare effective under the Securities Exchange Act of 1934, as amended, which we refer to as the Exchange Act, the registration statement for the registration of our common stock issued in connection with the distribution.

Sprint Nextel will mail the information statement relating to the spin-off to its stockholders.

Sprint Nextel and Sprint Capital Corporation will enter into an exchange agreement pursuant to which Sprint Nextel will agree to transfer our senior notes and the cash proceeds of our new borrowings that will be paid to Sprint Nextel to Sprint Capital Corporation in satisfaction of intercompany indebtedness.

We will enter into a credit facility, which will be effective as of the distribution date.

The SEC will declare effective under the Securities Act of 1933, as amended, which we refer to as the Securities Act, the registration statement of which this prospectus is a part and the registration statement relating to Sprint Capital Corporation's resale of the senior notes.

We, Sprint Capital Corporation and certain underwriters will enter into an underwriting agreement relating to Sprint Capital Corporation's resale of all or a

portion of the senior notes.

On or Before the Distribution Date:

We will have entered into numerous agreements with Sprint Nextel, including:

the separation and distribution agreement;

transition services agreements;

commercial service agreements;

the tax sharing agreement;

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intellectual property agreements; and

the employee matters agreement.

On the Distribution Date:

Sprint Nextel will receive opinions of counsel as to the tax-free nature of the distribution.

Sprint Nextel will transfer to us assets consisting primarily of Sprint Nextel's incumbent local communications operations.

In exchange for, and as a condition to, Sprint Nextel's transfer to us of the assets and our assumption of certain liabilities, we will (1) issue to Sprint Nextel shares of our common stock and (2) issue to Sprint Nextel our senior notes and transfer to Sprint Nextel the cash proceeds of our new borrowings, in an aggregate amount of approximately \$6.6 billion.

Sprint Nextel will distribute its shares of our common stock pro rata to all of its stockholders of record as of the record date.

We will issue shares of restricted stock and RSUs, including the restricted stock and RSUs being issued under this prospectus, to holders of Sprint Nextel restricted stock and RSUs.

Following the Distribution Date:

We expect that our common stock will begin trading on the New York Stock Exchange on a regular way basis under the symbol "EQ" on the first trading day following the distribution date.

We will operate as a separate public company.

Sprint Nextel will transfer to Sprint Capital Corporation, in satisfaction of indebtedness owed to Sprint Capital Corporation, the senior notes and the cash proceeds of our new borrowings that will be paid to Sprint Nextel.

We expect that Sprint Capital Corporation will subsequently sell all or a portion of the senior notes for cash in an underwritten public offering.

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We expect to pay a regular quarterly dividend beginning in the third quarter of 2006. We currently expect the dividend to be in the aggregate amount of approximately \$75 million in each full quarter. All decisions regarding the declaration and payment of dividends, including with respect to the initial dividend, will be at the discretion of our board of directors and will be evaluated from time to time in light of our financial condition, earnings, growth prospects, funding requirements, applicable law and other factors our board deems relevant. See Dividend Policies.

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Certain Anti-takeover Effects	Provisions expected to be included in our certificate of incorporation and bylaws and certain provisions of Delaware law may have the effect of making it more difficult for a potential acquirer to obtain control of our company in a transaction not approved by our board of directors. Moreover, certain provisions of the tax sharing agreement that we will enter into with Sprint Nextel in connection with the spin-off could discourage potential acquisition proposals. See Risk Factors Risk Factors Relating to Ownership of our Common Stock Anti-takeover provisions of our certificate of incorporation and bylaws , the terms of our spin-off from Sprint Nextel and certain provisions of Delaware law could delay or prevent a change of control that you may favor and Description of Our Capital Stock Common Stock Anti-Takeover Provisions .
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Risk Factors	You should review the risks relating to the spin-off, our business and ownership of our common stock described in Risk Factors .
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The Restricted Stock and RSUs

In connection with the spin-off, we are issuing our restricted stock, RSUs and common stock issuable under the RSUs under this prospectus to current and former Sprint Nextel employees who hold Sprint Nextel restricted stock and RSUs at the time of the distribution and who will not become Embarq employees at the spin-off. Based on the distribution ratio for the spin-off, the holders of Sprint Nextel restricted stock will receive one share of our restricted stock for every 20 shares of Sprint Nextel restricted stock held on the distribution date. The RSUs represent the right to receive the number of shares of our common stock that would have been received with respect to the number of shares of Sprint Nextel common stock issuable under the corresponding Sprint Nextel RSU at the time of the distribution. The restricted stock and RSUs covered by this prospectus will have substantially the same terms and conditions as the corresponding Sprint Nextel restricted stock and RSUs. The current and former Sprint Nextel employees receiving the restricted stock and RSUs covered by this prospectus will also retain their Sprint Nextel restricted stock and RSUs, which will continue to represent the right to receive the same number of shares of Sprint Nextel common stock as before the distribution. For additional information regarding the restricted stock and RSUs, see [Description of Restricted Stock and RSUs](#).

The Offering

Securities Offered	2,500 shares of restricted stock and 371,500 RSUs that represent the right to receive 371,500 shares of our common stock.
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Use of Proceeds	We will not receive any proceeds from the issuance of the common stock or RSUs covered by this prospectus.
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Listing	There is no trading market for our RSUs. Before May 4, 2006, there was no trading market for our common stock. On that date, shares of our common stock began trading on a when issued basis. Our common stock has been authorized for listing on the New York Stock Exchange, under the symbol EQ .
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The following table sets forth our summary combined financial data. The following financial position data as of December 31, 2005 and 2004 and results of operations and cash flow data for the years ended December 31, 2005, 2004 and 2003 have been derived from our combined financial statements that were audited by KPMG LLP. The results of operations and cash flow data for the years ended December 31, 2002 and 2001 and the financial position data as of December 31, 2003, 2002 and 2001 have been derived from our unaudited combined financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. The following information should be read together with our combined financial statements and the notes related to those combined financial statements. See Management's Discussion and Analysis of Financial Condition and Results of Operations and Index to Financial Statements and Financial Statement Schedule.

Our combined financial information may not be indicative of our future performance and does not necessarily reflect what our financial condition and results of operations would have been had we operated as a separate, stand-alone entity during the periods presented, particularly since many changes will occur in our operations and capitalization as a result of our spin-off from Sprint Nextel.

	As of and For the Years Ended December 31,				
	2005	2004	2003(1)	2002	2001
(millions, except as noted)				(unaudited)	(unaudited)
Results of Operations					
Net operating revenues	\$ 6,254	\$ 6,139	\$ 6,159	\$ 6,250	\$ 6,547
Total operating expense	4,702	4,549	4,543	4,654	4,965
Operating income (2)	1,552	1,590	1,616	1,596	1,582
Net income (3)	878	917	1,554	933	998
Cash Flow Data					
Net cash provided by operating activities	\$ 1,904	\$ 2,064	\$ 1,804	\$ 2,258	\$ 1,832
Capital expenditures	828	975	1,118	1,136	1,353
Financial Position					
Total assets	\$ 9,221	\$ 9,329	\$ 9,268	\$ 8,745	\$ 9,593
Property, plant and equipment, gross	19,784	19,470	18,975	18,332	17,684
Property, plant and equipment, net	7,804	7,977	7,979	7,444	7,371
Total debt (including short-term and long-term borrowings)	1,125	1,240	1,392	2,033	2,360
Total business equity	4,852	4,960	4,889	4,004	4,490
Other Data (unaudited):					
OIBDA (4)	\$ 2,531	\$ 2,562	\$ 2,608	\$ 2,680	\$ 2,638
Ending access lines (5)	7.35	7.67	7.90	8.08	8.21
Ending high-speed Internet lines in service (thousands)	693	492	304	151	55

(1) The results of operations and cash flow data for the year ended December 31, 2003 is derived from our audited combined financial statements. The financial position data as of December 31, 2003 is unaudited.

(2) In 2005, we recorded \$79 million in allocated asset impairments of which \$77 million resulted from the abandonment of a network monitoring software application.

In 2004, we recorded restructuring charges of \$40 million. The restructuring charges were related to severance costs associated with Sprint Nextel's organizational realignment.

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In 2003, we recorded restructuring charges of \$25 million. The restructuring charges were related to severance costs associated with Sprint Nextel's organizational realignment, in the amount of \$26 million,

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and \$5 million for asset impairments. The 2003 restructuring charges were offset by the finalization of the 2001 and 2002 restructuring liability in the amount of \$6 million.

In 2002, we recorded restructuring charges of \$57 million. The restructuring charges were primarily related to the consolidations in Sprint Nextel's network, information technology and billing and accounts receivable organizations, as well as additional steps to reduce overall operating costs.

In 2001, we recorded restructuring charges of \$113 million. The restructuring charges were primarily related to consolidation and streamlining of marketing and network operations.

- (3) In 2003, we adopted Statement of Financial Accounting Standard No. 143, *Accounting for Asset Retirement Obligations*. In connection with this adoption, we recognized a cumulative effect of change in accounting principle credit, net of tax, of \$258 million. Additionally, in 2003, we recognized an after tax gain of \$375 million related to the sale of the directory publishing business.
- (4) We define Operating Income Before Depreciation and Amortization, or OIBDA, as operating income adjusted to exclude depreciation and amortization.

We use OIBDA, among other metrics, to evaluate our operating performance and as one of the components of incentive compensation targets for eligible employees. OIBDA is a performance measure that captures the income and expenses which relate to our business and are managed by our executives. Because our business is capital intensive, depreciation and amortization are excluded from the measurement as they are non-cash items. Other relevant, internal management measures addressing return on invested capital as well as U.S. generally accepted accounting principles, or GAAP, measures are used to manage the level of and return on capital investments. Overall financing and investment decisions are managed at a corporate level. We believe the presentation of this measure is relevant and is useful for investors as it enhances the transparency of our financial information by allowing them to view our performance through the eyes of our executive management. OIBDA is also among the primary measures used externally by analysts and peers in the industry for purposes of assessing operating performance.

Since OIBDA is not a measure of performance calculated in accordance with GAAP it should not be considered in isolation from, or as a substitute for, net income. As required by the SEC, provided below are reconciliations of OIBDA to income from continuing operations, the most directly comparable GAAP financial measure.

Reconciliation of Non-GAAP Measure

	As of and for the Years Ended December 31,				
	2005	2004	2003	2002	2001
(millions)				(unaudited)	(unaudited)
Income from continuing operations	\$ 894	\$ 917	\$ 920	\$ 897	\$ 958
Income tax expense	578	569	569	552	598
Other (income) expense, net (a)	(3)	2	6	12	(128)
Premium on early retirement of debt			5		

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Interest expense	83	102	116	136	154
Depreciation and amortization	979	972	992	1,084	1,056
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
OIBDA	\$ 2,531	\$ 2,562	\$ 2,608	\$ 2,681	\$ 2,638
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>

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- (a) The \$128 million of income reflected in 2001 arose primarily from curtailment gains resulting from the amendment of certain post-retirement benefit plans.
- (5) At March 31, 2006, we had approximately 7.26 million access lines.

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RISK FACTORS

You should carefully consider the risks described below, together with all of the other information included in this prospectus, in evaluating our company and our common stock. If any of the risks described below actually occurs, our business, financial results, financial condition and stock price could be materially adversely affected.

Risk Factors Relating to the Spin-off

Our future financial performance may be worse than the performance reflected in our historical financial information included in this prospectus.

The historical financial information we have included in this prospectus may not reflect what our results of operations, financial position and cash flows would have been had we been an independent company during the periods presented or be indicative of what our results of operations, financial position and cash flows may be in the future when we are an independent company. This is primarily a result of the following three factors:

our historical financial information reflects allocations for services historically provided by Sprint Nextel, and we expect these allocations to be different from the costs we will incur for these services in the future as a smaller independent company, including with respect to services provided by Sprint Nextel under the transition services agreements and other commercial service agreements. We expect that, in some instances, the costs incurred for these services as a smaller independent company will be higher than the share of total Sprint Nextel expenses allocated to us historically;

our historical financial information does not reflect the debt and related interest expense (as shown on the pro forma contractual obligations table under Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources Liquidity) that we will incur as part of the spin-off, including debt we will incur in order to transfer cash and issue securities to Sprint Nextel in consideration of Sprint Nextel's transfer to us of the local telecommunications division assets; and

the historical financial information does not reflect the increased costs associated with being an independent company, including changes that we expect in our cost structure, personnel needs, financing and operations of the transferred business as a result of the spin-off from Sprint Nextel (e.g., we may experience losses on our wholesale wireless operations following the spin-off), and from reduced economies of scale.

For these reasons, our future financial performance may be worse than the performance implied by the historical financial information we have presented in this prospectus.

For additional information about the past financial performance of our business and the basis of the presentation of the historical combined financial statements, see Selected Combined Financial Data, Management's Discussion and Analysis of Financial Condition and Results of Operations, Unaudited Pro Forma Combined Financial Information and the historical combined financial statements and the accompanying notes included elsewhere in this prospectus.

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We have no history operating as a separate public company on which you can evaluate our business strategy.

Historically, our business has been principally operated as one of Sprint Nextel's business units, and therefore we have no operating history as a separate public company. Accordingly, there can be no assurance that our business strategy and operations will be successful on a stand-alone basis.

We may experience increased costs or decreased operational efficiencies as a result of our need to replace corporate functions previously provided by Sprint Nextel.

Sprint Nextel has historically performed many important corporate functions for our operations, including information technology support, treasury, accounting, finance and tax administration, human resources, legal, regulatory, public relations and strategic development functions. Following the spin-off, Sprint Nextel will

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provide support to us with respect to certain of these functions, including customer bill printing and mailing services, information technology application and support services, data center services and human resources helpdesk services, on a transitional basis for up to two years. We will need to replicate certain facilities, systems, infrastructure and personnel to which we will no longer have access after our spin-off from Sprint Nextel. These initiatives will be costly to implement. We estimate that capital expenditures and other costs associated with developing and implementing our own support functions, including information technology systems and infrastructure, in these areas will be approximately \$237 million.

In addition, there may be an adverse operational impact on our business as a result of the significant time of our management and other employees and internal resources that will need to be dedicated to building these capabilities during the first few years following the spin-off that otherwise would be available for other business initiatives and opportunities. When we begin to operate these functions independently, if we do not have in place adequate systems and business functions of our own, or obtain them from other providers, we may not be able to operate our company effectively and our profitability may decline.

Our profitability may be adversely affected when revenues for certain support functions that we will provide to Sprint Nextel on a transitional basis following the spin-off cease.

Following the spin-off, we will provide support to Sprint Nextel with respect to certain functions on a transitional basis for up to two years. Among the principal services that we will provide to Sprint Nextel are billing support services, field technician support for complex voice customers and information technology application services. Amounts paid by Sprint Nextel for these services are expected to be approximately \$30 million annually. Upon expiration of these transitional arrangements, we will need to replace such amounts with new revenue sources or otherwise reduce our cost structure appropriately or our profitability will suffer.

Our spin-off from Sprint Nextel could adversely affect our business and profitability due to our loss of Sprint Nextel's strong brand, reputation, capital base and purchasing power.

As a business unit of Sprint Nextel, we have marketed our products and services using the Sprint brand name and logo, and we believe the association with Sprint Nextel has provided us with preferred status among our customers and employees due to Sprint Nextel's:

globally recognized brands;

perceived high-quality products and services;

strong capital base and financial strength; and

significant purchasing power.

We may not be able to achieve or maintain comparable name recognition or status under our new brand, which could adversely affect our ability to attract and retain customers, resulting in reduced sales and revenues. Our separation from Sprint Nextel could also adversely affect our ability to attract and retain key employees. We will also incur substantial capital and other costs associated with launching and marketing our new

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brand. We may be required to change our marketing strategy to reflect the loss of the preferred brand status (e.g., we could determine to more aggressively price our services for high-speed Internet access and that strategy could result in lower profitability). In addition, we have historically benefited from Sprint Nextel's size and purchasing power in procuring goods and services. Following the spin-off, we may be unable to obtain goods and services at prices and on terms as favorable as those obtained before the spin-off, which could decrease our overall profitability.

If the distribution does not qualify as a tax-free transaction, tax could be imposed on Sprint Nextel stockholders.

Sprint Nextel received a private letter ruling from the Internal Revenue Service, or IRS, that the distribution will qualify for tax-free treatment under the Internal Revenue Code of 1986, as amended, or the Code,

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Sections 355 and 361. The private letter ruling was granted on July 20, 2005, in response to a request dated April 6, 2005. Certain additional information was provided to the IRS before and after the private letter ruling was received. In addition, Sprint Nextel intends to obtain, immediately before the distribution, an opinion of counsel from each of Cravath, Swaine & Moore LLP and Paul, Weiss, Rifkind, Wharton & Garrison LLP that the distribution will qualify for tax-free treatment. The receipt of the opinions is a condition to the distribution, which may be waived by Sprint Nextel in its discretion. If satisfactory opinions from counsel regarding the tax-free qualification of the distribution cannot be obtained, Sprint Nextel's board of directors would consider not completing the distribution. The IRS ruling relies, and the opinions will rely, on representations, assumptions and undertakings, including those relating to the past and future conduct of our business, and neither the IRS ruling nor the opinions would be valid if such representations, assumptions and undertakings were incorrect. Moreover, the IRS private letter ruling does not address all the issues that are relevant to determining whether the distribution will qualify for tax-free treatment. The issues not addressed by the private letter ruling consist primarily of issues on which the IRS customarily declines to rule. These issues are expected to be addressed by the opinions.

Notwithstanding the IRS private letter ruling and the opinions, the IRS could determine that the distribution should be treated as a taxable transaction if it determines that any of the representations, assumptions or undertakings that were included in the request for the private letter ruling is false or has been violated or if it disagrees with the conclusions in the opinions that are not covered by the IRS ruling. If the distribution fails to qualify for tax-free treatment, it will be treated as a taxable dividend to Sprint Nextel stockholders in an amount equal to the fair market value of our common stock issued to Sprint Nextel common stockholders.

If the distribution does not qualify as a tax-free transaction, tax could be imposed on Sprint Nextel and we may be required to indemnify Sprint Nextel for such tax.

For the reasons described in the preceding risk factor, the distribution may not be tax-free to Sprint Nextel. In that event, Sprint Nextel would be required to recognize gain in an amount up to the fair market value of our common stock that Sprint Nextel distributes on the distribution date plus the fair market value of the senior notes that Sprint Nextel receives from us. The treatment of the distribution for federal tax purposes is not dependent on the tax treatment of the Sprint Nextel merger.

Furthermore, events subsequent to the distribution could cause Sprint Nextel to recognize gain on the distribution. For example, under Code Section 355(e), even minimal acquisitions of either our equity securities or Sprint Nextel's equity securities that are deemed to be part of a plan or a series of related transactions that include the distribution and the Sprint Nextel merger could cause Sprint Nextel to recognize gain on the distribution.

Under the tax sharing agreement between Sprint Nextel and us, we are generally required to indemnify Sprint Nextel against any tax resulting from the distribution if such 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 (excluding the distribution of our common stock in the spin-off), (2) other actions or failures to act by us or (3) any of our representations or undertakings being incorrect or violated. We estimate that if any of these conditions occurs the indemnification obligation to Sprint Nextel for taxes would be significant and we are unlikely to have the ability to pay that obligation.

We are agreeing to certain restrictions to preserve the tax-free treatment of the distribution to Sprint Nextel, which may reduce our strategic and operating flexibility.

To preserve the tax-free treatment to Sprint Nextel of the distribution, under a tax sharing agreement that we will enter into with Sprint Nextel, for specified periods of up to 30 months following the distribution, we may be prohibited, except in specified circumstances, from:

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issuing, redeeming or being involved in other acquisitions of our equity securities;

transferring significant amounts of our assets;

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amending our certificate of incorporation or bylaws;

failing to maintain certain components of our business as an active business; or

engaging in other actions or transactions that could jeopardize the tax-free status of the distribution.

These restrictions may limit our ability to pursue strategic transactions or engage in new business or other transactions that may maximize the value of our business. See Agreements with Sprint Nextel Tax Sharing Agreement.

Following the spin-off, we will have substantial indebtedness, which could restrict our ability to pay dividends and have a negative impact on our financing options and liquidity position.

On or shortly before the distribution date, we expect to enter into a credit facility with certain financial institutions and, in connection with the spin-off, will transfer approximately \$2.1 billion in cash borrowed under the credit facility and issue approximately \$4.5 billion in senior notes to Sprint Nextel. As a result, on the distribution date we will have approximately \$7.25 billion of total debt outstanding and expect to have interest expense of approximately \$515 million annually.

The extent to which we are leveraged could:

limit our ability to obtain additional financing in the future for working capital, capital expenditures and acquisitions;

limit our ability to refinance our indebtedness on terms acceptable to us or at all;

require us to dedicate a significant portion of our cash flow from operations to paying the principal of and interest on our indebtedness, thereby reducing funds available for other corporate purposes;

make it more difficult for us to pay our anticipated cash dividends of \$75 million quarterly (or \$300 million annually) on our common stock; and

make us more vulnerable to economic downturns and limit our ability to withstand competitive pressures.

Our financing arrangements will subject us to various restrictions that could limit our operating flexibility.

We expect that our credit facility and other financing arrangements will contain covenants and other restrictions that, among other things, will require us to satisfy certain financial tests and maintain certain financial ratios and restrict our ability to incur additional indebtedness. In addition, both the indenture governing the senior notes and the credit facility will restrict our ability to create liens, which could limit our ability to incur additional indebtedness and restrict the ability of our subsidiaries to incur additional indebtedness. The restrictions and covenants in our

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anticipated financing arrangements, and in future financing arrangements, may limit our ability to respond to market conditions, provide for capital investment needs or take advantage of business opportunities by limiting the amount of additional borrowings we may incur. See Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources Liquidity.

The agreements that we are entering into with Sprint Nextel may involve, or may appear to involve, conflicts of interest.

Because the spin-off involves the separation of Sprint Nextel's existing businesses into two independent companies, we are entering into certain agreements with Sprint Nextel to provide a framework for our initial relationship with Sprint Nextel following the spin-off. We have negotiated these agreements with Sprint Nextel while we are still a wholly owned subsidiary of Sprint Nextel. Accordingly, our executive officers and some of our directors were employees, officers or directors of Sprint Nextel or its subsidiaries at the time of the negotiations and, as such, had an obligation to serve the interests of Sprint Nextel and its subsidiaries. As a result, they could be viewed as having had a conflict of interest.

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Some of the agreements we are entering into with Sprint Nextel contain early termination provisions that, if exercised by Sprint Nextel, could be materially detrimental to our ability to operate our business.

We are entering into commercial service agreements with Sprint Nextel under which each company will obtain services from the other. Some of these agreements are subject to various restrictions and early termination provisions. For instance, we will market and sell our own branded wireless service under a wholesale agreement with Sprint Nextel. Although this agreement has a seven year term, Sprint Nextel has the right to terminate the agreement if we fail to meet subscriber targets within the first two years of the agreement, if we transfer more than 50% of our subscribers to another carrier or if a change of control of our company occurs. There are also certain restrictions that prevent us from transferring our base of wireless subscribers to another carrier. These restrictions may reduce our strategic and operating flexibility. Early termination of these agreements could have an adverse effect on our ability to operate our business.

We do not own or have a license to all technology that may be necessary to expand our product offerings, which could adversely affect our business and profitability.

We may need to obtain the right to use certain patents from Sprint Nextel or third parties to be able to offer new products and services. We have the right to use all of Sprint Nextel's existing patents only for a two-year period after the distribution date (although we do have the right to use the Sprint Nextel patents for business that we are conducting as of the distribution date for the life of those patents). If we cannot license or otherwise obtain rights to use any required technology from Sprint Nextel following that two-year period or from a third party on reasonable terms, our ability to offer new IP-based products and services, including VoIP (a technology that enables customers to make telephone calls using high-speed Internet access services), or other new offerings may be restricted, made more costly or delayed. Our inability to implement IP-based or other new offerings on a cost-effective basis could impair our ability to successfully meet increasing competition from companies offering integrated communications services, including cable operators and other service providers offering high-speed Internet services that can be used as a platform to support voice services utilizing VoIP. Our inability to deploy new technologies could also prevent us from successfully diversifying, modifying or bundling our service offerings and result in accelerated loss of access lines, customer usage and revenues or otherwise adversely affect our business and profitability. See Agreements with Sprint Nextel Patent Agreement.

Restrictions in the patent agreement that we are entering into with Sprint Nextel could adversely affect our ability to grow through acquisitions, be acquired or make divestitures.

Following the spin-off, if we grow by acquisitions to become more than twice our size at the time of the distribution, any new companies that we acquire, or operations that are integrated with new acquisitions, will not have the benefit of the patent agreement with Sprint Nextel. If we undergo a change of control and there is a functional integration of our operations with a third party we will lose the benefits of some or all of the patent agreement with Sprint Nextel. The benefits of that agreement do not extend to any parent company or any companies under common control with us. These limitations may make us less attractive as an acquisition candidate and reduce the value that an acquirer would be willing to pay for our business. Divestitures of our assets and operations could also be restricted because the benefits of the agreement would continue to apply only if divested operations or assets are isolated from the other members of the corporate group making the acquisition and only if the business is conducted in substantially the same manner and in substantially the same geographic area that it was conducted before the divestiture. These limitations may make our assets less attractive to a potential acquirer and could reduce the value that an acquirer would be willing to pay for the assets. See Agreements with Sprint Nextel Patent Agreement.

Risk Factors Relating to our Business

We face widespread competition that may reduce our market share and harm our financial performance.

We face significant competition from a number of different types of communications services providers, including wireless telephone service providers, Internet service providers, cable companies, companies that offer VoIP and competitive local exchange carriers, or CLECs.

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In particular, we face increasing competition from wireless telephone service providers. As wireless carriers continue to expand and improve their network coverage while lowering their prices, some customers choose to stop using traditional wireline phone service and instead rely solely on wireless service. We anticipate that this trend toward solely using wireless services will continue, particularly if wireless service rates continue to decline and the quality of wireless services improves. Technological developments in cellular telephone, personal communications services, digital microwave, satellite, broadband radio services, local multipoint distribution services, meshed wireless fidelity, or WiFi, and other wireless technologies are expected to permit the further development of alternatives to traditional wireline communications services.

We also face increasing competition from cable operators and other service providers offering high-speed Internet services that can be used as a platform to support voice services utilizing VoIP technology. As VoIP becomes a more robust and widely available service, existing competitors could become more formidable and new competitors could enter our markets.

Many of our current and potential competitors have market presence, engineering, technical and marketing capabilities and financial, personnel and other resources greater than ours, and mergers or other combinations involving our competitors may increase this competitive factor. In addition, some of our competitors can conduct operations or raise capital at a lower cost than we can and are subject to less regulation, taxes or fees. Consequently, some competitors are able to charge lower prices for their products and services, to develop and expand their communications and network infrastructures more quickly, to adapt more swiftly to new or emerging technologies and changes in customer requirements, and to devote greater resources to the marketing and sale of their products and services than we can.

Competition may adversely impact our revenues and profits in several ways, including:

the loss of customers and market share;

the possibility of customers shifting to less profitable services;

forcing us to lower prices or increase capital or marketing expenses to remain competitive; and

increasing our need to incur additional costs in order to diversify by offering new products or services.

We face increased competition from companies offering integrated communication services.

The traditional dividing lines between providers of local and long distance telephone services and wireless, video, Internet and cable television services are increasingly becoming blurred, in part because of changes in the regulatory environment that have facilitated the offering of integrated services. Through mergers, joint ventures and various service expansion strategies, providers of competing communication services are increasingly able to provide integrated services in many of the markets we serve. If we are unable to offer integrated service offerings, we may not be able to compete successfully against competitors that offer more integrated service packages.

In recent years, we have broadened our service and product offerings in pursuit of our strategy of growing our share of communications spending by customers within our local service territories. As a business unit of Sprint Nextel, we bundled Sprint Nextel's long distance and CDMA-based wireless services, expanded high-speed Internet coverage and provided video capability with Echostar Communications Corp.

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Following the spin-off, we expect to continue to expand our high-speed Internet coverage and to continue our relationship with Echostar. We also expect to offer certain wireline services and CDMA-based wireless services through wholesale (such as the MVNO relationship) and sales agency relationships with Sprint Nextel. However, it may be more difficult for us to achieve our goal of continuing to enhance our customers service experience with a single, clear invoice and integrated customer care for bundled services. We cannot assure you that we will be able to continue successfully our recent product diversification efforts.

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New technologies may be developed that could displace our service offerings.

We expect competition to intensify as new technologies, products and services are developed. Changes in technology may permit new entrants into the communications services marketplace, and as a result the future prospects of the incumbent wireline industry and the success of our services remain uncertain. We cannot predict which of many possible future technologies, products or services will be important for us to develop in order to maintain our competitive position or what expenditures will be required to develop and provide these technologies, products or services. To the extent we do not keep pace with technological advances or fail to timely respond to technology-driven changes in our industry, we could lose market share or experience a decline in revenue and net income.

We may not be able to compete successfully against Sprint Nextel, which has greater financial resources and superior brand recognition.

In addition to the competitive threats posed to us by other wireless carriers and cable operators, Sprint Nextel has stated publicly that it expects to pursue an aggressive strategy of serving as a wireless alternative to wireline service and to advance competition by, for example, pursuing alliances or joint ventures with cable operators that may have the effect of making the cable operators' voice offerings that compete with our services more attractive. To this end, Sprint Nextel recently announced a joint venture with several major cable operators that provide services that compete directly with those that we offer. As Sprint Nextel will be a substantially larger company with greater financial resources and superior brand recognition, we may not be able to compete successfully against Sprint Nextel or its alliances or joint ventures.

Our industry is highly regulated and continues to undergo various regulatory and legislative changes, which could adversely affect our prospects and results of operations.

As an ILEC, we have traditionally been subject to significant regulation from federal, state and local authorities and in many respects are subject to more extensive regulation than some of our competitors. This regulation imposes substantial compliance costs on us, restricts our ability to adjust rates to reflect market conditions and impacts our ability to compete and respond to changing industry conditions. In recent years, the communications industry has undergone various fundamental regulatory changes, including those resulting from federal and state legislation, that have generally permitted competition in each segment of the telephone industry, while also in some respects reducing the regulation of ILECs. These and subsequent regulatory and legislative changes could adversely affect us by reducing the switched access charges that we are permitted to charge customers for use of our network to originate and terminate calls, altering our tariff structures, or otherwise changing the nature of our operations and competition in our industry. In particular, Congress and state legislatures may enact laws, and the Federal Communications Commission, or FCC, and state regulatory commissions may adopt new regulations or take other actions that could adversely affect our business prospects or results of operations.

The regulatory uncertainty surrounding VoIP and the apparent use of VoIP by some CLECs, long distance carriers and wireless carriers as a strategy to minimize access charges may adversely affect our access revenues. Adoption by the FCC of intercarrier compensation reform could reduce or eliminate other opportunities for access charge arbitrage, but could also reduce our revenues unless the plan provides a feasible mechanism to replace those revenues with revenues from other sources. Depending on its outcome, the FCC's recently instituted proceeding regarding regulation of rates for dedicated special access services that we sell to other carriers could affect what we charge for those services in the future.

Similarly, recent rule changes that permit customers to retain their wireline or wireless numbers when switching to another service provider could increase the number of our customers who choose to disconnect their wireline service and rely exclusively on their wireless service for their communications needs. Other pending rulemakings could also have a substantial impact on our operations, including in particular

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rulemakings on intercarrier compensation and universal service. In addition, various federal legislative proposals are pending that

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could substantially alter universal service support mechanisms, which could adversely affect the operating income we derive from those sources. Litigation and different objectives among federal and state regulators could create uncertainty and delay our ability to respond to new regulations. Moreover, changes in tax laws, regulations or policies could increase our tax rate. We are unable to predict the future actions of Congress, state legislatures and the various regulatory bodies that govern us, but those actions could materially affect our business.

Due to competitive, technological and regulatory changes, we cannot assure you that our core business will grow, and it could decline, which could have an adverse effect on our business and future prospects.

Due to the competitive, technological and regulatory changes described above, the local communications industry has recently experienced a decline in access lines, interstate and intrastate access traffic and long distance traffic. The recent decline in access lines and usage, coupled with the other changes resulting from competitive, technological and regulatory developments, could materially adversely affect our core business and future prospects. We anticipate that expected increases in our data revenue will be partially offset by continued declines in revenues from traditional voice services. Our access lines declined 4.1%, 2.9% and 2.2% in 2005, 2004 and 2003, respectively, and declined 4.9% at March 31, 2006 compared to March 31, 2005. Due to competitive factors we expect access line loss to continue.

We may not keep all of the long distance customers that are transferred to us by Sprint Nextel.

As part of the separation, we expect Sprint Nextel will, subject to state and federal regulatory approvals, transfer to our long distance subsidiary all of Sprint Nextel's switched long distance consumer customers, certain of its switched long distance business customers and certain IP data customers, which, in any case, reside or are headquartered in our local service territories. We are required by applicable regulations to provide the affected customers with notice of the transfer, and in the case of consumer customers, we must also provide them with an opportunity to opt out of the transfer. To the extent that customers opt out of the transfer or switch to competitive carriers following the transfer, our revenues and profitability could be adversely affected.

Our capital raising may adversely affect holders of our common stock by increasing our leverage and reducing our credit ratings.

In addition to the new financing arrangements we expect to enter into as part of the spin-off, we may need to incur additional debt or issue securities in order to fund working capital needs, capital expenditures and product development requirements or to make acquisitions and other investments. Due to limitations in our tax sharing agreement, for specified periods of up to 30 months following the distribution date, any additional capital we seek to raise may have to be in the form of debt, which could increase our leverage and reduce our credit ratings.

We may not have access to capital on acceptable terms, and if we are not able to obtain sufficient financing, we may be unable to maintain or grow our business.

Following the spin-off, our credit ratings are expected to be lower than the current ratings of Sprint Nextel. Differences in credit ratings affect the interest rate charged on financings, as well as the amounts of indebtedness and types of financing structures that may be available to us. Regulatory restrictions and the terms of our indebtedness limit our ability to raise capital through our subsidiaries, pledge the stock of our subsidiaries, encumber the assets of our subsidiaries and cause our subsidiaries to guarantee our indebtedness. We may not be able to raise the capital we require on acceptable terms, if at all. If we are not able to obtain sufficient financing, we may be unable to maintain or grow our business. In addition, our financing costs may be higher than they were as part of Sprint Nextel as reflected in our historical financial statements.

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Further, issuances of equity securities will be subject to limitations imposed on us in the tax sharing agreement that we will enter with Sprint Nextel.

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A significant portion of our workforce is unionized, and if we are unable to reach new agreements before our current labor contracts expire, our unionized workers could engage in strikes or other labor actions that could materially disrupt our ability to provide services to our customers.

As of December 31, 2005, we had approximately 14,500 active employees. Approximately 7,000 of these employees (48%) were represented by unions which are subject to collective bargaining agreements. We expect to have approximately 20,000 employees at the time of the spin-off. This expected increase is primarily the result of the transfer of Sprint Nextel employees, who perform corporate headquarters functions, to our company, as well as some external hiring.

Each year, a portion of our labor agreements expire pursuant to their terms and we negotiate the terms of new agreements. In 2006, the contracts governing approximately 29% of the union workforce lapse and are scheduled to be renegotiated. We cannot predict the outcome of these negotiations. We may be unable to reach new agreements, and union employees may engage in strikes, work slowdowns or other labor actions, which could materially disrupt our ability to provide services. New labor agreements may impose significant new costs on us, which could adversely affect our financial condition and results of operations in the future.

We face hurricane and other natural disaster risks, which can disrupt our operations and cause us to incur substantial additional capital costs.

Approximately 52% of our access lines are located in Florida, North Carolina, South Carolina and Texas, and our operations there are subject to the many hazards inherent in being located in areas frequently hit by severe storms, hurricanes and tornadoes, including downed telephone lines, power-outages, destroyed property and equipment, and work interruptions. For example, during 2004 when numerous major hurricanes hit our local service territories, we incurred approximately \$60 million of incremental labor and material costs related to service restoration and network repairs.

Although we maintain property and casualty insurance and may under certain circumstances be able to seek recovery of some additional costs through increased rates, only a portion of our additional costs directly related to the hurricanes in 2004 and 2005 was recoverable. We cannot predict whether we will continue to be able to obtain insurance for hurricane-related damages or, if obtainable and carried, whether this insurance will be adequate to cover our liabilities. In addition, we expect any insurance of this nature to be subject to substantial deductibles and to provide for premium adjustments based on claims. Any future hurricane-related costs and work interruptions could adversely affect our operations in the South and our financial condition.

Our designated executive team has not previously worked together to lead an independent company, and any inability of members of the executive team to work together effectively or the loss of any of them could adversely affect our performance.

While the persons expected to be our executive officers have significant industry experience, some do not have extensive operating experience with the incumbent local communications operations of Sprint Nextel, and they have not worked together as managers of an independent, stand-alone company. As a separate company, we will have substantially fewer resources than Sprint Nextel. Our success will depend, in part, on the ability of our executives to work effectively as a team in this new environment. Any inability of our executive officers to work together effectively or the loss of any of them could impair our operational and financial performance.

Risk Factors Relating to Ownership of our Common Stock

The market price and trading volume of our common stock may be volatile.

On May 4, 2006, our common stock began trading on a "when issued" basis. We have not and will not set an initial price for our common stock. The price for our common stock will be established by the public market. We are unable to predict whether large amounts of our common stock will be sold in the open market following

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the distribution. We are also unable to predict the number of buyers that will be in the market at any time. Our smaller size and different investment characteristics may not appeal to the current investor base of Sprint Nextel. There is no assurance that there will be sufficient buying interest to offset any sales, and, accordingly, the price of our common stock could be depressed by those sales or be more volatile.

Neither we nor Sprint Nextel can assure you as to the trading price of our common stock after the distribution or as to whether the combined trading prices of our common stock and Sprint Nextel's common stock after the distribution will, in the aggregate, be less than, equal to or greater than the trading prices of the Sprint Nextel common stock before the distribution. The market price of our common stock could fluctuate significantly for many reasons, including in response to the risk factors listed in this prospectus or for reasons not specifically related to our performance, such as industry or market trends, reports by industry analysts, investor perceptions, or negative announcements by our customers or competitors regarding their own performance, as well as general economic and industry conditions. For example, to the extent that other companies within our industry experience declines in their stock price, our stock price may decline as well.

A portion of our current investor base may be required to sell our stock following the distribution.

A portion of Sprint Nextel's common stock is held by index funds tied to the Standard & Poor's 500 Index or other stock indices in which Sprint Nextel is included as a component. If at any time we are not included as a component in those indices, the corresponding index funds will likely be required to sell their shares of our common stock and the price of our common stock could be depressed by those sales.

Anti-takeover provisions of our certificate of incorporation and bylaws, the terms of our spin-off from Sprint Nextel and certain provisions of Delaware law could delay or prevent a change of control that you may favor.

Provisions expected to be included in our certificate of incorporation and bylaws may discourage, delay or prevent a merger or other change of control that stockholders may consider favorable or may impede the ability of the holders of our common stock to change our management. Provisions expected to be included in our certificate of incorporation or bylaws, among other things, would:

limit the right of stockholders to call meetings of stockholders;

regulate how stockholders may present proposals or nominate directors for election at annual meetings of stockholders;

require any business combination initiated by a stockholder of 10% or more of our common stock to be approved by the holders of at least 75% of our common stock; and

authorize our board of directors to issue preferred stock in one or more series, without stockholder approval.

An acquisition or further issuance of our equity securities could trigger the application of Section 355(e) of the Code, requiring us under the tax sharing agreement to indemnify Sprint Nextel for the resulting tax. This indemnity obligation might discourage, delay or prevent a change of control that you may consider favorable.

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In addition, several of the agreements that we have entered into with Sprint Nextel, including certain commercial service agreements, require Sprint Nextel's consent to any assignment by us of our rights and obligations under the agreements and may also be terminated upon a change of control of our company. The consent and termination rights set forth in these agreements might discourage, delay or prevent a change of control that you may consider favorable.

Finally, following the spin-off, we will be subject to Section 203 of the Delaware General Corporation Law, which may have an anti-takeover effect with respect to transactions not approved in advance by our board of directors, including discouraging takeover attempts that might result in a premium over the market price for shares of our common stock.

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CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

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

statements relating to our plans, intentions, expectations, objectives or goals, including those relating to the establishment of our new brand and the benefits of the spin-off;

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

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

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

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

expected benefits from the spin-off may not be fully realized;

our revenues and operating costs may be different than expected following the spin-off;

our ability to establish our new brand;

a determination by the IRS that the distribution should be treated as a taxable transaction;

our different capital structure as an independent company, including our access to capital, credit ratings, indebtedness and ability to raise additional financing;

volatility in the equity market;

the effects of vigorous competition in the markets in which we operate;

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the effects of other mergers and consolidations in the industries relevant to our operations and unexpected announcements or developments from others in those industries;

the costs and business risks associated with providing new services and entering new markets;

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

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

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

the uncertainties related to the implementation of our business strategies;

unexpected results of litigation filed against our company;

the impact of equipment failure, natural disasters, terrorist acts or other breaches of network or information technology security;

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

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the costs of compliance with regulatory mandates;

the possibility of one or more of the markets in which we compete being impacted by changes in political or other factors, such as monetary policy, legal and regulatory changes or other external factors over which we have no control; and

other risks referenced from time to time in our future filings with the SEC and those factors listed under Risk Factors.

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

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USE OF PROCEEDS

We will not receive any proceeds from the issuance of the common stock or RSUs covered by this prospectus.

DIVIDEND POLICY

We expect to pay a regular quarterly dividend beginning in the third quarter of 2006. We currently expect the dividend to be in the aggregate amount of approximately \$75 million in each full quarter, which is comparable to the aggregate amount that Sprint Nextel stockholders are receiving from Sprint Nextel for each quarterly dividend paid following the Sprint Nextel merger.

Our ability to fund a regular quarterly dividend will be impacted by our ongoing ability to generate sufficient cash from operations. Effective as of the distribution date, payments on approximately \$7.25 billion of indebtedness and our quarterly dividend will account for the majority of our financing activities.

All decisions regarding the declaration and payment of dividends, including with respect to the initial dividend, will be at the discretion of our board of directors and will be evaluated from time to time in light of our financial condition, earnings, growth prospects, funding requirements, applicable law and other factors our board deems relevant.

Table of Contents**CAPITALIZATION**

The following table sets forth as of December 31, 2005:

our capitalization on a historical basis; and

our capitalization on a pro forma basis giving effect to the transactions provided for in the separation and distribution agreement, including (1) the delivery to Sprint Nextel of (a) approximately 149 million shares of our common stock, using a distribution ratio of one share of our common stock for every 20 shares of Sprint Nextel common stock, (b) approximately \$4.5 billion of senior notes and (c) cash proceeds of approximately \$2.1 billion from borrowings under our credit facility, and (2) elimination of the related party notes payable.

You should read this table in conjunction with Unaudited Pro Forma Combined Financial Information, Management's Discussion and Analysis of Financial Condition and Results of Operations and our combined financial statements and notes to combined financial statements included elsewhere in this prospectus.

	As of	
	December 31, 2005	
	Actual	Pro Forma
	(in millions, except per share amounts)	
Current maturities of long-term debt	\$ 2	\$ 2
Long-term debt:		
Credit facility (1)(2)	\$	\$ 2,100
Senior notes (2)		4,485
Other long-term debt	1,123	663
Total long-term debt	1,123	7,248
Total debt	1,125	7,250
Business equity	4,852	
Stockholders' equity		
Common stock, par value \$0.01 per share, 1,250 shares authorized, 149 shares issued and outstanding		1
Additional paid in capital		(601)
Retained earnings		
Accumulated other comprehensive loss		(471)
Total stockholders' equity		(1,071)
Total capitalization	\$ 5,977	\$ 6,179

-
- (1) After the borrowing of funds under our credit facility and transfer of such funds to Sprint Nextel, we expect to have \$1 billion of borrowing availability, subject to customary conditions, under our credit facility.
- (2) The amounts set forth in the table above with respect to the credit facility and the senior notes assume that we issue to Sprint Nextel senior notes in an aggregate initial principal amount of approximately \$4.5 billion and transfer to Sprint Nextel approximately \$2.1 billion of cash borrowed under our credit facility. The allocation between the principal amount of the senior notes and amounts borrowed under the credit facility could change but will not exceed \$6.6 billion in the aggregate.

Table of Contents**SELECTED COMBINED FINANCIAL DATA**

The following table sets forth our selected combined financial data. The following financial position data as of December 31, 2005 and 2004 and results of operations, dividends paid to Sprint Nextel and cash flow data for the years ended December 31, 2005, 2004 and 2003 have been derived from our combined financial statements that were audited by KPMG LLP. The results of operations, cash flow data and dividends paid to Sprint Nextel for the years ended December 31, 2002 and 2001 and the financial position data as of December 31, 2003, 2002 and 2001 have been derived from our unaudited combined financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. The following information should be read together with our combined financial statements and the notes related to those combined financial statements. See Management's Discussion and Analysis of Financial Condition and Results of Operations and Index to Financial Statements and Financial Statement Schedule.

Our combined financial information may not be indicative of our future performance and does not necessarily reflect what our financial condition and results of operations would have been had we operated as a separate, stand-alone entity during the periods presented, particularly since many changes will occur in our operations and capitalization as a result of our spin-off from Sprint Nextel.

	As of and For the Years Ended December 31,				
	2005	2004	2003(1)	2002	2001
(millions)				(unaudited)	(unaudited)
Results of Operations					
Net operating revenues	\$ 6,254	\$ 6,139	\$ 6,159	\$ 6,250	\$ 6,547
Operating income (2)	1,552	1,590	1,616	1,596	1,582
Income from continuing operations (2)	894	917	920	897	958
Dividends paid to Sprint Nextel	\$ 983	\$ 865	\$ 683	\$ 864	\$ 699
Financial Position					
Total assets	\$ 9,221	\$ 9,329	\$ 9,268	\$ 8,745	\$ 9,593
Property, plant and equipment, gross	19,784	19,470	18,975	18,332	17,684
Property, plant and equipment, net	7,804	7,977	7,979	7,444	7,371
Total debt (including short-term and long-term borrowings)	1,125	1,240	1,392	2,033	2,360
Total business equity	4,852	4,960	4,889	4,004	4,490
Cash Flow Data					
Net cash provided by operating activities	\$ 1,904	\$ 2,064	\$ 1,804	\$ 2,258	\$ 1,832
Capital expenditures	828	975	1,118	1,136	1,353

(1) The results of operations, dividends paid to Sprint Nextel and cash flow data for the year ended December 31, 2003 is derived from our audited combined financial statements. The financial position data as of December 31, 2003 is unaudited.

(2) In 2005, we recorded \$79 million in allocated asset impairments of which \$77 million resulted from the abandonment of a network monitoring software application.

In 2004, we recorded restructuring charges reducing our operating income by \$40 million and income from continuing operations by \$25 million. The restructuring charges were related to severance costs associated with Sprint Nextel's organizational realignment.

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In 2003, we recorded restructuring charges reducing our operating income by \$25 million and income from continuing operations by \$16 million. The restructuring charges were related to severance costs associated with Sprint Nextel's organizational realignment, in the amount of \$26 million, \$13 million, net of tax, and asset impairments of \$5 million, \$3 million, net of tax. The 2003 restructuring charges were offset by the finalization of the 2001 and 2002 restructuring liability in the amount of \$6 million.

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In 2002, we recorded restructuring charges reducing our operating income by \$57 million and income from continuing operations by \$36 million. The restructuring charges were primarily related to the consolidations in Sprint Nextel's network, information technology and billing and accounts receivable organizations, as well as additional steps to reduce overall operating costs.

In 2001, we recorded restructuring charges reducing our operating income by \$113 million and income from continuing operations by \$70 million. The restructuring charges were primarily related to consolidation and streamlining of marketing and network operations.

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UNAUDITED PRO FORMA COMBINED FINANCIAL INFORMATION

The unaudited pro forma combined financial information presented below has been derived from our audited combined financial statements as of and for the year ended December 31, 2005. The pro forma adjustments and notes to the pro forma combined financial information give effect to the distribution of our common stock by Sprint Nextel and the other transactions contemplated by the separation and distribution agreement that we have entered into with Sprint Nextel. This unaudited pro forma combined financial information should be read in conjunction with

Management's Discussion and Analysis of Financial Condition and Results of Operations and our combined financial statements and notes related to those combined financial statements included elsewhere in this prospectus.

The unaudited pro forma combined statement of operations for the year ended December 31, 2005 has been prepared as if the distribution had occurred as of January 1, 2005. The unaudited pro forma condensed combined balance sheet as of December 31, 2005 has been prepared as if the distribution occurred on December 31, 2005. The pro forma adjustments are based on the best information available and assumptions that management believes are reasonable. The unaudited pro forma combined financial information is for illustrative and informational purposes only and is not intended to represent or be indicative of what our results of operations or financial position would have been had the transactions contemplated by the separation and distribution and related transactions occurred on the dates indicated. The unaudited pro forma combined financial information also should not be considered representative of our future results of operations or financial position.

The pro forma adjustments give effect to the following transactions provided for in the separation and distribution agreement:

the execution of our credit facility and concurrent borrowing of approximately \$2.1 billion against the facility;

the delivery to Sprint Nextel of (1) approximately 149 million shares of our common stock, using a distribution ratio of one share of our common stock for every 20 shares of Sprint Nextel common stock, (2) approximately \$4.5 billion of senior notes and (3) cash proceeds of approximately \$2.1 billion from borrowings under our credit facility;

the transfer to us by Sprint Nextel of the assets of the incumbent local communications and wholesale product distribution operations;

the transfer to us by Sprint Nextel of all other assets and liabilities related to the ongoing operations of our business previously held by Sprint Nextel or its subsidiaries;

the transfer to us by Sprint Nextel of the in-territory consumer and business long distance customers, as well as the transfers to Sprint Nextel of certain in-territory equipment and professional service customers;

the dividend to, or contribution by, Sprint Nextel of the remaining non-commercial service-related intercompany balances;

adjustments to provide that we will have \$200 million in cash as of the distribution date; and

the distribution by Sprint Nextel of our common stock pro rata to its stockholders of record as of the record date.

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See the notes to unaudited pro forma combined financial information for a more detailed discussion of these events.

Due to regulations governing the preparation of pro forma financial information, the following non-recurring separation and distribution related expenses associated with establishing ourselves as an independent company are not included as a pro forma adjustment in the unaudited pro forma combined statement of

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operations; however, they are reflected as an adjustment in the unaudited pro forma condensed combined balance sheet.

Non-recurring, separation costs estimated to be approximately \$265 million pretax. An additional \$35 million was incurred in 2005 and included in our audited combined financial statements. Due to the scope and complexity of the underlying projects, the amount of these costs could increase or decrease materially and the timing of incurrence of these costs could change. The following table sets forth our actual and estimated non-recurring separation costs by category and period:

	Year Ending 31-Dec-06 (Estimate)(1)	2007 and Beyond (Estimate)	Total (Estimate)
		(millions)	
Re-branding and brand launch	\$ 33	\$ 15	\$ 48
Information technology systems and infrastructure	116	34	150
Transaction costs	13		13
Employee retention and other	27	5	32
Wireless capability development	22		22
Total	\$ 211	\$ 54	\$ 265
Portion of total representing capitalized costs	\$ 86	\$ 24	\$ 110

- (1) We estimate that approximately \$127 million of these costs will be incurred before June 2006, of which approximately \$52 million related to information technology systems and infrastructure costs and wireless capability development costs are expected to be capitalized when incurred.

The pro forma adjustments do not give effect to the following recurring items:

the annual aggregate costs resulting from the establishment of the corporate support services for our business, including information technology, human resources, treasury, tax, risk management, accounting and financial reporting, investor relations, legal, procurement and other services. By 2008, we estimate these annual costs to be approximately \$100 million greater than the costs historically allocated to us by Sprint Nextel for these services; or

the annual aggregate costs we will incur under our agreement with Sprint Nextel to purchase wholesale wireless services, which we currently estimate will be approximately \$6 million in 2006, \$48 million in 2007 and \$116 million in 2008 based on our projected growth of the wireless offering.

Table of Contents**EMBARQ CORPORATION (formerly referred to as the New Local Company)****PRO FORMA COMBINED STATEMENT OF OPERATIONS (Unaudited)***(in millions, except per share amounts)***Year Ended December 31, 2005**

	Pro Forma Adjustments						Pro Forma
	Historical	Customer Transfers(1)	Capital Structure(2)	Pension(3)	Shared Assets/Liabilities(4)	Other(5)	
Net Operating Revenues	\$ 6,254	\$ 434	\$	\$	\$	\$ 13	\$ 6,701
Operating Expenses							
Costs of services and products	2,306	226				3	2,535
Selling, general and administrative	1,338	74		(15)	(147)	5	1,255
Depreciation and amortization	979				90	1	1,070
Restructuring and asset impairments	79						79
Total operating expenses	4,702	300		(15)	(57)	9	4,939
Operating Income	1,552	134		15	57	4	1,762
Interest expense	(83)		(462)		25		(520)
Other income	3						3
Income from continuing operations before income taxes	1,472	134	(462)	15	82	4	1,245
Income tax expense (6)	(578)	(52)	169	(6)	(32)	(2)	(501)
Income from Continuing Operations	\$ 894	\$ 82	\$ (293)	\$ 9	\$ 50	\$ 2	\$ 744
Pro forma basic earnings per common share (7)							
Income from continuing operations							\$ 4.99
Pro forma basic shares outstanding (7)							149
Pro forma fully diluted earnings per common share (8)							
Income from continuing operations							\$ 4.96
							150

**Pro forma fully diluted shares
outstanding (8)**

Table of Contents**EMBARQ CORPORATION (formerly referred to as the New Local Company)****PRO FORMA CONDENSED COMBINED BALANCE SHEET (Unaudited)***(in millions, except per share amounts)*

	December 31, 2005							
	Pro Forma Adjustments							
						Non-recurring		
	Historical	Customer Transfers(1)	Capital Structure(9)	Pension(3)	Shared Assets/Liabilities(10)	Separation Costs(11)	Other(5)	Pro Forma
Assets								
Current assets								
Cash and equivalents	\$ 103	\$	\$ 97	\$	\$	\$	\$	\$ 200
Other	969	(8)			31		2	994
Total current assets	1,072	(8)	97		31		2	1,194
Gross property, plant and equipment	19,784				557	86	13	20,440
Accumulated depreciation	(11,980)				(305)		(1)	(12,286)
Net property, plant and equipment	7,804				252	86	12	8,154
Other assets	345			(228)	8			125
Total	\$ 9,221	\$ (8)	\$ 97	\$ (228)	\$ 291	\$ 86	\$ 14	\$ 9,473
Liabilities and Stockholders' Equity								
Current liabilities								
Current maturities of long-term debt	\$ 2	\$	\$	\$	\$	\$	\$	\$ 2
Other	1,082	8			(146)	211		1,155
Total current liabilities	1,084	8			(146)	211		1,157
Noncurrent liabilities								
Long-term debt	1,123		2,100		(460)			2,763
Long-term notes payable distributed to Sprint Nextel			4,485					4,485
Deferred income taxes	1,290	(36)		(130)	(30)		(3)	1,091
Postretirement and other benefit obligations	793			73	42			908
Other	79			31	30			140
Total noncurrent liabilities	3,285	(36)	6,585	(26)	(418)		(3)	9,387
Business equity	5,377		(5,377)					
Accumulated other comprehensive loss	(525)		525					

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Total business equity	4,852	(4,852)						
Stockholders' equity								
Common stock, \$.01 par value, 1,250 shares authorized, 149 shares issued and outstanding		1						1
Additional paid in capital	20	(1,112)	(256)	855	(125)	17	(601)	
Retained earnings								
Accumulated other comprehensive loss		(525)	54				(471)	
Total stockholders' equity	20	(1,636)	(202)	855	(125)	17	(1,071)	
Total	\$ 9,221	\$ (8)	\$ 97	\$ (228)	\$ 291	\$ 86	\$ 14	\$ 9,473

Table of Contents**EMBARQ CORPORATION (formerly referred to as the New Local Company)****NOTES TO PRO FORMA COMBINED FINANCIAL INFORMATION**

- (1) Represents net revenue of \$469 million, operating expenses of \$328 million and income from continuing operations of \$86 million resulting from the transfer from Sprint Nextel of the in-territory consumer and business long distance customers. A \$36 million deferred tax asset, representing the tax effect of the fair market value of these customers, will also be generated from this transfer. Also included is net revenue of \$35 million, operating expenses of \$28 million and income from continuing operations of \$4 million resulting from the transfer to Sprint Nextel of certain in-territory equipment and professional services customers, whose accounts are part of nationwide service agreements. These customer transfers will not occur before the spin-off as these customers and agreements are part of a Sprint Nextel subsidiary that will remain with Sprint Nextel after the spin-off.
- (2) Reflects the adjustment to record interest expense on long term debt incurred as consideration for our business. Pro forma interest expense was calculated as follows:

	Principal Outstanding	Assumed Interest Rate	Estimated Annual Expense	Sensitivity to Change of 1/8% in Interest Rate
			(millions)	
Senior notes	\$ 4,485	7.5%	\$ 336	\$ 6
Credit facility	2,100	6.0%	126	3
Total	\$ 6,585		\$ 462	\$ 9

The rate on the senior notes was derived after giving consideration to the impact of our derivative instruments in limiting our exposure to increases in the United States Dollar London Interbank Offered Rate, or LIBOR, and the U.S. Treasury rate. See Note 3 of the Notes to the Combined Financial Statements included elsewhere in this prospectus for additional details. The actual interest expense related to the senior notes will be dependent on rates prevailing at the date of issuance. We assumed an effective interest rate of 6.0% for the approximately \$2.1 billion anticipated to be borrowed under our credit facility. The rate on the credit facility was based on a review of the LIBOR forward interest rate curve through April 2007. We cannot predict the movement of future interest rates and thus cannot determine the period this rate would remain in effect. The derivative instruments referred to in Note 3 of the Notes to Combined Financial Statements have not been considered in determining the interest rate on the credit facility nor did these instruments have a material impact on the determination of the rate used on the senior notes. The actual interest expense related to the credit facility will be dependent on market and other conditions at the time of issuance. As described under Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources Liquidity, the allocation between the amount of senior notes and amounts borrowed under the credit facility could change but will not exceed \$6.6 billion in the aggregate.

- (3) Reflects the estimated allocation, as determined by an independent actuary and consistent with the Code, Treasury Regulations and the Employee Retirement Income Security Act of 1974, as amended, or ERISA, guidelines, of the Sprint Nextel defined benefit pension plan to reflect the accumulated benefit obligation, fair value of plan assets and annual expense with respect to the active and retired employees of our business. The assumptions used to estimate both net periodic pension costs as well as the benefit obligation

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were as follows: (1) discount rate of 5.75%, (2) long-term rate of return on plan assets of 8.75% and (3) blended rate of future pay raises of 4.25%.

(4) Reflects the following:

elimination of allocated depreciation expense and capital charges. These allocated charges were historically recorded as selling, general and administrative expense;

increase in depreciation expense resulting from the transfer of property, plant and equipment, or PP&E, from a subsidiary of Sprint Nextel. Estimated useful lives did not change as a result of the transfer; and

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EMBARQ CORPORATION (formerly referred to as the New Local Company)

NOTES TO PRO FORMA COMBINED FINANCIAL INFORMATION (Continued)

elimination of interest expense related to related party notes payable.

- (5) Represents the transfer by a subsidiary of Sprint Nextel of the operations and related assets of fiber rings located outside of our local service territory in Florida.
- (6) Represents the estimated income taxes for the pro forma adjustments. The statutory federal and state tax rates used to reflect the impact of taxes on interest expense discussed in Note (2) are lower than the comparable tax rate used for other adjustments because the statutory state income tax rate for the legal entity incurring the interest expense is lower than the projected overall state income tax rate.
- (7) The number of shares used to compute pro forma basic earnings per share was the number of shares of common stock assumed to be outstanding at the distribution date using a distribution ratio of one share of our common stock for every 20 shares of Sprint Nextel common stock outstanding at March 31, 2006.
- (8) The number of shares used to compute pro forma fully diluted earnings per share was the number of shares of common stock assumed outstanding at the distribution date adjusted for potentially dilutive common shares. Potentially dilutive common shares primarily include the dilutive effects of shares issuable under our equity plans. Options to purchase 18 million shares of Sprint Nextel common stock held by our employees will be converted in connection with the spin-off and result in fully diluted shares outstanding of 150 million. This information is subject to the actual number of dilutive options outstanding at distribution, their related intrinsic value and the current market price of the shares.
- (9) Reflects the recapitalization of our business through the following series of transactions:

cash payment of approximately \$2.1 billion to Sprint Nextel obtained through borrowings under our credit facility;

issuance of approximately \$4.5 billion of senior notes, ranging in maturity from 7 to 30 years from the anticipated issuance at the distribution date;

cash infusion from Sprint Nextel to bring our opening cash balance to \$200 million; and

the assumed issuance of approximately 149 million shares of our common stock. See Note (7) above.

- (10) Reflects the transfer of certain assets and liabilities related to the operations of our business which were previously held by a subsidiary of Sprint Nextel. Also included is the elimination of the intercompany balances, including related party notes payable, except for the amounts associated with normal commercial services provided to or from Sprint Nextel. The following table further details the intercompany balance elimination included in other current liabilities:

				Non-recurring	
		Customer	Shared Asset/	Separation	
	Historical	Transfers	Liabilities	Costs	Pro Forma
			(millions)		
Accounts payable (AP)	\$ 265	\$	\$ 63	\$ 211	\$ 539
Affiliated payable (component of AP in historical statements)	263		(263)		
Other	554	8	54		616
Total other current liabilities	\$ 1,082	\$ 8	\$ (146)	\$ 211	\$ 1,155

- (11) Reflects the balance sheet effect of the non-recurring separation related expenses as discussed in the introduction to Unaudited Pro Forma Combined Financial Information. Pursuant to regulations governing the preparation of pro forma financial information, these expenses are not reflected in the unaudited pro forma combined statement of operations.

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**MANAGEMENT'S DISCUSSION AND ANALYSIS
OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following information should be read in conjunction with our selected combined financial and operating data and the accompanying combined financial statements and related notes. See Index to Financial Statements and Financial Statement Schedule. The following discussion may contain forward-looking statements that reflect our plans, estimates and beliefs. Our actual results could differ materially from those discussed in these forward-looking statements. Factors that could cause or contribute to these differences include, but are not limited to, those discussed below and elsewhere in this prospectus, particularly in Risk Factors and Cautionary Statement Regarding Forward-Looking Statements.

Our combined financial information may not be indicative of our future performance and does not necessarily reflect what our financial condition and results of operations would have been had we operated as a separate, stand-alone entity during the periods presented, particularly since many changes will occur in our operations and capitalization as a result of our spin-off from Sprint Nextel.

Overview

We are currently a subsidiary of Sprint Nextel. Sprint Nextel has determined to spin off our company by distributing all of our common stock to its stockholders as a dividend. We have entered into a separation and distribution agreement with Sprint Nextel containing the key provisions relating to the separation of our business from Sprint Nextel. The separation and distribution agreement identifies the assets to be transferred, liabilities to be assumed and contracts to be assigned to us. Our capital structure will be changed significantly at the date of the spin-off from Sprint Nextel.

Our operations consist mainly of regulated incumbent local phone companies operating in 18 states. We provide local voice and data services, including high-speed Internet, for customers within our local service territories. We also provide access to our local network and other wholesale communications services for other carriers, sales of communications equipment and other services to residential and business customers.

Key business factors that impacted the year ended December 31, 2005 include:

Continued competition from wireless and cable providers negatively impacted revenue, operating income and total access lines in service. We expect access line loss to continue.

We added nearly 201,000 new high-speed Internet lines in service increasing high-speed Internet revenues from \$224 million for the year ended December 31, 2004 to \$326 million for the year ended December 31, 2005.

We entered into a new sales contract with a large communications company resulting in additional product distribution sales of \$104 million.

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Key business factors that are anticipated to impact our 2006 performance are summarized below.

These estimates represent management's judgment based on currently available information. A number of risks and uncertainties, including but not limited to, the impact of increased competition as well as the effectiveness of our response to that competition and our success in achieving growth targets concerning high-speed Internet lines in service could cause our actual results to differ materially from those presented below. See Cautionary Statement Regarding Forward-Looking Statements.

	Estimated Income
	from Continuing Operations
	Before Income Taxes
	increase (decrease)
	(millions)
Core Operations:	
Continued competition from wireless providers and increased competition from cable providers are expected to drive increased levels of access line losses, which are anticipated to negatively impact revenue and income from continuing operations before income taxes.	
Continued growth in high-speed Internet lines in service, partially offset by pricing incentives largely associated with bundled service offerings, is expected to generate increased data revenues. Up-front selling and installation costs will partially offset the impact of this increase in data revenues.	
Product distribution sales are expected to decline as a result of the exit from certain markets and the spin off from Sprint Nextel. This is expected to have minimal impact on income from continuing operations before income taxes due to the low margins associated with this business.	
Anticipated losses from wireless service offering attributable to up-front customer acquisition costs.	
Anticipated productivity improvements across our business will partially offset the items presented above.	
Estimated impact to 2006 performance	(\$150) (\$210)
Spin-off Related(1):	
Customer transfers (principally in-territory consumer and business long distance customers) and elimination of allocated charges from Sprint Nextel (e.g., merger and integration costs, asset impairments and return on investment charge) (2)	\$210-\$250
Increased costs resulting from our spin-off from Sprint Nextel (e.g., establishing our own corporate support functions consisting primarily of employee-related expenses) (3)	(\$80)
Incremental non-recurring separation costs	(\$100)
Incremental interest expense resulting from the issuance of \$4.485 billion of senior notes and borrowings of \$2.1 billion under our credit facility (4)	(\$460)
Elimination of interest expense on related-party notes	\$25

(1) See Unaudited Pro Forma Combined Financial Information.

(2) 2006 impact will be dependent on the actual date of the spin-off.

(3) Estimated to be \$100 million annually by 2008.

(4) 2006 impact will be dependent on the actual date of the spin-off and prevailing interest rates at that time.

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The following factors are also expected to affect liquidity in 2006:

Dividend payments to stockholders are anticipated to be approximately \$300 million annually. If the spin-off occurs before June 30, 2006, our anticipated dividend payments to stockholders in 2006 will be approximately \$150 million.

Capital expenditures are anticipated to be approximately \$960 million, including certain one-time capital expenditures associated with IT systems and other capabilities required to be created in order for Embarq to operate as a separate company.

Planned Separation from Sprint Nextel

On December 15, 2004, the boards of directors of Sprint and Nextel each unanimously approved a strategic merger combining Sprint and Nextel in a merger of equals. Upon completion of the merger on August 12, 2005, Sprint changed its name to Sprint Nextel Corporation and Sprint Nextel common stock is now quoted on the New York Stock Exchange under the symbol S. Previously existing shares of Sprint common stock remain outstanding as Sprint Nextel common stock, as Sprint was the acquiring entity for legal and accounting purposes.

When the merger was announced, Sprint also announced its intention to pursue the spin-off of the companies comprising our operations, after completion of the merger. The distribution, now expected to occur in the second quarter of 2006, will occur through a tax-free distribution by Sprint Nextel of all of the shares of our common stock to Sprint Nextel's stockholders. The separation is subject to certain conditions including receipt of necessary state and federal regulatory approvals and our transfer to Sprint Nextel of cash and senior notes in the aggregate amount of approximately \$6.6 billion in partial consideration for, and as a condition to, Sprint Nextel's transfer to us of the local telecommunications division and wholesale product distribution operations and the consumer and certain business long distance customers located in our local service territories, as described below in New Financing Arrangements. We anticipate we will incur separation and distribution related expenses associated with establishing ourselves as an independent company. These expenses are expected to be significant and will be expensed as incurred.

Basis of Presentation

We are presenting the Combined Balance Sheets as of December 31, 2005 and 2004. The Combined Statements of Operations, Combined Statements of Cash Flows, and the Combined Statements of Business Equity and Comprehensive Income (Loss) are presented for the years ended December 31, 2005, 2004 and 2003.

Our combined financial statements were prepared using the specific financial accounting records of the entities that comprise the local communications business of Sprint Nextel, including the wholesale distribution of communication products. These combined financial statements have been presented using the historical results of operations and historical basis of assets and liabilities of these businesses. All intercompany transactions between these combined entities have been eliminated.

Our operations are divided into two segments, Local and Product Distribution. Our chief operating decision maker determines resource allocation and assesses financial performance based on these two segments. The Local segment includes local exchange voice services, access

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by phone customers and other carriers to our local network, high-speed Internet services and other data transport and special access services. The Product Distribution segment includes the wholesale distribution of communications equipment.

The combined financial statements are prepared using accounting principles generally accepted in the U.S. 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 and assumptions. Additionally, the assets and liabilities included in our combined financial statements may differ from our assets and liabilities upon

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completion of the spin-off. The spin-off will be completed on the terms contained in the separation and distribution agreement that we have entered into with Sprint Nextel. Our management believes that all historical costs of operations have been reflected in the combined financial statements.

We are also presenting unaudited pro forma combined financial information to reflect adjustments for and give effect to the transactions contemplated by the separation and distribution agreement as well as provide disclosures regarding actual and estimated one-time separation costs and with respect to the impact of our wireless commercial service agreement. See Unaudited Pro Forma Combined Financial Information included elsewhere in this prospectus.

New Financing Arrangements

In connection with the spin-off, we will enter into a credit facility with certain financial institutions. We expect to transfer to Sprint Nextel approximately \$6.6 billion in the form of cash and senior notes in partial consideration for, and as a condition to, Sprint Nextel's transfer to us of our business. The assumed allocation of consideration is expected to result in the issuance to Sprint Nextel of our senior notes in an aggregate initial principal amount of approximately \$4.5 billion and the transfer to Sprint Nextel of approximately \$2.1 billion in cash borrowed under our credit facility. The credit facility will also provide a revolving credit arrangement, including letters of credit, to help satisfy other financing needs. We expect that the terms of our credit facility will include customary covenants that, among other things, will require us to satisfy certain financial tests, maintain certain financial ratios, restrict our ability to create liens, which could limit our ability to incur additional indebtedness, and restrict the ability of our subsidiaries to incur additional indebtedness. To the extent permitted, we may also incur additional indebtedness from time to time for general corporate purposes, including working capital requirements, capital expenditures and future acquisitions.

We anticipate that immediately following the distribution date, we will have combined cash and equivalents of \$200 million and available liquidity under the credit facility of \$1 billion. As a result of the borrowings to be incurred and paid to Sprint Nextel in partial consideration for our assets and existing borrowings of our subsidiaries, we will have approximately \$7.25 billion of indebtedness on the distribution date.

Centralized Management and Allocations

Sprint Nextel uses a centralized cash management program, whereby Sprint Nextel advances funds to and from its subsidiaries. These advances are accounted for as short-term borrowings and bear interest at a market rate that is substantially equal to the rate the subsidiary would be able to obtain from third parties on a short-term basis. Following the spin-off, we will be responsible for our own cash management functions. Advance receivables with Sprint Nextel have been presented as Cash and equivalents for purposes of these historical combined financial statements. Advance payables with Sprint Nextel have been presented as short-term borrowings.

Sprint Nextel provides facilities, information services, marketing and certain corporate and administrative services to its subsidiaries, including our company. Sprint Nextel directly assigns, where possible, related costs based on actual use of these services. Where direct assignment is not possible or practical, Sprint Nextel uses other indirect methods, including time studies and headcounts, to estimate the allocation of shared service costs to its subsidiaries. The services provided by Sprint Nextel to its subsidiaries are generally accounted for based on fully distributed costs, which we believe approximates fair value. The costs allocated are not necessarily indicative of costs that will be charged or incurred in the future. Related party payables to Sprint Nextel resulting from the allocation of shared service costs are settled approximately one month after their initial recognition. Related party payables for purposes of historical combined financial statements have been presented as Accounts payable.

Following the spin-off, Sprint Nextel will continue to provide us with many of these services pursuant to a transition services agreement for a period of up to two years following the separation. We will also arrange to

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procure other services pursuant to arrangements with third parties or through our own employees. We currently expect that the aggregate annual costs we will pay to Sprint Nextel under the transition services agreement for services that have historically been provided by Sprint Nextel will not differ significantly from the amounts reflected in our historical combined financial statements, which include charges for those services. We also expect that by 2008 our annual incremental costs resulting from the establishment of corporate support services for our business will be approximately \$100 million. Assuming a distribution date of May 31, 2006, we expect to incur significant non-recurring costs to establish our new brand of approximately \$48 million and information technology investment to create the underlying infrastructure to support our business functions of approximately \$150 million.

As a separate company, we will no longer benefit from being included in Sprint Nextel's insurance package and will be responsible for obtaining our own insurance. We currently estimate that our first annual property insurance premium, with a \$10 million deductible, will be approximately \$5 million. Factors contributing to this premium include (1) the concentration of our assets in windstorm areas, (2) the number of older buildings that we will own and (3) general property insurance market conditions following recent hurricanes, especially Hurricane Katrina in 2005. We could be subject to windstorm sublimits and/or aggregate limits that could potentially limit our insurance recovery in the future. Overall insurance market conditions will determine premiums paid in future years.

See Note 12 of the Notes to Combined Financial Statements for additional related party transaction information.

Business Environment

We operate in an industry that has been and continues to be subject to consolidation and dynamic change. In light of these changes in the communications industry, including bankruptcies, over-capacity and the highly competitive pricing environment in all communications sectors, we routinely assess the implications of these industry factors on our operations. These assessments may impact the future valuation of our long-lived assets and could have a material effect on our business, financial condition, liquidity and results of operations.

Critical Accounting Policies

The fundamental objective of financial reporting is to provide useful information that allows a reader to understand our business activities. To aid in that understanding, management has identified our critical accounting policies. These policies are considered critical because they have the potential to have a material impact on our combined financial statements, and because they require judgments and estimation due to the uncertainty involved in measuring, at a specific point in time, events that are continuous in nature.

Long-lived Asset Recovery.

A significant portion of our total assets are long-lived assets, consisting primarily of property, plant and equipment, or PP&E. Changes in technology or in our intended use of these assets, as well as changes in broad economic or industry factors, may cause the estimated period of use or the value of these assets to change.

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Depreciable Lives of Assets. Estimates and assumptions are used both in setting depreciable lives and testing for recoverability of our long lived assets. Assumptions are based on internal studies of use, industry data on lives, recognition of technological advancements and understanding of business strategy. We perform annual internal studies to confirm the appropriateness of depreciable lives for each category of PP&E. These studies utilize models, which take into account actual usage, physical wear and tear, replacement history, and assumptions about technology evolution, and in certain instances actuarially-determined probabilities to calculate remaining lives of our asset base.

We believe that the accounting estimate related to the establishment of asset depreciable lives is a critical accounting estimate because: (1) it requires our management to make assumptions about technology evolution

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and competitive uses of assets, and (2) the impact of changes in these assumptions could be material to our financial position, as well as our results of operations. Management's assumptions about technology and its future development require significant judgment because the timing and impacts of technology advances are difficult to predict, and actual experience has varied from previous assumptions and could continue to do so.

If our studies had resulted in a depreciable rate that was 5% higher or lower than those used in the preparation of our combined financial statements, recorded depreciation expense would have been impacted by approximately \$58 million and \$57 million for the years ended December 31, 2005 and 2004, respectively.

PP&E and Definite Life Intangibles. PP&E and definite life intangibles are evaluated for impairment whenever indicators of impairment exist. Accounting standards require that if an impairment indicator is present, we must assess whether the carrying amount of the asset is unrecoverable by estimating the sum of the future cash flows expected to result from the asset, undiscounted and without interest charges. If the carrying amount is more than the recoverable amount, an impairment charge must be recognized, based on the fair value of the asset.

We believe that the accounting estimate related to asset impairment is a critical accounting estimate because: (1) it requires management to make assumptions about future revenues and costs of sales over the life of the asset, (2) judgment is involved in determining the occurrence of a triggering event and (3) the impact that recognizing an impairment would have on our financial position, as well as our results of operations, could be material. Management's assumptions about future revenues require significant judgment as actual revenues have fluctuated in the past and may continue to do so.

In estimating future revenues, we use our internal business forecasts. We develop our forecasts based on recent revenue data for existing products and services, planned timing of new products and services, and other industry and economic factors.

During the fourth quarter of 2005, Sprint Nextel terminated development and deployment of a network monitoring software application resulting in approximately \$77 million in asset impairment charges to our business.

Employee Benefit Plan Assumptions.

Retirement benefits are a significant cost of doing business for us and yet represent obligations that will be settled far in the future. Retirement benefit accounting is intended to reflect the recognition of the future benefit costs over the employee's expected tenure with us based on the terms of the benefit plans and the related investment and funding decisions. The accounting standards require that management make assumptions regarding such variables as the return on assets, the discount rate and future health care costs. Changes in these key assumptions can have a significant impact on the projected benefit obligation and periodic benefit cost incurred.

We believe that the accounting estimate related to retirement benefit accounting is a critical accounting estimate because: (1) it requires assumptions about discount rates, future health care costs, and future return on assets funding the obligation and (2) the impact that changes in actual performance versus these estimates would have on the projected benefit obligation reported on our balance sheet and the related benefit expense could be material.

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In determining pension obligations, assumptions concerning market performance are required. Market performance has fluctuated in the recent past and could have continued volatility in the future. In selecting a discount rate, an independent actuary models a hypothetical portfolio of bonds rated AA- or better that produces cash flows matching the projected benefit payments of the plan. To determine the return on asset assumption, forward-looking estimates of the expected long-term returns for a portfolio invested in accordance with the target investment policy is used.

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The assumptions associated with the employee benefit plans are made by Sprint Nextel's management, and while these assumptions are critical to the determination of estimates used in the plan accounting, the assessment of risk associated with an estimate differing from the actual events that may transpire must be assessed at the Sprint Nextel level. Following the spin-off, these assessments will be made by our management.

In determining post-retirement medical and life insurance benefit obligations, assumptions are made concerning the cost of health care, including the assumed medical inflation rate, and the discount rate. Again, as these plans are managed by Sprint Nextel's management, the assessment of risk associated with an estimate differing from the actual events that may transpire must be assessed at the Sprint Nextel level. Following the spin-off, these assessments will be made by our management.

Income Taxes.

Current income tax expense represents the amount of income taxes paid or currently payable to various taxing jurisdictions in which we operate. Inherent in the current provision for income taxes are estimates and judgments regarding the interpretations of tax regulations, the tax class life assigned to assets, and the timing of deferred tax asset and liability realization. The amount of income taxes we ultimately pay is subject to ongoing audits by federal and state taxing authorities. Our estimate for the potential outcome for any uncertain tax issues is highly judgmental. We believe we have adequately provided for any foreseeable outcome related to these matters. However, our future results may include adjustments to our estimated tax liabilities in the period the assessments are made or resolved. As a result, our effective tax rate may fluctuate on a quarterly basis.

The combined financial statements reflect certain amounts related to deferred tax assets and liabilities, which result from temporary differences between the assets and liabilities measured for financial statement purposes versus the assets and liabilities measured for tax return purposes. Management must assess the expected realizable future tax benefits of deferred tax assets and record any required valuation allowances. We maintained a \$2 million valuation allowance in each of the periods presented. The valuation allowance relates to state net operating loss carryovers. Actual income taxes could vary from estimates due to changes in income tax laws, significant changes in the jurisdictions in which we operate or our ability to generate sufficient future taxable income.

We believe that the accounting estimate related to establishing deferred taxes is a critical accounting estimate because: (1) it requires management to make assessments about the timing of future events, including the probability of expected future taxable income and available tax planning opportunities, and (2) the impact that changes in actual performance as compared to these estimates could have on the realization of tax benefits as reported in our results of operations could be material. Management's assumptions require significant judgment because actual performance has fluctuated in the past and may continue to do so.

We recorded income tax expense of \$578 million for the year ended December 31, 2005 and we carried a net deferred tax liability of \$1.3 billion at December 31, 2005. This amount includes approximately \$1.5 billion in deferred tax liabilities, which is partially offset by a \$281 million deferred tax asset. See Note 9 of the Notes to the Combined Financial Statements.

Revenue Recognition Policies.

We recognize operating revenues as services are rendered or as products are delivered to customers in accordance with SEC Staff Accounting Bulletin No. 104, Revenue Recognition. In connection with recording revenue, estimates and assumptions are required in determining the

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expected conversion of the revenue streams to cash collected. The revenue estimation process requires management to make assumptions based on historical results, future expectations, the economic and competitive environment, changes in the credit worthiness of our customers and other relevant factors. Changes in these key assumptions can have a significant impact on the projection of cash collected and the periodic revenue stream recognized.

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We believe that the accounting estimates related to the establishment of revenue and receivable reserves and the associated provisions in the results of operations are critical accounting estimates because: (1) they require management to make assumptions about future billing adjustments for disputes with customers, unauthorized usage, future returns on asset sales and future access adjustments for disputes with CLECs and inter-exchange carriers, as well as the future economic viability of our customer base; and (2) the impact that changes in actual performance as compared to these estimates would have on the accounts receivable reported on our balance sheet and the results reported in our statements of operations could be material. In selecting these assumptions, we use historical trending of write-offs, industry norms, regulatory decisions and recognition of current market indicators about general economic conditions to assess the impact on collectibility of accounts.

If the revenue reserve balances for the years ended December 31, 2005 and 2004 were to be increased by 1%, our net operating revenues would be reduced approximately \$1 million for each period. If the accounts receivable reserve estimates as a percentage of accounts receivable for the years ended December 31, 2005 and 2004 were increased by 1%, bad debt expense would increase approximately \$7 million for each period.

Management believes the reserve estimate selected, in each instance, represents its best estimate of future outcomes, but the actual outcomes could differ from the estimate selected.

Results of Operations

For the year ended December 31, 2005, we produced strong growth in data revenues through our high-speed Internet offerings and strong growth in product distribution due to a significant new contract. We continued to be impacted by developing competition and product substitution that resulted in a decline in access lines and switched access minutes of use and therefore a decline in voice revenues.

In the fourth quarter of 2005, Sprint Nextel, in conjunction with our management, terminated development and deployment of a network management software application resulting in approximately \$77 million in allocated asset impairment charges to our business.

For the year ended December 31, 2004, we recorded a \$40 million restructuring charge representing severance, real estate and other costs associated with the overall Sprint Nextel organizational realignment.

Combined Operations

Year ended December 31, 2005 compared to year ended December 31, 2004.

Years ended	December 31, 2005	December 31, 2004
	(millions)	
Net operating revenues	\$ 6,254	\$ 6,139
Operating income	\$ 1,552	\$ 1,590

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Operating margin	24.8%	25.9%
Capital expenditures	\$ 828	\$ 975

Net Operating Revenues. Net operating revenues increased \$115 million, or 2%, for 2005 as compared to 2004. Data revenues and Product Distribution revenues increased \$150 million and \$163 million, respectively, stemming from a 41% increase in high-speed Internet lines in service and a new Product Distribution contract. These increases were partially offset by a decrease of \$154 million in voice revenues resulting from a 4% decrease in access lines and a \$44 million reduction in other revenues. We ended 2005 with approximately 7.35 million switched access lines. The reduction in access lines was driven principally by losses to wireless and cable providers, along with broadband substitution.

Operating income decreased \$38 million, or 2%, for 2005 compared to 2004. The growth in net operating revenues discussed above was more than offset by increased costs of services and products of \$171 million and

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increased restructuring and asset impairment costs of \$39 million. The increase in costs of services and products was due to increased Product Distribution revenues. Partially offsetting these cost increases was a decrease of \$64 million in selling, general and administrative expenses driven by cost containment initiatives.

Year ended December 31, 2004 compared to year ended December 31, 2003.

<u>Years ended</u>	<u>December 31, 2004</u>	<u>December 31, 2003</u>
	(millions)	
Net operating revenues	\$ 6,139	\$ 6,159
Operating income	\$ 1,590	\$ 1,616
Operating margin	25.9%	26.2%
Capital expenditures	\$ 975	\$ 1,118

Net Operating Revenues. Net operating revenues decreased \$20 million for the year ended December 31, 2004 compared to the year ended December 31, 2003. The decrease was due to lower voice revenue of \$111 million and declines in equipment and other sales, which reduced other revenue by \$57 million. We ended 2004 with 7.67 million switched access lines, a 3% decrease compared to the prior year. Product Distribution revenues increased \$45 million, or 13%, for the year ended December 31, 2004 compared to the year ended December 31, 2003. The increase was due to growth in sales to third parties partially offset by lower sales to other Sprint Nextel subsidiaries.

Operating income decreased \$26 million, or 2%, for the year ended December 31, 2004 compared to the year ended December 31, 2003. Reduced revenues, discussed above, resulted in a corresponding decrease of \$2 million in costs of products and services. Increases in restructuring and asset impairment charges and selling, general and administrative costs more than offset this decrease.

Year ended December 31, 2005 compared to year ended December 31, 2004.

Segmental Results of Operations**Local**

<u>Years ended</u>	<u>December 31, 2005</u>	<u>December 31, 2004</u>
	(millions)	
Net operating revenues		
Voice	\$ 4,003	\$ 4,157
Data	983	833
Other	705	749

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Total net operating revenues	5,691	5,739
	<u> </u>	<u> </u>
Operating expenses		
Costs of services and products	1,815	1,814
Selling, general and administrative	1,226	1,298
Depreciation and amortization	982	967
Restructuring and asset impairment	79	40
	<u> </u>	<u> </u>
Total operating expenses	4,102	4,119
	<u> </u>	<u> </u>
Operating income	\$ 1,589	\$ 1,620
	<u> </u>	<u> </u>
Operating margin	27.9%	28.2%
	<u> </u>	<u> </u>
Capital expenditures	\$ 850	\$ 999
	<u> </u>	<u> </u>

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Voice Revenues. Voice revenues, consisting of revenue from local communication services, and access by phone customers and other carriers to our local network, decreased \$154 million, or 4%, for the year ended December 31, 2005. This results from both a decrease in access lines and lower access minutes of use. Access lines decreased from 7.67 million lines at December 31, 2004 to 7.35 million lines at December 31, 2005 accounting for \$63 million of the decrease. Switched access minutes of use in 2005 decreased 7% compared to 2004 resulting in a \$38 million decrease in revenues. Additionally, FCC-allowable cost recoveries associated with local number portability ceased in 2004 causing a \$6 million decrease in voice revenues for 2005. Recoveries for the cost of pooling local telephone numbers ceased in 2004 causing a decrease of \$18 million. The wireless local number portability, or WLNP, charges that started in 2004 and ended in 2005 caused a decrease of \$16 million.

Data Revenues. Data revenues are mainly generated from high-speed Internet, local data transport services and special access. Data revenues increased \$150 million, or 18%, for the year ended December 31, 2005 compared to the year ended December 31, 2004. This increase was driven by strong growth in high-speed Internet lines in service and special access sales primarily to wireless companies. We ended 2005 with 693,000 high-speed Internet lines in service, an increase of 41% compared to December 31, 2004.

Other Revenues. Other revenues are primarily generated from maintenance agreements, professional services agreements, sales agency relationships and the sale of communications equipment. Other revenues declined \$44 million, or 6%, during the year ended December 31, 2005. This decrease was due to a de-emphasis of business equipment sales, which accounted for approximately \$21 million of the decrease, and elimination of some sales agency agreements, which accounted for approximately \$16 million of the decrease.

Costs of Services and Products. Costs of services and products include costs to operate and maintain our network. These costs were comparable year over year. Increases in labor strike costs of \$5 million and increased network charges related to the expansion of high-speed Internet of \$9 million were offset by a \$19 million year-over-year decline in hurricane-related expenses. Costs of services and products were 32% of net operating revenues for the years ended December 31, 2005 and 2004.

Selling, General and Administrative Expense. Selling, general and administrative, or SG&A, expense decreased \$72 million, or 6%, for the year ended December 31, 2005 compared to the year ended December 31, 2004. The decrease was due to cost containment initiatives, which resulted in \$73 million in lower allocated costs and reduced information technology costs of approximately \$60 million. These reductions were partially offset by \$51 million in allocated merger, integration and spin-off related costs. SG&A expense was 22% of net operating revenues for the year ended December 31, 2005 compared to 23% for the year ended December 31, 2004.

SG&A expense includes charges for estimated bad debt expense. The reserve for bad debt requires management's judgment and is based on historical trending, industry norms and recognition of current market indications regarding general economic conditions. Bad debt expense as a percentage of net revenues was 1% for the years ended December 31, 2005 and 2004. The reserve for bad debt as a percent of outstanding accounts receivable was 8% at December 31, 2005 and 9% at December 31, 2004.

Depreciation and Amortization Expense. Depreciation and amortization expense increased \$15 million, or 2%, for the year ended December 31, 2005 compared to the year ended December 31, 2004. Approximately \$5 million of the increase was due to increased plant investment. The remainder of the increase was due to the annual remaining life depreciation rate update process. As part of the depreciation rate update process, depreciation rates were increased for digital switching equipment and metallic cable, while other items had minor adjustments. The rate updates resulted in increased depreciation expense of \$10 million for 2005. Depreciation and amortization expense was 17% of net operating revenues for each of the years ended December 31, 2005 and 2004.

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Restructuring and Asset Impairments. In 2005, we recorded \$79 million in restructuring and asset impairment costs. Sprint Nextel, in conjunction with our management, terminated development and deployment of a network management software application resulting in approximately \$77 million in allocated asset impairment charges. The project was terminated after evaluating business strategies as it was determined that the project would not provide the cost structure, flexibility or operational functionality we would need once the spin-off is complete.

For the year ended December 31, 2004, we recorded a \$40 million restructuring charge representing severance, real estate and other costs associated with the overall Sprint Nextel organizational realignment.

See Note 5 of the Notes to the Combined Financial Statements for additional information regarding restructuring and impairment charges.

Capital Expenditures. For the year 2005 compared to the year 2004, capital expenditures decreased by \$149 million, or 15%, resulting from increased capital efficiency achieved primarily by tighter capacity management, vendor cost reductions and successful execution of equipment re-use opportunities. Capacity spending reductions represented 76% of the decrease, with regulatory mandates and operational requirements representing the remainder.

Year ended December 31, 2004 compared to year ended December 31, 2003.

Years ended	December 31,	December 31,
	2004	2003
	(millions)	
Net operating revenues		
Voice	\$ 4,157	\$ 4,268
Data	833	730
Other	749	806
Total net operating revenues	5,739	5,804
Operating expenses		
Costs of services and products	1,814	1,854
Selling, general and administrative	1,298	1,285
Depreciation and amortization	967	983
Restructuring and asset impairments	40	24
Total operating expenses	4,119	4,146
Operating income	\$ 1,620	\$ 1,658
Operating margin	28.2%	28.6%
Capital expenditures	\$ 999	\$ 1,143

Voice Revenues. Voice revenues decreased \$111 million, or 3%, for 2004 due to a decrease in access lines, which reduced revenues by approximately \$53 million. Additionally, FCC-allowable cost recoveries associated with local number portability ceased in 2004 causing a \$42 million decrease in voice revenues. Recoveries for the cost of pooling local telephone numbers ceased in 2004 causing a decrease of \$18 million in 2005, which was offset by an increase of \$18 million in WLNP charges which started in July 2004.

Data Revenues. Data revenues increased \$103 million, or 14%, during 2004 as a result of strong growth in high-speed Internet services. We ended 2004 with 492,000 high-speed Internet lines in service, an increase of 62% compared to the end of 2003.

Other Revenues. Other revenues decreased \$57 million, or 7%, during 2004, principally driven by a decline in business equipment sales of \$38 million. The decrease in equipment sales was a result of both a planned shift

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in focus to selling higher margin products as well as a reduction in customer demand. Additionally, we moved to a sales agency relationship for PCS handsets rather than taking ownership of the handsets, thereby reducing revenue by approximately \$28 million.

Costs of Services and Products. Costs of services and products decreased \$40 million, or 2%, during 2004. General expense controls within the information technology and support organizations resulted in approximately \$35 million of savings. Additionally, lower costs of \$18 million and \$29 million associated with business equipment sales and PCS handset sales, respectively, were partially offset by a \$25 million increase in hurricane-related expenses and \$14 million in associated consumer equipment expenses. Costs of services and products were 32% of net operating revenues for both 2004 and 2003.

Selling, General and Administrative Expense. SG&A expense increased \$13 million, or 1%, during 2004 compared to 2003. The increase was driven by \$29 million in stock-based compensation expense, recoveries of bad debts in 2003 of \$35 million that did not recur in 2004 and other various increases totaling approximately \$19 million. These increases were partially offset by general cost controls within the information technology and support organizations of approximately \$70 million. Bad debt expense as a percentage of net revenues was 1% for both the year ended December 31, 2004 and the year ended December 31, 2003. The reserve for bad debt expense as a percent of outstanding accounts receivable was 9% at December 31, 2004 and 2003.

SG&A expense was 23% of net operating revenues for the year ended December 31, 2004 and 22% for the year ended December 31, 2003.

Depreciation and Amortization Expense. Depreciation and amortization expense decreased \$16 million, or 2%, year over year, and was 17% of net operating revenues for each of the years ended December 31, 2004 and 2003. Effective January 1, 2003, we adopted Statement of Financial Accounting Standards, or SFAS No. 143, Accounting for Asset Retirement Obligations, which eliminated the accrual for removal cost from the depreciable rate. For further information on the implementation of SFAS No. 143, see Note 4 of the Notes to Combined Financial Statements.

Restructuring and Asset Impairment. For the years ended December 31, 2004 and 2003, we recorded approximately \$40 million and \$20 million, respectively, of severance costs associated with the Sprint Nextel organizational realignment.

During the year ended December 31, 2003, Sprint Nextel terminated deployment of its Insight video service resulting in our recognition of approximately \$5 million in asset impairment charges.

For additional discussion of restructuring and asset impairments, see Note 5 of the Notes to Combined Financial Statements.

Capital Expenditures. Capital expenditures decreased by \$144 million, or 13%, in 2004 compared to 2003 as we changed our network deployment guidelines and engineering standards.

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Year ended December 31, 2005 compared to year ended December 31, 2004.

<u>Years ended</u>	<u>December 31,</u> <u>2005</u>	<u>December 31,</u> <u>2004</u>
	(millions)	
Net operating revenues		
Third party	\$ 509	\$ 341
Related party	54	59
Intercompany	386	450
Total net operating revenues	949	850
Operating expenses		
Costs of products	850	745
Selling, general and administrative	112	104
Depreciation and amortization	21	22
Total operating expenses	983	871
Operating loss	\$ 34	\$ 21
Operating margin	(3.6)%	(2.5)%
Capital expenditures	\$ 5	\$ 2

Net Operating Revenues. Product distribution revenues consist of sales to third parties, sales to related parties, consisting of Sprint Nextel entities other than us, and intercompany sales, consisting of sales to our Local segment. Product distribution revenues increased \$99 million, or 12%, in 2005 compared to 2004, driven by higher equipment sales to third parties. Of the \$168 million increase in sales to third parties, \$104 million, or 62%, was due to a significant new contract with a large communications company. Partially offsetting third-party sales were decreases of \$5 million in related party revenues and \$64 million in intercompany sales, which were caused by lower capital expenditures by the Local segment and related parties.

Costs of Products. Costs of products include costs of equipment sold. These costs increased \$105 million, or 14%, during 2005 compared to 2004. The increase was driven by the increase in sales to third parties. Costs of products were 90% of net operating revenues for 2005 compared to 88% for 2004.

Selling, General and Administrative Expense. SG&A expense increased \$8 million, or 8%, for 2005 compared to 2004. The increase was due to increased business selling costs associated with increased third party sales. SG&A expense was 12% of net operating revenues for both 2005 and 2004.

SG&A expense includes charges for estimated bad debt expense. The reserve for bad debt requires management's judgment and is based on historical trending, industry norms and recognition of current market indications regarding general economic conditions. Bad debt expense was approximately \$1 million for the years ended December 31, 2005 and 2004. The reserve for bad debt as a percent of outstanding third and related party accounts receivable was 4% at December 31, 2005 compared to 5% at December 31, 2004.

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Year ended December 31, 2004 compared to year ended December 31, 2003.

Years ended	December 31, 2004	December 31, 2003
	(millions)	
Net operating revenues		
Third party	\$ 341	\$ 290
Related party	59	65
Inter-company	450	485
Total net operating revenues	850	840
Operating expenses		
Costs of products	745	743
Selling, general and administrative	104	104
Depreciation and amortization	22	23
Restructuring and asset impairments		1
Total operating expenses	871	871
Operating loss	\$ 21	\$ 31
Operating margin	(2.5)%	(3.7)%
Capital expenditures	\$ 2	\$ 1

Net Operating Revenues. Product Distribution revenues increased \$10 million, or 1%, for 2004 compared to 2003. The increase was due to growth in sales to third party customers partially offset by lower sales to related parties and inter-company sales. Sales to third parties increased due to increases in capital spending in the communications industry. The decreases in related party and intercompany revenues were a result of both a planned shift in focus to selling higher margin products and a reduction in customer demand.

Costs of Products. Costs of products were comparable year over year. Consistent with sales, costs of products reflected the planned shift in focus to selling higher margin products and a reduction in customer demand for equipment. Costs of products were 88% of net operating revenues for each of the years ended December 31, 2004 and 2003.

Selling, General and Administrative Expense. SG&A expense was comparable year over year. Pension cost and stock-based compensation expense increased approximately \$2 million each, but were offset by general cost controls. Bad debt expense as a percentage of net revenues was not significant in either year. The reserve for bad debt expense as a percent of outstanding third and related party accounts receivable was 5% at December 31, 2004 compared to 8% at December 31, 2003.

SG&A expense was 12% of net operating revenues for both 2004 and 2003.

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Restructuring and Asset Impairment. For the year ended December 31, 2003, we recorded approximately \$1 million of severance costs associated with the Sprint Nextel organizational realignment.

Nonoperating Items

Interest Expense

The effective interest rates in the following table reflect interest expense on long-term debt only. Interest costs on short-term borrowings and interest costs on deferred compensation plans have been excluded so as not to distort the effective interest rates on long-term debt.

<u>Years ended December 31,</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>
Effective interest rate on long-term debt	7.7%	7.6%	7.6%

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Our effective interest rate on long-term debt increased for the year ended December 31, 2005 primarily due to the retirement of debt with lower interest rates. Historical interest expense on long-term debt is not representative of anticipated interest expense that will be incurred after our spin-off from Sprint Nextel, as it does not reflect the level of borrowing that our business will assume upon the spin-off. For more information on our financing activities, see Liquidity and Capital Resources.

Premium on Early Retirement of Debt

There were no early retirements of debt in either 2005 or 2004. Premiums on the early retirement of debt of \$5 million were incurred in 2003. See Note 6 of the Notes to Combined Financial Statements for more information.

Income Taxes

Our combined effective tax rate was 39.3% for the year ended December 31, 2005. The combined effective tax rate was 38.3% for the year ended December 31, 2004 and 38.2% for the year ended December 31, 2003. See Note 9 of the Notes to Combined Financial Statements for a reconciliation of the effective income tax rates to the statutory federal rate for income taxes related to continuing operations.

Discontinued Operations, Net

In 2002, Sprint Nextel signed a definitive agreement to sell its directory publishing business to R.H. Donnelley for \$2.23 billion in cash. The sale, which closed in January 2003, included Centel Directories Company, or CDC, a wholly owned subsidiary of Centel, which is included in our company. In connection with the sale in 2003, we received \$647 million in cash, recognized a pre-tax gain of \$635 million (\$375 million after tax) and, up to the date of sale, recognized \$1 million after tax from the results of operations.

Cumulative Effect of Changes in Accounting Principle, Net

The Financial Accounting Standards Board, or FASB, Interpretation No. 47, or FIN 47, was issued in 2005, interpreting the application of SFAS No. 143 (see discussion of SFAS No. 143 below). FIN 47 requires the recognition of a liability for legal obligations to perform an asset retirement activity in which the timing and/or method of the settlement are conditioned on a future event. We adopted FIN 47 in the fourth quarter of 2005, which resulted in the recognition of an asset retirement obligation, or ARO, liability of \$28 million, an ARO asset of \$4 million and a cumulative effect of change in accounting principles, net of tax, of \$16 million. The ARO liability is included in Other noncurrent liabilities&#