

CENTURYTEL INC  
Form 10-Q  
August 03, 2006

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-Q

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

For the quarterly period ended June 30, 2006

or

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

Commission File Number: 1-7784

**CenturyTel, Inc.**

(Exact name of registrant as specified in its charter)

Louisiana  
(State or other jurisdiction of  
incorporation or organization)

72-0651161  
(I.R.S. Employer  
Identification No.)

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

As of July 31, 2006, there were 116,409,896 shares of common stock outstanding.



## TABLE OF CONTENTS

|   | <u>Page</u><br><u>No.</u> |
|---|---------------------------|
| Part I. Financial Information:  |                           |
| Item 1. Financial Statements  |                           |
| Consolidated Statements of Income--Three Months and Six Months Ended June 30, 2006 and 2005               | 3                         |
| Consolidated Statements of Comprehensive Income--Three Months and Six Months Ended June 30, 2006 and 2005 | 4                         |
| Consolidated Balance Sheets--June 30, 2006 and December 31, 2005  | 5                         |
| Consolidated Statements of Cash Flows-- Six Months Ended June 30, 2006 and 2005                           | 6                         |
| Consolidated Statements of Stockholders' Equity--Six Months Ended June 30, 2006 and 2005                  | 7                         |
| Notes to Consolidated Financial Statements*   | 8-13                      |
| Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations             | 14-22                     |
| Item 3. Quantitative and Qualitative Disclosures About Market Risk  | 23                        |
| Item 4. Controls and Procedures   | 24                        |
| Part II. Other Information:   |                           |
| Item 1. Legal Proceedings   | 25                        |
| Item 1A. Risk Factors   | 25                        |
| Item 2. Unregistered Sales of Equity Securities and Use of Proceeds                                       | 25                        |
| Item 4. Submission of Matters to a Vote of Security Holders   | 25-26                     |

Item 6. Exhibits and Reports on Form 8-K 26

Signature 26

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

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

|  | Three months<br>ended June 30,                               |          | Six months<br>ended June 30, |           |
|--|--|----------|------------------------------|-----------|
|  | 2006   | 2005     | 2006                         | 2005      |
|  | (Dollars, except per share amounts, and shares in thousands) |          |                              |           |
| <b>OPERATING REVENUES</b>  | \$ 609,131   | 606,413  | 1,220,780                    | 1,201,695 |
| <b>OPERATING EXPENSES</b>  |  |          |                              |           |
| Cost of services and products (exclusive of depreciation and amortization) | 216,466  | 194,873  | 439,418                      | 386,866   |
| Selling, general and administrative  | 95,596   | 95,206   | 191,536                      | 189,460   |
| Depreciation and amortization  | 131,820  | 130,452  | 266,385                      | 262,627   |
| Total operating expenses   | 443,882  | 420,531  | 897,339                      | 838,953   |
| <b>OPERATING INCOME</b>  | 165,249  | 185,882  | 323,441                      | 362,742   |
| <b>OTHER INCOME (EXPENSE)</b>  |  |          |                              |           |
| Interest expense   | (50,639)   | (49,647) | (100,725)                    | (102,272) |
| Income from unconsolidated cellular entity                                 | 2,076  | 724      | 4,149                        | 2,037     |
| Nonrecurring gains   | 118,649  | -        | 118,649                      | -         |
| Other income (expense)   | 2,734  | 1,220    | 5,258                        | 2,755     |
| Total other income (expense)   | 72,820   | (47,703) | 27,331                       | (97,480)  |
| <b>INCOME BEFORE INCOME TAX</b>  |  |          |                              |           |
| <b>EXPENSE</b>   | 238,069  | 138,179  | 350,772                      | 265,262   |
| Income tax expense   | 85,701   | 53,061   | 128,979                      | 100,528   |
| <b>NET INCOME</b>  | \$ 152,368   | 85,118   | 221,793                      | 164,734   |
| <b>BASIC EARNINGS PER SHARE</b>  | \$ 1.32  | .65      | 1.86                         | 1.25      |
| <b>DILUTED EARNINGS PER SHARE</b>  | \$ 1.26  | .64      | 1.80                         | 1.23      |
| <b>DIVIDENDS PER COMMON SHARE</b>  | \$ .0625   | .06      | .125                         | .12       |
| <b>AVERAGE BASIC SHARES</b>  |  |          |                              |           |
| <b>OUTSTANDING</b>   | 115,441  | 130,299  | 118,917                      | 131,241   |
| <b>AVERAGE DILUTED SHARES</b>  |  |          |                              |           |
| <b>OUTSTANDING</b>   | 121,636  | 135,345  | 124,798                      | 136,257   |

See accompanying notes to consolidated financial statements.

**CenturyTel, Inc.**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**  
**(UNAUDITED)**

|  | Three months<br>ended June 30, |        | Six months<br>ended June 30, |         |
|--|--------------------------------|--------|------------------------------|---------|
|  | 2006                           | 2005   | 2006                         | 2005    |
|  | (Dollars in thousands)         |        |                              |         |
| <b>NET INCOME</b>  | \$ 152,368                     | 85,118 | 221,793                      | 164,734 |
| <b>OTHER COMPREHENSIVE INCOME, NET OF TAX:</b>   |                                |        |                              |         |
| Minimum pension liability adjustment,<br>net of \$799, \$194, (\$25) and (\$76) tax                        | 1,282                          | 310    | (41)                         | (122)   |
| Unrealized gain (loss) on investments, net of<br>(\$133), \$198, (\$92) and \$122 tax                      | (213)                          | 316    | (148)                        | 196     |
| <b>Derivative instruments:</b>   |                                |        |                              |         |
| Net loss on derivatives hedging the<br>variability of cash flows, net of (\$2,606) tax                     | -                              | -      | -                            | (4,181) |
| Reclassification adjustment for losses<br>included in net income, net of \$59, \$66,<br>\$117 and \$85 tax | 94                             | 106    | 188                          | 137     |
| <b>COMPREHENSIVE INCOME</b>  | \$ 153,531                     | 85,850 | 221,792                      | 160,764 |

See accompanying notes to consolidated financial statements.

**CenturyTel, Inc.**  
**CONSOLIDATED BALANCE SHEETS**  
**(UNAUDITED)**

|  | June 30,<br>2006    | December 31,<br>2005 |
|--|---------------------|----------------------|
| (Dollars in thousands)   |                     |                      |
| <b><u>ASSETS</u></b>   |                     |                      |
| <b>CURRENT ASSETS</b>  |                     |                      |
| Cash and cash equivalents                                      | \$ 1,769            | 158,846              |
| Accounts receivable, less allowance of \$20,441 and \$21,721   | 214,989             | 236,714              |
| Materials and supplies, at average cost                        | 6,389               | 6,998                |
| Other  | 17,105              | 20,458               |
| <b>Total current assets</b>                                    | <b>240,252</b>      | <b>423,016</b>       |
| <b>NET PROPERTY, PLANT AND EQUIPMENT</b>                       |                     |                      |
| Property, plant and equipment                                  | 7,844,529           | 7,801,377            |
| Accumulated depreciation                                       | (4,672,522)         | (4,496,891)          |
| <b>Net property, plant and equipment</b>                       | <b>3,172,007</b>    | <b>3,304,486</b>     |
| <b>GOODWILL AND OTHER ASSETS</b>                               |                     |                      |
| Goodwill   | 3,431,136           | 3,432,649            |
| Other  | 590,589             | 602,556              |
| <b>Total goodwill and other assets</b>                         | <b>4,021,725</b>    | <b>4,035,205</b>     |
| <b>TOTAL ASSETS</b>  | <b>\$ 7,433,984</b> | <b>7,762,707</b>     |
| <b><u>LIABILITIES AND EQUITY</u></b>                           |                     |                      |
| <b>CURRENT LIABILITIES</b>                                     |                     |                      |
| Current maturities of long-term debt                           | \$ 381,455          | 276,736              |
| Accounts payable   | 101,891             | 104,444              |
| Accrued expenses and other liabilities                         |                     |                      |
| Salaries and benefits  | 59,057              | 60,521               |
| Income taxes   | 79,625              | 110,521              |
| Other taxes  | 56,496              | 58,660               |
| Interest   | 74,738              | 71,580               |
| Other  | 15,547              | 14,851               |
| Advance billings and customer deposits                         | 51,287              | 48,917               |
| <b>Total current liabilities</b>                               | <b>820,096</b>      | <b>746,230</b>       |
| <b>LONG-TERM DEBT</b>  | <b>2,239,263</b>    | <b>2,376,070</b>     |
| <b>DEFERRED CREDITS AND OTHER LIABILITIES</b>                  | <b>1,073,065</b>    | <b>1,023,134</b>     |
| <b>STOCKHOLDERS' EQUITY</b>                                    |                     |                      |
| Common stock, \$1.00 par value, authorized 350,000,000 shares, |                     |                      |

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|   |                     |                  |
|---|---------------------|------------------|
| issued and outstanding 116,300,908 and 131,074,399 shares | 116,301             | 131,074          |
| Paid-in capital   | 107,927             | 129,806          |
| Accumulated other comprehensive loss, net of tax          | (9,620)             | (9,619)          |
| Retained earnings   | 3,079,291           | 3,358,162        |
| Preferred stock - non-redeemable                          | 7,661               | 7,850            |
| Total stockholders' equity                                | 3,301,560           | 3,617,273        |
| <b>TOTAL LIABILITIES AND EQUITY</b>                       | <b>\$ 7,433,984</b> | <b>7,762,707</b> |

See accompanying notes to consolidated financial statements.



**CenturyTel, Inc.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(UNAUDITED)**

|   | Six months<br>ended June 30, |           |
|---|------------------------------|-----------|
|   | 2006                         | 2005      |
|   | (Dollars in thousands)       |           |
| <b>OPERATING ACTIVITIES</b>   |                              |           |
| Net income  | \$ 221,793                   | 164,734   |
| Adjustments to reconcile net income to net cash provided by operating activities: |                              |           |
| Depreciation and amortization   | 266,385                      | 262,627   |
| Nonrecurring gains  | (118,649)                    | -         |
| Income from unconsolidated cellular entity  | (4,149)                      | (2,037)   |
| Deferred income taxes   | 22,352                       | 25,947    |
| Changes in current assets and current liabilities:                                |                              |           |
| Accounts receivable   | 21,641                       | 7,860     |
| Accounts payable  | (2,553)                      | (236)     |
| Accrued income and other taxes  | (28,113)                     | 12,184    |
| Other current assets and other current liabilities, net                           | 8,719                        | (854)     |
| Retirement benefits   | 14,926                       | 12,517    |
| Excess tax benefits from share-based compensation                                 | (4,947)                      | -         |
| (Increase) decrease in other noncurrent assets                                    | 969                          | (1,477)   |
| Increase (decrease) in other noncurrent liabilities                               | 1,550                        | (584)     |
| Other, net  | 6,393                        | (1,768)   |
| Net cash provided by operating activities   | 406,317                      | 478,913   |
| <b>INVESTING ACTIVITIES</b>   |                              |           |
| Payments for property, plant and equipment  | (130,455)                    | (176,914) |
| Proceeds from redemption of Rural Telephone Bank stock                            | 122,819                      | -         |
| Proceeds from sale of assets  | 5,865                        | -         |
| Acquisitions, net of cash acquired  | -                            | (73,152)  |
| Distributions from unconsolidated cellular entity                                 | -                            | 2,339     |
| Investment in unconsolidated cellular entity                                      | (5,222)                      | -         |
| Other, net  | (1,296)                      | (2,955)   |
| Net cash used in investing activities   | (8,289)                      | (250,682) |
| <b>FINANCING ACTIVITIES</b>   |                              |           |
| Payments of debt  | (12,559)                     | (511,625) |
| Net proceeds from issuance of long-term debt                                      | -                            | 344,173   |
| Proceeds from issuance of common stock  | 41,206                       | 20,457    |
| Repurchase of common stock  | (573,888)                    | (530,700) |
| Settlement of equity units  | -                            | 398,164   |
| Cash dividends  | (14,661)                     | (15,956)  |
| Excess tax benefits from share-based compensation                                 | 4,947                        | -         |
| Other, net  | (150)                        | 503       |
| Net cash used in financing activities   | (555,105)                    | (294,984) |
| Net decrease in cash and cash equivalents   | (157,077)                    | (66,753)  |
| Cash and cash equivalents at beginning of period                                  | 158,846                      | 167,215   |

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|  |    |         |         |
|--|----|---------|---------|
| Cash and cash equivalents at end of period                         | \$ | 1,769   | 100,462 |
| Supplemental cash flow information:                                |    |         |         |
| Income taxes paid  | \$ | 132,666 | 87,013  |
| Interest paid (net of capitalized interest of \$1,005 and \$1,281) | \$ | 96,562  | 96,347  |

See accompanying notes to consolidated financial statements.

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

|   | Six months<br>ended June 30, |                  |
|---|------------------------------|------------------|
|   | 2006                         | 2005             |
|   | (Dollars in thousands)       |                  |
| <b>COMMON STOCK</b>   |                              |                  |
| Balance at beginning of period  | \$ 131,074                   | 132,374          |
| Issuance of common stock through dividend reinvestment, incentive and benefit plans and other | 1,740                        | 1,061            |
| Issuance of common stock upon settlement of equity units                                      | -                            | 12,881           |
| Repurchase of common stock  | (16,523)                     | (16,409)         |
| Conversion of preferred stock into common stock   | 10                           | -                |
| Balance at end of period  | 116,301                      | 129,907          |
| <b>PAID-IN CAPITAL</b>  |                              |                  |
| Balance at beginning of period  | 129,806                      | 222,205          |
| Issuance of common stock through dividend reinvestment, incentive and benefit plans           | 39,466                       | 19,396           |
| Issuance of common stock upon settlement of equity units                                      | -                            | 385,283          |
| Repurchase of common stock  | (71,362)                     | (514,291)        |
| Conversion of preferred stock into common stock   | 179                          | -                |
| Excess tax benefits from share-based compensation   | 4,947                        | -                |
| Amortization of unearned compensation and other   | 4,891                        | 613              |
| Balance at end of period  | 107,927                      | 113,206          |
| <b>ACCUMULATED OTHER COMPREHENSIVE LOSS, NET OF TAX</b>                                       |                              |                  |
| Balance at beginning of period  | (9,619)                      | (8,334)          |
| Change in other comprehensive loss, net of tax  | (1)                          | (3,970)          |
| Balance at end of period  | (9,620)                      | (12,304)         |
| <b>RETAINED EARNINGS</b>  |                              |                  |
| Balance at beginning of period  | 3,358,162                    | 3,055,545        |
| Net income  | 221,793                      | 164,734          |
| Repurchase of common stock (through 2006 accelerated share repurchase program)                | (486,003)                    | -                |
| Cash dividends declared   |                              |                  |
| Common stock - \$.125 and \$.12 per share, respectively                                       | (14,467)                     | (15,757)         |
| Preferred stock   | (194)                        | (199)            |
| Balance at end of period  | 3,079,291                    | 3,204,323        |
| <b>PREFERRED STOCK - NON-REDEEMABLE</b>   |                              |                  |
| Balance at beginning of period  | 7,850                        | 7,975            |
| Conversion of preferred stock into common stock   | (189)                        | -                |
| Balance at end of period  | 7,661                        | 7,975            |
| <b>TOTAL STOCKHOLDERS' EQUITY</b>   | <b>\$ 3,301,560</b>          | <b>3,443,107</b> |

See accompanying notes to consolidated financial statements.

**CenturyTel, Inc.**  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
JUNE 30, 2006  
(UNAUDITED)

**(1) Basis of Financial Reporting**

Our consolidated financial statements include the accounts of CenturyTel, Inc. and its majority-owned subsidiaries. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to rules and regulations of the Securities and Exchange Commission; however, in the opinion of management, the disclosures made are adequate to make the information presented not misleading. The consolidated financial statements and footnotes included in this Form 10-Q should be read in conjunction with the consolidated financial statements and notes thereto included in our annual report on Form 10-K for the year ended December 31, 2005.

The financial information for the three months and six months ended June 30, 2006 and 2005 has not been audited by independent certified public accountants; however, in the opinion of management, all adjustments necessary to present fairly the results of operations for the three-month and six-month periods have been included therein. The results of operations for the first six months of the year are not necessarily indicative of the results of operations which might be expected for the entire year.

**(2) Goodwill and Other Intangible Assets**

Goodwill and other intangible assets as of June 30, 2006 and December 31, 2005 were composed of the following:

|  | June 30,<br>2006 | Dec. 31,<br>2005 |
|--|------------------|------------------|
| (Dollars in thousands)                       |                  |                  |
| Goodwill                                     | \$ 3,431,136     | 3,432,649        |
| Intangible assets subject to amortization    |                  |                  |
| Customer base                                |                  |                  |
| Gross carrying amount                        | \$ 25,094        | 25,094           |
| Accumulated amortization                     | (6,186)          | (5,349)          |
| Net carrying amount                          | \$ 18,908        | 19,745           |
| Contract rights                              |                  |                  |
| Gross carrying amount                        | \$ 4,187         | 4,187            |
| Accumulated amortization                     | (2,559)          | (1,861)          |
| Net carrying amount                          | \$ 1,628         | 2,326            |
| Intangible asset not subject to amortization | \$ 36,690        | 36,690           |

Goodwill decreased due to the sale of our Arizona telephone properties in May 2006 (see Note 10 for additional information).

Total amortization expense related to the intangible assets subject to amortization for the first six months of 2006 was \$1.5 million and is expected to be \$3.1 million annually in 2006, \$2.6 million in 2007 and \$1.7 million annually thereafter through 2010.

**(3) Postretirement Benefits**

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

Net periodic postretirement benefit cost for the three months and six months ended June 30, 2006 and 2005 included the following components:

|   | Three months<br>ended June 30, |       | Six months<br>ended June 30, |         |
|---|--------------------------------|-------|------------------------------|---------|
|   | 2006                           | 2005  | 2006                         | 2005    |
|   | (Dollars in thousands)         |       |                              |         |
| Service cost                                    | \$ 1,783                       | 1,480 | 3,491                        | 3,145   |
| Interest cost                                   | 4,846                          | 4,130 | 9,490                        | 8,359   |
| Expected return on plan assets                  | (623)                          | (643) | (1,219)                      | (1,220) |
| Amortization of unrecognized actuarial loss     | 950                            | 769   | 1,860                        | 1,458   |
| Amortization of unrecognized prior service cost | (221)                          | (451) | (433)                        | (938)   |
| Net periodic postretirement benefit cost        | \$ 6,735                       | 5,285 | 13,189                       | 10,804  |

We contributed \$6.4 million to our postretirement health care plan in the first six months of 2006 and expect to contribute approximately \$13 million for the full year.

**(4) Defined Benefit Retirement Plans**

We sponsor defined benefit pension plans for substantially all employees. We also sponsor a Supplemental Executive Retirement Plan to provide certain officers with supplemental retirement, death and disability benefits.

Net periodic pension expense for the three months and six months ended June 30, 2006 and 2005 included the following components:

|                                | Three months<br>ended June 30, |         | Six months<br>ended June 30, |          |
|--------------------------------|--------------------------------|---------|------------------------------|----------|
|                                | 2006                           | 2005    | 2006                         | 2005     |
|                                | (Dollars in thousands)         |         |                              |          |
| Service cost                   | \$ 4,220                       | 3,804   | 8,483                        | 7,679    |
| Interest cost                  | 6,160                          | 6,200   | 12,377                       | 12,012   |
| Expected return on plan assets | (8,183)                        | (7,357) | (16,367)                     | (14,613) |
| Recognized net losses          | 1,962                          | 1,816   | 3,840                        | 3,133    |
| Net amortization and deferral  | (123)                          | 89      | 6                            | 167      |
| Net periodic pension expense   | \$ 4,036                       | 4,552   | 8,339                        | 8,378    |

The amount of the 2006 contribution to our pension plans will be determined based on a number of factors, including the results of the 2006 actuarial valuation. At this time, the amount of the 2006 contribution is not known.

**(5) Stock-based Compensation**

Effective January 1, 2006, we adopted the provisions of Statement of Financial Accounting Standards No. 123 (Revised 2004), "Share-Based Payments" ("SFAS 123(R)"). SFAS 123(R) requires us to measure our cost of awarding employees with equity instruments based upon the fair value of the award on the grant date. Such cost will be recognized as compensation expense over the period during which the employee is required to provide service in exchange for the award. Compensation cost is also recognized over the applicable remaining vesting period for any outstanding options that were not fully vested as of January 1, 2006. We did not have any unvested outstanding options as of January 1, 2006 since our Board of Directors accelerated the vesting of all unvested options effective as of December 31, 2005, as described below. We elected the modified prospective transition method as permitted by SFAS 123(R); accordingly, prior period results have not been restated.

We currently maintain programs which allow the Board of Directors, through the Compensation Committee, to grant incentives to certain employees and our outside directors in any one or a combination of several forms, including incentive and non-qualified stock options; stock appreciation rights; restricted stock; and performance shares. As of June 30, 2006, we had reserved approximately 9.4 million shares of common stock which may be issued in connection with incentive awards made in the future under our current incentive programs. We also offer an Employee Stock Purchase Plan whereby employees can purchase our common stock at a 15% discount based on the lower of the beginning or ending stock price during recurring six-month periods stipulated in such program.

As of December 31, 2005, we had approximately 6.0 million options outstanding from prior grants, all of which were issued at a price either equal to or exceeding the then-current market price. All of these options were exercisable as a result of actions taken by our Board of Directors in December 2005 to accelerate the vesting of all unvested options outstanding, effective as of December 31, 2005, in order to eliminate the recognition of compensation expense which otherwise would have been required upon the effectiveness of SFAS 123(R).

In the first six months of 2006, certain of our employees were granted an aggregate of 960,375 stock options at market value. All of these options expire ten years after the date of grant and have a three-year vesting period. The weighted average fair value of each option was estimated as of the date of grant to be \$12.75 using a Black-Scholes option pricing model using the following assumptions: dividend yield - .7%; expected volatility - 30%; weighted average risk free interest rate - 4.64% (rates ranged from 4.28% to 5.04%); and expected term - 7 years (executive officers) and 5 years (all other employees).

In the first six months of 2005, certain of our employees were granted an aggregate of 907,925 stock options at market value. The weighted average fair value of each option was estimated as of the date of grant to be \$12.65 using a Black-Scholes option pricing model using the following assumptions: dividend yield - .7%; expected volatility - 30%; weighted average risk free interest rate - 4.18% (rates ranged from 3.90% to 4.20%); and expected term - 7 years.

The expected volatility was based on the historical volatility of our common stock over the 7- and 5- year terms mentioned above. The expected term was determined based on the historical exercise and forfeiture rates for similar grants.

Stock option transactions during the first six months of 2006 were as follows:

|                               | Number     | Average  | Remaining   | Aggregate |
|-------------------------------|------------|----------|-------------|-----------|
|                               | of options | price    | contractual | intrinsic |
|                               |            |          | term (in    | value     |
|                               |            |          | years)      |           |
| Outstanding December 31, 2005 | 5,995,458  | \$ 30.63 |             |           |
| Granted                       | 960,375    | 35.82    |             |           |



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|                           |             |    |       |     |               |
|---------------------------|-------------|----|-------|-----|---------------|
| Exercised                 | (1,305,115) |    | 27.94 |     |               |
| Forfeited/Cancelled       | (14,720)    |    | 35.75 |     |               |
| Outstanding June 30, 2006 | 5,635,998   | \$ | 32.13 | 6.5 | \$ 28,317,000 |
| Exercisable June 30, 2006 | 4,687,173   | \$ | 31.38 | 5.9 | \$ 27,052,000 |

In addition, during the first six months of 2006, we issued 293,943 shares of restricted stock to certain employees and our outside directors at a weighted-average price of \$36.02 per share. During the first six months of 2005, we issued 286,123 shares of restricted stock at a weighted-average price of \$33.47 per share. Such restricted stock vests over a five-year period (for employees) and a three-year period (for outside directors). Nonvested restricted stock transactions during the first six months of 2006 were as follows:

|                              | Number<br>of shares | Average grant<br>date fair value |
|------------------------------|---------------------|----------------------------------|
| Nonvested at January 1, 2006 | 511,919             | \$ 30.92                         |
| Granted                      | 293,943             | 36.02                            |
| Vested                       | (73,302)            | 32.88                            |
| Forfeited                    | (714)               | 32.54                            |
| Nonvested at June 30, 2006   | 731,846             | \$ 32.77                         |

The total compensation cost for share-based payment arrangements for the first six months of 2006 was \$6.0 million (\$3.8 million after-tax; \$.03 per diluted share). We recognized approximately \$2.2 million of tax benefit related to such arrangements in the first half of 2006. As of June 30, 2006, there was \$27.3 million of total unrecognized compensation cost related to the share-based payment arrangements, which is expected to be recognized over a weighted-average period of 3.5 years.

We received net cash proceeds of \$36.5 million during the first six months of 2006 in connection with option exercises. The total intrinsic value of options exercised (the amount by which the market price of the stock on the date of exercise exceeded the market price of the stock on the date of grant) was \$12.6 million during the first six months of 2006 and \$5.4 million during the first six months of 2005. The excess tax benefit realized from stock options exercised and restricted stock released during the first six months of 2006 was \$4.9 million. The total fair value of restricted stock that vested during the first half of 2006 was \$2.4 million.

Prior to January 1, 2006, we accounted for our stock options using the intrinsic value method in accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees". Generally, we did not recognize any stock-based compensation expense for stock options in our consolidated statements of income prior to 2006. If compensation cost for our options had been determined consistent with SFAS 123(R), our net income and earnings per share on a pro forma basis for the three months and six months ended June 30, 2005 would have been as follows:

|   | Three months<br>ended<br>June 30, 2005           | Six months<br>ended<br>June 30, 2005 |
|---|--|--------------------------------------|
|   | (Dollars in thousands, except per share amounts) |                                      |
| Net income, as reported                               | \$ 85,118  | 164,734                              |
| Less: Total stock-based employee compensation expense | (1,685)  | (5,903)                              |

|  |    |        |         |
|--|----|--------|---------|
| determined under fair value based method, net of tax |    |        |         |
| Pro forma net income                                 | \$ | 83,433 | 158,831 |
| Basic earnings per share                             |    |        |         |
| As reported  | \$ | .65    | 1.25    |
| Pro forma  | \$ | .64    | 1.21    |
| Diluted earnings per share                           |    |        |         |
| As reported  | \$ | .64    | 1.23    |
| Pro forma  | \$ | .63    | 1.18    |

## (6) Business Segments

We are an integrated communications company engaged primarily in providing an array of communications services to our customers, including local exchange, long distance, Internet access and broadband services. We strive to maintain our customer relationships by, among other things, bundling our service offerings to provide our customers with a complete offering of integrated communications services. As a result of increased bundling of our local exchange and long distance service offerings, beginning in the first quarter of 2006, we have combined the revenues of such offerings into a category entitled "Voice". Prior periods have been restated to insure comparability. Our operating revenues for our products and services include the following components:

|                          | Three months<br>ended June 30, |         | Six months<br>ended June 30, |           |
|--------------------------|--------------------------------|---------|------------------------------|-----------|
|                          | 2006                           | 2005    | 2006                         | 2005      |
|                          | (Dollars in thousands)         |         |                              |           |
| Voice                    | \$ 216,786                     | 221,708 | 434,235                      | 446,208   |
| Network access           | 221,586                        | 239,404 | 446,832                      | 469,682   |
| Data                     | 84,447                         | 76,049  | 167,685                      | 148,955   |
| Fiber transport and CLEC | 36,051                         | 21,636  | 71,831                       | 41,879    |
| Other                    | 50,261                         | 47,616  | 100,197                      | 94,971    |
| Total operating revenues | \$ 609,131                     | 606,413 | 1,220,780                    | 1,201,695 |

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

We derive our network access revenues primarily from (i) providing services to various carriers and customers in connection with the use of our facilities to originate and terminate their interstate and intrastate voice and data transmissions and (ii) receiving universal support funds which allows us to recover a portion of our costs under federal and state cost recovery mechanisms.

We derive our data revenues primarily by providing Internet access services (both digital subscriber line ("DSL") and dial-up services) and data transmission services over special circuits and private lines in our local exchange service areas.

Our fiber transport and CLEC revenues include revenues from our fiber transport, competitive local exchange carrier and security monitoring businesses.

We derive other revenues primarily by (i) leasing, selling, installing and maintaining customer premise telecommunications equipment and wiring, (ii) providing billing and collection services for third parties, (iii)

participating in the publication of local directories and (iv) offering our new video and wireless services.

#### (7) Accelerated Share Repurchase Program

On February 21, 2006, our Board of Directors approved a stock repurchase program authorizing us to repurchase up to \$1.0 billion of our common stock and terminated the approximately \$13 million remaining balance of our existing \$200 million share repurchase program approved in February 2005. In February 2006, we repurchased the first \$500 million of common stock through accelerated share repurchase agreements entered into with various investment banks, repurchasing and retiring approximately 14.36 million shares of common stock at an average initial price of \$34.83 per share. We funded repurchases under these agreements principally through short-term borrowings. We used cash generated from operations during 2006 and the proceeds received from the redemption of our investment in stock of the Rural Telephone Bank (see Note 10) to reduce indebtedness during the second quarter of 2006.

As part of the accelerated share repurchase transactions, we simultaneously entered into forward contracts with the investment banks whereby the investment banks purchased an aggregate of 14.36 million shares of our common stock during the terms of the contracts. At the end of the repurchase period in mid-July 2006, we paid an aggregate of approximately \$28.4 million cash to the investment banks since the investment banks' weighted average purchase price during the repurchase period (\$37.10) was higher than the initial average price. We will reflect such settlement amount as an adjustment to equity in our financial statements for the third quarter of 2006.

In connection with calculating our diluted earnings per share, we assumed the accelerated share repurchase market price adjustment would be settled through our issuance of additional shares of common stock, which was allowed at our discretion in the agreements. Accordingly, the estimated shares issuable based on the fair value of the forward contract at June 30, 2006 was included in the weighted average shares outstanding for the computation of diluted earnings per share for the periods ended June 30, 2006.

#### (8) Reduction in Workforce

On March 1, 2006, we announced a reduction of our workforce of approximately 275 jobs, or 4% of our workforce, primarily due to increased competitive pressures and the loss of access lines over the last several years. We incurred a one-time net pre-tax charge of approximately \$4.9 million in the first quarter of 2006 (consisting of a \$6.2 million charge to operating expenses, net of a \$1.3 million favorable revenue impact related to such expenses) in connection with the severance and related costs. Of the \$6.2 million charged to operating expenses, approximately \$5.5 million was reflected in cost of services and products and \$682,000 was reflected in selling, general and administrative expenses. The following table reflects additional information regarding the severance-related liability for the first six months of 2006 (in thousands):

|                              |         |
|------------------------------|---------|
| Balance at December 31, 2005 | \$ -    |
| Amount accrued to expense    | 6,176   |
| Amount paid                  | (5,638) |
| Balance at June 30, 2006     | \$ 538  |

#### (9) Commitments and Contingencies

In Barbrasue Beattie and James Sovis, on behalf of themselves and all others similarly situated, v. CenturyTel, Inc., filed on October 28, 2002, in the United States District Court for the Eastern District of Michigan (Case No.

02-10277), the plaintiffs allege that we unjustly and unreasonably billed customers for inside wire maintenance services, and seek unspecified money damages and injunctive relief under various legal theories on behalf of a purported class of over two million customers in our telephone markets. On March 10, 2006, the Court certified a class of plaintiffs and issued a ruling that the billing descriptions we used for these services during an approximately 18-month period between October 2000 and May 2002 were legally insufficient. We have appealed this decision. The Court's order does not specify the award of damages, the scope of which remains subject to significant fact-finding. At this time, we cannot reasonably estimate the amount or range of possible loss; however, we believe it to be significantly below the amount of revenues billed for such services during the above-specified period. We do not believe that the ultimate outcome of this litigation will have a material adverse effect on our financial position or results of operations.

The Telecommunications Act of 1996 allows local exchange carriers to file access tariffs on a streamlined basis and, if certain criteria are met, deems those tariffs lawful. Tariffs that have been "deemed lawful" in effect nullify an interexchange carrier's ability to seek refunds should the earnings from the tariffs ultimately result in earnings above the authorized rate of return prescribed by the FCC. Certain of our telephone subsidiaries file interstate tariffs with the FCC using this streamlined filing approach. For those tariffs that have not yet been "deemed lawful," we initially record as a liability our earnings in excess of the authorized rate of return, and may thereafter recognize as revenues some or all of these amounts at the end of the applicable settlement period as our legal entitlement thereto becomes more certain. As of June 30, 2006, the amount of our earnings in excess of the authorized rate of return reflected as a liability on the balance sheet for the 2003/2004 monitoring period aggregated approximately \$44 million. The settlement period related to the 2003/2004 monitoring period lapses on September 30, 2007. We will continue to monitor the legal status of any proceedings that could impact our entitlement to these funds.

As discussed below in Note 10, we received approximately \$122.8 million in cash from the dissolution of the Rural Telephone Bank ("RTB"). Some portion of these proceeds, while not estimable at this time, may be subject to review by regulatory authorities who may require us to record a portion thereof as a regulatory liability.

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

#### **(10) Nonrecurring gains**

In April 2006, upon dissolution of the RTB, we received \$122.8 million in cash for redemption of our investment in stock of the RTB and recorded a pre-tax gain of approximately \$117.8 million in the second quarter of 2006 related to this transaction. We used the cash to reduce our indebtedness.

In May 2006, we sold the assets of our local exchange operations in Arizona for approximately \$5.9 million cash and recorded a pre-tax gain of approximately \$866,000 in the second quarter of 2006.

Item 2.

**CenturyTel, Inc.**

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

**Overview**

Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") included herein should be read in conjunction with MD&A and the other information included in our annual report on Form 10-K for the year ended December 31, 2005. The results of operations for the three months and six months ended June 30, 2006 are not necessarily indicative of the results of operations which might be expected for the entire year.

We are an integrated communications company engaged primarily in providing local exchange, network access, long distance, Internet access and broadband services to customers in 25 states. We derive our revenues from providing (i) local exchange and long distance telephone services, (ii) network access services, (iii) data services, which includes both DSL and dial-up Internet services, as well as special access and private line services, (iv) fiber transport, competitive local exchange and security monitoring services and (v) other related services. For additional information on our revenue sources, see Note 6 to our financial statements included in Item 1 of Part I of this quarterly report.

As previously disclosed, we anticipate our diluted earnings per share for the remainder of 2006 compared to 2005 will be negatively impacted as a result of (i) lower Universal Service Fund and intrastate revenues, (ii) declines in access lines, (iii) declines in the amount of revenue recorded related to prior year settlement agreements, (iv) the recognition of stock option expense in accordance with SFAS 123(R) and (v) expenses associated with expanding our new video and wireless service offerings. See below for additional information.

On June 30, 2005, we acquired fiber assets in 16 metropolitan markets from KMC Telecom Holdings, Inc. ("KMC").

In the first quarter of 2006, we announced a reduction of our workforce of approximately 275 jobs and, in connection therewith, incurred a one-time net pre-tax charge of approximately \$4.9 million (consisting of a \$6.2 million charge to operating expenses, net of a \$1.3 million favorable revenue impact related to such expenses) for the severance and related costs.

In the second quarter of 2006, we (i) recorded a one-time pre-tax gain of approximately \$117.8 million upon redemption of our investment in the stock of the Rural Telephone Bank ("RTB") and (ii) sold our local exchange operations in Arizona.

*In addition to historical information, this management's discussion and analysis includes certain forward-looking statements that are based on current expectations only, and are subject to a number of risks, uncertainties and assumptions, many of which are beyond our control. Actual events and results may differ materially from those anticipated, estimated or projected if one or more of these risks or uncertainties materialize, or if underlying assumptions prove incorrect. Factors that could affect actual results include but are not limited to: the timing, success and overall effects of competition from a wide variety of competitive providers; the risks inherent in rapid technological change; the effects of ongoing changes in the regulation of the communications industry; our ability to effectively manage our expansion opportunities, including retaining and hiring key personnel; possible changes in the demand for, or pricing of, our products and services; our ability to successfully introduce new product or service offerings on a timely and cost-effective basis; our ability to collect our receivables from financially troubled communications companies; our ability to successfully negotiate collective bargaining agreements on reasonable term without work stoppages; the effects of adverse weather; other risks referenced from time to time in this report or other of our filings with the Securities and Exchange Commission; and the effects of more general factors such as changes in interest rates, in tax rates, in accounting policies or practices, in operating, medical or administrative*

*costs, in general market, labor or economic conditions, or in legislation, regulation or public policy. These and other uncertainties related to the business are described in greater detail in Item 1A to our Form 10-K for the year ended December 31, 2005, as updated by Part II of this report below. You are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this report. We undertake no obligation to update any of our forward-looking statements for any reason.*

**RESULTS OF OPERATIONS****Three Months Ended June 30, 2006 Compared  
to Three Months Ended June 30, 2005**

Net income was \$152.4 million and \$85.1 million for the second quarter of 2006 and 2005, respectively. Diluted earnings per share for the second quarter of 2006 and 2005 was \$1.26 and \$.64, respectively. Included in net income (and diluted earnings per share) for the second quarter of 2006 was approximately \$72.4 million (\$.59 per share) related to nonrecurring gains, substantially all of which related to the redemption of our RTB stock. See Note 10 for additional information. The decline in the number of average diluted shares outstanding is primarily attributable to share repurchases that have occurred since the beginning of 2005.

|  | Three months<br>ended June 30,                                  |          |
|--|---|----------|
|  | 2006  | 2005     |
|  | (Dollars, except per share<br>amounts, and shares in thousands) |          |
| Operating income                           | \$ 165,249  | 185,882  |
| Interest expense                           | (50,639)  | (49,647) |
| Income from unconsolidated cellular entity | 2,076   | 724      |
| Nonrecurring gains                         | 118,649   | -        |
| Other income (expense)                     | 2,734   | 1,220    |
| Income tax expense                         | (85,701)  | (53,061) |
| Net income                                 | \$ 152,368  | 85,118   |
| Basic earnings per share                   | \$ 1.32   | .65      |
| Diluted earnings per share                 | \$ 1.26   | .64      |
| Average basic shares outstanding           | 115,441   | 130,299  |
| Average diluted shares outstanding         | 121,636   | 135,345  |

Operating income decreased \$20.6 million (11.1%) as a \$2.7 million (.4%) increase in operating revenues was more than offset by a \$23.4 million (5.6%) increase in operating expenses.

**Operating Revenues**

|                | Three months<br>ended June 30, |         |
|----------------|--------------------------------|---------|
|                | 2006                           | 2005    |
|                | (Dollars in thousands)         |         |
| Voice          | \$ 216,786                     | 221,708 |
| Network access | 221,586                        | 239,404 |

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|                          |            |         |
|--------------------------|------------|---------|
| Data                     | 84,447     | 76,049  |
| Fiber transport and CLEC | 36,051     | 21,636  |
| Other                    | 50,261     | 47,616  |
|                          | \$ 609,131 | 606,413 |

The \$4.9 million (2.2%) decrease in voice revenues is primarily due to (i) a \$5.7 million decrease due to a 4.7% decline in the average number of access lines served by us during the second quarter of 2006 compared to the second quarter of 2005; (ii) a \$7.0 million decrease due to a decline in the average rate we charged our long distance customers; and (iii) a \$4.7 million decline as a result of a decrease in minutes of use in extended area calling plans in certain areas and the effect of rate reductions. Such decreases were partially offset by an \$11.5 million increase in long distance revenues primarily attributable to an 8.7% increase in the average number of long distance lines served and increased long distance minutes of use.

Excluding the sale of our Arizona telephone properties in May 2006, access lines declined 21,500 (1.0%) during the second quarter of 2006 compared to a decline of 25,200 (1.1%) during the second quarter of 2005. We believe the decline in the number of access lines during 2006 and 2005 is primarily due to the displacement of traditional wireline telephone services by other competitive services. Based on current conditions and anticipated competition, we expect access lines to decline between 4.5% and 5.5% for 2006.

Network access revenues decreased \$17.8 million (7.4%) in the second quarter of 2006 primarily due to (i) a \$6.5 million decline attributable to the recognition of prior year revenues in the second quarter of 2005; (ii) a \$4.9 million decrease in revenues from the federal Universal Service Fund primarily due to an increase in the nationwide average cost per loop factor used by the Federal Communications Commission to allocate funds among all recipients; and (iii) a \$3.3 million decrease as a result of lower intrastate revenues due to a reduction in intrastate minutes (partially due to the displacement of minutes by wireless, electronic mail and other optional calling services). We believe that intrastate minutes will continue to decline in 2006, although we cannot precisely estimate the magnitude of such decreases.

Data revenues increased \$8.4 million (11.0%) substantially due to a \$9.2 million increase in Internet revenues due primarily to growth in the number of DSL customers, partially offset by a decrease in the number of dial-up customers.

Fiber transport and CLEC revenues increased \$14.4 million (66.6%), of which \$12.9 million was due to revenues from the fiber assets acquired on June 30, 2005 from KMC and \$1.4 million was attributable to growth in our incumbent fiber transport business.

Other revenues increased \$2.6 million (5.6%) primarily due to a \$2.8 million increase in revenues of our new video and wireless reseller service offerings.

## Operating Expenses

|  | Three months<br>ended June 30, |         |
|--|--------------------------------|---------|
|  | 2006                           | 2005    |
|  | (Dollars in thousands)         |         |
| Cost of services and products (exclusive of depreciation and amortization) | \$ 216,466                     | 194,873 |
| Selling, general and administrative  | 95,596                         | 95,206  |
| Depreciation and amortization  | 131,820                        | 130,452 |



|    |         |         |
|----|---------|---------|
| \$ | 443,882 | 420,531 |
|----|---------|---------|

Cost of services and products increased \$21.6 million (11.1%) primarily due to (i) a \$9.8 million increase in expenses incurred by the properties acquired from KMC; (ii) a \$6.6 million increase in costs associated with growth in our long distance business; (iii) a \$3.8 million increase in expenses associated with our new video and wireless reseller service offerings; and (iv) a \$2.4 million increase in Internet expenses primarily due to growth in the number of DSL customers.

Selling, general and administrative expenses increased \$390,000 (.4%) primarily due to a \$3.2 million increase in expenses incurred from the properties acquired from KMC which was substantially offset by a \$2.9 million reduction in bad debt expense.

Depreciation and amortization increased \$1.4 million (1.0%) primarily due to a \$5.3 million increase due to higher levels of plant in service and a \$1.4 million increase due to depreciation and amortization of the properties acquired from KMC. Such increases were substantially offset by a \$3.7 million reduction in depreciation expense due to certain assets becoming fully depreciated and a \$2.2 million decrease due to rate reductions in certain jurisdictions.

### **Interest Expense**

Interest expense increased \$992,000 (2.0%) in the second quarter of 2006 compared to the second quarter of 2005. A \$2.6 million increase due to higher average interest rates was substantially offset by a \$2.1 million reduction due to decreased average debt outstanding.

### **Income From Unconsolidated Cellular Entity**

Income from unconsolidated cellular entity, which represents our share of the income from our 49% interest in a cellular partnership, was \$2.1 million and \$724,000 in the second quarter of 2006 and 2005, respectively.

### **Nonrecurring Gains**

The second quarter of 2006 included nonrecurring pre-tax gains of approximately \$118.6 million, substantially all of which relates to the redemption of our RTB stock upon dissolution of the RTB. See Note 10 for additional information.

### **Other Income (Expense)**

Other income (expense) includes the effects of certain items not directly related to our core operations, including interest income and allowance for funds used during construction. Other income (expense) was \$2.7 million for the second quarter of 2006 compared to \$1.2 million for the second quarter of 2005.

### **Income Tax Expense**

The effective income tax rate was 36.0% and 38.4% for the three months ended June 30, 2006 and 2005, respectively. Income tax expense was reduced by approximately \$6.4 million in the second quarter of 2006 due to the resolution of various income tax audit issues.

**Six Months Ended June 30, 2006 Compared  
to Six Months Ended June 30, 2005**

Net income was \$221.8 million and \$164.7 million for the first six months of 2006 and 2005, respectively. Diluted earnings per share for the first six months of 2006 and 2005 was \$1.80 and \$1.23, respectively. Included in net income (and diluted earnings per share) for the first six months of 2006 was approximately \$72.4 million (\$.58 per share) related to nonrecurring gains, substantially all of which related to the redemption of our RTB stock. See Note 10 for additional information. The decline in the number of average diluted shares outstanding is primarily attributable to share repurchases that have occurred since the beginning of 2005.

|  | Six months<br>ended June 30,                                       |           |
|--|--|-----------|
|  | 2006   | 2005      |
|  | (Dollars, except per share<br>amounts, and shares in<br>thousands) |           |
| Operating income                           | \$ 323,441   | 362,742   |
| Interest expense                           | (100,725)  | (102,272) |
| Income from unconsolidated cellular entity | 4,149  | 2,037     |
| Nonrecurring gains                         | 118,649  | -         |
| Other income (expense)                     | 5,258  | 2,755     |
| Income tax expense                         | (128,979)  | (100,528) |
| Net income                                 | \$ 221,793   | 164,734   |
| Basic earnings per share                   | \$ 1.86  | 1.25      |
| Diluted earnings per share                 | \$ 1.80  | 1.23      |
| Average basic shares outstanding           | 118,917  | 131,241   |
| Average diluted shares outstanding         | 124,798  | 136,257   |

Operating income decreased \$39.3 million (10.8%) as a \$19.1 million (1.6%) increase in operating revenues was more than offset by a \$58.4 million (7.0%) increase in operating expenses.

**Operating Revenues**

|                          | Six months<br>ended June 30, |         |
|--------------------------|------------------------------|---------|
|                          | 2006                         | 2005    |
|                          | (Dollars in thousands)       |         |
| Voice                    | \$ 434,235                   | 446,208 |
| Network access           | 446,832                      | 469,682 |
| Data                     | 167,685                      | 148,955 |
| Fiber transport and CLEC | 71,831                       | 41,879  |
| Other                    | 100,197                      | 94,971  |

|    |           |           |
|----|-----------|-----------|
| \$ | 1,220,780 | 1,201,695 |
|----|-----------|-----------|

The \$12.0 million (2.7%) decrease in voice revenues is primarily due to (i) an \$11.2 million decrease due to a 4.6% decline in the average number of access lines; (ii) a \$12.2 million decrease due to a decline in the average rate we charged our long distance customers; and (iii) a \$13.2 million decline as a result of a decrease in minutes of use in extended area calling plans in certain areas and the effect of rate reductions. Such decreases were partially offset by (i) a \$19.4 million increase in long distance revenues primarily attributable to an 8.8% increase in the average number of long distance lines and increased long distance minutes of use and (ii) a \$3.4 million increase due to our providing custom calling features to more customers.

Excluding the sale of our Arizona telephone operations in May 2006, access lines declined 43,900 (2.0%) during the first six months of 2006 compared to a decline of 40,300 (1.7%) during the first six months of 2005. We believe the decline in the number of access lines during 2006 and 2005 is primarily due to the displacement of traditional wireline telephone services by other competitive services. Based on current conditions and anticipated competition, we expect access lines to decline between 4.5% and 5.5% for 2006.

Network access revenues decreased \$22.9 million (4.9%) in the first six months of 2006 primarily due to (i) an \$8.9 million decrease in revenues from the federal Universal Service Fund primarily due to an increase in the nationwide average cost per loop factor used by the Federal Communications Commission to allocate funds among all recipients; (ii) a \$6.7 million decrease as a result of lower intrastate revenues due to a reduction in intrastate minutes (partially due to the displacement of minutes by wireless, electronic mail and other optional calling services); and (iii) a \$5.9 million decline attributable to the recognition of prior year revenues in the second quarter of 2005. We believe that intrastate minutes will continue to decline in 2006, although we cannot precisely estimate the magnitude of such decreases. Such decreases were partially offset by a \$2.9 million increase due to the implementation of a billing charge which the FCC permitted us to begin assessing to our customers in the second quarter of 2005 to recover a portion of our network upgrade costs incurred in order to provide local number portability services.

Data revenues increased \$18.7 million (12.6%) substantially due to a \$18.3 million increase in Internet revenues due primarily to growth in the number of DSL customers, partially offset by a decrease in the number of dial-up customers.

Fiber transport and CLEC revenues increased \$30.0 million (71.5%), of which \$26.4 million was due to revenues from the fiber assets acquired on June 30, 2005 from KMC and \$3.5 million was attributable to growth in our incumbent fiber transport business.

Other revenues increased \$5.2 million (5.5%) primarily due to a \$5.2 million increase in revenues of our new video and wireless reseller service offerings.

## Operating Expenses

|  | Six months<br>ended June 30, |         |
|--|------------------------------|---------|
|  | 2006                         | 2005    |
|  | (Dollars in thousands)       |         |
| Cost of services and products (exclusive of depreciation and amortization) | \$ 439,418                   | 386,866 |
| Selling, general and administrative  | 191,536                      | 189,460 |
| Depreciation and amortization  | 266,385                      | 262,627 |
|  | \$ 897,339                   | 838,953 |

Included in aggregate operating expenses is a one-time charge of \$6.2 million (most of which is reflected in “Cost of services and products”) related to severance and related costs associated with our March 2006 reduction in workforce. See Note 8 for additional information.

Cost of services and products increased \$52.6 million (13.6%) primarily due to (i) a \$20.1 million increase in expenses incurred by the properties acquired from KMC; (ii) a \$10.5 million increase in costs associated with growth in our long distance business; (iii) a \$7.4 million increase in expenses associated with our new video and wireless reseller service offerings; (iv) \$5.5 million of severance and related costs associated with our workforce reduction; and (v) a \$5.3 million increase in Internet expenses primarily due to growth in the number of DSL customers.

Selling, general and administrative expenses increased \$2.1 million (1.1%) primarily due to a \$6.6 million increase in expenses incurred from the properties acquired from KMC which was substantially offset by a \$4.7 million reduction in bad debt expense.

Depreciation and amortization increased \$3.8 million (1.4%) primarily due to a \$9.8 million increase due to higher levels of plant in service and a \$2.8 million increase due to depreciation and amortization of the properties acquired from KMC. Such increases were substantially offset by an \$8.7 million reduction in depreciation expense due to certain assets becoming fully depreciated.

### **Interest Expense**

Interest expense decreased \$1.5 million (1.5%) in the first six months of 2006 compared to the first six months of 2005. A \$4.2 million reduction due to decreased average debt outstanding and the \$1.2 million one-time charge incurred in the first quarter of 2005 discussed in the next paragraph were partially offset by a \$4.5 million increase due to higher average interest rates.

In February 2005, we remarketed substantially all of our \$500 million of outstanding Series J senior notes due 2007 at an interest rate of 4.628%. In connection with the remarketing, we purchased and retired approximately \$400 million of the notes, resulting in approximately \$100 million remaining outstanding. Included in interest expense for the first quarter of 2005 was a one-time charge of \$1.2 million related to the write-off of unamortized deferred debt costs related to the portion of the Series J notes retired. See Other Income (Expense) for additional amounts that were expensed in the first quarter of 2005 related to this transaction.

### **Income From Unconsolidated Cellular Entity**

Income from unconsolidated cellular entity, which represents our share of the income from our 49% interest in a cellular partnership, was \$4.1 million and \$2.0 million in the first six months of 2006 and 2005, respectively.

### **Nonrecurring Gains**

The second quarter of 2006 included nonrecurring pre-tax gains of approximately \$118.6 million, substantially all of which relates to the redemption of our RTB stock upon dissolution of the RTB. See Note 10 for additional information.

### **Other Income (Expense)**

Other income (expense) includes the effects of certain items not directly related to our core operations, including interest income and allowance for funds used during construction. Other income (expense) was \$5.3 million for the first six months of 2006 compared to \$2.8 million for the six months of 2005. The first six months of 2005 included a one-time \$4.8 million debt extinguishment expense related to purchasing and retiring approximately \$400 million of the Series J notes, as mentioned above. The first six months of 2005 was favorably impacted by \$3.2 million of

non-recurring interest income related to the settlement of various income tax audits.

### **Income Tax Expense**

The effective income tax rate was 36.8% and 37.9% for the six months ended June 30, 2006 and 2005, respectively. Income tax expense was reduced by approximately \$6.4 million in the first six months of 2006 due to the resolution of various income tax audit issues. Income tax expense for the first six months of 2005 was reduced by approximately \$1.3 million as a result of the settlement of various income tax audits.

## **LIQUIDITY AND CAPITAL RESOURCES**

Excluding cash used for acquisitions, we rely on cash provided by operations to fund our operating and capital expenditures. Our operations have historically provided a stable source of cash flow which has helped us continue our long-term program of capital improvements.

Net cash provided by operating activities was \$406.3 million during the first six months of 2006 compared to \$478.9 million during the first six months of 2005. Our accompanying consolidated statements of cash flows identify major differences between net income and net cash provided by operating activities for each of these periods. As relief from the effects of Hurricane Katrina, certain of our affected subsidiaries were granted a deferral from making their remaining 2005 estimated federal income and excise tax payments until 2006. In the first six months of 2006, we made payments of approximately \$75 million to satisfy our remaining 2005 estimated payments. For additional information relating to our operations, see Results of Operations.

Net cash used in investing activities was \$8.3 million and \$250.7 million for the six months ended June 30, 2006 and 2005, respectively. Payments for property, plant and equipment were \$46.5 million less in the first six months of 2006 than in the comparable period during 2005. Our budgeted capital expenditures for 2006 total approximately \$325 million. We have invested significant amounts in our wireline network in the last several years and believe we are in a position to move closer to maintenance capital expenditure levels for the foreseeable future for our wireline properties. Our capital expenditure budget also includes amounts for expanding our new service offerings and our data networks. We received approximately \$128.7 million cash from asset dispositions in 2006, of which approximately \$122.8 million was from the redemption of our RTB stock upon dissolution of the RTB and \$5.9 million was from the sale of our local exchange operations in Arizona. See Note 10 for additional information. We paid approximately \$73.2 million cash in 2005 to acquire certain fiber assets in 16 markets from KMC.

Net cash used in financing activities was \$555.1 million during the first six months of 2006 compared to \$295.0 million during the first six months of 2005. We repurchased 16.5 million shares (for \$573.9 million) and 16.4 million shares (for \$530.7 million) in the first six months of 2006 and 2005, respectively, substantially all of which was repurchased in accordance with previously announced stock repurchase programs. The 2006 repurchases include 14.36 million shares repurchased (for a total price of approximately \$500 million) under accelerated share repurchase agreements with investment banks (see Note 7 for additional information). We initially funded the accelerated share repurchase agreements principally through borrowings under our \$750 million credit facility and cash on hand and subsequently refinanced the credit facility borrowings through the issuance of short-term commercial paper, which as of June 30, 2006, had been repaid in full. We used cash generated from operations during 2006 and the \$122.8 million of proceeds received from the redemption of our investment in stock of the RTB to reduce indebtedness. As part of the 2006 accelerated share repurchase transactions, we simultaneously entered into forward contracts with the investment banks whereby the investment banks purchased an aggregate of 14.36 million shares of our common stock during the terms of the contracts. At the end of the repurchase period in mid-July 2006, we paid an aggregate of approximately \$28.4 million cash to the investment banks since the investment banks' weighted average purchase price during the repurchase period was higher than the initial average price. We will reflect such settlement amount as an adjustment to

equity.

In the first quarter of 2005, we paid \$100 million to retire our Series E senior notes at their scheduled maturity with cash on hand.

In February 2005, we remarketed substantially all of our \$500 million of outstanding Series J senior notes due 2007 at an interest rate of 4.628%. We received no proceeds in connection with the remarketing as all proceeds were placed into a trust to secure the obligation of our equity unit holders to purchase common stock from us on May 16, 2005. In connection with the remarketing, we purchased and retired approximately \$400 million of the notes, resulting in approximately \$100 million remaining outstanding. We incurred a pre-tax charge of approximately \$6 million in the first quarter of 2005 related to purchasing and retiring the notes. Proceeds to purchase such notes came from the February 2005 issuance of \$350 million of 5% senior notes, Series M, due 2015 and cash on hand.

We have available a five-year, \$750 million revolving credit facility which expires in March 2010. Up to \$150 million of the credit facility can be used for letters of credit, which reduces the amount available for other extensions of credit. Available borrowings under our credit facility are also effectively reduced by any outstanding borrowings under our commercial paper program. Our commercial paper program borrowings in turn are effectively limited to the total amount available under our credit facility. As of June 30, 2006, we had no outstanding indebtedness under our credit facility or commercial paper program.

In May 2006, Standard & Poor's downgraded our long-term debt rating from BBB+ to BBB with a negative outlook, citing the continued loss of access lines.

In July 2006, we paid a deposit of approximately \$59 million in order to participate in the upcoming Advanced Wireless Services ("AWS") spectrum auction to be held in August 2006. We are currently evaluating our opportunities regarding this spectrum, particularly with respect to spectrum that covers or is contiguous to our existing service territories. Unused deposit amounts will be returned to us upon completion of the auction.

We funded the \$59 million AWS deposit and the \$28.4 million accelerated share repurchase settlement with cash on hand and short-term borrowings. As of July 31, 2006, we had \$40.0 million outstanding in short-term borrowings.

## **OTHER MATTERS**

### **Accounting for the Effects of Regulation**

We currently account for our regulated telephone operations (except for the properties acquired from Verizon in 2002) in accordance with the provisions of Statement of Financial Accounting Standards No. 71, "Accounting for the Effects of Certain Types of Regulation" ("SFAS 71"). While we continuously monitor the ongoing applicability of SFAS 71 to our regulated telephone operations due to the changing regulatory, competitive and legislative environments, we believe that SFAS 71 still applies. However, it is possible that changes in regulation or legislation or anticipated changes in competition or in the demand for regulated services or products could result in our telephone operations not being subject to SFAS 71 in the future. In that event, implementation of Statement of Financial Accounting Standards No. 101 ("SFAS 101"), "Regulated Enterprises - Accounting for the Discontinuance of Application of FASB Statement No. 71," would require the write-off of previously established regulatory assets and liabilities. SFAS 101 further provides that the carrying amounts of property, plant and equipment are to be adjusted only to the extent the assets are impaired and that impairment shall be judged in the same manner as for nonregulated enterprises.

If our regulated operations cease to qualify for the application of SFAS 71, we do not expect to record an impairment charge related to the carrying value of the property, plant and equipment of our regulated telephone operations. Additionally, upon the discontinuance of SFAS 71, we would be required to revise the lives of our property, plant and equipment to reflect the estimated useful lives of the assets. We do not expect such revisions in asset lives, or the elimination of other regulatory assets and liabilities, to have a material unfavorable impact on our results of operations. For regulatory purposes, the accounting and reporting of our telephone subsidiaries would not be affected by the discontinued application of SFAS 71.

### **Recent Product Developments**

During 2005, we began offering co-branded satellite television service to virtually all households in our local exchange service areas, except for the LaCrosse, Wisconsin market, where we initiated our switched digital television service. We continue to monitor the results from this initial launch of switched digital television service and currently plan to initiate a second switched digital video trial during 2006. In mid-2005, we began reselling wireless services and, by the end of June 2006, we offered wireless service through this reselling arrangement to markets serving nearly 30% of our residential access lines.

Item 3.

**CenturyTel, Inc.**

**QUANTITATIVE AND QUALITATIVE  
DISCLOSURES ABOUT MARKET RISK**

We are exposed to market risk from changes in interest rates on our long-term debt obligations. We have estimated our market risk using sensitivity analysis. Market risk is defined as the potential change in the fair value of a fixed-rate debt obligation due to a hypothetical adverse change in interest rates. Fair value on long-term debt obligations is determined based on a discounted cash flow analysis, using the rates and maturities of these obligations compared to terms and rates currently available in the long-term financing markets. The results of the sensitivity analysis used to estimate market risk are presented below, although the actual results may differ from these estimates.

At June 30, 2006, the fair value of our long-term debt was estimated to be \$2.6 billion based on the overall weighted average rate of our debt of 7.0% and an overall weighted maturity of 9 years compared to terms and rates currently available in long-term financing markets. Market risk is estimated as the potential decrease in fair value of our long-term debt resulting from a hypothetical increase of 70 basis points in interest rates (ten percent of our overall weighted average borrowing rate). Such an increase in interest rates would result in approximately a \$102.3 million decrease in fair value of our long-term debt at June 30, 2006. As of June 30, 2006, after giving effect to interest rate swaps currently in place, approximately 81% of our long-term debt obligations were fixed rate.

We seek to maintain a favorable mix of fixed and variable rate debt in an effort to limit interest costs and cash flow volatility resulting from changes in rates. From time to time, we use derivative instruments to (i) lock-in or swap our exposure to changing or variable interest rates for fixed interest rates or (ii) to swap obligations to pay fixed interest rates for variable interest rates. We have established policies and procedures for risk assessment and the approval, reporting and monitoring of derivative instrument activities. We do not hold or issue derivative financial instruments for trading or speculative purposes. Management periodically reviews our exposure to interest rate fluctuations and implements strategies to manage the exposure.

At June 30, 2006, we had outstanding four fair value interest rate hedges associated with the full \$500 million aggregate principal amount of our Series L senior notes, due 2012, that pay interest at a fixed rate of 7.875%. These hedges are “fixed to variable” interest rate swaps that effectively convert our fixed rate interest payment obligations under these notes into obligations to pay variable rates that range from the six-month London InterBank Offered Rate (“LIBOR”) plus 3.229% to the six-month LIBOR plus 3.67%, with settlement and rate reset dates occurring each six months through the expiration of the hedges in August 2012. During the first six months of 2006, we realized an average interest rate under these hedges of 9.15%. Interest expense was increased by \$3.2 million during the first six months of 2006 as a result of these hedges. The aggregate fair market value of these hedges was \$37.2 million at June 30, 2006 and is reflected both as a liability and as a decrease in our underlying long-term debt on the June 30, 2006 balance sheet. With respect to each of these hedges, market risk is estimated as the potential change in the fair value of the hedge resulting from a hypothetical 10% increase in the forward rates used to determine the fair value. A hypothetical 10% increase in the forward rates would result in a \$15.6 million decrease in the fair value of these hedges at June 30, 2006, and would also increase our interest expense.

Certain shortcomings are inherent in the method of analysis presented in the computation of fair value of financial instruments. Actual values may differ from those presented if market conditions vary from assumptions used in the fair value calculations. The analysis above incorporates only those risk exposures that existed as of June 30, 2006.



Item 4.

**CenturyTel, Inc.**

**CONTROLS AND PROCEDURES**

We maintain disclosure controls and procedures designed to provide reasonable assurances that information required to be disclosed by us in the reports we file under the Securities Exchange Act of 1934 is timely recorded, processed, summarized and reported as required. Our Chief Executive Officer, Glen F. Post, III, and our Chief Financial Officer, R. Stewart Ewing, Jr., have evaluated our disclosure controls and procedures as of June 30, 2006. Based on the evaluation, Messrs. Post and Ewing concluded that our disclosure controls and procedures have been effective in providing reasonable assurance that they have been timely alerted of material information required to be filed in this quarterly report. Since the date of Messrs. Post's and Ewing's most recent evaluation, there have been no significant changes in our internal controls or in other factors that could significantly affect these controls. The design of any system of controls is based in part upon certain assumptions about the likelihood of future events and contingencies, and there can be no assurance that any design will succeed in achieving its stated goals. Because of inherent limitations in any control system, misstatements due to error or fraud could occur and not be detected.

## PART II. OTHER INFORMATION

**CenturyTel, Inc.**Item 1. Legal Proceedings.

See Note 9 included in Part I, Item 1, of this report.

Item 1A. Risk Factors.

We expect that changes in the nationwide average cost per loop factors implemented in March 2006 by the FCC to allocate support funds will reduce our receipts from the main support program administered by the federal Universal Service Fund by approximately \$12 million to \$16 million in 2006 compared to 2005.

The statement above updates and supercedes the disclosure of risk factors contained in Item 1A of our annual report on Form 10-K for the year ended December 31, 2005. Except as modified by the superceding statement above, we continue to remain subject to the risks described in such annual report.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

In February 2006, our Board of Directors authorized a \$1.0 billion share repurchase program under which, in February 2006, we repurchased \$500 million (or approximately 14.36 million shares) of our common stock under accelerated share repurchase agreements with certain investment banks at an initial average price of \$34.83. The investment banks completed their repurchases in mid-July 2006 and in connection therewith we paid an aggregate of approximately \$28.4 million cash to the investment banks since their weighted average purchase price during the repurchase period (\$37.10) was higher than the initial average price. With the completion of the accelerated share repurchase program, we retain authority to repurchase through June 30, 2007 the \$500 million of our common stock that remains under our \$1.0 billion program.

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

At our annual meeting of shareholders on May 11, 2006, the shareholders elected four Class III directors to serve until the 2009 annual meeting of shareholders and until their successors are duly elected and qualified.

The following number of votes were cast for or were withheld from the following nominees:

| <u>Class III<br/>Nominees</u> | <u>For</u>  | <u>Withheld</u> |
|-------------------------------|-------------|-----------------|
| Fred R.<br>Nichols            | 159,984,988 | 12,292,580      |
| Harvey P.<br>Perry            | 159,993,956 | 12,283,612      |
| Jim D.<br>Reppond             | 155,639,592 | 16,637,976      |
| Joseph R.<br>Zimmel           | 162,637,199 | 9,640,369       |

The Class I and Class II directors whose terms continued after the meeting are:

| <u>Class I</u>        | <u>Class II</u>   |
|-----------------------|-------------------|
| William R. Boles, Jr. | Virginia Boulet   |
| W. Bruce Hanks        | Calvin Czeschin   |
| C. G. Melville, Jr.   | James B. Gardner  |
| Glen F. Post, III     | Gregory J. McCray |

The following represents the votes cast by the shareholders to ratify the appointment of KPMG LLP as our independent auditor for 2006:

|                  |             |
|------------------|-------------|
| For              | 158,600,155 |
| Against          | 9,016,662   |
| Abstain          | 2,371,279   |
| Broker non-votes | 2,289,472   |

Item 6. Exhibits and Reports on Form 8-K

A. Exhibits

|      |   |
|------|---|
| 10.1 | Form of Restricted Stock Agreement pursuant to the 2005 Directors Stock Plan, entered into between CenturyTel and each of its outside directors as of May 12, 2006. |
| 11   | Computations of Earnings Per Share.   |
| 31.1 | Registrant's Chief Executive Officer certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.   |
| 31.2 | Registrant's Chief Financial Officer certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.   |
| 32   | Registrant's Chief Executive Officer and Chief Financial Officer certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.                           |

B. Reports on Form 8-K

The following items were reported in the Form 8-K filed April 27, 2006:

Items 2.02 and 9.01 - Results of Operations and Financial Condition and Financial Statements and Exhibits. News release announcing first quarter 2006 operating results.

**SIGNATURE**

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

**CenturyTel, Inc.**

Date: August 2, 2006

/s/ Neil A. Sweasy

Neil A. Sweasy  
Vice President and  
Controller  
(Principal Accounting  
Officer)