CENTURYLINK, INC
Form 10-Q
August 09, 2012

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2012

or

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

For the transition period from to
Commission File No. 001-7784

CENTURYLINK, INC.
(Exact name of registrant as specified in its charter)

Louisiana	**72-0651161**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
100 CenturyLink Drive, Monroe, Louisiana	**71203**
(Address of principal executive offices)	**(Zip Code)**

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

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 ý   No o

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ý	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

On August 2, 2012, there were 622,649,622 shares of common stock outstanding.

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

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PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CENTURYLINK, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

		Three Months Ended June 30,		Six Months Ended June 30,	
		2012	2011	2012	2011
		(Dollars in millions except per share amounts and shares in thousands)			
OPERATING REVENUES	$	4,612	4,406	9,222	6,102
OPERATING EXPENSES					
Cost of services and products (exclusive of depreciation and amortization)		1,912	1,781	3,789	2,407
Selling, general and administrative		835	968	1,706	1,205
Depreciation and amortization		1,208	1,177	2,416	1,546
Total operating expenses		3,955	3,926	7,911	5,158
OPERATING INCOME		657	480	1,311	944
OTHER INCOME (EXPENSE)					
Interest expense		(335)	(280)	(678)	(408)
Net loss on early retirement of debt		(202)	(1)	(194)	(1)
Other income (expense)		3	(13)	15	(10)
Total other income (expense)		(534)	(294)	(857)	(419)
INCOME BEFORE INCOME TAX EXPENSE		123	186	454	525
Income tax expense		49	71	180	199
NET INCOME	$	74	115	274	326
EARNINGS PER COMMON SHARE					
BASIC	$	.12	.19	.44	.72
DILUTED	$	.12	.19	.44	.72
DIVIDENDS DECLARED PER COMMON SHARE	$	.725	.725	1.45	1.45
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING					
BASIC		619,887	598,884	619,048	451,358
DILUTED		621,839	600,259	621,095	452,369

See accompanying notes to consolidated financial statements.

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CENTURYLINK, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(UNAUDITED)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
	(Dollars in millions)			
NET INCOME	$ 74	115	274	326
OTHER COMPREHENSIVE INCOME (LOSS):				
Auction rate securities marked to market, net of $, $, $(2), and $ tax			3	
Foreign currency translation adjustment and other, net of $, $2, $, and $2 tax	(3)	(4)	1	(4)
Items related to employee benefit plans:				
Change in net actuarial loss, net of $(3), $(1), $(6), and $(3) tax	5	2	10	4
Other comprehensive income (loss)	2	(2)	14	
COMPREHENSIVE INCOME	$ 76	113	288	326

See accompanying notes to consolidated financial statements.

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CENTURYLINK, INC.

CONSOLIDATED BALANCE SHEETS (UNAUDITED)

		June 30, 2012	December 31, 2011
		(Dollars in millions and shares in thousands)	
ASSETS			
CURRENT ASSETS			
Cash and cash equivalents	$	281	128
Accounts receivable, less allowance of $157 and $145		1,920	1,977
Deferred income taxes, net		1,018	1,019
Other		628	393
Total current assets		3,847	3,517
NET PROPERTY, PLANT AND EQUIPMENT			
Property, plant and equipment		30,623	29,585
Accumulated depreciation		(11,569)	(10,141)
Net property, plant and equipment		19,054	19,444
GOODWILL AND OTHER ASSETS			
Goodwill		21,732	21,732
Customer relationships, net		7,635	8,239
Other intangible assets, net		1,922	2,243
Other		900	869
Total goodwill and other assets		32,189	33,083
TOTAL ASSETS	$	55,090	56,044
LIABILITIES AND STOCKHOLDERS' EQUITY			
CURRENT LIABILITIES			
Current maturities of long-term debt	$	1,903	480
Accounts payable		1,134	1,400
Accrued expenses and other liabilities			
Salaries and benefits		653	633
Other taxes		371	383
Interest		279	293
Other		269	255
Advance billings and customer deposits		598	573
Total current liabilities		5,207	4,017
LONG-TERM DEBT		19,682	21,356
DEFERRED CREDITS AND OTHER LIABILITIES			
Benefit plan obligations, net		4,720	4,855
Deferred income taxes, net		3,955	3,800
Other		1,215	1,189
Total deferred credits and other liabilities		9,890	9,844
COMMITMENTS AND CONTINGENCIES (Note 10)			
STOCKHOLDERS' EQUITY			
Preferred stock non-redeemable, $25.00 par value, authorized 2,000 shares, issued and outstanding 9 and 9 shares			
Common stock, $1.00 par value, authorized 1,600,000 and 800,000 shares, respectively, issued and outstanding 622,327 and 618,514 shares, respectively		622	619
Additional paid-in capital		18,999	18,901

Accumulated other comprehensive loss		(998)	(1,012)
Retained earnings		1,688	2,319
Total stockholders' equity		20,311	20,827
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$	55,090	56,044

See accompanying notes to consolidated financial statements.

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CENTURYLINK, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	Six Months Ended June 30, 2012	2011
	(Dollars in millions)	
OPERATING ACTIVITIES		
Net income	$ 274	326
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	2,416	1,546
Deferred income taxes	137	174
Provision for uncollectible accounts	103	61
Long-term debt (premium) discount amortization	(49)	(66)
Net loss on early retirement of debt	194	1
Changes in current assets and current liabilities:		
Accounts receivable	(64)	8
Accounts payable	(140)	(24)
Accrued income and other taxes	22	67
Other current assets and other current liabilities, net	(6)	22
Retirement benefits	(163)	(129)
Changes in other noncurrent assets and liabilities	53	(10)
Other, net	22	42
Net cash provided by operating activities	2,799	2,018
INVESTING ACTIVITIES		
Payments for property, plant and equipment and capitalized software	(1,305)	(790)
Cash acquired in Qwest acquisition, net of $5 cash paid		419
Proceeds from sale of property	133	
Other, net	(3)	9
Net cash used in investing activities	(1,175)	(362)
FINANCING ACTIVITIES		
Net proceeds from issuance of long-term debt	3,361	2,602
Payments of long-term debt	(3,630)	(857)
Early retirement of debt costs	(324)	(13)
Net payments on credit facility	(27)	(365)
Dividends paid	(905)	(657)
Net proceeds from issuance of common stock	65	58
Repurchase of common stock	(20)	(30)
Other, net	7	(21)
Net cash (used in) provided by financing activities	(1,473)	717
Effect of exchange rate changes on cash and cash equivalents	2	
Net increase in cash and cash equivalents	153	2,373
Cash and cash equivalents at beginning of period	128	173
Cash and cash equivalents at end of period	$ 281	2,546
Supplemental cash flow information:		
Income taxes (paid) refunded, net	$ (31)	99

Interest paid (net of capitalized interest of $21 and $10)	(729)	(460)

See accompanying notes to consolidated financial statements.

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CENTURYLINK, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(UNAUDITED)

	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
	(Dollars in millions)	
COMMON STOCK (represents dollars and shares)		
Balance at beginning of period	$ 619	305
Issuance of common stock to acquire Qwest, including shares issued in connection with share-based compensation awards		294
Issuance of common stock through dividend reinvestment, incentive and benefit plans	4	4
Shares withheld to satisfy tax withholdings	(1)	(1)
Balance at end of period	622	602
ADDITIONAL PAID-IN CAPITAL		
Balance at beginning of period	18,901	6,181
Issuance of common stock to acquire Qwest, including shares issued in connection with share-based compensation awards		11,974
Issuance of common stock through dividend reinvestment, incentive and benefit plans	61	55
Shares withheld to satisfy tax withholdings	(19)	(15)
Share-based compensation and other, net	56	41
Balance at end of period	18,999	18,236
TREASURY STOCK		
Balance at beginning of period		
Shares withheld to satisfy tax withholdings		(14)
Balance at end of period		(14)
ACCUMULATED OTHER COMPREHENSIVE LOSS		
Balance at beginning of period	(1,012)	(141)
Other comprehensive income	14	
Balance at end of period	(998)	(141)
RETAINED EARNINGS		
Balance at beginning of period	2,319	3,302
Net income	274	326
Dividends declared	(905)	(657)
Balance at end of period	1,688	2,971
TOTAL STOCKHOLDERS' EQUITY	$ 20,311	21,654

See accompanying notes to consolidated financial statements.

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CENTURYLINK, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

Unless the context requires otherwise, references in this report to "CenturyLink," "we," "us" and "our" refer to CenturyLink, Inc. and its consolidated subsidiaries, including SAVVIS, Inc. and its consolidated subsidiaries (referred to as "Savvis") for periods on or after July 15, 2011 and Qwest Communications International Inc. and its consolidated subsidiaries (referred to as "Qwest") for periods on or after April 1, 2011.

(1) Basis of Presentation

We are an integrated communications company engaged primarily in providing an array of communications services to our residential, business, governmental and wholesale customers. Our communications services include local and long-distance, network access, private line (including special access), public access, broadband, data, managed hosting (including cloud hosting), colocation, wireless and video services. In certain local and regional markets, we also provide local access and fiber transport services to competitive local exchange carriers and security monitoring services.

Our consolidated balance sheet as of December 31, 2011, which was derived from our audited financial statements, and our unaudited interim consolidated financial statements provided herein have been prepared in accordance with the instructions for Form 10-Q. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to rules and regulations of the Securities and Exchange Commission ("SEC"); however, in our opinion, the disclosures made are adequate to make the information presented not misleading. We believe that these consolidated financial statements include all normal recurring adjustments necessary to fairly present the results for the interim periods. The results of operations for the first six months of the year are not indicative of the results of operations that might be expected for the entire year. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and the notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2011.

The accompanying consolidated financial statements include our accounts and the accounts of our subsidiaries over which we exercise control. These subsidiaries include Savvis, since we acquired it on July 15, 2011, and Qwest, since we acquired it on April 1, 2011. For more information on these acquisitions and the revisions made to our original estimates of the fair value of the assets acquired and the liabilities assumed, see Note 2 Acquisitions. All intercompany amounts and transactions with our consolidated subsidiaries have been eliminated.

To simplify the overall presentation of our financial statements, we report immaterial amounts attributable to noncontrolling interests in certain of our subsidiaries as follows: (i) income attributable to noncontrolling interests in other income (expense), (ii) equity attributable to noncontrolling interests in additional paid-in capital and (iii) cash flows attributable to noncontrolling interests in other financing activities.

We also have reclassified certain other prior period amounts to conform to the current period presentation, including the categorization of our revenues and our segment reporting. For more information on our segments, see Note 9 Segment Information. These changes had no impact on total revenues, total operating expenses or net income for any period.

Effective January 1, 2012, we changed our rates of capitalized labor as we transitioned certain of Qwest's legacy systems to our historical company systems. This transition resulted in an estimated $20 million to $30 million increase in the amount of labor capitalized as an asset compared to the

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amount that would have been capitalized if Qwest had continued to use its legacy systems and a corresponding estimated $20 million to $30 million decrease in operating expenses for the six months ended June 30, 2012. This change is expected to result in an estimated operating expense reduction of approximately $30 million to $50 million for the year ending December 31, 2012. The reduction in expenses described above, net of tax, increased net income approximately $12 million to $18 million, or $0.02 to $0.03 per basic and diluted common share, for the six months ended June 30, 2012 and is expected to increase net income by approximately $18 million to $30 million, or $0.03 to $0.05 per basic and diluted common share, for the year ending December 31, 2012.

Effective January 1, 2012, we changed our estimates of the economic lives and net salvage value for certain telecommunications equipment. These changes resulted in additional depreciation expense of approximately $7 million and $13 million for the three and six months ended June 30, 2012, respectively, and are expected to result in additional depreciation expense of approximately $26 million for the year ending December 31, 2012. This additional depreciation expense, net of tax, reduced net income by approximately $5 million and $8 million, or $0.01 and $0.01 per basic and diluted common share, for the three and six months ended June 30, 2012, respectively, and is expected to reduce net income by approximately $17 million, or approximately $0.03 per basic and diluted common share, for the year ending December 31, 2012.

On April 2, 2012, our subsidiary, Qwest Corporation ("QC"), sold an office building for net proceeds of $133 million. As part of the transaction, QC agreed to lease a portion of the building from the new owner. As a result, the $16 million gain from the sale was deferred and will be recognized as a reduction to rent expense over the 10 year lease term.

During the second quarter of 2012, management committed to a plan to sell our Advanced Wireless Services A Block and 700 MHz wireless spectrum. The 700 MHz wireless spectrum is in the A, B, and C Blocks. We have agreed to sales terms with two purchasers and expect to reach agreements with various other purchasers within the next twelve months. These transactions are expected to be subject to regulatory approval and may not close within the next year. At June 30, 2012, the wireless spectrum assets were classified as assets held for sale. As a result, we reclassified $154 million from "other intangible assets, net" to "current assets other".

(2) Acquisitions

Acquisition of Savvis

On July 15, 2011, we acquired all of the outstanding common stock of Savvis, a provider of cloud hosting, managed hosting, colocation and network services in domestic and foreign markets. We believe this acquisition enhances our ability to provide information technology services to our existing business customers and strengthens our opportunities to attract new business customers in the future. Each share of Savvis common stock outstanding immediately prior to the acquisition converted into the right to receive $30 per share in cash and 0.2479 shares of CenturyLink common stock. The aggregate consideration of $2.382 billion was based on:

- cash payments of $1.732 billion;
- the 14.313 million shares of CenturyLink common stock issued to consummate the acquisition;
- the closing stock price of CenturyLink common stock at July 14, 2011 of $38.54; and
- the estimated net value of the pre-combination portion of certain share-based compensation awards assumed by CenturyLink of $98 million, of which $33 million was paid in cash.

Upon completing the acquisition, we also paid $547 million to retire certain pre-existing Savvis debt and accrued interest, and paid related transaction expenses totaling $15 million. The cash payments required on or about the closing date were funded using existing cash balances, which

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included the net proceeds from our June 2011 issuance of senior notes with an aggregate principal amount of $2.0 billion.

We have recognized the assets and liabilities of Savvis based on our estimates of their acquisition date fair values. The determination of the fair values of the assets acquired and liabilities assumed (and the related determination of estimated lives of depreciable tangible and identifiable intangible assets) requires significant judgment. As such, we have not completed our valuation analysis and calculations in sufficient detail necessary to arrive at the final estimates of the fair value of Savvis' assets acquired and liabilities assumed, along with the related allocations to goodwill and intangible assets. The fair values of certain tangible assets, intangible assets, contingent liabilities and residual goodwill are the most significant areas not yet finalized and therefore are subject to change. We expect to complete our final fair value determinations no later than the third quarter of 2012. Our final fair value determinations may be significantly different than those reflected in this report.

Based on our preliminary estimate, the aggregate consideration paid by us exceeds the aggregate estimated fair value of the assets acquired and liabilities assumed by $1.349 billion, which we have recognized as goodwill. This goodwill is attributable to strategic benefits, including enhanced financial and operational scale and product and market diversification that we expect to realize. None of the goodwill associated with this acquisition is deductible for income tax purposes.

The following is our assignment of the aggregate consideration:

	July 15, 2011	
	(Dollars in millions)	
Cash, accounts receivable and other current assets*	$	214
Property, plant and equipment		1,367
Identifiable intangible assets:		
Customer relationships		739
Other		51
Other noncurrent assets		27
Current liabilities, excluding current maturities of long-term debt		(129)
Current maturities of long-term debt		(38)
Long-term debt		(840)
Deferred credits and other liabilities		(358)
Goodwill		1,349
Aggregate consideration	$	2,382

* Includes estimated fair value of $90 million for accounts receivable which had gross contractual value of $101 million on July 15, 2011. The $11 million difference between the gross contractual value and the estimated fair value assigned represents our best estimate as of July 15, 2011 of contractual cash flows that would not be collected.

During the six months ended June 30, 2012, we retrospectively adjusted our previously reported preliminary assignment of the aggregate Savvis consideration for changes to our original estimates. These changes are the result of additional information obtained since the filing of our Form 10-K for the year ended December 31, 2011. Due to these revisions in our estimates, (i) customer relationships decreased $55 million due to a decrease in our customer relationships valuation, (ii) property, plant and equipment increased $32 million primarily from a revision to our valuation of our capital lease assets, and (iii) deferred credits and other liabilities decreased by $30 million primarily from changes in deferred taxes. Among other minor revisions, goodwill decreased by $8 million as an offset to the above-mentioned changes. The depreciation and amortization expense impact of the adjustments to intangible assets and property, plant and equipment valuations did not result in a material change to previously reported amounts.

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Acquisition of Qwest

On April 1, 2011, we acquired all of the outstanding common stock of Qwest, a provider of data, Internet, video and voice services nationwide and globally. We entered into this acquisition, among other things, to realize certain strategic benefits, including enhanced financial and operational scale, market diversification and leveraged combined networks. As of the acquisition date, Qwest served approximately 9.0 million access lines and approximately 3.0 million broadband subscribers across 14 states. Each share of Qwest common stock outstanding immediately prior to the acquisition converted into the right to receive 0.1664 shares of CenturyLink common stock, with cash paid in lieu of fractional shares. The aggregate consideration of $12.273 billion was based on:

- the 294 million shares of CenturyLink common stock issued to consummate the acquisition;
- the closing stock price of CenturyLink common stock at March 31, 2011 of $41.55;
- the estimated net value of the pre-combination portion of share-based compensation awards assumed by CenturyLink of $52 million (excluding the value of restricted stock included in the number of issued shares specified above); and
- cash paid in lieu of the issuance of fractional shares of $5 million.

We assumed approximately $12.7 billion of long-term debt in connection with our acquisition of Qwest.

In the first quarter of 2012, we completed our valuation of the fair value of Qwest's assets acquired and liabilities assumed, along with the related allocations to goodwill and intangible assets. The aggregate consideration exceeded the aggregate estimated fair value of the assets acquired and liabilities assumed by $10.123 billion, which we have recognized as goodwill. This goodwill is attributable to strategic benefits, including enhanced financial and operational scale, market diversification and leveraged combined networks that we expect to realize. None of the goodwill associated with this acquisition is deductible for income tax purposes.

The following is our assignment of the aggregate consideration:

	April 1, 2011 (Dollars in millions)
Cash, accounts receivable and other current assets*	$ 2,121
Property, plant and equipment	9,529
Identifiable intangible assets:	
Customer relationships	7,558
Capitalized software	1,702
Other	189
Other noncurrent assets	390
Current liabilities, excluding current maturities of long-term debt	(2,426)
Current maturities of long-term debt	(2,422)
Long-term debt	(10,253)
Deferred credits and other liabilities	(4,238)
Goodwill	10,123
Aggregate consideration	$ 12,273

* Includes estimated fair value of $1.194 billion for accounts receivable which had gross contractual value of $1.274 billion on April 1, 2011. The $80 million difference between the gross contractual value and the estimated fair value assigned represents our best estimate as of April 1, 2011 of contractual cash flows that would not be collected.

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During the first quarter of 2012, we retrospectively adjusted our previously reported preliminary assignment of the aggregate Qwest consideration for changes to our original estimates of the fair value of certain items at the acquisition date. These changes are the result of additional information obtained since the filing of our Form 10-K for the year ended December 31, 2011. Due to these revisions of our estimates, (i) identifiable intangible assets decreased due to a $67 million decrease in our customer relationships valuation, (ii) property, plant and equipment decreased by $25 million primarily from a revision to our valuation of our buildings, and (iii) deferred credits and other liabilities decreased by $63 million primarily from a revision to one of our lease valuations and changes in tax liabilities. Among other minor revisions, goodwill increased by $17 million as an offset to the above-mentioned changes. The depreciation and amortization expense impact of the adjustments to intangible assets and property, plant and equipment valuations did not result in a material change to previously reported amounts.

On the acquisition date, we assumed several of the contingencies of Qwest. For more information on our contingencies, see Note 10 Commitments and Contingencies.

Acquisition-Related Expenses

We have incurred operating expenses related to our acquisition of Savvis in July 2011, Qwest in April 2011 and Embarq Corporation ("Embarq") in July 2009. The table below summarizes our expenses related to our acquisitions, which consist primarily of integration and severance expenses:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	**2011**	**2012**	**2011**
	(Dollars in millions)			
Acquisition-related expenses	$ 12	266	51	301

The total amounts of these expenses are recognized in our cost of services and selling, general and administrative expenses.

References to Acquired Businesses

In the discussion that follows, we refer to the incremental business activities that we now operate as a result of the Savvis acquisition and the Qwest acquisition as "Legacy Savvis" and "Legacy Qwest", respectively. References to "Legacy CenturyLink", when used in reference to a comparison of our consolidated results for the six months ended June 30, 2012 and 2011, mean the business we operated prior to the Qwest and Savvis acquisitions, and, when used in reference to a comparison of our consolidated results for the three months ended June 30, 2012 and 2011, mean the business we operated immediately prior to the Savvis acquisition.

Combined Pro Forma Operating Results

For the three and six months ended June 30, 2012, CenturyLink's results of operations included operating revenues (net of intercompany eliminations) attributable to Qwest of $2.7 billion and $5.4 billion, respectively, and Savvis of $278 million and $544 million, respectively. The addition of Qwest and Savvis post-acquisition operations did not contribute significantly to our consolidated net income.

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The following unaudited pro forma financial information for the three and six months ended June 30, 2011 presents the combined results of CenturyLink as if the Qwest and Savvis acquisitions had been consummated as of January 1, 2010.

	Three Months Ended June 30,		Six Months Ended June 30,	
	Actual 2012	Pro Forma 2011	Actual 2012	Pro Forma 2011
	(Dollars in millions)			
Operating revenues	$ 4,612	4,669	9,222	9,406
Net income	74	83	274	358
Basic earnings per common share	.12	.13	.44	.58
Diluted earnings per common share	.12	.13	.44	.58

This pro forma information reflects certain adjustments to previously reported historical operating results, consisting of primarily:

- decreased operating revenues and expenses due to the elimination of deferred revenues and deferred expenses associated with installation activities and capacity leases that were assigned no value at the acquisition date and the elimination of transactions among CenturyLink, Qwest and Savvis that are now subject to intercompany elimination;

- increased amortization expense related to identifiable intangible assets, net of decreased depreciation expense to reflect the fair value of property, plant and equipment;

- decreased recognition of retiree benefit expenses for Qwest due to the elimination of unrecognized actuarial losses;

- decreased interest expense primarily due to the amortization of an adjustment to reflect the increased fair value of long-term debt of Qwest recognized on the acquisition date; and

- the related income tax effects.

The pro forma information does not necessarily reflect the actual results of operations had the Qwest and Savvis acquisitions been consummated at January 1, 2010, nor is it necessarily indicative of future operating results. The pro forma information does not adjust for integration costs incurred by us, Qwest and Savvis during 2011 (which are further described above in this note) or integration costs to be incurred by us in future periods. In addition, the pro forma information does not give effect to any potential revenue enhancements, cost synergies or other operating efficiencies that could result from the acquisitions.

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(3) Goodwill, Customer Relationships and Other Intangible Assets

Our goodwill, customer relationships and other intangible assets consisted of the following:

	June 30, 2012	December 31, 2011
	(Dollars in millions)	
Goodwill	$ 21,732	21,732
Customer relationships, less accumulated amortization of $1,941 and $1,337	$ 7,635	8,239
Indefinite-life intangible assets	268	422
Other intangible assets subject to amortization		
Capitalized software, less accumulated amortization of $658 and $441	1,493	1,622
Tradenames and patents, less accumulated amortization of $109 and $73	161	199
Total other intangible assets, net	$ 1,922	2,243

We amortize customer relationships over estimated lives ranging from 10 years to 12.5 years, using either the sum-of-the-years-digits or straight-line methods, depending on the type of customer. We amortize capitalized software, which consists primarily of assets obtained from the Qwest acquisition, using the straight-line method over estimated lives ranging up to seven years. Approximately $237 million of our capitalized software represents costs to develop an integrated billing and customer care system and is being amortized over a 20 year period. We amortize tradenames and patent assets predominantly using the sum-of-the-years digits method over an estimated life of four years.

The table below summarizes our amortization expense:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
	(Dollars in millions)			
Amortization expense	$ 430	453	860	507

During the second quarter of 2012, we reclassified $154 million from "Other intangible assets, net" to "current assets-other", see Note 1 Basis of Presentation.

Our goodwill was derived from numerous acquisitions where the purchase price exceeded the fair value of the net assets acquired. For more information on our recent acquisitions and resulting fair values, see Note 2 Acquisitions.

As previously announced, effective April 1, 2012, we restructured our operating segments to support our new operating structure. We attributed our goodwill balances to our realigned segments as follows:

	June 30, 2012
	(Dollars in millions)
Regional markets	$ 13,816
Wholesale markets	3,287
Enterprise markets network	3,320
Enterprise markets data hosting	1,309
Total goodwill	$ 21,732

For additional information on the reorganization of our segments, see Note 9 Segment Information.

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(4) Long-Term Debt and Credit Facilities

Long-term debt, including unamortized discounts and premiums, is as follows:

	Interest Rates		Maturities		June 30, 2012	December 31, 2011
					(Dollars in millions)	
CenturyLink, Inc.						
Senior notes	5.000%	7.875%	2012	2042	$ 6,568	4,518
Credit facility[1]	2.000%		2017		250	277
Term loan	2.250%		2019		435	
Subsidiaries						
Qwest						
Senior notes[2]	6.500%	8.375%	2013	2052	10,201	11,460
Embarq Corporation						
Senior notes	7.082%	7.995%	2016	2036	2,669	4,013
First mortgage bonds	6.875%	8.770%	2013	2025	322	322
Other	6.750%	9.000%	2013	2019	200	200
Other subsidiary notes						
First mortgage notes	2.000%	10.000%	2012	2018	60	65
Capital lease and other obligations	Various		Various		790	712
Unamortized premiums and other, net					90	269
Total long-term debt					21,585	21,836
Less current maturities					(1,903)	(480)
Long-term debt, excluding current maturities					$ 19,682	21,356

(1) The information presented here illustrates the interest rate and maturity on our credit facility as amended on April 6, 2012.

(2) The $750 million of Qwest Corporation Notes due 2013 are floating rate notes, with rates that reset every three months. As of the most recent measurement date of June 15, 2012, the rate for these notes was 3.718%, which is not included in the range of rates stated above.

New Issuances

On June 25, 2012, QC issued $400 million aggregate principal amount of 7.00% Notes due 2052 in exchange for net proceeds, after deducting underwriting discounts and expenses, of $387 million. The notes are unsecured obligations and may be redeemed, in whole or in part, on or after July 1, 2017 at a redemption price equal to 100% of the principal amount redeemed plus accrued interest.

On April 18, 2012, CenturyLink, Inc. entered into a term loan in the amount of $440 million with CoBank and several other Farm Credit System banks. This term loan is payable in 29 consecutive quarterly installments of $5.5 million in principal plus interest through April 18, 2019, when the balance will be due. We have the option of paying monthly interest based upon either London Interbank Offered Rate ("LIBOR") or the base rate (as defined in the credit agreement) plus an applicable margin between 1.50% to 2.50% per annum for LIBOR loans and 0.50% to 1.50% per annum for base rate loans depending on our then current senior unsecured long-term debt rating. Our term loan is guaranteed by two of our wholly-owned subsidiaries, Embarq and Qwest Communications International Inc ("QCII"), and one of QCII's wholly-owned subsidiaries.

On April 2, 2012, QC issued $525 million aggregate principal amount of 7.00% Notes due 2052 in exchange for net proceeds, after deducting underwriting discounts and expenses, of $508 million. The

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notes are unsecured obligations and may be redeemed, in whole or in part, on or after April 1, 2017 at a redemption price equal to 100% of the principal amount redeemed plus accrued interest.

On March 12, 2012, CenturyLink, Inc. issued (i) $650 million aggregate principal amount of 7.65% Senior Notes due 2042 in exchange for net proceeds, after deducting underwriting discounts, of approximately $644 million and (ii) $1.4 billion aggregate principal amount of 5.80% Senior Notes due 2022 in exchange for net proceeds, after deducting underwriting discounts, of approximately $1.389 billion. The notes are unsecured obligations and may be redeemed at any time on the terms and conditions specified therein.

Repayments

On May 17, 2012, QCII redeemed $500 million of its 7.50% Notes due 2014, which resulted in an immaterial gain.

On April 23, 2012, Embarq redeemed the remaining $200 million of its 6.738% Notes due 2013, which resulted in an immaterial loss.

On April 18, 2012, QC completed a cash tender offer to purchase a portion of its $811 million of 8.375% Notes due 2016 and its $400 million of 7.625% Notes due 2015. With respect to its 8.375% Notes due 2016, QC received and accepted tenders of approximately $575 million aggregate principal amount of these notes, or 71%, for $722 million including a premium, fees and accrued interest. With respect to its 7.625% Notes due 2015, QC received and accepted tenders of approximately $308 million aggregate principal amount of these notes, or 77%, for $369 million including a premium, fees and accrued interest. The completion of this tender offer resulted in a loss of $46 million.

On April 2, 2012, Embarq completed a cash tender offer to purchase a portion of its $528 million of 6.738% Notes due 2013 and its $2.0 billion of 7.082% Notes due 2016. With respect to its 6.738% Notes due 2013, Embarq received and accepted tenders of approximately $328 million aggregate principal amount of these notes, or 62%, for $360 million including a premium, fees and accrued interest. With respect to its 7.082% Notes due 2016, Embarq received and accepted tenders of approximately $816 million aggregate principal amount of these notes, or 41%, for $944 million including a premium, fees and accrued interest. The completion of these tender offers resulted in a loss of $144 million.

On March 1, 2012, QCII redeemed $800 million of its 7.50% Notes due 2014, which resulted in an immaterial gain.

Credit Facility

On April 6, 2012, we amended and restated our $1.7 billion revolving credit facility to increase the aggregate principal amount available to $2.0 billion and to extend the maturity date to April 2017. This amended credit facility (the "Credit Facility") has 18 lenders, with commitments ranging from $2.5 million to $177 million and allows us to obtain revolving loans and to issue up to $400 million of letters of credit, which will reduce the amount available for other extensions of credit. Interest will be assessed on future borrowings using either the LIBOR or the base rate (as defined in the Credit Facility) plus an applicable margin between 1.25% and 2.25% per annum for LIBOR loans and 0.25% and 1.25% per annum for base rate loans depending on our then current senior unsecured long-term debt rating. Our obligations under the Credit Facility are guaranteed by two of our wholly-owned subsidiaries, Embarq and QCII, and one of QCII's wholly-owned subsidiaries. As of June 30, 2012, there was $250 million outstanding under the Credit Facility.

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Covenants

As of June 30, 2012, we believe we were in compliance with the provisions and covenants of our debt agreements.

Subsequent Event

On July 20, 2012, QC redeemed all $484 million of its 7.5% Notes due 2023, which resulted in an immaterial loss.

(5) Severance and Leased Real Estate

Periodically, we have implemented reductions in our workforce and have accrued liabilities for related severance costs. These workforce reductions resulted primarily from the progression or completion of our integration plans, increased competitive pressures and reduced workload demands due to the loss of access lines.

We report severance liabilities within "accrued expenses and other liabilities salaries and benefits" in our consolidated balance sheets and report severance expenses in cost of services and products and selling, general and administrative expenses in our consolidated statements of operations. We have not allocated any severance expense to our regional markets, wholesale markets, enterprise markets network or enterprise markets data hosting segments.

In periods prior to our acquisition of Qwest, Qwest had ceased using certain real estate that it was leasing under long-term operating leases. As of the April 1, 2011 acquisition date, we recognized liabilities to reflect our estimates of the fair values of the existing lease obligations for real estate for which Qwest had ceased using, net of estimated sublease rentals. Our fair value estimates were determined using discounted cash flow methods. We recognize expense to reflect accretion of the discounted liabilities and periodically, we adjust the expense when our actual experience differs from our initial estimates. We report the current portion of liabilities for ceased-use real estate leases in "accrued expenses and other liabilities other" and report the noncurrent portion in "deferred credits and other liabilities other" in our consolidated balance sheets. We report the related expenses in "selling, general and administrative expenses" in our consolidated statements of operations.

As of June 30, 2012 and December 31, 2011, the current portion of our leased real estate accrual was $32 million and $27 million, respectively, and the noncurrent portion was $115 million and $126 million, respectively. The remaining lease terms range from 0.1 years to 13.5 years, with a weighted average of 9.1 years.

Changes in our accrued liabilities for severance expenses and leased real estate were as follows:

	Severance	Real Estate
	(Dollars in millions)	
Balance at December 31, 2011	$ 37	153
Accrued to expense	57	1
Payments, net	(29)	(4)
Reversals and adjustments	(3)	
Balance at March 31, 2012	62	150
Accrued to expense	24	2
Payments, net	(57)	(5)
Reversals and adjustments		
Balance at June 30, 2012	$ 29	147

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(6) Employee Benefits

Net periodic pension income included the following components:

	Pension Plans			
	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
	(Dollars in millions)			
Service cost	$ 23	20	45	28
Interest cost	156	169	312	229
Expected return on plan assets	(212)	(212)	(424)	(285)
Recognition of prior service cost	1		2	
Recognition of net actuarial loss	7	3	15	7
Net periodic pension income	$ (25)	(20)	(50)	(21)

Net periodic post-retirement benefit expense included the following components:

	Post-Retirement Plans			
	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
	(Dollars in millions)			
Service cost	$ 5	4	11	7
Interest cost	44	48	87	55
Expected return on plan assets	(11)	(13)	(22)	(14)
Recognition of prior service cost		(1)		(1)
Net periodic post-retirement benefit expense	$ 38	38	76	47

We report net periodic pension income and net periodic post-retirement benefit expense in cost of services and products and selling, general and administrative expenses on our consolidated statements of operations.

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(7) Earnings per Common Share

Basic and diluted earnings per common share were calculated as follows:

		Three Months Ended June 30,		Six Months Ended June 30,	
		2012	2011	2012	2011
		(Dollars in millions, except per share amounts shares in thousands)			
Income (Numerator):					
Net income	$	74	115	274	326
Earnings applicable to non-vested restricted stock		(1)		(1)	(1)
Net income applicable to common stock for computing basic earnings per common share		73	115	273	325
Net income as adjusted for purposes of computing diluted earnings per common share	$	73	115	273	325
Shares (Denominator):					
Weighted average number of shares:					
Outstanding during period		621,600	600,699	620,670	453,042
Non-vested restricted stock		(2,660)	(1,922)	(2,602)	(1,965)
Non-vested restricted stock units		947	107	980	281
Weighted average shares outstanding for computing basic earnings per common share		619,887	598,884	619,048	451,358
Incremental common shares attributable to dilutive securities:					
Shares issuable under convertible securities		13	13	13	13
Shares issuable under incentive compensation plans		1,939	1,362	2,034	998
Number of shares as adjusted for purposes of computing diluted earnings per common share		621,839	600,259	621,095	452,369
Earnings per common share:					
Basic	$	.12	.19	.44	.72
Diluted	$	.12	.19	.44	.72

Our calculations of diluted earnings per common share exclude shares of common stock that are issuable upon exercise of stock options when the exercise price is greater than the average market price of our common stock during the period. Such potentially issuable shares totaled 2.3 million and 2.5 million for the three months ended June 30, 2012 and 2011, respectively, and 2.3 million and 2.1 million for the six months ended June 30, 2012 and 2011, respectively.

(8) Fair Value Disclosure

Our financial instruments consist of cash and cash equivalents, accounts receivable, investments, accounts payable and long-term debt, excluding capital lease obligations. The carrying amounts of our cash and cash equivalents, accounts receivable and accounts payable approximate their fair values.

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Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between independent and knowledgeable parties who are willing and able to transact for an asset or liability at the measurement date. We use valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs when determining fair value and then we rank the estimated values based on the reliability of the inputs used.

We determined the fair values of our long-term debt, including the current portion, based on quoted market prices where available or, if not available, based on discounted future cash flows using current market interest rates.

The three input levels in the hierarchy of fair value measurements are defined by the Financial Accounting Standards Board generally as follows:

Input Level	Description of Input
Level 1	Observable inputs such as quoted market prices in active markets.
Level 2	Inputs other than quoted prices in active markets that are either directly or indirectly observable.
Level 3	Unobservable inputs in which little or no market data exists.

The following table presents the carrying amounts and estimated fair values of our investment securities, which are reported in "noncurrent other assets", and long-term debt, excluding capital lease obligations, as well as the input levels used to determine the fair values:

			June 30, 2012		December 31, 2011	
		Input Level	Carrying Amount	Fair Value	Carrying Amount	Fair Value
			(Dollars in millions)			
Assets	Investments securities	3	$ 59	59	73	73
Liabilities	Long-term debt excluding capital lease obligations	2	20,795	21,726	21,124	22,052

Our investment securities consist of auction rate securities maturing in 2033 and 2035 that are not actively traded in liquid markets. We have designated these securities as available for sale and, accordingly, we report them on our balance sheet under our "goodwill and other assets other" line item at fair value on a recurring basis. We estimated the fair value of these securities at June 30, 2012 using a probability-weighted cash flow model that considers the coupon rate for the securities, probabilities of default and liquidation prior to maturity, and a discount rate commensurate with the creditworthiness of the issuer. During the first quarter of 2012, we sold $17 million of these securities, which resulted in an immaterial gain.

(9) Segment Information

In the second quarter of 2012, in order to more effectively leverage the strategic assets from our recent acquisitions of Embarq, Qwest and Savvis and to better serve our business and government customers, we restructured our business into the following operating segments:

Regional markets. Consists generally of providing strategic and legacy products and services to local government, residential consumers, small to medium-sized businesses and regional customers. Our strategic products and services offered to these customers include our private line, broadband, Multi-Protocol Label Switching ("MPLS"), hosting, and video services. Our legacy services offered to these customers include local and long-distance service;

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Wholesale markets. Consists generally of providing strategic and legacy products and services to other domestic and international communications providers. Our strategic products and services offered to these customers are mainly private line (including special access) and MPLS. Our legacy services offered to these customers include unbundled network elements ("UNEs") which allow our wholesale customers the use of our network or a combination of our network and their own networks to provide voice and data services to their customers, long-distance and switched access services;

Enterprise markets network. Consists generally of providing strategic and legacy network communications products and services to national and international enterprise and government customers. Our strategic products and services offered to these customers include our private line, broadband, MPLS and hosting services. Our legacy services offered to these customers include local and long-distance services.

Enterprise markets data hosting. Consists generally of providing colocation, managed hosting and cloud services to national and international enterprise and government customers.

We have restated previously reported segment results due to the above-described reorganization of our business. Segment results are summarized below:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
	(Dollars in millions)			
Total segment revenues	$ 4,346	4,158	8,690	5,723
Total segment expenses	2,024	1,821	4,002	2,385
Total segment income	$ 2,322	2,337	4,688	3,338
Total margin percentage	53%	56%	54%	58%
Regional markets:				
Revenues	$ 2,477	2,540	4,963	3,677
Expenses	1,048	1,043	2,079	1,500
Income	$ 1,429	1,497	2,884	2,177
Margin percentage	58%	59%	58%	59%
Wholesale markets:				
Revenues	$ 944	980	1,905	1,362
Expenses	286	304	573	401
Income	$ 658	676	1,332	961
Margin percentage	70%	69%	70%	71%
Enterprise markets network:				
Revenues	$ 648	630	1,280	676
Expenses	479	472	936	482
Income	$ 169	158	344	194
Margin percentage	26%	25%	27%	29%
Enterprise markets data hosting:				
Revenues	$ 277	8	542	8
Expenses	211	2	414	2
Income	$ 66	6	128	6

Margin percentage	24%	75%	24%	75%

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We categorize our products and services into the following four categories:

Strategic services, which include primarily broadband, private line (including special access which we market to wholesale and business customers who require dedicated equipment to transmit large amounts of data between sites), MPLS (which is a data networking technology that can deliver the quality of service required to support real-time voice and video), hosting (including cloud hosting and managed hosting), colocation, Ethernet, video (including resold satellite and our facilities-based video services), voice over Internet Protocol ("VoIP") and Verizon Wireless services;

Legacy services, which include primarily local, long-distance, switched access, public access, integrated services digital network ("ISDN") (which uses regular telephone lines to support voice, video and data applications), and traditional wide area network ("WAN") services (which allows a local communications network to link to networks in remote locations);

Data integration, which includes the sale of telecommunications equipment located on customers' premises and related professional services, such as network management, installation and maintenance of data equipment and building of proprietary fiber-optic broadband networks for our government and business customers; and

Other, which consists primarily of universal service funds ("USF") revenue and surcharges.

Operating revenues for our products and services are summarized below:

		Three Months Ended June 30,		Six Months Ended June 30,	
		2012	2011	2012	2011
		(Dollars in millions)			
Strategic services	$	2,076	1,726	4,132	2,265
Legacy services		2,100	2,280	4,243	3,275
Data integration		170	152	315	183
Other		266	248	532	379
Total operating revenues	$	4,612	4,406	9,222	6,102

Other operating revenues include revenues from universal service funds which allow us to recover a portion of our costs under federal and state cost recovery mechanisms and certain surcharges to our customers, including billings for our required contributions to several USF programs. These surcharge billings to our customers are reflected on a gross basis in our statements of operations (included in both operating revenues and expenses) and aggregated approximately $272 million and $150 million for the six months ended June 30, 2012 and 2011, respectively. We also generate other operating revenues from leasing and subleasing of space in our office buildings, warehouses and other properties. We centrally-manage the activities that generate these other operating revenues and consequently these revenues are not included in any of our four segments presented above.

Our segment revenues include all revenues from our strategic, legacy and data integration services as described in more detail above. Segment revenues are based upon each customer's classification to an individual segment. We report our segment revenues based upon all services provided that segment's customers. We report our segment expenses for our four segments as follows:

Direct expenses, which primarily are specific, incremental expenses incurred as a direct result of providing services and products to segment customers, along with selling, general and administrative expenses that are directly associated with specific segment customers or activities; and

Allocated expenses, which include network expenses, facilities expenses and other expenses such as fleet and real estate expenses.

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During the first quarter of 2012, as we transitioned certain of Qwest's legacy systems to our historical company systems, we updated our methodologies for reporting our direct expenses and for allocating our expenses to our segments. Specifically, we no longer include certain fleet expenses for our regional markets segment in direct expenses; they are now expenses allocated to our segments, with the exception of enterprise markets data hosting. In addition, we now more fully allocate network building rent and power expenses to our regional markets, wholesale markets and enterprise markets network segments. We determined that it was impracticable to recast our segment results for prior periods to reflect these changes in methodology.

During the second quarter of 2012, as we reorganized our business into our four segments as indicated above, we further revised our methodology for how we allocate our expenses to our segments to better align segment expenses with related revenues. Under our revised methodology, we no longer allocate certain product development costs to our segments, but we do now allocate certain expenses from our enterprise markets data hosting segment to our other three segments. We have restated prior periods to reflect these changes in our methodology.

We do not assign depreciation and amortization expense to our segments, as the related assets and capital expenditures are centrally-managed. Other unassigned operating expenses consist primarily of expenses for certain centrally-managed administrative functions (such as finance, information technology, legal and human resources), severance expenses and restructuring expenses. The enterprise markets data hosting segment does include certain finance, information technology, legal and human resources expenses due to continuing use of certain legacy accounting systems acquired with the purchase of Savvis. Interest expense is also excluded from segment results because we manage our financing on a total company basis and have not allocated assets or debt to specific segments. In addition, other income (expense) does not relate to our segment operations and is therefore excluded from our segment results. Our segment results do not include any intersegment revenue or expenses. Our chief operating decision maker does not review assets and capital expenditures by segment, nor does he include the centrally-managed income and expenses noted above in the calculation of segment income.

The following table reconciles segment income to net income:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	**2011**	**2012**	**2011**
	(Dollars in millions)			
Total segment income	$ 2,322	2,337	4,688	3,338
Other operating revenues	266	248	532	379
Depreciation and amortization	(1,208)	(1,177)	(2,416)	(1,546)
Other unassigned operating expenses	(723)	(928)	(1,493)	(1,227)
Other income (expense)	(534)	(294)	(857)	(419)
Income tax expense	(49)	(71)	(180)	(199)
Net income	$ 74	115	274	326

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(10) Commitments and Contingencies

In this section, when we refer to a class action as "putative" it is because a class has been alleged, but not certified in that matter. Until and unless a class has been certified by the court, it has not been established that the named plaintiffs represent the class of plaintiffs they purport to represent.

We have established accrued liabilities for the matters described below where losses are deemed probable and reasonably estimable.

Litigation Matters Relating to CenturyLink and Embarq

In December 2009, subsidiaries of CenturyLink filed two lawsuits against subsidiaries of Sprint Nextel to recover terminating access charges for VoIP traffic owed under various interconnection agreements and tariffs which presently approximate $34 million. The lawsuits allege that Sprint Nextel has breached contracts, violated tariffs, and violated the Federal Communications Act by failing to pay these charges. One lawsuit, filed on behalf of all legacy Embarq operating entities, was tried in federal court in Virginia in August 2010 and, in March 2011, a ruling was issued in our favor and against Sprint Nextel. In the first quarter of 2012, Sprint Nextel filed an appeal of this decision. The other lawsuit, filed on behalf of all Legacy CenturyLink operating entities, is pending in federal court in Louisiana. In that case, in early 2011 the Court dismissed certain of CenturyLink's claims, referred other claims to the Federal Communications Commission ("FCC"), and stayed the litigation. In April 2012, Sprint Nextel filed a petition with the FCC, seeking a declaratory ruling that CenturyLink's access charges do not apply to VoIP originated calls. We have not deferred revenue related to these matters as an adverse outcome is not probable based upon current circumstances.

In William Douglas Fulghum, et al. v. Embarq Corporation, et al., filed on December 28, 2007 in the United States District Court for the District of Kansas, a group of retirees filed a putative class action lawsuit challenging the decision to make certain modifications in retiree benefits programs relating to life insurance, medical insurance and prescription drug benefits, generally effective January 1, 2006 and January 1, 2008 (which, at the time of the modifications, was expected to reduce estimated future expenses for the subject benefits by more than $300 million). Defendants include Embarq, certain of its benefit plans, its Employee Benefits Committee and the individual plan administrator of certain of its benefits plans. Additional defendants include Sprint Nextel and certain of its benefit plans. The Court certified a class on certain of plaintiffs' claims, but rejected class certification as to other claims. Embarq and other defendants continue to vigorously contest these claims and charges. On October 14, 2011, the Fulghum lawyers filed a new, related lawsuit, Abbott et al. v. Sprint Nextel et al. Neither CenturyLink nor Embarq is named a defendant in the new lawsuit. In Abbott, approximately 1,800 plaintiffs allege breach of fiduciary duty in connection with the changes in retiree benefits that also are at issue in the Fulghum case. The Abbott plaintiffs are all members of the class that was certified in Fulghum on claims for allegedly vested benefits (Counts I and III), and the Abbott claims are similar to the Fulghum breach of fiduciary duty claim (Count II), on which the Fulghum court denied class certification. The Court has stayed proceedings in Abbott indefinitely. We have not accrued a liability for these matters as it is premature to determine whether an accrual is warranted and, if so, a reasonable estimate of probable liability.

Litigation Matters Relating to Qwest

The terms and conditions of applicable bylaws, certificates or articles of incorporation, agreements or applicable law may obligate Qwest to indemnify its former directors, officers or employees with respect to certain of the matters described below, and Qwest has been advancing legal fees and costs to certain former directors, officers or employees in connection with certain matters described below.

On September 29, 2010, the trustees in the Dutch bankruptcy proceeding for KPNQwest, N.V. (of which Qwest was a major shareholder) filed a lawsuit in the District Court of Haarlem, the

Netherlands, alleging tort and mismanagement claims under Dutch law. Qwest and Koninklijke KPN N.V. ("KPN") are defendants in this lawsuit along with a number of former KPNQwest supervisory board members and a former officer of KPNQwest, some of whom were formerly affiliated with Qwest. Plaintiffs allege, among other things, that defendants' actions were a cause of the bankruptcy of KPNQwest, and they seek damages for the bankruptcy deficit of KPNQwest, which is claimed to be approximately €4.2 billion (or approximately $5.3 billion based on the exchange rate on June 30, 2012), plus statutory interest. Two lawsuits asserting similar claims were previously filed against Qwest and others in federal courts in New Jersey in 2004 and Colorado in 2009; those courts dismissed the lawsuits without prejudice on the grounds that the claims should not be litigated in the United States.

On September 13, 2006, Cargill Financial Markets, Plc and Citibank, N.A. filed a lawsuit in the District Court of Amsterdam, the Netherlands, against Qwest, KPN, KPN Telecom B.V., and other former officers, employees or supervisory board members of KPNQwest, some of whom were formerly affiliated with Qwest. The lawsuit alleges that defendants misrepresented KPNQwest's financial and business condition in connection with the origination of a credit facility and wrongfully allowed KPNQwest to borrow funds under that facility. Plaintiffs allege damages of approximately €219 million (or approximately $275 million based on the exchange rate on June 30, 2012). On April 25, 2012, the court issued its judgment denying the claims asserted by Cargill and Citibank in their lawsuit. Cargill and Citibank are appealing that decision.

We have not accrued a liability for the above matters. With regard to the trustees' action, it is premature to determine whether an accrual is warranted and, if so, a reasonable estimate of probable liability. We will continue to defend against the pending KPNQwest litigation matters vigorously.

Several putative class actions relating to the installation of fiber-optic cable in certain rights-of-way were filed against Qwest on behalf of landowners on various dates and in various courts in Alabama, Arizona, California, Colorado, Delaware, Florida, Georgia, Illinois, Indiana (in both Illinois and Indiana there is a federal and a state court case), Iowa, Kansas, Kentucky, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Nebraska, Nevada, New Jersey, New Mexico, New York, North Carolina, Oklahoma, Oregon, Pennsylvania, South Carolina, Tennessee, Texas, Utah, Virginia, Washington and Wisconsin. For the most part, the complaints challenge our right to install our fiber-optic cable in railroad rights-of-way. The complaints allege that the railroads own the right-of-way as an easement that did not include the right to permit us to install our fiber-optic cable in the right-of-way without the Plaintiffs' consent. Most of the actions purport to be brought on behalf of state-wide classes in the named Plaintiffs' respective states, although two of the currently pending actions purport to be brought on behalf of multi-state classes. Specifically, the Illinois state court action purports to be on behalf of landowners in Illinois, Iowa, Kentucky, Michigan, Minnesota, Nebraska, Ohio and Wisconsin, and the Indiana state court action purports to be on behalf of a national class of landowners. In general, the complaints seek damages on theories of trespass and unjust enrichment, as well as punitive damages. On July 18, 2008, a federal district court in Massachusetts entered an order preliminarily approving a settlement that would have resolved all of the claims now asserted in the actions described above, except the action pending in Tennessee. On December 9, 2009, the court denied final approval of the settlement on grounds that it lacked subject matter jurisdiction. The parties are now engaged in negotiating and finalizing settlements on a state-by-state basis, and have filed and received final approval of settlements in Alabama and Illinois federal court, and in Tennessee state court. Final approval also has been granted in federal court actions in Idaho, Montana and North Dakota, to which Qwest is not a party. We have accrued an amount that we believe is probable for these matters; however, the amount is not material to our financial statements.

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Other

From time to time, we are involved in other proceedings incidental to our business, including patent infringement allegations, administrative hearings of state public utility commissions relating primarily to rate making, actions relating to employee claims, various tax issues, environmental law issues, 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.

(11) Labor Union Contracts

Over 40% of our employees are members of various bargaining units represented by the Communications Workers of America and the International Brotherhood of Electrical Workers. Approximately 13,000 or 28% of our employees are subject to collective bargaining agreements that expire October 6, 2012.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Unless the context requires otherwise, references in this report to "CenturyLink," "we," "us" and "our" refer to CenturyLink, Inc. and its consolidated subsidiaries, including Qwest Communications International Inc. and its consolidated subsidiaries (referred to as "Qwest") for periods on or after April 1, 2011 and including SAVVIS, Inc. and its consolidated subsidiaries (referred to as "Savvis") for periods on or after July 15, 2011.

All references to "Notes" in this Item 2 refer to the Notes to Consolidated Financial Statements included in Item 1 of this quarterly report.

Certain statements in this report constitute forward-looking statements. See "Risk Factors" in Item 1A of Part II of this report for a discussion of certain risk factors applicable to our business, 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, 2011. The results of operations for the first six months of the year are not indicative of the results of operations that might be expected for the entire year.

We are an integrated communications company engaged primarily in providing an array of communications services to our residential, business, governmental and wholesale customers. Our communications services include local and long-distance, network access, private line (including special access), public access, broadband, data, managed hosting (including cloud hosting), colocation, wireless, and video services. In certain local and regional markets, we also provide local access and fiber transport services to competitive local exchange carriers and security monitoring 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 of June 30, 2012, we operated 14.1 million access lines in 37 states, and served 5.8 million broadband subscribers. During the second quarter of 2012, we updated our methodology for counting broadband subscribers to include business and wholesale subscribers instead of only retail and small business subscribers. We have restated our previously reported amounts to reflect this change. Our access line methodology includes only those access lines that we use to provide services to external customers and excludes lines used solely by us and our affiliates. Our methodology also excludes unbundled loops and includes stand-alone broadband subscribers. Our methodology for counting access lines may not be comparable to those of other companies. We also operate 52 data centers throughout North America, Europe and Asia.

Our consolidated financial statements include the accounts of CenturyLink, Inc. ("CenturyLink") and its majority-owned subsidiaries. These subsidiaries include Savvis beginning July 15, 2011, and Qwest beginning April 1, 2011. For more information, see Note 2 Acquisitions. Due to the significant size of these acquisitions, direct comparisons of our results of operations for the three and six months ended June 30, 2012 to the three and six months ended June 30, 2011 are less meaningful than usual. We discuss below, under "Segment Results", certain trends that we believe are significant to the combined company.

We have recognized the assets and liabilities of Savvis based on our estimates of their acquisition date fair values. The determination of the fair values of the assets acquired and liabilities assumed (and the related determination of estimated lives of depreciable tangible and identifiable intangible assets) requires significant judgment. As such, we have not completed our valuation analysis and calculations

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in sufficient detail necessary to arrive at the final estimates of the fair value of Savvis' assets acquired and liabilities assumed, along with the related allocations to goodwill and intangible assets. The fair values of certain tangible assets, intangible assets, contingent liabilities and residual goodwill are the most significant areas not yet finalized and therefore are subject to change. We expect to complete our final fair value determinations no later than the third quarter of 2012. Our final fair value determinations may be significantly different than those reflected in this report.

In the discussion that follows, we refer to the incremental business activities that we now operate as a result of the Savvis acquisition and the Qwest acquisition as "Legacy Savvis" and "Legacy Qwest", respectively. References to "Legacy CenturyLink", when used in reference to a comparison of our consolidated results for the six months ended June 30, 2012 and 2011, mean the business we operated prior to the Qwest and Savvis acquisitions, and, when used in reference to a comparison of our consolidated results for the three months ended June 30, 2012 and 2011, mean the business we operated immediately prior to the Savvis acquisition.

We have incurred operating expenses related to our acquisition of Savvis in July 2011, Qwest in April 2011 and Embarq Corporation ("Embarq") in July 2009. These expenses are reflected in cost of services and products and selling, general and administrative expenses in our consolidated statements of operations as summarized below.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
	(Dollars in millions)			
Cost of services and products (exclusive of depreciation and amortization):				
Integration and other expenses associated with acquisitions	$ 4	13	8	25
Severance expenses, accelerated recognition of share-based awards and retention compensation associated with acquisitions		13		15
	$ 4	26	8	40
Selling, general and administrative:				
Integration and other expenses associated with acquisitions	$ 5	104	14	122
Severance expenses, accelerated recognition of share-based awards and retention compensation associated with acquisitions	3	136	29	139
	$ 8	240	43	261

This table does not include costs incurred by Qwest or Savvis prior to being acquired by us. Based on current plans and information, we estimate that, in relation to our Qwest acquisition, we expect integration expenses to be less than $800 million (which includes approximately $440 million of cumulative expenses incurred through June 30, 2012) and our capital expenditures associated with integration activities will approximate $200 million (which includes approximately $50 million of cumulative capital expenditures incurred through June 30, 2012). We anticipate that the amount of our integration costs in future quarters will vary substantially based on integration activities conducted during those periods, and could in certain cases be significantly higher than those incurred by us during the three months ended June 30, 2012.

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Effective April 1, 2012, in order to more effectively leverage the strategic assets from our recent acquisitions of Embarq, Qwest and Savvis to better serve our business and government customers, we restructured our business into the following operating segments:

Regional markets, which consists primarily of providing products and services to local, government, residential consumers, small to medium-sized businesses and regional enterprise customers;

Wholesale markets, which consists primarily of providing products and services to other domestic and international communications providers;

Enterprise markets network, which consists primarily of providing network communications products and services to national and international enterprise and government customers; and

Enterprise markets data hosting, which consists primarily of providing colocation, managed hosting and cloud services to national and international enterprise and government customers.

We report financial information separately for each of these segments; however, as described in further detail below, our segment information does not include capital expenditures, total assets, or certain revenues and expenses that we manage on a centralized basis. As we continue to integrate our recent acquisitions, we plan to make additional changes to the way we assess performance and make decisions about allocating resources, which will likely further change our segment reporting. Our segment results are not necessarily indicative of the results of operations that our segments would have achieved had they operated as stand-alone entities during the periods presented. For additional information about our segments, see Note 9 Segment Information and "Results of Operations Segment Results" below.

Results of Operations

The following table summarizes the results of our consolidated operations for the three and six months ended June 30, 2012 and 2011, presented in a manner that we believe will be useful for understanding the relevant trends affecting our business. Our operating results include operations of Savvis for periods after July 15, 2011 and Qwest for periods after April 1, 2011.

		Three Months Ended June 30,		Six Months Ended June 30,	
		2012	**2011**	**2012**	**2011**
		(Dollars in millions except per share amounts)			
Operating revenues	$	4,612	4,406	9,222	6,102
Operating expenses		3,955	3,926	7,911	5,158
Operating income		657	480	1,311	944
Other income (expense)		(534)	(294)	(857)	(419)
Income tax expense		49	71	180	199
Net income	$	74	115	274	326
EARNINGS PER COMMON SHARE					
Basic	$	.12	.19	.44	.72
Diluted	$	.12	.19	.44	.72

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The following table summarizes certain of our operational metrics:

	As of June 30,		Increase/	
	2012	2011	(Decrease)	% Change
		(in thousands)		
Broadband subscribers	5,763	5,519	244	4%
Access lines	14,145	15,057	(912)	(6)%
Employees	47,100	48,400	(1,300)	(3)%

During the second quarter of 2012, we updated our methodology for counting broadband subscribers to include business and wholesale subscribers instead of only retail and small business subscribers. We have restated our previously reported amounts to reflect this change.

During the last several years, we have experienced revenue declines (excluding the impact of acquisitions) primarily due to declines in access lines, intrastate access rates and minutes of use. Prior to its acquisition, Qwest had experienced similar declines in its revenues. To mitigate these declines, we remain focused on efforts to, among other things:

- promote long-term relationships with our customers through bundling of integrated services;
- provide new services, such as video, cloud hosting, managed hosting, colocation services and other additional services that may become available in the future due to advances in technology or improvements in our infrastructure;
- provide our broadband and premium services to a higher percentage of our customers;
- pursue acquisitions of additional assets if available at attractive prices;
- increase usage of our networks; and
- market our products and services to new customers.

Operating Revenues

We currently categorize our products, services and revenues among the following four categories:

- *Strategic services*, which include primarily broadband, private line (including special access which we market to wholesale and business customers who require dedicated equipment to transmit large amounts of data between sites), Multi-Protocol Label Switching ("MPLS") (which is a data networking technology that can deliver the quality of service required to support real-time voice and video), hosting (including cloud hosting and managed hosting), colocation, Ethernet, video (including resold satellite and our facilities-based video services), voice over Internet Protocol ("VoIP") and Verizon Wireless services;
- *Legacy services*, which include primarily local, long-distance, switched access, public access, integrated services digital network ("ISDN") (which uses regular telephone lines to support voice, video and data applications), and traditional wide area network ("WAN") services (which allows a local communications network to link to networks in remote locations);
- *Data integration*, which includes the sale of telecommunications equipment located on customers' premises and related professional services, such as network management, installation and maintenance of data equipment and building of proprietary fiber-optic broadband networks for our government and business customers; and

Other, which consists primarily of universal service fund ("USF") revenue and surcharges. Unlike the first three revenue categories, other revenues are not included in our segment revenues.

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The following tables summarize our operating revenues:

	Three Months Ended June,		Increase / (Decrease)		
	2012	2011	CenturyLink	Savvis	Total
			(Dollars in millions)		
Strategic services	$ 2,076	1,726	72	278	350
Legacy services	2,100	2,280	(180)		(180)
Data integration	170	152	18		18
Other	266	248	18		18
Total operating revenues	$ 4,612	4,406	(72)	278	206

	Six Months Ended June,		Increase / (Decrease)			
	2012	2011	CenturyLink	Qwest	Savvis	Total
			(Dollars in millions)			
Strategic services	$ 4,132	2,265	116	1,207	544	1,867
Legacy services	4,243	3,275	(280)	1,248		968
Data integration	315	183	16	116		132
Other	532	379	21	132		153
Total operating revenues	$ 9,222	6,102	(127)	2,703	544	3,120

As noted in the tables above, total operating revenues for the three months ended June 30, 2012 increased due to our acquisition of Savvis and increased for the six months ended June 30, 2012 due to our acquisitions of Qwest and Savvis. Legacy CenturyLink operating revenues decreased $72 million and $127 million during the three and six months ended June 30, 2012 as compared to the three and six months ended June 30, 2011. This decrease was primarily attributable to declines in legacy services revenues, principally due to the continuing loss of access lines in our markets. We believe the decline in the number of access lines was primarily due to the displacement of traditional wireline telephone services by other competitive products and services. We estimate that our access lines loss will be between 5.7% and 6.3% in 2012. Our legacy services revenues were also negatively impacted in 2012 by the continued migration of customers to bundled service offerings at lower effective rates. The decreases in our legacy services revenues were partially offset by higher revenues from strategic services revenues. Ethernet, MPLS and broadband services accounted for a majority of the growth in strategic services revenues.

Further analysis of our operating revenues by segment is provided below in "Segment Results."

Operating Expenses

Our operating expenses increased substantially for the six months ended June 30, 2012, in comparison to 2011 primarily due to our acquisitions of Qwest and Savvis.

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The following tables summarize our operating expenses:

	Three Months Ended June 30,		Increase / (Decrease)		
	2012	2011	CenturyLink	Savvis	Total
	(Dollars in millions)				
Cost of services and products (exclusive of depreciation and amortization)	$ 1,912	1,781	(12)	143	131
Selling, general and administrative	835	968	(207)	74	(133)
Depreciation and amortization	1,208	1,177	(44)	75	31
Total operating expenses	$ 3,955	3,926	(263)	292	29

	Six Months Ended June 30,		Increase / (Decrease)			
	2012	2011	CenturyLink	Qwest	Savvis	Total
	(Dollars in millions)					
Cost of services and products (exclusive of depreciation and amortization)	$ 3,789	2,407	17	1,082	283	1,382
Selling, general and administrative	1,706	1,205	(125)	483	143	501
Depreciation and amortization	2,416	1,546	(21)	741	150	870
Total operating expenses	$ 7,911	5,158	(129)	2,306	576	2,753

For the three and six months ended June 30, 2012, Legacy CenturyLink cost of services and products (exclusive of depreciation and amortization) were relatively unchanged as compared to the comparable periods in 2011. During the periods, we experienced decreases in severance and salaries and wages, which were partially offset by a paid time off accounting adjustment for Legacy Qwest union employees and increases in CPE costs, professional fees, and USF contribution rates.

Legacy CenturyLink's selling, general and administrative expenses decreased for the three and six months ended June 30, 2012 primarily due to a decrease in severance and integration expenses relating to our recent acquisitions. As discussed in the "overview" section, our selling general and administrative expenses for the three and six months ended June 30, 2011 included substantial severance and integration costs related to the Qwest acquisition. See Note 2 Acquisitions.

Effective January 1, 2012, we changed our rates of capitalized labor as we transitioned certain of Qwest's legacy systems to our historical company systems. This transition resulted in an estimated $20 million to $30 million increase in the amount of labor capitalized as an asset compared to the amount that would have been capitalized if Qwest had continued to use its legacy systems and a corresponding estimated $20 million to $30 million decrease in operating expenses for the six months ended June 30, 2012. This change is expected to result in an estimated operating expense reduction of approximately $30 million to $50 million for the year ending December 31, 2012.

Excluding the effects of the acquisitions of Qwest and Savvis, depreciation and amortization expense for Legacy CenturyLink decreased due to annual updates of our depreciation rates for capitalized assets, as partially offset by net growth in capital assets.

Further analysis of our operating expenses by segment is provided below in "Segment Results."

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Other Consolidated Results

The following tables summarize our total other income (expense) and income tax expense:

	Three Months Ended June 30, 2012	Three Months Ended June 30, 2011	Increase / (Decrease) CenturyLink	Increase / (Decrease) Savvis	Increase / (Decrease) Total
	(Dollars in millions)				
Interest expense	$ (335)	(280)	48	7	55
Net loss on early retirement of debt	(202)	(1)	201		201
Other income (expense)	3	(13)	(17)	1	(16)
Total other income (expense)	$ (534)	(294)	232	8	240
Income tax expense	49	71	nm	nm	(21)

	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011	Increase / (Decrease) CenturyLink	Increase / (Decrease) Qwest	Increase / (Decrease) Savvis	Increase / (Decrease) Total
	(Dollars in millions)					
Interest expense	$ (678)	(408)	88	169	13	270
Net loss on early retirement of debt	(194)	(1)	201	(8)		193
Other income (expense)	15	(10)	(25)	(1)	1	(25)
Total other income (expense)	$ (857)	(419)	264	160	14	438
Income tax expense	180	199	nm	nm	nm	(18)

nm Attributing changes in income tax expense to the acquisitions of Savvis or Qwest is considered not meaningful.

Interest Expense

Interest expense increased for the three and six months ended June 30, 2012, compared to the three and six months ended June 30, 2011, primarily due to increased levels of debt and a substantial reduction in the amount of debt premium amortization. Since our acquisition of Qwest, certain of its debt securities have carried premiums, which have been retired during the six months ended June 30, 2012, causing a reduction in the amortization of those premiums. These increases were partially offset by a decrease in interest expense due to the retirement of several debt securities, which in some cases were refinanced with debt securities with lower interest rates.

Net Loss on Early Retirement of Debt

In the second quarter of 2012, our subsidiaries Embarq and Qwest Corporation ("QC") completed premium-priced cash tender offers for the purchase of certain of their respective outstanding debt securities, resulting in an aggregate loss of $193 million. Also in the second quarter of 2012, Embarq and our subsidiary Qwest Communications International Inc. ("QCII") redeemed certain of their respective outstanding debt securities which resulted in a net loss of $9 million.

In the first quarter of 2012, QCII redeemed certain of its outstanding debt securities, which resulted in a gain of $8 million.

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Other Income (Expense)

Other income (expense) reflects certain items not directly related to our core operations, including our share of income from our 49% interest in a cellular partnership, interest income, gains and losses from non-operating asset dispositions and impairments and foreign currency gains and losses. Other income (expense) was greater for the three and six months ended June 30, 2011 as compared to the three and six months ended June 30, 2012 primarily due to the recognition of a one-time $16 million fee paid in June 2011 relating to the acquisition of Savvis.

Income Tax Expense

Income tax expense for the six months ended June 30, 2012 and 2011 was $180 million and $199 million, respectively, or an effective tax rate of 39.7% and 37.9%, respectively.

Segment Results

We have restated previously reported segment results due to the above-described reorganization of our business. Segment results are summarized below:

		Three Months Ended June 30,		Six Months Ended June 30,	
		2012	2011	2012	2011
		(Dollars in millions)			
Total segment revenues	$	4,346	4,158	8,690	5,723
Total segment expenses		2,024	1,821	4,002	2,385
Total segment income	$	2,322	2,337	4,688	3,338
Total margin percentage		53%	56%	54%	58%
Regional markets:					
Revenues	$	2,477	2,540	4,963	3,677
Expenses		1,048	1,043	2,079	1,500
Income	$	1,429	1,497	2,884	2,177
Margin percentage		58%	59%	58%	59%
Wholesale markets:					
Revenues	$	944	980	1,905	1,362
Expenses		286	304	573	401
Income	$	658	676	1,332	961
Margin percentage		70%	69%	70%	71%
Enterprise markets network:					
Revenues	$	648	630	1,280	676
Expenses		479	472	936	482
Income	$	169	158	344	194
Margin percentage		26%	25%	27%	29%
Enterprise markets data hosting:					
Revenues	$	277	8	542	8
Expenses		211	2	414	2
Income	$	66	6	128	6
Margin percentage		24%	75%	24%	75%

In connection with the reorganization of our segments effective April 1, 2012, we also revised the way we categorize our segment revenues and segment expenses. Our major categories of segment

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revenues are strategic services, legacy services and data integration, each of which is described in more detail in "Operating Revenues" above.

As indicated in Note 9 Segment Information, we have the following four segments, which currently derive revenues from the following categories of products and services:

Segment	Revenues
Regional Markets	Strategic, Legacy and Data Integration
Wholesale Markets	Strategic and Legacy
Enterprise Markets Network	Strategic, Legacy and Data Integration
Enterprise Markets Data Hosting	Strategic

We report our segment expenses for our four segments as follows:

Direct expenses, which primarily are specific, incremental expenses incurred as a direct result of providing services and products to segment customers, along with selling, general and administrative expenses that are directly associated with specific segment customers or activities; and

Allocated expenses, which include network expenses, facilities expenses and other expenses such as fleet and real estate expenses.

During the first quarter of 2012, as we transitioned certain of Qwest's legacy systems to our historical company systems, we updated our methodologies for reporting our direct expenses and for allocating our expenses to our segments. Specifically, we no longer include certain fleet expenses for our regional markets segment in direct expenses; they are now expenses allocated to our segments, with the exception of enterprise markets data hosting. In addition, we now more fully allocate network building rent and power expenses to our regional markets, wholesale markets and enterprise markets network segments. We determined that it was impracticable to recast our segment results for prior periods to reflect these changes in methodology.

During the second quarter of 2012, as we reorganized our business into our four segments as indicated above, we further revised our methodology for how we allocate our expenses to our segments to better align segment expenses with related revenues. Under our revised methodology, we no longer allocate certain product development costs to our segments, but we do now allocate certain expenses from our enterprise markets data hosting segment to our other three segments. We have restated prior periods to reflect these changes in our methodology.

We do not assign depreciation and amortization expense to our segments, as the related assets and capital expenditures are centrally-managed. Other unassigned operating expenses consist primarily of expenses for certain centrally-managed administrative functions (such as finance, information technology, legal and human resources), severance expenses and restructuring expenses. The enterprise markets data hosting segment does include certain finance, information technology, legal and human resources expenses due to continuing use of certain legacy accounting systems acquired with the purchase of Savvis. Interest expense is also excluded from segment results because we manage our financing on a total company basis and have not allocated assets or debt to specific segments. In addition, other income (expense) does not relate to our segment operations and is therefore excluded from our segment results. Our segment results do not include any intersegment revenue or expenses. Our chief operating decision maker does not review assets and capital expenditures by segment, nor does he include the centrally-managed income and expenses noted above in the calculation of segment income.

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Regional Markets

The operations of our regional markets segment have been impacted by several significant trends, including those described below.

Strategic services. We continue to focus on increasing subscribers of our broadband services in our regional markets segment. In order to remain competitive, we believe continually increasing connection speeds is important. As a result, we continue to invest in our fiber to the node ("FTTN"), deployment, which allows for the delivery of higher speed broadband services. While traditional broadband services are declining, they have been more than offset by growth in fiber-based broadband services. We also continue to expand our product offerings including facilities-based video services, Ethernet, MPLS and other managed services and we continue to enhance our marketing efforts as we compete in a maturing market in which most consumers already have broadband services. We expect these efforts will improve our ability to compete and increase our strategic revenues.

Facilities-based video expenses. As we continue to expand our facilities-based video service infrastructure, we are incurring start-up expenses in advance of the revenue that this service is expected to generate. Although, over time, we expect that our revenue for facilities-based video services will offset the expenses incurred, the timing of this revenue growth is uncertain.

Access lines. Our voice revenues have been, and we expect they will continue to be, adversely affected by access line losses. Intense competition and product substitution continue to drive our access line losses. For example, many consumers are substituting cable and wireless voice and electronic mail, texting and social networking services for traditional voice telecommunications services. We expect that these factors will continue to negatively impact our business. As a result of the expected loss of access line revenues, we continue to offer service bundling and other product promotions to help mitigate this trend, as described below.

Service bundling and product promotions. We offer our customers the ability to bundle multiple products and services. These customers can bundle local services with other services such as broadband, video, long-distance and wireless. While our video and wireless services are an important piece of our customer retention strategy, they do not significantly contribute to our strategic services revenues. However, we believe customers value the convenience of, and price discounts associated with, receiving multiple services through a single company. While bundle price discounts have resulted in lower average revenues for our individual products, we believe service bundles continue to positively impact our customer retention and our ability to compete with other telecommunications service providers. In addition to our bundle discounts, we also offer from time to time limited time promotions on our broadband service, which we believe further aids our ability to attract and retain customers and increase usage of our services.

Data integration. We expect both data integration revenue and the related costs will fluctuate from quarter to quarter as this offering tends to be more sensitive than others to changes in the economy and in spending trends of our state and local government customers.

Operating efficiencies. We continue to evaluate our operating structure and focus. This involves balancing our segment workforce in response to our workload requirements, productivity improvements and changes in industry, competitive, technological and regulatory conditions.

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The following tables summarize the results of operations from our regional markets segment:

	Regional Markets Segment				
	Three Months Ended June 30,		Increase / (Decrease)		
	2012	2011	CenturyLink	Savvis	Total
	(Dollars in millions)				
Segment revenues:					
Strategic services	$ 894	843	50	1	51
Legacy services	1,510	1,631	(121)		(121)
Data integration	73	66	7		7
Total revenues	2,477	2,540	(64)	1	(63)
Segment expenses:					
Direct	981	980	1		1
Allocated	67	63	3	1	4
Total expenses	1,048	1,043	4	1	5
Segment income	$ 1,429	1,497	(68)		(68)
Segment margin percentage	58%	59%			

Regional Markets Segment					
Six Months Ended June 30,		Increase / (Decrease)			
2012	2011	CenturyLink	Qwest	Savvis	Tot