FitchRatings
KNOW YOUR RISK

Corporates

Telecom
U.S. and Canada
Credit Analysis

CenturyTel, Inc.

Ratings

Security Class	Current Rating
Long-Term IDR	BBB–
Senior Unsecured Revolving Credit Facility	BBB–
Senior Unsecured Debt	BBB–
Short-Term IDR	F3
Commercial Paper	F3

Outlook

Stable

Financial Data

CenturyTel, Inc.
($ Mil.)

	12/31/08	12/31/07
Revenues	2,600	2,656
EBITDA	1,262	1,349
Total Debt with Equity Credit	3,315	3,021
Total Debt with Equity Credit/Operating EBITDA (x)	2.63	2.24
Free Cash Flow	346	675

Analysts

John C. Culver, CFA
+1 312 368-3216
john.culver@fitchratings.com

David E. Peterson
+1 312 368-3177
david.peterson@fitchratings.com

Related Research

- *Fitch Affirms CenturyTel's & Embarq's Ratings on Acquisition Announcement, Oct. 28, 2008*
- *Fitch Downgrades CenturyTel's IDR to 'BBB–'; Outlook Stable, June 24, 2008*
- *CenturyTel, Inc., May 1, 2008*

Rating Rationale

- On Oct. 28, 2008, Fitch Ratings affirmed the ratings of CenturyTel, Inc. (CenturyTel) and Embarq Corporation (Embarq), including the 'BBB–' long-term issuer default ratings (IDRs) of the two companies, following the announcement on the previous day that the companies had a definitive agreement to merge in a tax-free, all-stock transaction.
- At the time of the announcement, the companies disclosed expectations that net leverage, pro forma and before synergies, would have been approximately 2.3 times (x) on a last 12 month (LTM) basis for Sept. 30, 2008. Pro forma net leverage after synergies would have been approximately 2.1x. In Fitch's view, leverage on either basis is sufficient to maintain investment-grade ratings. The company has not set specific leverage targets to be maintained after the close of the transaction, although Fitch notes that the company intends to maintain investment-grade ratings. Financial flexibility is expected to be maintained, as on a pro forma basis, the company is targeting a dividend payout of approximately 50% of free cash flow. This level is similar to the recent policies of the two companies. The company may resume share repurchases after the merger, within the constraints of the investment-grade rating.
- At the time of the announcement, CenturyTel disclosed it had obtained an $800 million bridge financing commitment in order to retire the amount outstanding on Embarq's revolving credit facility at the time of close. In January 2009, the two companies announced Embarq had obtained an amendment from its lenders removing the change-of-control provision, thus keeping the existing revolving facility in place. Embarq's facility will be reduced to $800 million from $1.5 billion, and will mature in May 2011, consistent with the current terms. The $360 million outstanding on Embarq's term facility is expected to be repaid on or before the close of the merger. The merger did not trigger other change-of-control provisions in the debt of either company.
- CenturyTel's current ratings also reflect the announcement in June 2008 of an increase in quarterly dividends to $0.70 per share from $0.06375 per share, beginning with the third quarter of 2008. In addition, the company paid a catch-up dividend for the second quarter of 2008 so that the quarterly rate totaled $0.70 per share. The increase raised its dividend payout as a percentage of free cash flow from nominal levels to a level approximating 50% of its free cash flow. At the time of the announcement, the company accelerated its existing $750 million common stock-repurchase program, which contributed to higher debt levels in 2008, but repurchases were halted in the third quarter of 2008 due to the downturn in the financial markets. As a result of the halt in the repurchase program as well as some borrowing on the credit facility to ensure the availability of adequate liquidity, cash rose to approximately $243 million at the end of 2008 from $64 million at June 30, 2008.
- CenturyTel's ratings are supported by the relatively high EBITDA margins generated by its rural local exchange carrier (RLEC) business and strong cash flow before capital spending and dividends.

- Revenues declined a modest 0.3% in 2008, when excluding $1.3 million and $50.1 million in one-time revenue items from 2008 and 2007, respectively. Competition for voice services caused the decline and was only partly offset by Madison River's results being reflected for the full year, and by growth from data and other services. The company experienced access-line losses of 6.4% in 2008, compared with the 5.7% loss on a normalized basis in 2007. Losses have been due to cable telephony, wireless substitution, as well as the downturn in the economy. In 2009, these factors will again pressure lines, and the company expects access-line losses to range from 5.7% to 6.7%.
- CenturyTel estimates cable telephony availability in its territory is approximately 43% to 47% of its lines, a relatively small increase over the prior year. Competitors have increased offerings in the small business space in some markets. In Fitch's view, CenturyTel's competitive pressure is modestly lower than experienced by the urban-based regional Bell operating companies (RBOCs), and the ultimate potential exposure is lower, as up to one-third of its lines do not face exposure to cable operators. To augment its traditional voice and high-speed data services, the company has been reselling satellite-based video services. The company also has two markets where it has deployed wireline-based video alternatives but has no current plans to expand to additional markets.
- In 2009 and beyond, CenturyTel could experience mixed effects from regulatory and political/economic developments. Federal economic stimulus spending starting in 2009 that targets the expansion of broadband services to unserved and underserved areas could be a positive for the company, but the details are unclear as the entire process to disburse funds is under development. In late 2009, the long-delayed reforms of the universal service funding (USF) mechanism and intercarrier compensation (ICC) could gain traction. Reform could have a negative effect on CenturyTel and other rural companies, although Fitch believes regulators are likely to phase in reforms.

Key Rating Drivers

- Fitch generally views leverage of 3.0x or below and a dividend payout of free cash flow no greater than 55% as being the threshold for an investment-grade rating for a rural local exchange carrier with flat growth prospects and limited competitive pressure. Fitch believes that the post-merger company will operate within these measures in the near future.
- A successful execution of the CenturyTel and Embarq merger integration process will be needed for the companies to realize the benefits of the merger. The anticipated $300 million in operating cost synergies will aid in offsetting the effect of competitive pressures on operating cash flows
- Fitch will continue to monitor competitive pressure on the post-merger company. Voice service availability from cable operators continues to expand, and wireless substitution could rise in a weakening economy. While the rural nature of the company moderates competitive pressures somewhat, in 2009 and beyond, revenues are nevertheless likely to be relatively flat or decline modestly.

Recent Events

On Oct. 27, 2008, CenturyTel and Embarq announced a definitive agreement whereby CenturyTel will acquire Embarq in a tax-free, all-stock transaction. The terms of the transaction call for CenturyTel to exchange 1.37 shares for each Embarq share, and the price represented a 36% premium over Embarq's closing stock price on Oct. 24, 2008, and an 11% premium over Embarq's average closing stock price during the prior

30 trading days. The enterprise value of the transaction at the time of the announcement was $11.6 billion, including the assumption of $5.8 billion in Embarq debt. The transaction multiple on an LTM basis as of Sept. 30, 2008, was 4.5x before synergies, and 3.9x after considering the merger's full synergies. Following the close of the transaction, Embarq's shareholders will own 66% of the company, and CenturyTel's shareholders will own 34%. Eight of the 15 member board of directors will come from the board of CenturyTel, and seven from the board of Embarq.

The transaction is expected to close in mid-2009, following the receipt of customary regulatory approvals. The companies estimate approvals will have to be obtained in 15 of the 33 states in which the combined company will operate. The shareholders of both companies approved the merger on Jan. 27, 2009.

The combination results in a large rural local exchange carrier, with 8 million access lines, 2 million broadband customers and operations in 33 states, with 2008 pro forma revenue of $8.7 billion and EBITDA of $3.9 billion. The enhanced scale of the company provides greater flexibility as it considers such strategic growth areas as Internet protocol television (IPTV) and wireless data services. In addition, the combined company will have greater financial flexibility to manage through upcoming regulatory reforms (universal service funding and intercarrier compensation).

The company believes it can achieve a total of $400 million of annual synergies within the first three years of the close of the transaction, and $275 million in integration expenses are forecast. The largest portion of the savings ($300 million) are operating cost savings, which arise from the elimination of duplicate headquarters and corporate costs, increased network and operational efficiencies, increased purchasing power and savings in IT support and advertising. An additional $30 million of capital spending savings is expected to come from increased purchasing power. Fitch believes that while there is execution risk present in meeting the operating cost and capital synergies, the risk is relatively low based on industry experience. On the other hand, in Fitch's view the company's revenue synergy targets of $75 million are subject to greater uncertainty.

CenturyTel was the winning bidder in the Federal Communication Commission's (FCC) 2008 700-megahertz (MHz) spectrum auction for 69 licenses (12 MHz for each A Block and B Block license), covering 14.6 million persons of population (POPs) (adjusted for overlapping A Block and B Block licenses) for $149 million. There is an approximately 50% overlap with its 2.1 million access lines, but the licenses also cover markets adjacent to its access lines, as well as areas where the company has fiber/competitive local exchange carrier (CLEC) assets. CenturyTel paid an average of $0.70/MHz/POP, which was below the overall average for the auction of $1.28. CenturyTel won licenses in the A Block and B Block, and its overall average of $0.70/MHz/POP was below the average for the A Block and B Block, which went for an average of $1.13/MHz/POP and $2.65/MHz/POP, respectively.

Thus far, CenturyTel has not disclosed detailed plans of its wireless strategy. Fitch believes the implementation of a successful wireless broadband business model would be positive for the company in the current competitive environment; however, near-term business and financial risk is higher, owing to the construction costs, initial operating losses and increased financing costs. Capital spending in wireless is not expected to be material until 2010.

Liquidity and Debt Structure

CenturyTel had approximately $3.315 billion in total debt outstanding, including $20 million of short-term debt and maturing long-term debt, and its balance sheet reflected approximately $243 million in cash and cash equivalents at Dec. 31, 2008.

CenturyTel also has a $708 million, five-year revolving credit facility that matures in December 2011. At Dec. 31, 2008, there was approximately $563 million outstanding on the revolving facility. The principal financial covenants in the credit facility limit debt-to-EBITDA for the past four quarters to no more than 4.0x, and EBITDA-to-interest plus preferred dividends (with the terms as defined in the agreement) to no less than 1.5x.

In February 2009, CenturyTel filed a universal shelf registration for the issuance of debt and equity securities. The registration is a replacement for a previous shelf registration that had expired in December 2008. CenturyTel has a $1.5 billion commercial paper program authorized, but effectively limits borrowing under the program to the amount available on its credit facility. Fitch believes CenturyTel's liquidity position and availability of financing are adequate to meet its $20 million of maturing debt obligations in 2009. The next significant maturities are not until 2010, when $519 million in debt comes due.

Free cash flow for 2008 was approximately $346 million, with the decline primarily due to the increase in the dividend, an increase in pension contributions and certain non-recurring items that were included in 2007. Dividends paid in 2008 rose to $220 million from $27 million in 2007, and pension contributions rose $51 million to $52.5 million in 2008. Capital spending in 2008 was down 12% relative to 2007, to approximately $287 million. In 2009, the company's guidance calls for capital spending to range from $280 million to $300 million, excluding the merger with Embarq and integration spending. Significant spending on the wireless network build-out is not expected until 2010, although a nominal amount could be spent in 2009.

Debt Structure — CenturyTel, Inc.
($ Mil., As of Dec. 31, 2008)

CenturyTel, Inc.

Long-Term IDR — BBB–
Senior Unsecured — BBB–
Short-Term IDR — F3
Commercial Paper — F3

Revolving Credit Facility	563
8.375% Senior Unsecured Notes Due 2010	500
7.875% Senior Unsecured Notes Due 2012	500
5.500% Senior Unsecured Notes Due 2013	250
5.000% Senior Unsecured Notes Due 2015	350
6.000% Senior Unsecured Notes Due 2017	500
7.200% Senior Unsecured Notes Due 2025	100
6.875% Senior Unsecured Debentures Due 2028	425

Operating Subsidiaries

First Mortgage Debt, Payable to Agencies of the U.S. Government and Cooperative Lending Agencies, Due in Installments Through 2028	108

Source: Company reports.

Key Covenant Summary — CenturyTel, Inc.

Issuer	CenturyTel, Inc.
Description of Debt	Unsecured Notes and Debentures
Document Date	March 31, 1994
Summary	There is an absence of strong financial covenant language.
Maturity	Various: 2009–2028
Amount Outstanding	$2.625 billion
Financial Covenants	No material provision noted.
Change of Control Provision	The most restrictive notes have a change of control repurchase event, which consists of a change of control, and a ratings event, as defined.
Sale of Assets Restriction	No material provision noted.
Additional Debt Restriction	No material provision noted.
Limitation on Secured Debt	Debt under the indenture shall be secured equally and ratable with new secured debt. Existing liens are permitted as are liens on future property acquired by the company and on property at the time of acquisition. Subsidiaries may incur secured indebtedness.
Cross Default	No material provision noted.
Cross Acceleration with Facility	No material provision noted.
Other	No material provision noted.

Financial Summary — CenturyTel, Inc.

($ Mil., Years Ended Dec. 31)

	2004	2005	2006	2007	2008
Profitability					
Operating EBITDA	1,254.86	1,268.34	1,200.94	1,349.30	1,261.53
Operating EBITDA Margin (%)	52.13	51.16	49.06	50.80	48.53
Funds from Operations (FFO) Return on Adjusted Capital (%)	17.90	19.25	17.40	19.34	16.24
Free Cash Flow (FCF) Margin (%)	22.38	20.89	20.32	25.41	13.31
Coverages (x)					
FFO Interest Coverage	5.43	5.89	5.07	5.79	5.14
Operating EBITDA/Gross Interest Expense	5.92	6.20	6.07	6.30	6.17
FFO Fixed Charge Coverage	5.43	5.89	5.07	5.79	5.14
FCF Debt-Service Coverage	1.63	1.50	1.85	1.80	2.45
Cash Flow from Operations/Capital Expenditures	2.48	2.32	2.68	3.16	2.97
Leverage (x)					
Long-Term Secured Debt/Operating EBITDA	—	—	—	—	—
Long-Term Secured Debt/FFO	—	—	—	—	—
Total Debt with Equity Credit/Operating EBITDA	2.13	2.10	2.16	2.24	2.63
FFO Adjusted Leverage	2.32	2.20	2.58	2.43	3.15
Total Adjusted Debt/Operating EBITDAR	2.13	2.10	2.16	2.24	2.63
FCF/Total Adjusted Debt (%)	20.18	19.47	19.15	22.34	10.44
Balance Sheet					
Short-Term Debt	249.62	276.74	178.01	279.90	20.41
Long-Term Senior Secured Debt	0.00	0.00	0.00	0.00	0.00
Long-Term Senior Unsecured Debt	2,762.02	2,376.07	2,412.85	2,734.36	3,294.12
Long-Term Subordinated Debt	0.00	0.00	0.00	0.00	0.00
Other Debt	7.98	7.85	7.45	6.97	0.24
Equity Credit	350.00	0.00	0.00	0.00	0.00
Total Debt with Equity Credit	**2,669.61**	**2,660.66**	**2,598.31**	**3,021.23**	**3,314.76**
Off-Balance-Sheet Debt	0.00	0.00	0.00	0.00	0.00
Total Adjusted Debt with Equity Credit	**2,669.61**	**2,660.66**	**2,598.31**	**3,021.23**	**3,314.76**
Cash Flow					
Funds From Operations	937.38	1,002.20	807.52	1,027.40	847.06
Change in Working Capital	18.45	(37.86)	32.82	2.22	6.07
Cash Flow from Operations	**955.83**	**964.34**	**840.34**	**1,029.62**	**853.12**
Total Non-Operating/Non-Recurring Cash Flow	—	—	—	—	—
Capital Expenditures	(385.32)	(414.87)	(314.07)	(326.05)	(286.82)
Common Dividends	(31.86)	(31.47)	(28.82)	(28.68)	(220.27)
Free Cash Flow	**538.65**	**518.01**	**497.45**	**674.89**	**346.04**
Net Acquisitions and Divestitures	(2.00)	(75.45)	5.87	(298.57)	15.81
Net Debt Proceeds	(179.39)	(349.17)	(59.00)	28.86	277.71
Net Equity Proceeds	(371.53)	(103.22)	(704.39)	(411.27)	(332.67)
Other (Investing and Financing)	(21.70)	1.47	126.89	14.83	(98.15)
Total Change in Cash	**(35.97)**	**(8.37)**	**(133.18)**	**8.73**	**208.93**
Ending Cash and Equivalents Balance	167.22	158.85	25.67	34.40	243.33
Short-Term Marketable Securities	—	—	—	—	—
Income Statement					
Revenue	2,407.37	2,479.25	2,447.73	2,656.24	2,599.75
Revenue Growth (%)	1.12	2.99	(1.27)	8.52	(2.13)
Operating EBIT	753.95	736.41	677.44	813.04	737.74
Gross Interest Expense	211.85	204.60	197.86	214.21	204.62

Source: Company reports.