IDEARC INC.
Form 10-Q
August 11, 2008

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q
QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2008
Commission file number: 1-32939
IDEARC INC.
(Exact Name of Registrant as Specified in Its Charter)

Delaware	**20-5095175**
(State of Incorporation)	(I.R.S. Employer Identification No.)
2200 West Airfield Drive, P.O Box 619810	**75261**
D/FW Airport, TX	(Zip Code)
(Address of Principal Executive Offices)	

Registrant s telephone number, including area code: **(972) 453-7000**

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 þ 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. (Check one):

Large accelerated filer þ	Accelerated filer o	Non-accelerated filer o	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 þ

As of August 7, 2008, there were 147,718,157 shares of the Registrant s common stock outstanding.

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FORWARD-LOOKING STATEMENTS

This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. You should not place undue reliance on these statements. These forward-looking statements include statements that reflect the current views of our senior management with respect to our financial performance and future events with respect to our business and industry in general. Statements that include the words may, could, should, would, believe, anticipate, forecast, estimate, expect, pr plan, project, outlook and similar statements of a future or forward-looking nature identify forward-looking statements. Forward-looking statements address matters that involve risks and uncertainties. Accordingly, there are or will be important factors that could cause our actual results to differ materially from those indicated in these statements. We believe that these factors include, but are not limited to, the following:

- risks related to our substantial indebtedness;
- risks related to our declining revenue, including a reduction in customer advertising spend resulting from the current economic downturn;
- limitations on our operating and strategic flexibility under the terms of our debt agreements;
- changes in our competitive position due to competition from other yellow pages directories publishers and other traditional and new media and our ability to anticipate or respond to changes in technology and user preferences;
- declining use of print yellow pages directories;
- our ability to successfully identify and implement cost initiatives;
- our ability to access capital markets should we choose to do so and changes in our credit ratings;
- changes in the availability and cost of paper and other raw materials used to print our directories and our reliance on third-party providers for printing and distribution services;
- increased credit risk associated with our reliance on small- and medium-sized businesses;
- changes in our operating performance;
- our ability to attract and retain qualified executives;
- our ability to maintain good relations with our unionized employees;
- changes in U.S. labor, business, political and/or economic conditions;
- changes in governmental regulations and policies and actions of regulatory bodies; and
- risks associated with our obligations under agreements entered into with Verizon in connection with our spin-off.

The foregoing factors should not be construed as exhaustive and should be read together with the other cautionary statements included in this and other reports we file with the Securities and Exchange Commission, including the information in Item 1A. Risk Factors in Part I of our Annual Report on Form 10-K for the year ended December 31, 2007. If one or more events related to these or other risks or uncertainties materialize, or if our underlying assumptions prove to be incorrect, actual results may differ materially from what we anticipate.

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements.

Idearc Inc. and Subsidiaries
Consolidated Statements of Income
(Unaudited)

	Three Months Ended June 30, 2008	Three Months Ended June 30, 2007	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
	(in millions, except per share amounts)			
Operating Revenue				
Print products	**$ 683**	$ 731	**$ 1,379**	$ 1,468
Internet	**75**	73	**148**	141
Other	**1**	1	**2**	2
Total Operating Revenue	**759**	805	**1,529**	1,611
Operating Expense				
Selling	**185**	188	**370**	376
Cost of sales (exclusive of depreciation and amortization)	**157**	156	**304**	314
General and administrative	**118**	97	**197**	203
Depreciation and amortization	**20**	22	**40**	44
Total Operating Expense	**480**	463	**911**	937
Operating Income	**279**	342	**618**	674
Interest expense, net	**163**	167	**329**	337
Income Before Provision for Income Taxes	**116**	175	**289**	337
Provision for income taxes	**40**	66	**102**	125
Net Income	**$ 76**	$ 109	**$ 187**	$ 212
Basic and diluted earnings per common share	**$ .52**	$ .75	**$ 1.28**	$ 1.45
Basic and diluted weighted-average common shares outstanding	**146**	146	**146**	146
Dividends declared per common share	**$**	$ .3425	**$ .3425**	$ .6850

See Notes to Consolidated Financial Statements.

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Idearc Inc. and Subsidiaries
Consolidated Balance Sheets
(Unaudited)

	At June 30, 2008	At December 31, 2007
	(in millions)	
Assets		
Current assets:		
Cash and cash equivalents	**$ 127**	$ 48
Accounts receivable, net of allowances of $83 and $77	**408**	423
Deferred directory costs	**312**	312
Prepaid expenses and other	**5**	10
Total current assets	**852**	793
Property, plant and equipment	**476**	471
Less: accumulated depreciation	**368**	356
	108	115
Goodwill	**73**	73
Intangible assets, net	**295**	303
Pension assets	**182**	171
Non-current deferred tax assets	**84**	124
Debt issuance costs	**81**	86
Other non-current assets	**3**	2
Total assets	**$ 1,678**	$ 1,667
Liabilities and Stockholders Equity (Deficit)		
Current liabilities:		
Accounts payable and accrued liabilities	**$ 233**	$ 272
Deferred revenue	**197**	209
Current maturities of long-term debt	**85**	48
Current deferred taxes	**23**	28
Other	**25**	31
Total current liabilities	**563**	588
Long-term debt	**8,959**	9,020
Employee benefit obligations	**316**	327
Unrecognized tax benefits	**87**	109
Other liabilities	**185**	223
Stockholders equity (deficit):		

Common stock ($.01 par value; 225 million shares authorized, 147,776,287 and 146,795,971 shares issued and outstanding in 2008 and 2007, respectively)	**1**	1
Additional paid-in capital (deficit)	**(8,769)**	(8,776)
Retained earnings	**498**	361
Accumulated other comprehensive loss	**(162)**	(186)
Total stockholders equity (deficit)	**(8,432)**	(8,600)
Total liabilities and stockholders equity (deficit)	**$ 1,678**	$ 1,667

See Notes to Consolidated Financial Statements.

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Idearc Inc. and Subsidiaries
Consolidated Statements of Cash Flows
(Unaudited)

	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
	(in millions)	
Cash Flows from Operating Activities		
Net income	**$ 187**	$ 212
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	**40**	44
Employee retirement benefits	**(1)**	10
Deferred income taxes	**7**	1
Provision for uncollectible accounts	**87**	64
Stock-based compensation	**1**	28
Changes in current assets and liabilities		
Accounts receivable	**(72)**	(152)
Deferred directory costs		(31)
Other current assets	**5**	1
Accounts payable and accrued liabilities.	**(66)**	(25)
Other, net	**(12)**	(14)
Net cash provided by operating activities	**176**	138
Cash Flows from Investing Activities		
Capital expenditures (including capitalized software)	**(25)**	(22)
Proceeds from sale of assets	**2**	1
Other, net		4
Net cash used in investing activities	**(23)**	(17)
Cash Flows from Financing Activities		
Repayment of long-term debt	**(24)**	(24)
Dividends paid to stockholders	**(50)**	(100)
Net cash used in financing activities	**(74)**	(124)
Increase (decrease) in cash and cash equivalents	**79**	(3)
Cash and cash equivalents, beginning of year	**48**	172
Cash and cash equivalents, end of period	**$ 127**	$ 169

See Notes to Consolidated Financial Statements.

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Idearc Inc. and Subsidiaries
Notes to Consolidated Financial Statements
(Unaudited)

Note 1
Basis of Presentation

Pursuant to the rules and regulations of the U. S. Securities and Exchange Commission (the SEC), the accompanying unaudited consolidated financial statements contain all adjustments, consisting of normal recurring items and accruals, necessary to fairly present the financial position, results of operations and cash flows of Idearc Inc. and its subsidiaries (collectively, Idearc or the Company). These interim financial statements do not contain all information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States, and should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2007. The results for the interim periods are not necessarily indicative of results for the full year. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amount of assets and liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities at the date of the financial statements. Certain prior period amounts have been reclassified to conform to current year presentation.

Recent Accounting Pronouncements

Fair Value Measurements

In February 2008, the Financial Accounting Standards Board (FASB) issued FASB Staff Position No. 157-2, *Partial Deferral of the Effective Date of Statement 157* (FSP 157-2), for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually) to fiscal years beginning after November 15, 2008. We are currently evaluating the potential impact of the adoption of the deferred portion of the Statement of Financial Accounting Standards No. 157, *Fair Value Measurements,* with regards to nonfinancial assets and liabilities, on our consolidated financial statements.

Business Combinations

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141 (revised 2007), *Business Combinations* (SFAS 141R), which replaces SFAS 141. SFAS 141R establishes principles and requirements for how an acquirer in a business combination recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any controlling interest; recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase; and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS 141R is to be applied prospectively to business combinations for which the acquisition date is on or after an entity s fiscal year that begins after December 15, 2008. We are currently evaluating the potential impact of the adoption of SFAS 141R on our consolidated financial statements.

Derivative Instruments and Hedging Disclosures

In March 2008, the FASB issued Statement of Financial Accounting Standards No. 161, *Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133* (SFAS 161). SFAS 161 requires enhanced disclosures about an entity s derivative and hedging activities. These enhanced disclosures will discuss (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under SFAS 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity s financial position, financial performance, and cash flows. SFAS 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. We are currently evaluating the potential impact of the adoption of SFAS 161 on our disclosures related to our consolidated financial statements.

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Determination of the Useful Life of Intangible Assets

In April 2008, the FASB issued FASB Staff Position FAS 142-3, *Determination of the Useful Life of Intangible Assets* (FSP FAS 142-3). FSP FAS 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, *Goodwill and Other Intangible Assets.* FSP FAS 142-3 is effective for fiscal years beginning after December 15, 2008 and early adoption is prohibited. We are currently evaluating the potential impact of the adoption of FSP FAS 142-3 on our consolidated financial statements.

Note 2

Restructuring

In the second quarter of 2008, the Company began implementing strategic organizational and market exit initiatives to improve ongoing operational efficiencies and reduce total operating costs. As a result, the Company recorded a restructuring charge of $7 million associated with one-time termination benefits impacting approximately 350 employees. This charge was recorded to general and administrative expense in the statements of income.

Note 3

Fair Value Measurements

On January 1, 2008, the Company adopted the provisions of Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (SFAS 157). SFAS 157 defines how fair value should be determined for financial reporting purposes by establishing a fair value framework applicable to all fair value measurements.

As required by SFAS 157, each financial asset and liability must be identified as having been valued according to a specified level of input as follows:

Level 1 Inputs - Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that are accessible at the measurement date;

Level 2 Inputs - Level 2 inputs utilize inputs other than quoted prices included in Level 1 that are observable for an asset or liability, either directly or indirectly. Level 2 inputs include quoted prices for similar assets or liabilities in active markets, and inputs other than quoted prices that are observable for an asset or liability; and

Level 3 Inputs - Level 3 inputs are unobservable inputs for the asset or liability, and include situations where there is little, if any, market activity for the asset or liability.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In these cases, the level in the fair value hierarchy, within which the fair value measurement in its entirety falls, has been determined based on the lowest level input that is significant to the fair value measurement in its entirety. Assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the asset or liability.

The measurement of fair value should be consistent with one of the following valuation techniques: market approach, income approach or cost approach. The Company uses the income approach to measure fair value of its financial instruments. The income approach uses valuation techniques to convert future amounts (for example, cash flows or earnings) to a single present amount (discounted). The measurement is based on the value indicated by current market expectations about those future amounts. Our only assets or liabilities measured at fair value on a recurring basis are our interest rate swap agreements, which, at June 30, 2008, are valued at $183 million ($119 million net of tax, recorded to accumulated other comprehensive loss) using Level 2 inputs, and are classified as other liabilities on the balance sheet.

Note 4

Earnings Per Share

Basic earnings per share are computed by dividing net income by the number of weighted-average common shares outstanding during the reporting period. Diluted earnings per share are calculated to give effect to all

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potentially dilutive common shares outstanding during the reporting period. The effect of potentially dilutive common shares for the three and six months ended June 30, 2008 and 2007 was not material.

The following table illustrates the calculation of basic and diluted earnings per share for the three and six months ended June 30, 2008 and 2007:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
	(in millions, except per share amounts)			
Income available to common stockholders	**$ 76**	$ 109	**$ 187**	$ 212
Weighted-average common shares outstanding	**146**	146	**146**	146
Basic and diluted earnings per share	**$ .52**	$ .75	**$ 1.28**	$ 1.45

Note 5

Additional Financial Information

The tables that follow provide additional financial information related to our consolidated financial statements.

Balance Sheets

The following table displays the components of accounts payable and accrued liabilities.

	At June 30, 2008	At December 31, 2007
	(in millions)	
Accounts payable and accrued liabilities		
Accounts payable	**$ 27**	$ 38
Accrued expenses	**64**	73
Accrued vacation pay	**22**	24
Accrued salaries and wages	**73**	80
Accrued taxes	**17**	26
Accrued interest	**30**	31
	$ 233	$ 272

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Comprehensive Income

The following table displays the computation of total comprehensive income.

	Three Months Ended June 30, 2008	Three Months Ended June 30, 2007	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
	(in millions)			
Net income	**$ 76**	$ 109	**$ 187**	$ 212
Other comprehensive income, net of taxes				
Unrealized gain on cash flow hedges	**114**	25	**24**	24
Adjustments for pension and post-employment benefits		2		3
Other comprehensive income	**114**	27	**24**	27
Total comprehensive income	**$ 190**	$ 136	**$ 211**	$ 239

The following table displays the components of accumulated other comprehensive loss.

	At June 30, 2008	At December 31, 2007
	(in millions)	
Unrealized losses on cash flow hedges, net of tax	**$ (119)**	$ (143)
Pension and post-employment benefits, net of tax	**(43)**	(43)
Accumulated other comprehensive loss	**$ (162)**	$ (186)

Note 6
Debt

Long-Term Debt

Outstanding long-term debt obligations are as follows:

	Interest Rates	Maturities	At June 30, 2008	At December 31, 2007
			(in millions)	
Senior secured credit facilities:				
Revolving credit facility	LIBOR + 1.50%	2011	**$**	$
Tranche A facility	LIBOR + 1.50%	2009-2013	**1,515**	1,515
Tranche B facility	LIBOR + 2.00%	2006-2014	**4,679**	4,703
Total senior secured credit facilities			**6,194**	6,218

Senior unsecured notes	8.0%	2016	**2,850**		2,850
Total long-term debt, including current maturities			**9,044**		9,068
Less: current maturities of long-term debt			**(85)**		(48)
Long-term debt			**$ 8,959**	$	9,020

Senior Secured Credit Facilities

As of June 30, 2008, Idearc had interest rate swap agreements with major financial institutions with notional amounts totaling $5,510 million. These swap agreements consist of three separate swap transactions with notional amounts of $1,710 million maturing on March 31, 2009, $2,700 million maturing on June 29, 2012 and $1,100 million maturing on September 30, 2010. In addition to these swap agreements, Idearc entered into two forward swap transactions effective March 31, 2009 with notional amounts of $800 million maturing on March 31, 2012 and $900 million with annual notional reductions of $200 million maturing on March 31, 2012. Under the swap agreements, we pay fixed rate interest at rates ranging from 4.86% to 5.15% and receive floating rate interest based on the three month LIBOR to hedge the variability in cash flows attributable to changes in the benchmark interest rate. These swap agreements comply with our debt covenants under our senior secured credit facilities that require that at least 50% of our total outstanding debt be subject to fixed interest rates until March 2009. We do not enter into financial instruments for trading or speculative purposes.

All derivative financial instruments are recognized as either assets or liabilities on the consolidated balance sheets with measurement at fair value. We determine the fair value of the derivative financial instruments in accordance with SFAS 157. On a quarterly basis, the fair value of our interest rate swap agreements is determined based on observable market prices of similar instruments. For those interest rate swap agreements in a liability position, we factor nonperformance risk into the measurement of fair value. See Note 3 for a further explanation of fair value measurements.

The Company assesses, at both the hedge s inception and on an ongoing basis, whether the derivatives used in hedged transactions have been highly effective in offsetting the variability in interest cash flows of the hedged items and are expected to remain highly effective in future periods. Changes in the fair value of outstanding cash flow hedge derivative instruments that are highly effective are recorded in accumulated other comprehensive loss, a component of stockholders equity (deficit), until net income is affected by the variability of cash flows of the hedged transaction. Any hedge ineffectiveness would be recorded in current period net income.

The interest rate swap agreements described above, designated as cash flow hedges, were assessed to be highly effective on a retrospective and prospective basis. Accordingly, the changes in fair value of the derivative instruments were recorded in accumulated other comprehensive loss. The derivative financial instruments are currently classified as other liabilities in the amount of $183 million ($119 million net of tax recorded to accumulated other comprehensive loss).

In addition to these interest rate swap agreements, Idearc entered into a basis swap transaction effective March 31, 2008 with a notional amount of $600 million ($400 million on Tranche A and $200 million on Tranche B) maturing December 31, 2008. Under this basis swap transaction, Idearc will receive one month LIBOR from the counter party, pay one month LIBOR plus the appropriate spread on the secured debt and pay three month LIBOR less 6.375 basis points to the swap counter party.

The senior secured credit facilities are guaranteed by substantially all subsidiaries of Idearc Inc. and are secured by substantially all present and future assets of Idearc Inc. and its subsidiaries.

Senior Unsecured Notes

The senior unsecured notes are guaranteed by substantially all subsidiaries of Idearc Inc. The senior unsecured notes are general unsecured obligations of Idearc Inc. and are effectively subordinated to all secured indebtedness of Idearc Inc. to the extent of the value of the assets securing this secured indebtedness. Idearc Inc. has no independent assets or operations. The guarantees by its subsidiaries are full and unconditional and joint and several, and any subsidiaries of Idearc Inc., other than the subsidiary guarantors, are minor. Our financing arrangements contain restrictions on our ability to pay dividends on shares of our common stock based on our satisfying certain performance measures and complying with other conditions.

Debt Covenants and Maturities

As of June 30, 2008, we were in compliance with the covenants in our debt agreements.

We made scheduled principal payments of $24 million in the first six months of 2008. Scheduled principal payments of long-term debt outstanding at June 30, 2008, are $24 million for the remainder of 2008, $123 million in 2009, $199 million in 2010, $275 million in 2011, $351 million in 2012 and $8,072 million thereafter.

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Note 7

Pension and Other Post-Employment Benefit Costs

We maintain non-contributory defined benefit pension plans for the majority of our employees. In addition, we maintain post-employment health care and life insurance plans for our retirees and their dependents, which are both contributory and non-contributory and include a limit on the Company s share of cost for certain recent and future retirees.

Net Periodic Cost (Income)

The following tables summarize the benefit costs (income) related to the Company s pension and post-employment health care and life insurance plans for the three and six months ended June 30, 2008 and 2007.

	Pension			
	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Service cost	**$ 2**	$ 2	**$ 4**	$ 4
Interest cost	**8**	9	**16**	18