IDEARC INC.
Form 10-Q
November 05, 2007
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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 SEPTEMBER 30, 2007

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,

D/FW Airport, TX	**75261**
(Address of Principal Executive Offices)	**(Zip Code)**

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 x No ¨

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

Large Accelerated Filer ¨ Accelerated Filer ¨ Non-Accelerated Filer x

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

As of November 1, 2007, there were 146,835,307 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 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, 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 inherent in our spin-off from our former parent corporation, Verizon Communications Inc., which we refer to as Verizon, including increased costs and reduced profitability associated with operating as an independent company;
- risks related to borrowings made in connection with our spin-off;
- risks associated with our dependence on key agreements entered into with Verizon in connection with our spin-off;
- risks associated with our ability to replicate services provided to us by Verizon prior to our spin-off and currently under the transition services agreement;
- increased demands on our management team as a result of operating as an independent company;
- changes in our competitive position due to competition from other yellow pages publishers and search engines and/or our ability to anticipate or respond to changes in technology and user preferences;
- changes in the availability and cost of printing raw materials and third-party printers and distributors;
- changes in U.S. labor, business, political and/or economic conditions;
- changes in governmental regulations and policies and actions of regulatory bodies;
- changes in operating performance; and
- access to capital markets and changes in credit ratings.

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, 2006. 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 September 30, 2007	Three Months Ended September 30, 2006	Nine Months Ended September 30, 2007	Nine Months Ended September 30, 2006
	(in millions, except per share amounts)			
Operating Revenue				
Print products	**$ 721**	$ 743	**$ 2,189**	$ 2,241
Internet	**69**	60	**210**	167
Other	**1**	2	**3**	12
Total Operating Revenue	**791**	805	**2,402**	2,420
Operating Expense				
Selling	**164**	172	**546**	522
Cost of sales (exclusive of depreciation and amortization)	**143**	149	**464**	474
General and administrative	**104**	88	**294**	286
Depreciation and amortization	**22**	23	**66**	67
Total Operating Expense	**433**	432	**1,370**	1,349
Operating Income	**358**	373	**1,032**	1,071
Interest expense (income), net	**168**	(8)	**505**	(21)
Income Before Provision for Income Taxes	**190**	381	**527**	1,092
Provision for income taxes	**73**	136	**198**	412
Net Income	**$ 117**	$ 245	**$ 329**	$ 680
Basic and diluted earnings per common share	**$ .80**	$ 1.68	**$ 2.25**	$ 4.66
Basic and diluted weighted-average common shares outstanding	**146**	146	**146**	146
Dividends declared per common share	**$ .3425**	$	**$ 1.0275**	$

See Notes to Consolidated Financial Statements.

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Idearc Inc. and Subsidiaries

Consolidated Balance Sheets

(Unaudited)

	At September 30, 2007	At December 31, 2006
	(in millions)	
Assets		
Current assets:		
Cash and cash equivalents	**$ 316**	$ 172
Accounts receivable, net of allowances of $72 and $76	**407**	325
Deferred directory costs	**299**	294
Prepaid expenses and other	**7**	13
Total current assets	**1,029**	804
Property, plant and equipment	**465**	474
Less: accumulated depreciation	**347**	331
	118	143
Goodwill	**73**	73
Other intangible assets, net	**85**	103
Pension assets	**184**	174
Non-current deferred tax assets	**77**	21
Debt issuance costs	**89**	97
Other noncurrent assets	**3**	
Total assets	**$ 1,658**	$ 1,415
Liabilities and Stockholders Equity (Deficit)		
Current liabilities:		
Accounts payable and accrued liabilities	**$ 320**	$ 412
Deferred revenue	**191**	190
Current maturities of long-term debt	**48**	48
Current deferred taxes	**49**	5
Other	**30**	42
Total current liabilities	**638**	697
Long-term debt	**9,031**	9,067
Employee benefit obligations	**322**	401
Unrecognized tax benefits	**121**	
Other liabilities	**77**	4
Stockholders equity (deficit):		
Common stock ($.01 par value; 225 million shares authorized, 146,835,307 and 145,851,862 shares issued and outstanding in 2007 and 2006, respectively)	**1**	1
Additional paid-in capital (deficit)	**(8,777)**	(8,786)
Retained earnings	**311**	99
Accumulated other comprehensive loss	**(66)**	(68)
Total stockholders equity (deficit)	**(8,531)**	(8,754)
Total liabilities and stockholders equity (deficit)	**$ 1,658**	$ 1,415

See Notes to Consolidated Financial Statements.

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Idearc Inc. and Subsidiaries

Consolidated Statements of Cash Flows

(Unaudited)

	Nine Months Ended September 30, 2007	2006
	(in millions)	
Cash Flows from Operating Activities		
Net income	**$ 329**	$ 680
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization expense	**66**	67
Employee retirement benefits	**(4)**	33
Deferred income taxes	**(5)**	(12)
Provision for uncollectible accounts	**111**	101
Stock based compensation expense	**34**	24
Changes in current assets and liabilities		
Accounts receivable	**(193)**	(60)
Deferred directory costs	**(5)**	21
Other current assets	**1**	(2)
Accounts payable and accrued liabilities	**18**	(49)
Other, net	**(18)**	(9)
Net cash provided by operating activities	**334**	794
Cash Flows from Investing Activities		
Capital expenditures (including capitalized software)	**(31)**	(40)
Acquisitions	**(3)**	(16)
Proceeds from sale of assets	**26**	20
Other, net	**4**	16
Net cash used in investing activities	**(4)**	(20)
Cash Flows from Financing Activities		
Repayment of long-term debt	**(36)**	
Change in note receivable due from former parent		(132)
Dividends paid to Idearc stockholders	**(150)**	
Dividends / returns of capital paid to former parent		(642)
Net cash used in financing activities	**(186)**	(774)
Increase in cash and cash equivalents	**144**	
Cash and cash equivalents, beginning of year	**172**	
Cash and cash equivalents, end of period	**$ 316**	$

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, 2006. 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.

Recent Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard No. 157, *Fair Value Measurements* (SFAS No. 157), which defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. SFAS No. 157 applies to other accounting pronouncements that require or permit fair value measurements. The new guidance is effective for financial statements issued for fiscal years beginning after November 15, 2007, and for interim periods within those fiscal years. We are currently evaluating the potential impact of the adoption of SFAS No. 157 on our consolidated financial position, results of operations and cash flow.

Note 2

Change in Accounting Principle

During our second quarter ended June 30, 2007, we changed our accounting methodology associated with the recognition of sales commissions. Sales commissions were previously expensed as incurred. We are now deferring sales commissions to deferred directory costs and recognizing these costs over the life of the directory or advertising service, consistent with our revenue recognition policies on such products and services. We believe this method is preferable because it provides a better matching of sales commissions with the related revenues and is the policy followed by other companies in the industry. Additionally, this method is consistent with our accounting policy for other direct and incremental costs which include paper, printing and initial distribution costs.

We recorded the change in accounting principle in accordance with the Statement of Financial Accounting Standards No. 154, *Accounting Changes and Error Corrections* (SFAS No. 154). SFAS No. 154 requires that all elective accounting changes be made on a retrospective basis. As such, the accompanying unaudited financial statements and related notes have been adjusted to apply the impact of this accounting change retrospectively to all prior periods.

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The following table illustrates the effect of the accounting change on the Consolidated Statements of Income:

Increase (decrease)	Three Months Ended September 30, 2007	Three Months Ended September 30, 2006	Nine Months Ended September 30, 2007	Nine Months Ended September 30, 2006
	(in millions, except per share amounts)			
Selling expense	**$ 10**	$ 4	**$ 6**	$ (11)
Provision for income taxes	**(4)**	(1)	**(2)**	4
Net Income	**$ (6)**	$ (3)	**$ (4)**	$ 7
Basic and diluted earnings per share	**$ (.04)**	$ (.02)	**$ (.03)**	$ .05

The effect of the accounting change on the Consolidated Balance Sheet as of December 31, 2006 resulted in the deferral of sales commissions to deferred directory costs of $147 million with a related deferred tax liability of $55 million. The cumulative effect of the change in accounting principle on retained earnings as of December 31, 2006 was $92 million. The change in accounting did not have an impact on our cash flows from operating activities.

Note 3

Other Intangible Assets

Other intangible assets are as follows:

	At September 30, 2007	At December 31, 2006
	(in millions)	
Internal use software:		
Gross carrying amount	**$ 286**	$ 272
Less: Accumulated amortization	**202**	169
Net book value of software	**84**	103
Other	**1**	
Total other intangible assets	**$ 85**	$ 103

Internal use software is amortized over a three to seven-year period. Amortization expense was $35 million for both the nine months ended September 30, 2007 and 2006. This expense is estimated to be $11 million for the remainder of 2007, $35 million in 2008, $24 million in 2009, $9 million in 2010, $2 million in 2011 and $1 million in 2012 for the software capitalized at September 30, 2007.

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Note 4

Debt

Long-Term Debt

Outstanding long-term debt obligations are as follows:

	Interest Rates	Maturities	At September 30, 2007	At December 31, 2006
			(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	**4,714**	4,750
Total senior secured credit facilities			**6,229**	6,265
Senior unsecured notes	8.0%	2016	**2,850**	2,850
Total long-term debt, including current maturities			**9,079**	9,115
Less: current maturities of long-term debt			**(48)**	(48)
Long-term debt			**$ 9,031**	$ 9,067

Senior Secured Credit Facilities

As of September 30, 2007, Idearc had interest rate swap agreements with major financial institutions with notional amounts totaling $5,510 million. These swaps 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 swaps, 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 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 swaps comply with our debt covenant that requires that at least 50% of our debt be subject to fixed rates for a minimum of two years. 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. On a quarterly basis, the fair value of interest rate swaps is determined based on quoted market prices. The Company formally 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 other comprehensive income, a component of stockholders equity (deficit), until net income is affected by the variability of cash flows of the hedged transaction. Any hedge ineffectiveness is recorded in current-period net income.

The interest rate swaps described above, designated as cash flow hedges, were formally 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 recorded in other noncurrent liabilities in the amount of $74 million.

The senior secured credit facilities are guaranteed by substantially all of Idearc Inc. s subsidiaries 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 of Idearc Inc. s subsidiaries. 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 such secured indebtedness. Idearc Inc.

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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 meeting certain performance measures and complying with other conditions.

During the second quarter, Idearc Inc. completed an offer to exchange the outstanding senior unsecured notes, which were originally issued in a private placement pursuant to Rule 144A and Regulation S under the Securities Act of 1933, as amended (the Securities Act), for an equal principal amount of a new issue of senior unsecured notes registered under the Securities Act. The terms of the new registered notes are substantially similar to the terms of the unregistered notes.

Debt Maturities

As of September 30, 2007, we are in compliance with all of our debt covenants.

We made scheduled principal payments of $36 million in the first nine months of 2007. Scheduled principal payments of long-term debt outstanding at September 30, 2007 are $12 million for the remainder of 2007, $48 million in 2008, $123 million in 2009, $199 million in 2010, $275 million in 2011 and $8,422 million thereafter.

Note 5

Stock-Based Compensation

Effective November 16, 2006, the Company adopted the Idearc Inc. Long Term Incentive Plan (the Plan). The Plan permits the granting of cash and equity-based incentive compensation awards, including restricted stock, restricted stock units, performance shares, performance units, stock options, and other awards, such as stock appreciation rights and cash incentive awards, to employees and non-management directors. The maximum number of shares of Idearc common stock authorized for issuance under the Plan is 2.5 million.

During the first nine months of 2007, the Company granted awards under the Plan to employees and non-management directors. These awards are discussed below.

Restricted Stock Units

The Plan provides for grants of restricted stock units (RSUs) that can be settled in cash, shares of Idearc common stock or a combination thereof. These awards are classified as either liability or equity awards based on the criteria established by SFAS No. 123(R) *Share-Based Payment.*

On January 9, 2007, certain employees were granted awards of RSUs that will vest on the first anniversary of the grant date. The value of each RSU is equal to the value of one share of Idearc common stock. The RSUs will be settled in cash based on the closing price of Idearc common stock on the vesting date. This award is classified as a liability award because it will be settled in cash. The Company s liability for this award is measured at its fair value at the end of each reporting period and, therefore, will fluctuate based on the performance of Idearc common stock. No dividends are payable on RSUs. However, dividend equivalents, equal to the amount of the dividend that would have been paid on an equivalent number of shares of Idearc common stock, will be granted in the form of additional RSUs. The dividend equivalent RSUs will be subject to the same vesting, forfeiture and other terms and conditions applicable to the RSUs. A portion of the cost related to this RSU liability award is included in the Company s compensation expense for the nine months ended September 30, 2007.

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Changes in the Company s RSU liability awards outstanding for the nine months ended September 30, 2007 were as follows:

	Restricted Stock Units (in thousands)	Weighted Average Fair Value
Nonvested RSUs at beginning of period		$
Granted	608	31.47
Dividend equivalents	19	31.47
Payments	(17)	32.96
Forfeitures	(71)	31.47
Nonvested RSUs at end of period	539	$ 31.47

Restricted Stock

The Plan provides for grants of restricted stock. These awards are classified as equity awards based on the criteria established by SFAS No. 123(R) *Share-Based Payment*.

On January 9, 2007, certain employees were granted awards of restricted stock that will vest in three equal annual installments over a three year period beginning on the grant date. No dividends are payable on unvested shares of restricted stock. However, dividend equivalents, equal to the amount of the dividend that would have been paid on the unvested shares as if they were vested, will be granted in the form of additional RSUs. Each dividend equivalent RSU will be settled with one share of Idearc common stock and will be subject to the same vesting, forfeiture and other terms and conditions applicable to the corresponding unvested shares of restricted stock.

On February 13, 2007, our non-management directors were granted two awards of restricted stock: a one-year award that will vest on the first anniversary of the grant date, and a three-year award that will vest on the third anniversary of the grant date. No dividends are payable on unvested shares of restricted stock. However, dividend equivalents, equal to the amount of the dividend that would have been paid on the unvested shares as if they were vested, will be credited to each non-management director and will be settled in cash. The dividend equivalents will be subject to the same vesting, forfeiture and other terms and conditions applicable to the corresponding unvested share of restricted stock.

A portion of the cost related to these restricted stock equity awards is included in the Company s compensation expense for the nine months ended September 30, 2007.

Changes in the Company s restricted stock awards outstanding for the nine months ended September 30, 2007 were as follows:

	Number of Restricted Stock Awards (in thousands)	Weighted Average Grant-Date Fair Value
Nonvested restricted stock at beginning of period		$
Granted	1,029	29.59
Dividend equivalent units	29	n/a
Vested		
Forfeitures	(45)	29.32
Nonvested restricted stock at end of period	1,013	$ 29.59

Performance Units

The Plan provides for grants of performance units that can be settled in cash, shares of Idearc common stock, or a combination thereof. These awards are classified as either liability or equity awards based on the criteria established by SFAS No. 123(R) *Share-Based Payment*.

On February 15, 2007, certain employees were granted a target number of performance units pursuant to the Company s 2007 long-term incentive compensation program. The target number of performance units may be increased (to a maximum of 150% of the target) or decreased (to zero) based on the Company s total stockholder return (TSR) relative to the TSR of a market benchmark over a three-year measurement period beginning on

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January 1, 2007 and ending on December 31, 2009 (the LTI Measurement Period). Each performance unit will be settled in cash upon vesting in an amount equal to the closing price of Idearc common stock on the last trading day in the LTI Measurement Period.

No dividends are payable on performance units. However, dividend equivalents, equal to the amount of the dividend that would have been paid on an equivalent number of shares of Idearc common stock, will be granted in the form of additional performance units. The dividend equivalent performance units will be subject to the same vesting, forfeiture and other terms and conditions applicable to the performance units.

This award is classified as a liability award because it will be settled in cash upon vesting. All payments are subject to approval by the Human Resources Committee of the Company s Board of Directors. The performance unit award liability is measured at its fair value at the end of each reporting period and will fluctuate based on the performance of Idearc common stock and Idearc s TSR relative to the TSR of the market benchmark. A portion of the cost related to this performance unit liability is included in the Company s stock-based compensation expense for the nine months ended September 30, 2007.

Changes in the Company s performance units outstanding for the nine months ended September 30, 2007 were as follows:

	Performance Units (in thousands)	**Weighted Average Fair Value**
Outstanding performance units at beginning of period		$
Granted	573	31.47
Dividend equivalents	17	31.47
Payments		
Forfeitures	(24)	31.47
Outstanding performance units at end of period	566	$ 31.47

The pre-tax compensation expense recognized for the three and nine months ended September 30, 2007 related to incentive compensation awards was $6 million and $34 million, respectively. For the three and nine months ended September 30, 2006, pre-tax compensation expense related to incentive compensation awards was $9 million and $24 million, respectively. The pre-tax compensation expense for the three and nine months ended September 30, 2006 relates to incentive compensation awards granted by Verizon.

As of September 30, 2007, unrecognized compensation expense related to the unvested portion of the Company s RSUs, restricted stock and performance units was approximately $31 million and is expected to be recognized over a weighted-average period of approximately two years.

Note 6

Pension and Other Postretirement Benefit Costs

We maintain noncontributory defined benefit pension plans for the majority of our employees. In addition, we maintain postretirement 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.

In the third quarter of 2007, we obtained updated actuarial calculations of our pension and postretirement health care and life insurance plans, which were based on actuarial assumptions and updated demographic data for Idearc on a stand-alone basis. These updated actuarial calculations did not have a significant impact to our pension assets or pension expense. For our post retirement health care liabilities, the actuarial calculations included the impact of capping retiree medical premiums for our bargained-for employees, which is contractually required beginning in 2009, and resulted in a $12 million reduction in our health care and life expenses for the nine months ended September 30, 2007 and a reduction in our retirement health care and life liability of approximately $91 million.

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During the nine months ended September 30, 2007, our lump sum pension distributions to separated and retired employees exceeded the expected annual sum of pension service and interest costs. Accordingly, under the provisions of Statement of Financial Accounting Standards No. 88, *Employers Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits,* we recorded a $7 million settlement gain in the third quarter of 2007, which represents a pro-rata recognition of the unrecognized gains associated with the separated and retired employees.

Net Periodic Cost

The following tables summarize the benefit costs related to the Company s pension and postretirement health care and life insurance plans for the three and nine months ended September 30, 2007.

	Pension		Health Care and Life	
September 30, 2007	**Three Months Ended**	**Nine Months Ended**	**Three Months Ended**	**Nine Months Ended**
		(in millions)		
Service cost	$ 1	$ 5	$ (1)	$ 2
Interest cost	8	26	1	13
Expected return on plan assets	(14)	(44)		
Amortization of prior service costs	1	1	(5)	(4)
Actuarial loss, net			2	4
Settlement (gain)	(7)	(7)		
Net periodic benefit (income) cost	$ (11)	$ (19)	$ (3)	$ 15

The net periodic costs for the three and nine months ended September 30, 2006 were a credit of $2 million and expense of $10 million for pension, respectively, and included a $4 million settlement gain in the third quarter, and $7 million and $23 million for health care and life insurance plans, respectively. Prior to our spin-off on November 17, 2006, we participated in Verizon s benefit plans. The structure of Verizon s benefit plans did not provide for the separate determination of certain disclosures for our Company for the periods prior to the spin date.

Note 7

Employee Benefits

Savings Plans

We sponsor defined contribution savings plans to provide opportunities for eligible employees to save for retirement on a tax-deferred basis. Substantially all of our employees are eligible to participate in these plans. Effective with the spin-off on November 17, 2006, Idearc established three defined contribution plans for the benefit of Idearc employees. These plans are substantially similar to the Verizon savings plans. Under the Company s savings plans, a certain percentage of eligible employee contributions are matched with Company cash allocated to the employees current investment elections. We recognize savings plan expenses based on our matching obligation attributable to our participating employees. For the three and nine months ended September 30, 2007, we recorded total savings plan expenses of $7 million and $22 million, respectively. For the three and nine months ended September 30, 2006, we recorded total savings plan expenses of $6 million and $16 million, respectively.

Severance Benefits

During the three and nine months ended September 30, 2007, we paid severance benefits of $1 million and $9 million, respectively.

Note 8

Comprehensive Income

Comprehensive income consists of net income and other gains and losses affecting stockholders equity that, under accounting principles generally accepted in the United States, are excluded from net income.

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The difference between net income and comprehensive income for each of the periods were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
	(in millions)			
Net income	**$ 117**	$ 245	**$ 329**	$ 680
Other comprehensive income, net of taxes				
Pension and postretirement plans	**47**		**50**	
Unrealized losses on cash flow hedges	**(72)**		**(48)**	
Total comprehensive income	**$ 92**	$ 245	**$ 331**	$ 680

The table below provides the balances of accumulated other comprehensive loss at September 30, 2007 and December 31, 2006:

	At September 30, 2007	At December 31, 2006
	(in millions)	
Pension and postretirement plans	**$ (18)**	$ (68)
Unrealized losses on cash flow hedges	**(48)**	
Accumulated other comprehensive loss	**$ (66)**	$ (68)

Note 9

Income Taxes

Idearc Inc. and its subsidiaries file income tax returns in the U.S. federal and various state jurisdictions. With few exceptions, we are no longer subject to U.S. federal and state and local examinations by tax authorities for years before 2000.

Effective January 1, 2007, we adopted the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes,* an interpretation of SFAS No. 109, *Accounting for Income Taxes* (FIN 48). FIN 48 clarifies the accounting for income taxes by prescribing a minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition.

As a result of the implementation of FIN 48, we recognized a $33 million decrease in the liability for unrecognized tax benefits, which was accounted for as an increase in the balance of retained earnings as of January 1, 2007.

The total amount of unrecognized tax benefits (including interest accruals) as of the date of adoption on January 1, 2007 is $108 million. Included in the balance at January 1, 2007 are $95 million of tax positions that, if recognized, would affect the effective tax rate. Also, included in the balance at January 1, 2007 are $13 million of tax positions for which the ultimate deductibility is highly certain but for which there is uncertainty about the timing of such deductibility. Because of the impact of the deferred tax accounting, other than interest and penalties, the disallowance of the shorter deductibility period would not affect the annual effective tax rate but would accelerate the payment of cash to the taxing authority to an earlier period.

The Company classifies and recognizes interest and penalties accrued related to unrecognized tax benefits in income tax expense. During the tax years ended December 31, 2006, 2005, and 2004, we recognized approximately $6 million, $3 million, and $1 million in interest, respectively. The Company had $13 million and $7 million of accrued interest at December 31, 2006, and 2005, respectively.

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The Company does not anticipate that the total amount of unrecognized tax benefits will significantly increase or decrease during the year ended December 31, 2007.

Income taxes for the nine months ended September 30, 2007 and 2006 have been included in the accompanying financial statements on the basis of an estimated annual effective tax rate. In determining the estimated annual effective tax rate, the Company included interest expense, but excluded the tax effect of one-time discrete items. The Company anticipates the effective tax rate, before adjusting for discrete items, to approximate 39.0% for 2007. The full year effective tax rate for 2006 was 38.9%.

Note 10

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 potentially dilutive common shares that were outstanding during the reporting period. As of September 30, 2007, there were approximately one million shares of unvested stock-based incentive awards outstanding. Using the treasury stock method, there were no material dilutive impacts associated with these awards for the three months or nine months ended September 30, 2007.

For periods prior to November 17, 2006, basic and diluted earnings per share are computed using the number of shares of Idearc common stock outstanding on November 17, 2006, the date on which the Idearc common stock was distributed by Verizon to its stockholders.

The following table illustrates the calculation of basic and diluted earnings per share for the three months ended and the nine months ended September 30, 2007 and 2006:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	**2006**	**2007**	**2006**
	(in millions, except per share amounts)			
Income available to common stockholders	**$ 117**	$ 245	**$ 329**	$ 680
Weighted-average common shares outstanding	**146**	146	**146**	146
Basic and diluted earnings per share	**$ .80**	$ 1.68	**$ 2.25**	$ 4.66

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Note 11

Additional Financial Information

The following table provides additional financial information related to our consolidated balance sheets:

	At September 30, 2007	At December 31, 2006
	(in millions)	
Accounts Payable and Accrued Liabilities		
Accounts payable	**$ 24**	$ 38
Accrued expenses	**77**	86
Accrued compensation	**107**	99
Accrued taxes	**23**	143
Accrued interest	**89**	46
	$ 320	$ 412

Note 12

Litigation

The Company is subject to various lawsuits and other claims in the normal course of business. In addition, from time to time, we receive communications from government or regulatory agencies concerning investigations or allegations of noncompliance with laws or regulations in jurisdictions in which we operate.

We establish reserves for specific liabilities in connection with regulatory and legal actions that we deem to be probable and estimable. No material amounts have been accrued in our financial statements with respect to any matters. In other instances, including the matters described below, we are not able to make a reasonable estimate of any liability because of the uncertainties related to the outcome and/or the amount or range of loss. We do not expect that the ultimate resolution of pending regulatory and legal matters in future periods, including the matters described below, will have a material effect on our financial condition or results of operations.

We are currently subject to a class action lawsuit from current and former sales representatives located in California. The plaintiffs in this case in which the class has been certified, claim that we reduced their incentive pay through offsets for cancellations, non-renewals and credits on customer accounts and shifted a general business risk of loss to our sales representatives through the assignment of accounts which we allegedly knew would not renew their purchases, or would renew them at a lower level. The plaintiffs seek amounts they allege were unlawfully deducted from their wages, civil penalties, interest, attorneys fees and costs. The ultimate outcome of this case is not determinable.

We are subject to a similar purported class action lawsuit from current and former sales representatives located in New York, Pennsylvania and New Jersey. The plaintiffs in this case allege claims similar to those described above in the California case regarding alleged reductions in incentive pay. The plaintiffs also have filed a Fair Labor Standards Act (FLSA) collective action seeking amounts for overtime they allege they worked for which they were not paid. On October 27, 2006, we filed a motion to dismiss all claims alleged in this case other than the FLSA overtime claims. On March 12, 2007, the plaintiffs in this case filed a motion for conditional certification of the FLSA overtime claims as an FLSA collective action. On June 11, 2007, the court granted conditional certification of the FLSA collective action. On July 25, 2007, the court granted our motion to dismiss all claims alleged in this case other than the FLSA overtime claims. The ultimate outcome of this case is not determinable.

In October 2007, the Company received a proposed assessment of approximately $28 million from the State of New York related to sales and use tax on printing and mailing charges. The proposed assessment relates to the audit period March 1998 through May 2005. The Company currently intends to dispute the proposed assessment. The ultimate outcome of this matter is not determinable.

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Note 13

Completion of Asset Acquisition

On September 15, 2007, the Company entered into a definitive agreement to purchase Switchboard.com and other online directory assets from InfoSpace, Inc. for $225 million, subject to certain adjustments as provided in the agreement. The acquisition was completed on October 31, 2007. The Company funded the acquisition using cash on hand.

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations.
Overview

We are a multi-platform media company that connects buyers with sellers, making consumers better shoppers and businesses more successful. Our multi-platform product portfolio strongly positions us in our market space. We are the second largest yellow pages directories publisher in the United States as measured by revenues, and we believe that we have the nation s leading Internet yellow pages directory. Our products include print yellow pages, print white pages, Superpages.com®, our Internet yellow pages directory, and an information directory for wireless subscribers, Superpages Mobile℠. We are the exclusive official publisher of Verizon print directories in the markets in which Verizon is currently the incumbent local exchange carrier, which we refer to as our incumbent markets. We use the Verizon brand on our print directories in our incumbent markets, as well as in our current markets in which Verizon is not the incumbent, which we refer to as our independent markets.

Basis of Presentation

The financial statements are prepared using accounting principles generally accepted in the United States (U.S. GAAP). These principles require management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities and the reported amounts of revenues and expenses. Actual results could differ from those estimates and assumptions. Examples of significant estimates include the allowance for doubtful accounts, the recoverability of property, plant and equipment, goodwill and other intangible assets, valuation allowances on tax assets and liabilities, and pension and postretirement benefit assumptions. See Critical Accounting Policies for a summary of the critical accounting policies used in preparing our financial statements.

The following discussion and analysis of our financial condition and results of operations covers a period prior to the consummation of our spin-off from Verizon and related transactions. Accordingly, the discussion and analysis of this historical period does not reflect the ongoing effects of the spin-off, including significantly increased leverage and debt service requirements.

Until the date of the spin-off on November 17, 2006, we operated the print and Internet yellow pages directories businesses of Verizon and not as a stand-alone company. For the period prior to November 17, 2006, the financial statements included herein have been derived from the historical financial statements of Verizon, and include the assets, liabilities, businesses and employees that were primarily related to Verizon s domestic print and Internet yellow pages directories publishing operations that were reported in Verizon s Information Services segment in its financial statements. To prepare these financial statements, we specifically identified all assets, liabilities, businesses and employees primarily related to those operations. All significant intercompany accounts and transactions have been eliminated. We believe these specific identifications are reasonable; however, the resulting amounts could differ from amounts that would be determined if we had operated on a stand-alone basis. Because of our relationship with Verizon, our historical results of operations, financial position and cash flows are not necessarily indicative of what they would have been had we operated without the shared resources of Verizon. Accordingly, our financial statements for the period prior to November 17, 2006, are not necessarily indicative of our future results of operations, financial position and cash flows. See our financial statements and related notes thereto included in Item 1. Financial Statements of this report.

Historically, we reimbursed Verizon for specific goods and services it provided to, or arranged for us, based on tariffed rates, market prices or negotiated terms that approximated market rates. These goods and services included items such as communications and data processing services, office space, professional fees and insurance coverage.

We also reimbursed Verizon for our share of costs incurred by Verizon to provide services on a common basis to all of its subsidiaries. These costs included allocations for legal, security, treasury, tax and audit services. The allocations were based on actual costs incurred by Verizon and periodic studies that identified employees, or groups of employees, who were totally or partially dedicated to performing activities that benefited us. In addition, we reimbursed Verizon for general corporate costs that indirectly benefited us, including costs for activities such as investor relations, financial planning, marketing services and benefits administration. These allocations were based on actual costs incurred by Verizon, as well as on our size relative to other Verizon subsidiaries. We believe that these cost allocations were reasonable for the services provided. We also believe that these cost allocations were consistent with the nature and approximate amount of the costs that we would have incurred on a stand-alone basis.

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The costs we incur as a stand-alone company include payment for services provided by Verizon under a transition services agreement, which became effective at the consummation of the spin-off. Under the transition services agreement, Verizon continues to provide certain services that it has historically provided to us, including portions of information technology, financial services and human resources for an interim period. During the period of the transition services agreement, we incur one-time costs for transition activities and may incur some duplicative expenses as we start up certain stand-alone functions. We fund these costs from available cash. Following the full implementation of our stand-alone functions and the termination of the transition services agreement, we expect costs for the stand-alone services to be similar to our historical costs. However, there can be no assurance that our costs will not exceed our historical cost allocations for similar services.

Results of Operations

Three Months Ended September 30, 2007 Compared to Three Months Ended September 30, 2006

The following table sets forth our operating results for the three month periods ended September 30, 2007 and 2006:

Three months ended September 30,	**2007**	**2006**	**Change**	**% Change**
		(in millions, except %)		
Operating Revenue				
Print products	$ 721	$ 743	$ (22)	(3.0)%
Internet	69	60	9	15.0
Other	1	2	(1)	(50.0)
Total operating revenue	791	805	(14)	(1.7)
Operating Expense				
Selling	164	172	(8)	(4.7)
Cost of sales (exclusive of depreciation and amortization)	143	149	(6)	(4.0)
General and administrative	104	88	16	18.2
Depreciation and amortization	22	23	(1)	(4.3)
Total operating expense	433	432	1	0.2
Operating income	358	373	(15)	(4.0)
Interest expense (income), net	168	(8)	176	nm
Income before provision for income taxes	190	381	(191)	(50.1)
Provision for income taxes	73	136	(63)	(46.3)
Net income	$ 117	$ 245	$ (128)	(52.2)%

Operating Revenue

Operating revenue of $791 million for the three months ended September 30, 2007 decreased $14 million, or 1.7%, compared to $805 million for the three months ended September 30, 2006 for the reasons described below.

Print Products. Revenue from print products of $721 million for the three months ended September 30, 2007 decreased $22 million, or 3.0%, compared to $743 million for the three months ended September 30, 2006. This decline resulted from reduced advertiser renewals, partially offset by the addition of new advertisers, increases in advertiser spending and revenue from new product offerings.

Internet. Internet revenue of $69 million for the three months ended September 30, 2007 increased $9 million, or 15.0%, compared to $60 million for the three months ended September 30, 2006, as we continued to expand our product offerings, market reach and advertiser base. Internet growth of 15.0% continues to show positive signs, as a result of the continued introduction of performance-based advertising products and the benefits of the 2006 Inceptor asset acquisition. Third quarter Internet revenue was disproportionately affected by a $4 million adjustment related to operational issues at one of our reseller channels, which we do not believe constitutes a continuing trend.

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Operating Expense

Operating expense of $433 million for the three months ended September 30, 2007 increased $1 million, or 0.2%, compared to $432 million for the three months ended September 30, 2006 for the reasons described below.

Selling. Selling expense of $164 million for the three months ended September 30, 2007 decreased $8 million, or 4.7%, compared to $172 million for the three months ended September 30, 2006. This decrease resulted primarily from lower employee benefit and advertising costs, partially offset by higher sales commissions.

Cost of Sales. Cost of sales of $143 million for the three months ended September 30, 2007 decreased $6 million, or 4.0%, compared to $149 million for the three months ended September 30, 2006. This decrease was primarily due to reduced employee related costs and employee benefits, partially offset by higher printing and distribution costs and Internet traffic costs associated with Superpages.com.

General and Administrative. General and administrative expense of $104 million for the three months ended September 30, 2007 increased $16 million, or 18.2%, compared to $88 million for the three months ended September 30, 2006. The increase is primarily related to increased bad debt expense, non-recurring separation costs related to the spin-off and contractor costs, partially offset by a decrease in general and administrative charges billed to us from our former parent during 2006, employee related costs, employee benefit costs, stock compensation expense, and a gain on the sale of a building.

Interest Expense (Income), Net

Interest expense, net of interest income, of $168 million increased $176 million compared to interest income, net, of $8 million for the three months ended September 30, 2006 as a result of issuing debt of $9,115 million in connection with our spin-off from our former parent.

Provision for Income Taxes

Provision for income taxes of $73 million for the three months ended September 30, 2007 decreased $63 million, or 46.3%, compared to $136 million for the three months ended September 30, 2006, primarily due to lower pretax income. The effective tax rates for the three months ended September 30, 2007 and 2006 were 38.4% and 35.7%, respectively. The difference in the effective tax rate is primarily due to favorable federal income tax deductions reported in the third quarter of 2006.

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Nine Months Ended September 30, 2007 Compared to Nine Months Ended September 30, 2006

The following table sets forth our operating results for the nine month periods ended September 30, 2007 and 2006:

Nine Months Ended September 30,	2007	2006	Change	% Change
	(in millions, except %)			
Operating Revenue				
Print products	$ 2,189	$ 2,241	$ (52)	(2.3)%
Internet	210	167	43	25.7
Other	3	12	(9)	(75.0)
Total operating revenue	2,402	2,420	(18)	(0.7)
Operating Expense				
Selling	546	522	24	4.6
Cost of sales (exclusive of depreciation and amortization)	464	474	(10)	(2.1)
General and administrative	294	286	8	2.8
Depreciation and amortization	66	67	(1)	(1.5)
Total operating expense	1,370	1,349	21	1.6
Operating income	1,032	1,071	(39)	(3.6)
Interest expense (income), net	505	(21)	526	nm
Income before provision for income taxes	527	1,092	(565)	(51.7)
Provision for income taxes	198	412	(214)	(51.9)
Net income	$ 329	$ 680	$ (351)	(51.6)%

Operating Revenue

Operating revenue of $2,402 million for the nine months ended September 30, 2007 decreased $18 million, or 0.7%, compared to $2,420 million for the nine months ended September 30, 2006 for the reasons described below.

Print Products. Revenue from print products of $2,189 million for the nine months ended September 30, 2007 decreased $52 million, or 2.3%, compared to $2,241 million for the nine months ended September, 2006. This decline resulted from reduced advertiser renewals, partially offset by the addition of new advertisers, increases in advertiser spending and revenue from new product offerings.

Internet. Internet revenue of $210 million for the nine months ended September 30, 2007 increased $43 million, or 25.7%, compared to $167 million for the nine months ended September 30, 2006, as we continued to expand our product offerings, market reach and advertiser base. There was a significant improvement in growth rate, 25.7% for the nine months ended September 30, 2007 as compared to 13.6% for the nine months ended September 30, 2006, resulting from the introduction of performance-based advertising products and the benefits of the 2006 Inceptor asset acquisition.

Other Revenue. Other revenue of $3 million for the nine months ended September 30, 2007 decreased $9 million, or 75.0%, compared to $12 million for the nine months ended September 30, 2006. This decrease is primarily due to the elimination of commercial printing services revenue, which was $7 million in the first three months of 2006. We sold our printing assets in February 2006.

Operating Expense

Operating expense of $1,370 million for the nine months ended September 30, 2007 increased $21 million, or 1.6%, compared to $1,349 million for the nine months ended September 30, 2006 for the reasons described below.

Selling. Selling expense of $546 million for the nine months ended September 30, 2007 increased $24 million, or 4.6%, compared to $522 million for the nine months ended September 30, 2006. This increase resulted primarily from higher employee-related costs associated with hiring additional sales force employees, higher sales commission costs and increased advertising, partially offset by lower employee benefit costs.

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Cost of Sales. Cost of sales of $464 million for the nine months ended September 30, 2007 decreased $10 million, or 2.1%, compared to $474 million for the nine months ended September 30, 2006. This decrease was primarily due to reduced employee related costs and employee benefit costs, partially offset by higher printing and distribution costs and Internet traffic costs associated with Superpages.com.

General and Administrative. General and administrative expense of $294 million for the nine months ended September 30, 2007 increased $8 million, or 2.8%, compared to $286 million for the nine months ended September 30, 2006. The increase is primarily related to increased bad debt expense, stock compensation expense, contractor costs and non-recurring separation costs related to the spin-off, partially offset by lower employee related costs, employee benefit costs, a gain on the sale of a building and lower general and administrative costs billed to us by our former parent.

Interest Expense (Income), Net

Interest expense, net of interest income, for the nine months ended September 30, 2007 was $505 million, an increase of $526 million compared to interest income, net, of $21 million for the nine months ended September 30, 2006. The increase was a result of issuing debt of $9,115 million in connection with our spin-off from our former parent.

Provision for Income Taxes

Provision for income taxes for the nine months ended September 30, 2007 of $198 million decreased $214 million, or 51.9%, compared to $412 million for the nine months ended September 30, 2006, primarily due to lower pretax income. The effective tax rates for the nine months ended September 20, 2007 and 2006 were 37.6% and 37.7%, respectively.

Income taxes for the nine months ended September 30, 2007 and 2006 have been included in the accompanying financial statements on the basis of an estimated annual effective tax rate. In determining the estimated annual effective tax rate, the Company included interest expense, but excluded the tax effect of one-time discrete items. The Company anticipates the effective tax rate, before adjusting for discrete items, to approximate 39.0% for 2007. The full year effective tax rate for 2006 was 38.9%.

Liquidity and Capital Resources

The following table sets forth a summary of cash flows for the nine month periods ended September 30, 2007 and 2006:

Nine months ended September 30,	**2007**	**2006**	**Change**
		(in millions)	
Cash Flows Provided By (Used In):			
Operating activities	$ 334	$ 794	$ (460)
Investing activities	(4)	(20)	16
Financing activities	(186)	(774)	588
Increase In Cash and Cash Equivalents	$ 144	$	$ 144

Our primary source of funds continues to be cash generated from operations. Net cash provided by operating activities of $334 million for the nine months ended September 30, 2007 decreased $460 million, compared to $794 million for the nine months ended September 30, 2006, primarily due to interest payments on debt incurred and separation costs associated with our spin-off from our former parent and an anticipated one-time increase in accounts receivable resulting from our decision to shift billing from Verizon to our own direct billing platform. In the past, amounts billed and collected by Verizon were received well in advance of normal customer payment experience. Now that we are direct billing all customers, the new higher account receivable balance represents actual customer collection experience. These unfavorable items are partially offset by lower income tax payments and other working capital items.

Net cash used in investing activities of $4 million for the nine months ended September 30, 2007 decreased $16 million, compared to $20 million of net cash used in investing activities for the nine months ended September 30, 2006. The decrease is due to lower capital expenditures, the Inceptor asset acquisition in 2006 and proceeds from the sales of assets, partially offset by lower amounts received from short term investments. Our short term investments include principally cash equivalents held in trust accounts for the payment of employee benefits.

Net cash used in financing activities of $186 million for the nine months ended September 30, 2007 decreased $588 million, or 76.0%, as compared to $774 million in the nine months ended September 30, 2006. In the nine months ended September 30, 2007, we paid dividends of $150 million to Idearc stockholders compared to a dividend/return of capital paid to our former parent in 2006 of $642 million. Additionally, in 2006 we had a $132 million increase in our note receivable with our former parent. This increase was offset by $36 million in principal payments in 2007 on our secured credit facilities. As a result of these principal payments, our outstanding long-term debt, including current maturities, was reduced from $9,115 million at December 31, 2006 to $9,079 million at September 30, 2007. For additional information related to long-term debt, see Note 4 to our unaudited financial statements included in this report.

On October 31, 2007, the Company completed the $225 million acquisition of Switchboard.com and other online directory assets from InfoSpace, Inc. The Company funded the acquisition using cash on hand.

We believe the net cash provided by our operating activities, supplemented as necessary with borrowings under our credit facility, and existing cash and cash equivalents will provide sufficient resources to meet our working capital requirements, estimated principal and interest debt service requirements and other cash needs for the remainder of 2007. We may borrow additional funds or issue debt or equity securities, subject to the limitations in our existing debt instruments, in the event we wish to pursue additional acquisition opportunities.

Critical Accounting Policies

A summary of the critical accounting policies used in preparing our financial statements is as follows:

Revenue Recognition

We earn revenues primarily from print and Internet yellow pages directory advertising. The sale of advertising in print directories is our primary source of revenues. We recognize revenues ratably over the life of each directory using the amortization method of accounting, with revenue recognition commencing in the month of publication. Our Internet yellow pages directory, Superpages.com, earns revenues from two sources: fixed-fee and performance-based advertising products. Fixed-fee advertising includes advertisement placement on our Superpages.com site and web site development and hosting for our advertisers. Revenues from fixed-fee advertisers are recognized monthly over the life of the advertising service. Performance-based advertising products revenues are earned when consumers connect with our Superpages.com advertisers by a click on their Internet advertising or a phone call to their businesses. We exclude non-qualifying clicks through proprietary technology. Performance-based advertising products revenues are recognized when there is evidence that qualifying transactions have occurred.

Expense Recognition

Certain direct costs related to sales and directory production are amortized over the average life of the product under the deferral and amortization method. Direct costs include paper, printing, initial distribution and sales commissions. Paper costs are stated on an average cost basis. All other costs are recognized as incurred.

During our second quarter ended June 30, 2007, we changed our accounting methodology associated with the recognition of sales commissions. Sales commissions were previously expensed as incurred. We are now deferring sales commissions to deferred directory costs and recognizing these costs over the life of the directory or advertising service, consistent with our revenue recognition policies on such products and services. We believe this method is preferable because it provides a better matching of sales commissions with the related revenues and is the policy followed by other companies in the industry. Additionally, this method is consistent with our accounting policy for other direct and incremental costs, which include paper, printing and initial distribution costs. We recorded the change in accounting principle in accordance with Statement of Financial Accounting Standards No. 154, *Accounting Changes and Error Corrections* (SFAS No. 154). SFAS No. 154 requires that all elective accounting changes be made on a retrospective basis. As such, the unaudited financial statements and related notes

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included in this report have been adjusted to apply the impact of this accounting change retrospectively to all prior periods. For additional information related to the change in accounting principle, see Note 2 to our unaudited financial statements included in this report.

Accounts Receivable

Accounts receivable is recorded net of an allowance for doubtful accounts. The allowance for doubtful accounts is calculated using a percentage of sales method based upon collection history and an estimate of uncollectible accounts. Management may exercise its judgment in adjusting the provision as a consequence of known items, including current economic factors and credit trends. Accounts receivable adjustments are recorded against the allowance for doubtful accounts. Bad debt expense as a percentage of revenue was 4.6% and 4.2% for the nine months ended September 30, 2007 and 2006, respectively.

Income Taxes

We account for income taxes in accordance with SFAS 109, *Accounting for Income Taxes* and of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes,* an interpretation of SFAS No. 109, *Accounting for Income Taxes* (FIN 48). Deferred tax assets or liabilities are recorded to reflect the future tax consequences of temporary differences between the financial reporting basis of assets and liabilities and their tax basis at each year-end. These amounts are adjusted, as appropriate, to reflect enacted changes in tax rates expected to be in effect when the temporary differences reverse. We have been included in Verizon s consolidated federal and state income tax returns prior to the spin-off and will file stand-alone returns for subsequent periods. However, the provision for income taxes in our consolidated financial statements has been determined as if we had filed our own consolidated income tax returns separate and apart from Verizon.

In the ordinary course of business, there may be many transactions and calculations where the ultimate tax outcome is uncertain. The determination of tax liabilities for unrecognized tax benefits involves dealing with uncertainties in the application of complex tax laws. Our tax liabilities are based on an estimate of the ultimate resolution of whether, and the extent to which, the tax benefit will be realized. Although we believe the estimates are reasonable, no assurance can be given that the final outcome of these matters will not be different than what is reflected in the historical income tax provisions and accruals.

As part of our estimation process, we must assess the likelihood that our deferred tax assets can be recovered. If recovery is not likely, the provision for taxes must be increased by recording a reserve in the form of a valuation allowance for the deferred tax assets that are estimated not to be ultimately recoverable. In this process, certain relevant criteria are evaluated including the existence of deferred tax liabilities that can be used to absorb deferred tax assets and taxable income in future years. Our judgment regarding future taxable income may change due to future market conditions, changes in U.S. tax laws and other factors. These changes, if any, may require material adjustments to these deferred tax assets and an accompanying reduction or increase in net income in the period when such determinations are made.

Idearc Inc. and its subsidiaries file income tax returns in the U.S. federal, and various state jurisdictions. With few exceptions, we are no longer subject to U.S. federal and state and local examinations by tax authorities for years before 2000.

Effective January 1, 2007, we adopted the provisions of FIN 48. FIN 48 clarifies the accounting for income taxes by prescribing a minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition.

As a result of the implementation of FIN 48, we recognized a $33 million decrease in the liability for unrecognized tax benefits, which was accounted for as an increase in the balance of retained earnings as of January 1, 2007.

The total amount of unrecognized tax benefits (including interest accruals) as of the date of adoption on January 1, 2007 is $108 million. Included in the balance at January 1, 2007 are $95 million of tax positions that, if recognized, would affect the effective tax rate. Also, included in the balance at January 1, 2007 are $13 million of tax positions for which the ultimate deductibility is highly certain but for which there is uncertainty about the timing of such deductibility. Because of the impact of the deferred tax accounting, other than interest and penalties, the disallowance of the shorter deductibility period would not affect the annual effective tax rate but would accelerate the payment of cash to the taxing authority to an earlier period.

The Company classifies and recognizes interest and penalties accrued related to unrecognized tax benefits in income tax expense. During the tax years ended December 31, 2006, 2005 and 2004, we recognized approximately $6 million, $3 million, and $1 million in interest, respectively. The Company had $13 million and $7 million of accrued interest at December 31, 2006 and 2005, respectively.

The Company does not anticipate that the total amount of unrecognized tax benefits will significantly increase or decrease during the year ending December 31, 2007.

Income taxes for the nine months ended September 30, 2007 and 2006 have been included in the accompanying financial statements on the basis of an estimated annual effective tax rate. In determining the estimated annual effective tax rate, the Company included interest expense, but excluded the tax effect of one-time discrete items. The Company anticipates the effective tax rate, before adjusting for discrete items, to approximate 39.0% for 2007. The full year effective tax rate for 2006 was 38.9%.

Off Balance Sheet Arrangements

We do not have any off-balance sheet arrangements that are material to our results of operations, financial condition or liquidity.

Recent Accounting Pronouncements

In September 2006, the FASB issued Statement of Financial Accounting Standard No. 157, *Fair Value Measurements* (SFAS No. 157), which defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. SFAS No. 157 applies to other accounting pronouncements that require or permit fair value measurements. The new guidance is effective for financial statements issued for fiscal years beginning after November 15, 2007, and for interim periods within those fiscal years. We are currently evaluating the potential impact of the adoption of SFAS No. 157 on our consolidated financial position, results of operations and cash flow.

Item 3. Quantitative and Qualitative Disclosure About Market Risk.

We are exposed to various types of market risk in the normal course of business. In particular, we are subject to interest rate variability primarily associated with borrowings under our credit facilities. The debt covenants under our credit agreements require us to employ risk management strategies to minimize our exposure to market risk.

As of September 30, 2007, Idearc had interest rate swap agreements with major financial institutions with notional amounts totaling $5,510 million. These swaps 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 swaps, 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 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 swaps comply with our debt covenant that requires that at least 50% of our debt be subject to fixed rates for a minimum of two years. We do not enter into financial instruments for trading or speculative purposes.

Item 4. Controls and Procedures.

Under the supervision and with the participation of our management, including our chief executive officer and chief financial officer, we have evaluated the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)) as of the end of the period covered by this report. Based on that evaluation, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report to provide reasonable assurance that information we are required to disclose in reports that are filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms specified by the Securities and Exchange Commission. We note that the design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving the stated goals under all potential future conditions.

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There have not been any changes in our internal control over financial reporting during the period covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II OTHER INFORMATION

Item 1. Legal Proceedings.

None.

Item 1A. Risk Factors.

There have been no material changes in our risk factors from those disclosed in Item 1A to Part I of our Annual Report on Form 10-K for the year ended December 31, 2006.

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

None.

Item 3. Defaults Upon Senior Securities.

None.

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

None.

Item 5. Other Information.

None.

Item 6. Exhibits.

Exhibit No.	Description
2.1	Asset Purchase Agreement, dated September 15, 2007, by and between Idearc Inc. and InfoSpace, Inc. (incorporated by reference to Exhibit 2.1 to Idearc Inc. s Current Report on Form 8-K, filed September 18, 2007)
31.1	Certification of Katherine J. Harless filed pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Andrew Coticchio filed pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Katherine J. Harless and Andrew Coticchio filed pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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SIGNATURES

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

	IDEARC INC.
November 5, 2007	/s/ Katherine J. Harless Katherine J. Harless President and Chief Executive Officer (Principal Executive Officer)
November 5, 2007	/s/ Andrew Coticchio Andrew Coticchio Executive Vice President, Chief Financial Officer and Treasurer (Principal Financial and Accounting Officer)

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