

**Note 1 Summary of Significant Accounting Policies**

United States Cellular Corporation ("U.S. Cellular"), a Delaware Corporation, is an 82.0%-owned subsidiary of Telephone and Data Systems, Inc. ("TDS").

**Nature of Operations**

U.S. Cellular owns, manages and invests in wireless systems throughout the United States. U.S. Cellular owned, or had the right to acquire pursuant to certain agreements, interests in 220 wireless markets, representing a total population of approximately 44.4 million, as of December 31, 2004.

U.S. Cellular served 4.9 million customers and had 175 majority-owned ("consolidated") markets in 27 states as of December 31, 2004. U.S. Cellular operates as one reportable segment.

**Principles of Consolidation**

The accounting policies of U.S. Cellular conform to accounting principles generally accepted in the United States of America ("U.S. GAAP"). The consolidated financial statements include the accounts of U.S. Cellular, its majority-owned subsidiaries since acquisition, general partnerships in which U.S. Cellular has a majority partnership interest and any entity where U.S. Cellular has a variable interest that will absorb a majority of the entity's expected gains or losses, or both. All material intercompany accounts and transactions have been eliminated.

U.S. Cellular adopted Financial Accounting Standards Board ("FASB") Interpretation No. 46R ("FIN 46R"), "Consolidation of Variable Interest Entities," in January 2004. The adoption of FIN 46R did not have a material impact on U.S. Cellular's financial position or results of operations.

**Business Combinations**

U.S. Cellular uses the purchase method of accounting for business combinations. U.S. Cellular includes as investments in subsidiaries the value of the consideration given and all direct and incremental costs relating to acquisitions. All costs relating to unsuccessful negotiations for acquisitions are charged to expense.

**Use of Estimates**

The preparation of consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect (a) the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and (b) the reported amounts of revenues and expenses during the reported period. Actual results could differ from those estimates.

**Reclassifications**

Certain amounts reported in prior years have been reclassified to conform to current period presentation. The reclassifications had no impact on previously reported net income and shareholders' equity.

**Cash and Cash Equivalents**

Cash and cash equivalents include cash and short-term, highly liquid investments with original maturities of three months or less.

Outstanding checks totaled \$19.3 million and \$22.3 million at December 31, 2004 and 2003, respectively, and are classified as accounts payable in the consolidated Balance Sheets.

**Accounts Receivable and Allowance for Doubtful Accounts**

U.S. Cellular's accounts receivable primarily consist of amounts owed by customers for both service provided and equipment sales, by agents for equipment sales, by other wireless carriers whose customers have used U.S. Cellular's wireless systems and by unaffiliated third-party partnerships or corporations pursuant to equity distribution declarations.

The allowance for doubtful accounts is the best estimate of the amount of probable credit losses in the existing accounts receivable. The allowance is based on historical write-off experience. Account receivable balances are reviewed on either an aggregate or individual basis for collectibility depending on the type of receivable. When it is probable the account balances will not be collected, the account balance is charged off against the allowance for the doubtful accounts. U.S. Cellular does not have any off-balance sheet credit exposure related to its customers.

The changes in the allowance for doubtful accounts during the years ended December 31, 2004, 2003 and 2002 were as follows:

	2004	2003	2002
(Dollars in thousands)			
Beginning Balance	\$13,786	\$17,866	\$ 9,799
Additions, net of recoveries	78,112	61,051	63,657
Deductions	(73,621)	(65,131)	(55,590)
Ending Balance	\$18,277	\$13,786	\$17,866

**Inventory**

Inventory is stated at the lower of cost or market with cost determined using the first-in, first-out method.

**Marketable Equity Securities**

Marketable equity securities are classified as available-for-sale, and are stated at fair market value. Net unrealized holding gains and losses are included in accumulated other comprehensive income. Realized gains and losses are determined on the basis of specific identification.

The market values of marketable equity securities may fall below the accounting cost basis of such securities. If management determines the decline in value to be other than temporary, the unrealized loss included in accumulated other comprehensive income is recognized and recorded as a non-operating loss in the statements of operations.

Factors that management considers in determining whether a decrease in the market value of its securities is an other than temporary decline include if there has been a significant change in the financial condition, operational structure or near-term prospects of the issuer; how long and how much the security has been below carrying value; and whether U.S. Cellular has the intent and ability to retain its investment in the issuer's securities to allow the market value to return to the accounting cost basis.

U.S. Cellular utilizes derivative financial instruments to reduce market risks due to fluctuations in market prices of its Vodafone Group Plc ("Vodafone") marketable equity securities, which represent over 99% of the total value of its marketable equity securities portfolio. At December 31, 2004 and 2003, U.S. Cellular had variable prepaid forward contracts ("forward contracts") maturing in 2007 in connection with all of its Vodafone marketable equity security portfolio, hedging the market price risk with respect to the contracted securities. The downside risk is hedged at or above the accounting cost basis thereby eliminating the risk of an other-than-temporary loss being recorded on these contracted securities.

### Derivative Instruments

U.S. Cellular utilizes derivative financial instruments to reduce marketable equity security market value risk. U.S. Cellular does not hold or issue derivative financial instruments for trading purposes. U.S. Cellular recognizes all derivatives as either assets or liabilities on the balance sheet and measures those instruments at fair value. Changes in fair value of those instruments are reported in the Statements of Operations or accumulated other comprehensive income depending on the use of the derivative and whether it qualifies for hedge accounting. The accounting for gains and losses associated with changes in the fair value of the derivative and the effect on the consolidated financial statements depends on the derivative's hedge designation and whether the hedge is anticipated to be highly effective in achieving offsetting changes in the fair value of the hedged item or cash flows of the asset hedged.

### Licenses

Licenses consist of costs incurred in acquiring Federal Communications Commission ("FCC") licenses to provide wireless service. These costs include amounts paid to license applicants and owners of interests in entities awarded licenses and all direct and incremental costs relating to acquiring the licenses. Licenses are intangible assets with indefinite useful lives, and are not amortized.

U.S. Cellular has determined that licenses are intangible assets with indefinite useful lives, based on the following factors:

- Radio spectrum is not a depleting asset.
- The ability to use radio spectrum is not limited to any one technology.
- U.S. Cellular and its consolidated subsidiaries are licensed to use radio spectrum through the FCC licensing process, which enables licensees to utilize specified portions of the spectrum for the provision of wireless service.
- U.S. Cellular and its consolidated subsidiaries are required to renew their FCC licenses every ten years. To date, all of U.S. Cellular's license renewal applications, filed for unique licenses in every year from 1994 to the present, have been granted by the FCC. Generally, license renewal applications filed by licensees otherwise in compliance with FCC regulations are routinely granted. If, however, a license renewal application is challenged, either by a competing applicant for the license or by a petition to deny the renewal application, the license will be renewed if the licensee can demonstrate its entitlement to a "renewal expectancy." Licensees are entitled to such an expectancy if they can demonstrate to the FCC that they have provided "substantial service" during their license term and have "substantially complied" with FCC rules and policies. U.S. Cellular believes that it could demonstrate its entitlement to a renewal expectancy in any of its markets in the unlikely event any of its license renewal applications were challenged and therefore believes that it is probable that its future license renewal applications will be granted.

### License Rights

In accordance with an exchange agreement with AT&T Wireless, U.S. Cellular has deferred the assignment and development of certain licenses for a period of up to five years from the closing date, August 1, 2003. The 21 licenses that have not yet been assigned to U.S. Cellular, with a recorded value of \$42.0 million, are included in license rights on the Balance Sheet.

### Goodwill

U.S. Cellular has goodwill as a result of the acquisition of licenses and wireless markets. Included in goodwill is the portion of the purchase price of acquisitions of interests in operating wireless markets that was not assigned to the other acquired assets, including licenses. No deferred taxes have been provided on goodwill.

### Impairment of Intangible Assets

Licenses and goodwill must be reviewed for impairment annually, or more frequently if events or changes in circumstances indicate that the asset might be impaired. U.S. Cellular performs the annual impairment review on licenses and goodwill during the second quarter. There can be no assurance that upon review at a later date material impairment charges will not be required.

The intangible asset impairment test consists of comparing the fair value of the intangible asset to the carrying amount of the intangible asset. If the carrying amount exceeds the fair value, an impairment loss is recognized for the difference. The goodwill impairment test is a two-step process. The first step compares the fair value of the reporting unit to its carrying value. If the carrying amount exceeds the fair value, the second step of the test is performed to measure the amount of impairment loss, if any. The second step compares the implied fair value of reporting unit goodwill with the carrying amount of that goodwill. To calculate the implied fair value of goodwill, an enterprise allocates the fair value of the reporting unit to all of the assets and liabilities of that reporting unit (including any unrecognized intangible assets) as if the reporting unit had been acquired in a business combination and the fair value was the price paid to acquire the reporting unit. The excess of the fair value of the reporting unit over the amounts assigned to the assets and liabilities of the reporting unit is the implied fair value of goodwill. If the carrying amount exceeds the implied fair value, an impairment loss is recognized for that difference.

The fair value of an intangible asset and reporting unit goodwill is the amount at which that asset or reporting unit could be bought or sold in a current transaction between willing parties. Therefore, quoted market prices in active markets are the best evidence of fair value and should be used when available. If quoted market prices are not available, the estimate of fair value is based on the best information available, including prices for similar assets and the use of other valuation techniques. Other valuation techniques include present value analysis, multiples of earnings or revenue, or a similar performance measure. The use of these techniques involve assumptions by management about factors that are highly uncertain including future cash flows, the appropriate discount rate, and other inputs. Different assumptions for these inputs or valuation methodologies could create materially different results.

U.S. Cellular tests goodwill for impairment at the level of reporting referred to as a reporting unit. U.S. Cellular has identified six reporting units pursuant to paragraph 30 of Statement of Financial Accounting Standard ("SFAS") No. 142, "Goodwill and Other Intangible Assets." The six reporting units represent six geographic groupings of FCC licenses, constituting six geographic service areas. U.S. Cellular combines its FCC licenses into six units of accounting for purposes of testing the licenses for impairment pursuant to Emerging Issues Task Force Issue 02-7, "Unit of Accounting for Testing Impairment of Indefinite-Lived Intangible Assets" ("EITF 02-7"), and SFAS No. 142, using the same geographic groupings as its reporting units. The divestitures of markets in 2004 resulted in the elimination of one of the six reporting units.

U.S. Cellular prepared valuations of each of the reporting units for purposes of goodwill impairment testing. A discounted cash flow approach was used to value each of the reporting units, using value drivers and risks specific to each individual geographic region. The cash flow estimates incorporate assumptions that market participants would use in their estimates of fair value. Key assumptions made in this process were the selection of a discount rate, estimated future cash flow levels, projected capital expenditures, and selection of terminal value multiples.

U.S. Cellular also prepared valuations of similar groupings of FCC licenses (units of accounting pursuant to EITF 02-7) using an excess earnings methodology, through the use of a discounted cash flow approach. This excess earnings methodology estimates the fair value of the intangible assets (FCC license units of accounting) by measuring the future cash flows of the license groups, reduced by charges for contributory assets such as working capital, trademarks, existing subscribers, fixed assets, assembled workforce and goodwill.

### Investments in Unconsolidated Entities

Investments in unconsolidated entities consists of investments where U.S. Cellular holds a less than 50% non-controlling ownership interest. U.S. Cellular follows the equity method of accounting, which recognizes U.S. Cellular's proportionate share of the income and losses accruing to it under the terms of its partnership or shareholder agreements, where U.S. Cellular's ownership interest equals or exceeds 20% for corporations and 3% to 5% for partnerships and limited liability companies. An estimate of U.S. Cellular's proportionate share of income is recorded each quarter with such estimate being adjusted to the actual share of income upon receipt of financial statements from the unconsolidated entity. The cost method of accounting is followed for certain minority interests where U.S. Cellular's ownership interest is less than 20% for corporations and 3% to 5% for partnerships and limited liability companies, or where U.S. Cellular does not have the ability to exercise significant influence.

### Property, Plant and Equipment

U.S. Cellular's property, plant and equipment is stated at the original cost of construction including capitalized costs of certain taxes, payroll-related expenses and estimated costs to remove the assets.

Renewals and betterments of units of property are recorded as additions to plant in service. The original cost of depreciable property retired (along with the related accumulated depreciation) is removed from plant in service and, together with removal cost less any salvage realized, is charged to depreciation expense. Repairs and renewals of minor units of property are charged to system operations expense.

### Depreciation

Depreciation is provided using the straight-line method over the estimated useful lives of the assets.

U.S. Cellular depreciates its leasehold improvement assets associated with leased properties over periods ranging from three to ten years, which approximates the shorter of the assets' economic lives or the specific lease terms, as defined in SFAS No. 13, "Accounting for Leases," as amended.

### Asset Impairment

U.S. Cellular reviews long-lived assets for impairment at least annually or whenever events or changes in circumstances indicate that the carrying amount may not be fully recoverable. The tangible asset impairment test is

a two-step process. The first step compares the carrying value of the assets with the estimated undiscounted cash flows over the remaining asset life. If the carrying value of the assets is greater than the undiscounted cash flows, the second step of the test is performed to measure the amount of impairment loss. The second step compares the estimated fair value of the assets to the carrying value of the assets. An impairment loss is recognized for the difference between the fair value of the assets (less cost to sell) and the carrying value of the assets.

The fair value of a tangible asset is the amount at which that asset could be bought or sold in a current transaction between willing parties. Therefore, quoted market prices in active markets are the best evidence of fair value and should be used when available. If quoted market prices are not available, the estimate of fair value is based on the best information available, including prices for similar assets and the use of other valuation techniques. A present value analysis of cash flow scenarios is often the best available valuation technique with which to estimate the fair value of the long-lived asset. The use of this technique involves assumptions by management about factors that are highly uncertain including future cash flows, the appropriate discount rate, and other inputs. Different assumptions for these inputs or valuation methodologies could create materially different results.

### Deferred Charges

Costs of developing new information systems are capitalized in accordance with Statement of Position 98-1, "Accounting for the Cost of Computer Software Developed or Obtained for Internal Use," ("SOP 98-1") and amortized over a three- or seven-year period, starting when each new system is placed in service.

Other deferred charges primarily represent legal and other charges incurred relating to the preparation of the agreements related to U.S. Cellular's various borrowing instruments, and are amortized over the respective financing periods of each instrument.

### Assets and Liabilities of Operations Held for Sale

U.S. Cellular accounts for the disposal of long-lived assets in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." When long-lived assets meet the held for sale criteria set forth in SFAS No. 144, the Balance Sheet reflects the assets and liabilities of the properties to be disposed of as assets and liabilities of operations held for sale. The assets and liabilities of operations held for sale are presented separately in the asset and liability sections of the Balance Sheet. The revenues and expenses of the properties to be disposed of are included in operations until the transaction is completed.

### Asset Retirement Obligation

SFAS No. 143, "Accounting for Asset Retirement Obligations," was issued in June 2001, and became effective for U.S. Cellular beginning January 1, 2003. SFAS No. 143 requires entities to record the fair value of a liability for legal obligations associated with an asset retirement in the period in which the obligations are incurred. When the liability is initially recorded, the entity capitalizes the cost of the asset retirement obligation by increasing the carrying amount of the related long-lived asset. Over time, the liability is accreted to its present value each period, and the capitalized cost is depreciated over the useful life of the related asset. Upon settlement of the obligations, any difference between the cost to retire an asset and the liability recorded is recognized in the Statements of Operations as a gain or loss.

U.S. Cellular is subject to asset retirement obligations associated primarily with its cell sites, retail sites and office locations. Asset retirement obligations generally include obligations to remediate leased land on which U.S. Cellular's cell sites and switching offices are located. U.S. Cellular is also generally required to return leased retail store premises and office space to their pre-existing conditions.

The change in asset retirement obligation during 2004 and 2003 was as follows:

	2004	2003
(Dollars in thousands)		
Beginning balance	\$64,501	\$54,438
Additional liabilities accrued	5,426	5,641
Disposition of assets	(2,065)	—
Accretion expense	4,672	4,422
Ending balance	\$72,534	\$64,501

### Revenue Recognition

Revenues from wireless operations primarily consist of charges for access, airtime, roaming and value added services provided for U.S. Cellular's retail customers and to end users through third-party resellers; charges to carriers whose customers use U.S. Cellular's systems when roaming; charges for long-distance calls made on U.S. Cellular's systems; amounts received from the universal service fund in states where U.S. Cellular has been designated an Eligible Telecommunications Carrier; end user equipment sales; and sales of accessories. Revenues are recognized as services are rendered. Unbilled revenues, resulting from wireless service provided from the billing cycle date to the end of each month and from other wireless carriers' customers using U.S. Cellular's systems for the last half of each month, are estimated and recorded.

Equipment sales represent a separate earnings process. Revenues from equipment and accessory sales are recognized upon delivery to the customer. In order to provide better control over handset quality, U.S. Cellular sells handsets to agents at a price approximately equal to cost. In most cases, the agents receive rebates from U.S. Cellular at the time the agents sign up new customers or retain current customers. U.S. Cellular accounts for the sale of equipment to agents in accordance with Emerging Issues Task Force ("EITF") Issue 01-09, "Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor's Products)." This standard requires that equipment sales revenue be reduced by the anticipated rebates to be paid to the agents at the time the agent purchases the handsets rather than at the time the agent signs up a new customer or retains a current customer. Similarly, U.S. Cellular offers certain rebates to customers related to handset purchases; in accordance with EITF Issue 01-09, the equipment sales revenue from a handset sale which includes such a rebate is recorded net of the rebate anticipated to be applied to the handset sale.

Activation fees charged with the sale of service only are deferred and recognized over the average customer service period.

Under EITF Issue 00-21, "Accounting for Multiple Element Arrangements," activation fees charged with the sale of equipment and service are allocated to the equipment and service based upon the relative fair values of each item. Due to the subsidy provided on customer handsets, this generally results in the recognition of the activation fee as additional handset revenue at the time of sale.

### Cumulative Effect of Accounting Changes

Effective January 1, 2003, U.S. Cellular adopted SFAS No. 143 and recorded the initial liability for legal obligations associated with an asset retirement. The cumulative effect of the implementation of this accounting standard on periods prior to 2003 was recorded in the first quarter of 2003, decreasing net income by \$14.3 million, net of income taxes of \$9.7 million and minority interest of \$0.5 million, or \$0.17 per diluted share.

The following pro forma amounts show the effect of the retroactive application of the change in accounting principle for the adoption of SFAS No. 143:

Year Ended December 31,	2003	2002
(Dollars in thousands, except per share amounts)		
Actual		
Net income (loss)	\$42,660	\$(26,945)
Basic earnings (loss) per share	0.50	(0.31)
Diluted earnings (loss) per share	\$ 0.49	\$ (0.31)
Pro forma		
Net income (loss)	\$57,006	\$(30,047)
Basic earnings (loss) per share	0.67	(0.34)
Diluted earnings (loss) per share	\$ 0.66	\$ (0.34)

December 31, 2002

(Dollars in thousands)

Pro forma – Balance Sheet data

Asset retirement obligation \$ 54,438

Effective January 1, 2002, U.S. Cellular adopted SFAS No. 142, and determined that wireless licenses have indefinite lives. Upon initial adoption, U.S. Cellular reviewed its investments in licenses and determined there was an impairment loss on certain licenses. The cumulative effect of the initial impairment upon the adoption of SFAS No. 142 reduced net income in 2002 by \$12.7 million, net of income taxes of \$8.2 million, or \$0.14 per diluted share.

Effective January 1, 2002, U.S. Cellular changed its method of accounting for commission expenses related to customer activations and began deferring expense recognition of a portion of commission expenses in the amount of deferred activation fee revenues. U.S. Cellular believes this change is a preferable method of accounting for such costs primarily due to the fact that the new method of accounting provides for better matching of revenue from customer activations to direct incremental costs associated with these activations within each reporting period. The cumulative effect of this accounting change on periods prior to 2002 was recorded in 2002 increasing net income by \$4.1 million, net of income taxes of \$3.0 million and minority interest of \$0.4 million, or \$0.05 per diluted share.

### Advertising Costs

U.S. Cellular expenses advertising costs as incurred. Advertising costs totaled \$161.3 million, \$130.0 million and \$91.6 million for the years ended December 31, 2004, 2003 and 2002, respectively.

### Income Taxes

U.S. Cellular is included in a consolidated federal income tax return with other members of the TDS consolidated group. TDS and U.S. Cellular are parties to a Tax Allocation Agreement. The Tax Allocation Agreement provides that U.S. Cellular and its subsidiaries be included with the TDS affiliated group in a consolidated federal income tax return and in state income or franchise tax returns in certain situations. U.S. Cellular and its subsidiaries



## Notes to Consolidated Financial Statements

calculate their income and credits as if they comprised a separate affiliated group. Under the Tax Allocation Agreement, U.S. Cellular remits its applicable income tax payments to TDS. U.S. Cellular had a tax receivable balance with TDS of \$1.3 million, \$5.4 million and \$28.0 million as of December 31, 2004, 2003 and 2002, respectively.

Deferred taxes are computed using the liability method, whereby deferred tax assets are recognized for deductible temporary differences and operating loss carryforwards, and deferred tax liabilities are recognized for taxable temporary differences. Both deferred tax assets and liabilities are measured using tax rates anticipated to be in effect when the temporary differences reverse. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax basis. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment. Deferred tax assets are reduced by a valuation allowance when it is more likely than not that some portion or all of the deferred tax assets will not be realized.

### Stock-Based Compensation

U.S. Cellular accounts for stock options and employee stock purchase plans under Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees," as allowed by SFAS No. 123, "Accounting for Stock-Based Compensation," using the intrinsic value method.

No compensation costs were recognized for the stock option and employee stock purchase plans. Had compensation cost for all plans been determined consistent with SFAS No. 123, U.S. Cellular's net income (loss) and earnings per share would have been reduced to the following pro forma amounts:

Year Ended December 31,	2004	2003	2002
(Dollars in thousands, except per share amounts)			
Net Income (Loss):			
As Reported	\$109,021	\$ 42,660	\$ (26,945)
Pro Forma Expense	(11,494)	(8,391)	(5,324)
Pro Forma	97,527	34,269	(32,269)
Basic Earnings Per Share:			
As Reported	1.26	0.50	(0.31)
Pro Forma Expense	(0.13)	(0.10)	(0.06)
Pro Forma	1.13	0.40	(0.37)
Diluted Earnings Per Share:			
As Reported	1.26	0.49	(0.31)
Pro Forma Expense	(0.13)	(0.10)	(0.06)
Pro Forma	\$ 1.13	\$ 0.39	\$ (0.37)

### Pension Plan

U.S. Cellular participates in a qualified noncontributory defined contribution pension plan sponsored by TDS. It provides pension benefits for the employees of U.S. Cellular and its subsidiaries. Under this plan, pension benefits and costs are calculated separately for each participant and are funded currently. Pension costs were \$5.5 million, \$6.1 million and \$5.0 million in 2004, 2003 and 2002, respectively.

### Operating Leases

U.S. Cellular is a party to various lease agreements for office space, retail sites, cell sites and equipment that are accounted for as operating leases. Certain leases have renewal options and/or fixed rental increases. Renewal options that are reasonably assured are included in determining the lease term.

During 2004, U.S. Cellular revised its accounting for certain operating leases that contain fixed rental increases to recognize lease revenue and expense on a straight-line basis over the lease term in accordance with SFAS No. 13, as amended, and related pronouncements. Pursuant to its revised accounting for such leases, U.S. Cellular recorded out-of-period adjustments to operating revenues and operating expenses during 2004. The adjustments were not considered material to the current year or to any prior years' earnings, earnings trends or individual financial statement line items. The adjustments were recorded in 2004, and no prior periods were adjusted. The impact of the out-of-period adjustments on the affected line items in the Statement of Operations for the year ended December 31, 2004 is as follows:

Year Ended December 31,	2004
(Dollars in thousands, except per share amounts)	
Increase (Decrease)	
Service revenues	\$ 821
Total operating revenues	821
System operations expenses	2,334
Selling, general and administrative expenses	1,606
Total operating expenses	3,940
Operating income	(3,119)
Net income	\$(1,871)
Basic earnings per share	\$ (0.02)
Diluted earnings per share	\$ (0.02)

### Recent Accounting Pronouncements

#### Share-Based Payment

SFAS No. 123 (revised 2004), "Share-Based Payment," was issued in December 2004 and becomes effective for U.S. Cellular in the third quarter of 2005. The statement requires that compensation cost resulting from all share-based payment transactions be recognized in the financial statements. U.S. Cellular has reviewed the provisions of this statement and expects to record compensation expense for certain share-based payment transactions, primarily related to stock options, in the Statement of Operations upon adoption of this standard. See the "Stock-Based Compensation" disclosure above for a pro forma impact on net income and earnings per share.

## Note 2 Income Taxes

Income tax provisions charged to income (loss) before cumulative effect of accounting change are summarized as follows:

Year Ended December 31,	2004	2003	2002
(Dollars in thousands)			
Current			
Federal	\$ 290	\$ 1,097	\$ 444
State	7,770	15,066	3,758
Deferred			
Federal	51,536	28,560	(4,674)
State	14,112	(7,491)	(7,069)
Total income tax expense (benefit)	\$73,708	\$37,232	\$(7,541)

## Notes to Consolidated Financial Statements

A reconciliation of U.S. Cellular's income tax expense (benefit) computed at the statutory rate to the reported income tax expense (benefit), and the statutory federal income tax expense (benefit) rate to U.S. Cellular's effective income tax expense (benefit) rate is as follows:

Year Ended December 31,	2004		2003		2002	
	Amount	Rate	Amount	Rate	Amount	Rate
(Dollars in millions)						
Statutory federal income tax expense (benefit)	\$67.4	35.0%	\$37.1	35.0%	\$(4.3)	(35.0)%
State income taxes, net of federal benefit	12.4	6.4	1.2	1.2	(2.4)	(19.1)
Effects of minority share of income excluded from consolidated federal income tax return	(0.8)	(0.4)	(5.0)	(4.5)	(4.5)	(36.3)
Effects of gains (losses) on investments and assets held for sale	2.8	1.5	2.2	2.0	2.9	23.6
Resolution of prior period tax issues	(7.3)	(3.8)	1.8	1.6	9.7	78.0
Research tax credits	(3.3)	(1.7)	—	—	—	—
Deferred tax rate change <sup>(1)</sup>	(0.2)	(0.1)	—	—	(8.4)	(68.2)
Other	2.7	1.4	(0.1)	(0.1)	(0.5)	(3.9)
Effective income tax expense (benefit)	\$73.7	38.3%	\$37.2	35.2%	\$(7.5)	(60.9)%

(1) Represents a reassessment of the rate at which U.S. Cellular provides for deferred taxes.

Net income (loss) for each of the three years ended December 31, 2004, includes gains and losses (reported in the captions gain (loss) on investments and (gain) loss on assets held for sale and loss on impairment of intangible assets in the Statements of Operations) that significantly affected income (loss) before income taxes and minority interest. The effective income tax rate excluding such gains and losses was 33.2%, 37.8% and 37.0% for the years ended December 31, 2004, 2003 and 2002, respectively.

The 2004 effective tax rate on operations excluding losses and gains is lower than 2003 due to favorable settlements of several tax issues in 2004. During 2004, the Internal Revenue Service ("IRS") substantially completed its audit of U.S. Cellular's federal income tax returns (through its parent company, TDS) for the tax years 1997 through 2001 and claims for research tax credits for the years 1995 through 2001. Primarily based on the results of the audit, U.S. Cellular reduced its accrual for audit contingency by \$7.3 million (3.8%) in 2004. Also in 2004, based upon the results of the federal income tax audit, U.S. Cellular recorded a \$3.3 million (1.7%) benefit for the research tax credits.

Income tax provisions charged to net income (loss) are summarized as follows:

Year Ended December 31,	2004	2003	2002
(Dollars in thousands)			
Current			
Federal	\$ 290	\$ 1,097	\$ 444
State	7,770	15,066	3,758
Deferred			
Federal	51,536	20,585	(9,057)
State	14,112	(9,186)	(8,000)
Total income tax expense (benefit)	\$73,708	\$27,562	\$(12,855)

Included in income tax expense charged to net income (loss) were deferred income tax benefits on cumulative effect of accounting change of \$9.7 million in 2003 and \$5.3 million in 2002.

U.S. Cellular current net deferred tax assets totaled \$83.7 million at December 31, 2004 and \$16.8 million at December 31, 2003. The net current deferred tax asset primarily represents the deferred tax effects of federal net operating loss ("NOL") carryforwards expected to be utilized in 2005, and the allowance for doubtful accounts on customer receivables.

The temporary differences that gave rise to the noncurrent deferred tax assets and liabilities are as follows:

December 31,	2004	2003
(Dollars in thousands)		
Deferred Tax Asset		
Net operating loss carryforward	\$ 33,162	\$ 30,671
Unearned revenue	1,772	1,772
Derivative instruments	27,951	22,015
Other	3,685	3,258
	66,570	57,716
Less valuation allowance	(20,243)	(10,480)
Total Deferred Tax Asset	46,327	47,236
Deferred Tax Liability		
Property, plant and equipment	341,693	222,213
Licenses	236,614	206,129
Marketable equity securities	91,923	84,287
Partnership investments	56,375	30,511
Total Deferred Tax Liability	726,605	543,140
Net Deferred Income Tax Liability	\$680,278	\$495,904

At December 31, 2004, U.S. Cellular and certain subsidiaries had \$405.3 million of state NOL carryforwards (generating a \$27.3 million deferred tax asset) available to offset future taxable income primarily of the individual subsidiaries which generated the losses. The state NOL carryforwards expire between 2005 and 2024. Certain subsidiaries which are not included in the federal consolidated income tax return, but file separate federal tax returns, had federal NOL carryforwards (generating a \$5.9 million deferred tax asset) available to offset future taxable income. The federal NOL carryforwards expire between 2005 and 2024. A valuation allowance was established for a portion of the state NOL carryforwards, and the federal NOL carryforwards, since it is more likely than not that a portion of such carryforwards will expire before they can be utilized.

U.S. Cellular is routinely subject to examination of its income tax returns by the IRS as a member of the TDS consolidated group and other tax authorities. U.S. Cellular periodically assesses the likelihood of adjustments to its tax liabilities resulting from these examinations to determine the adequacy of its provision for income taxes, including related interest. Management judgment is required in assessing the eventual outcome of these examinations. Changes to such assessments affect the calculation of U.S. Cellular's income tax expense. As a result of the substantial completion of federal and state tax audits, U.S. Cellular has reclassified \$51 million from deferred liabilities and credits-other to accrued taxes in the current liabilities section of the Balance Sheet.

### Note 3 Earnings Per Share

Basic earnings per share is computed by dividing net income (loss) by the weighted average number of common shares outstanding during the period. Diluted earnings per share is computed using net income and weighted average common shares adjusted to include the effect of potentially dilutive securities. Potentially dilutive securities include incremental shares issuable upon exercise of outstanding stock options and conversion of debentures.

The amounts used in computing Earnings per Common and Series A Common Shares and the effect on income and the weighted average number of Common and Series A Common Shares of dilutive potential common stock are as follows:

Year Ended December 31,	2004	2003	2002
(Dollars and shares in thousands)			
Basic and Diluted Earnings per Share			
Income (loss) used in basic and diluted earnings per share	\$109,021	\$ 57,006	\$(18,385)
Cumulative effect of accounting change	—	(14,346)	(8,560)
	<u>\$109,201</u>	<u>\$ 42,660</u>	<u>\$(26,945)</u>
Weighted average number of Common Shares used in basic earnings per share	86,244	86,136	86,086
Effect of Dilutive Securities:			
Stock options and stock appreciation rights <sup>(1)</sup>	492	466	—
Conversion of convertible debentures <sup>(2)</sup>	—	—	—
Weighted average number of Common Shares used in diluted earnings per share	<u>86,736</u>	<u>86,602</u>	<u>86,086</u>
Basic Earnings per Share			
Income (loss) before cumulative effect of accounting change	\$ 1.26	\$ 0.67	\$ (0.22)
Cumulative effect of accounting change	—	(0.17)	(0.09)
	<u>\$ 1.26</u>	<u>\$ 0.50</u>	<u>\$ (0.31)</u>
Diluted Earnings per Share			
Income (loss) before cumulative effect of accounting change	\$ 1.26	\$ 0.66	\$ (0.22)
Cumulative effect of accounting change	—	(0.17)	(0.09)
	<u>\$ 1.26</u>	<u>\$ 0.49</u>	<u>\$ (0.31)</u>

(1) Stock options convertible into 910,477 Common Shares in 2004, 1,322,132 Common Shares in 2003, and 1,753,950 Common Shares in 2002 were not included in computing diluted earnings per share because their effects were anti-dilutive.

(2) Debentures convertible into 2,944,347 Common Shares in 2003 and 2,945,256 Common Shares in 2002 were not included in computing diluted earnings per share because their effects were anti-dilutive. All outstanding debentures were redeemed on July 26, 2004.

### Note 4 Licenses and Goodwill

Changes in licenses and goodwill are primarily the result of impairments and acquisitions and divestitures of wireless markets by U.S. Cellular. See Note 11 – Acquisitions, Divestitures and Exchanges for the details of the changes in licenses and goodwill.

In conjunction with the implementation of SFAS No. 142, "Goodwill and Other Intangible Assets" on January 1, 2002, U.S. Cellular recorded an impairment loss of \$20.9 million, before income tax benefits of \$8.2 million as a cumulative effect of an accounting change on licenses for the excess carrying value of the licenses over the fair value. In 2003, U.S. Cellular recorded an additional impairment loss of \$49.6 million on licenses in two reporting units and a \$3.5 million loss on impairment of its investment in a non-operating license. An additional \$1.8 million impairment loss was recorded in 2004 on the Daytona Beach, FL license, which was sold in December 2004. See Note 1 – Summary of Significant Accounting Policies under the heading "Impairment of Intangible Assets" for a detailed discussion of the license impairment test.

A schedule of license activity follows:

Year Ended December 31,	2004	2003
(Dollars in thousands)		
Balance, beginning of year	\$1,231,363	\$1,247,197
Acquisitions <sup>(1)</sup>	5,629	178,609
Divestitures	(8,426)	(76,905)
Allocation to assets of operations held for sale	—	(63,569)
Impairment loss	(1,830)	(53,095)
Other	2,065	(874)
Balance, end of year <sup>(1)</sup>	<u>\$1,228,801</u>	<u>\$1,231,363</u>

(1) Includes \$42.0 million of License rights from the AT&T Wireless transaction in 2003.

A schedule of goodwill activity follows:

Year Ended December 31,	2004	2003
(Dollars in thousands)		
Balance, beginning of year	\$ 430,256	\$ 504,744
Additions	4,225	7,516
Divestitures	(8,257)	(69,961)
Allocation to assets of operations held for sale	—	(7,565)
Other	(306)	(4,478)
Balance, end of year	<u>\$ 425,918</u>	<u>\$ 430,256</u>

### Note 5 Customer Lists

Customer lists, intangible assets from the acquisition of wireless properties, are being amortized based on average customer retention periods using the declining balance method. The acquisition of certain minority interests in 2004 added \$12.9 million to the gross balance of customer lists. Amortization expense was \$12.4 million, \$15.6 million and \$6.6 million for the years ended December 31, 2004, 2003 and 2002. Amortization expense related to customer list assets recorded as of December 31, 2004 for the years 2005 through 2009 is expected to be \$8.2 million, \$5.4 million, \$3.6 million, \$2.4 million and \$1.6 million, respectively.

## Note 6 Marketable Equity Securities

Information regarding U.S. Cellular's marketable equity securities is summarized as follows:

December 31,	2004	2003
(Dollars in thousands)		
Vodafone Group Plc		
10,245,370 American Depositary Receipts	\$280,518	\$256,544
Rural Cellular Corporation 370,882 Common Shares	2,311	2,949
Other	—	695
Aggregate fair value	282,829	260,188
Accounting cost, as adjusted	160,161	160,161
Gross unrealized holding gains (losses)	122,668	100,027
Tax effect	(48,430)	(39,518)
Net unrealized holding gains (losses)	74,238	60,509
Derivatives net of tax	(42,845)	(33,720)
Accumulated other comprehensive income	\$ 31,393	\$ 26,789

U.S. Cellular and its subsidiaries hold a substantial amount of marketable equity securities that are publicly traded and can have volatile movements in share prices. U.S. Cellular and its subsidiaries do not make direct investments in publicly traded companies and all of these interests were acquired as a result of sales, trades or reorganizations of other assets.

The investment in Vodafone resulted from certain dispositions of non-strategic wireless investments to or settlements with AirTouch Communications, Inc. ("AirTouch"), in exchange for stock of AirTouch, which was then acquired by Vodafone, whereby U.S. Cellular received American Depositary Receipts representing Vodafone stock. The investment in Rural Cellular Corporation ("Rural Cellular") is the result of a consolidation of several wireless partnerships in which U.S. Cellular subsidiaries held interests in Rural Cellular, and the distribution of Rural Cellular stock in exchange for these interests.

The market values of the marketable equity securities may fall below the accounting cost basis of such securities. If U.S. Cellular determines the decline in value of the marketable equity securities to be other than temporary, the unrealized loss included in accumulated other comprehensive income is recognized and recorded as a loss in the Statements of Operations.

U.S. Cellular and its subsidiaries have entered into a number of forward contracts related to over 99% of the market value of the marketable equity securities that they hold. The risk management objective of the forward contracts is to hedge the value of the marketable equity securities from losses due to decreases in the market prices of the securities while retaining a share of gains from increases in the market prices of such securities. The downside risk is hedged at or above the accounting cost basis thereby eliminating the risk of an other-than-temporary loss on these contracted securities.

## Note 7 Investments in Unconsolidated Entities

Investments in unconsolidated entities consist of amounts invested in wireless entities in which U.S. Cellular holds a minority interest. These investments are accounted for using either the equity or cost method, as shown in the following table:

December 31,	2004	2003
(Dollars in thousands)		
Equity method investments:		
Capital contributions, loans and advances	\$ 15,619	\$ 27,032
Goodwill	11,154	16,389
Cumulative share of income	380,379	360,728
Cumulative share of distributions	(245,764)	(235,953)
	161,388	168,196
Cost method investments:		
Capital contributions, net of partnership distributions and impairments	891	1,888
Goodwill	485	485
	1,376	2,373
Total investments in unconsolidated entities	\$ 162,764	\$ 170,569

U.S. Cellular follows the equity method of accounting for minority interests where U.S. Cellular's ownership interest is 20% or greater for corporations or greater than 3% to 5% for partnerships and limited liability companies. This method recognizes, on a current basis, U.S. Cellular's proportionate share of the income and losses accruing to it under the terms of the respective partnership and shareholder agreements. Income and losses from the entities are reflected in the consolidated statements of operations on a pretax basis as investment income. Investment income totaled \$68.5 million, \$52.1 million and \$42.1 million in 2004, 2003 and 2002, respectively. As of December 31, 2004, U.S. Cellular follows the cost method of accounting for its investments where U.S. Cellular's ownership interest is less than 20% for corporations or less than 3% for partnerships and limited liability companies, or where U.S. Cellular does not have the ability to exercise significant influence.

Investments in unconsolidated entities include goodwill and costs in excess of the underlying book value of certain investments. At December 31, 2004, \$151.2 million represented the investment in underlying equity and \$11.6 million represented goodwill. At December 31, 2003, \$153.7 million represented the investment in underlying equity and \$16.9 million represented goodwill.

With the adoption of FIN 46R in January 2004, one wireless market that was included in investment in unconsolidated entities as of the end of 2003 was included in consolidated operations. This market was subsequently sold to ALLTEL on November 30, 2004 along with other wireless properties. In the ALLTEL transaction, U.S. Cellular sold five minority interests that had been included in investment in unconsolidated entities. The transaction reduced goodwill \$5.1 million and the investment in underlying equity by \$17.2 million. See Note 11 – Acquisitions, Divestitures and Exchanges for more information related to this transaction.

During 2003, U.S. Cellular reduced the carrying value of one of its cost method investments by \$1.7 million, to its underlying equity value. This charge was included in gain (loss) on investments on the Statement of Operations.

Los Angeles SMSA Limited Partnership meets certain tests pursuant to Rule 3-09 of SEC Regulation S-X, contributing \$43.4 million, \$30.2 million and



\$19.7 million in investment income in 2004, 2003 and 2002, respectively. U.S. Cellular's more significant investments in unconsolidated entities consist of the following:

December 31,	Percentage Ownership	
	2004	2003
Los Angeles SMSA Limited Partnership	5.5%	5.5%
Raleigh-Durham MSA Limited Partnership <sup>(1)</sup>	—	8.0%
Midwest Wireless Communications, LLC	15.2%	15.2%
North Carolina RSA 1 Partnership	50.0%	50.0%
Oklahoma City SMSA Limited Partnership	14.6%	14.6%

(1) As a result of the agreement with ALLTEL, as described more fully in Note 11 – Acquisitions, Divestitures and Exchanges, U.S. Cellular's investment in this partnership was sold to ALLTEL on November 30, 2004.

Based primarily on data furnished to U.S. Cellular by third parties, the following summarizes the combined assets, liabilities and equity, and the combined results of operations of the wireless entities in which U.S. Cellular's investments are accounted for by the equity method:

December 31,	2004	2003
(Dollars in thousands)		
Assets		
Current	\$ 274,000	\$ 225,000
Due from affiliates	584,000	522,000
Property and other	1,647,000	1,625,000
	<u>\$2,505,000</u>	<u>\$2,372,000</u>

Liabilities and Equity		
Current liabilities	\$ 202,000	\$ 181,000
Deferred credits	3,000	82,000
Long-term debt	87,000	17,000
Long-term capital lease obligations	23,000	—
Partners' capital and shareholders' equity	2,190,000	2,092,000
	<u>\$2,505,000</u>	<u>\$2,372,000</u>

Year Ended December 31,	2004	2003	2002
(Dollars in thousands)			
Results of Operations			
Revenues	\$3,019,000	\$2,488,000	\$2,162,000
Operating expenses	2,103,000	1,839,000	1,685,000
Operating income	916,000	649,000	477,000
Other income (expense), net	29,000	8,000	17,000
Net income	<u>\$ 945,000</u>	<u>\$ 657,000</u>	<u>\$ 494,000</u>

## Note 8 Property, Plant and Equipment

Property, plant and equipment in service and under construction, net of accumulated depreciation, consists of:

December 31,	2004	2003
(Dollars in thousands)		
Cell site-related equipment	\$ 2,003,842	\$ 1,777,251
Land, buildings and leasehold improvements	782,262	621,070
Switching-related equipment	617,650	460,165
Office furniture and equipment	225,180	203,139
Other operating equipment	153,940	127,542
Work in process	127,206	252,010
	<u>3,910,080</u>	<u>3,441,177</u>
Accumulated depreciation	<u>(1,544,644)</u>	<u>(1,267,293)</u>
	<u>\$ 2,365,436</u>	<u>\$ 2,173,884</u>

During 2004, U.S. Cellular adjusted the useful lives of Time Division Multiple Access ("TDMA") radio equipment, switch software and antenna equipment. TDMA radio equipment lives were adjusted to be fully depreciated by the end of 2008, which is the latest date the wireless industry will be required by law to support analog service. U.S. Cellular currently uses TDMA radio equipment to support analog service, and expects to have its digital radio network fully migrated to Code Division Multiple Access ("CDMA") 1XRTT or some future generation of CDMA technology by that time. The useful lives for certain switch software were reduced to one year from three years and antenna equipment lives were reduced to seven years from eight years in order to better align the useful lives with the actual length of time the assets are expected to be in use. These changes increased depreciation by \$14.9 million in 2004. The changes in useful lives reduced net income by \$9.0 million, or \$0.10 per share in 2004.

In 2004, certain TDMA digital radio equipment consigned to a third party for future sale was taken out of service and was written down by \$17.2 million prior to its consignment, increasing depreciation expense by that amount. This writedown was necessary to reduce the book value of the assets sold or to be sold to the proceeds received or expected to be received from their disposition.

In preparation for the implementation of a fixed asset management and tracking software system, including a bar code asset identification system, U.S. Cellular conducted a physical inventory review of its cell site fixed assets in 2004. As a result of the review, U.S. Cellular charged \$11.9 million to depreciation expense in 2004 for the write-off of certain assets.

Useful lives generally range from six to twenty-five years for cell site-related equipment; twenty years for buildings; three to ten years, which approximates the shorter of the assets' economic lives or the specific lease terms, for leasehold improvements; one to eight years for switching-related equipment; three to five years for office furniture and equipment; and five to twenty-five years for other operating equipment.

## Note 9 Operations Held for Sale

There were no operations held for sale as of December 31, 2004.

On November 26, 2003, U.S. Cellular announced that it had entered into a definitive agreement to sell its southern Texas wireless markets to AT&T Wireless Services, Inc. ("AT&T Wireless"), now a subsidiary of Cingular Wireless LLC, for \$96.5 million in cash. The U.S. Cellular markets sold to AT&T Wireless include 25 megahertz metropolitan statistical area and rural service area licenses representing 1.3 million population equivalents, approximately 150 cell sites and 76,000 customers. The closing of the sale occurred on February 18, 2004.

The sale was accounted for in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." The balance sheet as of December 31, 2003 reflected assets and liabilities of the wireless properties to be sold as assets and liabilities of operations held for sale. The revenues and expenses of the markets were included in operations until the completion of the sale.

## Notes to Consolidated Financial Statements

The following table summarizes the recorded value of the assets and liabilities of operations held for sale as of December 31, 2003:

December 31,	2003
(Dollars in thousands)	
Current assets	\$ 5,363
Property, plant and equipment, net	45,710
Licenses	63,569
Goodwill	7,565
Other assets	316
Loss on assets held for sale	(22,000)
Assets of operations held for sale	<u>\$100,523</u>
Current liabilities	\$ 2,189
Non-current liabilities	238
Liabilities of operations held for sale	<u>\$ 2,427</u>

In 2003, U.S. Cellular recorded a loss of \$22.0 million as a loss on assets held for sale (included in operating expenses) representing the difference between the carrying value of the markets to be sold to AT&T Wireless and the cash received in the transaction. In 2004, this amount was reduced by \$0.7 million, to finalize the loss upon closing of the transaction, for an aggregate loss of \$21.3 million.

### Note 10 Supplemental Cash Flow Disclosures

Following are supplemental cash flow disclosures regarding interest and income taxes paid and certain noncash transactions:

Year Ended December 31,	2004	2003	2002
(Dollars in thousands)			
Interest paid	\$ 83,656	\$ 51,954	\$ 36,431
Income taxes paid (refunds received)	(28,955)	(29,621)	33,446
9% Series A notes issued for Chicago acquisition	\$ —	\$ —	\$175,000

### Note 11 Acquisitions, Divestitures and Exchanges

U.S. Cellular assesses its wireless holdings on an ongoing basis in order to maximize the benefits derived from its operating markets. U.S. Cellular also reviews attractive opportunities for the acquisition of additional wireless spectrum.

#### 2004 Activity

On December 20, 2004, U.S. Cellular completed the sale of its Daytona Beach, Florida 20 megahertz C block personal communications service license to MetroPCS California/Florida, Inc. ("MetroPCS") for \$8.5 million. U.S. Cellular recorded impairment losses of \$1.8 million in 2004 and \$3.5 million in 2003 included within investment and other income (expense) related to the Daytona license. Also included in gain (loss) on investments in 2004 was a loss of \$0.3 million associated with buying out the former partner of the Daytona investment.

On November 30, 2004, U.S. Cellular completed the sale to ALLTEL of certain wireless properties. U.S. Cellular sold two consolidated properties and five minority interests to ALLTEL for \$80.2 million in cash, including repayment of debt and working capital that is subject to adjustment. U.S. Cellular recorded a pre-tax gain of \$36.7 million related to the ALLTEL

transaction, representing the excess of the cash received over the net book value of the assets and liabilities sold. The portion of the gain related to the two consolidated markets included in operations of \$10.1 million, was recorded in (gain) loss on assets held for sale in the Statement of Operations. The remaining portion of the gains of \$26.6 million was recorded in gain (loss) on investments included within investment and other income (expense) on the Statement of Operations. U.S. Cellular has included the results of operations of the markets sold to ALLTEL in the Statement of Operations through November 30, 2004.

The following table summarizes the estimated fair values of the recorded value of the assets and liabilities transferred to ALLTEL.

	November 30, 2004
(Dollars in thousands)	
Current assets	\$ (2,364)
Property, plant and equipment	(10,029)
Licenses transferred	(258)
Goodwill	(8,257)
Investment in unconsolidated entities	(22,282)
Other assets and liabilities	1,394
Current liabilities	1,400
Minority interest divested	(3,192)
Gain recorded on transfer	(36,659)
Cash received	<u>\$ (80,247)</u>

On February 18, 2004, U.S. Cellular completed the sale of certain of its wireless properties in southern Texas to AT&T Wireless for \$96.5 million in cash, including a working capital adjustment. The U.S. Cellular properties sold to AT&T Wireless included wireless assets and customers in six markets. An aggregate loss of \$21.3 million (including a \$22.0 million estimate of the loss on assets of operations held for sale in the fourth quarter of 2003 and a \$0.7 million reduction of the loss in 2004) was recorded as a loss on assets of operations held for sale (included in operating expenses), representing the difference between the carrying value of the markets sold to AT&T Wireless and the cash received in the transaction. On December 31, 2003, U.S. Cellular reflected the assets and liabilities to be transferred to AT&T Wireless as assets and liabilities of operations held for sale in accordance with SFAS No. 144. U.S. Cellular has included the results of operations of the markets sold to AT&T Wireless in the Statement of Operations through February 17, 2004.

The following table summarizes the recorded value of the southern Texas assets and liabilities sold to AT&T Wireless.

	February 18, 2004
(Dollars in thousands)	
Current assets	\$ (4,342)
Property, plant and equipment	(46,592)
Licenses transferred	(63,237)
Goodwill	(7,565)
Other assets and liabilities	1,483
Current liabilities	2,455
Loss recorded on transfer	21,275
Cash received	<u>\$ (96,523)</u>

In addition, in 2004, U.S. Cellular purchased certain minority interests in several wireless markets in which it already owned a controlling interest for \$40.8 million in cash and \$2.0 million to be paid in 2005. These acquisitions increased licenses, goodwill and customer lists by \$5.6 million, \$4.2 million and \$12.9 million, respectively.

## Notes to Consolidated Financial Statements

In aggregate, the 2004 acquisitions, divestitures and exchanges decreased licenses by \$2.8 million and goodwill by \$4.0 million. Licenses and goodwill associated with the southern Texas transaction with AT&T Wireless that closed in 2004 were included in assets of operations held for sale in 2003.

### 2003 Activity

During 2003, U.S. Cellular completed an exchange with AT&T Wireless along with the acquisition of two minority interests.

On August 1, 2003, U.S. Cellular completed the transfer of properties to AT&T Wireless and the assignments to it by AT&T Wireless of a portion of the licenses covered by the agreement with AT&T Wireless. On the initial closing date, U.S. Cellular also received approximately \$34.0 million in cash and minority interests in six markets in which it currently owns a controlling interest. Also on the initial closing date, U.S. Cellular transferred wireless assets and customers in 10 markets in Florida and Georgia to AT&T Wireless. The assignment and development of certain licenses has been deferred by U.S. Cellular for a period of up to five years from the closing date, in accordance with the agreement. U.S. Cellular will take possession of the licenses in staggered closings over that five-year period to comply with the service requirements of the FCC. The acquisition of the licenses in the exchange was accounted for as a purchase by U.S. Cellular and the transfer of the properties by U.S. Cellular to AT&T Wireless was accounted for as a sale. U.S. Cellular capitalized \$2.8 million of costs associated with the AT&T Wireless transaction.

The 15 licenses that have been transferred to U.S. Cellular as of December 31, 2003, with a recorded value of \$136.6 million, are included in licenses on the consolidated Balance Sheet. The 21 licenses that have not yet been assigned to U.S. Cellular, with a recorded value of \$42.0 million, are included in license rights on the Balance Sheet. U.S. Cellular has included the results of operations in the Florida and Georgia markets in the Statement of Operations until the date of transfer, August 1, 2003.

Prior to the close of the AT&T Wireless exchange, U.S. Cellular allocated \$70.0 million of goodwill related to the properties transferred to AT&T Wireless to assets of operations held for sale in accordance with SFAS No. 142. A loss of \$23.9 million was recorded as a loss on assets held for sale (included in operating expenses), representing the difference between the book value of the markets transferred to AT&T Wireless and the fair value of the assets received or to be received in this transaction.

The following table summarizes the estimated fair values of the AT&T Wireless licenses received and the recorded value of the Florida and Georgia assets and liabilities transferred to AT&T Wireless.

	August 1, 2003
(Dollars in thousands)	
Current assets	\$(12,785)
Property, plant and equipment	(88,314)
Wireless licenses transferred	(76,905)
Wireless licenses received	136,571
Wireless license rights	42,037
Goodwill	(69,961)
Minority interests acquired	3,000
Other assets and liabilities	(717)
Current liabilities	9,213
Loss recorded on transfer	23,908
Cash received	\$(33,953)

In addition, in 2003, U.S. Cellular acquired the minority interest in two entities which held wireless licenses for \$2.3 million.

In aggregate, the 2003 acquisitions, divestitures and exchanges increased licenses by \$59.7 million and license rights by \$42.0 million and reduced goodwill by \$62.4 million.

### 2002 Activity

On August 7, 2002, U.S. Cellular completed the acquisition of the assets and certain liabilities of Chicago 20MHz, LLC now known as United States Cellular Operating Company of Chicago, LLC ("USCOC of Chicago" or the "Chicago Market") from PrimeCo Wireless Communications LLC ("PrimeCo"). USCOC of Chicago operates a wireless system in the Chicago major trading area. USCOC of Chicago is the holder of certain FCC licenses, including a 20 megahertz personal communications service license in the Chicago major trading area (excluding Kenosha County, Wisconsin) covering 13.2 million population equivalents.

U.S. Cellular financed the purchase price (\$617.8 million) using \$327.3 million of revolving lines of credit, \$175.0 million in 30 year notes issued to PrimeCo, a \$105.0 million loan from TDS and a \$10.5 million accrued payable. U.S. Cellular has included the USCOC of Chicago results of operations in the Statement of Operations subsequent to the purchase date.

The tangible fixed assets were recorded at fair value. The personal communications service licenses were valued at \$163.5 million. The customer list was assigned a value of \$43.4 million and is being amortized based on a 30 month average customer retention period using the declining balance method.

Total goodwill attributed to the Chicago acquisition aggregated \$168.4 million. In January 2003, U.S. Cellular repurchased the \$45.2 million 9% Series A notes that remained outstanding at December 31, 2002, at 90% of face value. The \$4.5 million gain on retirement of the 9% Series A notes was credited to goodwill, reducing the aggregate goodwill attributed to the Chicago acquisition to \$163.9 million. Such goodwill is deductible for tax purposes and will be amortized over 15 years.

The following table summarizes the estimated fair values of the PrimeCo assets acquired and liabilities assumed at the date of acquisition.

	August 7, 2002
(Dollars in thousands)	
Current assets, excluding \$6,984 cash acquired	\$ 34,081
Property, plant and equipment	235,953
Other assets	815
Customer list	43,400
Wireless licenses	163,500
Goodwill	168,436
Total assets acquired	646,185
Current liabilities	(22,518)
Non-current liabilities	(1,300)
Total liabilities acquired	(23,818)
Net assets purchased	622,367
Notes issued to PrimeCo	(175,000)
Accrued but unpaid items	(15,500)
Cash required	\$ 431,867

## Notes to Consolidated Financial Statements

In addition, during 2002, U.S. Cellular completed the acquisition of majority interests in licenses in three personal communications service markets and three minority interests in other personal communications service markets, representing approximately 1.4 million population equivalents, for consideration totaling \$21.1 million.

In aggregate, the 2002 acquisitions, divestitures and exchanges increased licenses by \$181.5 million and goodwill by \$172.3 million.

### Pro Forma Operations

Assuming the exchanges and acquisitions accounted for as purchases during the period January 1, 2003 to December 31, 2004, had taken place on January 1, 2003; and the acquisitions during the period January 1, 2002 to December 31, 2002 had taken place on January 1, 2002, unaudited pro forma results of operations would have been as follows:

Year Ended December 31,	2004	2003	2002
(Unaudited, dollars in thousands, except per share amounts)			
Service revenues	\$2,621,679	\$2,283,885	\$2,208,079
Equipment sales revenues	189,831	155,157	105,510
Interest expense (including cost to finance acquisitions)	86,241	64,607	62,431
Income (loss) before cumulative effect of accounting change	\$ 99,913	\$ 57,303	\$ (55,282)
Net income (loss)	99,913	42,958	(63,843)
Earnings per share – basic	\$ 1.16	\$ 0.50	\$ (0.74)
Earnings per share – diluted	\$ 1.15	\$ 0.50	\$ (0.74)

### Note 12 Gain (Loss) on Investments

The following table summarizes the components of gain (loss) on investments included in investment and other income (expense) in the Statement of Operations.

Year Ended December 31,	2004	2003	2002
(Dollars in thousands)			
Gain on sale of investment interests	\$ 26,578	\$ —	\$ —
Impairment of unconsolidated interests	(2,142)	(5,200)	(8,413)
Marketable equity securities other-than-temporary losses	—	—	(244,699)
Notes receivable impairment	—	—	(38,116)
Other	—	—	(4,226)
	\$ 24,436	\$ (5,200)	\$ (295,454)

In 2004, U.S. Cellular recorded a gain of \$26.6 million related to the ALLTEL transaction representing the excess of the cash received over the net book value of the minority investments sold.

U.S. Cellular recorded impairment losses of \$1.8 million in 2004 and \$3.5 million in 2003 related to the Daytona license that was sold to MetroPCS in December 2004. Also included in gain (loss) on investments was a \$0.3 million loss associated with buying out the former partner of the Daytona investment.

Also in 2003, U.S. Cellular reduced the carrying value of one of its cost method investments by \$1.7 million to its underlying equity value based on a cash flow analysis.

In 2002, management determined that a decline in the value of marketable equity securities relative to their respective accounting cost basis was other than temporary and charged an aggregate \$244.7 million loss to the Statement of Operations and reduced the accounting cost basis of such marketable equity securities by a corresponding amount.

U.S. Cellular had certain notes receivable from Kington Management Corporation ("Kington"). The notes related to the purchase by Kington of certain U.S. Cellular minority interests in 2000. The values of the notes were directly related to the values of the minority cellular market interests. During 2002, management concluded that the notes receivable were impaired, and reduced the carrying value of the notes by \$38.1 million.

U.S. Cellular recorded additional losses in 2002 of \$8.4 million related to the withdrawal from a partnership in which it had owned an investment interest and \$4.2 million related to the reduction in value of a land purchase option.

### Note 13 Notes Payable

U.S. Cellular has used short-term debt to finance acquisitions, for general corporate purposes and to repurchase common shares. Proceeds from the sale of long-term debt from time to time have been used to reduce such short-term debt. Proceeds from the sale of non-strategic wireless and other investments from time to time have also been used to reduce short-term debt.

On December 19, 2003, U.S. Cellular amended its \$325 million revolving credit facility with a group of banks to increase the size of the facility to \$700 million. At December 31, 2004, U.S. Cellular's \$700 million revolving credit facility had \$30.0 million of borrowings and \$0.2 million of letters of credit outstanding against it leaving \$669.8 million available for use. On December 9, 2004, U.S. Cellular entered into an agreement to amend the terms and conditions of this facility. The primary changes to the terms and conditions are that (i) the maturity date has been extended to December 2009; (ii) the facility fee and certain interest rates payable on loans have been reduced; (iii) a utilization fee has been added for each day that facility usage exceeds 50% of the total facility; and (iv) the material adverse change condition has been removed with respect to drawdowns. Borrowings bear interest at the London InterBank Offered Rate ("LIBOR") rate plus a contractual spread based on U.S. Cellular's credit rating. At December 31, 2004, the contractual spread was 30 basis points (the one-month LIBOR rate was 2.4% at December 31, 2004). U.S. Cellular may select borrowing periods of either seven days or one, two, three or six months. Under certain circumstances, with less than two days' notice of intent to borrow, interest on borrowings is the prime rate less 50 basis points (the prime rate was 5.25% at December 31, 2004). U.S. Cellular currently pays facility and administration fees at an aggregate annual rate of 0.11% of the total facility. These fees totaled \$1.5 million in 2004, \$0.7 million in 2003 and \$0.5 million in 2002.



Until December 23, 2003, U.S. Cellular had a \$500 million revolving credit facility with a group of banks. This credit facility was terminated on December 23, 2003 in connection with the amendment of U.S. Cellular's \$325 million credit facility to \$700 million. The terms of the revolving credit facility provided for borrowings with interest at the LIBOR plus a margin percentage based on U.S. Cellular's credit rating. Interest and principal were due the last day of the borrowing period, as selected by U.S. Cellular, of either seven days or one, two, three or six months. U.S. Cellular paid facility and administration fees at an aggregate annual rate of 0.10% of the total \$500 million facility. These payments totaled \$0.5 million for the years ended December 31, 2003 and 2002.

Information concerning notes payable is shown in the table that follows.

Year Ended December 31,	2004	2003
(Dollars in thousands)		
Balance at end of year	\$ 30,000	\$ —
Weighted average interest rate at end of year	4.8%	—%
Maximum amount outstanding during the year	\$100,000	\$627,000
Average amount outstanding during the year <sup>(1)</sup>	\$ 47,917	\$490,667
Weighted average interest rate during the year <sup>(1)</sup>	2.1%	1.5%

(1) The average was computed based on month-end balances.

The financial covenants associated with U.S. Cellular's revolving credit facility requires that U.S. Cellular and subsidiaries maintain certain debt-to-capital and interest coverage ratios. The covenants prescribe certain terms associated with intercompany loans from TDS or TDS subsidiaries to U.S. Cellular or U.S. Cellular subsidiaries.

U.S. Cellular's interest cost on its revolving credit facility would increase if its current credit ratings from either Standard & Poor's or Moody's were lowered. However, the credit facility would not cease to be available solely as a result of a decline in its credit rating. A downgrade in U.S. Cellular's credit rating could adversely affect its ability to renew existing, or obtain access to new, credit facilities in the future. Standard & Poor's currently rates U.S. Cellular at A- with a Negative Outlook. Moody's currently rates U.S. Cellular at Baa1, with a Negative Outlook.

The maturity date of U.S. Cellular's credit facility would accelerate in the event of a change in control.

The continued availability of the revolving credit facility requires U.S. Cellular to comply with certain negative and affirmative covenants, maintain certain financial ratios and represent certain matters at the time of each borrowing. On April 19, 2004 and December 22, 2004, U.S. Cellular announced that it expected to restate certain financial statements. The restatements resulted in a default under the revolving credit agreement. U.S. Cellular was not in violation of any covenants that require it to maintain certain financial ratios. U.S. Cellular did not fail to make any scheduled payments under such revolving credit agreement. U.S. Cellular received waivers from the lenders associated with the credit agreement under which the lenders agreed to waive any defaults that may have occurred as a result of the restatements. As of December 31, 2004, U.S. Cellular is in compliance with all covenants and other requirements set forth in the revolving credit agreement.

## Note 14 Long-Term Debt

Long-term debt is as follows:

December 31,	2004	2003
(Dollars in thousands)		
6.7% senior notes maturing in 2033	\$ 544,000	\$ 444,000
Unamortized discount	(13,070)	(7,171)
	530,930	436,829
7.5% senior notes, maturing in 2034	330,000	—
7.25% senior notes, maturing in 2007	—	250,000
8.75% senior notes, maturing in 2032	130,000	130,000
Other 9.0% due in 2009	10,000	13,000
6% zero coupon convertible debentures (Liquid Yield Option Notes), maturing in 2015	—	310,749
Unamortized discount	—	(153,090)
	—	157,659
Total long-term debt	1,000,930	987,488
Less: Current portion of long-term debt	—	3,000
Total long-term debt, excluding current portion	\$1,000,930	\$ 984,488

### Unsecured Notes

In June 2004, U.S. Cellular issued \$330 million in aggregate principal amount of unsecured 7.5% senior notes due June 15, 2034. Interest on the notes is payable quarterly. U.S. Cellular may redeem the notes, in whole or in part, at any time on and after June 17, 2009, at a redemption price equal to 100% of the principal amount redeemed plus accrued and unpaid interest to the redemption date. The net proceeds from this offering, after deducting underwriting discounts, were approximately \$319.6 million.

Also, in June 2004, U.S. Cellular issued \$100 million in aggregate principal amount of unsecured 6.7% senior notes due December 15, 2033 priced to yield 7.21% to maturity. The net proceeds from this offering, after deducting underwriting discounts, were approximately \$92.9 million. This was a further issuance of U.S. Cellular's 6.7% senior notes that were issued in December 2003, in the aggregate principal amount of \$444 million.

The total net proceeds from the 7.5% and 6.7% senior note offerings completed in June 2004, after deducting underwriting discounts, were approximately \$412.5 million. Of this amount, \$163.3 million was used to redeem U.S. Cellular's Liquid Yield Option Notes, in July 2004, at accreted value. The balance of the net proceeds, together with borrowings under the revolving credit agreement, was used to redeem all \$250 million of U.S. Cellular's 7.25% senior notes on August 16, 2004. No gain or loss was recognized as a result of such redemptions. However, U.S. Cellular wrote off \$3.6 million of deferred debt expenses related to the redemption of long-term debt to other income (expense), net in the Statement of Operations, in 2004.

In December 2003, U.S. Cellular sold \$444 million of 6.7% senior notes due December 15, 2033, priced to yield 6.83% to maturity. Interest is paid semi-annually. U.S. Cellular may redeem the notes, in whole or in part, at any time prior to maturity at a redemption price equal to the greater of (a) 100% of the principal amount of such notes, plus accrued but unpaid interest, or (b) the sum of the present values of the remaining scheduled payments of principal and interest thereon discounted to the redemption date on a semi-annual basis at the Treasury Rate plus .30%. The proceeds were used to repay a portion of short-term debt.



## Notes to Consolidated Financial Statements

In November 2002, U.S. Cellular sold \$130 million of 8.75% senior notes due November 7, 2032. Interest is paid quarterly. U.S. Cellular may redeem the notes beginning in 2007 at the principal amount plus accrued interest.

U.S. Cellular's \$250 million, unsecured 7.25% senior notes were due 2007 and interest was payable semi-annually. U.S. Cellular redeemed the notes in August 2004 at the principal amount plus accrued interest.

### Liquid Yield Option Notes

On July 26, 2004, U.S. Cellular redeemed its Liquid Yield Option Notes at accreted value. The unsecured 6% yield to maturity zero coupon convertible redeemable notes were due in 2015. Each Liquid Yield Option Note was convertible at the option of the holder at any time at a conversion rate of 9.475 U.S. Cellular Common Shares per \$1,000 of note. Upon notice of conversion, U.S. Cellular had the option to deliver its Common Shares or cash equal to the market value of the Common Shares. U.S. Cellular had the option to redeem the Liquid Yield Option Notes for cash at the issue price plus accrued original issue discount through the date of redemption. Holders had the right to exercise their conversion option prior to the redemption date. There were no Liquid Yield Option Notes redeemed in 2003 and 2002.

### General

The covenants of long-term debt obligations of U.S. Cellular, among other things, restrict its subsidiaries' ability, subject to certain exclusions, to incur additional liens; enter into sale and leaseback transactions; and sell, consolidate, or merge assets. As of December 31, 2004, U.S. Cellular was in compliance with all of the covenants of its debt obligations.

The annual requirements for principal payments on long-term debt over the next five years, excluding the forward contracts, are approximately \$10.0 million in 2009. No amounts are required in the years 2005 through 2008.

### Forward Contracts

During 2002, a subsidiary of U.S. Cellular entered into forward contracts with counterparties in connection with its 10,245,370 Vodafone Group Plc American Depositary Receipts. The \$159.9 million principal amount of the forward contracts is accounted for as a loan. The collar portions of the forward contracts are accounted for as derivative instruments. The Vodafone securities are pledged as collateral for the forward contracts.

The forward contracts mature in May 2007. The forward contracts require quarterly interest payments at the LIBOR rate plus 50 basis points (the three-month LIBOR rate was 2.56% at December 31, 2004).

The risk management objective of the forward contracts is to hedge the value of the Vodafone securities from losses due to decreases in the market prices of the securities ("downside limit") while retaining a share of gains from increases in the market prices of such securities ("upside potential"). The downside limit is hedged at or above the accounting cost basis, thereby eliminating the risk of an other-than-temporary loss being recorded on these contracted securities.

Under the terms of the forward contracts, a subsidiary of U.S. Cellular continues to own the contracted shares and will receive dividends paid on such contracted shares, if any. The forward contracts mature May 2007 and, at U.S. Cellular's option, may be settled in shares of the security or in cash, pursuant to formulas that "collar" the price of the shares. The collars effectively reduce U.S. Cellular's downside limit and upside potential on the contracted shares. The collars are typically adjusted for any changes in

dividends on the contracted shares. If the dividend increases, the collar's upside potential is typically reduced. If the dividend decreases the collar's upside potential is typically increased. If U.S. Cellular elects to settle in shares, it will be required to deliver the number of shares of the contracted security determined pursuant to the formula. If shares are delivered in the settlement of the forward contract, U.S. Cellular would incur a current tax liability at the time of delivery based on the difference between the tax basis of the marketable equity securities and the net amount realized through maturity. If U.S. Cellular elects to settle in cash, it will be required to pay an amount in cash equal to the fair market value of the number of shares determined pursuant to the formula. U.S. Cellular has provided guarantees to the counterparties which provide assurance that all principal and interest amounts will be paid by its consolidated subsidiaries upon settlement of the contracts.

U.S. Cellular is required to comply with certain covenants under the forward contracts. On April 19, 2004 and December 22, 2004, U.S. Cellular announced that it expected to restate certain financial statements. The restatements resulted in defaults under certain of the forward contracts. U.S. Cellular was not in violation of any covenants that require it to maintain certain financial ratios. U.S. Cellular did not fail to make any scheduled payments under such forward contracts. U.S. Cellular received waivers from the counterparty to such forward contracts under which the counterparty agreed to waive any defaults that may have occurred as a result of the restatement. As of December 31, 2004, U.S. Cellular is in compliance with all covenants and other requirements set forth in the forward contracts.

## Note 15 Financial Instruments and Derivatives

Financial instruments are as follows:

December 31,	2004		2003	
(Dollars in thousands)	Book Value	Fair Value	Book Value	Fair Value
Cash and cash equivalents	\$ 40,922	\$ 40,922	\$ 9,848	\$ 9,848
Current portion of long-term debt	—	—	3,000	3,000
Current portion of long-term debt-affiliated	—	—	105,000	105,000
Notes payable	30,000	30,000	—	—
Long-term debt	1,000,930	1,082,745	984,488	1,044,481
Forward contracts	\$ 159,856	\$ 159,856	\$ 159,856	\$ 159,856

The carrying amounts of cash and cash equivalents and notes payable approximates fair value due to the short-term nature of these financial instruments. The fair value of U.S. Cellular's long-term debt was estimated using market prices for the 6.7% senior notes, the 7.5% senior notes, the 8.75% senior notes and the 6% zero coupon convertible debentures, and discounted cash flow analysis for the remaining debt. The carrying amounts of the variable rate forward contracts approximates fair value due to the repricing of the instruments on a quarterly basis.

### Derivatives

During 2002, U.S. Cellular entered into forward contracts in connection with its 10,245,370 Vodafone American Depositary Receipts. The principal amount of the forward contracts is accounted for as a loan. The collar portions of the forward contracts are accounted for as derivative instruments. The forward contracts reduce the downside limit to a range of \$15.07 to \$16.07 per share and upside potential to a range of \$21.05 to \$22.60 per share.

The forward contracts for the forecasted transactions and hedged items are designated as cash flow hedges and recorded as assets or liabilities on the Balance Sheet at their fair value. The fair value of the derivative instruments is determined using the Black-Scholes model.

The forward contracts are designated as cash flow hedges, where changes in the forward contract's fair value are recognized in accumulated other comprehensive income until they are recognized in earnings when the forward contract is settled. If the delivery of the contracted shares does not occur, or it becomes probable that it will not occur, the gain or loss on the related cash flow hedge is recognized in earnings at that time. No components of the forward contracts are excluded in the measurement of hedge effectiveness. The critical terms of the forward contracts are the same as the underlying forecasted transactions; therefore, changes in the fair value of the forward contracts are anticipated to be effective in offsetting changes in the expected cash flows from the forecasted transactions. No gains or losses related to ineffectiveness of cash flow hedges were recognized in earnings for the years ended December 31, 2004 and 2003.

Management has evaluated the expected timing of the hedged forecasted transactions to deliver the underlying shares to settle the forward contracts, and believes that these forecasted transactions are probable of occurring in the periods specified in the related hedge documentation or within an additional two-month period of time thereafter.

U.S. Cellular reported a derivative liability of \$70.8 million and \$55.7 million at December 31, 2004 and 2003, respectively. These amounts are included in the Balance Sheet caption deferred liabilities and credits.

#### **Note 16 Minority Interest in Subsidiaries**

Under SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity," certain minority interests in consolidated entities with finite lives may meet the standard's definition of a mandatorily redeemable financial instrument and thus require reclassification as liabilities and remeasurement at the estimated amount of cash that would be due and payable to settle such minority interests under the applicable entity's organization agreement, assuming an orderly liquidation of the finite-lived entity, net of estimated liquidation costs (the "settlement value"). U.S. Cellular's consolidated financial statements include such minority interests that meet the standard's definition of mandatorily redeemable financial instruments. These mandatorily redeemable minority interests represent interests held by third parties in consolidated partnerships and limited liability companies ("LLCs"), where the terms of the underlying partnership or LLC agreement provide for a defined termination date at which time the assets of the subsidiary are to be sold, the liabilities are to be extinguished and the remaining net proceeds are to be distributed to the minority interest holders and U.S. Cellular in accordance with the respective partnership and LLC agreements. The termination dates of U.S. Cellular's mandatorily redeemable minority interests range from 2042 to 2100.

The settlement value of U.S. Cellular's mandatorily redeemable minority interests was estimated to be \$129.9 million at December 31, 2004 and \$104.7 million at December 31, 2003. This represents the estimated amount of cash that would be due and payable to settle minority interests assuming an orderly liquidation of the finite-lived consolidated partnerships and LLCs

on December 31, 2004 and 2003, net of estimated liquidation costs. This amount is being disclosed pursuant to the requirements of FASB Staff Position ("FSP") No. FAS 150-3, "Effective Date, Disclosures, and Transition for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatorily Redeemable Noncontrolling Interests" under FASB Statement No. 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity." U.S. Cellular has no current plans or intentions to liquidate any of the related partnerships or LLCs prior to their scheduled termination dates. The corresponding carrying value of the minority interests in finite-lived consolidated partnerships and LLCs at December 31, 2004 and 2003 was \$38.1 million and \$35.2 million, respectively, and is included in the Balance Sheet caption minority interest. The excess of the aggregate settlement value over the aggregate carrying value of the mandatorily redeemable minority interests of \$91.8 million and \$69.5 million, respectively, was primarily due to the unrecognized appreciation of the minority interest holders' share of the underlying net assets in the consolidated partnerships and LLCs. Neither the minority interest holders' share, nor U.S. Cellular's share, of the appreciation of the underlying net assets of these subsidiaries is reflected in the consolidated financial statements under U.S. GAAP. The estimate of settlement value was based on certain factors and assumptions. A change in those factors and assumptions could result in a materially larger or smaller settlement amount.

#### **Note 17 Common Shareholders' Equity**

##### **Employee Benefit Plans**

The following table summarizes Common Shares issued, including reissued Treasury Shares, for the employee benefit plans described as follows:

Year Ended December 31,	2004	2003
Employee stock options and awards	255,000	14,000
Employee Stock Purchase Plan	19,000	11,000
	<u>274,000</u>	<u>25,000</u>

##### **Tax-Deferred Savings Plan**

U.S. Cellular has reserved 67,000 Common Shares for issuance under the TDS Tax-Deferred Savings Plan, a qualified profit-sharing plan pursuant to Sections 401(a) and 401(k) of the Internal Revenue Code. Participating employees have the option of investing their contributions in a U.S. Cellular Common Share fund, a TDS Common Share fund, or certain unaffiliated funds.

##### **Stock-Based Compensation Plans**

U.S. Cellular accounts for stock options, restricted stock awards and employee stock purchase plans under APB Opinion No. 25. No compensation costs have been recognized for the stock option and employee stock purchase plans. Compensation costs were recognized for restricted stock awards as expenses in the Statement of Operations.

## Notes to Consolidated Financial Statements

A summary of the status of U.S. Cellular's stock option plans at December 31, 2004, 2003 and 2002 and changes during the years then ended is presented in the table and narrative as follows:

	Number of Options	Weighted Average Option Price	Weighted Average Black-Scholes Values of Option Grants
Stock options			
Outstanding			
December 31, 2001			
(200,000 exercisable)	884,000	\$50.42	
Granted	869,000	\$38.80	\$19.74
Exercised	(9,000)	\$29.45	
Canceled	(201,000)	\$47.17	
Outstanding			
December 31, 2002			
(336,000 exercisable)	1,543,000	\$45.15	
Granted	1,435,000	\$23.85	\$10.99
Exercised	(2,000)	\$24.37	
Canceled	(448,000)	\$40.18	
Outstanding			
December 31, 2003			
(496,000 exercisable)	2,528,000	\$33.87	
Granted	796,000	\$37.46	\$16.27
Exercised	(220,000)	\$27.26	
Canceled	(248,000)	\$32.97	
Outstanding			
December 31, 2004			
(883,000 exercisable)	2,856,000	\$35.44	

U.S. Cellular has established stock option plans that provide for the grant of stock options to officers and employees and has reserved 6,256,000 Common Shares at December 31, 2004, for options granted and to be granted to key employees. The options under the plan are exercisable from the date of vesting through 2005 to 2014, or 30 days following the date of the employee's termination of employment, if earlier. Under the plan, 883,000 stock options were exercisable at December 31, 2004, have exercise prices between \$23.61 and \$73.31 and a weighted average exercise price of \$41.33 per share. The weighted average exercise price of options exercisable at December 31, 2003 and 2002, was \$46.22 and \$46.71, respectively.

The following table provides certain details concerning U.S. Cellular stock options outstanding at December 31, 2004:

Range of Exercise Price	Stock Options Outstanding	Weighted Average Exercise Price	Weighted Average Contractual Life Remaining (Years)
\$23.20–\$36.99	1,405,000	\$26.04	8.2
\$37.00–\$49.99	1,221,000	\$40.60	7.9
\$50.00–\$73.31	230,000	\$65.76	4.8

The following table provides certain details concerning U.S. Cellular stock options exercisable at December 31, 2004:

Range of Exercise Price	Stock Options Exercisable	Weighted Average Exercise Price
\$23.61–\$36.99	275,000	\$25.53
\$37.00–\$49.99	452,000	\$42.50
\$50.00–\$73.31	156,000	\$66.23

The fair value of each option grant was estimated on the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions used for grants in 2004, 2003 and 2002, respectively: risk-free interest rates of 3.6%, 3.7% and 4.6%; expected dividend yields of zero for all years; expected lives of 6.6 years, 9.3 years and 9.4 years; and expected volatility of 36.0%, 29.4% and 39.4%.

U.S. Cellular has granted key employees restricted shares of stock that fully vest after three years. The number of shares granted were 86,000, 142,000 and 87,000 in the years 2004, 2003 and 2002, respectively. The weighted-average values of the shares granted were \$38.65, \$23.70 and \$39.71 in 2004, 2003 and 2002, respectively. The expenses included in operating income due to grants of restricted shares were \$4.2 million, \$2.8 million and \$1.6 million in 2004, 2003 and 2002, respectively.

### Employee Stock Purchase Plan

U.S. Cellular had 130,000 Common Shares reserved under the 2003 Employee Stock Purchase Plan, which will terminate on December 31, 2008. The plan became effective April 1, 2003, and provides for eligible employees of U.S. Cellular and its subsidiaries to purchase a limited number of U.S. Cellular Common Shares on a quarterly basis. The per share cost to each participant is at 85% of the market value of the Common Shares as of the issuance date.

### Series A Common Shares

Series A Common Shares are convertible on a share-for-share basis into Common Shares. In matters other than the election of directors, each Series A Common Share is entitled to ten votes per share, compared to one vote for each Common Share. The Series A Common Shares are entitled to elect 75% of the directors (rounded down), and the Common Shares elect 25% of the directors (rounded up). As of December 31, 2004, a majority of U.S. Cellular's Common Shares and all of U.S. Cellular's outstanding Series A Common Shares were held by TDS.

### Common Share Repurchase Program

The Board of Directors of U.S. Cellular from time to time has authorized the repurchase of U.S. Cellular Common Shares not owned by TDS.

U.S. Cellular's primary repurchase program expired in December 2003. However, U.S. Cellular has an ongoing authorization to repurchase a limited amount of U.S. Cellular Common Shares on a quarterly basis, primarily for use in employee benefit plans.

In 2004, U.S. Cellular repurchased 91,700 U.S. Cellular Common Shares under this authorization for an aggregate purchase price of \$3.9 million, representing an average per share price of \$42.62 including commissions. A total of 275,000 treasury shares were issued in 2004 pursuant to certain employee and non-employee benefit plans.

## Notes to Consolidated Financial Statements

In 2003, no U.S. Cellular Common Shares were repurchased and 32,000 treasury shares were issued pursuant to certain employee and non-employee benefit plans.

In 2002, no U.S. Cellular Common Shares were repurchased and 69,000 treasury shares were issued pursuant to certain employee and non-employee benefit plans.

### Accumulated Other Comprehensive Income

The cumulative balance of unrealized gains and (losses) on securities and derivative instruments and related income tax effects included in Accumulated other comprehensive income are as follows:

Year Ended December 31,	2004	2003
(Dollars in thousands)		
<b>Marketable Equity Securities</b>		
Balance, beginning of year	\$ 60,509	\$ 15,488
Add (deduct):		
Unrealized gains on marketable equity securities	22,641	74,227
Income tax (expense)	(8,912)	(29,327)
Net unrealized gains (losses)	13,729	44,900
Recognized losses on marketable equity securities	—	200
Income tax (benefit)	—	(79)
Net recognized losses from marketable equity securities included in net income	—	121
Net change in unrealized gains (losses) on marketable equity security in comprehensive income	13,729	45,021
Balance, end of year	\$ 74,238	\$ 60,509
<b>Derivative Instruments</b>		
Balance, beginning of year	\$(33,720)	\$ (5,181)
Add (deduct):		
Unrealized loss on derivative instruments	(15,061)	(47,026)
Income tax benefit	5,936	18,487
Net change in unrealized gains (losses) on derivative instruments included in comprehensive income	(9,125)	(28,539)
Balance, end of year	\$(42,845)	\$(33,720)
<b>Accumulated Other Comprehensive Income</b>		
Balance, beginning of year	\$ 26,789	\$ 10,307
Net change in marketable equity security	13,729	45,021
Net change in derivative instruments	(9,125)	(28,539)
Net change in unrealized gains (losses) included in comprehensive income	4,604	16,482
Balance, end of year	\$ 31,393	\$ 26,789

### Note 18 Related Parties

U.S. Cellular is billed for all services it receives from TDS, pursuant to the terms of various agreements between U.S. Cellular and TDS. The majority of these billings are included in U.S. Cellular's selling, general and administrative expenses. Some of these agreements were established at a time prior to U.S. Cellular's initial public offering when TDS owned more than 90% of U.S. Cellular's outstanding capital stock and may not reflect terms that would be obtainable from an unrelated third party through arm's-length negotiations. Such billings are based on expenses specifically identified to U.S. Cellular and on allocations of common expenses. Such allocations are based on the relationship of U.S. Cellular's assets, employees, investment in plant and expenses to the total assets, employees, investment in plant and expenses of TDS. Management believes the method used to allocate common expenses is reasonable and that all expenses and costs applicable

to U.S. Cellular are reflected in the accompanying financial statements. Billings to U.S. Cellular from TDS totaled \$78.9 million, \$73.3 million and \$61.4 million in 2004, 2003 and 2002, respectively.

In August 2002, U.S. Cellular entered into a loan agreement with TDS under which it borrowed \$105 million, which was used to purchase the Chicago market. The loan bore interest at an annual rate of 8.1%, payable quarterly, and originally became due in August 2008, with prepayments optional. The loan was subordinated to the 2002 Revolving Credit Facility until December 19, 2003. The terms of the loan did not contain restrictive covenants that were greater than those included in U.S. Cellular's senior debt, except that the loan agreement provided that U.S. Cellular could not incur senior debt in an aggregate principal amount in excess of \$325 million unless it obtained the consent of TDS as a lender. U.S. Cellular's Board of Directors, including independent directors, approved the terms of this loan and determined that such terms were fair to U.S. Cellular and all of its shareholders. On February 9, 2004, U.S. Cellular prepaid this note in its entirety.

U.S. Cellular has a Cash Management Agreement with TDS under which U.S. Cellular may from time to time deposit its excess cash with TDS for investment under TDS's cash management program. Deposits made under the agreement are available to U.S. Cellular on demand and bear interest each month at the 30-day Commercial Paper Rate as reported in The Wall Street Journal, plus 1/4%, or such higher rate as TDS may at its discretion offer on such deposits. Interest income from such deposits was \$33,000, \$94,000 and \$209,000 in 2004, 2003 and 2002, respectively.

### Note 19 Commitments and Contingencies

#### Capital Expenditures

Anticipated capital expenditures for 2005 primarily reflect U.S. Cellular's plans for construction, system expansion and the buildout of certain of its personal communication service licensed areas. U.S. Cellular plans to finance its construction program using internally generated cash and short-term and long-term financing. U.S. Cellular's estimated capital spending for 2005 is \$570 million to \$610 million. These expenditures primarily address the following needs:

- Expand and enhance U.S. Cellular's coverage in its service areas.
- Provide additional capacity to accommodate increased network usage by current customers.
- Enhance U.S. Cellular's retail store network and office systems.

U.S. Cellular's overlay of its previously utilized technologies, primarily Time Division Multiple Access ("TDMA"), with Code Division Multiple Access ("CDMA-1XRTT") technology was completed in 2004. U.S. Cellular will utilize CDMA-1XRTT technology in building out the licenses it has acquired and expects to acquire in the future from AT&T Wireless.

While U.S. Cellular does not expect a significant portion of its capital spending in 2005 to be related to the buildout of newly acquired licensed areas, it does expect that capital spending related to these areas could be significant in 2006 and over the following several years.

### Lease Commitments

U.S. Cellular is a party to various lease agreements, both as lessee and lessor, for office space, retail sites, cell sites and equipment, which are accounted for as operating leases. Certain leases have renewal options and/or fixed rental increases. Renewal options that are reasonably assured are included in determining the lease term. Future minimum rental payments required and rental receipts expected under operating leases that have noncancelable lease terms in excess of one year as of December 31, 2004 are as follows:

	Minimum Future Rental Payments	Minimum Future Rental Receipts
(Dollars in thousands)		
2005	\$ 79,152	\$ 11,492
2006	68,570	9,267
2007	54,205	7,172
2008	41,528	5,753
2009	27,427	3,584
Thereafter	\$153,353	\$ 3,566

Rental expense totaled \$95.6 million, \$72.0 million and \$57.2 million in 2004, 2003 and 2002, respectively. Rental revenue totaled \$12.8 million, \$10.0 million and \$8.5 million in 2004, 2003 and 2002, respectively.

### Indemnifications

U.S. Cellular enters into agreements in the normal course of business that provide for indemnification of counterparties. These include certain asset sales and financings with other parties. The terms of the indemnification vary by agreement. The events or circumstances that would require U.S. Cellular to perform under these indemnities are transaction specific; however, these agreements may require U.S. Cellular to indemnify the counterparty for costs and losses incurred from litigation or claims arising from the underlying transaction. U.S. Cellular is unable to estimate the maximum potential liability for these types of indemnifications as the amounts are dependent on the outcome of future events, the nature and likelihood of which cannot be determined at this time. Historically, U.S. Cellular has not made any significant indemnification payments under such agreements.

### Legal Proceedings

U.S. Cellular is involved in legal proceedings before the Federal Communications Commission and various state and federal courts from time to time. Management does not believe that any of such proceedings will have a materially adverse impact on the financial position, results of operations or cash flows of U.S. Cellular.

### Note 20 Subsequent Events

U.S. Cellular is a limited partner in Carroll Wireless, L.P. ("Carroll Wireless"), an entity which participated in the auction of wireless spectrum designated by the FCC as Auction 58. Carroll Wireless was qualified to bid on spectrum which was available only to companies that fall under the FCC definition of "designated entities," which are small businesses that have a limited amount of assets. Carroll Wireless was a successful bidder for 17 licensed areas in Auction 58 which ended on February 15, 2005. These 17 licensed areas cover portions of 11 states and are in markets which are either adjacent to or overlap current U.S. Cellular licensed areas.

On March 4, 2005, Carroll Wireless increased the amount on deposit with the FCC to approximately \$26 million and filed an application with the FCC seeking a grant of the subject licenses. The aggregate amount due to the FCC for the 17 licenses is \$129.9 million, net of all bidding credits to which Carroll Wireless is entitled as a designated entity. U.S. Cellular consolidates Carroll Wireless for financial reporting purposes, pursuant to the guidelines of FIN 46R, as U.S. Cellular anticipates absorbing a majority of Carroll Wireless' expected gains or losses.

Carroll Wireless is in the process of developing its long-term business and financing plans. As of March 4, 2005, U.S. Cellular has made capital contributions and advances to Carroll Wireless and/or its general partner of approximately \$26 million. Pending finalization of Carroll Wireless' permanent financing plan, and upon request by Carroll Wireless, U.S. Cellular may make capital contributions and advances to Carroll Wireless and/or its general partner of up to \$130 million to fund the payments to the FCC and additional working capital.

On February 18, 2005, TDS disclosed that the TDS Board of Directors unanimously approved the distribution of TDS Special Common Shares in the form of a stock dividend, subject to TDS shareholder approval of an increase in the authorized number of TDS Special Common Shares and certain other conditions.

TDS also disclosed that, following such action at some time in the future TDS may possibly offer to issue TDS Special Common Shares in exchange for all of the Common Shares of U.S. Cellular which are not owned by TDS (a "Possible U.S. Cellular Transaction"). TDS currently owns approximately 82% of the shares of common stock of U.S. Cellular. TDS disclosed that a Possible U.S. Cellular Transaction would cause U.S. Cellular to become a wholly owned subsidiary of TDS. TDS disclosed that it has no set time frame for taking action with respect to a Possible U.S. Cellular Transaction and there are no assurances that a transaction will occur.