- increased customer use of its services;
- launching service in new areas;
- reduced inbound roaming revenues; and
- continued enhancements to its wireless network.

The effects of these factors are expected to be mitigated to some extent by the following factors:

- reduced customer usage costs per minute and outbound roaming costs per minute; and
- expansion of revenues from data-related services and newly launched markets.

In the exchange and divestiture transactions discussed previously, U.S. Cellular has divested operations that were generating revenues, cash flows from operations and operating income; however, a significant portion of such revenues, cash flows from operations and operating income was attributable to inbound roaming traffic and was not primarily generated by U.S. Cellular's customers in those markets. In exchange, U.S. Cellular received cash and received or will receive licenses that will be in a development phase for several years. U.S. Cellular uses cash proceeds from these transactions to help defray costs related to building out new markets. U.S. Cellular anticipates that it may require debt or equity financing over the next few years for capital expenditures, for the development of new markets and to further its growth in recently launched markets. However, U.S. Cellular has substantial borrowing capacity available under its revolving credit agreement to meet those needs.

Financing Initiatives

U.S. Cellular had cash and cash equivalents totaling $40.9 million and $669.8 million of availability under its revolving credit facilities as of December 31, 2004. U.S. Cellular is also generating substantial cash flows from operations. Cash flows from operating activities totaled $518.4 million in 2004, $621.7 million in 2003 and $620.1 million in 2002. In addition, U.S. Cellular has access to public and private capital markets to help meet its long-term financing needs. Management believes that cash on hand, expected future cash flows from operations and existing sources of external financing provide substantial financial flexibility and are sufficient to permit U.S. Cellular to finance its contractual obligations and anticipated capital expenditures.

U.S. Cellular is committed to maintaining a strong Balance Sheet and its investment grade rating. During 2004, 2003 and 2002, U.S. Cellular entered into financing transactions that have provided financial flexibility as it continues to grow its wireless business. These transactions are summarized as follows:

2004

- Sold $330 million of 30-year, 7.5% senior notes and $100 million of 30-year, 6.7% senior notes.
- Redeemed $250 million of 7.25% senior notes and $163.3 million of 6% zero coupon convertible debentures (also known as Liquid Yield Option Notes).
- Renegotiated and extended the maturity date of its $700 million revolving credit facility with a series of banks to December 2009.
- Repurchased 91,700 Common Shares.

2003

- Sold $444 million of 30-year, 6.7% senior notes and repaid all borrowings under its revolving credit facility.
- Amended its $325 million revolving credit facility entered into in 2002 to increase the capacity to $700 million.
- Canceled its revolving credit facility entered into in 1997, which had previously had a capacity of $500 million.

2002

- Monetized its investment in Vodafone Group Plc through variable prepaid forward contracts ("forward contracts") which mature in 2007, receiving $159.9 million in cash.
- Established a five-year, $325 million revolving credit facility with a series of banks.
- Sold $130 million of 30-year, 8.75% senior notes.

See "Financial Resources" and "Liquidity and Capital Resources."

Results of Operations

Following is a table of summarized operating data for U.S. Cellular's consolidated operations:

December 31,(1a)	2004	2003	2002
Total market population(2)	44,391,000	46,267,000	41,048,000
Customers(3)	4,945,000	4,409,000	4,103,000
Market penetration(4)	11.14%	9.53%	10.00%
Total full-time equivalent employees	6,725	6,225	6,100
Cell sites in service	4,856	4,184	3,914

For the Year Ended December 31,(1b)	2004	2003	2002
Average monthly service revenue per customer(5)	$ 47.15	$ 47.38	$ 47.25
Post-pay churn rate per month(6)	1.5%	1.5%	1.8%
Sales and marketing cost per gross customer addition(7)	$ 404	$ 380	$ 365

(1a) Amounts in 2004 (i) do not include the two markets sold to ALLTEL in November 2004; (ii) do not include the six markets sold to AT&T Wireless in February 2004; (iii) do not include the 10 markets transferred to AT&T Wireless in August 2003; and (iv) include the 15 markets acquired and transferred from AT&T Wireless in August 2003. Amounts in 2003 (i) include the two markets sold to ALLTEL in November 2004; (ii) include the six markets sold to AT&T Wireless in February 2004; (iii) do not include the 10 markets transferred to AT&T Wireless in August 2003; and (iv) include the 15 markets acquired and transferred from AT&T Wireless in August 2003. Amounts in 2002 include the results from the Chicago market acquired in August 2002.

(1b) Amounts in 2004 (i) include the results of the two markets sold to ALLTEL through November 30, 2004; (ii) include the results of the six markets sold to AT&T Wireless through February 17, 2004; (iii) do not include the results of the 10 markets transferred to AT&T Wireless in August 2003 for the entire period; and (iv) include the development and operating activities of the 15 markets acquired and transferred from AT&T Wireless in August 2003 for the entire period. Amounts in 2003 (i) include the results of the two markets sold to ALLTEL in November 2004 for the entire period; (ii) include the results of the six markets sold to AT&T Wireless in February 2004 for the entire period; (iii) include the results of the 10 markets transferred to AT&T Wireless through July 31, 2003; and (iv) include the development and acquisition activities of the 15 markets acquired and transferred from AT&T Wireless from the transfer date of August 1, 2003 to December 31, 2003. Amounts in 2002 include the operations of the Chicago market from August 7 through December 31.

(2) Represents 100% of the population of the markets in which U.S. Cellular has a controlling financial interest for financial reporting purposes. The total market population of 1.5 million in the 10 markets that U.S. Cellular transferred to AT&T Wireless in August 2003 is excluded from this amount for 2003, as the customers of these 10 markets are not included in U.S. Cellular's consolidated customer base as of December 31, 2003 or 2004. The total market population of the two markets sold to ALLTEL in November 2004 and the six markets sold to AT&T Wireless in February 2004 are not included in this amount for 2004, as the customers sold in these transactions are not included in U.S. Cellular's consolidated customer base as of December 31, 2004.

(3) U.S. Cellular's customer base consists of the following types of customers:

December 31,	2004	2003	2002
Customers on postpay service plans in which the end user is a customer of U.S. Cellular ("postpay customers")	4,303,000	3,942,000	3,765,000
End user customers acquired through U.S. Cellular's agreement with a third party ("reseller customers")*	467,000	316,000	213,000
Total postpay customer base	4,770,000	4,258,000	3,978,000
Customers on prepaid service plans in which the end user is a customer of U.S. Cellular ("prepaid customers")	175,000	151,000	125,000
Total customers	4,945,000	4,409,000	4,103,000

* Pursuant to its agreement with the third party, U.S. Cellular is compensated by the third party on a postpay basis; as a result, all customers U.S. Cellular has acquired through this agreement are considered to be postpay customers.

(4) Calculated using 2003, 2002 and 2001 Claritas population estimates for 2004, 2003 and 2002, respectively. "Total market population" is used only for the purposes of calculating market penetration, which is calculated by dividing customers by the total market population (without duplication of population in overlapping markets).

(5) Management uses this measurement to assess the amount of service revenue U.S. Cellular generates each month on a per unit basis. Variances in this measurement are monitored and compared to variances in expenses on a per unit basis. Average monthly service revenue per customer is calculated as follows:

Year Ended or at December 31,	2004	2003	2002
Service revenue (000s)	$2,647,227	$2,423,789	$2,098,893
Divided by average customers during period (000s)	4,679	4,263	3,702
Divided by twelve months in each period	12	12	12
Average monthly revenue per customer	$ 47.15	$ 47.38	$ 47.25

(6) Postpay churn rate per month represents the percentage of the postpay customer base that disconnects service each month, including both postpay customers and reseller customer numbers. Reseller customers can disconnect service without the associated account number being disconnected from U.S. Cellular's network if the reseller elects to reuse the customer telephone number. Only those reseller customer numbers that are disconnected from U.S. Cellular's network are counted in the number of postpay disconnects. The calculation divides the total number of postpay and reseller customers who disconnect service during the period by the number of months in such period, and then divides that quotient by the average monthly postpay customer base, which includes both postpay and reseller customers, for such period.

(7) For a discussion of the components of this calculation, see "Operating Expenses – Selling, General and Administrative."

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 Statement of Financial Accounting Standards ("SFAS") No. 13, "Accounting for Leases," as amended, and related pronouncements. Pursuant to its revised accounting for such leases, U.S. Cellular recorded out-of-period adjustments to operating revenues of $0.8 million and operating expenses of $3.9 million 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 reduced operating income by $3.1 million and net income by $1.9 million, or $0.02 per diluted share.

Operating Revenues

Year Ended December 31,	2004	2003	2002
(Dollars in thousands)			
Retail service(1)	$2,301,152	$2,032,287	$1,696,648
Inbound roaming	171,444	221,737	255,443
Long-distance and other(1)	174,631	169,765	146,802
Service Revenues	2,647,227	2,423,789	2,098,893
Equipment sales	190,392	158,994	98,693
Total Operating Revenues	$2,837,619	$2,582,783	$2,197,586

(1) Certain amounts reported in prior years have been reclassified to conform to current period presentation.

Operating revenues increased $254.8 million, or 10%, to $2,837.6 million in 2004 from $2,582.8 million in 2003 and increased $385.2 million, or 18%, in 2003 from $2,197.6 million in 2002.

Service revenues increased $223.4 million, or 9%, to $2,647.2 million in 2004 from $2,423.8 million in 2003, and increased $324.9 million, or 15%, in 2003 from $2,098.9 million in 2002. Service revenues primarily consist of: (i) charges for access, airtime, roaming and value-added services provided to U.S. Cellular's retail customers ("retail service"); (ii) charges to other wireless carriers whose customers use U.S. Cellular's wireless systems when roaming ("inbound roaming"); and (iii) charges for long-distance calls made on U.S. Cellular's systems. The increases in both years were primarily due to the growth in the number of retail customers in each year. Monthly service revenue per customer averaged $47.15 in 2004, $47.38 in 2003 and $47.25 in 2002.

Retail service revenues increased $268.9 million, or 13%, to $2,301.2 million in 2004 from $2,032.3 million in 2003, and increased $335.7 million, or 20%, in 2003 from $1,696.6 million in 2002. Growth in U.S. Cellular's average customer base of 10% and 15% in 2004 and 2003, respectively, and an increase in average monthly retail service revenues per customer were the primary reasons for the increases in retail service revenues in all three years. The average number of customers is affected by the timing of acquisitions and divestitures in all three years, including the acquisition of the Chicago market in August 2002 and the disposition of markets in August 2003, February 2004 and November 2004.

Management anticipates that growth in the customer base in U.S. Cellular's wireless markets will be slower in the future, primarily as a result of the increased competition in its markets and continued penetration of the consumer market. However, as U.S. Cellular expands its operations in recently acquired markets in future years, it anticipates adding customers and revenues in those markets, increasing its overall customer and revenue growth rates.

In addition, the increases in retail service revenues in both years reflect increases of $16.4 million in 2004 and $45.9 million in 2003 in amounts billed to U.S. Cellular's customers to offset costs related to certain regulatory mandates, such as universal service funding, wireless number portability and E-911 infrastructure, which are being passed through to customers. In particular, the amounts U.S. Cellular charges to its customers to offset universal service funding costs increased significantly due to changes in FCC regulations beginning April 1, 2003.

Average monthly retail service revenues per customer increased 3% to $40.98 in 2004 from $39.73 in 2003, and increased 4% in 2003 from $38.19 in 2002. These increases were driven by an increase in average minutes of use per customer, the effect of which was partially offset by a decline in average revenue per minute of use. An increase in revenues from data-related products and services, which totaled $67.0 million in 2004, positively impacted average monthly retail service revenues per customer in 2004.

Monthly local retail minutes of use per customer averaged 539 in 2004, 422 in 2003 and 304 in 2002. The increases in both years were driven by U.S. Cellular's focus on designing sales incentive programs and customer billing rate plans to stimulate overall usage. In 2003, the increase was also attributable to the acquisition of the Chicago market in August 2002, whose customers used more minutes per month than the U.S. Cellular average. The impact on retail service revenues of the increased minutes of use in both years was partially offset by a decrease in average revenue per minute of use. The decrease in average revenue per minute of use reflects the effects of increasing competition, which has led to the inclusion of an increasing number of minutes in package pricing plans. Management anticipates that U.S. Cellular's average revenue per minute of use will continue to decline in the future, reflecting increased competition and continued penetration of the consumer market.

Inbound roaming revenues decreased $50.3 million, or 23%, to $171.4 million in 2004 from $221.7 million in 2003, and decreased $33.7 million, or 13%, in 2003 from $255.4 million in 2002. The decreases in revenue related to inbound roaming on U.S. Cellular's systems in both years primarily resulted from a decrease in revenue per roaming minute of use, partially offset by an increase in roaming minutes used. Also contributing to the decrease in both years were the transfer of the Florida and Georgia markets and the sale of the southern Texas markets to AT&T Wireless in August 2003 and February 2004, respectively. These markets had historically provided substantial amounts of inbound roaming revenues. The increases in inbound roaming minutes of use in both years were primarily driven by the overall growth in the number of customers throughout the wireless industry. The declines in revenue per minute of use in both years were primarily due to the general downward trend in negotiated rates.

Management anticipates that the future rate of growth in inbound roaming minutes of use will be reduced due to three factors:

- newer customers may roam less than existing customers, reflecting further penetration of the consumer market;
- the divestiture of U.S. Cellular's markets in Florida and Georgia in August 2003 and in southern Texas in February 2004, which have historically provided substantial inbound roaming minutes of use; and
- U.S. Cellular's roaming partners may switch their business from U.S. Cellular to other operators or to their own systems.

Management also anticipates that average inbound roaming revenue per minute of use will continue to decline, reflecting the continued general downward trend in negotiated rates.

Long-distance and other revenues increased $4.8 million, or 3%, to $174.6 million in 2004 from $169.8 million in 2003, and increased $23.0 million, or 16%, in 2003 from $146.8 million in 2002. The increases in both years primarily reflected $12.7 million and $12.7 million increases, respectively, in competitive eligible telecommunications carrier funds received for the states in which U.S. Cellular is eligible to receive such funds.

Partially offsetting the increase in 2004 were decreases in the remaining long-distance and other revenues. The decrease was driven by price reductions primarily related to long-distance charges on roaming minutes of use as well as U.S. Cellular's increasing use of pricing plans for its customers which include long-distance calling at no additional charge. This effect was partially offset by an increase in the volume of long-distance calls billed by U.S. Cellular to other wireless carriers whose customers used U.S. Cellular's systems to make long-distance calls.

In 2003, the increase in the volume of long-distance calls on U.S. Cellular's systems, by both U.S. Cellular's customers and customers of other wireless carriers who were using U.S. Cellular's systems while roaming, further increased long-distance and other revenues. This effect was partially offset by price reductions primarily related to long-distance charges on roaming minutes of use as well as U.S. Cellular's increasing use of pricing plans for its customers which include long-distance calling at no additional charge.

Equipment sales revenues increased $31.4 million, or 20%, to $190.4 million in 2004 from $159.0 million in 2003, and increased $60.3 million, or 61%, in 2003 from $98.7 million in 2002.

U.S. Cellular includes in its equipment sales revenues any handsets and related accessories sold to its customers, whether the customers are new to U.S. Cellular or are current customers who are changing handsets. U.S. Cellular also sells handsets to its agents at a price approximately equal to U.S. Cellular's cost, before applying any rebates. Selling handsets to agents enables U.S. Cellular to provide better control over handset quality, establish roaming preferences and pass along quantity discounts.

In these transactions with agents, equipment sales revenues are recognized upon delivery of the related products to the agents, net of any anticipated agent rebates. In most cases, the agents receive a rebate from U.S. Cellular at the time the agents provide handsets to sign up new customers or retain current customers.

U.S. Cellular anticipates that it will continue to sell handsets to agents in the future, and that it will continue to provide rebates to agents who provide handsets to new and current customers. Equipment sales revenues have grown less significantly than cost of equipment sold in 2004 and 2003 due to the continued substantial discounting of handsets. This trend is occurring throughout the wireless industry.

The increase in equipment sales revenues in both years primarily represents $25.7 million and $52.7 million increases, respectively, in handset sales to agents. Customers added to U.S. Cellular's customer base through its marketing distribution channels ("gross customer activations"), one of the primary drivers of equipment sales revenues, increased 15% in 2004 and 24% in 2003. In 2003, the number of handsets provided to current customers for retention purposes also increased significantly, further increasing equipment sales revenues. Retention transactions have increased as U.S. Cellular's customer base has grown and it continued to focus on retaining customers by offering existing customers new handsets similar to those offered to new customers as the expiration dates of customers' service contracts approached.

Operating Expenses

Year Ended December 31,	2004	2003	2002
(Dollars in thousands)			
System operations (excluding depreciation shown below)	$ 563,069	$ 576,159	$ 492,750
Cost of equipment sold	486,952	355,150	242,523
Selling, general and administrative	1,122,700	1,004,655	829,993
Depreciation	450,032	374,769	311,993
Amortization and accretion	47,910	57,564	39,161
Loss on impairment of intangible assets	—	49,595	—
(Gain) loss on assets held for sale	(10,806)	45,908	—
Total Operating Expenses	$2,659,857	$2,463,800	$1,916,420

Operating expenses increased $196.1 million, or 8%, to $2,659.9 million in 2004 from $2,463.8 million in 2003, and increased $547.4 million, or 29%, in 2003 from $1,916.4 million in 2002.

System operations expenses (excluding depreciation) decreased $13.1 million, or 2%, to $563.1 million in 2004 from $576.2 million in 2003, and increased $83.4 million, or 17%, in 2003 from $492.8 million in 2002. System operations expenses include charges from landline telecommunications service providers for U.S. Cellular's customers' use of their facilities, costs related to local interconnection to the landline network, charges for maintenance of U.S. Cellular's network, long-distance charges, outbound roaming expenses and payments to third-party data product and platform developers. The changes in system operations expenses in both years were due to the following factors:

- the number of cell sites within U.S. Cellular's systems increased 16% to 4,856 in 2004 from 4,184 in 2003 and increased 7% from 3,914 in 2002, as U.S. Cellular continues to expand and enhance coverage in its service areas through both acquisitions and internal growth; and
- increases in minutes of use on U.S. Cellular's systems and by its customers using other systems when roaming.

The ongoing reductions both in the per-minute cost of usage on U.S. Cellular's systems and in negotiated roaming rates offset the above factors.

As a result of the above factors, the components of system operations expenses were affected as follows:

- the cost of minutes used on U.S. Cellular's systems increased $22.4 million, or 13%, in 2004 and $46.5 million, or 38%, in 2003, while total minutes used on U.S. Cellular's systems increased 40% in 2004 and 67% in 2003;
- maintenance, utility and cell site expenses increased $16.3 million, or 10% in 2004 and $40.3 million, or 31%, in 2003, as the average number of cell sites in service increased 11% and 19% in 2004 and 2003, respectively. The increase in 2004 included an adjustment of $3.2 million (of which $2.3 million was an out-of-period expense) recorded to reflect straight-line lease expense for certain lease arrangements with fixed rental increases; and
- expenses incurred when U.S. Cellular's customers used other systems while roaming decreased $51.8 million, or 22%, in 2004 and decreased $3.4 million, or 1%, in 2003, primarily due to the decreases in per-minute cost of roaming revenues and the divestitures of markets to AT&T Wireless in 2003 and 2004. The per-minute cost of roaming charges is negotiated with other carriers in tandem with per minute rates for inbound roaming revenues and have experienced a general decline over the past several years. Also in 2004, U.S. Cellular received $8.1 million of refunds of sales taxes on outbound roaming transactions which had been charged to system operations expenses in prior years.

In addition, system operations expenses increased in 2003 due to the August 2002 acquisition of the Chicago market, as a full year of activity in the Chicago market is included in 2003 compared to only the period from August 7 – December 31 in 2002. Systems operations expenses decreased in 2004 and 2003 due to the August 2003 transfer and February 2004 sale of markets to AT&T Wireless.

In 2004 and 2003, roaming charges paid by U.S. Cellular to third parties when its customers roamed in the Chicago market and other recently launched markets declined. Continued integration of these markets into U.S. Cellular's operations resulted in increased use of U.S. Cellular's system by its customers and a corresponding decrease in roaming by its customers on other systems, primarily in the Midwest. Prior to acquiring the Chicago market and other recently launched markets, U.S. Cellular paid roaming charges to third parties when any of its customers roamed in those markets.

Monthly systems operations expenses per customer decreased 11% to $10.03 in 2004 and increased 2% to $11.26 in 2003 from $11.09 in 2002. This measurement is calculated by dividing total system operations expenses as reported for each of the annual periods by 12, then dividing that quotient by average customers during each respective 12-month period as defined in footnote 5 to the table of summarized operating data shown at the beginning of the Results of Operations section. Management uses this measurement to assess the cost of customer usage and network usage and maintenance on a per unit basis and to monitor efficiency.

In total, management expects system operations expenses to increase over the next few years, driven by the following factors:

- increases in the number of cell sites within U.S. Cellular's systems as it continues to add capacity and enhance quality in all markets, and continues development activities in new markets; and
- increases in minutes of use, both on U.S. Cellular's systems and by U.S. Cellular's customers on other systems when roaming.

These factors are expected to be partially offset by anticipated decreases in the per-minute cost of usage both on U.S. Cellular's systems and on other carriers' networks. As the Chicago area and other recently launched markets have historically been among U.S. Cellular's customers' most popular roaming destinations management anticipates that the continued integration of these markets into its operations will result in a further increase in minutes of use by U.S. Cellular's customers on its systems and a corresponding decrease in minutes of use by its customers on other systems, resulting in a lower overall increase in minutes of use by U.S. Cellular's customers on other systems. Such a shift in minutes of use should reduce U.S. Cellular's per-minute cost of usage in the future, to the extent that its customers use U.S. Cellular's systems rather than other carriers' networks.

Cost of equipment sold increased $131.8 million or 37%, to $487.0 million in 2004 from $355.2 million in 2003, and increased $112.7 million, or 46% in 2003 from $242.5 million in 2002.

The increases in both years were primarily due to $69.7 million and $80.7 million increases, respectively, in handset sales to agents. Also contributing were 15% and 24% increases, respectively, in gross customer activations as well as an increase in handsets sold to customers for retention purposes in both years as the number of retention transactions has increased. U.S. Cellular continued to focus on retaining customers by offering existing customers handset pricing similar to that offered to new customers as the expiration date of customers' service contracts approached.

In addition, the overall cost per handset increased in 2004 as customers purchased higher priced data-enabled handsets. These handsets are required for customers to access U.S. Cellular's **easy**edge[SM] suite of services which was launched in the second half of 2003.

Selling, general and administrative expenses increased $118.0 million, or 12%, to $1,122.7 million in 2004 from $1,004.7 million in 2003, and increased $174.7 million, or 21%, in 2003 from $830.0 million in 2002. Selling, general and administrative expenses primarily consist of salaries, commissions and expenses of field sales and retail personnel and offices; agent commissions and related expenses; corporate marketing, merchandise management and telesales department salaries and expenses; advertising; and public relations expenses. Selling, general and administrative expenses also include the costs of operating U.S. Cellular's customer care centers, the costs of serving customers and the majority of U.S. Cellular's corporate expenses.

The increase in selling, general and administrative expenses in 2004 is primarily due to the following:

- a $31.3 million increase in advertising costs, primarily related to marketing of the U.S. Cellular brand in the Chicago market and in the markets which were launched in 2004, and the marketing of U.S. Cellular's data-related wireless services, which were launched in the second half of 2003;
- a $28.4 million increase in employee and agent commissions and other payments made to agents for the activation and retention of customers, primarily driven by the 15% increase in gross customer activations and the increase in customer retention transactions;
- a $20.7 million increase in expenses related to payments into the federal universal service fund, primarily due to an increase in rates due to changes in the FCC regulations, substantially all of which is offset by increases in retail service revenue for amounts passed through to customers; and
- a $17.1 million increase in bad debt expense, primarily attributable to the increase in operating revenues and the increase in write-offs of accounts receivable considered uncollectible in 2004.

These increases were partially offset by a $24.9 million decrease in billing-related expenses, primarily due to the migration in the third quarter of 2003 of the Chicago market's operations to the same billing system used by U.S. Cellular's other markets.

The increase in selling, general and administrative expenses in 2003 is primarily due to the following factors:

- a $38.4 million increase in advertising costs, primarily related to the continued marketing of the U.S. Cellular brand in the Chicago market and the marketing of U.S. Cellular's data-related wireless services;
- a $30.1 million increase in expenses related to payments into the federal universal service fund, based on an increase in rates due to changes in the FCC regulations, substantially all of which is offset by increases in long-distance and other revenue for amounts passed through to customers; and
- a $29.3 million increase in billing-related expenses, primarily due to the expenses related to the maintenance of the Chicago market's billing system and the transition to the system used in U.S. Cellular's other operations in July 2003.

In both years, increases were also attributable to the increases in employee-related expenses associated with acquiring, serving and retaining customers, primarily as a result of the increase in U.S. Cellular's customer base.

In 2003, the increase in salaries and other sales-related costs is also attributable to the expenses incurred in preparation for U.S. Cellular's launch of data-related wireless services in its markets.

Sales and marketing cost per gross customer activation totaled $404 in 2004, $380 in 2003 and $365 in 2002. Sales and marketing cost per gross customer activation is not calculable using financial information derived directly from the Statements of Operations. The definition of sales and marketing cost per gross customer activation that U.S. Cellular uses as a measure of the cost to acquire additional customers through its marketing distribution channels may not be comparable to similarly titled measures that are reported by other companies.

Below is a summary of sales and marketing cost per gross customer activation for each period:

Year ended December 31,	2004	2003	2002
(Dollars in thousands, except per customer amounts)			
Components of cost:			
Selling, general and administrative expenses related to the acquisition of new customers(1)	$ 496,593	$ 428,944	$ 368,888
Cost of equipment sold to new customers(2)	346,399	248,539	185,283
Less equipment sales revenues from new customers(3)	(213,833)	(162,402)	(100,164)
Total cost	$ 629,159	$ 515,081	$ 454,007
Gross customer activations (000s)(4)	1,557	1,357	1,244
Sales and marketing cost per gross customer activation	$ 404	$ 380	$ 365

(1) Selling, general and administrative expenses related to the acquisition of new customers are reconciled to reported selling, general and administrative expenses as follows:

Year ended December 31,	2004	2003	2002
(Dollars in thousands)			
Selling, general and administrative expenses, as reported	$1,122,700	$1,004,655	$ 829,993
Less expenses related to serving and retaining customers	(626,107)	(575,711)	(461,105)
Selling, general and administrative expenses related to the acquisition of new customers	$ 496,593	$ 428,944	$ 368,888

(2) Cost of equipment sold to new customers is reconciled to reported cost of equipment sold as follows:

Year ended December 31,	2004	2003	2002
(Dollars in thousands)			
Cost of equipment sold as reported	$ 486,952	$ 355,150	$ 242,523
Less cost of equipment sold related to the retention of existing customers	(140,553)	(106,611)	(57,240)
Cost of equipment sold to new customers	$ 346,399	$ 248,539	$ 185,283

(3) Equipment sales revenue from new customers is reconciled to reported equipment sales revenues as follows:

Year ended December 31,	2004	2003	2002
(Dollars in thousands)			
Equipment sales revenues, as reported	$ 190,392	$ 158,994	$ 98,693
Less equipment sales revenues related to the retention of existing customers, excluding agent rebates	(27,267)	(27,328)	(13,108)
Add agent rebate reductions of equipment sales revenues related to the retention of existing customers	50,708	30,736	14,579
Equipment sales revenues from new customers	$ 213,833	$ 162,402	$ 100,164

(4) Gross customer activations represent customers added to U.S. Cellular's customer base, during the respective periods presented, through its marketing distribution channels.

Monthly general and administrative expenses per customer, including the net costs related to the renewal or upgrade of service contracts of existing U.S. Cellular customers ("net customer retention costs"), increased 5% to $14.07 in 2004 and increased 15% to $13.40 in 2003 from $11.70 in 2002. Management uses this measurement to assess the cost of serving and retaining its customers on a per-unit basis.

This measurement is reconciled to total selling, general and administrative expenses as follows:

Year ended December 31,	2004	2003	2002
(Dollars in thousands, except per customer amounts)			
Components of cost(1):			
Selling, general and administrative expenses, as reported	$1,122,700	$1,004,655	$ 829,993
Less selling, general and administrative expenses related to the acquisition of new customers	(496,593)	(428,944)	(368,888)
Add cost of equipment sold related to the retention of existing customers	140,553	106,611	57,240
Less equipment sales revenues related to the retention of existing customers, excluding agent rebates	(27,267)	(27,328)	(13,108)
Add agent rebate reductions of equipment sales revenues related to the retention of existing customers	50,708	30,736	14,579
Net cost of serving and retaining customers	$ 790,101	$ 685,730	$ 519,816
Divided by average customers during period (000s)(2)	4,679	4,263	3,702
Divided by twelve months in each period	12	12	12
Average monthly general and administrative expenses per customer	$ 14.07	$ 13.40	$ 11.70

(1) These components were previously identified in the table which calculates sales and marketing cost per customer activation and related footnotes.

(2) Average customers for each respective period as previously listed in footnote 5 to the table of summarized operating data.

Depreciation expense increased $75.2 million, or 20%, to $450.0 million in 2004 from $374.8 million in 2003, and increased $62.8 million, or 20%, from $312.0 million in 2002. The increases in both years reflect rising average fixed asset balances, which increased 13% in 2004 and 23% in 2003. Increased fixed asset balances in both 2004 and 2003 resulted from the following factors:

- the addition of 840 and 507 new cell sites in 2004 and 2003, respectively, built to launch service and improve coverage and capacity in U.S. Cellular's markets; and
- the acquisition in 2002 and continuing development of the Chicago market.

In addition, the following factors also contributed to the increase in 2004:

- certain Time Division Multiple Access ("TDMA") digital radio equipment consigned to a third party for future sale was taken out of service and written down by $17.2 million prior to its consignment, increasing depreciation expense by that amount. This write-down was necessary to reduce the book value of the assets to be sold to their estimated proceeds from disposition;
- a reduction of useful lives of certain TDMA radio equipment, switch software and antenna equipment, which increased depreciation expense $14.9 million;
- 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. As a result of the review, U.S. Cellular charged $11.9 million to depreciation expense for the write-off of certain assets; and
- an $11.3 million addition to depreciation expense related to the write-down of certain assets prior to their disposition.

Additionally, U.S. Cellular recorded $8.6 million less depreciation expense in 2004 than in 2003 as depreciation on the properties sold to AT&T Wireless and ALLTEL was only recorded through November 2003 and August 2004, respectively, in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets."

In 2003, U.S. Cellular took certain cell sites, in which its antennae were co-located on third parties' towers, out of service, writing off the remaining net book value of the related assets. This write-off increased depreciation expense $7.0 million in 2003. These cell sites were acquired from another carrier in a 2001 transaction.

U.S. Cellular recorded $11.6 million less depreciation expense in 2003 than in 2002 as depreciation on the properties transferred to AT&T Wireless in the exchange transaction was only recorded through March 2003 in accordance with SFAS No. 144.

In 2002, U.S. Cellular charged $15.0 million to depreciation expense to reflect the write-off of certain analog equipment based on fixed asset inventory reviews performed in 2002.

Amortization and accretion expense decreased $9.7 million, or 17%, to $47.9 million in 2004 from $57.6 million in 2003, and increased $18.4 million, or 47%, from $39.2 million in 2002. The decrease in 2004 was primarily caused by an $8.6 million decrease in amortization related to the customer list intangible assets and other amortizable assets acquired in the Chicago market transaction during 2002. The customer list assets are amortized using the declining balance method, based on average customer retention periods of each customer list. Therefore, decreasing amounts of amortization expense will be recorded in each 12-month period following the establishment of each customer list asset. The increase in 2003 is primarily driven by the $11.1 million increase in amortization related to the customer list intangible assets and other deferred charges acquired in the Chicago market transaction during 2002.

In accordance with SFAS No. 143, "Accounting for Asset Retirement Obligations," as of January 1, 2003, U.S. Cellular began accreting liabilities for future remediation obligations associated with leased properties. Such accretion expense totaled $5.0 million in 2004 and $4.4 million in 2003.

Loss on impairment of intangible assets totaled $49.6 million in 2003. In accordance with SFAS No. 142, "Goodwill and Other Intangible Assets," U.S. Cellular performed the annual impairment test for its investment in licenses for 2003. The carrying value of the licenses in each reporting unit was compared to the estimated fair value of the licenses in each reporting unit. The license values in two reporting units were determined to be impaired and a loss of $49.6 million was recorded. The 2004 annual testing resulted in no impairments.

See "Application of Critical Accounting Policies and Estimates – Investment in Licenses and Goodwill" for further discussion of U.S. Cellular's intangible asset impairment testing.

(Gain) loss on assets held for sale totaled a gain of $10.8 million in 2004 and a loss of $45.9 million in 2003.

In 2004, the gain related to two divestitures completed in 2004. The sale of two consolidated markets to ALLTEL in November 2004 resulted in a $10.1 million gain on assets held for sale. The remaining amount of $0.7 million was recorded in 2004 as a reduction of a $22.0 million estimated loss recorded in the fourth quarter 2003 on the sale of U.S. Cellular markets in southern Texas to AT&T Wireless on February 18, 2004. The result was an aggregate loss of $21.3 million, representing the difference between the carrying value of the markets sold and the cash received in the transaction. For further discussion of these transactions, see "Liquidity and Capital Resources – Acquisitions, Exchanges and Divestitures."

In 2003, $23.9 million of the total loss represents the difference between the fair value of the assets U.S. Cellular received and expects to receive in the AT&T Wireless exchange transaction completed on August 1, 2003, and the recorded value of the Florida and Georgia market assets it transferred to AT&T Wireless. The loss also includes a $22.0 million write-down related to the wireless assets which were sold to AT&T Wireless in February 2004.

Operating Income

Operating income increased $58.8 million, or 49%, to $177.8 million in 2004, from $119.0 million in 2003, and decreased $162.2 million, or 58%, from $281.2 million in 2002. The operating income margins (as a percent of service revenues) were 6.7% in 2004, 4.9% in 2003 and 13.4% in 2002.

The increase in operating income and operating income margin in 2004 reflects the following:

- increased service revenues primarily due to the growth in the number of retail customers; and
- gains recorded on assets held for sale in 2004 compared to losses recorded on assets held for sale and loss on intangible assets in 2003.

The increase in 2004 was offset by the following:

- increased expenses related to the launch of new operating markets in 2004;
- decreased roaming revenue resulting from a decrease in revenue per roaming minute of use;
- decreased operating income due to markets divested to AT&T Wireless;
- increased equipment subsidies reflecting increased competition and gross customer activations as well as an increase in handsets sold to customers for retention purposes;
- increased depreciation expense driven by an increase in average fixed assets related to ongoing improvements to and the expansion of U.S. Cellular's wireless network as well as asset write-offs; and
- increased selling, general and administrative expenses primarily driven by increased advertising and commissions expenses.

The decline in operating income and operating income margin in 2003 reflects the following:

- increased selling, general and administrative expenses, primarily driven by the acquisition and subsequent transition of the Chicago market's operations and billing system; and additional costs related to advertising and marketing the U.S. Cellular brand, especially in the Chicago market, and related to the launch of U.S. Cellular's data-related wireless services in certain markets;
- increased depreciation expense, driven by an increase in average fixed assets related to ongoing improvements to and the expansion of U.S. Cellular's wireless network;
- increased system operations expenses, primarily driven by increases in the number of cell sites in and the number of minutes used by U.S. Cellular's customers and roaming customers on U.S. Cellular's network; and
- increased equipment subsidies, primarily due to U.S. Cellular's practice of selling handsets to agents; this practice began in 2002 and increased the volume of handset sales, as well as the increase in customer retention-related equipment transactions.

Operating income and operating income margin in 2003 also reflect:

- the losses on assets held for sale related to both the exchange transaction that was completed August 1, 2003, and the sale transaction involving AT&T Wireless that was pending at December 31, 2003; and
- the loss on impairment of intangible assets.

These expense increases were partially offset by increased service revenues, which were driven by growth in the number of customers served by U.S. Cellular's systems and increases in average monthly revenue per customer.

U.S. Cellular expects most of the above factors, except for those related to the transition of the Chicago market and the gains and losses on assets held for sale and impairments related to events in 2004 and 2003, to continue to have an effect on operating income and operating margins for the next several quarters. Any changes in the above factors, as well as the effects of other drivers of U.S. Cellular's operating results, may cause operating income and operating margins to fluctuate over the next several quarters.

U.S. Cellular anticipates that it will continue to invest in and incur expenses related to markets it has acquired and in which it has initiated service over the past few years. In addition, U.S. Cellular anticipates initiating marketing operations in the St. Louis, Missouri market in 2005. The timing of such a market launch is not known, but will require significant continued investment and is expected to have a significant impact on U.S. Cellular's results when marketing operations begin.

U.S. Cellular also incurred additional expenses related to its launch of data-related wireless services in many of its markets in 2004 and 2003, and expects to incur expenses related to its continued marketing of data-related wireless services in the next few years.

As a result, depending on the timing and effectiveness of these initiatives, U.S. Cellular's operating income may range from $220 million to $270 million in 2005, including $530 million of anticipated depreciation, amortization and accretion expenses, compared to operating income of $177.8 million in 2004. Its corresponding operating margins may range from 7% to 9% in 2005, compared to an operating margin of 6.7% in 2004.

U.S. Cellular anticipates that service revenues will total approximately $2.9 billion in 2005, compared to service revenues of $2.65 billion in 2004. The anticipated service revenue growth in 2005 reflects the continued growth in U.S. Cellular's customer base and the continued marketing of data-related wireless services in its markets.

Depending on the timing and effectiveness of its marketing efforts, U.S. Cellular anticipates that its net customer activations from its marketing channels will total 425,000 to 475,000 in 2005.

U.S. Cellular anticipates that its net costs associated with customer growth, service and retention; initiation of new services; launches in new markets; and fixed asset additions will continue to grow. U.S. Cellular anticipates that its net customer retention costs will increase in the future as its customer base grows, as competitive pressures continue and as per-unit handset costs increase without compensating increases in the per-unit sales price of handsets to customers and agents.

Effects of Competition on Operating Income

U.S. Cellular competes directly with several wireless communications services providers, including enhanced specialized mobile radio service providers, in each of its markets. In general, there are between four and six competitors in each wireless market in which U.S. Cellular provides service. U.S. Cellular generally competes against each of the five near-nationwide wireless companies: Verizon Wireless, Sprint (and affiliates), Cingular Wireless LLC (which recently merged with AT&T Wireless), T-Mobile USA Inc. and Nextel Communications ("Nextel"). However, not all five of these competitors operate in all markets where U.S. Cellular does business. U.S. Cellular believes that these competitors have substantially greater financial, technical, marketing, sales, purchasing and distribution resources than it does. In addition, Sprint recently proposed to acquire Nextel which would likely increase this competitor's access to such resources.

The use of national advertising and promotional programs by such national wireless operators may be a source of additional competitive and pricing pressures in all U.S. Cellular markets, even if those operators may not provide service in a particular market. U.S. Cellular provides wireless services comparable to the national competitors, but the other wireless companies operate in a wider geographic area and are able to offer no- or low-cost roaming and long-distance calling packages over a wider area on their own networks than U.S. Cellular can offer on its network. If U.S. Cellular offers the same calling area as one of these competitors, it will incur roaming charges for calls made in portions of the calling area that are not part of its network.

In the Midwest, U.S. Cellular's largest contiguous service area, it can offer larger regional service packages without incurring significant roaming charges than it is able to offer in other parts of its network. U.S. Cellular also employs a customer satisfaction strategy throughout its markets which it believes has contributed to a relatively low customer churn rate, which in turn has had a positive impact on its cost to add a net new customer.

Some of U.S. Cellular's competitors bundle other services, such as landline telephone service and Internet access, with their wireless communications services, which U.S. Cellular either does not have the ability to offer or has chosen not to offer.

In addition, U.S. Cellular competes against both larger and smaller regional wireless companies in certain areas, including ALLTEL, Western Wireless Corporation and Rural Cellular Corporation, and against resellers of wireless services. Since each of these competitors operates on systems using spectrum licensed by the FCC and has comparable technology and facilities, competition for customers among these systems in each market is principally on the basis of quality of service, price, size of area covered, services offered and responsiveness of customer service. ALLTEL has recently agreed to acquire Western Wireless Corporation, which may increase this competitor's financial, technical, marketing, sales, purchasing and distribution resources.

Since U.S. Cellular's competitors do not disclose their subscriber counts in specific regional service areas, market share for the competitors in each regional market cannot be accurately determined.

Effects of Wireless Number Portability on Operating Income

The FCC has adopted wireless number portability rules requiring wireless carriers to allow a customer to retain, subject to certain geographical limitations, their existing telephone number when switching from one telecommunications carrier to another. These rules have become effective for all U.S. Cellular markets on or before May 24, 2004.

U.S. Cellular has been successful in facilitating number portability requests in a timely manner. The implementation of wireless number portability has not had a material effect on U.S. Cellular's results of operations to date. However, U.S. Cellular is unable to predict the impact that the implementation of number portability will have in the future. The implementation of wireless number portability may increase churn rates for U.S. Cellular and other wireless companies, as the ability of customers to retain their wireless telephone numbers removes a significant barrier for customers who wish to change wireless carriers. However, to the extent U.S. Cellular loses customers, the effect may be offset to the extent it is able to obtain additional new customers who wish to change their service from other wireless carriers as a result of wireless number portability. The future volume of any porting requests, and the processing costs related thereto, may increase U.S. Cellular's operating costs in the future. Any of the above factors could have an adverse effect on U.S. Cellular's competitive position, costs of obtaining new subscribers, liquidity, financial position and results of operations.

Investment and Other Income (Expense) primarily includes investment income, interest and dividend income, gain (loss) on investments and interest expense. Investment and other income (expense) totaled $14.9 million in 2004, ($12.8) million in 2003 and ($293.6) million in 2002.

Investment income totaled $68.5 million in 2004, $52.1 million in 2003 and $42.1 million in 2002. Investment income primarily represents U.S. Cellular's share of net income from the markets managed by others that are accounted for by the equity method. The aggregate net income of these investment markets increased significantly in 2004 and 2003, resulting in a corresponding increase in investment income.

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 to investment income in 2004, 2003 and 2002, respectively.

Interest and dividend income totaled $10.8 million in 2004, $4.9 million in 2003 and $7.0 million in 2002. Interest income increased $3.6 million in 2004. U.S. Cellular earned $3.8 million of interest income on a tax refund claim. Dividend income increased $2.3 million in 2004 due to an increase in dividend income received on shares owned of Vodafone Group Plc ("Vodafone"). The decrease in 2003 primarily reflected decreased interest income earned due to a lower average cash balance in 2003 than 2002.

Interest expense totaled $86.2 million in 2004, $64.6 million in 2003 and $47.9 million in 2002. Interest expense is summarized by related debt instrument in the following table:

Year Ended December 31,	2004	2003	2002
(Dollars in millions)			
6.7% senior notes	$33.7	$ 2.0	$ –
7.25% senior notes	11.6	18.5	18.5
7.5% senior notes	13.5	–	–
8.75% senior notes	11.4	11.4	1.8
9% Series A notes	–	–	4.6
8.1% Intercompany note(1)	0.9	8.6	3.5
6% Liquid Yield Option Notes	5.9	9.4	8.9
Revolving credit facilities	3.2	9.8	5.8
Forward contracts(2)	3.2	2.9	2.1
Other	2.8	2.0	2.7
Total Interest Expense	$86.2	$64.6	$47.9

(1) In August 2002, U.S. Cellular entered into a loan agreement with TDS under which it borrowed $105 million. The loan bore interest at an annual rate of 8.1%, payable quarterly, and originally became due in August 2008, with prepayments optional. In February 2004, U.S. Cellular repaid all outstanding principal and interest related to this note. For further information regarding this note, see "Certain Relationships and Related Transactions."

(2) In May 2002, U.S. Cellular entered into the forward contracts, which were negotiated with third parties relating to its investment in 10.2 million Vodafone American Depositary Receipts ("ADRs"). Taken together, the forward contracts allowed U.S. Cellular to borrow an aggregate of $159.9 million against the Vodafone ADRs. The forward contracts bear interest, payable quarterly, at the London InterBank Offered Rate ("LIBOR") plus 50 basis points. The three-month LIBOR rate at December 31, 2004 was 2.56%. For further information regarding the forward contracts, see "Market Risk."

The increase in interest expense in 2004 was primarily due to the effects of the issuances of 6.7% senior notes in December 2003 and June 2004, the issuance of 7.5% senior notes in June 2004 and subsequent repayment of lower variable interest rate revolving credit facility borrowings in December 2003.

U.S. Cellular's $544 million principal amount of 6.7% senior notes is due in December 2033. These notes are unsecured and interest is payable semi-annually on June 15 and December 15 of each year. U.S. Cellular originally issued $444 million of the 6.7% senior notes in December 2003 in order to reduce the use of its revolving credit facility and the related interest rate risk. An additional $100 million of such notes was issued in June 2004. The proceeds of such additional issuance, together with the proceeds of the 7.5% senior notes discussed below, were used to redeem the Liquid Yield Option Notes in July 2004. The balance of the net proceeds, together with borrowings under the revolving credit agreement, was used to redeem all of U.S. Cellular's 7.25% senior notes in August 2004.

In June 2004, U.S. Cellular issued $330 million in aggregate principal amount of 7.5% senior notes due 2034. These notes are unsecured and interest is payable quarterly on March 15, June 15, September 15 and December 15 of each year.

The Liquid Yield Option Notes accreted interest at 6% annually, but did not require current cash payments of interest. All accreted interest was added to the outstanding principal balance on June 15 and December 15 of each year for purposes of calculating interest expense. U.S. Cellular redeemed all of such notes for cash in July 2004.

U.S. Cellular's $250 million principal amount of 7.25% senior notes was due in August 2007. These notes were unsecured and interest was payable semi-annually on February 15 and August 15 of each year. U.S. Cellular redeemed all of such notes for cash in 2004. Interest expense related to the revolving credit facilities decreased in 2004 primarily due to the decrease in average borrowings outstanding as compared to 2003.

The increase in interest expense in 2003 was primarily due to notes that were outstanding for a longer period of time in 2003 than in 2002. The $105 million, 8.1% Intercompany note with TDS originated in August 2002; the $130 million of 8.75% senior notes were issued in November 2002; and the $444 million of 6.7% senior notes were issued in December 2003.

For further information regarding U.S. Cellular's 8.75% senior notes, 6.7% senior notes and 7.5% senior notes, see "Liquidity and Capital Resources – Long-Term Debt." For information regarding U.S. Cellular's revolving credit facilities, see "Liquidity and Capital Resources – Revolving Credit Facilities." For information on the forward contracts, see "Market Risk." For information regarding the 8.1% intercompany note, see "Certain Relationships and Related Transactions."

Gain (loss) on investments totaled a gain of $24.4 million in 2004 and losses of $5.2 million in 2003 and $295.5 million in 2002. In 2004, U.S. Cellular recorded a $26.6 million gain on the sale of investment interests to ALLTEL. This gain was partially offset by a $1.8 million loss to reflect an impairment in the carrying value of the investment in the Daytona license sold to MetroPCS and a $0.3 million loss associated with buying out the partner in the Daytona investment.

In 2003, a $3.5 million license impairment loss was recorded related to U.S. Cellular's investment in the Daytona license. Also in 2003, a $1.7 million impairment loss was recorded related to U.S. Cellular's minority investment in a wireless market that it accounts for using the cost method.

U.S. Cellular and its subsidiaries hold a substantial amount of marketable equity securities, the majority of which are the result of sales or trades of non-strategic assets. These securities are publicly traded and can have volatile 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. U.S. Cellular continues to hold these investments, in part, because their associated low tax basis would trigger a substantial taxable gain upon disposition. See "Liquidity and Capital Resources – Marketable Equity Securities and Forward Contracts" for a discussion of marketable equity securities.

In 2002, management determined that the decline in value of certain marketable equity securities relative to their book basis was other than temporary and charged a $244.7 million loss to the Statement of Operations. U.S. Cellular has subsequently utilized derivative financial instruments to eliminate any future other than temporary losses related to these marketable equity securities. See "Market Risk" for a discussion of other-than-temporary losses.

Also in 2002, U.S. Cellular recorded a $38.1 million write-down in the value of notes receivable related to the 2000 sales of certain minority interests. Additionally, U.S. Cellular recorded losses of $8.5 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.

Income Taxes

Income tax expense (benefit) totaled an expense of $73.7 million in 2004, an expense of $37.2 million in 2003, and a benefit of $7.5 million in 2002. The corresponding effective tax (benefit) rates were 38.3% in 2004, 35.1% in 2003 and (60.9%) in 2002.

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, loss on impairment of intangible assets, and (gain) loss on assets held for sale in the Statement of Operations).

2004

- Tax expenses of $22.1 million were recorded on gains from the sale of assets to ALLTEL and to AT&T Wireless.

2003

- Tax benefits of $19.7 million were recorded on (gain) loss on assets of operations held for sale.
- Tax benefit of $19.6 million was recorded on loss on impairment of intangible assets.
- Tax benefit of $1.6 million was recorded on loss on investments.

2002

- Tax benefit of $99.1 million was recorded on investments in marketable equity securities as a result of management's determination that unrealized losses with respect to the investments were other than temporary.
- Tax benefits of $13.1 million were recorded on impairments of investments.

The effective income tax rate excluding the items listed above was 33.2% in 2004, 37.8% in 2003 and 37.0% in 2002. The 2004 effective tax rate includes the effects of 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 – 2001 and claims for research tax credits for the years 1995 – 2001. Primarily based on the results of the audit, U.S. Cellular reduced its accrual for audit contingency by $7.3 million in 2004. Also in 2004, based upon the results of the federal income tax audit, U.S. Cellular recorded a $3.3 million benefit for the research tax credits. See Note 2 – Income Taxes in the Notes to Consolidated Financial Statements for further discussion of the effective tax rate.

TDS and U.S. Cellular are parties to a Tax Allocation Agreement, pursuant to which U.S. Cellular is included in a consolidated federal income tax return with other members of the TDS consolidated group.

For financial reporting purposes, U.S. Cellular computes federal income taxes as if it was filing a separate return as its own affiliated group and was not included in the TDS group.

Cumulative Effect of Accounting Change

Effective January 1, 2003, U.S. Cellular implemented SFAS No. 143, "Accounting for Asset Retirement Obligations." 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.

Effective January 1, 2002, U.S. Cellular adopted SFAS No. 142, "Goodwill and Other Intangible Assets," and determined that 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 began deferring expense recognition of a portion of its commission expenses in the amount of deferred activation fee revenues. 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, or $0.05 per diluted share.

Net Income (Loss)

Net income (loss) totaled income of $109.0 million in 2004, income of $42.7 million in 2003 and a loss of $26.9 million in 2002. Diluted earnings (loss) per share was $1.26 in 2004, $0.49 in 2003 and ($0.31) in 2002. In 2004, operating income and gains on investments increased significantly compared to 2003, leading to the increase in net income and diluted earnings per share. In 2003, losses on investments were significantly reduced compared to 2002, leading to the increase in net income and diluted earnings per share.

Inflation

Management believes that inflation affects U.S. Cellular's business to no greater extent than the general economy.

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" section in Note 1 – Summary of Significant Accounting Policies for a pro forma impact on net income and earnings per share.