

issued orders that will adversely affect the cost of providing some services for TDS Telecom's competitive local exchange carrier operations in those states, primarily services to residential customers and certain small business customers. The pricing data for the major markets of TDS Telecom's competitive local exchange carrier became available in the fourth quarter of 2004. These pricing changes, as well as other regulatory changes and competitive pressures in 2004, triggered an impairment review by TDS Telecom of its competitive local exchange carrier operations' tangible and intangible assets. As a result of the impairment review, TDS Telecom concluded that the long-lived tangible assets of its competitive local exchange carrier operations were impaired and recorded an \$87.9 million loss in the Statement of Operations. TDS Telecom also concluded that goodwill associated with the competitive local exchange carrier operations was impaired and recorded a loss of \$29.4 million in the Statement of Operations. See Application of Critical Accounting Policies and Estimates – "Licenses and Goodwill" and "Property, Plant and Equipment" for further discussions of the impairments.

Changes in the telecommunications regulatory environment, including the effects of potential changes in the rules governing universal service funding and potential changes in the amounts or methods of intercarrier compensation, could have a material adverse effect on TDS Telecom's financial condition, results of operations and cash flows.

Effects of Wireless Number Portability

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. Local exchange carriers in the largest 100 metropolitan statistical areas in the United States were required to be capable of facilitating wireless number portability as of November 24, 2003. Local exchange carriers outside such 100 areas were required to implement wireless number portability requirements on May 24, 2004 or within six months of the relevant request, whichever is later. However, local exchange carriers may seek waivers or extensions of these deadlines pursuant to the Communications Act and the FCC's rules. TDS Telecom has established a schedule to implement local number portability. As of December 31, 2004, TDS Telecom has equipped 96% of its incumbent local exchange carrier physical access lines and will complete the remaining local number portability schedule by mid 2005. Through December 31, 2004, TDS Telecom has received 233 wireline to wireless port requests. TDS is unable to predict the impact that the implementation of wireless number portability will have on the business of TDS Telecom in the future.

INFLATION

Management believes that inflation affects TDS'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 TDS 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. TDS 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 the 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.

FINANCIAL RESOURCES

TDS operates a capital- and marketing-intensive business. In recent years, TDS has generated cash from its operations, received cash proceeds from divestitures, used its short-term credit facilities and used long-term debt financing to fund its construction costs and operating expenses. TDS anticipates further increases in wireless customers and wireline equivalent access lines, and in revenues and operating expenses. Cash flows may fluctuate from quarter to quarter and from year to year due to seasonality, market startups and other factors.

Year Ended December 31,	2004	2003	2002
(Dollars in thousands)			
Cash flows from (used in)			
Operating activities	\$ 747,389	\$ 920,413	\$ 793,637
Investing activities	(564,372)	(700,490)	(1,366,584)
Financing activities	47,913	(581,208)	1,731,139
Net increase (decrease) in cash and cash equivalents	\$ 230,930	\$(361,285)	\$ 1,158,192

Cash Flows From Operating Activities represents a significant source of funds to TDS. Net income (loss) including adjustments to reconcile net income (loss) to net cash provided by operating activities, excluding changes in assets and liabilities from operations totaled \$778.7 million in 2004, \$792.4 million in 2003 and \$815.5 million in 2002. Included in the adjustments to reconcile net income to net cash provided by operating activities in 2004 is a deduction for the payment of \$68.1 million of accreted interest on the repayment of U.S. Cellular's Liquid Yield Option Notes. Changes in assets and liabilities from operations required \$31.3 million in 2004, provided \$128.0 million in 2003 and required \$21.9 million in 2002, reflecting timing differences in the collection of accounts receivable, payment of accounts payable and accrued taxes.

Cash Flows From Investing Activities primarily represents uses of funds to acquire, construct and upgrade modern high-quality communications networks and facilities as a basis for creating long-term value for shareowners. In recent years, rapid changes in technology and new opportunities have required substantial investments in revenue-enhancing and cost-reducing upgrades of TDS's

networks. Cash flows used for investing activities primarily represent cash required for capital expenditures, and the acquisition of wireless and wireline telephone properties and wireless spectrum. Proceeds from merger and divestiture transactions and distributions from unconsolidated entities have provided funds in recent years which have partially offset the cash requirements for investing activities; however, such sources cannot be relied upon to provide continuing or regular sources of financing.

The primary purpose of TDS's construction and expansion expenditures is to provide for customer growth, to upgrade service, launch new markets, and to take advantage of service-enhancing and cost-reducing technological developments in order to maintain competitive services. Cash expenditures for capital additions required \$798.3 million in 2004, \$777.0 million in 2003 and \$899.0 million in 2002. U.S. Cellular's capital additions totaled \$655.1 million in 2004, \$632.5 million in 2003 and \$730.6 million in 2002. These additions represent the construction of 840, 507 and 437 cell sites in 2004, 2003 and 2002, respectively, as well as other plant additions and costs related to the development of U.S. Cellular's office systems. In 2004, 2003 and 2002, these plant additions included approximately \$13 million, \$58 million and \$215 million, respectively, for the migration to a single digital wireless equipment platform. Other plant additions in all three years also included significant amounts related to the replacement of retired assets. TDS Telecom's capital additions for its incumbent local exchange carrier operations totaled \$103.1 million in 2004, \$111.9 million in 2003 and \$116.5 million in 2002, representing expenditures for switch modernization and outside plant facilities to maintain and enhance the quality of service and offer new revenue opportunities. TDS Telecom's capital expenditures for competitive local exchange carrier operations totaled \$35.2 million in 2004, \$27.3 million in 2003 and \$51.9 million in 2002 for switching and other network facilities. Corporate capital expenditures totaled \$4.9 million in 2004 and \$5.3 million in 2003.

Cash used for acquisitions, excluding cash acquired, totaled \$40.8 million in 2004, \$5.1 million in 2003 and \$531.2 million in 2002. TDS's acquisitions include primarily the purchase of controlling interests in wireless markets and telephone properties, minority interests that increased the ownership of majority-owned markets and wireless spectrum. 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. U.S. Cellular purchased two additional minority interests in majority-owned wireless markets in 2003 for \$2.3 million and capitalized costs associated with the AT&T Wireless exchange of \$2.8 million. On August 7, 2002, U.S. Cellular completed the acquisition of the Chicago market. U.S. Cellular paid \$431.9 million in cash, net of cash acquired, and issued \$175 million of 9% Series A notes due in 2032. U.S. Cellular financed the cash portion of the purchase price by using its revolving credit facility and a \$105 million loan from TDS. An additional \$10.5 million was paid in January 2003 to adjust the purchase price for the final working capital adjustment. TDS also acquired two telephone companies (\$78.2 million), three PCS licenses (\$18.0 million) and additional minority interests in majority-owned markets (\$3.1 million) in 2002.

TDS received cash of \$247.6 million from divestitures in 2004. The sale of wireless properties in southern Texas by U.S. Cellular to AT&T Wireless provided \$96.5 million. The sale of wireless properties to ALLTEL provided U.S. Cellular \$79.8 million (net of \$0.4 million cash divested) and TDS Telecom \$62.7 million. U.S. Cellular also received \$8.5 million from the sale of Daytona in 2004 and paid \$0.3 million to buy out the partner in this investment. In 2003, U.S. Cellular received \$34.0 million from AT&T Wireless in connection with the exchange of properties for licenses. See "Acquisitions, Exchanges and Divestitures" in the Liquidity and Capital Resources section.

Distributions from unconsolidated investments provided \$49.2 million in 2004, \$45.4 million in 2003 and \$31.3 million in 2002. U.S. Cellular is a limited partner in a designated entity that deposited \$9.0 million with the FCC related to the wireless spectrum Auction 58, which took place in early 2005. The designated entity is consolidated by U.S. Cellular for financial reporting purposes. In 2002, U.S. Cellular received cash refunds of \$56.1 million on wireless spectrum Auction 35 deposits.

Cash Flows From Financing Activities primarily reflects changes in short-term debt balances, proceeds from the sale of long-term debt and from entering into forward contracts, cash used to repurchase Common Shares and cash used for the repayment of long-term notes and the repurchase and conversion of debt securities.

TDS has used short-term debt to finance acquisitions, for general corporate purposes and to repurchase Common Shares. Internally generated funds as well as proceeds from forward contracts and the sale of non-strategic cellular and other investments, from time to time, have been used to reduce short-term debt. In addition, TDS has taken advantage of opportunities to reduce short-term debt with proceeds from the sale of long-term debt securities, including sales of debt securities by subsidiaries.

In 2004, U.S. Cellular issued \$330 million of 7.5% senior notes due June 2034 and \$100 million of 6.7% senior notes due December 2033. The net proceeds of these offerings totaled approximately \$412.5 million. Of this amount, U.S. Cellular used \$163.3 million to redeem its Liquid Yield Option Notes at accreted value. The balance of the net proceeds, together with borrowings under revolving credit facilities, was used to redeem all \$250 million of U.S. Cellular's 7.25% senior notes. The Liquid Yield Option Notes redemption includes the repayment of principal amount of the original debt of \$95.2 million, presented as an item reducing cash flow from financing activities, and the payment of \$68.1 million of accreted interest, presented as an item reducing cash flow from operating activities.

In 2003, TDS redeemed and cancelled the \$300 million of Trust Originated Preferred Securities. The redemption was financed with cash on hand. U.S. Cellular repaid the remaining principal amount outstanding on its 9% Series A notes with \$40.7 million in cash, which was financed using U.S. Cellular's revolving credit facilities. The 9% Series A notes are now retired. In 2003, U.S. Cellular received \$432.9 million net proceeds from the issuance of \$444.0 million of 6.7% senior notes due December 2033. These proceeds were used to repay all outstanding borrowings under the revolving credit facility entered into in 1997.

In 2002, TDS received \$1,631.8 million from forward contracts related to its investments in Deutsche Telekom, Vodafone and VeriSign. A portion of the proceeds from the Deutsche Telekom and VeriSign forward contracts was used by TDS to pay down TDS's short-term debt. U.S. Cellular received \$159.9 million from forward contracts related to its Vodafone investment and used the proceeds to pay down short-term debt.

In November 2002, U.S. Cellular issued \$130 million of 8.75% senior notes due in November 2032. The net proceeds of \$129.8 million, after the reimbursement of expenses, were used to repurchase a portion of the \$175 million 9% Series A notes that U.S. Cellular issued in connection with the acquisition of the Chicago market.

TDS retired a total of \$70.5 million and \$51.0 million of medium-term notes at par value in 2003 and 2002, respectively. Borrowings under revolving credit facilities totaled \$420.0 million in 2004, primarily to repay long-term debt and fund capital expenditures; \$279.3 million in 2003, primarily to fund capital expenditures; and \$542.6 million in 2002, primarily to fund the Chicago market acquisition and capital expenditures. Repayments under the revolving credit facilities totaled \$390.0 million in 2004, \$739.3 million in 2003 and \$346.6 million in 2002. Dividends paid on TDS Common and Preferred Shares, excluding dividends reinvested, totaled \$38.0 million in 2004, \$36.2 million in 2003 and \$34.4 million in 2002.

The Board of Directors of TDS has authorized the repurchase of TDS Common Shares. During 2004, TDS repurchased 214,800 of its Common Shares, for an aggregate purchase price of \$14.9 million, or an average of \$69.15 per share including commissions. During 2003, TDS repurchased 1,960,900 of its Common Shares, for an aggregate purchase price of \$92.4 million, or an average of \$47.10 per share including commissions. No shares were repurchased in 2002. Cash required for the repurchase of the Common Shares totaled \$20.4 million in 2004 and \$86.8 million in 2003, reflecting differences in the number of shares acquired and timing differences in the cash disbursements.

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 of its Common Shares under this authorization for an aggregate purchase price of \$3.9 million, or an average of \$42.62 per share including commissions. U.S. Cellular did not purchase any of its Common Shares in 2003 and 2002.

LIQUIDITY AND CAPITAL RESOURCES

TDS believes that cash flows from operating activities, existing cash and cash equivalents and funds available from line of credit arrangements provide sufficient financial resources to finance TDS's near-term capital, business development and expansion expenditures. TDS and its subsidiaries may have access to public and private capital markets to help meet their long-term financing

needs. TDS and its subsidiaries anticipate accessing public and private capital markets to issue debt and equity securities when and if capital requirements, financial market conditions and other factors warrant.

However, the availability of external financial resources is dependent on economic events, business developments, technological changes, financial conditions or other factors. If at any time financing is not available on terms acceptable to TDS, TDS might be required to reduce its business development and capital expenditure plans, which could have a materially adverse effect on its business and financial condition. TDS does not believe that any circumstances that could materially adversely affect TDS's liquidity or its capital resources are currently reasonably likely to occur, but it cannot provide assurances that such circumstances will not occur or that they will not occur rapidly. Economic downturns, changes in financial markets or other factors could rapidly change the availability of TDS's liquidity and capital resources. Uncertainty of access to capital for telecommunications companies, deterioration in the capital markets, other changes in market conditions or other factors could limit or restrict the availability of financing on terms and prices acceptable to TDS, which could require TDS to reduce its construction, development, acquisition programs and Common Share repurchase programs.

TDS generates substantial funds from the operations of U.S. Cellular and TDS Telecom. Cash flows from operating activities totaled \$747.4 million in 2004, \$920.4 million in 2003 and \$793.6 million in 2002. TDS and its subsidiaries had cash and cash equivalents totaling \$1,168.6 million at December 31, 2004.

Revolving Credit Facilities

As discussed below, TDS and its subsidiaries had \$1,266.4 million of revolving credit facilities available for general corporate purposes as well as an additional \$75.0 million of bank lines of credit as of December 31, 2004.

TDS had a \$600 million revolving credit facility with a group of banks at December 31, 2004. TDS had \$3.4 million of letters of credit outstanding against the revolving credit facility, leaving \$596.6 million available for use. On December 9, 2004, TDS 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 and (ii) the material adverse change condition has been removed with respect to drawdowns. Borrowings bear interest at the London InterBank Offered Rate ("LIBOR") plus a contractual spread based on TDS'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). Under certain circumstances, with less than two days' notice of intent to borrow, interest on borrowings are at the prime rate less 50 basis points (the prime rate was 5.25% at December 31, 2004).

TDS also had \$75 million of direct bank lines of credit at December 31, 2004, all of which were unused. The terms of the direct bank lines of credit provide for borrowings at negotiated rates up to the prime rate (the prime rate was 5.25% at December 31, 2004).