

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