

TELEPHONE & DATA SYSTEMS INC /DE/  
Form 10-Q  
August 01, 2014

|   |   |  |  |  |  |  |  |  |  |                                   |  |  |  |  |  |  |  |            |           |
|---|---|--|--|--|--|--|--|--|--|-----------------------------------|--|--|--|--|--|--|--|------------|-----------|
|   |   |  |  |  |  |  |  |  |  |                                   |  |  |  |  |  |  |  |            |           |
| UNITED STATES   |   |  |  |  |  |  |  |  |  |                                   |  |  |  |  |  |  |  |            |           |
| SECURITIES AND EXCHANGE COMMISSION  |   |  |  |  |  |  |  |  |  |                                   |  |  |  |  |  |  |  |            |           |
| Washington, D.C. 20549  |   |  |  |  |  |  |  |  |  |                                   |  |  |  |  |  |  |  |            |           |
| FORM 10-Q   |   |  |  |  |  |  |  |  |  |                                   |  |  |  |  |  |  |  |            |           |
| <b>(Mark One)</b>   |   |  |  |  |  |  |  |  |  |                                   |  |  |  |  |  |  |  |            |           |
| x   | <b>QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934</b>  |  |  |  |  |  |  |  |  |                                   |  |  |  |  |  |  |  |            |           |
|   |   |  |  |  |  |  |  |  |  |                                   |  |  |  |  |  |  |  |            |           |
| For the quarterly period ended June 30, 2014  |   |  |  |  |  |  |  |  |  |                                   |  |  |  |  |  |  |  |            |           |
|   |   |  |  |  |  |  |  |  |  |                                   |  |  |  |  |  |  |  |            |           |
| OR  |   |  |  |  |  |  |  |  |  |                                   |  |  |  |  |  |  |  |            |           |
|   |   |  |  |  |  |  |  |  |  |                                   |  |  |  |  |  |  |  |            |           |
|   | <b>TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934</b> |  |  |  |  |  |  |  |  |                                   |  |  |  |  |  |  |  |            |           |
|   |   |  |  |  |  |  |  |  |  |                                   |  |  |  |  |  |  |  |            |           |
| For the transition period from to   |   |  |  |  |  |  |  |  |  |                                   |  |  |  |  |  |  |  |            |           |
|   |   |  |  |  |  |  |  |  |  |                                   |  |  |  |  |  |  |  |            |           |
| Commission file number 001-14157  |   |  |  |  |  |  |  |  |  |                                   |  |  |  |  |  |  |  |            |           |
|   |   |  |  |  |  |  |  |  |  |                                   |  |  |  |  |  |  |  |            |           |
| TELEPHONE AND DATA SYSTEMS, INC.  |   |  |  |  |  |  |  |  |  |                                   |  |  |  |  |  |  |  |            |           |
| (Exact name of Registrant as specified in its charter)  |   |  |  |  |  |  |  |  |  |                                   |  |  |  |  |  |  |  |            |           |
| Delaware  |   |  |  |  |  |  |  |  |  | 36-2669023                        |  |  |  |  |  |  |  |            |           |
| (State or other jurisdiction of incorporation or organization)  |   |  |  |  |  |  |  |  |  | (IRS Employer Identification No.) |  |  |  |  |  |  |  |            |           |
|   |   |  |  |  |  |  |  |  |  |                                   |  |  |  |  |  |  |  |            |           |
| <b><u>30 North LaSalle Street, Suite 4000, Chicago, Illinois 60602</u></b>  |   |  |  |  |  |  |  |  |  |                                   |  |  |  |  |  |  |  |            |           |
| (Address of principal executive offices) (Zip code)   |   |  |  |  |  |  |  |  |  |                                   |  |  |  |  |  |  |  |            |           |
|   |   |  |  |  |  |  |  |  |  |                                   |  |  |  |  |  |  |  |            |           |
| Registrant's telephone number, including area code: (312) 630-1900  |   |  |  |  |  |  |  |  |  |                                   |  |  |  |  |  |  |  |            |           |
|   |   |  |  |  |  |  |  |  |  |                                   |  |  |  |  |  |  |  |            |           |
| <b>Indicate by check mark</b>   |   |  |  |  |  |  |  |  |  |                                   |  |  |  |  |  |  |  | <b>Yes</b> | <b>No</b> |
| <ul style="list-style-type: none"> <li>whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.</li> </ul> |   |  |  |  |  |  |  |  |  |                                   |  |  |  |  |  |  |  | x          |           |

|  |  |  |  |   |                   |  |  |  |  |                                     |  |  |  |  |                           |  |   |   |  |
|--|--|--|--|---|-------------------|--|--|--|--|-------------------------------------|--|--|--|--|---------------------------|--|---|---|--|
|  |  |  |  |   |                   |  |  |  |  |                                     |  |  |  |  |                           |  |   |   |  |
| • whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). |  |  |  |   |                   |  |  |  |  |                                     |  |  |  |  |                           |  | x |   |  |
| • whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.  |  |  |  |   |                   |  |  |  |  |                                     |  |  |  |  |                           |  |   |   |  |
| Large accelerated filer  |  |  |  | x | Accelerated filer |  |  |  |  | Non-accelerated filer               |  |  |  |  | Smaller reporting company |  |   |   |  |
|  |  |  |  |   |                   |  |  |  |  |                                     |  |  |  |  |                           |  |   |   |  |
| • whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).  |  |  |  |   |                   |  |  |  |  |                                     |  |  |  |  |                           |  |   | x |  |
|  |  |  |  |   |                   |  |  |  |  |                                     |  |  |  |  |                           |  |   |   |  |
|  |  |  |  |   |                   |  |  |  |  |                                     |  |  |  |  |                           |  |   |   |  |
|  |  |  |  |   |                   |  |  |  |  |                                     |  |  |  |  |                           |  |   |   |  |
| Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.  |  |  |  |   |                   |  |  |  |  |                                     |  |  |  |  |                           |  |   |   |  |
|  |  |  |  |   |                   |  |  |  |  |                                     |  |  |  |  |                           |  |   |   |  |
| <b>Class</b>   |  |  |  |   |                   |  |  |  |  | <b>Outstanding at June 30, 2014</b> |  |  |  |  |                           |  |   |   |  |
| Common Shares, \$0.01 par value  |  |  |  |   |                   |  |  |  |  | 101,032,392 Shares                  |  |  |  |  |                           |  |   |   |  |
| Series A Common Shares, \$0.01 par value   |  |  |  |   |                   |  |  |  |  | 7,185,356 Shares                    |  |  |  |  |                           |  |   |   |  |
|  |  |  |  |   |                   |  |  |  |  |                                     |  |  |  |  |                           |  |   |   |  |
|  |  |  |  |   |                   |  |  |  |  |                                     |  |  |  |  |                           |  |   |   |  |
|  |  |  |  |   |                   |  |  |  |  |                                     |  |  |  |  |                           |  |   |   |  |
|  |  |  |  |   |                   |  |  |  |  |                                     |  |  |  |  |                           |  |   |   |  |
|  |  |  |  |   |                   |  |  |  |  |                                     |  |  |  |  |                           |  |   |   |  |
|  |  |  |  |   |                   |  |  |  |  |                                     |  |  |  |  |                           |  |   |   |  |
|  |  |  |  |   |                   |  |  |  |  |                                     |  |  |  |  |                           |  |   |   |  |

| Telephone and Data Systems, Inc.             |                       |   |  |           |
|--|-----------------------|---|--|-----------|
| Quarterly Report on Form 10-Q                |                       |   |  |           |
| For the Quarterly Period Ended June 30, 2014 |                       |   |  |           |
| Index  |                       |   |  |           |
|  |                       |   |  | Page No.  |
| Part I.                                      | Financial Information |   |  |           |
|  |                       |   |  |           |
|  | Item 1.               | Financial Statements (Unaudited)  |  | <u>1</u>  |
|  |                       |   |  |           |
|  |                       | Consolidated Statement of Operations  |  | <u>1</u>  |
|  |                       | Three and Six Months Ended June 30, 2014 and 2013                                     |  |           |
|  |                       |   |  |           |
|  |                       | Consolidated Statement of Comprehensive Income  |  | <u>2</u>  |
|  |                       | Three and Six Months Ended June 30, 2014 and 2013                                     |  |           |
|  |                       |   |  |           |
|  |                       | Consolidated Statement of Cash Flows  |  | <u>3</u>  |
|  |                       | Six Months Ended June 30, 2014 and 2013   |  |           |
|  |                       |   |  |           |
|  |                       | Consolidated Balance Sheet  |  | <u>4</u>  |
|  |                       | June 30, 2014 and December 31, 2013   |  |           |
|  |                       |   |  |           |
|  |                       | Consolidated Statement of Changes in Equity   |  | <u>6</u>  |
|  |                       | Six Months Ended June 30, 2014 and 2013   |  |           |
|  |                       |   |  |           |
|  |                       | Notes to Consolidated Financial Statements  |  | <u>8</u>  |
|  |                       |   |  |           |
|  | Item 2.               | Management's Discussion and Analysis of Financial Condition and Results of Operations |  | <u>24</u> |
|  |                       |   |  |           |
|  |                       | Overview  |  | <u>24</u> |
|  |                       |   |  |           |
|  |                       | Six Months Ended June 30, 2014 and 2013   |  |           |
|  |                       | Results of Operations — Consolidated  |  | <u>29</u> |
|  |                       | Results of Operations — U.S. Cellular   |  | <u>31</u> |
|  |                       | Results of Operations — TDS Telecom   |  | <u>36</u> |
|  |                       |   |  |           |

|                   |                          |  |  |           |  |
|-------------------|--------------------------|--|--|-----------|--|
|                   |                          |  | <u>Three Months Ended June 30, 2014 and 2013</u>                   |           |  |
|                   |                          |  | <u>Results of Operations — Consolidated</u>                        | <u>42</u> |  |
|                   |                          |  | <u>Results of Operations — U.S. Cellular</u>                       | <u>44</u> |  |
|                   |                          |  | <u>Results of Operations — TDS Telecom</u>                         | <u>46</u> |  |
|                   |                          |  |  |           |  |
|                   |                          |  | <u>Recent Accounting Pronouncements</u>                            | <u>49</u> |  |
|                   |                          |  |  |           |  |
|                   |                          |  | <u>Financial Resources</u>   | <u>49</u> |  |
|                   |                          |  |  |           |  |
|                   |                          |  | <u>Liquidity and Capital Resources</u>                             | <u>51</u> |  |
|                   |                          |  |  |           |  |
|                   |                          |  | <u>Application of Critical Accounting Policies and Estimates</u>   | <u>54</u> |  |
|                   |                          |  |  |           |  |
|                   |                          |  | <u>Safe Harbor Cautionary Statement</u>                            | <u>55</u> |  |
|                   |                          |  |  |           |  |
|                   | <u>Item 3.</u>           |  | <u>Quantitative and Qualitative Disclosures About Market Risk</u>  | <u>58</u> |  |
|                   |                          |  |  |           |  |
|                   | <u>Item 4.</u>           |  | <u>Controls and Procedures</u>                                     | <u>59</u> |  |
|                   |                          |  |  |           |  |
| <u>Part II.</u>   | <u>Other Information</u> |  |  |           |  |
|                   |                          |  |  |           |  |
|                   | <u>Item 1.</u>           |  | <u>Legal Proceedings</u>   | <u>60</u> |  |
|                   |                          |  |  |           |  |
|                   | <u>Item 1A.</u>          |  | <u>Risk Factors</u>  | <u>60</u> |  |
|                   |                          |  |  |           |  |
|                   | <u>Item 2.</u>           |  | <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | <u>60</u> |  |
|                   |                          |  |  |           |  |
|                   | <u>Item 5.</u>           |  | <u>Other Information</u>   | <u>62</u> |  |
|                   |                          |  |  |           |  |
|                   | <u>Item 6.</u>           |  | <u>Exhibits</u>  | <u>63</u> |  |
|                   |                          |  |  |           |  |
| <u>Signatures</u> |                          |  |  |           |  |
|                   |                          |  |  |           |  |
|                   |                          |  |  |           |  |

Table of Contents

|  |  |                          |  |                           |           |  |             |           |  |                         |           |  |             |           |
|--|--|--------------------------|--|---------------------------|-----------|--|-------------|-----------|--|-------------------------|-----------|--|-------------|-----------|
| <b>Part I. Financial Information</b>                               |  |                          |  |                           |           |  |             |           |  |                         |           |  |             |           |
| <b>Item 1. Financial Statements</b>                                |  |                          |  |                           |           |  |             |           |  |                         |           |  |             |           |
|  |  |                          |  |                           |           |  |             |           |  |                         |           |  |             |           |
| <b>Telephone and Data Systems, Inc.</b>                            |  |                          |  |                           |           |  |             |           |  |                         |           |  |             |           |
| <b><u>Consolidated Statement of Operations</u></b>                 |  |                          |  |                           |           |  |             |           |  |                         |           |  |             |           |
| <b><u>(Unaudited)</u></b>  |  |                          |  |                           |           |  |             |           |  |                         |           |  |             |           |
|  |  |                          |  |                           |           |  |             |           |  |                         |           |  |             |           |
|  |  |                          |  | <b>Three Months Ended</b> |           |  |             |           |  | <b>Six Months Ended</b> |           |  |             |           |
|  |  |                          |  | <b>June 30,</b>           |           |  |             |           |  | <b>June 30,</b>         |           |  |             |           |
| <b>(Dollars and shares in thousands, except per share amounts)</b> |  |                          |  | <b>2014</b>               |           |  | <b>2013</b> |           |  | <b>2014</b>             |           |  | <b>2013</b> |           |
| <b>Operating revenues</b>  |  |                          |  |                           |           |  |             |           |  |                         |           |  |             |           |
|  | Service  |                          |  | \$                        | 1,072,179 |  | \$          | 1,115,661 |  | \$                      | 2,152,421 |  | \$          | 2,314,563 |
|  | Equipment and product sales  |                          |  |                           | 164,213   |  |             | 112,505   |  |                         | 279,933   |  |             | 222,176   |
|  |  | Total operating revenues |  |                           | 1,236,392 |  |             | 1,228,166 |  |                         | 2,432,354 |  |             | 2,536,739 |
|  |  |                          |  |                           |           |  |             |           |  |                         |           |  |             |           |
| <b>Operating expenses</b>  |  |                          |  |                           |           |  |             |           |  |                         |           |  |             |           |
|  | Cost of services (excluding Depreciation, amortization and accretion reported below) |                          |  |                           | 286,488   |  |             | 275,837   |  |                         | 562,446   |  |             | 574,964   |
|  | Cost of equipment and products   |                          |  |                           | 313,011   |  |             | 239,894   |  |                         | 619,658   |  |             | 500,659   |
|  | Selling, general and administrative  |                          |  |                           | 470,902   |  |             | 470,720   |  |                         | 934,571   |  |             | 957,623   |
|  | Depreciation, amortization and accretion   |                          |  |                           | 204,567   |  |             | 254,203   |  |                         | 429,486   |  |             | 496,280   |
|  | (Gain) loss on asset disposals, net  |                          |  |                           | 7,903     |  |             | 8,319     |  |                         | 10,333    |  |             | 13,935    |
|  | (Gain) loss on sale of business and other exit costs, net                            |                          |  |                           | 2,611     |  |             | (303,034) |  |                         | (4,289)   |  |             | (296,103) |
|  | (Gain) loss on license sales and exchanges   |                          |  |                           | -         |  |             | -         |  |                         | (91,446)  |  |             | -         |
|  |  | Total operating expenses |  |                           | 1,285,482 |  |             | 945,939   |  |                         | 2,460,759 |  |             | 2,247,358 |
|  |  |                          |  |                           |           |  |             |           |  |                         |           |  |             |           |
| <b>Operating income (loss)</b>                                     |  |                          |  |                           | (49,090)  |  |             | 282,227   |  |                         | (28,405)  |  |             | 289,381   |
|  |  |                          |  |                           |           |  |             |           |  |                         |           |  |             |           |
| <b>Investment and other income (expense)</b>                       |  |                          |  |                           |           |  |             |           |  |                         |           |  |             |           |
|  | Equity in earnings of unconsolidated entities  |                          |  |                           | 34,790    |  |             | 35,605    |  |                         | 72,117    |  |             | 62,694    |

|   |  |    |          |    |          |    |          |    |          |
|---|--|----|----------|----|----------|----|----------|----|----------|
|   | Interest and dividend income   |    | 2,751    |    | 2,600    |    | 5,237    |    | 4,178    |
|   | Gain (loss) on investments   |    | -        |    | 14,518   |    | -        |    | 14,518   |
|   | Interest expense   |    | (27,898) |    | (23,749) |    | (56,605) |    | (48,247) |
|   | Other, net   |    | 50       |    | (197)    |    | 210      |    | (351)    |
|   | Total investment and other income  |    | 9,693    |    | 28,777   |    | 20,959   |    | 32,792   |
|   |  |    |          |    |          |    |          |    |          |
|   | <b>Income (loss) before income taxes</b>                                     |    | (39,397) |    | 311,004  |    | (7,446)  |    | 322,173  |
|   | Income tax expense (benefit)   |    | (13,671) |    | 132,607  |    | (2,014)  |    | 136,787  |
|   | <b>Net income (loss)</b>   |    | (25,726) |    | 178,397  |    | (5,432)  |    | 185,386  |
|   | Less: Net income (loss) attributable to noncontrolling interests, net of tax |    | (3,688)  |    | 22,320   |    | (1,648)  |    | 27,890   |
|   | <b>Net income (loss) attributable to TDS shareholders</b>                    |    | (22,038) |    | 156,077  |    | (3,784)  |    | 157,496  |
|   | TDS Preferred dividend requirement   |    | (12)     |    | (12)     |    | (25)     |    | (25)     |
|   | <b>Net income (loss) available to common shareholders</b>                    | \$ | (22,050) | \$ | 156,065  | \$ | (3,809)  | \$ | 157,471  |
|   |  |    |          |    |          |    |          |    |          |
|   | <b>Basic weighted average shares outstanding</b>                             |    | 108,719  |    | 108,385  |    | 108,853  |    | 108,320  |
|   | <b>Basic earnings (loss) per share attributable to TDS shareholders</b>      | \$ | (0.20)   | \$ | 1.44     | \$ | (0.04)   | \$ | 1.45     |
|   |  |    |          |    |          |    |          |    |          |
|   | <b>Diluted weighted average shares outstanding</b>                           |    | 108,719  |    | 108,913  |    | 108,853  |    | 108,827  |
|   | <b>Diluted earnings (loss) per share attributable to TDS shareholders</b>    | \$ | (0.20)   | \$ | 1.42     | \$ | (0.04)   | \$ | 1.44     |
|   |  |    |          |    |          |    |          |    |          |
|   | <b>Dividends per share to TDS shareholders</b>                               | \$ | 0.1340   | \$ | 0.1275   | \$ | 0.2680   | \$ | 0.2550   |
|   |  |    |          |    |          |    |          |    |          |
| The accompanying notes are an integral part of these consolidated financial statements. |  |    |          |    |          |    |          |    |          |

Table of Contents

| Telephone and Data Systems, Inc.  |  |  |  |                    |          |      |         |                  |         |      |         |
|---|--|--|--|--------------------|----------|------|---------|------------------|---------|------|---------|
| <u>Consolidated Statement of Comprehensive Income</u>                     |  |  |  |                    |          |      |         |                  |         |      |         |
| <u>(Unaudited)</u>  |  |  |  |                    |          |      |         |                  |         |      |         |
|   |  |  |  | Three Months Ended |          |      |         | Six Months Ended |         |      |         |
|   |  |  |  | June 30,           |          |      |         | June 30,         |         |      |         |
| (Dollars in thousands)  |  |  |  | 2014               |          | 2013 |         | 2014             |         | 2013 |         |
| Net income (loss)   |  |  |  | \$                 | (25,726) | \$   | 178,397 | \$               | (5,432) | \$   | 185,386 |
| Net change in accumulated other   |  |  |  |                    |          |      |         |                  |         |      |         |
| comprehensive income (loss)   |  |  |  |                    |          |      |         |                  |         |      |         |
| Change in net unrealized gain (loss) on equity                            |  |  |  |                    |          |      |         |                  |         |      |         |
| investments   |  |  |  |                    | 341      |      | 51      |                  | 341     |      | 51      |
| Change in foreign currency translation adjustment                         |  |  |  |                    | (17)     |      | -       |                  | (21)    |      | 15      |
| Change related to retirement plan   |  |  |  |                    |          |      |         |                  |         |      |         |
| Amounts included in net periodic benefit cost for the period              |  |  |  |                    |          |      |         |                  |         |      |         |
| Amortization of prior service cost  |  |  |  |                    | (911)    |      | (902)   |                  | (1,822) |      | (1,804) |
| Amortization of unrecognized net loss                                     |  |  |  |                    | 322      |      | 602     |                  | 644     |      | 1,204   |
|   |  |  |  |                    | (589)    |      | (300)   |                  | (1,178) |      | (600)   |
| Change in deferred income taxes   |  |  |  |                    | 224      |      | 114     |                  | 447     |      | 228     |
| Change related to retirement plan, net of tax                             |  |  |  |                    | (365)    |      | (186)   |                  | (731)   |      | (372)   |
| Net change in accumulated other comprehensive income (loss)               |  |  |  |                    | (41)     |      | (135)   |                  | (411)   |      | (306)   |
| Comprehensive income (loss)   |  |  |  |                    | (25,767) |      | 178,262 |                  | (5,843) |      | 185,080 |
| Less: Comprehensive income (loss) attributable to noncontrolling interest |  |  |  |                    | (3,688)  |      | 22,320  |                  | (1,648) |      | 27,890  |
| Comprehensive income (loss) attributable                                  |  |  |  | \$                 | (22,079) | \$   | 155,942 | \$               | (4,195) | \$   | 157,190 |

|   |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|---|--|--|--|--|--|--|--|--|--|--|--|--|--|--|
| to  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| TDS shareholders  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|   |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| The accompanying notes are an integral part of these consolidated financial statements. |  |  |  |  |  |  |  |  |  |  |  |  |  |  |



Table of Contents

| <b><u>Telephone and Data Systems, Inc.</u></b>     |  |   |    |                         |             |
|--|--|---|----|-------------------------|-------------|
| <b><u>Consolidated Statement of Cash Flows</u></b> |  |   |    |                         |             |
| <b><u>(Unaudited)</u></b>                          |  |   |    |                         |             |
|  |  |   |    | <b>Six Months Ended</b> |             |
|  |  |   |    | <b>June 30,</b>         |             |
| <b>(Dollars in thousands)</b>                      |  |   |    | <b>2014</b>             | <b>2013</b> |
| <b>Cash flows from operating activities</b>        |  |   |    |                         |             |
|  | Net income (loss)  |   | \$ | (5,432)                 | \$ 185,386  |
|  | Add (deduct) adjustments to reconcile net income to cash flows |   |    |                         |             |
|  | from operating activities                                      |   |    |                         |             |
|  |  | Depreciation, amortization and accretion                  |    | 429,486                 | 496,280     |
|  |  | Bad debts expense   |    | 52,098                  | 35,187      |
|  |  | Stock-based compensation expense                          |    | 15,488                  | 12,902      |
|  |  | Deferred income taxes, net                                |    | (33,346)                | (21,246)    |
|  |  | Equity in earnings of unconsolidated entities             |    | (72,117)                | (62,694)    |
|  |  | Distributions from unconsolidated entities                |    | 65,569                  | 47,635      |
|  |  | (Gain) loss on asset disposals, net                       |    | 10,333                  | 13,935      |
|  |  | (Gain) loss on sale of business and other exit costs, net |    | (4,289)                 | (296,103)   |
|  |  | (Gain) loss on investments                                |    | -                       | (14,518)    |
|  |  | (Gain) loss on license sales and exchanges                |    | (91,446)                | -           |
|  |  | Noncash interest expense                                  |    | 1,014                   | 997         |
|  |  | Other operating activities                                |    | 3                       | 505         |
|  | Changes in assets and liabilities from operations              |   |    |                         |             |
|  |  | Accounts receivable                                       |    | 40,459                  | (5,781)     |
|  |  | Inventory   |    | 38,674                  | (8,105)     |
|  |  | Accounts payable  |    | (43,132)                | 58,204      |
|  |  | Customer deposits and deferred revenues                   |    | 13,139                  | 7,897       |
|  |  | Accrued taxes   |    | 1,049                   | 150,425     |
|  |  | Accrued interest  |    | 22                      | 2,172       |
|  |  | Other assets and liabilities                              |    | (101,930)               | (81,586)    |
|  |  |   |    | 315,642                 | 521,492     |
| <b>Cash flows from investing activities</b>        |  |   |    |                         |             |
|  | Cash used for additions to property, plant and equipment       |   |    | (339,907)               | (384,281)   |
|  | Cash paid for acquisitions and licenses                        |   |    | (18,681)                | (14,150)    |
|  | Cash received from divestitures                                |   |    | 125,905                 | 480,000     |
|  | Cash received for investments                                  |   |    | 10,000                  | 15,000      |
|  | Other investing activities                                     |   |    | 3,720                   | 14,127      |

|   |  |  |  |  |            |  |    |           |
|---|--|--|--|--|------------|--|----|-----------|
|   |  |  |  |  | (218,963)  |  |    | 110,696   |
|   |  |  |  |  |            |  |    |           |
| <b>Cash flows from financing activities</b>   |  |  |  |  |            |  |    |           |
|   | Repayment of long-term debt  |  |  |  | (589)      |  |    | (605)     |
|   | TDS Common Shares reissued for benefit plans,<br>net of tax payments           |  |  |  | 401        |  |    | 776       |
|   | U.S. Cellular Common Shares reissued for benefit plans, net of<br>tax payments |  |  |  | 830        |  |    | (2,206)   |
|   | Repurchase of TDS Common Shares  |  |  |  | (20,090)   |  |    | -         |
|   | Repurchase of U.S. Cellular Common Shares                                      |  |  |  | (8,298)    |  |    | (18,425)  |
|   | Dividends paid to TDS shareholders   |  |  |  | (29,107)   |  |    | (27,598)  |
|   | U.S. Cellular dividends paid to noncontrolling public shareholders             |  |  |  | -          |  |    | (75,235)  |
|   | Distributions to noncontrolling interests                                      |  |  |  | (482)      |  |    | (3,292)   |
|   | Other financing activities   |  |  |  | 5,502      |  |    | 331       |
|   |  |  |  |  | (51,833)   |  |    | (126,254) |
|   |  |  |  |  |            |  |    |           |
| <b>Net increase in cash and cash equivalents</b>  |  |  |  |  | 44,846     |  |    | 505,934   |
|   |  |  |  |  |            |  |    |           |
| <b>Cash and cash equivalents</b>  |  |  |  |  |            |  |    |           |
|   | Beginning of period  |  |  |  | 830,014    |  |    | 740,481   |
|   | End of period  |  |  |  | \$ 874,860 |  | \$ | 1,246,415 |
|   |  |  |  |  |            |  |    |           |
| The accompanying notes are an integral part of these consolidated financial statements. |  |  |  |  |            |  |    |           |

Table of Contents

| Telephone and Data Systems, Inc.           |   |  |            |    |              |
|--|---|--|------------|----|--------------|
| <u>Consolidated Balance Sheet — Assets</u> |   |  |            |    |              |
| <u>(Unaudited)</u>                         |   |  |            |    |              |
| (Dollars in thousands)                     |   |  | June 30,   |    | December 31, |
|  |   |  | 2014       |    | 2013         |
| <b>Current assets</b>                      |   |  |            |    |              |
|  | Cash and cash equivalents   |  | \$ 874,860 | \$ | 830,014      |
|  | Short-term investments  |  | 40,035     |    | 50,104       |
|  | Accounts receivable   |  |            |    |              |
|  | Due from customers and agents, less allowances of \$37,543 and \$63,690, respectively             |  | 460,823    |    | 551,611      |
|  | Other, less allowances of \$2,276 and \$1,914, respectively                                       |  | 163,438    |    | 179,503      |
|  | Inventory, net  |  | 205,886    |    | 244,560      |
|  | Net deferred income tax asset   |  | 106,077    |    | 106,077      |
|  | Prepaid expenses  |  | 88,860     |    | 87,920       |
|  | Income taxes receivable   |  | 9,197      |    | 2,397        |
|  | Other current assets  |  | 32,274     |    | 35,151       |
|  |   |  | 1,981,450  |    | 2,087,337    |
| <b>Assets held for sale</b>                |   |  | 5,980      |    | 16,027       |
| <b>Investments</b>                         |   |  |            |    |              |
|  | Licenses  |  | 1,460,484  |    | 1,423,779    |
|  | Goodwill  |  | 834,352    |    | 836,843      |
|  | Franchise rights  |  | 124,487    |    | 123,668      |
|  | Other intangible assets, net of accumulated amortization of \$122,767 and \$112,752, respectively |  | 61,536     |    | 71,454       |
|  | Investments in unconsolidated entities  |  | 308,661    |    | 301,772      |
|  | Other investments   |  | 589        |    | 641          |
|  |   |  | 2,790,109  |    | 2,758,157    |
| <b>Property, plant and equipment</b>       |   |  |            |    |              |
|  | In service and under construction   |  | 11,220,652 |    | 11,239,804   |
|  | Less: Accumulated depreciation  |  | 7,470,705  |    | 7,361,660    |
|  |   |  | 3,749,947  |    | 3,878,144    |
| <b>Other assets and deferred charges</b>   |   |  | 180,183    |    | 164,482      |

|   |  |  |  |    |           |  |    |           |
|---|--|--|--|----|-----------|--|----|-----------|
|   |  |  |  |    |           |  |    |           |
| <b>Total assets</b>   |  |  |  | \$ | 8,707,669 |  | \$ | 8,904,147 |
|   |  |  |  |    |           |  |    |           |
| The accompanying notes are an integral part of these consolidated financial statements. |  |  |  |    |           |  |    |           |

Table of Contents

| Telephone and Data Systems, Inc.                           |  |  |  |          |           |              |           |
|--|--|--|--|----------|-----------|--------------|-----------|
| <u>Consolidated Balance Sheet — Liabilities and Equity</u> |  |  |  |          |           |              |           |
| <u>(Unaudited)</u>   |  |  |  |          |           |              |           |
|  |  |  |  | June 30, |           | December 31, |           |
| (Dollars and shares in thousands)                          |  |  |  | 2014     |           | 2013         |           |
| <b>Current liabilities</b>                                 |  |  |  |          |           |              |           |
|  | Current portion of long-term debt  |  |  | \$       | 890       | \$           | 1,646     |
|  | Accounts payable   |  |  |          | 425,051   |              | 496,069   |
|  | Customer deposits and deferred revenues  |  |  |          | 302,496   |              | 289,445   |
|  | Accrued interest   |  |  |          | 6,671     |              | 6,673     |
|  | Accrued taxes  |  |  |          | 73,227    |              | 70,518    |
|  | Accrued compensation   |  |  |          | 98,099    |              | 115,031   |
|  | Other current liabilities  |  |  |          | 166,270   |              | 212,374   |
|  |  |  |  |          | 1,072,704 |              | 1,191,756 |
| <b>Liabilities held for sale</b>                           |  |  |  |          | 722       |              | -         |
| <b>Deferred liabilities and credits</b>                    |  |  |  |          |           |              |           |
|  | Net deferred income tax liability  |  |  |          | 828,458   |              | 862,975   |
|  | Other deferred liabilities and credits   |  |  |          | 460,862   |              | 458,709   |
| <b>Long-term debt</b>                                      |  |  |  |          | 1,718,832 |              | 1,720,074 |
| <b>Commitments and contingencies</b>                       |  |  |  |          | -         |              | -         |
| <b>Noncontrolling interests with redemption features</b>   |  |  |  |          | 911       |              | 536       |
| <b>Equity</b>  |  |  |  |          |           |              |           |
|  | TDS shareholders' equity   |  |  |          |           |              |           |
|  | Series A Common and Common Shares  |  |  |          |           |              |           |
|  | Authorized 290,000 shares (25,000 Series A Common and 265,000 Common Shares)   |  |  |          |           |              |           |
|  | Issued 132,730 shares (7,185 Series A Common and 125,545 Common Shares) and 132,711 shares (7,166 Series A Common and 125,545 Common Shares), respectively |  |  |          |           |              |           |
|  | Outstanding 108,217 shares (7,185 Series A Common and 101,032 Common Shares) and 108,757 shares (7,166 Series A Common and                                 |  |  |          |           |              |           |

|   |  |  |   |  |                     |  |           |                  |
|---|--|--|---|--|---------------------|--|-----------|------------------|
|   |  |  | 101,591 Common Shares), respectively  |  |                     |  |           |                  |
|   |  |  | Par Value (\$.01 per share) (\$72 Series A<br>Common and \$1,255 Common Shares) |  | 1,327               |  |           | 1,327            |
|   |  |  | Capital in excess of par value  |  | 2,312,515           |  |           | 2,308,807        |
|   |  |  | Treasury shares at cost:  |  |                     |  |           |                  |
|   |  |  | 24,513 and 23,954 Common Shares,<br>respectively                                |  | (737,835)           |  |           | (721,354)        |
|   |  |  | Accumulated other comprehensive loss  |  | (980)               |  |           | (569)            |
|   |  |  | Retained earnings   |  | 2,496,735           |  |           | 2,529,626        |
|   |  |  | Total TDS shareholders' equity  |  | 4,071,762           |  |           | 4,117,837        |
|   |  |  |   |  |                     |  |           |                  |
|   |  |  | Preferred shares  |  | 824                 |  |           | 824              |
|   |  |  | Noncontrolling interests  |  | 552,594             |  |           | 551,436          |
|   |  |  |   |  |                     |  |           |                  |
|   |  |  | Total equity  |  | 4,625,180           |  |           | 4,670,097        |
|   |  |  |   |  |                     |  |           |                  |
|   |  |  | <b>Total liabilities and equity</b>   |  | <b>\$ 8,707,669</b> |  | <b>\$</b> | <b>8,904,147</b> |
|   |  |  |   |  |                     |  |           |                  |
| The accompanying notes are an integral part of these consolidated financial statements. |  |  |   |  |                     |  |           |                  |

Table of Contents

| Telephone and Data Systems, Inc.   |                              |                                      |                              |   |                      |                                      |                     |                                 |                 |  |
|--|------------------------------|--------------------------------------|------------------------------|---|----------------------|--------------------------------------|---------------------|---------------------------------|-----------------|--|
| <u>Consolidated Statement of Changes in Equity</u>                           |                              |                                      |                              |   |                      |                                      |                     |                                 |                 |  |
| <u>(Unaudited)</u>   |                              |                                      |                              |   |                      |                                      |                     |                                 |                 |  |
| TDS Shareholders   |                              |                                      |                              |   |                      |                                      |                     |                                 |                 |  |
| (Dollars and<br>in thousands)  | Series A<br>Common<br>Shares | Capital in<br>Excess of<br>Par Value | Treasury<br>Common<br>Shares | Accumulated<br>Other<br>Comprehensive<br>Income<br>(Loss) | Retained<br>Earnings | Total TDS<br>Shareholders'<br>Equity | Preferred<br>Shares | Non<br>controlling<br>Interests | Total<br>Equity |  |
| December<br>31,<br>2013  | \$ 1,327                     | \$ 2,308,807                         | \$ (721,354)                 | \$ (569)  | \$ 2,529,626         | \$ 4,117,837                         | \$ 824              | \$ 551,436                      | \$ 4,670,097    |  |
| Add<br>(Deduct)  |                              |                                      |                              |   |                      |                                      |                     |                                 |                 |  |
| Net<br>income<br>attributable<br>to<br>TDS<br>shareholders                   | -                            | -                                    | -                            | -   | (3,784)              | (3,784)                              | -                   | -                               | (3,784)         |  |
| Net<br>income<br>(loss)<br>attributable<br>to<br>noncontrolling<br>interests |                              |                                      |                              |   |                      |                                      |                     |                                 |                 |  |
| classified<br>as<br>equity   | -                            | -                                    | -                            | -   | -                    | -                                    | -                   | (2,045)                         | (2,045)         |  |
| Net<br>unrealized<br>gain  | -                            | -                                    | -                            | 341   | -                    | 341                                  | -                   | -                               | 341             |  |

[illegible]





Table of Contents

| Telephone and Data Systems, Inc.                                   |                              |                                      |                              |   |                      |                                      |                     |                                 |                 |  |  |
|--|------------------------------|--------------------------------------|------------------------------|---|----------------------|--------------------------------------|---------------------|---------------------------------|-----------------|--|--|
| <u>Consolidated Statement of Changes in Equity</u>                 |                              |                                      |                              |   |                      |                                      |                     |                                 |                 |  |  |
| <u>(Unaudited)</u>   |                              |                                      |                              |   |                      |                                      |                     |                                 |                 |  |  |
| TDS Shareholders   |                              |                                      |                              |   |                      |                                      |                     |                                 |                 |  |  |
| (Dollars and<br>in thousands)                                      | Series A<br>Common<br>Shares | Capital in<br>Excess of<br>Par Value | Treasury<br>Common<br>Shares | Accumulated<br>Other<br>Comprehensive<br>Income<br>(Loss) | Retained<br>Earnings | Total TDS<br>Shareholders'<br>Equity | Preferred<br>Shares | Non<br>controlling<br>Interests | Total<br>Equity |  |  |
| December<br>31,<br>2012  | \$ 1,327                     | \$ 2,304,122                         | \$ (750,099)                 | \$ (8,132)  | \$ 2,464,318         | \$ 4,011,536                         | \$ 825              | \$ 643,966                      | \$ 4,656,327    |  |  |
| Add<br>(Deduct)  |                              |                                      |                              |   |                      |                                      |                     |                                 |                 |  |  |
| Net<br>income<br>attributable<br>to<br>TDS<br>shareholders         | -                            | -                                    | -                            | -   | 157,496              | 157,496                              | -                   | -                               | 157,496         |  |  |
| Net<br>income<br>attributable<br>to<br>noncontrolling<br>interests |                              |                                      |                              |   |                      |                                      |                     |                                 |                 |  |  |
| classified<br>as<br>equity   | -                            | -                                    | -                            | -   | -                    | -                                    | -                   | 27,871                          | 27,871          |  |  |
| Net<br>unrealized<br>gain  | -                            | -                                    | -                            | 51  | -                    | 51                                   | -                   | -                               | 51              |  |  |

[illegible]

|   |   |          |   |   |   |   |          |   |          |          |  |  |  |  |  |  |  |  |  |
|---|---|----------|---|---|---|---|----------|---|----------|----------|--|--|--|--|--|--|--|--|--|
| plans   |   |          |   |   |   |   |          |   |          |          |  |  |  |  |  |  |  |  |  |
| Adjust investment in subsidiaries for repurchases, issuances and other compensation plans | - | (1,166)  | - | - | - | - | (1,166)  | - | (13,457) | (14,622) |  |  |  |  |  |  |  |  |  |
| Stock-based compensation awards   | - | 6,124    | - | - | - | - | 6,124    | - | -        | 6,124    |  |  |  |  |  |  |  |  |  |
| Tax windfall (shortfall) from stock awards  | - | (648)    | - | - | - | - | (648)    | - | -        | (648)    |  |  |  |  |  |  |  |  |  |
| Distributions to noncontrolling interests   | - | -        | - | - | - | - | -        | - | (3,292)  | (3,292)  |  |  |  |  |  |  |  |  |  |
| Adjust investment in subsidiaries for noncontrolling interest purchases                   | - | (10,322) | - | - | - | - | (10,322) | - | 5,294    | (5,028)  |  |  |  |  |  |  |  |  |  |
| Deconsolidation of partnerships   | - | -        | - | - | - | - | -        | - | (43,770) | (43,770) |  |  |  |  |  |  |  |  |  |

|                     |    |       |    |           |    |           |    |         |    |           |    |           |    |     |    |         |    |          |
|---------------------|----|-------|----|-----------|----|-----------|----|---------|----|-----------|----|-----------|----|-----|----|---------|----|----------|
| June<br>30,<br>2013 | \$ | 1,327 | \$ | 2,299,091 | \$ | (738,397) | \$ | (8,438) | \$ | 2,586,567 | \$ | 4,140,150 | \$ | 825 | \$ | 541,377 | \$ | 4,682,35 |
|                     |    |       |    |           |    |           |    |         |    |           |    |           |    |     |    |         |    |          |

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

**Telephone and Data Systems, Inc.**

**Notes to Consolidated Financial Statements**

**1. Basis of Presentation**

The accounting policies of Telephone and Data Systems, Inc. (“TDS”) conform to accounting principles generally accepted in the United States of America (“GAAP”) as set forth in the Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”). The consolidated financial statements include the accounts of TDS and subsidiaries in which it has a controlling financial interest, including TDS’ 84%-owned wireless telephone subsidiary, United States Cellular Corporation (“U.S. Cellular”) and TDS’ wholly-owned subsidiary, TDS Telecommunications Corporation (“TDS Telecom”). In addition, the consolidated financial statements include certain entities in which TDS has a variable interest that require consolidation under GAAP. All material intercompany accounts and transactions have been eliminated.

The consolidated financial statements included herein have been prepared by TDS, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). Certain information and disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. However, TDS believes that the disclosures included herein are adequate to make the information presented not misleading. These consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in TDS’ Annual Report on Form 10-K (“Form 10-K”) for the year ended December 31, 2013.

TDS’ business segments reflected in this Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2014 are U.S. Cellular, TDS Telecom’s Wireline, Cable and Hosted and Managed Services (“HMS”) operations, and the Non-Reportable Segment which includes TDS’ majority-owned printing and distribution company, Suttle-Straus, Inc. (“Suttle-Straus”) and TDS’ wholly-owned wireless telephone subsidiary, Airadigm Communications, Inc. (“Airadigm”). Periods presented for comparative purposes have been re-presented to conform to this segment presentation. All of TDS’ segments operate only in the United States, except for HMS, which includes an insignificant foreign operation. See Note 11 — Business Segment Information for summary financial information on each business segment.

The accompanying unaudited consolidated financial statements contain all adjustments (consisting of only normal recurring items, unless otherwise disclosed) necessary for a fair statement of the financial position as of June 30, 2014 and December 31, 2013, and the results of operations and changes in comprehensive income for the three and six months ended June 30, 2014 and 2013 and cash flows and changes in equity for the six months ended June 30, 2014 and 2013. These results are not necessarily indicative of the results to be expected for the full year.

#### Recently Issued Accounting Pronouncements

On April 10, 2014, the FASB issued Accounting Standards Update 2014-08, *Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity* (“ASU 2014-08”). ASU 2014-08 changes the requirements and disclosures for reporting discontinued operations. TDS is required to adopt the provisions of ASU 2014-08 effective January 1, 2015, but early adoption is permitted. TDS adopted the provisions of ASU 2014-08 upon its issuance. The adoption of ASU 2014-08 did not have a significant impact on TDS’ financial position or results of operations.

On May 28, 2014, the FASB issued Accounting Standards Update 2014-09, *Revenue from Contracts with Customers* (“ASU 2014-09”). ASU 2014-09 outlines a single comprehensive model to use in accounting for revenue arising from contracts with customers. TDS is required to adopt the provisions of ASU 2014-09 effective January 1, 2017. Early adoption is prohibited. TDS is evaluating what effects the adoption of ASU 2014-09 will have on TDS’ financial position and results of operations.

#### Equipment Installment Plans

U.S. Cellular offers customers the option to purchase certain devices under installment contracts over a period of up to 24 months. Equipment revenue under these contracts is recognized at the time the device is delivered to the end-user customer for the selling price of the device, net of any deferred imputed interest or guarantee liability, if applicable. For certain installment plans, after a specified period of time, the customer may have the right to upgrade to a new device and have the remaining unpaid installment contract balance waived, subject to certain conditions, including trading in the original device in good working condition and signing a new equipment installment contract. U.S. Cellular values this trade-in right as a guarantee liability. The guarantee liability is initially measured at fair value and is determined based on assumptions including the probability and timing of the customer upgrading to a new device, the customer’s estimated remaining installment contract balance at the time of trade-in

## Table of Contents

and the fair value of the device being traded-in at the time of trade-in. As of June 30, 2014, the short-term guarantee liability and imputed interest liability related to equipment installment plans of \$15.3 million is recorded in Customer deposits and deferred revenues in the Consolidated Balance Sheet and the long-term imputed interest liability related to equipment installment plans of \$0.7 million is recorded in Other deferred liabilities and credits in the Consolidated Balance Sheet. As of June 30, 2014, short-term equipment installment plan receivables of \$23.9 million are included in Accounts receivable – customers and agents in the Consolidated Balance Sheet and long-term equipment installment plan receivables of \$19.8 million are included in Other assets and deferred charges in the Consolidated Balance Sheet.

U.S. Cellular equipment installment plans do not provide for explicit interest charges. For equipment installment plans with a duration of twelve months or less, U.S. Cellular does not impute interest. For equipment installment plans with a duration of greater than twelve months, U.S. Cellular imputes interest and recognizes such interest income over the duration of the plan as a component of Interest and dividend income.

## Reclassifications

Certain prior year amounts have been reclassified to conform to the 2014 financial statement presentation. These reclassifications did not affect consolidated net income attributable to TDS shareholders, cash flows, assets, liabilities or equity for the years presented.

In 2014, TDS began presenting separately Equipment and product sales and Cost of equipment and products. As a result of recent HMS acquisitions, these amounts are now more significant to TDS and, accordingly, are shown as separate captions under Operating revenues and Operating expenses, respectively, on the Consolidated Statement of Operations. Amounts in 2013 have been reclassified to conform to the 2014 presentation. The separate presentation of Equipment and product sales and Cost of equipment and products had no other impact on the TDS financial statements.

## Amounts Collected from Customers and Remitted to Governmental Authorities

If a tax is assessed upon the customer and TDS merely acts as an agent in collecting the tax on behalf of the imposing governmental authority, then amounts collected from customers and remitted to governmental authorities are recorded on a net basis within a tax liability account in the Consolidated Balance Sheet. If the tax is assessed upon TDS, then amounts collected from customers as recovery of the tax are recorded in Service revenues and amounts remitted to governmental authorities are recorded in Selling, general and administrative expenses in the Consolidated Statement of Operations. The amounts recorded gross in revenues that are billed to customers and remitted to governmental authorities totaled \$29.1 million and \$59.1 million for the three and six months ended June 30, 2014, respectively,



and \$31.9 million and \$67.9 million for the three and six months ended June 30, 2013, respectively.

## 2. Fair Value Measurements

As of June 30, 2014 and December 31, 2013, TDS did not have any financial or nonfinancial assets or liabilities that were required to be recorded at fair value in its Consolidated Balance Sheet in accordance with GAAP. However, TDS has applied the provisions of fair value accounting for purposes of computing the fair value of financial instruments for disclosure purposes as displayed below.

|                           |                         |  | Level within<br>the Fair<br>Value<br>Hierarchy | June 30, 2014 |           |  |            |           |  | December 31, 2013 |           |  |            |           |  |
|---------------------------|-------------------------|--|--|---------------|-----------|--|------------|-----------|--|-------------------|-----------|--|------------|-----------|--|
|                           |                         |  |  | Book Value    |           |  | Fair Value |           |  | Book Value        |           |  | Fair Value |           |  |
| (Dollars in thousands)    |                         |  |  |               |           |  |            |           |  |                   |           |  |            |           |  |
| Cash and cash equivalents |                         |  | 1  | \$            | 874,860   |  | \$         | 874,860   |  | \$                | 830,014   |  | \$         | 830,014   |  |
| Short-term investments    |                         |  |  |               |           |  |            |           |  |                   |           |  |            |           |  |
|                           | U.S. Treasury Notes     |  | 1  |               | 40,035    |  |            | 40,035    |  |                   | 50,104    |  |            | 50,104    |  |
| Long-term debt            |                         |  |  |               |           |  |            |           |  |                   |           |  |            |           |  |
|                           | Retail                  |  | 1  |               | 1,178,250 |  |            | 1,177,723 |  |                   | 1,178,250 |  |            | 1,048,010 |  |
|                           | Institutional and other |  | 2  |               | 537,691   |  |            | 555,775   |  |                   | 537,454   |  |            | 512,635   |  |

Short-term investments are designated as held-to-maturity investments and recorded at amortized cost in the Consolidated Balance Sheet. Long-term debt excludes capital lease obligations and the current portion of Long-term debt.

## Table of Contents

The fair values of Cash and cash equivalents and Short-term investments approximate their book values due to the short-term nature of these financial instruments. The fair value of "Retail" Long-term debt was estimated using market prices for TDS' 7.0% Senior Notes, 6.875% Senior Notes, 6.625% Senior Notes and 5.875% Senior Notes, and U.S. Cellular's 6.95% Senior Notes. TDS' institutional debt includes U.S. Cellular's 6.7% Senior Notes which are traded over the counter. TDS estimated the fair value of its institutional and other debt through a discounted cash flow analysis using the interest rates or estimated yield to maturity for each borrowing, which ranged from 0.00% to 6.59% at June 30, 2014.

### **3. Income Taxes**

TDS' overall effective tax rate on Income (loss) before income taxes for the three and six months ended June 30, 2014 was 34.7% and 27.0%, respectively, and for the three and six months ended June 30, 2013 was 42.6% and 42.5%, respectively.

The lower effective tax rate for the six months ended June 30, 2014 resulted from the relatively low amount of Income (loss) before income taxes in this period, which magnified the effective rate impact of discrete tax expense items.

The effective tax rates for the three and six months ended June 30, 2013 reflected incremental deferred tax expense related to the NY1 & NY2 Deconsolidation (as described in Note 7 — Investments in Unconsolidated Entities) and the Divestiture Transaction (as described in Note 5 — Acquisitions, Divestitures and Exchanges) in 2013.

### **4. Earnings Per Share**

Basic earnings (loss) per share attributable to TDS shareholders is computed by dividing Net income (loss) available to common shareholders of TDS by the weighted average number of common shares outstanding during the period. Diluted earnings (loss) per share attributable to TDS shareholders is computed by dividing Net income (loss) available to common shareholders of TDS by the weighted average number of common shares outstanding during the period adjusted to include the effects of potentially dilutive securities. Potentially dilutive securities primarily include incremental shares issuable upon exercise of outstanding stock options and the vesting of restricted stock units.

The amounts used in computing earnings (loss) per common share and the effects of potentially dilutive securities on the weighted average number of common shares were as follows:

|   |  |  |  |  | Three Months Ended |          |      |         | Six Months Ended |         |      |         |
|---|--|--|--|--|--------------------|----------|------|---------|------------------|---------|------|---------|
|   |  |  |  |  | June 30,           |          |      |         | June 30,         |         |      |         |
|   |  |  |  |  | 2014               |          | 2013 |         | 2014             |         | 2013 |         |
| <b>(Dollars and shares in thousands, except per share amounts)</b>          |  |  |  |  |                    |          |      |         |                  |         |      |         |
| Basic earnings (loss) per share attributable to TDS shareholders:           |  |  |  |  |                    |          |      |         |                  |         |      |         |
| Net income (loss) available to common shareholders of                       |  |  |  |  |                    |          |      |         |                  |         |      |         |
| TDS used in basic earnings (loss) per share                                 |  |  |  |  | \$                 | (22,050) | \$   | 156,065 | \$               | (3,809) | \$   | 157,471 |
| Adjustments to compute diluted earnings:                                    |  |  |  |  |                    |          |      |         |                  |         |      |         |
| Noncontrolling interest adjustment  |  |  |  |  |                    | -        |      | (1,173) |                  | (5)     |      | (1,209) |
| Preferred dividend adjustment   |  |  |  |  |                    | -        |      | 12      |                  | -       |      | 25      |
| Net income (loss) attributable to common shareholders of                    |  |  |  |  |                    |          |      |         |                  |         |      |         |
| TDS used in diluted earnings (loss) per share                               |  |  |  |  | \$                 | (22,050) | \$   | 154,904 | \$               | (3,814) | \$   | 156,287 |
| Weighted average number of shares used in basic earnings (loss) per share:  |  |  |  |  |                    |          |      |         |                  |         |      |         |
| Common Shares   |  |  |  |  |                    | 101,543  |      | 101,246 |                  | 101,682 |      | 101,171 |
| Series A Common Shares  |  |  |  |  |                    | 7,176    |      | 7,139   |                  | 7,171   |      | 7,149   |
| Total   |  |  |  |  |                    | 108,719  |      | 108,385 |                  | 108,853 |      | 108,320 |
| Effects of dilutive securities:   |  |  |  |  |                    |          |      |         |                  |         |      |         |
| Stock options   |  |  |  |  |                    | -        |      | 110     |                  | -       |      | 108     |
| Restricted stock units  |  |  |  |  |                    | -        |      | 364     |                  | -       |      | 345     |
| Preferred shares  |  |  |  |  |                    | -        |      | 54      |                  | -       |      | 54      |
| Weighted average number of shares used in diluted earnings (loss) per share |  |  |  |  |                    | 108,719  |      | 108,913 |                  | 108,853 |      | 108,827 |
| Basic earnings (loss) per share attributable to TDS shareholders            |  |  |  |  | \$                 | (0.20)   | \$   | 1.44    | \$               | (0.04)  | \$   | 1.45    |
| Diluted earnings (loss) per share attributable to TDS shareholders          |  |  |  |  | \$                 | (0.20)   | \$   | 1.42    | \$               | (0.04)  | \$   | 1.44    |

Table of Contents

Certain Common Shares issuable upon the exercise of stock options, vesting of restricted stock units or conversion of preferred shares were not included in average diluted shares outstanding for the calculation of Diluted earnings (loss) per share attributable to TDS shareholders because their effects were antidilutive. The number of such Common Shares excluded, if any, is shown in the table below.

|                              |  | Three Months Ended |  |       | Six Months Ended |  |       |
|------------------------------|--|--------------------|--|-------|------------------|--|-------|
|                              |  | June 30,           |  |       | June 30,         |  |       |
|                              |  | 2014               |  | 2013  | 2014             |  | 2013  |
| <b>(Shares in thousands)</b> |  |                    |  |       |                  |  |       |
| Stock options                |  | 8,883              |  | 7,348 | 8,777            |  | 7,012 |
|                              |  |                    |  |       |                  |  |       |
| Restricted stock units       |  | 824                |  | 200   | 737              |  | 102   |
|                              |  |                    |  |       |                  |  |       |
| Preferred shares             |  | 56                 |  | -     | 56               |  | -     |

**5. Acquisitions, Divestitures and Exchanges**Divestiture Transaction

On November 6, 2012, U.S. Cellular entered into a Purchase and Sale Agreement with subsidiaries of Sprint Corp., fka Sprint Nextel Corporation (“Sprint”). Pursuant to the Purchase and Sale Agreement, on May 16, 2013, U.S. Cellular transferred customers and certain PCS license spectrum to Sprint in U.S. Cellular’s Chicago, central Illinois, St. Louis and certain Indiana/Michigan/Ohio markets (“Divestiture Markets”) in consideration for \$480 million in cash. The Purchase and Sale Agreement also contemplated certain other agreements, together with the Purchase and Sale Agreement collectively referred to as the “Divestiture Transaction.”

Pursuant to the Purchase and Sale Agreement, U.S. Cellular and Sprint also entered into certain other agreements, including customer and network transition services agreements, which require U.S. Cellular to provide customer, billing and network services to Sprint for a period of up to 24 months after the May 16, 2013 closing date. Sprint will reimburse U.S. Cellular for providing such services at an amount equal to U.S. Cellular’s estimated costs, including applicable overhead allocations. These services were substantially complete as of March 31, 2014. In addition, these agreements require Sprint to reimburse U.S. Cellular up to \$200 million (the “Sprint Cost Reimbursement”) for certain network decommissioning costs, network site lease rent and termination costs, network access termination costs, and employee termination benefits for specified engineering employees. It is estimated that up to \$175 million of the Sprint Cost Reimbursement will be recorded in (Gain) loss on sale of business and other exit costs, net and up to \$25 million of the Sprint Cost Reimbursement will be recorded in Cost of services in the Consolidated Statement of

Operations. For the six months ended June 30, 2014, \$34.1 million of the Sprint Cost Reimbursement had been received and recorded in Cash received from divestitures in the Consolidated Statement of Cash Flows.

Financial impacts of the Divestiture Transaction are classified in the Consolidated Statement of Operations within Operating income. The table below describes the amounts TDS has recognized and expects to recognize in the Consolidated Statement of Operations between the date the Purchase and Sale Agreement was signed and the end of the transition services period.

## Table of Contents

[illegible]

|  |           |  |              |              |             |            |              |             |  |  |  |  |  |  |  |  |  |  |  |  |
|--|-----------|--|--------------|--------------|-------------|------------|--------------|-------------|--|--|--|--|--|--|--|--|--|--|--|--|
| Total (Gain)<br>loss on sale of<br>business and<br>other<br>exit costs, net                |           |  |              |              |             |            |              |             |  |  |  |  |  |  |  |  |  |  |  |  |
| <b>Depreciation,<br/>amortization<br/>and accretion<br/>expense</b>                        |           |  |              |              |             |            |              |             |  |  |  |  |  |  |  |  |  |  |  |  |
| Incremental<br>depreciation,<br>amortization and<br>accretion,<br>net of salvage<br>values | 2012-2014 |  | 211,656      | 211,656      | 211,656     | 13,085     | 88,324       | -           |  |  |  |  |  |  |  |  |  |  |  |  |
| <b>(Increase)<br/>decrease in<br/>Operating<br/>income</b>                                 |           |  | \$ (110,271) | \$ (125,271) | \$ (83,520) | \$ (4,609) | \$ (208,103) | \$ (10,640) |  |  |  |  |  |  |  |  |  |  |  |  |





licenses and certain tower assets in certain markets in Wisconsin, Iowa, Minnesota and Michigan, in consideration for \$91.5 million in cash at closing. The transaction also includes a program in which Airadigm would earn a migration fee from U.S. Cellular for each Airadigm customer who becomes a U.S. Cellular customer. Since both parties to this transaction are controlled by TDS, upon closing, U.S. Cellular will record the transferred assets at Airadigm's net book value. In addition, federal net operating loss carryforwards are expected to become realizable by TDS. Therefore, TDS expects to reduce its valuation allowance by approximately \$10 million upon the transaction closing, and recognize income tax benefit for this same amount. The transaction is subject to certain conditions. Subject to the satisfaction or (if permitted) waiver of all conditions, the transaction is expected to close during the third quarter of 2014.

As a result of the Agreement, Airadigm will shut down operation of its consumer wireless business and most of the associated network. Except for certain operations that will be continued, Airadigm's assets not acquired by U.S. Cellular will be sold or otherwise disposed of, its tower leases, interconnection and other agreements will be terminated and most of its employees will be terminated. The shut-down of Airadigm's consumer wireless business is expected to be substantially complete in the third quarter of 2014. As a result of the Agreement and the related impacts from the shut-down of Airadigm's consumer wireless business discussed herein, TDS expects to recognize expenses related to exit and disposal activities within Operating income in its Statement of Operations between Signing Date and the end of the shut-down period as follows:

|  |   |                        |        |    |        | <b>Actual Amount<br/>Recognized Three<br/>and Six Months<br/>Ended</b> |        |
|--|---|------------------------|--------|----|--------|--|--------|
| <b>(Dollars in thousands)</b>                                    |   | <b>Projected Range</b> |        |    |        | <b>June 30, 2014</b>   |        |
| <b>(Gain) loss on sale of business and other exit costs, net</b> |   |                        |        |    |        |  |        |
|  | Charges for the impairment and decommissioning                  |                        |        |    |        |  |        |
|  | of various operating assets                                     | \$                     | 8,000  | \$ | 17,000 | \$   | 12,214 |
|  | Employee related costs including severance, retention           |                        |        |    |        |  |        |
|  | and outplacement  |                        | 1,000  |    | 2,000  |  | 500    |
|  | Contract termination costs                                      |                        | 10,000 |    | 15,000 |  | 408    |
|  | Transaction costs   |                        | -      |    | 1,000  |  | -      |
|  | Total (Gain) loss on sale of business and other exit costs, net | \$                     | 19,000 | \$ | 35,000 | \$   | 13,122 |
|  |   |                        |        |    |        |  |        |

Table of Contents

|                                  |  |   |   |    |                                   |    |   |                    |   |                    |   |    |   |                 |     |
|----------------------------------|--|---|---|----|-----------------------------------|----|---|--------------------|---|--------------------|---|----|---|-----------------|-----|
|                                  |  | As a result of the transaction, TDS recognized the following amounts in the Consolidated Balance Sheet: |   |    |                                   |    |   |                    |   |                    |   |    |   |                 |     |
|                                  |  |   |   |    |                                   |    |   |                    |   |                    |   |    |   |                 |     |
|                                  |  |   |   |    | <b>Period Ended June 30, 2014</b> |    |   |                    |   |                    |   |    |   |                 |     |
|                                  |  | <b>Balance</b>  |   |    |                                   |    |   | <b>Cash</b>        |   |                    |   |    |   | <b>Balance</b>  |     |
|                                  |  | <b>May 23,</b>  |   |    |                                   |    |   | <b>Settlements</b> |   |                    |   |    |   | <b>June 30,</b> |     |
|                                  |  | <b>2014</b>   |   |    |                                   |    |   | <b>(1)</b>         |   |                    |   |    |   | <b>2014</b>     |     |
|                                  |  |   |   |    | <b>Costs</b>                      |    |   |                    |   | <b>Adjustments</b> |   |    |   |                 |     |
|                                  |  |   |   |    | <b>Incurred</b>                   |    |   |                    |   | <b>(2)</b>         |   |    |   |                 |     |
| <b>(Dollars in thousands)</b>    |  |   |   |    |                                   |    |   |                    |   |                    |   |    |   |                 |     |
| <b>Accrued compensation</b>      |  |   |   |    |                                   |    |   |                    |   |                    |   |    |   |                 |     |
|                                  | Employee related costs including   |   |   |    |                                   |    |   |                    |   |                    |   |    |   |                 |     |
|                                  | severance, retention and outplacement  | \$  | - | \$ | 500                               | \$ | - | \$                 | - | \$                 | - | \$ | - | \$              | 500 |
| <b>Other current liabilities</b> |  |   |   |    |                                   |    |   |                    |   |                    |   |    |   |                 |     |
|                                  | Contract termination costs   | \$  | - | \$ | 408                               | \$ | - | \$                 | - | \$                 | - | \$ | - | \$              | 408 |
|                                  |  |   |   |    |                                   |    |   |                    |   |                    |   |    |   |                 |     |
| (1)                              | Cash settlement amounts are included in either the Net income or changes in Other assets and liabilities line items as part of Cash flows from operating activities on the Consolidated Statement of Cash Flows. |   |   |    |                                   |    |   |                    |   |                    |   |    |   |                 |     |
| (2)                              | Adjustment to liability represents changes to previously accrued amounts.  |   |   |    |                                   |    |   |                    |   |                    |   |    |   |                 |     |

Other Acquisitions, Divestitures and Exchanges

On May 1, 2014, TDS entered into an agreement to acquire substantially all of the assets of a group of companies operating as BendBroadband, headquartered in Bend, Oregon for \$261 million in cash, subject to working capital and other adjustments. BendBroadband is a full-service communications company, offering an extensive range of broadband, fiber connectivity, cable television and telephone services for commercial and residential customers in Central Oregon. The agreement also includes a Tier III data center providing colocation and managed services and a cable advertising and broadcast business. The transaction is subject to governmental regulatory approvals, compliance with the Hart-Scott-Rodino Act and other conditions. Subject to approvals, the transaction is expected to close in the third quarter of 2014.

On March 5, 2014, U.S. Cellular sold the majority of its St. Louis area non-operating market spectrum license for \$92.3 million. A gain of \$75.8 million was recorded in (Gain) loss on license sales and exchanges in the Consolidated Statement of Operations in the first quarter of 2014.

On February 14, 2014, U.S. Cellular completed an exchange whereby U.S. Cellular received one E block PCS spectrum license covering Milwaukee, WI in exchange for one D block PCS spectrum license covering Milwaukee, WI. The exchange of licenses provided U.S. Cellular with spectrum to meet anticipated future capacity and coverage requirements. No cash, customers, network assets, other assets or liabilities were included in the exchange. As a result of this transaction, TDS recognized a gain of \$15.7 million, representing the difference between the \$15.9 million fair value of the license surrendered, calculated using a market approach valuation method, and the \$0.2 million carrying value of the license surrendered. This gain was recorded in (Gain) loss on license sales and exchanges in the Consolidated Statement of Operations in the first quarter of 2014.

|                               |  |   |                       |     |                 |        |                 |       |                                      |       |                    |     |                                   |        |                                      |     |  |  |  |
|-------------------------------|--|---|-----------------------|-----|-----------------|--------|-----------------|-------|--------------------------------------|-------|--------------------|-----|-----------------------------------|--------|--------------------------------------|-----|--|--|--|
|                               |  | At June 30, 2014 and December 31, 2013, the following assets and liabilities were classified in the Consolidated Balance Sheet as "Assets held for sale" and "Liabilities held for sale": |                       |     |                 |        |                 |       |                                      |       |                    |     |                                   |        |                                      |     |  |  |  |
|                               |  |   |                       |     |                 |        |                 |       |                                      |       |                    |     |                                   |        |                                      |     |  |  |  |
|                               |  |   | <b>Current Assets</b> |     | <b>Licenses</b> |        | <b>Goodwill</b> |       | <b>Property, Plant and Equipment</b> |       | <b>Investments</b> |     | <b>Total Assets Held for Sale</b> |        | <b>Liabilities Held for Sale (1)</b> |     |  |  |  |
| <b>(Dollars in thousands)</b> |  |   |                       |     |                 |        |                 |       |                                      |       |                    |     |                                   |        |                                      |     |  |  |  |
| <b>June 30, 2014</b>          |  |   |                       |     |                 |        |                 |       |                                      |       |                    |     |                                   |        |                                      |     |  |  |  |
| Divestiture of Wireline       |  |   |                       |     |                 |        |                 |       |                                      |       |                    |     |                                   |        |                                      |     |  |  |  |
| Markets (2)                   |  |   | \$                    | 534 | \$              | -      | \$              | 2,546 | \$                                   | 2,800 | \$                 | 100 | \$                                | 5,980  | \$                                   | 722 |  |  |  |
|                               |  |   |                       |     |                 |        |                 |       |                                      |       |                    |     |                                   |        |                                      |     |  |  |  |
| <b>December 31, 2013</b>      |  |   |                       |     |                 |        |                 |       |                                      |       |                    |     |                                   |        |                                      |     |  |  |  |
| Divestiture of Spectrum       |  |   |                       |     |                 |        |                 |       |                                      |       |                    |     |                                   |        |                                      |     |  |  |  |
| Licenses                      |  |   | \$                    | -   | \$              | 16,027 | \$              | -     | \$                                   | -     | \$                 | -   | \$                                | 16,027 | \$                                   | -   |  |  |  |
|                               |  |   |                       |     |                 |        |                 |       |                                      |       |                    |     |                                   |        |                                      |     |  |  |  |
| (1)                           |  | Liabilities held for sale primarily consisted of Customer deposits and deferred revenues and Other deferred liabilities and credits.  |                       |     |                 |        |                 |       |                                      |       |                    |     |                                   |        |                                      |     |  |  |  |
|                               |  |   |                       |     |                 |        |                 |       |                                      |       |                    |     |                                   |        |                                      |     |  |  |  |
| (2)                           |  | On May 2, 2014, TDS Telecom entered into agreements with third parties to sell certain Wireline markets.  |                       |     |                 |        |                 |       |                                      |       |                    |     |                                   |        |                                      |     |  |  |  |

Table of Contents**6. Intangible Assets**

Changes in Licenses for the six months ended June 30, 2014 are presented below. There were no significant changes to Goodwill, Franchise rights or Other intangible assets during the six months ended June 30, 2014.

| <u>Licenses</u>               |                |    |                      |    |                 |    |                               |    |              |
|-------------------------------|----------------|----|----------------------|----|-----------------|----|-------------------------------|----|--------------|
|                               |                |    |                      |    |                 |    |                               |    |              |
|                               |                |    | <b>U.S. Cellular</b> |    | <b>Wireline</b> |    | <b>Non-Reportable Segment</b> |    | <b>Total</b> |
| <b>(Dollars in thousands)</b> |                |    |                      |    |                 |    |                               |    |              |
| Balance December 31, 2013     |                | \$ | 1,405,759            | \$ | 2,800           | \$ | 15,220                        | \$ | 1,423,779    |
|                               | Acquisitions   |    | 20,986               |    | -               |    | -                             |    | 20,986       |
|                               | Exchanges, net |    | 15,719               |    | -               |    | -                             |    | 15,719       |
| Balance June 30, 2014         |                | \$ | 1,442,464            | \$ | 2,800           | \$ | 15,220                        | \$ | 1,460,484    |

**7. Investments in Unconsolidated Entities**

Investments in unconsolidated entities consist of amounts invested in wireless and wireline entities in which TDS holds a noncontrolling interest. These investments are accounted for using either the equity or cost method.

|                               |  |                                    |    |             |    |             |                                  |             |  |  |
|-------------------------------|--|------------------------------------|----|-------------|----|-------------|----------------------------------|-------------|--|--|
|                               | The following table, which is based on information provided in part by third parties, summarizes the combined results of operations of TDS' equity method investments. |                                    |    |             |    |             |                                  |             |  |  |
|                               |  |                                    |    |             |    |             |                                  |             |  |  |
|                               |  | <b>Three Months Ended June 30,</b> |    |             |    |             | <b>Six Months Ended June 30,</b> |             |  |  |
|                               |  | <b>2014</b>                        |    | <b>2013</b> |    | <b>2014</b> |                                  | <b>2013</b> |  |  |
| <b>(Dollars in thousands)</b> |  |                                    |    |             |    |             |                                  |             |  |  |
| Revenues                      | \$   | 1,635,216                          | \$ | 1,550,200   | \$ | 3,259,900   | \$                               | 3,025,820   |  |  |
| Operating expenses            |  | 1,209,412                          |    | 1,100,477   |    | 2,343,092   |                                  | 2,139,467   |  |  |
| Operating income              |  | 425,804                            |    | 449,723     |    | 916,808     |                                  | 886,353     |  |  |
| Other income, net             |  | 378                                |    | 713         |    | 2,403       |                                  | 1,222       |  |  |
| Net income                    | \$   | 426,182                            | \$ | 450,436     | \$ | 919,211     | \$                               | 887,575     |  |  |

NY1 & NY2 Deconsolidation

U.S. Cellular holds a 60.00% interest in St. Lawrence Seaway RSA Cellular Partnership (“NY1”) and a 57.14% interest in New York RSA 2 Cellular Partnership (“NY2”) (together with NY1, the “Partnerships”). The remaining interests in the Partnerships are held by Cellco Partnership d/b/a Verizon Wireless (“Verizon Wireless”). Prior to April 3, 2013, because U.S. Cellular owned a greater than 50% interest in each of these Partnerships and based on U.S. Cellular’s rights under the Partnership Agreements, TDS consolidated the financial results of these Partnerships in accordance with GAAP.

On April 3, 2013, U.S. Cellular entered into an agreement with Verizon Wireless relating to the Partnerships. The agreement amends the Partnership Agreements in several ways which provide Verizon Wireless with substantive participating rights that allow Verizon Wireless to make decisions that are in the ordinary course of business of the Partnerships and which are significant to directing and executing the activities of the business. Accordingly, as required by GAAP, TDS deconsolidated the Partnerships effective as of April 3, 2013 and thereafter reported them as equity method investments in its consolidated financial statements (“NY1 & NY2 Deconsolidation”). After the NY1 & NY2 Deconsolidation, TDS retained the same ownership percentages in the Partnerships and continues to report the same percentages of income from the Partnerships. Effective April 3, 2013, TDS’ income from the Partnerships is reported in Equity in earnings of unconsolidated entities in the Consolidated Statement of Operations.

#### **8. Variable Interest Entities (VIEs)**

TDS consolidates variable interest entities in which it has a controlling financial interest and is the primary beneficiary. A controlling financial interest will have both of the following characteristics: (a) the power to direct the VIE activities that most significantly impact economic performance and (b) the obligation to absorb VIE losses and the right to receive benefits that are significant to the VIE. TDS reviews these criteria initially at the time it enters into agreements and subsequently when reconsideration events occur.

##### Consolidated VIEs

As of June 30, 2014, TDS holds a variable interest in and consolidates the following VIEs under GAAP:

Table of Contents

- Aquinas Wireless L.P. (“Aquinas Wireless”); and
- King Street Wireless L.P. (“King Street Wireless”) and King Street Wireless, Inc., the general partner of King Street Wireless.

The power to direct the activities that most significantly impact the economic performance of Aquinas Wireless and King Street Wireless (collectively, the “limited partnerships”) is shared. Specifically, the general partner of these VIEs has the exclusive right to manage, operate and control the limited partnerships and make all decisions to carry on the business of the partnerships; however, the general partner of each partnership needs consent of the limited partner, a TDS subsidiary, to sell or lease certain licenses, to make certain large expenditures, admit other partners or liquidate the limited partnerships. Although the power to direct the activities of the VIEs is shared, TDS has a disproportionate level of exposure to the variability associated with the economic performance of the VIEs, indicating that TDS is the primary beneficiary of the VIEs in accordance with GAAP. Accordingly, these VIEs are consolidated.

The following table presents the classification of the consolidated VIEs’ assets and liabilities in TDS’ Consolidated Balance Sheet.

|                               |                                    | <b>June 30,</b> |         | <b>December 31,</b> |         |
|-------------------------------|------------------------------------|-----------------|---------|---------------------|---------|
|                               |                                    | <b>2014</b>     |         | <b>2013</b>         |         |
| <b>(Dollars in thousands)</b> |                                    |                 |         |                     |         |
| <b>Assets</b>                 |                                    |                 |         |                     |         |
|                               | Cash and cash equivalents          | \$              | 2,466   | \$                  | 2,076   |
|                               | Other current assets               |                 | 71      |                     | 1,184   |
|                               | Licenses                           |                 | 311,476 |                     | 310,475 |
|                               | Property, plant and equipment, net |                 | 15,311  |                     | 18,600  |
|                               | Other assets and deferred charges  |                 | 148     |                     | 511     |
|                               | Total assets                       | \$              | 329,472 | \$                  | 332,846 |
| <b>Liabilities</b>            |                                    |                 |         |                     |         |
|                               | Current liabilities                | \$              | 29      | \$                  | 46      |
|                               | Deferred liabilities and credits   |                 | 1,689   |                     | 3,139   |
|                               | Total liabilities                  | \$              | 1,718   | \$                  | 3,185   |

Other Related Matters

Aquinas Wireless and King Street Wireless were formed to participate in Federal Communications Commission (“FCC”) auctions of wireless spectrum and to fund, establish, and provide wireless service with respect to any FCC licenses won in the auctions. As such, these entities have risks similar to those described in the “Risk Factors” in TDS’ Form 10-K for the year ended December 31, 2013.

U.S. Cellular currently provides 4G LTE service in conjunction with King Street Wireless.

TDS may agree to make additional capital contributions and/or advances to Aquinas Wireless and King Street Wireless and/or to their general partners to provide additional funding for the development of licenses granted in various auctions. TDS may finance such amounts with a combination of cash on hand, borrowings under its revolving credit agreement and/or long-term debt. There is no assurance that TDS will be able to obtain additional financing on commercially reasonable terms or at all to provide such financial support.

There were no capital contributions or advances made to Aquinas Wireless or King Street Wireless or their general partners in the six months ended June 30, 2014 and 2013.

## **9. Noncontrolling Interests**

The following schedule discloses the effects of Net income (loss) attributable to TDS shareholders and changes in TDS’ ownership interest in U.S. Cellular on TDS’ equity:

Table of Contents

|   |  |  |  | <b>Six Months Ended</b> |          |    |             |
|---|--|--|--|-------------------------|----------|----|-------------|
|   |  |  |  | <b>June 30,</b>         |          |    |             |
|   |  |  |  | <b>2014</b>             |          |    | <b>2013</b> |
| <b>(Dollars in thousands)</b>                                       |  |  |  |                         |          |    |             |
| Net income (loss) attributable to TDS shareholders                  |  |  |  | \$                      | (3,784)  | \$ | 157,496     |
| Transfer (to) from the noncontrolling interests                     |  |  |  |                         |          |    |             |
| Change in TDS' Capital in excess of par value from                  |  |  |  |                         |          |    |             |
| U.S. Cellular's issuance of U.S. Cellular shares                    |  |  |  |                         | (10,292) |    | (9,712)     |
| Change in TDS' Capital in excess of par value from                  |  |  |  |                         |          |    |             |
| U.S. Cellular's repurchase of U.S. Cellular shares                  |  |  |  |                         | 242      |    | 3,470       |
| Purchase of ownership in subsidiaries from noncontrolling interests |  |  |  |                         | -        |    | (27)        |
| Net transfers (to) from noncontrolling interests                    |  |  |  |                         | (10,050) |    | (6,269)     |
| Change from net income (loss) attributable to TDS and               |  |  |  |                         |          |    |             |
| transfers (to) from noncontrolling interests                        |  |  |  | \$                      | (13,834) | \$ | 151,227     |

**10. Common Share Repurchases**

On August 2, 2013, the Board of Directors of TDS authorized a \$250 million stock repurchase program for the purchase of TDS Common Shares from time to time pursuant to open market purchases, block transactions, private purchases or otherwise, depending on market conditions. This authorization does not have an expiration date.

On November 17, 2009, the Board of Directors of U.S. Cellular authorized the repurchase of up to 1,300,000 Common Shares on an annual basis beginning in 2009 and continuing each year thereafter, on a cumulative basis. These purchases will be made pursuant to open market purchases, block purchases, private purchases or otherwise, depending on market conditions. This authorization does not have an expiration date.

Share repurchases made under these authorizations were as follows:

|   | <b>Number<br/>of Shares</b> | <b>Average Cost<br/>Per Share</b> | <b>Amount</b> |
|---|-----------------------------|-----------------------------------|---------------|
| <b><u>Six Months Ended June 30,</u></b> |                             |                                   |               |



| (Dollar amounts and shares in thousands) |                             |     |    |       |    |        |
|--|-----------------------------|-----|----|-------|----|--------|
| <b><u>2014</u></b>                       |                             |     |    |       |    |        |
|  | TDS Common Shares           | 809 | \$ | 26.09 | \$ | 21,096 |
|  | U.S. Cellular Common Shares | 212 | \$ | 40.49 | \$ | 8,598  |
|  |                             |     |    |       |    |        |
| <b><u>2013</u></b>                       |                             |     |    |       |    |        |
|  | TDS Common Shares           | -   | \$ | -     | \$ | -      |
|  | U.S. Cellular Common Shares | 496 | \$ | 37.16 | \$ | 18,425 |

Table of Contents

**11. Business Segment Information**

U.S. Cellular and TDS Telecom are billed for all services they receive from TDS, consisting primarily of information processing, accounting and finance, and general management services. Such billings are based on expenses specifically identified to U.S. Cellular and TDS Telecom and on allocations of common expenses. Management believes the method used to allocate common expenses is reasonable and that all expenses and costs applicable to U.S. Cellular and TDS Telecom are reflected in the accompanying business segment information on a basis that is representative of what they would have been if U.S. Cellular and TDS Telecom operated on a stand-alone basis.

Financial data for TDS' reportable segments for the three and six month periods ended, or as of June 30, 2014 and 2013, is as follows. See Note 1 — Basis of Presentation for additional information.

Table of Contents

|  |                             |               |          |          |         | TDS Telecom |        |     |        |                          |       |                   |         |                        |        |   |         |  |  |
|--|-----------------------------|---------------|----------|----------|---------|-------------|--------|-----|--------|--------------------------|-------|-------------------|---------|------------------------|--------|---|---------|--|--|
|  |                             |               |          |          |         |             |        |     |        |                          |       |                   |         |                        |        |   |         |  |  |
| Three Months Ended or as of June 30, 2014  |                             | U.S. Cellular |          | Wireline |         | Cable       |        | HMS |        | TDS Telecom Eliminations |       | TDS Telecom Total |         | Non-Reportable Segment |        | Corporate, Eliminations and Other Reconciling Items |         |  |  |
| (Dollars in thousands)   |                             |               |          |          |         |             |        |     |        |                          |       |                   |         |                        |        |   |         |  |  |
| Operating revenues   |                             |               |          |          |         |             |        |     |        |                          |       |                   |         |                        |        |   |         |  |  |
|  | Service                     | \$            | 843,473  | \$       | 180,297 | \$          | 22,484 | \$  | 27,575 | \$                       | (298) | \$                | 230,058 | \$                     | 4,505  | \$  | (5,857) |  |  |
|  | Equipment and product sales |               | 114,300  |          | 431     |             | -      |     | 40,361 |                          | -     |                   | 40,792  |                        | 9,121  |   | -       |  |  |
|  | Total operating revenues    |               | 957,773  |          | 180,728 |             | 22,484 |     | 67,936 |                          | (298) |                   | 270,850 |                        | 13,626 |   | (5,857) |  |  |
| Cost of services (excluding Depreciation, amortization and accretion reported below) |                             |               | 187,131  |          | 64,305  |             | 11,394 |     | 21,301 |                          | (249) |                   | 96,751  |                        | 4,252  |   | (1,646) |  |  |
| Cost of equipment and products   |                             |               | 271,978  |          | 481     |             | -      |     | 33,875 |                          | -     |                   | 34,356  |                        | 6,677  |   | -       |  |  |
| Selling, general and administrative  |                             |               | 404,252  |          | 47,708  |             | 6,285  |     | 12,376 |                          | (49)  |                   | 66,320  |                        | 3,517  |   | (3,187) |  |  |
| Depreciation, amortization and accretion   |                             |               | 148,337  |          | 41,827  |             | 4,557  |     | 6,791  |                          | -     |                   | 53,175  |                        | 1,492  |   | 1,563   |  |  |
| (Gain) loss on asset disposals, net  |                             |               | 6,893    |          | 514     |             | 425    |     | 44     |                          | -     |                   | 983     |                        | 27     |   | -       |  |  |
| (Gain) loss on sale of business and other exit                                       |                             |               | (10,511) |          | -       |             | -      |     | -      |                          | -     |                   | -       |                        | 13,122 |   | -       |  |  |

|  |    |           |    |           |    |         |    |         |    |   |    |           |    |          |    |          |  |  |  |  |
|--|----|-----------|----|-----------|----|---------|----|---------|----|---|----|-----------|----|----------|----|----------|--|--|--|--|
| costs, net                                     |    |           |    |           |    |         |    |         |    |   |    |           |    |          |    |          |  |  |  |  |
| Operating income (loss)                        |    | (50,307)  |    | 25,893    |    | (177)   |    | (6,451) |    | - |    | 19,265    |    | (15,461) |    | (2,587)  |  |  |  |  |
| Equity in earnings of unconsolidated entities  |    | 33,120    |    | 4         |    | -       |    | -       |    | - |    | 4         |    | -        |    | 1,666    |  |  |  |  |
| Interest and dividend income                   |    | 1,573     |    | 490       |    | 1       |    | 22      |    | - |    | 513       |    | -        |    | 665      |  |  |  |  |
| Interest expense                               |    | (14,336)  |    | 677       |    | 30      |    | (439)   |    | - |    | 268       |    | (1,149)  |    | (12,681) |  |  |  |  |
| Other, net                                     |    | 100       |    | (95)      |    | -       |    | 45      |    | - |    | (50)      |    | (1)      |    | 1        |  |  |  |  |
| Income (loss) before income taxes              |    | (29,850)  |    | 26,969    |    | (146)   |    | (6,823) |    | - |    | 20,000    |    | (16,611) |    | (12,936) |  |  |  |  |
| Add back:                                      |    |           |    |           |    |         |    |         |    |   |    |           |    |          |    |          |  |  |  |  |
| Depreciation, amortization and accretion       |    | 148,337   |    | 41,827    |    | 4,557   |    | 6,791   |    | - |    | 53,175    |    | 1,492    |    | 1,563    |  |  |  |  |
| (Gain) loss on sale of business and other exit |    |           |    |           |    |         |    |         |    |   |    |           |    |          |    |          |  |  |  |  |
| costs, net                                     |    | (10,511)  |    | -         |    | -       |    | -       |    | - |    | -         |    | 13,122   |    | -        |  |  |  |  |
| Interest expense                               |    | 14,336    |    | (677)     |    | (30)    |    | 439     |    | - |    | (268)     |    | 1,149    |    | 12,681   |  |  |  |  |
| Adjusted income (loss) before income taxes     |    |           |    |           |    |         |    |         |    |   |    |           |    |          |    |          |  |  |  |  |
|  | \$ | 122,312   | \$ | 68,119    | \$ | 4,381   | \$ | 407     | \$ | - | \$ | 72,907    | \$ | (848)    | \$ | 1,308    |  |  |  |  |
|  |    |           |    |           |    |         |    |         |    |   |    |           |    |          |    |          |  |  |  |  |
| Investments in unconsolidated entities         | \$ | 270,215   | \$ | 3,810     | \$ | -       | \$ | -       | \$ | - | \$ | 3,810     | \$ | -        | \$ | 34,636   |  |  |  |  |
| Total assets                                   | \$ | 6,298,967 | \$ | 1,408,809 | \$ | 287,809 | \$ | 335,680 | \$ | - | \$ | 2,032,298 | \$ | 46,610   | \$ | 329,794  |  |  |  |  |
| Capital expenditures                           | \$ | 143,927   | \$ | 27,370    | \$ | 7,181   | \$ | 10,628  | \$ | - | \$ | 45,179    | \$ | 308      | \$ | 1,267    |  |  |  |  |

Table of Contents

|  |                             |               |           |          |         | TDS Telecom |        |                          |       |                   |         |                        |        |   |          |       |           |  |  |
|--|-----------------------------|---------------|-----------|----------|---------|-------------|--------|--------------------------|-------|-------------------|---------|------------------------|--------|---|----------|-------|-----------|--|--|
|  |                             |               |           |          |         |             |        |                          |       |                   |         |                        |        |   |          |       |           |  |  |
| Three Months Ended or as of June 30, 2013  |                             | U.S. Cellular |           | Wireline |         | HMS         |        | TDS Telecom Eliminations |       | TDS Telecom Total |         | Non-Reportable Segment |        | Corporate, Eliminations and Other Reconciling Items |          | Total |           |  |  |
| (Dollars in thousands)   |                             |               |           |          |         |             |        |                          |       |                   |         |                        |        |   |          |       |           |  |  |
| Operating revenues   |                             |               |           |          |         |             |        |                          |       |                   |         |                        |        |   |          |       |           |  |  |
|  | Service                     | \$            | 910,966   | \$       | 181,428 | \$          | 23,205 | \$                       | (107) | \$                | 204,526 | \$                     | 4,956  | \$  | (4,787)  | \$    | 1,115,661 |  |  |
|  | Equipment and product sales |               | 84,164    |          | 765     |             | 18,169 |                          | -     |                   | 18,934  |                        | 9,407  |   | -        |       | 112,505   |  |  |
|  | Total operating revenues    |               | 995,130   |          | 182,193 |             | 41,374 |                          | (107) |                   | 223,460 |                        | 14,363 |   | (4,787)  |       | 1,228,166 |  |  |
| Cost of services (excluding Depreciation, amortization and accretion reported below) |                             |               | 192,267   |          | 65,729  |             | 15,071 |                          | (107) |                   | 80,693  |                        | 3,225  |   | (348)    |       | 275,837   |  |  |
| Cost of equipment and products   |                             |               | 217,070   |          | 1,094   |             | 15,114 |                          | -     |                   | 16,208  |                        | 6,616  |   | -        |       | 239,894   |  |  |
| Selling, general and administrative  |                             |               | 404,127   |          | 56,692  |             | 9,361  |                          | -     |                   | 66,053  |                        | 3,711  |   | (3,171)  |       | 470,720   |  |  |
| Depreciation, amortization and accretion   |                             |               | 202,580   |          | 43,193  |             | 5,563  |                          | -     |                   | 48,756  |                        | 1,500  |   | 1,367    |       | 254,203   |  |  |
| (Gain) loss on asset disposals, net  |                             |               | 9,018     |          | (765)   |             | 83     |                          | -     |                   | (682)   |                        | (1)    |   | (16)     |       | 8,319     |  |  |
| (Gain) loss on sale of business and other exit                                       |                             |               | (249,024) |          | -       |             | -      |                          | -     |                   | -       |                        | -      |   | (54,010) |       | (303,034) |  |  |

|   |  |  |              |  |  |  |              |  |  |  |            |  |  |      |  |  |              |  |  |           |  |  |            |  |  |              |
|---|--|--|--------------|--|--|--|--------------|--|--|--|------------|--|--|------|--|--|--------------|--|--|-----------|--|--|------------|--|--|--------------|
| costs, net  |  |  |              |  |  |  |              |  |  |  |            |  |  |      |  |  |              |  |  |           |  |  |            |  |  |              |
| Operating income (loss)                                   |  |  | 219,092      |  |  |  | 16,250       |  |  |  | (3,818)    |  |  | -    |  |  | 12,432       |  |  | (688)     |  |  | 51,391     |  |  | 282,227      |
| Equity in earnings of unconsolidated entities             |  |  | 35,602       |  |  |  | 7            |  |  |  | -          |  |  | -    |  |  | 7            |  |  | -         |  |  | (4)        |  |  | 35,605       |
| Interest and dividend income                              |  |  | 969          |  |  |  | 546          |  |  |  | 16         |  |  | -    |  |  | 562          |  |  | 1         |  |  | 1,068      |  |  | 2,600        |
| Gain (loss) on investments                                |  |  | 18,527       |  |  |  | -            |  |  |  | -          |  |  | -    |  |  | -            |  |  | -         |  |  | (4,009)    |  |  | 14,518       |
| Interest expense  |  |  | (10,154)     |  |  |  | 795          |  |  |  | (403)      |  |  | -    |  |  | 392          |  |  | (1,001)   |  |  | (12,986)   |  |  | (23,749)     |
| Other, net  |  |  | 321          |  |  |  | (126)        |  |  |  | -          |  |  | -    |  |  | (126)        |  |  | (394)     |  |  | 2          |  |  | (197)        |
| Income (loss) before income taxes                         |  |  | 264,357      |  |  |  | 17,472       |  |  |  | (4,205)    |  |  | -    |  |  | 13,267       |  |  | (2,082)   |  |  | 35,462     |  |  | 311,004      |
| Add back:   |  |  |              |  |  |  |              |  |  |  |            |  |  |      |  |  |              |  |  |           |  |  |            |  |  |              |
| Depreciation, amortization and accretion                  |  |  | 202,580      |  |  |  | 43,193       |  |  |  | 5,563      |  |  | -    |  |  | 48,756       |  |  | 1,500     |  |  | 1,367      |  |  | 254,203      |
| (Gain) loss on sale of business and other exit costs, net |  |  | (249,024)    |  |  |  | -            |  |  |  | -          |  |  | -    |  |  | -            |  |  | -         |  |  | (54,010)   |  |  | (303,034)    |
| Gain (loss) on investments                                |  |  | (18,527)     |  |  |  | -            |  |  |  | -          |  |  | -    |  |  | -            |  |  | -         |  |  | 4,009      |  |  | (14,518)     |
| Interest expense  |  |  | 10,154       |  |  |  | (795)        |  |  |  | 403        |  |  | -    |  |  | (392)        |  |  | 1,001     |  |  | 12,986     |  |  | 23,749       |
| Adjusted income (loss) before income taxes                |  |  | \$ 209,540   |  |  |  | \$ 59,870    |  |  |  | \$ 1,761   |  |  | \$ - |  |  | \$ 61,631    |  |  | \$ 419    |  |  | \$ (186)   |  |  | \$ 271,404   |
|   |  |  |              |  |  |  |              |  |  |  |            |  |  |      |  |  |              |  |  |           |  |  |            |  |  |              |
| Investments in unconsolidated entities                    |  |  | \$ 276,363   |  |  |  | \$ 3,809     |  |  |  | \$ -       |  |  | \$ - |  |  | \$ 3,809     |  |  | \$ -      |  |  | \$ 31,874  |  |  | \$ 312,046   |
| Total assets  |  |  | \$ 6,329,778 |  |  |  | \$ 1,473,173 |  |  |  | \$ 267,062 |  |  | \$ - |  |  | \$ 1,740,235 |  |  | \$ 59,293 |  |  | \$ 625,459 |  |  | \$ 8,754,765 |
| Capital expenditures                                      |  |  | \$ 168,497   |  |  |  | \$ 33,342    |  |  |  | \$ 2,258   |  |  | \$ - |  |  | \$ 35,600    |  |  | \$ 232    |  |  | \$ 1,715   |  |  | \$ 206,044   |



Table of Contents

|  |                             |               |           | TDS Telecom |         |       |        |     |         |                          |       |                   |         |                        |        |  |         |
|--|-----------------------------|---------------|-----------|-------------|---------|-------|--------|-----|---------|--------------------------|-------|-------------------|---------|------------------------|--------|--|---------|
|  |                             |               |           |             |         |       |        |     |         |                          |       |                   |         |                        |        |  |         |
| Six Months Ended or as of June 30, 2014  |                             | U.S. Cellular |           | Wireline    |         | Cable |        | HMS |         | TDS Telecom Eliminations |       | TDS Telecom Total |         | Non-Reportable Segment |        | Corporate, Elimination and Other Reconciling Items |         |
| (Dollars in thousands)   |                             |               |           |             |         |       |        |     |         |                          |       |                   |         |                        |        |  |         |
| Operating revenues   |                             |               |           |             |         |       |        |     |         |                          |       |                   |         |                        |        |  |         |
|  | Service                     | \$            | 1,697,086 | \$          | 357,230 | \$    | 44,987 | \$  | 54,951  | \$                       | (979) | \$                | 456,189 | \$                     | 9,018  | \$   | (9,872) |
|  | Equipment and product sales |               | 186,498   |             | 984     |       | -      |     | 76,093  |                          | -     |                   | 77,077  |                        | 16,358 |  | -       |
|  | Total operating revenues    |               | 1,883,584 |             | 358,214 |       | 44,987 |     | 131,044 |                          | (979) |                   | 533,266 |                        | 25,376 |  | (9,872) |
| Cost of services (excluding Depreciation, amortization and accretion expense reported below) |                             |               | 367,738   |             | 128,705 |       | 22,349 |     | 38,247  |                          | (894) |                   | 188,407 |                        | 8,502  |  | (2,201) |
| Cost of equipment and products   |                             |               | 542,452   |             | 964     |       | -      |     | 64,342  |                          | -     |                   | 65,306  |                        | 11,900 |  | -       |
| Selling, general and administrative  |                             |               | 799,816   |             | 94,228  |       | 12,663 |     | 27,211  |                          | (85)  |                   | 134,017 |                        | 7,263  |  | (6,525) |
| Depreciation, amortization and accretion   |                             |               | 316,090   |             | 84,563  |       | 8,918  |     | 13,469  |                          | -     |                   | 106,950 |                        | 3,294  |  | 3,152   |
| (Gain) loss on asset disposals, net  |                             |               | 8,827     |             | 759     |       | 490    |     | 78      |                          | -     |                   | 1,327   |                        | 170    |  | 9       |
| (Gain) loss on sale of   |                             |               | (17,411)  |             | -       |       | -      |     | -       |                          | -     |                   | -       |                        | 13,122 |  | -       |



[illegible]

|                      |    |         |    |        |    |        |    |        |    |   |    |        |    |     |    |       |
|----------------------|----|---------|----|--------|----|--------|----|--------|----|---|----|--------|----|-----|----|-------|
| Capital expenditures | \$ | 233,508 | \$ | 50,268 | \$ | 13,400 | \$ | 13,379 | \$ | - | \$ | 77,047 | \$ | 403 | \$ | 2,321 |
|----------------------|----|---------|----|--------|----|--------|----|--------|----|---|----|--------|----|-----|----|-------|

Table of Contents

|  |    | TDS Telecom   |            |           |                          |                   |                        |   |    |           |  |
|--|----|---------------|------------|-----------|--------------------------|-------------------|------------------------|---|----|-----------|--|
| Six Months Ended or as of June 30, 2013  |    | U.S. Cellular | Wireline   | HMS       | TDS Telecom Eliminations | TDS Telecom Total | Non-Reportable Segment | Corporate, Eliminations and Other Reconciling Items |    | Total     |  |
| (Dollars in thousands)   |    |               |            |           |                          |                   |                        |   |    |           |  |
| Operating revenues   |    |               |            |           |                          |                   |                        |   |    |           |  |
| Services   | \$ | 1,907,315     | \$ 362,106 | \$ 45,205 | \$ (185)                 | \$ 407,126        | \$ 9,589               | \$ (9,467)  | \$ | 2,314,563 |  |
| Equipment and product sales  |    | 169,561       | 1,662      | 31,733    | -                        | 33,395            | 19,220                 | -   |    | 222,176   |  |
| Total operating revenues   |    | 2,076,876     | 363,768    | 76,938    | (185)                    | 440,521           | 28,809                 | (9,467)   |    | 2,536,739 |  |
| Cost of services (excluding Depreciation, amortization and accretion expense reported below) |    | 408,566       | 132,168    | 28,673    | (185)                    | 160,656           | 6,446                  | (704)   |    | 574,964   |  |
| Cost of equipment and products   |    | 458,761       | 2,104      | 26,326    | -                        | 28,430            | 13,468                 | -   |    | 500,659   |  |
| Selling, general and administrative  |    | 824,207       | 114,072    | 19,282    | -                        | 133,354           | 7,472                  | (7,410)   |    | 957,623   |  |
| Depreciation, amortization and accretion   |    | 392,425       | 87,216     | 11,031    | -                        | 98,247            | 3,009                  | 2,599   |    | 496,280   |  |
| (Gain) loss on asset disposals, net  |    | 14,452        | (602)      | 113       | -                        | (489)             | -                      | (28)  |    | 13,935    |  |
| (Gain) loss on sale of business and  |    | (242,093)     | -          | -         | -                        | -                 | -                      | (54,010)  |    | (296,103) |  |

[illegible]

Adjusted income before income taxes is a segment measure reported to the chief operating decision maker for purposes of making decisions about allocating resources to the segments and assessing their performance. Adjusted income before income taxes is defined as Income (loss) before income taxes, adjusted for the items set forth in the reconciliation above. Adjusted income before income taxes excludes these items in order to show operating results on a more comparable basis from period to period. From time to time, TDS may also exclude other items from adjusted income before income taxes if such items help reflect operating results on a more comparable basis. TDS does not intend to imply that any of such items that are excluded are non-recurring, infrequent or unusual; such items may occur in the future. TDS believes Adjusted income before income taxes is a useful measure of TDS' operating results before significant recurring non-cash charges, discrete gains and losses and financing charges (Interest expense).

Table of Contents

**12. Supplemental Cash Flow Disclosures**

Under the American Recovery and Reinvestment Act of 2009 (“the Recovery Act”), TDS Telecom was awarded \$105.1 million in federal grants and will provide \$30.9 million of its own funds to complete 44 projects to provide broadband access in unserved areas. TDS Telecom received \$12.0 million and \$34.6 million in grants during the six months ended June 30, 2014 and 2013, respectively. TDS Telecom has received cumulative grants of \$75.6 million as of June 30, 2014. These funds reduced the carrying amount of the assets to which they relate. TDS Telecom had recorded \$15.7 million and \$23.6 million in grants receivable at June 30, 2014 and December 31, 2013, respectively. These amounts were included as a component of Accounts receivable, Other, in the Consolidated Balance Sheet.

Table of Contents

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

Telephone and Data Systems, Inc. ("TDS") is a diversified telecommunications company providing high-quality telecommunications services to approximately 4.7 million wireless customers and 1.1 million wireline and cable connections at June 30, 2014. TDS conducts substantially all of its wireless operations through its 84% owned subsidiary, United States Cellular Corporation ("U.S. Cellular"). TDS provides wireline services, cable services and Hosted and Managed Services ("HMS"), through its wholly-owned subsidiary, TDS Telecommunications Corporation ("TDS Telecom").

The following discussion and analysis should be read in conjunction with TDS' interim consolidated financial statements and notes included in Item 1 above, and with the description of TDS' business, its audited consolidated financial statements and Management's Discussion and Analysis of Financial Condition and Results of Operations included in TDS' Annual Report on Form 10-K ("Form 10-K") for the year ended December 31, 2013.

**OVERVIEW**

The following is a summary of certain selected information contained in the comprehensive Management's Discussion and Analysis of Financial Condition and Results of Operations that follows. The overview does not contain all of the information that may be important. You should carefully read the entire Management's Discussion and Analysis of Financial Condition and Results of Operations and not rely solely on the overview.

The following provides historical and forward-looking information and analysis about TDS' existing business segments. In addition, TDS' consolidated operations include corporate operations, corporate investments and the Non-Reportable Segment, which includes TDS' majority-owned printing and distribution company, Suttle-Straus, Inc. ("Suttle-Straus") and TDS' wholly-owned wireless telephone subsidiary, Airadigm Communications, Inc. ("Airadigm"), and may in the future include other possible activities or businesses that are not included within the operating results of U.S. Cellular or TDS Telecom. Accordingly, the combined operating results do not currently represent, and in the future will not represent, the only components of the consolidated operating results of TDS, which will continue to reflect such other operations, investments, segments, activities or businesses.

**U.S. Cellular**

In its consolidated operating markets, U.S. Cellular serves approximately 4.7 million customers in 23 states. As of June 30, 2014, U.S. Cellular's average penetration rate in its consolidated operating markets was 14.7%. U.S. Cellular

operates on a customer satisfaction strategy, striving to meet or exceed customer needs by providing a comprehensive range of wireless products and services, excellent customer support, and a high-quality network.

Financial and operating highlights in the six months ended June 30, 2014 included the following:

- In March 2014, U.S. Cellular sold the majority of its St. Louis area non-operating market license for \$92.3 million. As a result of this sale, a gain of \$75.8 million was recorded in (Gain) loss on license sales and exchanges in the Consolidated Statement of Operations.
- In February 2014, U.S. Cellular completed a license exchange in Milwaukee. As a result of this transaction, a gain of \$15.7 million was recorded in (Gain) loss on license sales and exchanges in the Consolidated Statement of Operations.

The following operating information is presented for Core Markets. As used here, Core Markets is defined as all consolidated markets in which U.S. Cellular currently conducts business and, therefore, excludes the Divestiture Markets and the NY1 & NY2 Partnerships. Core Markets as defined also includes any other income or expenses due to U.S. Cellular's direct or indirect ownership interests in other spectrum in the Divestiture Markets which was not included in the Divestiture Transaction and other retained assets from the Divestiture Markets. See Note 5 — Acquisitions, Divestitures and Exchanges and Note 7 — Investments in Unconsolidated Entities in the Notes to Consolidated Financial Statements for additional information.

- Total customers were 4,653,000 at June 30, 2014, including 4,500,000 retail customers (97% of total).
- Retail customer net losses were 110,000 in the first six months of 2014 compared to net losses of 47,000 in 2013. In the postpaid category, there were net losses of 119,000 in 2014, compared to net losses of 86,000 in 2013. Postpaid defections increased due to billing system conversion issues and aggressive promotions by other carriers. Prepaid net additions were 9,000 in 2014 compared to net additions of 39,000 in 2013. The decline resulted from lower net additions in the national retail channel.
- Postpaid customers comprised approximately 92% of U.S. Cellular's retail customers as of June 30, 2014. The postpaid churn rate was 2.0% in 2014 compared to 1.6% in 2013. Billing system conversion issues and aggressive competitive offerings contributed to the increase in postpaid churn. The prepaid churn rate was 6.7% in 2014 compared to 5.8% in 2013.





Table of Contents

- Billed average revenue per user (“ARPU”) increased to \$53.62 in 2014 from \$50.97 in 2013 reflecting an increase in postpaid ARPU due to increases in smartphone adoption and corresponding revenues from data products and services. Service revenue ARPU increased to \$60.23 in 2014 from \$57.52 in 2013 due primarily to an increase in postpaid ARPU, offset by a decrease in inbound roaming revenue.
- Postpaid customers on smartphone service plans increased to 55% as of June 30, 2014 compared to 46% as of June 30, 2013. In addition, smartphones represented 73% of all devices sold in 2014 compared to 64% in 2013.
- Beginning in the second quarter of 2014, U.S. Cellular expanded its offerings for equipment installment plans. For the three months ended June 30, 2014, 15% of total smartphone sales to customers were made under an equipment installment plan.

The following financial information is presented for U.S. Cellular consolidated results:

- Retail service revenues of \$1,510.9 million decreased \$175.5 million, or 10%, in 2014 due to a decrease of 799,000 in the average number of customers (including approximately 500,000 due to the reductions caused by the Divestiture Transaction and NY1 & NY2 Deconsolidation) partially offset by an increase in billed ARPU.
- Total additions to Property, plant and equipment were \$233.5 million, including expenditures to deploy fourth generation Long-term Evolution (“4G LTE”) equipment, construct cell sites, increase capacity in existing cell sites and switches, outfit new and remodel existing retail stores, and enhance billing and other customer management related systems and platforms. Total cell sites in service decreased 20% year-over-year to 6,183 primarily as a result of the NY1 & NY2 Deconsolidation and the deactivation of certain cell sites in the Divestiture Markets.
- Operating income (loss) decreased \$263.0 million, to a loss of \$42.5 million in 2014. The (Gain) loss on license sales and exchanges and the (Gain) loss on sale of business and other exit costs contributed \$108.9 million and \$242.1 million to operating income in 2014 and 2013, respectively. Without these items, operating income decreased \$129.8 million due to lower service revenues and higher equipment subsidies, which were partially offset by lower system operations, selling, general and administrative, and depreciation, amortization and accretion expense.

U.S. Cellular anticipates that its future results may be affected by the following factors:

- Effects of industry competition on service and equipment pricing;
- U.S. Cellular completed the migration of its customers to a new Billing and Operational Support System (“B/OSS”) in the third quarter of 2013. Intermittent system outages and delayed system response times negatively impacted customer service and sales operations at certain times. System enhancements continue to be implemented to address these issues, and customer service and sales operations response times have improved. However, any future operational problems associated with the new billing system could have adverse effects on U.S. Cellular’s business (in areas such as overall customer satisfaction, customer attrition, uncollectible accounts receivable, gross customer additions, or operating expenses). All of these factors could have a material adverse effect on U.S. Cellular’s results of operations or cash flows;
- Impacts of selling Apple iPhone products;
- Impacts of selling devices under equipment installment plans;
- Relative ability to attract and retain customers in a competitive marketplace in a cost effective manner;
- Expanded distribution of products and services in third-party national retailers;
- Potential increases in prepaid customers, who generally generate lower ARPU and higher churn, as a percentage of U.S. Cellular’s customer base in response to changes in customer preferences and industry dynamics;
- The nature and rate of growth in the wireless industry, requiring U.S. Cellular to grow revenues primarily from selling additional products and services to its existing customers, increasing the number of multi-device users among its existing customers, increasing data products and services and attracting wireless customers switching from other wireless carriers;
- Continued growth in revenues and costs related to data products and services and declines in revenues from voice services;



Table of Contents

- Rapid growth in the demand for new data devices and services which may result in increased cost of equipment sold and other operating expenses and the need for additional investment in network capacity and enhancements;
- Further consolidation among carriers in the wireless industry, which could result in increased competition for customers and/or cause roaming revenues to decline;
- Uncertainty related to various rulemaking proceedings underway at the Federal Communications Commission (“FCC”);
- The ability to negotiate satisfactory 4G LTE data roaming agreements with other wireless operators.

See “Results of Operations—U.S. Cellular.”

**TDS Telecom**

The Wireline and Cable segments seek to be the preferred telecommunications solutions providers in their chosen markets serving both residential and commercial customers by developing and delivering high-quality products through a superior network that meets or exceeds customers’ needs and to outperform the competition by maintaining superior customer service. TDS Telecom provides broadband, voice, and video services to residential customers through value-added bundling of products. The commercial focus is to provide advanced IP-based voice and data services to small to medium sized businesses. The HMS segment provides colocation, dedicated hosting, hosted application management, cloud computing services and planning, engineering, procurement, installation, sales and management of Information Technology (“IT”) infrastructure hardware solutions.

On October 4, 2013, TDS acquired 100% of the outstanding shares of MSN Communications, Inc. (“MSN”) for \$43.6 million in cash. The operations of MSN are included in the HMS segment. On August 1, 2013, TDS Telecom acquired substantially all of the assets of Baja Broadband, LLC (“Baja”) for \$264.1 million in cash. The operations of Baja comprise the Cable segment. These acquisitions impact the comparability of TDS Telecom’s operating results.

On May 1, 2014, TDS entered into an agreement to acquire substantially all of the assets of a group of companies operating as BendBroadband, headquartered in Bend, Oregon for \$261 million in cash, subject to working capital and other adjustments. BendBroadband is a full-service communications company, offering an extensive range of

broadband, fiber connectivity, cable television and telephone services for commercial and residential customers in Central Oregon. The agreement also includes a Tier III data center providing colocation and managed services and a cable advertising and broadcast business. At December 31, 2013, BendBroadband passed approximately 79,000 homes and businesses, with approximately 36,000 video subscribers, 41,000 high-speed broadband subscribers and 22,000 digital voice subscribers. BendBroadband generated annual revenues of \$70 million in 2013. The transaction is subject to governmental regulatory approvals, compliance with the Hart-Scott-Rodino Act and other conditions. Subject to approvals, the transaction is expected to close in the third quarter of 2014.

TDS Telecom's financial results for the six months ended June 30, 2014 included the following:

- Operating revenues increased \$92.7 million or 21% to \$533.3 million in 2014. The increase was due primarily to \$97.3 million from acquisitions of Baja and MSN, partially offset by a \$6.0 million decrease in Wireline Wholesale revenues.
- Operating expenses increased \$75.8 million or 18% to \$496.0 million in 2014 due primarily to \$96.9 million from acquisitions, partially offset by a \$25.7 million decrease in Wireline expenses.

TDS anticipates that TDS Telecom's future results will be affected by the following factors:

- Continued increases in competition from wireless and other wireline providers, cable providers, and technologies such as Voice over Internet Protocol ("VoIP"), DOCSIS 3.0 and higher, and fourth-generation ("4G") mobile technology;
- Continued increases in consumer data usage and demand for high-speed data services;
- Continued declines in Wireline voice connections;
- Continued focus on customer retention programs, including discounting for "triple-play" bundles including voice, broadband and video or satellite video;
- The expansion of Internet Protocol television ("IPTV") into additional market areas;

- Continued growth in hosted and managed services which may result in the need for additional investment in data centers;

## Table of Contents

- Continued focus on cost-reduction initiatives through product and service cost improvements and process efficiencies;
- The Federal government's disbursement of Broadband Stimulus Funds to bring broadband to rural customers;
- The National Broadband Plan and other rulemaking by the FCC, including uncertainty related to future funding from the Universal Service Fund ("USF"), broadband requirements, intercarrier compensation and changes in access reform;
- Impacts of the Baja and MSN transactions, including, but not limited to, the ability to successfully integrate and operate these businesses and the financial impacts of such transactions;
- Impacts of the BendBroadband transaction, including, but not limited to, the ability to obtain regulatory approval, successfully complete the transaction, integrate and operate the businesses of BendBroadband, and the financial impacts of such transaction, including the effects on TDS' capital resources and liquidity as a result of the use of \$261 million in cash for the purchase price; and
- Potential acquisitions or divestitures by TDS and/or TDS Telecom of wireline, cable, HMS or other businesses.

See "Results of Operations—TDS Telecom."

## **Pro Forma Financial Information**

Refer to TDS' Form 8-K filed on August 2, 2013 for pro forma financial information related to the Divestiture Transaction and the NY1 & NY2 Deconsolidation for the three and six months ended June 30, 2013, as if the transactions had occurred at the beginning of the period.

## **REGULATORY DEVELOPMENTS**



## **FCC Interoperability Order**

On October 25, 2013, the FCC adopted a Report and Order and Order of Proposed Modification confirming a voluntary industry agreement on interoperability in the Lower 700 MHz spectrum band. The FCC's Report and Order laid out a roadmap for the voluntary commitments of AT&T and DISH Network Corporation ("DISH") to become fully binding. The FCC implemented the AT&T commitments in an Order adopted in the first quarter of 2014 that modified AT&T's Lower 700 MHz licenses. Pursuant to these commitments, AT&T will begin incorporating changes in its network and devices that will foster interoperability across all paired spectrum blocks in the Lower 700 MHz Band and support LTE roaming on AT&T networks for carriers with compatible Band 12 devices, consistent with the FCC's rules on roaming. AT&T will be implementing the foregoing changes in phases starting with network software enhancement taking place possibly through the third quarter of 2015 with the AT&T Band 12 device roll-out to follow. In addition, the FCC has adopted changes in its technical rules for certain unpaired spectrum licensed to AT&T and DISH in the Lower 700 MHz band to enhance prospects for Lower 700 MHz interoperability. AT&T's network and devices currently interoperate across only two of the three paired blocks in the Lower 700 MHz band. U.S. Cellular's LTE deployment, carried out in conjunction with its partner, King Street Wireless, utilizes spectrum in all three of these blocks and, consequently, was not interoperable with the AT&T configuration. U.S. Cellular believes that the FCC action will broaden the ecosystem of devices available to U.S. Cellular's customers over time.

## **FCC Net Neutrality Proposal**

In May 2014, the FCC issued a notice of proposed rulemaking seeking comments on revised net neutrality rules. The revised proposed rules are substantially similar to rules adopted in 2010 that were vacated by a U.S. Court of Appeals in January 2014 (as described in our Form 10-K for the year ended December 31, 2013), except that they include certain changes intended to allow the revised proposed rules to be sustained considering the Court's decision. In particular, whereas the vacated rules prohibited fixed (i.e., cable and telephone) Internet Service Providers from engaging in "unreasonable discrimination" in transmitting internet traffic, the revised proposed rules would prohibit those carriers from engaging in "commercially unreasonable practices." The FCC is also considering applying that standard to wireless Internet Service Providers, which were not subject to the former "unreasonable discrimination" standard. All types of Internet Service Providers previously were and would again be prohibited from "blocking" access to lawful Internet services, and remain subject to "transparency" requirements which were not vacated by the Court of Appeals. The FCC also now proposes to "enhance" those transparency requirements to provide for greater disclosure of network management practices. The FCC proceeding is currently pending, and we cannot predict the outcome of the proceeding.

Table of Contents

**FCC Spectrum Auction 97**

The FCC has scheduled an auction of AWS-3 spectrum licenses, referred to as Auction 97, to begin on November 13, 2014. U.S. Cellular evaluates opportunities to acquire additional spectrum in FCC auctions and may participate as a bidder or member of a bidding group. If U.S. Cellular participates, information relating to this will be disclosed at a later time, subject to FCC rules. In such event, applicable FCC anti-collusion rules will place certain restrictions on public disclosures and business communications with other companies relating to U.S. Cellular's participation, commencing on the application deadline of September 12, 2014 until the down payment deadline for Auction 97, which will be the later of January 7, 2015 or ten business days after release of the auction closing public notice. These anti-collusion rules, which could last three to four months or more, may restrict the normal conduct of U.S. Cellular's disclosures and/or business communications by U.S. Cellular relating to the auction. The restrictions could have an adverse effect on U.S. Cellular's business, financial condition or results of operations.

Table of Contents

| Six Months Ended June 30, 2014 Compared to Six Months Ended June 30, 2013 |  |                               |  |      |           |      |           |    |           |  |                   |   |
|---|--|-------------------------------|--|------|-----------|------|-----------|----|-----------|--|-------------------|---|
|   |  |                               |  |      |           |      |           |    |           |  |                   |   |
| RESULTS OF OPERATIONS — CONSOLIDATED                                      |  |                               |  |      |           |      |           |    |           |  |                   |   |
|   |  |                               |  |      |           |      |           |    |           |  |                   |   |
| Six Months Ended June 30,   |  |                               |  | 2014 |           | 2013 |           |    | Change    |  | Percentage Change |   |
| (Dollars in thousands, except per share amounts)                          |  |                               |  |      |           |      |           |    |           |  |                   |   |
| Operating revenues  |  |                               |  |      |           |      |           |    |           |  |                   |   |
|   | U.S. Cellular  |                               |  | \$   | 1,883,584 | \$   | 2,076,876 | \$ | (193,292) |  | (9)               | % |
|   | TDS Telecom  |                               |  |      | 533,266   |      | 440,521   |    | 92,745    |  | 21                | % |
|   | All other (1)  |                               |  |      | 15,504    |      | 19,342    |    | (3,838)   |  | (20)              | % |
|   |  | Total operating revenues      |  |      | 2,432,354 |      | 2,536,739 |    | (104,385) |  | (4)               | % |
| Operating expenses  |  |                               |  |      |           |      |           |    |           |  |                   |   |
|   | U.S. Cellular  |                               |  |      | 1,926,066 |      | 1,856,318 |    | 69,748    |  | 4                 | % |
|   | TDS Telecom  |                               |  |      | 496,007   |      | 420,198   |    | 75,809    |  | 18                | % |
|   | All other (1)(2)                                       |                               |  |      | 38,686    |      | (29,158)  |    | 67,844    |  | >100              | % |
|   |  | Total operating expenses      |  |      | 2,460,759 |      | 2,247,358 |    | 213,401   |  | 9                 | % |
| Operating income (loss)   |  |                               |  |      |           |      |           |    |           |  |                   |   |
|   | U.S. Cellular  |                               |  |      | (42,482)  |      | 220,558   |    | (263,040) |  | >(100)            | % |
|   | TDS Telecom  |                               |  |      | 37,259    |      | 20,323    |    | 16,936    |  | 83                | % |
|   | All other (1)(2)                                       |                               |  |      | (23,182)  |      | 48,500    |    | (71,682)  |  | >(100)            | % |
|   |  | Total operating income (loss) |  |      | (28,405)  |      | 289,381   |    | (317,786) |  | >(100)            | % |
| Other income and (expenses)   |  |                               |  |      |           |      |           |    |           |  |                   |   |
|   | Equity in earnings of unconsolidated entities          |                               |  |      | 72,117    |      | 62,694    |    | 9,423     |  | 15                | % |
|   | Interest and dividend income                           |                               |  |      | 5,237     |      | 4,178     |    | 1,059     |  | 25                | % |
|   | Gain (loss) on investments                             |                               |  |      | -         |      | 14,518    |    | (14,518)  |  | N/M               |   |
|   | Interest expense                                       |                               |  |      | (56,605)  |      | (48,247)  |    | (8,358)   |  | 17                | % |
|   | Other, net   |                               |  |      | 210       |      | (351)     |    | 561       |  | >100              | % |
|   |  | Total other income (expenses) |  |      | 20,959    |      | 32,792    |    | (11,833)  |  | (36)              | % |
| Income before income taxes  |  |                               |  |      | (7,446)   |      | 322,173   |    | (329,619) |  | >(100)            | % |
|   | Income tax expense                                     |                               |  |      | (2,014)   |      | 136,787   |    | (138,801) |  | >(100)            | % |
|   |  |                               |  |      |           |      |           |    |           |  |                   |   |
| Net income (loss)   |  |                               |  |      | (5,432)   |      | 185,386   |    | (190,818) |  | >(100)            | % |
|   | Less: Net income (loss) attributable to noncontrolling |                               |  |      | (1,648)   |      | 27,890    |    | (29,538)  |  | >(100)            | % |

|  |  |  |    |         |  |    |         |  |    |           |  |         |  |
|--|--|--|----|---------|--|----|---------|--|----|-----------|--|---------|--|
|  | interests, net of tax  |  |    |         |  |    |         |  |    |           |  |         |  |
| <b>Net income attributable to TDS shareholders</b>                 |  |  |    | (3,784) |  |    | 157,496 |  |    | (161,280) |  | >(100)% |  |
|  | Preferred dividend requirement   |  |    | (25)    |  |    | (25)    |  |    | -         |  | -       |  |
| <b>Net income available to common shareholders</b>                 |  |  | \$ | (3,809) |  | \$ | 157,471 |  | \$ | (161,280) |  | >(100)% |  |
| <b>Basic earnings per share attributable to TDS shareholders</b>   |  |  | \$ | (0.04)  |  | \$ | 1.45    |  | \$ | (1.49)    |  | >(100)% |  |
| <b>Diluted earnings per share attributable to TDS shareholders</b> |  |  | \$ | (0.04)  |  | \$ | 1.44    |  | \$ | (1.48)    |  | >(100)% |  |
| N/M - Percent change not meaningful                                |  |  |    |         |  |    |         |  |    |           |  |         |  |
| (1)  | Consists of Non-Reportable Segment, corporate operations and intercompany eliminations between U.S. Cellular, TDS Telecom, the Non-Reportable Segment and corporate operations.  |  |    |         |  |    |         |  |    |           |  |         |  |
| (2)  | Due to the Airadigm Transaction, TDS recognized expenses of \$13.1 million related to exit and disposal activities in 2014. In 2013, TDS recognized an incremental gain of \$53.5 million compared to U.S. Cellular upon closing of the Divestiture Transaction as a result of lower asset basis in the assets disposed. See Note 5 – Acquisitions, Divestitures and Exchanges in the Notes to the Consolidated Financial Statements for additional information related to these transactions. |  |    |         |  |    |         |  |    |           |  |         |  |

### Operating revenues and expenses

See “Results of Operations — U.S. Cellular” and “Results of Operations — TDS Telecom” below for factors that affected consolidated Operating revenues and expenses.

Table of Contents

**Equity in earnings of unconsolidated entities**

TDS' investment in the Los Angeles SMSA Limited Partnership ("LA Partnership") contributed \$39.6 million and \$40.4 million to Equity in earnings of unconsolidated entities in 2014 and 2013, respectively.

On April 3, 2013, TDS deconsolidated the NY1 & NY2 Partnerships and began reporting them as equity method investments in its consolidated financial statements as of that date. Equity in earnings of the NY1 & NY2 Partnerships was \$13.7 million and \$8.6 million in 2014 and 2013, respectively. See Note 7 — Investments in Unconsolidated Entities in Notes to Consolidated Financial Statements for additional information.

**Gain (loss) on investments**

In 2013, in connection with the deconsolidation of the NY1 & NY2 Partnerships, TDS recognized a non-cash pre-tax gain of \$14.5 million.

**Interest expense**

The increase in interest expense was due primarily to a decrease in capitalized interest related to network and systems projects. Interest cost capitalized was \$3.8 million and \$12.1 million for 2014 and 2013, respectively.

**Income tax expense**

See Note 3 — Income Taxes in the Notes to Consolidated Financial Statements for a discussion of the overall effective tax rate on Income before income taxes.

**Net income (loss) attributable to noncontrolling interests, net of tax**

Net income (loss) attributable to noncontrolling interests, net of tax includes the noncontrolling public shareholders' share of U.S. Cellular's net income (loss) and the noncontrolling shareholders' or partners' share of certain TDS or U.S. Cellular subsidiaries' net income (loss).

|  |  |  |    | Six Months Ended |  |      |        |
|--|--|--|----|------------------|--|------|--------|
|  |  |  |    | June 30,         |  |      |        |
|  |  |  |    | 2014             |  | 2013 |        |
| <b>(Dollars in thousands)</b>  |  |  |    |                  |  |      |        |
| Net income (loss) attributable to noncontrolling interests, net of tax |  |  |    |                  |  |      |        |
|  | U.S. Cellular noncontrolling public shareholders'  |  | \$ | 70               |  | \$   | 23,111 |
|  | Noncontrolling shareholders' or partners' (1)  |  |    | (1,718)          |  |      | 4,779  |
|  |  |  | \$ | (1,648)          |  | \$   | 27,890 |
|  |  |  |    |                  |  |      |        |
| (1)  | The decrease from 2013 to 2014 is due primarily to the elimination of the noncontrolling interest as a result of the NY1 & NY2 Deconsolidation on April 3, 2013. |  |    |                  |  |      |        |

[Table of Contents](#)**RESULTS OF OPERATIONS — U.S. CELLULAR**

TDS provides wireless telephone service through U.S. Cellular, an 84%-owned subsidiary. U.S. Cellular owns, manages and invests in wireless markets throughout the United States.

**Summary Operating Data for U.S. Cellular Consolidated Markets**

Following is a table of summarized operating data for U.S. Cellular's Consolidated Markets. Consolidated Markets herein refers to markets which U.S. Cellular currently consolidates, or previously consolidated in the periods presented, and is not adjusted in prior periods for subsequent divestitures or deconsolidations. Unless otherwise noted, figures reported in Results of Operations are representative of consolidated results.

| <b>As of or for Six Months Ended June 30,</b>              |                 |                                   | <b>2014</b> |  | <b>2013</b> |  |
|--|-----------------|-----------------------------------|-------------|--|-------------|--|
| <b>Retail Customers</b>                                    |                 |                                   |             |  |             |  |
|  | <b>Postpaid</b> |                                   |             |  |             |  |
|  |                 | Total at end of period            | 4,148,000   |  | 4,412,000   |  |
|  |                 | Gross additions                   | 387,000     |  | 356,000     |  |
|  |                 | Net additions (losses)            | (119,000)   |  | (194,000)   |  |
|  |                 | ARPU(1)                           | \$ 57.18    |  | \$ 54.80    |  |
|  |                 | Churn rate(2)                     | 2.0 %       |  | 1.9 %       |  |
|  |                 | Smartphone penetration(3)         | 55.3 %      |  | 45.5 %      |  |
|  | <b>Prepaid</b>  |                                   |             |  |             |  |
|  |                 | Total at end of period            | 352,000     |  | 381,000     |  |
|  |                 | Gross additions                   | 150,000     |  | 181,000     |  |
|  |                 | Net additions (losses)            | 9,000       |  | 16,000      |  |
|  |                 | ARPU(1)                           | \$ 33.18    |  | \$ 32.76    |  |
|  |                 | Churn rate(2)                     | 6.7 %       |  | 6.6 %       |  |
| <b>Total customers at end of period</b>                    |                 |                                   | 4,653,000   |  | 4,968,000   |  |
| <b>Billed ARPU(1)</b>                                      |                 |                                   | \$ 53.62    |  | \$ 51.15    |  |
| <b>Service revenue ARPU(1)</b>                             |                 |                                   | \$ 60.23    |  | \$ 57.85    |  |
| <b>Smartphones sold as a percent of total devices sold</b> |                 |                                   | 72.8 %      |  | 63.7 %      |  |
| <b>Total Population</b>                                    |                 |                                   |             |  |             |  |
|  |                 | Consolidated markets(4)           | 54,817,000  |  | 84,025,000  |  |
|  |                 | Consolidated operating markets(4) | 31,729,000  |  | 31,822,000  |  |
| <b>Market penetration at end of period</b>                 |                 |                                   |             |  |             |  |
|  |                 | Consolidated markets(5)           | 8.5 %       |  | 5.9 %       |  |
|  |                 | Consolidated operating markets(5) | 14.7 %      |  | 15.6 %      |  |

|                                    |    |         |  |    |         |
|------------------------------------|----|---------|--|----|---------|
| <b>Capital expenditures (000s)</b> | \$ | 233,508 |  | \$ | 286,907 |
| <b>Total cell sites in service</b> |    | 6,183   |  |    | 7,748   |
| <b>Owned towers</b>                |    | 4,457   |  |    | 4,411   |

| Summary Operating Data for U.S. Cellular Core Markets   |                                   |                           |      |            |  |  |      |            |  |
|---|-----------------------------------|---------------------------|------|------------|--|--|------|------------|--|
|   |                                   |                           |      |            |  |  |      |            |  |
| Following is a table of summarized operating data for U.S. Cellular's Core Markets. For comparability, Core Markets as presented here excludes the results of the Divestiture Markets and NY1 and NY2 Partnerships as of or for the six months ended June 30, 2013. |                                   |                           |      |            |  |  |      |            |  |
|   |                                   |                           |      |            |  |  |      |            |  |
| As of or for Six Months Ended June 30,  |                                   |                           | 2014 |            |  |  | 2013 |            |  |
| Retail Customers  |                                   |                           |      |            |  |  |      |            |  |
|   | Postpaid                          |                           |      |            |  |  |      |            |  |
|   |                                   | Total at end of period    |      | 4,148,000  |  |  |      | 4,412,000  |  |
|   |                                   | Gross additions           |      | 387,000    |  |  |      | 341,000    |  |
|   |                                   | Net additions (losses)    |      | (119,000)  |  |  |      | (86,000)   |  |
|   |                                   | ARPU(1)                   | \$   | 57.18      |  |  | \$   | 54.34      |  |
|   |                                   | Churn rate(2)             |      | 2.0 %      |  |  |      | 1.6 %      |  |
|   |                                   | Smartphone penetration(3) |      | 55.3 %     |  |  |      | 45.5 %     |  |
|   | Prepaid                           |                           |      |            |  |  |      |            |  |
|   |                                   | Total at end of period    |      | 352,000    |  |  |      | 381,000    |  |
|   |                                   | Gross additions           |      | 150,000    |  |  |      | 167,000    |  |
|   |                                   | Net additions (losses)    |      | 9,000      |  |  |      | 39,000     |  |
|   |                                   | ARPU(1)                   | \$   | 33.18      |  |  | \$   | 32.36      |  |
|   |                                   | Churn rate(2)             |      | 6.7 %      |  |  |      | 5.8 %      |  |
| Total customers at end of period  |                                   |                           |      | 4,653,000  |  |  |      | 4,968,000  |  |
| Billed ARPU(1)  |                                   |                           | \$   | 53.62      |  |  | \$   | 50.97      |  |
| Service revenue ARPU(1)   |                                   |                           | \$   | 60.23      |  |  | \$   | 57.52      |  |
| Smartphones sold as a percent of total devices sold   |                                   |                           |      | 72.8 %     |  |  |      | 64.0 %     |  |
| Total Population  |                                   |                           |      |            |  |  |      |            |  |
|   | Consolidated markets(4)           |                           |      | 54,817,000 |  |  |      | 84,025,000 |  |
|   | Consolidated operating markets(4) |                           |      | 31,729,000 |  |  |      | 31,822,000 |  |
| Market penetration at end of period   |                                   |                           |      |            |  |  |      |            |  |
|   | Consolidated markets(5)           |                           |      | 8.5 %      |  |  |      | 5.9 %      |  |
|   | Consolidated operating markets(5) |                           |      | 14.7 %     |  |  |      | 15.6 %     |  |
| Capital expenditures (000s)   |                                   |                           | \$   | 233,508    |  |  | \$   | 279,073    |  |
| Total cell sites in service   |                                   |                           |      | 6,183      |  |  |      | 6,113      |  |
| Owned towers  |                                   |                           |      | 3,892      |  |  |      | 3,846      |  |



Table of Contents

(1) ARPU metrics are calculated by dividing a revenue base by an average number of customers by the number of months in the period. These revenue bases and customer populations are shown below:

- a. Postpaid ARPU consists of total postpaid service revenues and postpaid customers.
- b. Prepaid ARPU consists of total prepaid service revenues and prepaid customers.
- c. Billed ARPU consists of total retail service or “billed” revenues (total postpaid, prepaid and reseller service revenues) and postpaid, prepaid and reseller customers.
- d. Service revenue ARPU consists of total retail service revenues, inbound roaming and other service revenues and postpaid, prepaid and reseller customers.

(2) Churn metrics represent the percentage of the postpaid or prepaid customers that disconnect service each month. These metrics represent the average monthly postpaid or prepaid churn rate for each respective period.

(3) Smartphones represent wireless devices which run on an Android, Apple, BlackBerry or Windows Mobile operating system, excluding tablets. Smartphone penetration is calculated by dividing postpaid smartphone customers by total postpaid customers.

(4) The decrease in the population of Consolidated markets is due primarily to the divestiture of the Mississippi Valley non-operating license in October 2013 and the majority of the St. Louis area non-operating market license in March 2014. Total Population is used only to calculate market penetration of consolidated markets and consolidated operating markets, respectively. See footnote (5) below.

(5) Market penetration is calculated by dividing the number of wireless customers at the end of the period by the total population of consolidated markets and consolidated operating markets, respectively, as estimated by Claritas. The increase in penetration is due primarily to a lower denominator as a result of the license divestitures described in footnote (4) above.

Table of Contents

| <b>Components of Operating Income</b>   |  |    |             |  |             |           |               |    |                          |  |        |   |
|---|--|----|-------------|--|-------------|-----------|---------------|----|--------------------------|--|--------|---|
| <b>Six Months Ended June 30,</b>  |  |    | <b>2014</b> |  | <b>2013</b> |           | <b>Change</b> |    | <b>Percentage Change</b> |  |        |   |
| <b>(Dollars in thousands)</b>   |  |    |             |  |             |           |               |    |                          |  |        |   |
| Retail service  |  | \$ | 1,510,918   |  | \$          | 1,686,399 |               | \$ | (175,481)                |  | (10)   | % |
| Inbound roaming   |  |    | 107,706     |  |             | 130,907   |               |    | (23,201)                 |  | (18)   | % |
| Other   |  |    | 78,462      |  |             | 90,009    |               |    | (11,547)                 |  | (13)   | % |
| Service revenues  |  |    | 1,697,086   |  |             | 1,907,315 |               |    | (210,229)                |  | (11)   | % |
| Equipment sales   |  |    | 186,498     |  |             | 169,561   |               |    | 16,937                   |  | 10     | % |
| Total operating revenues  |  |    | 1,883,584   |  |             | 2,076,876 |               |    | (193,292)                |  | (9)    | % |
|   |  |    |             |  |             |           |               |    |                          |  |        |   |
| System operations (excluding Depreciation, amortization and accretion reported below) |  |    | 367,738     |  |             | 408,566   |               |    | (40,828)                 |  | (10)   | % |
| Cost of equipment sold  |  |    | 542,452     |  |             | 458,761   |               |    | 83,691                   |  | 18     | % |
| Selling, general and administrative   |  |    | 799,816     |  |             | 824,207   |               |    | (24,391)                 |  | (3)    | % |
| Depreciation, amortization and accretion  |  |    | 316,090     |  |             | 392,425   |               |    | (76,335)                 |  | (19)   | % |
| (Gain) loss on asset disposals, net   |  |    | 8,827       |  |             | 14,452    |               |    | (5,625)                  |  | (39)   | % |
| (Gain) loss on sale of business and other exit costs, net                             |  |    | (17,411)    |  |             | (242,093) |               |    | 224,682                  |  | 93     | % |
| (Gain) loss on license sales and exchanges  |  |    | (91,446)    |  |             | -         |               |    | (91,446)                 |  | N/M    |   |
| Total operating expenses  |  |    | 1,926,066   |  |             | 1,856,318 |               |    | 69,748                   |  | 4      | % |
| Operating income (loss)   |  | \$ | (42,482)    |  | \$          | 220,558   |               | \$ | (263,040)                |  | >(100) | % |
|   |  |    |             |  |             |           |               |    |                          |  |        |   |
| N/M - Not meaningful  |  |    |             |  |             |           |               |    |                          |  |        |   |

**Operating Revenues***Service revenues*

Service revenues consist primarily of: (i) charges for access, airtime, roaming, recovery of regulatory costs and value added services, including data products and services, provided to U.S. Cellular's retail customers and to end users through third party resellers ("retail service"); (ii) charges to other wireless carriers whose customers use U.S. Cellular's wireless systems when roaming; and (iii) amounts received from the Federal Universal Service Fund ("USF").

### ***Retail service revenues***

Retail service revenues decreased by \$175.5 million, or 10%, in 2014 to \$1,510.9 million due to a decrease in U.S. Cellular's average customer base (including the reductions caused by the Divestiture Transaction and NY1 & NY2 Deconsolidation) partially offset by an increase in billed ARPU.

Billed ARPU increased to \$53.62 in 2014 from \$51.15 in 2013. This overall increase is due primarily to an increase in postpaid ARPU to \$57.18 in 2014 from \$54.80 in 2013, reflecting increases in smartphone adoption and corresponding revenues from data products and services.

U.S. Cellular expects continued pressure on retail service revenues in the foreseeable future due to industry competition for customers and related effects on pricing of service plan offerings offset to some degree by continued adoption of smartphones and data usage. In addition, beginning in the second quarter of 2014, U.S. Cellular expanded its offerings of equipment installment plans. To the extent that customers adopt these plans, U.S. Cellular expects an increase in equipment sales revenues. In addition, certain of the equipment installment plans provide the customer with a reduction in the monthly access charge for the device; thus, to the extent that existing customers adopt such plans, U.S. Cellular expects a reduction in retail service revenues and ARPU.

### ***Inbound roaming revenues***

Inbound roaming revenues decreased by \$23.2 million, or 18%, in 2014 to \$107.7 million. The decrease was due primarily to a \$17.6 million impact related to the Divestiture Transaction and NY1 & NY2 Deconsolidation. The remaining decrease in the Core Markets was due to a decrease in rates and a decline in voice volume, partially offset by higher data usage.

Table of Contents

***Other revenues***

Other revenues decreased by \$11.5 million, or 13%, in 2014 compared to 2013, due primarily to a \$14.2 million decrease in eligible telecommunications carriers ("ETC") support.

Pursuant to the FCC's Reform Order ("Reform Order"), U.S. Cellular's current ETC support is being phased down at the rate of 20% per year beginning July 1, 2012. The Phase II Mobility Fund was not operational by July 2014. Therefore, as provided by the Reform Order, the phase down is currently suspended and U.S. Cellular will continue to receive 60% of its baseline support until the Phase II Mobility Fund is operational. At this time, U.S. Cellular cannot predict the net effect of the FCC's changes to the USF high cost support program in the Reform Order. Accordingly, U.S. Cellular cannot predict whether such changes will have a material adverse effect on U.S. Cellular's business, financial condition or results of operations.

***Equipment sales revenues***

Equipment sales revenues include revenues from sales of wireless devices and related accessories to both new and existing customers, as well as revenues from sales of devices and accessories to agents. All Equipment sales revenues are recorded net of rebates.

U.S. Cellular offers a competitive line of quality wireless devices to both new and existing customers. U.S. Cellular's customer acquisition and retention efforts include offering new wireless devices to customers at discounted prices; in addition, customers on currently offered rate plans receive loyalty reward points that may be used to purchase a new wireless device or accelerate the timing of a customer's eligibility for a wireless device upgrade at promotional pricing. U.S. Cellular also continues to sell wireless devices to agents including national retailers; this practice enables U.S. Cellular to provide better control over the quality of wireless devices sold to its customers, establish roaming preferences and earn quantity discounts from wireless device manufacturers which are passed along to agents and other retailers.

Beginning in the second quarter of 2014, U.S. Cellular expanded its offerings of equipment installment plans. To the extent that customers adopt these plans, U.S. Cellular expects an increase in equipment sales revenues. In addition, certain of the equipment installment plans provide the customer with a reduction in the monthly access charge for the device; thus, to the extent that existing customers adopt such plans, U.S. Cellular expects a reduction in retail service revenues and ARPU.

Equipment sales revenues increased \$16.9 million, or 10%, in 2014 to \$186.5 million. In the Core Markets, equipment sales revenues increased by \$24.6 million due primarily to an increase in average revenue per device sold (including the impact of sales under equipment installment plans), partially offset by the sale of fewer devices, primarily in the feature phone category. The increase in equipment sales revenues in the Core Markets was partially offset by the effects of the Divestiture Transaction and the NY1 & NY2 Deconsolidation.

## Operating Expenses

### *System operations expenses (excluding Depreciation, amortization and accretion)*

System operations expenses (excluding Depreciation, amortization, and accretion) include charges from telecommunications service providers for U.S. Cellular's customers' use of their facilities, costs related to local interconnection to the wireline network, charges for cell site rent and maintenance of U.S. Cellular's network, long-distance charges, outbound roaming expenses and payments to third party data product and platform developers.

System operations expenses decreased \$40.8 million, or 10%, to \$367.7 million. Key components of the net changes in System operations expense were as follows:

- Customer usage expenses decreased by \$24.4 million, or 19%, driven by impacts of the Divestiture Transaction and NY1 & NY2 Deconsolidation and decreases in network costs due to lower rates for long distance usage and lower fees for platform and content providers.
- Maintenance, utility and cell site expenses decreased \$13.2 million, or 7%, driven primarily by impacts of the Divestiture Transaction and NY1 & NY2 Deconsolidation and lower headcount, partially offset by costs related to 4G LTE support.
- Expenses incurred when U.S. Cellular's customers used other carriers' networks while roaming decreased \$3.2 million, or 4%, due primarily to the Divestiture Transaction and NY1 & NY2 Deconsolidation, lower voice usage and lower rates, offset by higher data roaming usage in the Core Markets.

## Table of Contents

U.S. Cellular expects system operations expenses to increase in the future to support the continued growth in cell sites and other network facilities as it continues to add capacity, enhance quality and deploy new technologies as well as to support increases in total customer usage, particularly data usage. However, these increases are expected to be offset to some extent by cost savings generated by shifting data traffic to the more efficient 4G LTE network from the 3G network.

### *Cost of equipment sold*

Cost of equipment sold increased by \$83.7 million, or 18%, in 2014 to \$542.5 million. The increase was driven by a 36% increase in the average cost per device sold, which more than offset the impact of selling fewer devices. Average cost per device sold increased due to general customer preference for higher-priced 4G LTE smartphones. Smartphones sold as a percentage of total devices sold were 73% and 64% in 2014 and 2013, respectively. The total number of devices sold decreased by 11%, partially due to the Divestiture Transaction.

U.S. Cellular's loss on equipment, defined as equipment sales revenues less cost of equipment sold, was \$356.0 million and \$289.2 million for 2014 and 2013, respectively. U.S. Cellular expects loss on equipment to continue to be a significant cost in the foreseeable future as wireless carriers continue to use device availability and pricing as a means of competitive differentiation. In addition, U.S. Cellular expects increasing sales of data centric wireless devices to result in higher equipment subsidies over time; these devices generally have higher purchase costs which cannot be recovered through proportionately higher selling prices to customers under the standard contract/subsidy model the industry has operated with for many years. However, U.S. Cellular expects the introduction of the equipment installment plans to offset the increases in loss on equipment to some degree.

### *Selling, general and administrative expenses*

Selling, general and administrative expenses include salaries, commissions and expenses of field sales and retail personnel and facilities; telesales department salaries and expenses; agent commissions and related expenses; corporate marketing and merchandise management; and advertising expenses. Selling, general and administrative expenses also include bad debts expense, costs of operating customer care centers and corporate expenses.

Key components of the \$24.4 million, or 3%, decrease to \$799.8 million were as follows:

- Selling and marketing expense decreased by \$7.0 million, or 2%, due primarily to the effects of the Divestiture Transaction and NY1 & NY2 Deconsolidation, offset by increases in advertising and commissions expenses.

- General and administrative expense decreased by \$17.4 million, or 4%, due primarily to the Divestiture Transaction and NY1 & NY2 Deconsolidation and lower consulting expenses related to the billing system conversion in the prior year, offset by an increase in bad debts expense.

***Depreciation, amortization and accretion***

Depreciation, amortization and accretion decreased \$76.3 million, or 19%, in 2014 to \$316.1 million due primarily to the higher amount of accelerated depreciation, amortization and accretion in the Divestiture Markets that occurred in 2013. The impact of the acceleration was \$13.1 million in 2014 compared to \$88.3 million in 2013. The accelerated depreciation, amortization and accretion in the Divestiture Markets was completed in the first quarter of 2014.

***(Gain) loss on asset disposals, net***

(Gain) loss on asset disposals, net was a loss in both 2014 and 2013 due primarily to the write-off and disposals of certain network assets.

***(Gain) loss on sale of business and other exit costs, net***

The net gain in both 2014 and 2013 resulted from the Divestiture Transaction. See Note 5 — Acquisitions, Divestitures and Exchanges in the Notes to Consolidated Financial Statements for additional information.

***(Gain) loss on license sales and exchanges***

The net gain in 2014 resulted from the sale of the St. Louis area non-operating market license and the license exchange in Milwaukee. See Note 5 — Acquisitions, Divestitures and Exchanges in the Notes to Consolidated Financial Statements for additional information.

Table of Contents

**RESULTS OF OPERATIONS — TDS TELECOM**

TDS Telecom provides broadband, video and voice telecommunications services and hosted and managed services in three reportable segments: Wireline, Cable and HMS. TDS Telecom's Wireline and Cable operations served 1,113,200 customer connections at June 30, 2014. TDS Telecom also provides hosted and managed services ("HMS") under the OneNeck IT Solutions ("OneNeck") brand, which provides colocation, dedicated hosting, hosted application management, cloud computing services and planning, engineering, procurement, installation, sales and management of Information Technology ("IT") infrastructure hardware solutions.

On October 4, 2013, TDS acquired 100% of the outstanding shares of MSN. The operations of MSN are included in the HMS segment since the date of acquisition. On August 1, 2013, TDS Telecom acquired substantially all of the assets of Baja. The operations of Baja are included in the Cable segment since the date of acquisition. These acquisitions impact the comparability of TDS Telecom's operating results.



Table of Contents

|  |   |               |                                  |  |      |  |          |         |  |  |          |         |  |  |          |  |
|--|---|---------------|----------------------------------|--|------|--|----------|---------|--|--|----------|---------|--|--|----------|--|
| The following table summarizes customer connections for TDS Telecom’s Wireline and Cable operations: |   |               |                                  |  |      |  |          |         |  |  |          |         |  |  |          |  |
|  |   |               |                                  |  |      |  |          |         |  |  |          |         |  |  |          |  |
| As of or for the six months ended June 30,   |   |               |                                  |  | 2014 |  |          | 2013    |  |  | Change   |         |  |  |          |  |
| Wireline   |   |               |                                  |  |      |  |          |         |  |  |          |         |  |  |          |  |
| Residential connections  |   |               |                                  |  |      |  |          |         |  |  |          |         |  |  |          |  |
|  |   | Voice (1)     |                                  |  |      |  | 346,100  |         |  |  | 364,100  |         |  |  | (18,000) |  |
|  |   | Broadband (2) |                                  |  |      |  | 232,700  |         |  |  | 231,700  |         |  |  | 1,000    |  |
|  |   | IPTV (3)      |                                  |  |      |  | 18,200   |         |  |  | 10,500   |         |  |  | 7,700    |  |
|  |   |               | Wireline residential connections |  |      |  |          | 597,000 |  |  |          | 606,300 |  |  | (9,300)  |  |
|  |   |               |                                  |  |      |  |          |         |  |  |          |         |  |  |          |  |
|  | Total residential revenue per connection (4)  |               |                                  |  |      |  | \$ 40.92 |         |  |  | \$ 40.05 |         |  |  | \$ 0.87  |  |
|  |   |               |                                  |  |      |  |          |         |  |  |          |         |  |  |          |  |
| Commercial connections   |   |               |                                  |  |      |  |          |         |  |  |          |         |  |  |          |  |
|  |   | Voice (1)     |                                  |  |      |  | 206,200  |         |  |  | 229,100  |         |  |  | (22,900) |  |
|  |   | Broadband (2) |                                  |  |      |  | 26,000   |         |  |  | 28,200   |         |  |  | (2,200)  |  |
|  |   | managedIP (5) |                                  |  |      |  | 133,300  |         |  |  | 112,000  |         |  |  | 21,300   |  |
|  |   |               | Wireline commercial connections  |  |      |  |          | 365,500 |  |  |          | 369,300 |  |  | (3,800)  |  |
|  |   |               |                                  |  |      |  |          |         |  |  |          |         |  |  |          |  |
|  | Total Wireline connections  |               |                                  |  |      |  | 962,500  |         |  |  | 975,600  |         |  |  | (13,100) |  |
|  |   |               |                                  |  |      |  |          |         |  |  |          |         |  |  |          |  |
| Cable  |   |               |                                  |  |      |  |          |         |  |  |          |         |  |  |          |  |
| Cable connections  |   |               |                                  |  |      |  |          |         |  |  |          |         |  |  |          |  |
|  |   | Video (6)     |                                  |  |      |  | 69,700   |         |  |  |          |         |  |  |          |  |
|  |   | Broadband (7) |                                  |  |      |  | 63,200   |         |  |  |          |         |  |  |          |  |
|  |   | Voice (7)     |                                  |  |      |  | 17,800   |         |  |  |          |         |  |  |          |  |
|  |   |               | Cable connections                |  |      |  |          | 150,700 |  |  |          |         |  |  |          |  |
|  |   |               |                                  |  |      |  |          |         |  |  |          |         |  |  |          |  |
|  | Total residential revenue per connection (4)  |               |                                  |  |      |  | \$ 57.09 |         |  |  |          |         |  |  |          |  |
|  |   |               |                                  |  |      |  |          |         |  |  |          |         |  |  |          |  |
| (1)  | The individual circuit connecting customers to TDS Telecom’s central office facilities.   |               |                                  |  |      |  |          |         |  |  |          |         |  |  |          |  |
|  |   |               |                                  |  |      |  |          |         |  |  |          |         |  |  |          |  |
| (2)  | The number of customers provided high-capacity data circuits via various technologies, including DSL and dedicated internet circuit technologies. |               |                                  |  |      |  |          |         |  |  |          |         |  |  |          |  |
|  |   |               |                                  |  |      |  |          |         |  |  |          |         |  |  |          |  |
| (3)  | The number of customers provided video services using IP networking technology.   |               |                                  |  |      |  |          |         |  |  |          |         |  |  |          |  |
|  |   |               |                                  |  |      |  |          |         |  |  |          |         |  |  |          |  |
| (4)  | Total residential revenue divided by the average number of total residential connections.   |               |                                  |  |      |  |          |         |  |  |          |         |  |  |          |  |

|     |   |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|-----|---|--|--|--|--|--|--|--|--|--|--|--|--|--|--|--|
|     |   |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| (5) | The number of telephone handsets, data lines and IP trunks providing communications using IP networking technology.   |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|     |   |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| (6) | Generally, a home or business receiving video programming counts as one video connection. In counting bulk residential or commercial connections, such as an apartment building or a hotel, connections are counted based on the number of units/rooms within the building receiving service. |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|     |   |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| (7) | Broadband and voice connections reflect billable number of lines into a building for high speed data and voice services, respectively.  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

Table of Contents

|                                |                              |                                |  |  |      |         |  |      |         |  |        |          |  |        |            |
|--------------------------------|------------------------------|--------------------------------|--|--|------|---------|--|------|---------|--|--------|----------|--|--------|------------|
| TDS Telecom                    |                              |                                |  |  |      |         |  |      |         |  |        |          |  |        |            |
|                                |                              |                                |  |  |      |         |  |      |         |  |        |          |  |        |            |
| Components of Operating Income |                              |                                |  |  |      |         |  |      |         |  |        |          |  |        |            |
|                                |                              |                                |  |  |      |         |  |      |         |  |        |          |  |        |            |
|                                |                              |                                |  |  |      |         |  |      |         |  |        |          |  |        |            |
|                                |                              |                                |  |  |      |         |  |      |         |  |        |          |  |        | Percentage |
| Six Months Ended June 30,      |                              |                                |  |  | 2014 |         |  | 2013 |         |  | Change |          |  | Change |            |
| (Dollars in thousands)         |                              |                                |  |  |      |         |  |      |         |  |        |          |  |        |            |
| Operating revenues             |                              |                                |  |  |      |         |  |      |         |  |        |          |  |        |            |
|                                | Wireline                     |                                |  |  | \$   | 358,214 |  | \$   | 363,768 |  | \$     | (5,554)  |  | (2)    | %          |
|                                | Cable                        |                                |  |  |      | 44,987  |  |      | -       |  |        | 44,987   |  | N/M    |            |
|                                | HMS                          |                                |  |  |      | 131,044 |  |      | 76,938  |  |        | 54,106   |  | 70     | %          |
|                                | Intra-company elimination    |                                |  |  |      | (979)   |  |      | (185)   |  |        | (794)    |  | >(100) | %          |
|                                |                              | TDS Telecom operating revenues |  |  |      | 533,266 |  |      | 440,521 |  |        | 92,745   |  | 21     | %          |
|                                |                              |                                |  |  |      |         |  |      |         |  |        |          |  |        |            |
| Operating expenses             |                              |                                |  |  |      |         |  |      |         |  |        |          |  |        |            |
|                                | Wireline                     |                                |  |  |      | 309,219 |  |      | 334,958 |  |        | (25,739) |  | (8)    | %          |
|                                | Cable                        |                                |  |  |      | 44,420  |  |      | -       |  |        | 44,420   |  | N/M    |            |
|                                | HMS                          |                                |  |  |      | 143,347 |  |      | 85,425  |  |        | 57,922   |  | 68     | %          |
|                                | Intra-company elimination    |                                |  |  |      | (979)   |  |      | (185)   |  |        | (794)    |  | >(100) | %          |
|                                |                              | TDS Telecom operating expenses |  |  |      | 496,007 |  |      | 420,198 |  |        | 75,809   |  | 18     | %          |
|                                |                              |                                |  |  |      |         |  |      |         |  |        |          |  |        |            |
|                                | TDS Telecom operating income |                                |  |  | \$   | 37,259  |  | \$   | 20,323  |  | \$     | 16,936   |  | 83     | %          |
|                                |                              |                                |  |  |      |         |  |      |         |  |        |          |  |        |            |
| N/M - Not meaningful           |                              |                                |  |  |      |         |  |      |         |  |        |          |  |        |            |

|                                |             |                        |  |  |      |         |      |         |        |         |                   |      |   |  |  |
|--------------------------------|-------------|------------------------|--|--|------|---------|------|---------|--------|---------|-------------------|------|---|--|--|
| Wireline Operations            |             |                        |  |  |      |         |      |         |        |         |                   |      |   |  |  |
|                                |             |                        |  |  |      |         |      |         |        |         |                   |      |   |  |  |
| Components of Operating Income |             |                        |  |  |      |         |      |         |        |         |                   |      |   |  |  |
|                                |             |                        |  |  |      |         |      |         |        |         |                   |      |   |  |  |
| Six Months Ended June 30,      |             |                        |  |  | 2014 |         | 2013 |         | Change |         | Percentage Change |      |   |  |  |
| (Dollars in thousands)         |             |                        |  |  |      |         |      |         |        |         |                   |      |   |  |  |
| Service revenues               |             |                        |  |  |      |         |      |         |        |         |                   |      |   |  |  |
|                                | Residential |                        |  |  | \$   | 145,865 | \$   | 145,915 | \$     | (50)    |                   | -    |   |  |  |
|                                | Commercial  |                        |  |  |      | 115,452 |      | 114,253 |        | 1,199   |                   | 1    | % |  |  |
|                                | Wholesale   |                        |  |  |      | 95,913  |      | 101,938 |        | (6,025) |                   | (6)  | % |  |  |
|                                |             | Total service revenues |  |  |      | 357,230 |      | 362,106 |        | (4,876) |                   | (1)  | % |  |  |
| Equipment and product sales    |             |                        |  |  |      | 984     |      | 1,662   |        | (678)   |                   | (41) | % |  |  |

|  |  |  |  |  |  |           |  |  |           |  |  |           |      |   |
|--|--|--|--|--|--|-----------|--|--|-----------|--|--|-----------|------|---|
|  |  |  | Total operating revenues                 |  |  | 358,214   |  |  | 363,768   |  |  | (5,554)   | (2)  | % |
|  |  |  |  |  |  |           |  |  |           |  |  |           |      |   |
|  |  |  | Cost of services (excluding              |  |  |           |  |  |           |  |  |           |      |   |
|  |  |  | Depreciation, amortization and           |  |  |           |  |  |           |  |  |           |      |   |
|  |  |  | accretion reported below)                |  |  | 128,705   |  |  | 132,168   |  |  | (3,463)   | (3)  | % |
|  |  |  | Cost of equipment and products           |  |  | 964       |  |  | 2,104     |  |  | (1,140)   | (54) | % |
|  |  |  | Selling, general and administrative      |  |  | 94,228    |  |  | 114,072   |  |  | (19,844)  | (17) | % |
|  |  |  | Depreciation, amortization and accretion |  |  | 84,563    |  |  | 87,216    |  |  | (2,653)   | (3)  | % |
|  |  |  | (Gain) loss on asset disposals, net      |  |  | 759       |  |  | (602)     |  |  | 1,361     | >100 | % |
|  |  |  | Total operating expenses                 |  |  | 309,219   |  |  | 334,958   |  |  | (25,739)  | (8)  | % |
|  |  |  | Total operating                          |  |  |           |  |  |           |  |  |           |      |   |
|  |  |  | income                                   |  |  | \$ 48,995 |  |  | \$ 28,810 |  |  | \$ 20,185 | 70   | % |

## Operating Revenues

**Residential revenues** consist of voice, data and video services to TDS Telecom's Wireline residential customer base.

Residential revenues were unchanged from the prior year at \$145.9 million in 2014. Legacy voice connections declined by 5% decreasing revenues by \$4.1 million, while IPTV connections grew 75% increasing revenues \$2.7 million. A 2% increase in average revenue per residential connection driven by price increases for broadband services, growth in customers opting for faster broadband speeds and growth in customers selecting higher tier IPTV packages increased revenues \$2.1 million.

## Table of Contents

**Commercial revenues** consist of data and voice services and sales and installation of IP-based telecommunication systems to TDS Telecom's Wireline commercial customer base.

Commercial revenues increased \$1.2 million or 1% to \$115.5 million in 2014. A 25% growth in average managed IP connections and a 1% increase in average revenue per connection increased commercial revenue, offsetting decreases in revenue from declining legacy voice and data connections.

**Wholesale revenues** represent compensation from other carriers for utilizing TDS Telecom's network infrastructure and regulatory recoveries.

Wholesale revenues decreased \$6.0 million or 6% to \$95.9 million. Revenues received through inter-state and intra-state regulatory recovery mechanisms decreased \$3.6 million. Wholesale revenues declined \$1.4 million due to a 12% reduction in minutes-of-use.

## **Operating Expenses**

### ***Cost of services (excluding Depreciation, amortization and accretion)***

Cost of services decreased \$3.5 million or 3% to \$128.7 million in 2014. Employee expenses decreased by \$2.4 million while reductions in costs of providing long-distance services and fewer promotional giveaways reduced expense by \$2.9 million. Charges related to the growth in IPTV increased cost of services \$1.9 million.

### ***Selling, general and administrative expenses***

Selling, general and administrative expenses decreased \$19.8 million or 17% to \$94.2 million in 2014 due to cost control efforts. Employee expenses decreased \$11.1 million and consulting and IT maintenance charges decreased \$2.5 million and \$1.7 million, respectively.

### ***Depreciation, amortization and accretion***

Depreciation, amortization and accretion expense decreased \$2.7 million or 3% to \$84.6 million in 2014 due primarily to depreciation being fully recognized on some assets.

|  |             |  |                          |                               |    |             |        |
|--|-------------|--|--------------------------|-------------------------------|----|-------------|--------|
| <b>Cable Operations</b>  |             |  |                          |                               |    |             |        |
|  |             |  |                          |                               |    |             |        |
| <b>Components of Operating Income</b>  |             |  |                          |                               |    |             |        |
|  |             |  |                          |                               |    |             |        |
| <b>Six Months Ended June 30,</b>   |             |  |                          |                               |    | <b>2014</b> |        |
| (Dollars in thousands)   |             |  |                          |                               |    |             |        |
| Service revenues   |             |  |                          |                               |    |             |        |
|  | Residential |  |                          |                               | \$ |             | 36,475 |
|  | Commercial  |  |                          |                               |    |             | 8,512  |
|  |             |  | Total operating revenues |                               |    |             | 44,987 |
|  |             |  |                          |                               |    |             |        |
| Cost of services (excluding Depreciation, amortization and accretion reported below) |             |  |                          |                               |    |             | 22,349 |
| Selling, general and administrative  |             |  |                          |                               |    |             | 12,663 |
| Depreciation, amortization and accretion   |             |  |                          |                               |    |             | 8,918  |
| (Gain) loss on asset disposals, net  |             |  |                          |                               |    |             | 490    |
|  |             |  | Total operating expenses |                               |    |             | 44,420 |
|  |             |  |                          | Total operating income (loss) | \$ |             | 567    |

## Operating Revenues

**Residential revenues** consist of video, broadband and voice services to TDS Telecom's Cable residential customer base.

At June 30, 2014, residential customer connections were 107,200, generating revenues of \$36.5 million in 2014.

**Commercial revenues** consist of video, broadband and voice services to TDS Telecom's Cable commercial customer base.

At June 30, 2014, commercial customer connections were 43,500, generating revenues of \$8.5 million in 2014.



Table of Contents**Operating Expenses*****Cost of services (excluding Depreciation, amortization and accretion)***

Cost of services (excluding Depreciation, amortization and accretion) of \$22.3 million were incurred in 2014 primarily for programming costs and expenses related to the delivery and support of services.

***Selling, general and administrative expenses***

Selling, general and administrative expenses of \$12.7 million were incurred primarily for product management, marketing, customer service, and general administration in 2014.

***Depreciation, amortization and accretion expense***

Depreciation, amortization and accretion expense was \$8.9 million. Amortization of the acquired customer list and trade name contributed \$2.7 million to the expense in 2014.

|  |  |  |  |    |             |    |             |    |               |  |                   |   |  |
|--|--|--|--|----|-------------|----|-------------|----|---------------|--|-------------------|---|--|
| <b>HMS Operations</b>                        |  |  |  |    |             |    |             |    |               |  |                   |   |  |
|  |  |  |  |    |             |    |             |    |               |  |                   |   |  |
| <b>Components of Operating Income (Loss)</b> |  |  |  |    |             |    |             |    |               |  |                   |   |  |
|  |  |  |  |    |             |    |             |    |               |  |                   |   |  |
| <b>Six Months Ended June 30,</b>             |  |  |  |    | <b>2014</b> |    | <b>2013</b> |    | <b>Change</b> |  | <b>Percentage</b> |   |  |
| (Dollars in thousands)                       |  |  |  |    |             |    |             |    |               |  |                   |   |  |
| Service revenues                             |  |  |  | \$ | 54,951      | \$ | 45,205      | \$ | 9,746         |  | 22                | % |  |
| Equipment and product sales                  |  |  |  |    | 76,093      |    | 31,733      |    | 44,360        |  | >100              | % |  |
| Total operating revenues                     |  |  |  |    | 131,044     |    | 76,938      |    | 54,106        |  | 70                | % |  |
|  |  |  |  |    |             |    |             |    |               |  |                   |   |  |
| Cost of services (excluding                  |  |  |  |    |             |    |             |    |               |  |                   |   |  |
| Depreciation, amortization and accretion     |  |  |  |    |             |    |             |    |               |  |                   |   |  |
| reported below)                              |  |  |  |    | 38,247      |    | 28,673      |    | 9,574         |  | 33                | % |  |



|  |  |  |             |  |            |  |            |  |      |   |
|--|--|--|-------------|--|------------|--|------------|--|------|---|
| Cost of equipment and products           |  |  | 64,342      |  | 26,326     |  | 38,016     |  | >100 | % |
| Selling, general and administrative      |  |  | 27,211      |  | 19,282     |  | 7,929      |  | 41   | % |
| Depreciation, amortization and accretion |  |  | 13,469      |  | 11,031     |  | 2,438      |  | 22   | % |
| (Gain) loss on asset disposals, net      |  |  | 78          |  | 113        |  | (35)       |  | (31) | % |
| Total operating expenses                 |  |  | 143,347     |  | 85,425     |  | 57,922     |  | 68   | % |
| Total operating income (loss)            |  |  | \$ (12,303) |  | \$ (8,487) |  | \$ (3,816) |  | (45) | % |

## Operating Revenues

**Service revenues** consist primarily of colocation, cloud computing and hosted managed services, application management, and installation and management of IT infrastructure hardware solutions.

Service revenues increased \$9.7 million or 22% to \$55.0 million in 2014. The acquisition of MSN in October of 2013 contributed \$6.8 million of this increase with the remaining increase due primarily to growth in colocation, dedicated hosting, hosted application management and cloud computing services of \$2.9 million or 8%.

**Equipment and product sales revenues** include revenues from sales of IT infrastructure hardware solutions.

Equipment and product sales revenues increased \$44.4 million to \$76.1 million in 2014 due to the acquisition of MSN.

## Operating Expenses

### *Cost of services (excluding Depreciation, amortization and accretion)*

Cost of services increased \$9.6 million to \$38.2 million in 2014 due primarily to \$5.4 million from the acquisition of MSN and increases in employee related expenses, data center maintenance and software costs to support growth in customer services.



Table of Contents

***Cost of equipment and products***

Cost of equipment and products increased \$38.0 million to \$64.3 million in 2014 due to the acquisition of MSN.

***Selling, general and administrative expense***

Selling, general and administrative expense increased \$7.9 million to \$27.2 million in 2014 due primarily to \$7.4 million from the acquisition of MSN.

***Depreciation, amortization and accretion expense***

Depreciation, amortization and accretion expense increased \$2.4 million to \$13.5 million due to customer list amortization from the MSN acquisition and depreciation on capital additions.

Table of Contents**Three Months Ended June 30, 2014 Compared to Three Months Ended June 30, 2013****RESULTS OF OPERATIONS — CONSOLIDATED**

|  |   |      |           |      |           |        |           |        |        | Percentage |  |
|--|---|------|-----------|------|-----------|--------|-----------|--------|--------|------------|--|
| Three Months Ended June 30,                      |   | 2014 |           | 2013 |           | Change |           | Change |        |            |  |
| (Dollars in thousands, except per share amounts) |   |      |           |      |           |        |           |        |        |            |  |
| <b>Operating revenues</b>                        |   |      |           |      |           |        |           |        |        |            |  |
|  | U.S. Cellular                                 | \$   | 957,773   | \$   | 995,130   | \$     | (37,357)  |        | (4)    | %          |  |
|  | TDS Telecom                                   |      | 270,850   |      | 223,460   |        | 47,390    |        | 21     | %          |  |
|  | All other (1)                                 |      | 7,769     |      | 9,576     |        | (1,807)   |        | (19)   | %          |  |
|  | Total operating revenues                      |      | 1,236,392 |      | 1,228,166 |        | 8,226     |        | 1      | %          |  |
| <b>Operating expenses</b>                        |   |      |           |      |           |        |           |        |        |            |  |
|  | U.S. Cellular                                 |      | 1,008,080 |      | 776,038   |        | 232,042   |        | 30     | %          |  |
|  | TDS Telecom                                   |      | 251,585   |      | 211,028   |        | 40,557    |        | 19     | %          |  |
|  | All other (1)(2)                              |      | 25,817    |      | (41,127)  |        | 66,944    |        | >100   | %          |  |
|  | Total operating expenses                      |      | 1,285,482 |      | 945,939   |        | 339,543   |        | 36     | %          |  |
| <b>Operating income (loss)</b>                   |   |      |           |      |           |        |           |        |        |            |  |
|  | U.S. Cellular                                 |      | (50,307)  |      | 219,092   |        | (269,399) |        | >(100) | %          |  |
|  | TDS Telecom                                   |      | 19,265    |      | 12,432    |        | 6,833     |        | 55     | %          |  |
|  | All other (1)(2)                              |      | (18,048)  |      | 50,703    |        | (68,751)  |        | >(100) | %          |  |
|  | Total operating income (loss)                 |      | (49,090)  |      | 282,227   |        | (331,317) |        | >(100) | %          |  |
| <b>Other income and (expenses)</b>               |   |      |           |      |           |        |           |        |        |            |  |
|  | Equity in earnings of unconsolidated entities |      | 34,790    |      | 35,605    |        | (815)     |        | (2)    | %          |  |
|  | Interest and dividend income                  |      | 2,751     |      | 2,600     |        | 151       |        | 6      | %          |  |
|  | Gain (loss) on investments                    |      | -         |      | 14,518    |        | (14,518)  |        | N/M    |            |  |
|  | Interest expense                              |      | (27,898)  |      | (23,749)  |        | (4,149)   |        | 17     | %          |  |
|  | Other, net                                    |      | 50        |      | (197)     |        | 247       |        | >100   | %          |  |
|  | Total investment and other income (expense)   |      | 9,693     |      | 28,777    |        | (19,084)  |        | (66)   | %          |  |
| <b>Income (loss) before income taxes</b>         |   |      | (39,397)  |      | 311,004   |        | (350,401) |        | >(100) | %          |  |
|  | Income tax expense (benefit)                  |      | (13,671)  |      | 132,607   |        | (146,278) |        | >(100) | %          |  |
| <b>Net income (loss)</b>                         |   |      | (25,726)  |      | 178,397   |        | (204,123) |        | >(100) | %          |  |
|  |   |      | (3,688)   |      | 22,320    |        | (26,008)  |        | >(100) | %          |  |

[illegible]

Table of Contents

**Operating Revenues and Expenses**

See “Results of Operations — U.S. Cellular” and “Results of Operations — TDS Telecom” below for factors that affected consolidated Operating Revenues and Expenses.

**Equity in earnings of unconsolidated entities**

TDS’ investment in the LA Partnership contributed \$18.4 million and \$19.8 million to Equity in earnings of unconsolidated entities in 2014 and 2013, respectively.

**Gain (loss) on investments**

Gain (loss) on investments in 2013 reflects a gain of \$14.5 million as a result of TDS’ deconsolidation of NY1 & NY2 in April 2013.

**Interest expense**

The increase in interest expense was due primarily to a decrease in capitalized interest related to network and systems projects. Interest cost capitalized was \$2.0 million and \$6.4 million for 2014 and 2013, respectively.

**Income tax expense (benefit)**

See Note 3 — Income Taxes in the Notes to Consolidated Financial Statements for a discussion overall effective tax rate on Income (loss) before income taxes.

**Net income (loss) attributable to noncontrolling interests, net of tax**

Net income (loss) attributable to noncontrolling interests, net of tax includes the noncontrolling public shareholders' share of U.S. Cellular's net income (loss) and the noncontrolling shareholders' or partners' share of certain TDS or U.S. Cellular subsidiaries' net income or loss.

|  |   |  |  | Three Months Ended |         |           |
|--|---|--|--|--------------------|---------|-----------|
|  |   |  |  | June 30,           |         |           |
|  |   |  |  | 2014               |         | 2013      |
| <b>(Dollars in thousands)</b>  |   |  |  |                    |         |           |
| Net income (loss) attributable to noncontrolling interests, net of tax |   |  |  |                    |         |           |
|  | U.S. Cellular noncontrolling public shareholders' |  |  | \$                 | (3,014) | \$ 22,340 |
|  | Noncontrolling shareholders' or partners'         |  |  |                    | (674)   | (20)      |
|  |   |  |  | \$                 | (3,688) | \$ 22,320 |

Table of Contents**RESULTS OF OPERATIONS — U.S. CELLULAR**

| <b>Components of Operating Income (Loss)</b>  |    |             |    |             |    |               |         |                          |  |
|---|----|-------------|----|-------------|----|---------------|---------|--------------------------|--|
|   |    |             |    |             |    |               |         |                          |  |
| <b>Three Months Ended June 30,</b>  |    | <b>2014</b> |    | <b>2013</b> |    | <b>Change</b> |         | <b>Percentage Change</b> |  |
| <b>(Dollars in thousands)</b>   |    |             |    |             |    |               |         |                          |  |
| Retail service  | \$ | 746,117     | \$ | 802,408     | \$ | (56,291)      | (7)%    |                          |  |
| Inbound roaming   |    | 57,580      |    | 65,033      |    | (7,453)       | (11)%   |                          |  |
| Other   |    | 39,776      |    | 43,525      |    | (3,749)       | (9)%    |                          |  |
| Service revenues  |    | 843,473     |    | 910,966     |    | (67,493)      | (7)%    |                          |  |
| Equipment sales   |    | 114,300     |    | 84,164      |    | 30,136        | 36%     |                          |  |
| Total operating revenues  |    | 957,773     |    | 995,130     |    | (37,357)      | (4)%    |                          |  |
| System operations (excluding Depreciation, amortization and accretion reported below) |    | 187,131     |    | 192,267     |    | (5,136)       | (3)%    |                          |  |
| Cost of equipment sold  |    | 271,978     |    | 217,070     |    | 54,908        | 25%     |                          |  |
| Selling, general and administrative   |    | 404,252     |    | 404,127     |    | 125           | -       |                          |  |
| Depreciation, amortization and accretion  |    | 148,337     |    | 202,580     |    | (54,243)      | (27)%   |                          |  |
| (Gain) loss on asset disposals, net   |    | 6,893       |    | 9,018       |    | (2,125)       | (24)%   |                          |  |
| (Gain) loss on sale of business and other exit costs, net                             |    | (10,511)    |    | (249,024)   |    | 238,513       | 96%     |                          |  |
| Total operating expenses  |    | 1,008,080   |    | 776,038     |    | 232,042       | 30%     |                          |  |
| Operating income (loss)   | \$ | (50,307)    | \$ | 219,092     | \$ | (269,399)     | >(100)% |                          |  |

**Operating Revenues*****Retail service revenues***

Retail service revenues decreased \$56.3 million, or 7%, to \$746.1 million in 2014 due primarily to a decrease in U.S. Cellular's average customer base (including the reductions caused by the Divestiture Transaction) partially offset by an increase in billed ARPU.



Billed ARPU increased to \$53.36 in 2014 compared to \$50.60 in 2013. The overall increase is due primarily to an increase in postpaid ARPU to \$56.82 in 2014 from \$54.18 in 2013, reflecting increases in smartphone adoption and corresponding revenues from data products and services.

***Inbound roaming revenues***

Inbound roaming revenues decreased by \$7.5 million, or 11%, to \$57.6 million in 2014 compared to 2013. The decrease was due in part to a \$3.4 million impact related to the Divestiture Transaction. The remaining decrease in the Core Markets was due to a decrease in rates and a decline in voice volume, partially offset by higher data usage.

***Other revenues***

Other revenues decreased by \$3.7 million, or 9%, to \$39.8 million, due primarily to a \$6.4 million decrease in ETC revenues. ETC revenues decreased due to the phase down of USF support as described in Results of Operations – U.S. Cellular for the six months ended June 30, 2014.

***Equipment sales revenues***

Equipment sales revenues increased by \$30.1 million, or 36%, in 2014 to \$114.3 million. The increase was due primarily to activity in the Core Markets, which reflected an increase in the average revenue per device sold (including the impact of sales under equipment installment plans), partially offset by the sale of fewer devices, primarily in the feature phone category. The increase in equipment sales revenues in the Core Markets was partially offset by the effects of the Divestiture Transaction.

Table of Contents

**Operating Expenses**

***System operations expenses (excluding Depreciation, amortization and accretion)***

Key components of the \$5.1 million, or 3%, decrease to \$187.1 million were as follows:

- Customer usage expense decreased \$6.8 million, or 11%, driven by the impacts of the Divestiture Transaction and lower fees for platform and content providers.
- Maintenance, utility and cell site expenses decreased \$1.1 million, or 1%, due primarily to the impacts of the Divestiture Transaction and lower headcount, partially offset by costs related to 4G LTE support.
- Expenses incurred when U.S. Cellular's customers used other carriers' networks while roaming increased \$2.7 million, or 7%, due primarily to an increase in data usage, partially offset by a decrease in voice usage, lower rates, and the impacts of the Divestiture Transaction.

***Cost of equipment sold***

Cost of equipment sold increased by \$54.9 million, or 25%, to \$272.0 million in 2014 due primarily to an increase of 34% in the average cost per device sold due to general customer preference for higher-priced 4G LTE smartphones. The increase in average cost per device sold was partially offset by fewer device sales in the Core Markets and impacts of the Divestiture Transaction.

***Selling, general and administrative expenses***

Selling, general and administrative expenses were essentially flat year over year. Key components of Selling, general and administrative expenses were as follows:

- Selling and marketing expense increased by \$2.5 million, or 1%, due primarily to an increase in commission and personnel expenses, partially offset by the effects of the Divestiture Transaction.
- General and administrative expense decreased by \$2.4 million, or 1%, due primarily to the Divestiture Transaction and lower consulting expenses related to the billing system conversion in the prior year, offset by an increase in bad debts expense.

***Depreciation, amortization and accretion***

Depreciation, amortization and accretion decreased \$54.2 million, or 27%, in 2014 to \$148.3 million due primarily to the higher amount of accelerated depreciation, amortization and accretion in the Divestiture Markets that occurred in 2013. The impact of the acceleration was \$50.3 million in 2013.

***(Gain) loss on asset disposals, net***

(Gain) loss on asset disposals, net was a loss in both 2014 and 2013 due primarily to the write-off and disposals of certain network assets.

***(Gain) loss on sale of business and other exit costs, net***

The net gain in both 2014 and 2013 resulted from the Divestiture Transaction. See Note 5 — Acquisitions, Divestitures and Exchanges in the Notes to Consolidated Financial Statements for additional information.

Table of Contents

| RESULTS OF OPERATIONS — TDS TELECOM |                           |                                |  |  |  |      |         |  |      |         |  |        |          |            |        |
|-------------------------------------|---------------------------|--------------------------------|--|--|--|------|---------|--|------|---------|--|--------|----------|------------|--------|
|                                     |                           |                                |  |  |  |      |         |  |      |         |  |        |          |            |        |
| TDS Telecom                         |                           |                                |  |  |  |      |         |  |      |         |  |        |          |            |        |
|                                     |                           |                                |  |  |  |      |         |  |      |         |  |        |          |            |        |
| Components of Operating Income      |                           |                                |  |  |  |      |         |  |      |         |  |        |          |            |        |
|                                     |                           |                                |  |  |  |      |         |  |      |         |  |        |          |            |        |
|                                     |                           |                                |  |  |  |      |         |  |      |         |  |        |          | Percentage |        |
| Three months ended June 30,         |                           |                                |  |  |  | 2014 |         |  | 2013 |         |  | Change |          |            | Change |
| (Dollars in thousands)              |                           |                                |  |  |  |      |         |  |      |         |  |        |          |            |        |
| Operating revenues                  |                           |                                |  |  |  |      |         |  |      |         |  |        |          |            |        |
|                                     | Wireline                  |                                |  |  |  | \$   | 180,728 |  | \$   | 182,193 |  | \$     | (1,465)  | (1)        | %      |
|                                     | Cable                     |                                |  |  |  |      | 22,484  |  |      | -       |  |        | 22,484   | N/M        |        |
|                                     | HMS                       |                                |  |  |  |      | 67,936  |  |      | 41,374  |  |        | 26,562   | 64         | %      |
|                                     | Intra-company elimination |                                |  |  |  |      | (298)   |  |      | (107)   |  |        | (191)    | >(100)     | %      |
|                                     |                           | TDS Telecom operating revenues |  |  |  |      | 270,850 |  |      | 223,460 |  |        | 47,390   | 21         | %      |
|                                     |                           |                                |  |  |  |      |         |  |      |         |  |        |          |            |        |
| Operating expenses                  |                           |                                |  |  |  |      |         |  |      |         |  |        |          |            |        |
|                                     | Wireline                  |                                |  |  |  |      | 154,835 |  |      | 165,943 |  |        | (11,108) | (7)        | %      |
|                                     | Cable                     |                                |  |  |  |      | 22,661  |  |      | -       |  |        | 22,661   | N/M        |        |
|                                     | HMS                       |                                |  |  |  |      | 74,387  |  |      | 45,192  |  |        | 29,195   | 65         | %      |
|                                     | Intra-company elimination |                                |  |  |  |      | (298)   |  |      | (107)   |  |        | (191)    | >(100)     | %      |
|                                     |                           | TDS Telecom operating expenses |  |  |  |      | 251,585 |  |      | 211,028 |  |        | 40,557   | 19         | %      |
|                                     |                           |                                |  |  |  |      |         |  |      |         |  |        |          |            |        |
| TDS Telecom operating income        |                           |                                |  |  |  | \$   | 19,265  |  | \$   | 12,432  |  | \$     | 6,833    | 55         | %      |
|                                     |                           |                                |  |  |  |      |         |  |      |         |  |        |          |            |        |
| N/M - Not meaningful                |                           |                                |  |  |  |      |         |  |      |         |  |        |          |            |        |

|                                |             |  |  |  |      |        |      |        |        |     |  |   |  |  |            |   |
|--------------------------------|-------------|--|--|--|------|--------|------|--------|--------|-----|--|---|--|--|------------|---|
| Wireline Operations            |             |  |  |  |      |        |      |        |        |     |  |   |  |  |            |   |
|                                |             |  |  |  |      |        |      |        |        |     |  |   |  |  |            |   |
| Components of Operating Income |             |  |  |  |      |        |      |        |        |     |  |   |  |  |            |   |
|                                |             |  |  |  |      |        |      |        |        |     |  |   |  |  |            |   |
|                                |             |  |  |  |      |        |      |        |        |     |  |   |  |  | Percentage |   |
| Three months ended June 30,    |             |  |  |  | 2014 |        | 2013 |        | Change |     |  |   |  |  | Change     |   |
| (Dollars in thousands)         |             |  |  |  |      |        |      |        |        |     |  |   |  |  |            |   |
| Service revenues               |             |  |  |  |      |        |      |        |        |     |  |   |  |  |            |   |
|                                | Residential |  |  |  | \$   | 73,360 | \$   | 72,911 | \$     | 449 |  | 1 |  |  |            | % |

Edgar Filing: TELEPHONE & DATA SYSTEMS INC /DE/ - Form 10-Q

|  |                          |  |  |           |  |           |  |          |  |      |   |
|--|--------------------------|--|--|-----------|--|-----------|--|----------|--|------|---|
|  | Commercial               |  |  | 57,472    |  | 57,128    |  | 344      |  | 1    | % |
|  | Wholesale                |  |  | 49,465    |  | 51,389    |  | (1,924)  |  | (4)  | % |
|  | Total service revenues   |  |  | 180,297   |  | 181,428   |  | (1,131)  |  | (1)  | % |
| Equipment and product sales              |                          |  |  | 431       |  | 765       |  | (334)    |  | (44) | % |
|  | Total operating revenues |  |  | 180,728   |  | 182,193   |  | (1,465)  |  | (1)  | % |
|  |                          |  |  |           |  |           |  |          |  |      |   |
| Cost of services (excluding              |                          |  |  |           |  |           |  |          |  |      |   |
| Depreciation, amortization and accretion |                          |  |  |           |  |           |  |          |  |      |   |
| reported below)                          |                          |  |  | 64,305    |  | 65,729    |  | (1,424)  |  | (2)  | % |
| Cost of equipment and products           |                          |  |  | 481       |  | 1,094     |  | (613)    |  | (56) | % |
| Selling, general and administrative      |                          |  |  | 47,708    |  | 56,692    |  | (8,984)  |  | (16) | % |
| Depreciation, amortization and accretion |                          |  |  | 41,827    |  | 43,193    |  | (1,366)  |  | (3)  | % |
| (Gain) loss on asset disposals, net      |                          |  |  | 514       |  | (765)     |  | 1,279    |  | >100 | % |
|  | Total operating expenses |  |  | 154,835   |  | 165,943   |  | (11,108) |  | (7)  | % |
|  | Total operating income   |  |  | \$ 25,893 |  | \$ 16,250 |  | \$ 9,643 |  | 59   | % |

Table of Contents

**Operating Revenues**

***Residential revenues***

Residential revenues grew 1% in 2014. An increase in revenue resulting from a 2% growth in average revenue per residential connections was partially offset by a decrease in revenue from a 2% reduction in average residential connections.

***Commercial revenues***

Commercial revenues grew 1% to \$57.5 million in 2014 due primarily to growth in managedIP revenues resulting from both a 22% increase in average managedIP connections and a 3% increase in average revenue per connection offsetting a decrease in revenue from a 10% decline in average voice connections.

***Wholesale revenues***

Wholesale revenues decreased \$1.9 million or 4% to \$49.5 million. Wholesale revenues declined \$0.7 million due to a 13% reduction in minutes-of-use. Revenues received through inter-state and intra-state regulatory mechanisms decreased \$0.8 million.

**Operating Expenses**

***Cost of services (excluding Depreciation, amortization and accretion)***

Cost of services decreased \$1.4 million or 2% to \$64.3 million in 2014. Decreases in employee expenses, cost of providing long distance services and promotional giveaways were partially offset by increased costs associated with the provisioning of IPTV.

***Selling, general and administrative expenses***

Selling, general and administrative expenses decreased \$9.0 million or 16% to \$47.7 million in 2014 due to cost control efforts which decreased employee related expenses \$5.1 million, consulting \$1.3 million and IT maintenance charges \$0.5 million.

|  |             |  |                               |    |             |        |
|--|-------------|--|-------------------------------|----|-------------|--------|
| <b>Cable Operations</b>  |             |  |                               |    |             |        |
|  |             |  |                               |    |             |        |
| <b>Components of Operating Income</b>  |             |  |                               |    |             |        |
|  |             |  |                               |    |             |        |
| <b>Three months ended June 30,</b>   |             |  |                               |    | <b>2014</b> |        |
| <b>(Dollars in thousands)</b>  |             |  |                               |    |             |        |
| Service revenues   |             |  |                               |    |             |        |
|  | Residential |  |                               | \$ |             | 18,222 |
|  | Commercial  |  |                               |    |             | 4,262  |
|  |             |  | Total operating revenues      |    |             | 22,484 |
|  |             |  |                               |    |             |        |
| Cost of services (excluding Depreciation, amortization and accretion reported below) |             |  |                               |    |             | 11,394 |
| Selling, general and administrative  |             |  |                               |    |             | 6,285  |
| Depreciation, amortization and accretion   |             |  |                               |    |             | 4,557  |
| (Gain) loss on asset disposals, net  |             |  |                               |    |             | 425    |
|  |             |  | Total operating expenses      |    |             | 22,661 |
|  |             |  |                               |    |             |        |
|  |             |  | Total operating income (loss) | \$ |             | (177)  |

**Operating Revenues*****Residential revenues***

At June 30, 2014, residential customer connections were 107,200, generating revenues of \$18.2 million in the quarter.

***Commercial revenues***

At June 30, 2014, commercial customer connections were 43,500, generating revenues of \$4.3 million in the quarter.





Table of Contents**Operating Expenses*****Cost of services (excluding Depreciation, amortization and accretion)***

Cost of services (excluding Depreciation, amortization and accretion) of \$11.4 million were incurred for programming costs and expenses related to the delivery and support of products in 2014.

***Selling, general and administrative expenses***

Selling, general and administrative expenses of \$6.3 million were incurred primarily for product management, marketing, customer service, and general administration in 2014.

***Depreciation, amortization and accretion expense***

Depreciation, amortization and accretion expense was \$4.6 million in 2014. Amortization of customer list and trade name contributed \$1.4 million of this expense.

|  |  |  |  |             |        |             |        |               |        |                   |      |   |  |
|--|--|--|--|-------------|--------|-------------|--------|---------------|--------|-------------------|------|---|--|
| <b>HMS Operations</b>                    |  |  |  |             |        |             |        |               |        |                   |      |   |  |
|  |  |  |  |             |        |             |        |               |        |                   |      |   |  |
| <b>Components of Operating Income</b>    |  |  |  |             |        |             |        |               |        |                   |      |   |  |
|  |  |  |  |             |        |             |        |               |        |                   |      |   |  |
| <b>Three months ended June 30,</b>       |  |  |  | <b>2014</b> |        | <b>2013</b> |        | <b>Change</b> |        | <b>Percentage</b> |      |   |  |
| <b>(Dollars in thousands)</b>            |  |  |  |             |        |             |        |               |        |                   |      |   |  |
| Service revenues                         |  |  |  | \$          | 27,575 | \$          | 23,205 | \$            | 4,370  |                   | 19   | % |  |
| Equipment and product sales              |  |  |  |             | 40,361 |             | 18,169 |               | 22,192 |                   | >100 | % |  |
| Total operating revenues                 |  |  |  |             | 67,936 |             | 41,374 |               | 26,562 |                   | 64   | % |  |
|  |  |  |  |             |        |             |        |               |        |                   |      |   |  |
| Cost of services (excluding              |  |  |  |             |        |             |        |               |        |                   |      |   |  |
| Depreciation, amortization and accretion |  |  |  |             |        |             |        |               |        |                   |      |   |  |
| reported below)                          |  |  |  |             | 21,301 |             | 15,071 |               | 6,230  |                   | 41   | % |  |

|  |  |  |            |  |  |            |  |  |            |  |      |   |
|--|--|--|------------|--|--|------------|--|--|------------|--|------|---|
| Cost of equipment and products           |  |  | 33,875     |  |  | 15,114     |  |  | 18,761     |  | >100 | % |
| Selling, general and administrative      |  |  | 12,376     |  |  | 9,361      |  |  | 3,015      |  | 32   | % |
| Depreciation, amortization and accretion |  |  | 6,791      |  |  | 5,563      |  |  | 1,228      |  | 22   | % |
| (Gain) loss on asset disposals, net      |  |  | 44         |  |  | 83         |  |  | (39)       |  | (47) | % |
| Total operating expenses                 |  |  | 74,387     |  |  | 45,192     |  |  | 29,195     |  | 65   | % |
| Total operating income (loss)            |  |  | \$ (6,451) |  |  | \$ (3,818) |  |  | \$ (2,633) |  | (69) | % |

## Operating Revenues

### *Service revenues*

Service revenues increased \$4.4 million or 19% to \$27.6 million in 2014. The acquisition of MSN contributed \$3.3 million of this increase with the remaining increase due primarily to growth in colocation, dedicated hosting, hosted application management and cloud computing services of \$1.3 million or 7%.

### *Equipment and product sales revenues*

Equipment and product sales revenues increased \$22.2 million to \$40.4 million in 2014 due to the acquisition of MSN.

## Operating Expenses

### *Cost of services (excluding Depreciation, amortization and accretion)*

Cost of services increased \$6.2 million to \$21.3 million in 2014 due to \$2.6 million from the acquisition of MSN and increases in employee related expenses, data center maintenance and software costs to support growth in customer services.

### *Cost of equipment and products*

Cost of equipment and products increased \$18.8 million to \$33.9 million in 2014 due to the acquisition of MSN.



Table of Contents***Selling, general and administrative expense***

Selling, general and administrative expense increased \$3.0 million to \$12.4 million in 2014 due to the acquisition of MSN.

***Depreciation, amortization and accretion expense***

Depreciation, amortization and accretion expense increased \$1.2 million to \$6.8 million due to customer list amortization from the MSN acquisition and depreciation on capital additions.

**RECENT ACCOUNTING PRONOUNCEMENTS**

See Note 1 — Basis of Presentation in the Notes to Consolidated Financial Statements for information on recent accounting pronouncements.

**FINANCIAL RESOURCES**

TDS operates a capital- and marketing-intensive business. TDS utilizes cash on hand, cash from operating activities, cash proceeds from divestitures and disposition of investments, short-term credit facilities and long-term debt financing to fund its acquisitions (including licenses), construction costs, operating expenses and share repurchases. Cash flows may fluctuate from quarter to quarter and year to year due to seasonality, the timing of acquisitions, capital expenditures and other factors. The table below and the following discussion in this Financial Resources section summarize TDS' cash flow activities for the six months ended June 30, 2014 and 2013.

|                               |   | <b>2014</b> |           | <b>2013</b> |           |
|-------------------------------|---|-------------|-----------|-------------|-----------|
| <b>(Dollars in thousands)</b> |   |             |           |             |           |
| Cash flows from (used in):    |   |             |           |             |           |
|                               | Operating activities                      | \$          | 315,642   | \$          | 521,492   |
|                               | Investing activities                      |             | (218,963) |             | 110,696   |
|                               | Financing activities                      |             | (51,833)  |             | (126,254) |
|                               | Net increase in cash and cash equivalents | \$          | 44,846    | \$          | 505,934   |

### **Cash Flows from Operating Activities**

Cash flows from operating activities were \$315.6 million in 2014 and \$521.5 million in 2013. This decrease was due primarily to lower earnings excluding gains recognized on sale of business and license sales and exchanges. Also contributing to this decrease were changes in Accounts payable balances driven primarily by payment timing differences related to operating expenses and device purchases. The above decreases in Cash flows from operating activities were partially offset by a decrease in inventory levels and a decrease in Accounts receivable balances in 2014. The decrease in Accounts receivable balances was driven by the high receivables at December 31, 2013 resulting from the conversion to a new U.S. Cellular billing system in the third quarter of 2013, and the subsequent decrease of Accounts receivable balances to more normal levels during 2014. This decrease in Accounts receivable balances during 2014 was partially offset by increases in equipment installment plan receivables at U.S. Cellular.

### **Cash Flows from Investing Activities**

TDS makes substantial investments to acquire wireless licenses and properties and to construct and upgrade telecommunications networks and facilities as a basis for creating long-term value for shareholders. In recent years, rapid changes in technology and new opportunities have required substantial investments in potentially revenue enhancing and cost-reducing upgrades to TDS' networks.

Capital expenditures (i.e., additions to property, plant and equipment and system development expenditures) totaled \$313.3 million in 2014 and \$356.2 million in 2013. Cash used for additions to property, plant and equipment is reported in the Consolidated Statement of Cash Flows and excludes amounts accrued in Accounts receivable and Accounts payable for capital expenditures at June 30, 2014 and includes amounts received and/or paid in the current period that were accrued at December 31, 2013. Cash used for additions to property, plant and equipment totaled \$339.9 million in 2014 and \$384.3 million in 2013. See "Capital Expenditures" in Liquidity and Capital Resources below for additional information on capital expenditures.

Table of Contents

|   |    |             |  |    |             |
|---|----|-------------|--|----|-------------|
| Cash payments for acquisitions for the six months ended June 30, 2014 and 2013 were as follows: |    |             |  |    |             |
|   |    |             |  |    |             |
| <b>Cash Payment for Acquisitions</b>  |    | <b>2014</b> |  |    | <b>2013</b> |
| <b>(Dollars in thousands)</b>   |    |             |  |    |             |
| U.S. Cellular licenses  | \$ | 17,245      |  | \$ | 14,150      |
| TDS Telecom HMS business  |    | (442)       |  |    | -           |
| TDS Telecom cable business  |    | 1,878       |  |    | -           |
| <b>Total</b>  | \$ | 18,681      |  | \$ | 14,150      |

Cash amounts paid for the acquisitions may differ from the purchase price due to cash acquired in the transactions and the timing of cash payments related to the respective transactions.

|  |    |             |  |    |             |
|--|----|-------------|--|----|-------------|
| Cash received from divestitures in 2014 and 2013 was as follows. |    |             |  |    |             |
|  |    |             |  |    |             |
| <b>Cash Received from Divestitures</b>                           |    | <b>2014</b> |  |    | <b>2013</b> |
| <b>(Dollars in thousands)</b>                                    |    |             |  |    |             |
| U.S. Cellular licenses   | \$ | 91,789      |  | \$ | -           |
| U.S. Cellular businesses   |    | 34,116      |  |    | 480,000     |
| <b>Total</b>   | \$ | 125,905     |  | \$ | 480,000     |

See Note 5 — Acquisitions, Divestitures and Exchanges in the Notes to Consolidated Financial Statements for additional information related to these divestitures.

TDS realized proceeds of \$10.0 million and \$15.0 million related to the maturities of certain of its investments in U.S. Treasury Notes in 2014 and 2013, respectively.

**Cash Flows from Financing Activities**

Cash flows from financing activities include proceeds from and repayments of short-term and long-term debt, dividends to shareholders, distributions to noncontrolling interests, cash used to repurchase Common Shares and cash proceeds from reissuance of Common Shares pursuant to stock-based compensation plans.

In 2014, TDS repurchased Common Shares for \$20.1 million. TDS did not repurchase any Common Shares in 2013. Payments for repurchases of U.S. Cellular Common Shares required \$8.3 million and \$18.4 million in 2014 and 2013, respectively. See Note 10 — Common Share Repurchases in the Notes to Consolidated Financial Statements for additional information related to these transactions.

U.S. Cellular did not pay any dividends in 2014. On June 25, 2013, U.S. Cellular paid a special cash dividend of \$5.75 per share, for an aggregate amount of \$482.3 million, to all holders of U.S. Cellular Common Shares and Series A Common Shares. Of the \$482.3 million paid, TDS received \$407.1 million while external shareholders received \$75.2 million. The cash paid to external shareholders is presented as U.S. Cellular dividends paid to noncontrolling public shareholders on the Consolidated Statement of Cash Flows.

### **Adjusted Free Cash Flow**

The following table presents Adjusted free cash flow. Adjusted free cash flow is defined as Cash flows from operating activities, as adjusted for cash proceeds from the Sprint Cost Reimbursement (which are included in Cash flows from investing activities in the Consolidated Statement of Cash Flows), less Cash used for additions to property, plant and equipment. Adjusted free cash flow is a non-GAAP financial measure which TDS believes may be useful to investors and other users of its financial information in evaluating the amount of cash generated by business operations (including cash proceeds from the Sprint Cost Reimbursement), after Cash used for additions to property, plant and equipment. The prior manner of calculating free cash flow has been adjusted to include the Sprint Cost Reimbursement. The reason for this is that the Sprint decommissioning cash outflows are included in “Cash flows from operating activities,” but the reimbursements from Sprint related to those outflows are not included in this caption.

Table of Contents

| <b>Six Months Ended June 30,</b>   |                         |  |    | <b>2014</b> |  |    | <b>2013</b> |
|--|-------------------------|--|----|-------------|--|----|-------------|
| <b>(Dollars in thousands)</b>  |                         |  |    |             |  |    |             |
| Cash flows from operating activities   |                         |  | \$ | 315,642     |  | \$ | 521,492     |
| Add: Sprint Cost Reimbursement (1)   |                         |  |    | 34,116      |  |    | -           |
| Less: Cash used for additions to property, plant and equipment   |                         |  |    | 339,907     |  |    | 384,281     |
|  | Adjusted free cash flow |  | \$ | 9,851       |  | \$ | 137,211     |
| (1)  |                         | See Note 5 — Acquisitions, Divestitures and Exchanges in the Notes to Consolidated Financial Statements for additional information related to the Sprint Cost Reimbursement. |    |             |  |    |             |
| See Cash Flows from Operating Activities and Cash Flows from Investing Activities for additional information related to the components of Adjusted free cash flow. |                         |  |    |             |  |    |             |

**LIQUIDITY AND CAPITAL RESOURCES**

TDS believes that existing cash and investment balances, funds available under its revolving credit facilities and expected cash flows from operating and investing activities provide substantial liquidity and financial flexibility for TDS to meet its normal financing needs for the foreseeable future. However, these sources may not be adequate to fund future expenditures, including spectrum license auctions and acquisitions, that the companies could potentially elect to make. It may be necessary to increase the size of the existing revolving credit facilities, to put in place new facilities, or to obtain other forms of financing in order to fund these potential expenditures. To the extent that sufficient funds are not available to TDS or its subsidiaries on terms or at prices acceptable to TDS, it could require TDS to reduce its construction, development and acquisition programs.

TDS cannot provide assurances that circumstances that could have a material adverse effect on its liquidity or capital resources will not occur. Economic conditions, changes in financial markets, TDS financial performance and/or prospects or other factors could restrict TDS' liquidity and availability of financing on terms and prices acceptable to TDS, which could require TDS to reduce its capital expenditure, acquisition or share repurchase programs. Such reductions could have a material adverse effect on TDS' business, financial condition or results of operations.

| The following table summarizes TDS' and U.S. Cellular's cash and investments as of June 30, 2014. |            |         |  |                          |         |
|---|------------|---------|--|--------------------------|---------|
|   |            |         |  |                          |         |
| <b>(Dollars in thousands)</b>   | <b>TDS</b> |         |  | <b>U.S. Cellular (1)</b> |         |
| Cash and cash equivalents   | \$         | 874,860 |  | \$                       | 404,058 |
| Short-term investments  | \$         | 40,035  |  | \$                       | 40,035  |
|   |            |         |  |                          |         |



|     |   |  |  |  |  |  |
|-----|---|--|--|--|--|--|
| (1) | Also included as a component of the TDS column. |  |  |  |  |  |
|     |   |  |  |  |  |  |

### Cash and Cash Equivalents

Cash and cash equivalents include cash and short-term, highly liquid investments with original maturities of three months or less. The primary objective of TDS' Cash and cash equivalents investment activities is to preserve principal. At June 30, 2014, the majority of TDS' Cash and cash equivalents was held in bank deposit accounts and in money market funds that invest exclusively in U.S. Treasury Notes or in repurchase agreements fully collateralized by such obligations. TDS monitors the financial viability of the money market funds and direct investments in which it invests and believes that the credit risk associated with these investments is low.

### Short-term Investments

Short-term investments consist of U.S. Treasury Notes which are designated as held-to-maturity investments and are recorded at amortized cost in the Consolidated Balance Sheet. For these investments, TDS' objective is to earn a higher rate of return on funds that are not anticipated to be required to meet liquidity needs in the near term, while maintaining a low level of investment risk. See Note 2 — Fair Value Measurements in the Notes to Consolidated Financial Statements for additional information on Short-term investments.

### Revolving Credit Facilities

TDS and U.S. Cellular have revolving credit facilities available for general corporate purposes.

In connection with U.S. Cellular's revolving credit facility, TDS and U.S. Cellular entered into a subordination agreement dated December 17, 2010 together with the administrative agent for the lenders under U.S. Cellular's revolving credit facility. At June 30, 2014, no U.S. Cellular debt was subordinated pursuant to this subordination agreement.

Table of Contents

In April 2014, two of the nationally recognized credit rating agencies downgraded the TDS and U.S. Cellular corporate and senior debt credit ratings. In July 2014, one of the nationally recognized credit rating agencies downgraded the TDS and U.S. Cellular corporate and senior debt credit ratings. After these downgrades, two of the nationally recognized credit rating agencies rated TDS and U.S. Cellular at sub-investment grade. One of the nationally recognized credit rating agencies rated TDS and U.S. Cellular at investment grade.

TDS' and U.S. Cellular's interest cost on their revolving credit facilities may be subject to increase if their current credit ratings from nationally recognized credit rating agencies are lowered, and may be subject to decrease if the ratings are raised. The April and July 2014 downgrades will increase the commitment fee on the revolving credit facilities by 0.075% per annum. The downgrades also will increase the interest rate on any borrowings by 0.25% per annum. The credit facilities do not cease to be available nor do the maturity dates accelerate solely as a result of a downgrade in TDS' or U.S. Cellular's credit rating. However, downgrades in TDS' or U.S. Cellular's credit rating could adversely affect their ability to renew the credit facilities or obtain access to other credit facilities in the future.

| The following table summarizes the terms of such revolving credit facilities as of June 30, 2014: |    |               |  |               |               |
|---|----|---------------|--|---------------|---------------|
|   |    |               |  |               |               |
| (Dollars in millions)   |    | TDS           |  | U.S. Cellular |               |
| Maximum borrowing capacity  | \$ | 400.0         |  | \$            | 300.0         |
| Letters of credit outstanding   | \$ | 0.3           |  | \$            | 17.5          |
| Amount borrowed   | \$ | -             |  | \$            | -             |
| Amount available for use  | \$ | 399.7         |  | \$            | 282.5         |
| Agreement date  |    | December 2010 |  |               | December 2010 |
| Maturity date   |    | December 2017 |  |               | December 2017 |

The continued availability of the revolving credit facilities requires TDS and U.S. Cellular to comply with certain negative and affirmative covenants, maintain certain financial ratios and make representations regarding certain matters at the time of each borrowing. TDS and U.S. Cellular believe that they were in compliance as of June 30, 2014 with all of the financial covenants and requirements set forth in their revolving credit facilities.

As more fully described on TDS' Form 8-K dated July 24, 2014, to provide for additional financial flexibility, TDS and U.S. Cellular entered into amendments to the revolving credit facilities agreements which increased the Consolidated Leverage Ratio (the ratio of Consolidated Funded Indebtedness to Consolidated Earnings before interest, taxes, depreciation and amortization ("EBITDA")) that the companies are required to maintain. Beginning July 1, 2014, TDS and U.S. Cellular are required to maintain the Consolidated Leverage Ratio at a level not to exceed 3.75 to 1.00 for the period of the four fiscal quarters most recently ended (this was 3.00 to 1.00 prior to July 1, 2014). The terms of the amendment decrease the maximum permitted Consolidated Leverage Ratio beginning January 1, 2016, with

further decreases effective July 1, 2016 and January 1, 2017 (and will return to 3.00 to 1.00 at that time). For the twelve months ended June 30, 2014, the actual Consolidated Leverage Ratio was 2.36 to 1.00. Future changes in TDS' and U.S. Cellular's financial condition could negatively impact their ability to meet the financial covenants and requirements in their revolving credit facilities agreements. TDS also has certain other non-material credit facilities from time to time.

### **Long-Term Financing**

There were no material changes to Long-Term Financing as disclosed in Management's Discussion and Analysis of Financial Condition and Results of Operations included in TDS' Form 10-K for the year ended December 31, 2013.

TDS and its subsidiaries' long-term debt indentures do not contain any provisions resulting in acceleration of the maturities of outstanding debt in the event of a change in TDS' credit rating. However, a downgrade in TDS' credit rating could adversely affect its ability to obtain long-term debt financing in the future. TDS believes that it and its subsidiaries were in compliance as of June 30, 2014 with all financial covenants and other requirements set forth in its long-term debt indentures. TDS and U.S. Cellular have not failed to make nor do they expect to fail to make any scheduled payment of principal or interest under such indentures.

The long-term debt principal payments due for the remainder of 2014 and the next four years represent less than 1% of the total long-term debt obligation at June 30, 2014. Refer to Market Risk — Long-Term Debt in TDS' Form 10-K for the year ended December 31, 2013 for additional information regarding required principal payments and the weighted average interest rates related to TDS' Long-term debt.

Table of Contents

**Capital Expenditures**

U.S. Cellular's capital expenditures for 2014 are expected to be approximately \$640 million. These expenditures are expected to be for the following general purposes:

- Expand and enhance network coverage in its service areas, including providing additional capacity to accommodate increased network usage, principally data usage, by current customers;
- Continue to deploy 4G LTE technology in certain markets;
- Expand and enhance the retail store network; and
- Develop and enhance office systems.

TDS Telecom's capital expenditures for 2014 are expected to be approximately \$200 million. These expenditures are expected to be for the following general purposes:

- Maintain and enhance existing infrastructure at Wireline, HMS and Cable;
- Fiber expansion in Wireline markets to support IPTV and super high speed data;
- Success-based spending to sustain managedIP, IPTV, HMS and Cable growth; and
- Expansion of HMS data center facilities.

TDS plans to finance its capital expenditures program for 2014 using primarily Cash flows from operating activities and, as necessary, existing cash balances and short-term investments.

**Acquisitions, Divestitures and Exchanges**

TDS assesses its business interests on an ongoing basis with a goal of improving the competitiveness of its operations and maximizing its long-term return on investment. As part of this strategy, TDS reviews attractive opportunities to acquire additional wireless operating markets and wireless spectrum; and telecommunications, cable, HMS or other possible businesses. In addition, TDS may seek to divest outright or include in exchanges for other interests those

interests that are not strategic to its long-term success. As a result, TDS may be engaged from time to time in negotiations relating to the acquisition, divestiture or exchange of companies, properties, wireless spectrum and other possible businesses. In general, TDS may not disclose such transactions until there is a definitive agreement. See Note 5 — Acquisitions, Divestitures and Exchanges in the Notes to Consolidated Financial Statements for additional information related to significant transactions.

### **Variable Interest Entities**

TDS consolidates certain entities because they are “variable interest entities” under accounting principles generally accepted in the United States of America (“GAAP”). See Note 8 — Variable Interest Entities (VIEs) in the Notes to Consolidated Financial Statements for additional information related to these variable interest entities. TDS may elect to make additional capital contributions and/or advances to these variable interest entities in future periods in order to fund their operations.

### **Common Share Repurchase Programs**

In the past year, TDS and U.S. Cellular have repurchased and expect to continue to repurchase their Common Shares, in each case subject to any available repurchase program. For additional information related to the current TDS and U.S. Cellular repurchase authorizations and repurchases made during 2014 and 2013, see Note 10 — Common Share Repurchases in the Notes to Consolidated Financial Statements and Part II, Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

### **Contractual and Other Obligations**

There were no material changes outside the ordinary course of business between December 31, 2013 and June 30, 2014 to the Contractual and Other Obligations disclosed in Management’s Discussion and Analysis of Financial Condition and Results of Operations included in TDS’ Form 10-K for the year ended December 31, 2013.

### **Off-Balance Sheet Arrangements**

TDS had no transactions, agreements or other contractual arrangements with unconsolidated entities involving “off-balance sheet arrangements,” as defined by SEC rules, that had or are reasonably likely to have a material current or future effect on its financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.



Table of Contents

**APPLICATION OF CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

TDS prepares its consolidated financial statements in accordance with GAAP. TDS' significant accounting policies are discussed in detail in Note 1 — Summary of Significant Accounting Policies and Recent Accounting Pronouncements in the Notes to Consolidated Financial Statements and TDS' Application of Critical Accounting Policies and Estimates is discussed in detail in Management's Discussion and Analysis of Financial Condition and Results of Operations, both of which are included in TDS' Form 10-K for the year ended December 31, 2013. There were no material changes to TDS' application of critical accounting policies and estimates during the six months ended June 30, 2014.

Table of Contents

**PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995**

**SAFE HARBOR CAUTIONARY STATEMENT**

This Form 10-Q, including exhibits, contains statements that are not based on historical facts and represent forward-looking statements, as this term is defined in the Private Securities Litigation Reform Act of 1995. All statements, other than statements of historical facts, that address activities, events or developments that TDS intends, expects, projects, believes, estimates, plans or anticipates will or may occur in the future are forward-looking statements. The words “believes,” “anticipates,” “estimates,” “expects,” “plans,” “intends,” “projects” and similar expressions intended to identify these forward-looking statements, but are not the exclusive means of identifying them. Such forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause actual results, events or developments to be significantly different from any future results, events or developments expressed or implied by such forward-looking statements. Such risks, uncertainties and other factors include those set forth below, as more fully described under “Risk Factors” in TDS’ Form 10-K for the year ended December 31, 2013. However, such factors are not necessarily all of the important factors that could cause actual results, performance or achievements to differ materially from those expressed in, or implied by, the forward-looking statements contained in this document. Other unknown or unpredictable factors also could have material adverse effects on future results, performance or achievements. TDS undertakes no obligation to update publicly any forward-looking statements whether as a result of new information, future events or otherwise. You should carefully consider the Risk Factors in TDS’ Form 10-K for the year ended December 31, 2013, the following factors and other information contained in, or incorporated by reference into, this Form 10-Q to understand the material risks relating to TDS’ business.

- *Intense competition in the markets in which TDS operates could adversely affect TDS’ revenues or increase its costs to compete.*
- *A failure by TDS to successfully execute its business strategy (including planned acquisitions, divestitures and exchanges) or allocate resources or capital could have an adverse effect on TDS’ business, financial condition or results of operations.*
- *A failure by TDS’ service offerings to meet customer expectations, including any continuing issues relating to the conversion to the new Billing and Operational Support System (“B/OSS”) in the third quarter of 2013, could limit TDS’ ability to attract and retain customers and could have an adverse effect on TDS’ business, financial condition or results of operations.*
- *TDS offers customers the option to purchase certain devices under installment contracts, which could result in higher churn and higher bad debts expense.*



- *TDS' system infrastructure may not be capable of supporting changes in technologies and services expected by customers, which could result in a loss of existing customers and revenues and impair TDS' ability to add new customers and revenues.*
- *Changes in roaming practices or other factors could cause TDS' roaming revenues to decline from current levels and/or impact TDS' ability to service its customers in geographic areas where TDS does not have its own network, which would have an adverse effect on TDS' business, financial condition or results of operations.*
- *A failure by TDS to obtain access to adequate radio spectrum to meet current or anticipated future needs and/or to accurately predict future needs for radio spectrum could have an adverse effect on TDS' business, financial condition or results of operations.*
- *To the extent conducted by the Federal Communications Commission ("FCC"), TDS is likely to participate in FCC auctions of additional spectrum in the future as an applicant or as a noncontrolling partner in another auction applicant and, during certain periods, will be subject to the FCC's anti-collusion rules, which could have an adverse effect on TDS.*
- *Changes in the regulatory environment or a failure by TDS to timely or fully comply with any applicable regulatory requirements could adversely affect TDS' business, financial condition or results of operations.*
- *Changes in Universal Service Fund ("USF") funding and/or intercarrier compensation could have an adverse impact on TDS' business, financial condition or results of operations.*
- *An inability to attract and/or retain highly competent management, technical, sales and other personnel could have an adverse effect on TDS' business, financial condition or results of operations.*
- *TDS' assets are concentrated primarily in the U.S. telecommunications industry. As a result, its results of operations may fluctuate based on factors related primarily to conditions in this industry.*
- *TDS' lower scale relative to larger competitors could adversely affect its business, financial condition or results of operations.*



Table of Contents

- *Changes in various business factors could have an adverse effect on TDS' business, financial condition or results of operations.*
- *Advances or changes in technology could render certain technologies used by TDS obsolete, could put TDS at a competitive disadvantage, could reduce TDS' revenues or could increase its costs of doing business.*
- *Complexities associated with deploying new technologies present substantial risk.*
- *TDS is subject to numerous surcharges and fees from federal, state and local governments, and the applicability and the amount of these fees are subject to great uncertainty.*
- *Performance under device purchase agreements could have a material adverse impact on TDS' business, financial condition or results of operations.*
- *Changes in TDS' enterprise value, changes in the market supply or demand for wireless licenses, wireline or cable markets or IT service providers, adverse developments in the businesses or the industries in which TDS is involved and/or other factors could require TDS to recognize impairments in the carrying value of its licenses, goodwill, franchise rights and/or physical assets.*
- *Costs, integration problems or other factors associated with acquisitions, divestitures or exchanges of properties or licenses and/or expansion of TDS' businesses could have an adverse effect on TDS' business, financial condition or results of operations.*
- *A significant portion of TDS' wireless revenues is derived from customers who buy services through independent agents and third-party national retailers who market TDS' services on a commission basis. If TDS' relationships with these agents or third-party national retailers are seriously harmed, its business, financial condition or results of operations could be adversely affected.*
- *TDS' investments in unproven technologies may not produce the benefits that TDS expects.*

- *A failure by TDS to complete significant network construction and systems implementation activities as part of its plans to improve the quality, coverage, capabilities and capacity of its networks and support systems could have an adverse effect on its operations.*
- *Financial difficulties (including bankruptcy proceedings) or other operational difficulties of TDS' key suppliers, termination or impairment of TDS' relationships with such suppliers, or a failure by TDS to manage its supply chain effectively could result in delays or termination of TDS' receipt of required equipment or services, or could result in excess quantities of required equipment or services, any of which could adversely affect TDS' business, financial condition or results of operations.*
- *TDS has significant investments in entities that it does not control. Losses in the value of such investments could have an adverse effect on TDS' financial condition or results of operations.*
- *A failure by TDS to maintain flexible and capable telecommunication networks or information technology, or a material disruption thereof, including breaches of network or information technology security, could have an adverse effect on TDS' business, financial condition or results of operations.*
- *Wars, conflicts, hostilities and/or terrorist attacks or equipment failures, power outages, natural disasters or other events could have an adverse effect on TDS' business, financial condition or results of operations.*
- *The market price of TDS' Common Shares is subject to fluctuations due to a variety of factors.*
- *Identification of errors in financial information or disclosures could require amendments to or restatements of financial information or disclosures included in this or prior filings with the Securities and Exchange Commission ("SEC"). Such amendments or restatements and related matters, including resulting delays in filing periodic reports with the SEC, could have an adverse effect on TDS' business, financial condition or results of operations.*

Table of Contents

- *The existence of material weaknesses in the effectiveness of internal control over financial reporting could result in inaccurate financial statements or other disclosures or failure to prevent fraud, which could have an adverse effect on TDS' business, financial condition or results of operations.*
- *Changes in facts or circumstances, including new or additional information that affects the calculation of potential liabilities for contingent obligations under guarantees, indemnities, claims, litigation or otherwise, could require TDS to record charges in excess of amounts accrued in the financial statements, which could have an adverse effect on TDS' business, financial condition or results of operations.*
- *Disruption in credit or other financial markets, a deterioration of U.S. or global economic conditions or other events could, among other things, impede TDS' access to or increase the cost of financing its operating and investment activities and/or result in reduced revenues and lower operating income and cash flows, which would have an adverse effect on TDS' business, financial condition or results of operations.*
- *Uncertainty of TDS' ability to access capital, deterioration in the capital markets, other changes in market conditions, changes in TDS' credit ratings 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 or acquisition programs.*
- *Settlements, judgments, restraints on its current or future manner of doing business and/or legal costs resulting from pending and future litigation could have an adverse effect on TDS' business, financial condition or results of operations.*
- *The possible development of adverse precedent in litigation or conclusions in professional studies to the effect that radio frequency emissions from wireless devices and/or cell sites cause harmful health consequences, including cancer or tumors, or may interfere with various electronic medical devices such as pacemakers, could have an adverse effect on TDS' wireless business, financial condition or results of operations.*
- *Claims of infringement of intellectual property and proprietary rights of others, primarily involving patent infringement claims, could prevent TDS from using necessary technology to provide products or services or subject TDS to expensive intellectual property litigation or monetary penalties, which could have an adverse effect on TDS' business, financial condition or results of operations.*

- *Certain matters, such as control by the TDS Voting Trust and provisions in the TDS Restated Certificate of Incorporation, may serve to discourage or make more difficult a change in control of TDS.*
- *Any of the foregoing events or other events could cause revenues, earnings, capital expenditures and/or any other financial or statistical information to vary from TDS' forward-looking estimates by a material amount.*

Table of Contents

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

**MARKET RISK**

Refer to the disclosure under Market Risk in TDS' Form 10-K for the year ended December 31, 2013 for additional information, including information regarding required principal payments and the weighted average interest rates related to TDS' Long-term debt. There have been no material changes to such information since December 31, 2013.

See Note 2 — Fair Value Measurements in the Notes to Consolidated Financial Statements for additional information related to the fair value of TDS' Long-term debt as of June 30, 2014.

Table of Contents

**Item 4. Controls and Procedures**

Evaluation of Disclosure Controls and Procedures

TDS maintains disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”)) that are designed to ensure that information required to be disclosed in its reports filed or submitted under the Exchange Act is processed, recorded, summarized and reported within the time periods specified in the Securities and Exchange Commission’s (“SEC”) rules and forms, and that such information is accumulated and communicated to TDS’ management, including its principal executive officer and principal financial officer, as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives.

As required by SEC Rule 13a-15(b), TDS carried out an evaluation, under the supervision and with the participation of management, including its principal executive officer and principal financial officer, of the effectiveness of the design and operation of TDS’ disclosure controls and procedures as of the end of the period covered by this Quarterly Report. Based on this evaluation, TDS’ principal executive officer and principal financial officer concluded that TDS’ disclosure controls and procedures were effective as of June 30, 2014, at the reasonable assurance level.

Changes in Internal Control Over Financial Reporting

Internal controls over financial reporting are updated as necessary to accommodate modifications to our business processes and accounting procedures. There have been no changes in TDS’ internal control over financial reporting during the quarter ended June 30, 2014 that have materially affected, or are reasonably likely to materially affect TDS’ internal control over financial reporting.



Table of Contents

**Part II. Other Information**

**Item 1. Legal Proceedings.**

Refer to the disclosure under Legal Proceedings in TDS' Form 10-K for the year ended December 31, 2013. There have been no material changes to such information since December 31, 2013.

**Item 1A. Risk Factors.**

In addition to the information set forth in this Form 10-Q, you should carefully consider the factors discussed in Part I, "Item 1A. Risk Factors" in TDS' Annual Report on Form 10-K for the year ended December 31, 2013, which could materially affect TDS' business, financial condition or future results. The risks described in this Form 10-Q and the Form 10-K for the year ended December 31, 2013, may not be the only risks that could affect TDS. Additional unidentified or unrecognized risks and uncertainties could materially adversely affect TDS' business, financial condition and/or operating results. Subject to the foregoing, TDS has not identified for disclosure any material changes to the risk factors as previously disclosed in TDS' Annual Report on Form 10-K for the year ended December 31, 2013, except as follows:

**TDS offers customers the option to purchase certain devices under installment contracts, which could result in higher churn and higher bad debts expense.**

Beginning in the second quarter of 2014, U.S. Cellular expanded its offerings of equipment installment plans. Such plans offer customers the option to purchase certain devices under installment contracts over a period of up to 24 months. U.S. Cellular expects that sales of devices under these plans, when compared to sales of devices made under the traditional subsidy model, will reduce retail service revenue and ARPU but increase equipment revenue. Compared to equipment sales made under the traditional subsidy model, these equipment installment plans involve different considerations regarding marketing, sales, customer retention and renewal, device replacement, customer churn, cash flows, accounting and other business considerations, including business risks. U.S. Cellular does not have significant experience in these new plans or a sufficient history to determine how these plans will affect U.S. Cellular's business, financial position or results of operations. In particular, customers on such plans can discontinue their service at any time without penalty, other than the obligation of any residual commitment they may have for unpaid service or for amounts due under the installment contract for the device. U.S. Cellular could experience reduced revenues and increased marketing costs to acquire new customers if it experiences an increase in churn, which could reduce its margins and operational and financial performance. In addition, customers who purchase their devices through equipment installment plans have the option to pay for their devices in installments over a period of up to 24 months. As a result, these plans subject U.S. Cellular to increased risks relating to consumer credit, which could result

in an increase in bad debts expense. These plans may be particularly sensitive to changes in general economic conditions and declines in the credit quality of customers. There is no assurance that such plans will not have an adverse effect on TDS' business, financial position or results of operations.

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

On August 2, 2013, the Board of Directors of TDS authorized a \$250 million stock repurchase program for TDS Common Shares. Depending on market conditions, such shares may be repurchased in compliance with Rule 10b-18 of the Securities Exchange Act of 1934, as amended ("Exchange Act"), pursuant to Rule 10b5-1 under the Exchange Act, or pursuant to accelerated share repurchase arrangements, prepaid share repurchases, private transactions or as otherwise authorized. This authorization does not have an expiration date.

The following table provides certain information with respect to all purchases made by or on behalf of TDS, and any open market purchases made by any "affiliated purchaser" (as defined by the SEC) of TDS, of TDS Common Shares during the quarter covered by this Form 10-Q.

| Period  |  | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs |
|---|--|----------------------------------|------------------------------|--|--|
| April 1 – 30, 2014  |  | 132,529                          | \$ 26.49                     | 132,529  | \$ 232,953,656   |
| May 1 – 31, 2014  |  | 247,575                          | 27.08                        | 247,575  | 226,250,171  |
| June 1 – 30, 2014   |  | 270,524                          | 26.02                        | 270,524  | 219,211,717  |
| Total for or as of the end of the quarter ended June 30, 2014 |  | 650,628                          | \$ 26.52                     | 650,628  | \$ 219,211,717   |
|   |  |                                  |                              |  |  |

Table of Contents

The following is additional information with respect to the Common Share authorization:

- i. The date the program was announced was August 2, 2013 by Form 8-K.
- ii. The amount approved was up to \$250 million in aggregate purchase price of TDS Common Shares.
- iii. The program does not have an expiration date.
- iv. The authorization did not expire during the second quarter of 2014.
- v. TDS did not determine to terminate the foregoing Common Share repurchase program, or cease making further purchases thereunder, during the second quarter of 2014.

Table of Contents

**Item 5. Other Information.**

The following information is being provided to update prior disclosures made pursuant to the requirements of Form 8-K, Item 2.03 — Creation of a Direct Financial Obligation or an Obligation Under an Off-Balance Sheet Arrangement of a Registrant.

Neither TDS nor U.S. Cellular borrowed or repaid any amounts under their revolving credit facilities in the second quarter of 2014 and had no borrowings outstanding under their revolving credit facilities as of June 30, 2014.

A description of TDS' revolving credit facility is included under Item 1.01 in TDS' Current Report on Form 8-K dated December 17, 2010, as such description is amended by Item 1.01 in TDS' Current Report on Form 8-K dated July 24, 2014, and is incorporated by reference herein.

A description of U.S. Cellular's revolving credit facility is included under Item 1.01 in U.S. Cellular's Current Report on Form 8-K dated December 17, 2010, as such description is amended by Item 1.01 in U.S. Cellular's Current Report on Form 8-K dated July 24, 2014, and is incorporated by reference herein.

Table of Contents

**Item 6. Exhibits.**

Exhibit 4.1 — Third Amendment dated July 24, 2014 to TDS Revolving Credit Agreement dated December 17, 2010, is hereby incorporated by reference to TDS' Current Report on Form 8-K dated July 24, 2014.

Exhibit 4.2 — Third Amendment dated July 24, 2014 to U.S. Cellular Revolving Credit Agreement dated December 17, 2010, is hereby incorporated by reference to U.S. Cellular's Current Report on Form 8-K dated July 24, 2014.

Exhibit 10.1 — Form of U.S. Cellular Long-Term Incentive Plan Restricted Stock Unit Award Agreement for Kenneth R. Meyers, is hereby incorporated by reference to Exhibit 10.1 to U.S. Cellular's Quarterly Report on Form 10-Q for the quarter ended March 31, 2014.

Exhibit 10.2 — Form of U.S. Cellular's Long-Term Incentive Plan Stock Option Award Agreement for Kenneth R. Meyers, is hereby incorporated by reference to Exhibit 10.2 to U.S. Cellular's Quarterly Report on Form 10-Q for the quarter ended March 31, 2014.

Exhibit 10.3 — Amendment Number One to TDS' 2011 Long-Term Incentive Plan is hereby incorporated by reference to Exhibit A to the TDS Notice of Annual Meeting of Shareholders and Proxy Statement dated April 18, 2014.

Exhibit 11 — Statement regarding computation of per share earnings is included herein as Note 4 — Earnings Per Share in the Notes to Consolidated Financial Statements.

Exhibit 12 — Statement regarding computation of ratio of earnings to fixed charges.

Exhibit 31.1 — Principal executive officer certification pursuant to Rule 13a-14 of the Securities Exchange Act of 1934.

Exhibit 31.2 — Principal financial officer certification pursuant to Rule 13a-14 of the Securities Exchange Act of 1934.

Exhibit 32.1 — Principal executive officer certification pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code.

Exhibit 32.2 — Principal financial officer certification pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code.

Exhibit 101.INS — XBRL Instance Document

Exhibit 101.SCH — XBRL Taxonomy Extension Schema Document

Exhibit 101.PRE — XBRL Taxonomy Presentation Linkbase Document

Exhibit 101.CAL — XBRL Taxonomy Calculation Linkbase Document

Exhibit 101.LAB — XBRL Taxonomy Label Linkbase Document

Exhibit 101.DEF — XBRL Taxonomy Extension Definition Linkbase Document

The foregoing exhibits include only the exhibits that relate specifically to this Form 10-Q or that supplement the exhibits identified in TDS' Form 10-K for the year ended December 31, 2013. Reference is made to TDS' Form 10-K for the year ended December 31, 2013 for a complete list of exhibits, which are incorporated herein except to the extent supplemented or superseded above.

Table of ContentsSIGNATURES

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

|       |                |   |  |
|-------|----------------|---|--|
|       |                | TELEPHONE AND DATA SYSTEMS, INC.  |  |
|       |                | (Registrant)  |  |
|       |                |   |  |
| Date: | August 1, 2014 | /s/ LeRoy T. Carlson, Jr.   |  |
|       |                | LeRoy T. Carlson, Jr.,<br><br>President and Chief Executive Officer<br><br>(principal executive officer)                            |  |
|       |                |   |  |
| Date: | August 1, 2014 | /s/ Douglas D. Shuma  |  |
|       |                | Douglas D. Shuma,<br><br>Senior Vice President and Controller<br><br>(principal financial officer and principal accounting officer) |  |

