UNITED STATES CELLULAR CORP
Form 10-Q
August 25, 2006

# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 10-Q

**x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the quarterly period ended March 31, 2006**

**OR**

**o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the transition period from to**

**Commission File Number 1-9712**

# UNITED STATES CELLULAR CORPORATION

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| **Delaware** | **62-1147325** |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |

**8410 West Bryn Mawr, Suite 700, Chicago, Illinois 60631**
(Address of principal executive offices) (Zip Code)

Registrant s telephone number, including area code: **(773) 399-8900**

Indicate by check mark 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.

Yes o No x

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check One):

Large accelerated filer x Accelerated filer o Accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No x

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

| Class | **Outstanding at June 30, 2006** |
|---|---|
| Common Shares, $1 par value | 54,197,834 Shares |
| Series A Common Shares, $1 par value | 33,005,877 Shares |

UNITED STATES CELLULAR CORPORATION

**QUARTERLY REPORT ON FORM 10-Q**
**FOR THE PERIOD ENDED MARCH 31, 2006**

**INDEX**

## PART I. FINANCIAL INFORMATION

**ITEM I. FINANCIAL STATEMENTS**

**UNITED STATES CELLULAR CORPORATION AND SUBSIDIARIES**
**CONSOLIDATED STATEMENTS OF OPERATIONS**

Unaudited

| | Three Months Ended March 31, 2006 | 2005 |
|---|---|---|
| | (Dollars in thousands, except per share amounts) | |
| OPERATING REVENUES | | |
| Service | $ 770,082 | $ 671,639 |
| Equipment sales | 67,154 | 39,432 |
| Total Operating Revenues | 837,236 | 711,071 |
| OPERATING EXPENSES | | |
| System operations (excluding Depreciation, amortization and accretion shown separately below) | 154,855 | 138,471 |
| Cost of equipment sold | 143,316 | 127,248 |
| Selling, general and administrative | 325,618 | 278,330 |
| Depreciation, amortization and accretion | 141,726 | 127,493 |
| Total Operating Expenses | 765,515 | 671,542 |
| OPERATING INCOME | 71,721 | 39,529 |
| INVESTMENT AND OTHER INCOME (EXPENSE) | | |
| Investment income | 19,483 | 14,440 |
| Interest and dividend income | 588 | 2,025 |
| Gain on investments | | 551 |
| Interest expense | (23,208) | (20,738) |
| Other income, net | 202 | 226 |
| Total Investment and Other Income (Expense) | (2,935) | (3,496) |
| INCOME BEFORE INCOME TAXES AND MINORITY INTEREST | 68,786 | 36,033 |
| Income tax expense | 27,649 | 13,934 |
| INCOME BEFORE MINORITY INTEREST | 41,137 | 22,099 |
| Minority share of income | (3,645) | (2,534) |
| NET INCOME | $ 37,492 | $ 19,565 |
| BASIC WEIGHTED AVERAGE SHARES OUTSTANDING (000s) | 87,213 | 86,405 |
| BASIC EARNINGS PER SHARE (Note 5) | $ 0.43 | $ 0.23 |
| DILUTED WEIGHTED AVERAGE SHARES OUTSTANDING (000s) | 87,807 | 87,125 |
| DILUTED EARNINGS PER SHARE (Note 5) | $ 0.43 | $ 0.22 |

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

UNITED STATES CELLULAR CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
Unaudited

| | Three Months Ended March 31, 2006 | 2005 |
|---|---|---|
| | (Dollars in thousands) | |
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net income | $ 37,492 | $ 19,565 |
| Add (deduct) adjustments to reconcile net income to net cash provided by operating activities | | |
| Depreciation, amortization and accretion | 141,726 | 127,493 |
| Bad debts expense | 7,394 | 6,445 |
| Deferred income taxes, net | (2,501) | 11,506 |
| Investment income | (19,483) | (14,440) |
| Distributions from unconsolidated entities | 5,547 | 1,394 |
| Minority share of income | 3,645 | 2,534 |
| Gain on investments | | (551) |
| Stock based compensation expense | 5,804 | 1,171 |
| Noncash interest expense | 445 | 445 |
| Changes in assets and liabilities from operations | | |
| Change in accounts receivable | (7,712) | 4,713 |
| Change in inventory | 7,629 | 7,167 |
| Change in accounts payable | (47,568) | (55,387) |
| Change in customer deposits and deferred revenues | 1,515 | 3,603 |
| Change in accrued taxes | 31,209 | 8,725 |
| Change in accrued interest | 9,363 | 8,678 |
| Change in other assets and liabilities | (15,025) | (20,188) |
| | 159,480 | 112,873 |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Additions to property, plant and equipment | (119,795) | (112,775) |
| Acquisitions, divestitures and exchanges | | (120,924) |
| Other investing activities | (1,697) | (1,042) |
| | (121,492) | (234,741) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Issuance of notes payable | 55,000 | 165,000 |
| Repayment of notes payable | (105,000) | (60,000) |
| Common shares reissued | 3,858 | 6,836 |
| Capital (distributions) to minority partners | (4,146) | |
| Other financing activities | 342 | (61) |
| | (49,946) | 111,775 |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | (11,958) | (10,093) |
| CASH AND CASH EQUIVALENTS- | | |
| Beginning of period | 29,003 | 41,062 |
| End of period | $ 17,045 | $ 30,969 |

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

UNITED STATES CELLULAR CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

ASSETS

Unaudited

| | March 31, 2006 | December 31, 2005 |
|---|---|---|
| | (Dollars in thousands) | |
| CURRENT ASSETS | | |
| Cash and cash equivalents | $ 17,045 | $ 29,003 |
| Accounts receivable | | |
| Customers, less allowance of $8,299 and $11,410, respectively | 284,523 | 281,896 |
| Roaming | 35,819 | 27,178 |
| Other | 47,293 | 58,436 |
| Inventory | 85,118 | 92,748 |
| Prepaid expenses | 37,539 | 31,026 |
| Deferred income tax asset | 8,052 | 8,218 |
| Other current assets | 17,549 | 15,145 |
| | 532,938 | 543,650 |
| INVESTMENTS | | |
| Licenses | 1,362,036 | 1,362,263 |
| Goodwill | 471,935 | 471,617 |
| Customer lists, net of accumulated amortization of $45,979 and $42,947, respectively | 46,286 | 49,318 |
| Marketable equity securities | 219,584 | 225,387 |
| Investments in unconsolidated entities | 185,915 | 170,337 |
| Notes and interest receivable long-term | 4,865 | 4,707 |
| | 2,290,621 | 2,283,629 |
| PROPERTY, PLANT AND EQUIPMENT | | |
| In service and under construction | 4,753,058 | 4,653,292 |
| Less accumulated depreciation | 2,193,509 | 2,076,528 |
| | 2,559,549 | 2,576,764 |
| | | |
| OTHER ASSETS AND DEFERRED CHARGES | 29,178 | 29,985 |
| | | |
| TOTAL ASSETS | $ 5,412,286 | $ 5,434,028 |

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

UNITED STATES CELLULAR CORPORATION AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

LIABILITIES AND SHAREHOLDERS EQUITY

Unaudited

| | March 31, 2006 (Dollars in thousands) | December 31, 2005 |
|---|---|---|
| CURRENT LIABILITIES | | |
| Notes payable | $ 85,000 | $ 135,000 |
| Accounts payable | | |
| Affiliated | 8,804 | 7,239 |
| Trade | 249,265 | 298,397 |
| Customer deposits and deferred revenues | 107,696 | 106,180 |
| Accrued taxes | 64,176 | 38,627 |
| Accrued compensation | 28,462 | 42,865 |
| Other current liabilities | 49,311 | 25,952 |
| | 592,714 | 654,260 |
| | | |
| DEFERRED LIABILITIES AND CREDITS | | |
| Net deferred income tax liability | 656,375 | 660,667 |
| Derivative liability | 21,003 | 25,818 |
| Asset retirement obligation | 93,490 | 90,224 |
| Other deferred liabilities and credits | 52,866 | 44,636 |
| | 823,734 | 821,345 |
| | | |
| LONG-TERM DEBT | | |
| Long-term debt | 1,001,498 | 1,001,385 |
| Forward Contracts | 159,856 | 159,856 |
| | 1,161,354 | 1,161,241 |
| | | |
| COMMITMENTS AND CONTINGENCIES (SEE NOTE 18) | | |
| | | |
| MINORITY INTEREST | 45,939 | 46,442 |
| | | |
| COMMON SHAREHOLDERS EQUITY | | |
| Common Shares, par value $1 per share; authorized 140,000,000 shares; issued 55,045,685 shares | 55,046 | 55,046 |
| Series A Common Shares, par value $1 per share; authorized 50,000,000 shares; issued and outstanding 33,005,877 shares | 33,006 | 33,006 |
| Capital in excess of par value | 1,281,408 | 1,286,964 |
| Treasury Shares, at cost, 847,851 and 962,863 Common Shares, respectively | (40,594 ) | (47,088 ) |
| Accumulated other comprehensive income | 24,319 | 24,944 |
| Retained earnings | 1,435,360 | 1,397,868 |
| | 2,788,545 | 2,750,740 |
| TOTAL LIABILITIES AND SHAREHOLDERS EQUITY | $ 5,412,286 | $ 5,434,028 |

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

UNITED STATES CELLULAR CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## 1. Basis of Presentation

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

The consolidated financial statements included herein have been prepared by U.S. Cellular, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission ( SEC ). Certain information and note disclosures normally included in financial statements prepared in accordance with U.S. GAAP have been condensed or omitted pursuant to such rules and regulations. However, U.S. Cellular believes that the disclosures included herein are adequate to make the information presented not misleading. It is suggested that these consolidated financial statements be read in conjunction with the consolidated financial statements and the notes thereto included in U.S. Cellular s Annual Report on Form 10-K for the year ended December 31, 2005 ( Form 10-K ).

The accompanying unaudited consolidated financial statements contain all adjustments (consisting of only normal recurring items unless otherwise disclosed) necessary to present fairly the financial position as of March 31, 2006, the results of operations for the three months ended March 31, 2006 and 2005, and the cash flows for the three months ended March 31, 2006 and 2005. The results of operations for the three months ended March 31, 2006 are not necessarily indicative of the results to be expected for the full year.

## 2. Summary of Significant Accounting Policies

Change in Accounting Principle Stock-Based Compensation

U.S. Cellular has established the following stock-based compensation plans: a long-term incentive plan and an employee stock purchase plan. U.S. Cellular employees are also eligible to participate in the Telephone and Data Systems, Inc. (TDS) employee stock purchase plan. These plans are described more fully in Note 3 - Stock-Based Compensation. Prior to January 1, 2006, U.S. Cellular accounted for those plans under the recognition and measurement provisions of Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees ( APB 25 ), and related interpretations, as permitted by Financial Accounting Standards Board ( FASB ) Statement of Financial Accounting Standards ( SFAS ) No. 123, Accounting for Stock-Based Compensation . Total stock-based employee compensation cost recognized in the Consolidated Statements of Operations under APB 25 was $1.2 million for the three months ended March 31, 2005, primarily for restricted stock unit and deferred compensation stock unit awards. No compensation cost was recognized in the Consolidated Statements of Operations under APB 25 for stock option awards for the three months ended March 31, 2005, because all outstanding options granted had an exercise price equal to the market value of the underlying common stock on the date of grant. The employee stock purchase plans qualified as non-compensatory plans under APB 25; therefore, no compensation cost was recognized for this plan during the three months ended March 31, 2005.

Effective January 1, 2006, U.S. Cellular adopted the fair value recognition provisions of SFAS No. 123(R), Share-Based Payment ( SFAS 123(R) ), using the modified prospective transition method. In addition, U.S. Cellular applied the provisions of Staff Accounting Bulletin No. 107 ( SAB 107 ), issued by the Securities and Exchange Commission in March 2005 in its adoption of SFAS 123(R). Under the modified prospective transition method, compensation cost recognized during the three months ended March 31, 2006 includes: (a) compensation cost for all share-based payments granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS 123, and (b) compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS 123(R). Results for prior periods have not been restated.

Under SFAS 123(R), the long-term incentive plan is considered a compensatory plan; therefore, recognition of compensation cost for grants made under this plan is required.

Under SFAS 123(R), the employee stock purchase plan is considered a compensatory plan; therefore, recognition of compensation cost for grants made under this plan is required. However, due to restrictions on activity under this plan that were in place during the three months ended March 31, 2006, no compensation cost was recognized during this period.

Upon adoption of SFAS 123(R), U.S. Cellular elected to continue to value its share-based payment transactions using a Black-Scholes valuation model, which was previously used by U.S. Cellular for purposes of preparing the pro forma disclosures under SFAS 123. Under the provisions of SFAS 123(R), stock-based compensation cost recognized during the period is based on the portion of the share-based payment awards that is ultimately expected to vest. Accordingly, stock-based compensation cost recognized in the first quarter of 2006 has been reduced for estimated forfeitures. SFAS 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Pre-vesting forfeitures were estimated based on historical experience related to similar awards, giving consideration to the contractual terms of the stock-based awards, vesting schedules and expectations of future employee behavior. U.S. Cellular believes that its historical experience is the best estimate of future expected life. In U.S. Cellular s pro forma information required under SFAS 123, U.S. Cellular also reduced stock-based compensation cost for estimated forfeitures. The expected life assumption was determined based on U.S. Cellular s historical experience. For purposes of both SFAS 123 and SFAS 123(R), the expected volatility assumption was based on the historical volatility of U.S. Cellular s common stock. The dividend yield assumption was zero because U.S. Cellular has never paid a dividend and has expressed its intention to retain all future earnings in the business. The risk-free interest rate assumption was determined using the implied yield currently available for zero-coupon U.S. government issues with a remaining term equal to the expected life of the stock options.

Compensation cost for stock option awards granted after January 1, 2006 will be recognized over the respective requisite service period of the awards, which is generally the vesting period, on a straight-line basis over the requisite service period for each separately vesting portion of the awards as if the awards were, in-substance, multiple awards (graded vesting attribution method), which is the same attribution method that was used by U.S. Cellular for purposes of its pro forma disclosures under SFAS 123.

Certain employees were eligible for retirement at the time that compensatory stock options were granted. Under the terms of the U.S. Cellular option agreements, options granted to these individuals will fully vest upon their retirement if they have reached the age of 65. Similarly, under the terms of U.S. Cellular s restricted stock unit agreements, restricted stock units vest upon retirement if the employee has reached the age of 65. Prior to the adoption of SFAS 123(R), U.S. Cellular used the nominal vesting method to recognize the pro forma stock-based compensation cost related to options and restricted stock units awarded to retirement-eligible employees. This method does not take into account the effect of early vesting due to the retirement of eligible employees. Upon adoption of SFAS 123(R), U.S. Cellular adopted the non-substantive vesting method , which requires the recognition of the entire expense related to options and restricted stock units granted to retirement-eligible employees. If the non-substantive vesting method had been applied in prior periods, the effect on previously disclosed pro forma stock-based compensation cost would not have been material.

On March 7, 2006, the U.S. Cellular Compensation Committee approved amendments to stock option award agreements. The amendments modify current and future options to extend the exercise period until 30 days following (i) the lifting of a suspension if options otherwise would expire or be forfeited during the suspension period and (ii) the lifting of a blackout if options otherwise would expire or be forfeited during a blackout period. U.S. Cellular temporarily suspended issuances of shares under the 2005 Long Term Incentive Plan on March 17, 2006, as required by SEC regulations, because U.S. Cellular did not file its Form 10-K for the year ended December 31, 2005 in a timely manner. Under SEC regulations, U.S. Cellular may not issue shares under its existing registration statement on Form S-8 related to the 2005 Long Term Incentive Plan until the date that U.S. Cellular is current with respect to its Form 10-K for the year ended December 31, 2005 and other periodic SEC filings. As required under the provisions of SFAS 123(R), U.S. Cellular evaluated the impact of this plan modification to determine if an adjustment to stock based compensation was required. U.S. Cellular determined that the impact of such an adjustment would not be material.

Pension Plan

U.S. Cellular participates in a qualified noncontributory defined contribution pension plan sponsored by Telephone and Data Systems, Inc. ( TDS ), U.S. Cellular s parent organization. The plan provides pension benefits for the employees of U.S. Cellular and its subsidiaries. Under this plan, pension benefits and costs are calculated separately for each participant and are funded currently. Pension costs were $1.9 million and $1.8 million for the three months ended March 31, 2006 and 2005, respectively.

Recent Accounting Pronouncements

FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes ( FIN 48 ), was issued in July 2006. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in accordance with SFAS No. 109, Accounting for Income Taxes. The interpretation prescribes a recognition threshold and measurement attribute for the recognition and measurement of a tax position taken or expected to be taken in a tax return. It also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. U.S. Cellular is currently reviewing the requirements of FIN 48 and has not yet determined the impact, if any, on its financial position or results of operations.

## 3. Stock-Based Compensation

Stock Based Compensation Plans

U.S. Cellular has established the following stock-based compensation plans: a long-term incentive plan and an employee stock purchase plan.

*Long-Term Incentive Plan* Under the U.S. Cellular 2005 Long-Term Incentive Plan, U.S. Cellular may grant fixed and performance-based incentive and non-qualified stock options, restricted stock, restricted stock units, and deferred compensation stock unit awards to key employees. U.S. Cellular had reserved 5,403,000 Common Shares at March 31, 2006, for equity awards granted and to be granted under this plan. At March 31, 2006, the only types of awards outstanding are fixed non-qualified stock option awards, restricted stock unit awards, and deferred compensation stock unit awards. At March 31, 2006, U.S. Cellular also had reserved 110,000 Common Shares for issuance to employees under an employee stock purchase plan. The maximum number of U.S. Cellular Common Shares that may be issued to employees under all stock-based compensation plans in effect at March 31, 2006 was 5,513,000 shares. U.S. Cellular currently utilizes treasury stock to satisfy stock option exercises, issuances under its employee stock purchase plan, restricted stock unit awards and deferred compensation stock unit awards.

*Stock Options* Stock options granted to key employees are exercisable over a specified period not in excess of ten years. Stock options generally vest over periods up to four years from the date of grant. Stock options outstanding as of March 31, 2006 expire between 2006 and 2015. However, vested stock options typically expire 30 days after the effective date of an employee s termination of employment for reasons other than retirement. Employees who leave at the age of retirement have 90 days (or one year if they satisfy certain requirements) within which to exercise their vested stock options. The exercise price of the option generally equals the market value of U.S. Cellular Common Shares on the date of grant.

U.S. Cellular estimates the fair value of stock options granted using the Black-Scholes valuation model. The fair value is then recognized as compensation cost on a straight-line basis over the requisite service period, which is generally the vesting period, for each separately vesting portion of the awards as if the awards were, in-substance, multiple awards, which is the same attribution method that was used by U.S. Cellular for purposes of its pro forma disclosures under SFAS 123. U.S. Cellular did not grant stock options during the three months ended March 31, 2006.

A summary of U.S. Cellular stock options outstanding (vested and nonvested) at March 31, 2006 and changes during the three months then ended is presented in the table below

| | Number of Options | Weighted Average Exercise Prices | Weighted Average Remaining Contractual Term | Aggregate Intrinsic Value |
|---|---|---|---|---|
| Outstanding at December 31, 2005 (877,000 exercisable) | 2,701,000 | $ 38.80 | 7.5 years | $ 55,522,000 |
| Granted | | | | |
| Exercised | 107,000 | $ 34.51 | | 2,259,000 |
| Forfeited | 29,000 | $ 39.70 | | 564,000 |
| Expired | 1,000 | $ 29.80 | | 18,000 |
| Outstanding at March 31, 2006 (1,514,000 exercisable) | 2,564,000 | $ 38.98 | 7.4 years | $ 52,252,000 |

The aggregate intrinsic value in the table above represents the total pretax intrinsic value (the difference between U.S. Cellular s closing stock price on the last trading day of the period and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on March 31, 2006. This amount will change in future periods based on the market price of U.S. Cellular s stock. U.S. Cellular received $3.7 million in cash from the exercise of stock options during the three months ended March 31, 2006.

A summary of U.S. Cellular nonvested stock options at March 31, 2006 and changes during the three months then ended is presented in the table below:

| | Number of Stock Options | Weighted Average Fair Values of Stock Options |
|---|---|---|
| Nonvested at December 31, 2005 | 1,824,000 | $ 14.19 |
| Granted | | |
| Vested | 748,000 | 17.23 |
| Forfeited | 26,000 | 14.22 |
| Nonvested at March 31, 2006 | 1,050,000 | 14.00 |

*Restricted Stock Units* U.S. Cellular grants restricted stock unit awards to key employees, which generally vest after three years.

U.S. Cellular estimates the fair value of restricted stock units based on the closing market price of U.S. Cellular shares on the date of grant, which is not adjusted for any dividends foregone during the vesting period because U.S. Cellular has never paid a dividend and has expressed the intention of retaining all future earnings in the business. The fair value is then recognized as compensation cost on a straight-line basis over the requisite service periods of the awards, which is generally the vesting period. Awards granted under this plan prior to 2005 were classified as liability awards due to a plan provision which allowed participants to elect tax withholding in excess of minimum statutory tax rates. In 2005, this provision was removed from the plan and awards after 2005 have been classified as equity awards.

A summary of U.S. Cellular nonvested restricted stock units at March 31, 2006 and changes during the three months then ended is presented in the table below:

Liability Classified Awards

| | Number of Restricted Stock Units | Weighted Average Grant-Date Fair Values of Restricted Stock Units |
|---|---|---|

| | | | | |
|---|---|---|---|---|
| Nonvested at December 31, 2005 | 181,000 | | $ | 29.79 |
| Granted | | | | |
| Vested | (108,000 | ) | $ | 23.73 |
| Forfeited | (1,000 | ) | $ | 38.65 |
| Nonvested at March 31, 2006 | 72,000 | | $ | 38.65 |

Equity Classified Awards

| | Number of Restricted Stock Units | Weighted Average Grant-Date Fair Values of Restricted Stock Units |
|---|---|---|
| Nonvested at December 31, 2005 | 201,000 | $ 45.63 |
| Granted | | |
| Vested | | $ |
| Forfeited | (5,000 ) | $ 45.63 |
| Nonvested at March 31, 2006 | 196,000 | $ 45.63 |

*Deferred Compensation Stock Units* Certain U.S. Cellular employees may elect to defer receipt of all or a portion of their annual bonuses and to receive a company matching contribution on the amount deferred. All bonus compensation that is deferred is immediately vested and is deemed to be invested in U.S. Cellular Common Share stock units. Upon vesting and distribution of such stock units, participants will receive U.S. Cellular Common Shares. The amount of U.S. Cellular s matching contribution depends on the portion of the annual bonus that is deferred. Participants receive a 25% match for amounts deferred up to 50% of their total annual bonus and a 33% match for amounts that exceed 50% of their total annual bonus; such matching contributions also are deemed to be invested in U.S. Cellular Common Share stock units. The matching contribution stock units vest ratably at a rate of one-third per year over three years. Upon vesting and distribution of such matching contribution stock units, participants will receive U.S. Cellular Common Shares.

U.S. Cellular estimates the fair value of deferred compensation matching contribution stock units based on the closing market price of U.S. Cellular Common Shares on the date of match. The fair value of such matching contribution stock units is then recognized as compensation cost on a straight-line basis over the requisite service periods of the awards, which is generally the vesting period.

A summary of U.S. Cellular nonvested deferred compensation stock units at March 31, 2006 and changes during the three months then ended is presented in the tables below:

| | Number of Stock Units | Weighted Average Fair Values of Stock Units |
|---|---|---|
| Nonvested at December 31, 2005 | 7,700 | $ 41.08 |
| Granted | | |
| Vested | 3,700 | 37.31 |
| Forfeited | | |
| Nonvested at March 31, 2006 | 4,000 | $ 44.62 |

Employee Stock Purchase Plan Under the 2003 Employee Stock Purchase Plan, eligible employees of U.S. Cellular and its subsidiaries may purchase a limited number of U.S. Cellular Common Shares on a quarterly basis. U.S. Cellular had reserved 110,000 Common Shares at March 31, 2006 for issuance under this plan. The plan became effective on April 1, 2003 and will terminate on December 31, 2008. The per share cost to each participant is 85% of the market value of the Common Shares as of the issuance date. U.S. Cellular employees are also eligible to participate in the TDS employee stock purchase plan. The effective dates and per share costs in the TDS plan are the same as those for the U.S. Cellular plan. Under SFAS 123(R), both of these employee stock purchase plans are considered compensatory plans; therefore recognition of compensation costs for stock issued under these plans is required. Compensation cost is measured as the difference between the cost of the shares to the plan participants and the fair market value of the shares on the date of issuance. However, due to restrictions on activity under these plans in place during the three months ended March 31, 2006, no compensation cost was recognized during this period for either plan.

Stock - Based Compensation Expense

The following table summarizes stock-based compensation expense recognized during the three months ended March 31, 2006:

| (Amounts in thousands) | |
|---|---|
| Compensation expense recognized for stock option awards | $ 2,993 |
| Compensation expense recognized for restricted stock unit awards | 2,088 |
| Compensation expense recognized for deferred compensation matching stock unit awards | 723 |
| Compensation expense recognized for awards under employee stock purchase plans | 0 |
| Total stock-based compensation, before income taxes | 5,804 |
| Income tax benefit | (2,333 ) |
| Total stock-based compensation expense, net of income taxes | $ 3,471 |

All stock-based compensation expense recognized during the three months ended March 31, 2006 was recorded in Selling, general and administrative expense.

As a result of adopting SFAS 123(R) on January 1, 2006, U.S. Cellular s income before income taxes and net income for the three months ended March 31, 2006 were $2.9 million and $1.8 million lower, respectively, than if it had continued to account for share-based compensation under APB 25. Basic and diluted earnings per share for the three months ended March 31, 2006 were $0.02 and $0.02 lower, respectively, than if U.S. Cellular had continued to account for share-based compensation under APB 25. For comparison, the following table illustrates the pro forma effect on net income and earnings per share had U.S. Cellular applied the fair value recognition provisions of SFAS 123(R) to its stock-based employee compensation plans for the three months ended March 31, 2005:

| (Dollars in thousands, except per share amounts) | |
|---|---|
| Net income, as reported | $ 19,565 |
| Add: Stock-based compensation expense included in reported net income, net of related tax effects | 706 |
| Deduct: Stock-based compensation expense determined under fair value based method for all awards, net of related tax effects | (2,619 ) |
| Pro forma net income | $ 17,652 |
| | |
| Earnings per share: | |
| Basic as reported | $ 0.23 |
| Basic pro forma | $ 0.21 |
| Diluted as reported | $ 0.22 |
| Diluted pro forma | $ 0.20 |

At March 31, 2006, unrecognized compensation cost for all U.S. Cellular stock-based compensation awards was $14.3 million. The unrecognized compensation cost for stock-based compensation awards at March 31, 2006 is expected to be recognized over a weighted average period of 0.8 years.

Prior to the adoption of SFAS 123(R), U.S. Cellular presented all tax benefits resulting from tax deductions associated with the exercise of stock options by employees as cash flows from operating activities in the Consolidated Statements of Cash Flows. SFAS 123(R) requires that excess tax benefits be classified as cash flows from financing activities in the Consolidated Statement of Cash Flows. For this purpose, the excess tax benefits are tax benefits related to the difference between the total tax deduction associated with the exercise of stock options by employees and the amount of compensation cost recognized for those options. For the three months ended March 31, 2006, excess tax benefits of $0.3 million were included within Other Financing Activities of the Cash Flows from Financing Activities pursuant to this requirement of SFAS 123(R).

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## 4. Income Taxes

The overall effective tax rate on income before income taxes and minority interest for the three months ended March 31, 2006 and 2005 was 40.2% and 38.7%, respectively. The effective tax rate for the 2006 period is higher than 2005 primarily due to an increase in tax expense for contingent tax liabilities.

In June of 2006, the Internal Revenue Service commenced its audit of the 2002 2004 consolidated federal tax returns of TDS and subsidiaries. U.S. Cellular is included in the TDS consolidated federal tax return. The audit is in its preliminary stages.

## 5. Earnings per Share

Basic earnings per share is computed by dividing net income by the weighted average number of common shares outstanding during the period. Diluted earnings per share is computed by dividing net income by the weighted average common shares adjusted to include the effect of potentially dilutive securities. Potentially dilutive securities included in diluted earnings per share represent incremental shares issuable upon exercise of outstanding stock options.

The net income amounts used in computing earnings per share and the effects on the weighted average number of common shares and earnings per share of potentially dilutive stock options are as follows:

| | **Three Months Ended March 31, 2006** | **2005** |
|---|---|---|
| | **(Dollars and shares in thousands, except earnings per share)** | |
| Net income | $ 37,492 | $ 19,565 |
| Weighted average number of shares used in basic earnings per share | 87,213 | 86,405 |
| Effect of Dilutive Securities: | | |
| Stock options (1) | 594 | 720 |
| Weighted average number of shares used in diluted earnings per share | 87,807 | 87,125 |
| Basic Earnings per Share | $ 0.43 | $ 0.23 |
| Diluted Earnings per Share | $ 0.43 | $ 0.22 |

(1) Stock options convertible into 159,776 Common Shares in 2006 and 242,322 Common Shares in 2005 were not included in computing Diluted Earnings per Share because their effects were antidilutive.

## 6. Marketable Equity Securities and Forward Contracts

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

Information regarding U.S. Cellular s marketable equity securities is summarized below.

| | March 31, 2006 (Dollars in thousands) | December 31, 2005 |
|---|---|---|
| Marketable Equity Securities | | |
| Vodafone Group Plc | | |
| 10,245,370 American Depositary Receipts (1) | $ 214,128 | $ 219,968 |
| Rural Cellular Corporation | | |
| 370,882 Common Shares | 5,456 | 5,419 |
| Aggregate fair value | 219,584 | 225,387 |
| Accounting cost basis | 160,161 | 160,161 |
| Gross unrealized holding gains | 59,423 | 65,226 |
| Deferred tax liability | (21,809 ) | (23,939 ) |
| Net unrealized holding gains | 37,614 | 41,287 |
| Derivatives net of tax | (13,295 ) | (16,343 ) |
| Accumulated other comprehensive income | $ 24,319 | $ 24,944 |

(1) See Note 19 Subsequent Events for a discussion of the Share Consolidation and Special Distribution related to the Vodafone ADRs that was effected on July 25, 2006. As a result of the Share Consolidation, the aggregate number of shares underlying ADRs was reduced from 10,245,370 to 8,964,698.

The investment in Vodafone Group Plc ( Vodafone ) resulted from certain dispositions of non-strategic wireless investments to or settlements with AirTouch Communications, Inc. ( AirTouch ), in exchange for stock of AirTouch, which was then acquired by Vodafone whereby U.S. Cellular received American Depositary Receipts ( ADRs ) representing Vodafone stock. See Note 19 - Subsequent Events for additional information related to U.S. Cellular s investment in Vodafone ADRs. The investment in Rural Cellular Corporation ( Rural Cellular ) is the result of a consolidation of several wireless partnerships, in which U.S. Cellular subsidiaries held interests, into Rural Cellular and the distribution of Rural Cellular stock in exchange for these interests.

U.S. Cellular has entered into a number of forward contracts related to over 97% of the market value of the marketable equity securities that it holds. The risk management objective of the forward contracts is to hedge the value of the marketable equity securities from losses due to decreases in the market prices of the securities while retaining a share of gains from increases in the market prices of such securities. The downside risk is hedged at or above the accounting cost basis of the securities, thereby eliminating the risk of an other-than-temporary loss on these contracted securities.

See Note 13 Long-term Debt and Forward Contracts for additional information related to U.S. Cellular s forward contracts.

## 7. Goodwill

U.S. Cellular has substantial amounts of goodwill as a result of the acquisition of wireless markets. The changes in goodwill for the three months ended March 31, 2006 and 2005 were as follows:

| | March 31, 2006 (Dollars in thousands) | March 31, 2005 |
|---|---|---|
| Balance, beginning of period | $ 471,617 | $ 445,212 |
| Acquisitions | | |
| Other adjustments | 318 | (10 ) |
| Balance, end of period | $ 471,935 | $ 445,202 |

## 8. Unconsolidated Entities

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

U.S. Cellular s significant investments in unconsolidated entities include the following:

| | March 31, 2006 | | March 31, 2005 | |
|---|---|---|---|---|
| Los Angeles SMSA Limited Partnership | 5.5 | % | 5.5 | % |
| Midwest Wireless Communications, L.L.C. (1) | 14.2 | % | 14.2 | % |
| North Carolina RSA 1 Partnership | 50.0 | % | 50.0 | % |
| Oklahoma City SMSA Limited Partnership | 14.6 | % | 14.6 | % |

(1) In addition, U.S. Cellular owns a 49% interest in an entity which owns approximately 2.9% interest in Midwest Wireless Holdings, L.L.C., the parent company of Midwest Wireless Communications, L.L.C.

Based primarily on data furnished to U.S. Cellular by third parties, the following summarizes the combined results of operations of U.S. Cellular s equity method investments:

| | Three Months Ended March 31, 2006 (Dollars in thousands) | 2005 |
|---|---|---|
| Results of Operations | | |
| Revenues | $ 987,000 | $ 780,000 |
| Operating expenses | 683,000 | 542,000 |
| Operating income | 304,000 | 238,000 |
| Other income (expense), net | 8,000 | 8,000 |
| Net Income | $ 312,000 | $ 246,000 |

See Note 19 Subsequent Events for additional information related to U.S. Cellular s investment in Midwest Wireless Communications, L.L.C.

## 9. Customer Lists

Customer lists, which are intangible assets resulting from acquisitions of wireless markets, are amortized based on average customer retention periods using the declining balance method. Amortization expense was $3.0 million and $2.3 million for the first quarter of 2006 and 2005, respectively. Amortization expense for the remainder of 2006 and for the years 2007-2010 is expected to be $8.8 million, $8.6 million, $6.5 million, $4.9 million and $3.3 million, respectively.

## 10. Property, Plant and Equipment

U.S. Cellular reviews the estimated useful lives of its property, plant and equipment, including leasehold improvements, annually and adjusts such estimated useful lives as appropriate. U.S. Cellular did not change the useful lives of its property, plant and equipment, including leasehold improvements, in 2006 or 2005.

## 11. Revolving Credit Facility

U.S. Cellular has a $700 million revolving credit facility available for general corporate purposes. At March 31, 2006, outstanding borrowings and letters of credit were $85.0 million and $0.5 million, respectively, leaving $614.5 million available for use. Borrowings under the revolving credit facility bear interest at the London InterBank Offered Rate ( LIBOR ) plus a contractual spread based on U.S. Cellular s credit rating (the one-month LIBOR was 4.83% at March 31, 2006). At March 31, 2006, the contractual spread was 60 basis points. U.S. Cellular may select borrowing periods of either seven days or one, two, three or six months. If U.S. Cellular provides less than two days notice of intent to borrow, interest on borrowings is the prime rate less 50 basis points (the prime rate was 7.75% at March 31, 2006). This credit facility expires in December 2009.

U.S. Cellular s interest cost on its revolving credit facility would increase if its current credit ratings from either Standard & Poor s or Moody s were lowered. However, the credit facility would not cease to be available or accelerate solely as a result of a decline in U.S. Cellular s credit rating. A downgrade in U.S. Cellular s credit rating could adversely affect its ability to renew existing, or obtain access to new, credit facilities in the future. At March 31, 2006, U.S. Cellular s credit ratings are as follows:

| | | |
|---|---|---|
| Moody s Investor Service | Baa3 | under review for possible further downgrade |
| Standard & Poor s | A- | on credit watch with negative implications |
| Fitch | BBB+ | on rating watch negative |

The maturity date of U.S. Cellular s revolving credit facility would accelerate in the event of a change in control. The continued availability of the revolving credit facility requires U.S. Cellular to comply with certain negative and affirmative covenants, maintain certain financial ratios and represent certain matters at the time of each borrowing. On November 10, 2005 U.S. Cellular announced that it would restate certain financial statements which caused U.S. Cellular to be late in certain SEC filings. The restatements and late filings resulted in defaults under the revolving credit facility. However, U.S. Cellular was not in violation of any covenants that require U.S. Cellular to maintain certain financial ratios and U.S. Cellular did not fail to make any scheduled payments. U.S. Cellular received waivers from the lenders associated with the revolving credit facility, under which the lenders agreed to waive any defaults that may have occurred as a result of the restatements and late filings. The waivers require the Form 10-K for the year ended December 31, 2005 to be filed by August 31, 2006, the Form 10-Q for the quarter ended March 31, 2006 to be filed within 30 days after the filing of the Form 10-K for the year ended December 31, 2005 and the Form 10-Q for the quarter ended June 30, 2006 to be filed within 45 days after the filing of the Form 10-Q for the quarter ended March 31, 2006. The Form 10-K for the year ended December 31, 2005 was filed on July 28, 2006.

## 12. Asset Retirement Obligations

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

U.S. Cellular accounts for its asset retirement obligations in accordance with SFAS No. 143, Accounting for Asset Retirement Obligations, ( SFAS 143 ) and FASB Interpretation No. 47, Accounting for Conditional Asset Retirement Obligations ( FIN 47 ), which require entities to record the fair value of a liability for legal obligations associated with an asset retirement in the period in which the obligations are incurred. At the time the liability is incurred, U.S. Cellular records a liability equal to the net present value of the estimated cost of the asset retirement obligation and increases the carrying amount of the related long-lived asset by an equal amount. Over time, the liability is accreted to its present value each period, and the capitalized cost is depreciated over the useful life of the related asset. Upon settlement of the obligations, any difference between the cost to retire an asset and the recorded liability (including accretion of discount) is recognized in the Consolidated Statements of Operations as a gain or loss.

The table below summarizes the changes in asset retirement obligations during the three months ended March 31, 2006 and 2005.

| | **March 31, 2006** | **March 31, 2005** |
|---|---|---|
| | **(Dollars in thousands)** | |
| Balance, beginning of period | $ 90,224 | $ 72,575 |
| Additional liabilities accrued | 1,529 | 678 |
| Accretion expense | 1,737 | 1,792 |
| Balance, end of period | $ 93,490 | $ 75,045 |

## 13. Long-Term Debt and Forward Contracts

There were no significant changes in long-term debt during the three months ended March 31, 2006.

The late filing of U.S. Cellular s Form 10-K for the year ended December 31, 2005 and Form 10-Q for the quarterly periods ended March 31, 2006 and June 30, 2006 and the failure to deliver such Forms 10-K and 10-Q to the trustee of the U.S. Cellular debt indenture on a timely basis, resulted in non-compliance under such debt indenture. However, this non-compliance did not result in an event of default or a default. U.S. Cellular believes that non-compliance was cured upon the filing of its Form 10-K for the year ended December 31, 2005 and its Form 10-Q for the quarterly period ended March 31, 2006, but that non-compliance continues to exist with respect to its Form 10-Q for the quarterly period ended June 30, 2006. U.S. Cellular has not failed to make nor does it expect to fail to make any scheduled payment of principal or interest under such indenture.

Except as noted above, U.S. Cellular believes it was in compliance as of March 31, 2006 with all covenants and other requirements set forth in long-term debt indentures. Such indentures do not contain any provisions resulting in acceleration of the maturities of outstanding debt in the event of a change in U.S. Cellular s credit rating. However, a downgrade in U.S. Cellular s credit rating could adversely affect its ability to obtain long-term debt financing in the future.

Forward Contracts

U.S. Cellular has forward contracts related to its 10,245,370 Vodafone Group Plc American Depositary Receipts. The Vodafone securities are pledged as collateral for the forward contracts. See Note 19 Subsequent Events for additional information related to U.S. Cellular s investment in Vodafone ADRs.

The $159.9 million principal amount of the forward contracts is accounted for as a loan. The collar portions of the forward contracts are accounted for as derivative instruments. The forward contracts mature in May 2007, and require quarterly interest payments at the LIBOR rate plus 50 basis points (the three-month LIBOR rate was 5.00% at March 31, 2006).

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

Under the terms of the forward contracts, a subsidiary of U.S. Cellular continues to own the contracted shares and will receive dividends paid on such contracted shares, if any. The forward contracts, at U.S. Cellular s option, may be settled in shares of the security or in cash, pursuant to formulas that collar the price of the shares. The collars effectively reduce U.S. Cellular s downside limit and upside potential on the contracted shares. The collars are typically adjusted for any changes in dividends on the contracted shares. If the dividend increases, the collar s upside potential is typically reduced. If the dividend decreases, the collar s upside potential is typically increased. If U.S. Cellular elects to settle in shares, it will be required to deliver the number of shares of the contracted security determined pursuant to the formula. If shares are delivered in the settlement of the forward contract, U.S. Cellular would incur a current tax liability at the time of delivery based on the difference between the tax basis of the marketable equity securities and the net amount realized through maturity. If U.S. Cellular elects to settle in cash, it will be required to pay an amount in cash equal to the fair market value of the number of shares determined pursuant to the formula. U.S. Cellular has provided guarantees to the counterparties which provide assurance that all principal and interest amounts will be paid by its consolidated subsidiary upon settlement of the contracts.

U.S. Cellular is required to comply with certain covenants under the forward contracts. On November 10, 2005, U.S. Cellular announced that it would restate certain financial statements which caused U.S. Cellular to be late in certain SEC filings. The restatements and late filings resulted in defaults under the forward contracts. However, U.S. Cellular was not in violation of any covenants that require U.S. Cellular to maintain certain financial ratios and U.S. Cellular did not fail to make any scheduled payments. U.S. Cellular received waivers from the counterparties associated with the forward contracts, under which the counterparties agreed to waive any defaults that may have occurred as a result of the restatements and late filings. The waivers require the Form 10-K for the year ended December 31, 2005 to be filed by August 31, 2006, the Form 10-Q for the quarter ended March 31, 2006 to be filed within 30 days after the filing of the Form 10-K for the year ended December 31, 2005 and the Form 10-Q for the quarter ended June 30, 2006 to be filed within 45 days after the filing of the Form 10-Q for the quarter ended March 31, 2006. The Form 10-K for the year ended December 31, 2005 was filed on July 28, 2006.

## 14. Minority Interest in Subsidiaries

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

The settlement value of U.S. Cellular s mandatorily redeemable minority interests was estimated to be $172.7 million at March 31, 2006. This represents the estimated amount of cash that would be due and payable to settle minority interests assuming an orderly liquidation of the finite-lived consolidated partnerships and L.L.C.s on March 31, 2006, net of estimated liquidation costs. This amount is being disclosed pursuant to the requirements of FASB Staff Position ( FSP ) No. FAS 150-3, Effective Date, Disclosures, and Transition for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatorily Redeemable Noncontrolling Interests . U.S. Cellular has no current plans or intentions to liquidate any of the related partnerships or L.L.C.s prior to their scheduled termination dates. The corresponding carrying value of the minority interests in finite-lived consolidated partnerships and L.L.C.s at March 31, 2006 was $41.9 million and is included in the Consolidated Balance Sheet caption Minority Interest. The excess of the aggregate settlement value over the aggregate carrying value of the mandatorily redeemable minority interests of $130.8 million is primarily due to the unrecognized appreciation of the minority interest holders share of the underlying net assets in the consolidated partnerships and L.L.C.s. Neither the minority interest holders share, nor U.S. Cellular s share, of the appreciation of the underlying net assets of these subsidiaries is reflected in the consolidated financial statements under U.S. GAAP. The estimate of settlement value was based on certain factors and assumptions. A change in those factors and assumptions could result in a materially larger or smaller settlement amount.

## 15. Common Share Repurchase Program

The Board of Directors of U.S. Cellular has authorized the repurchase of a limited amount of U.S. Cellular Common Shares on a quarterly basis, primarily for use in employee benefit plans. No U.S. Cellular Common Shares were repurchased in the first quarter of 2006 or 2005.

## 16. Acquisitions, Divestitures and Exchanges

U.S. Cellular assesses its existing wireless 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, U.S. Cellular reviews attractive opportunities to acquire additional operating markets and wireless spectrum. In addition, U.S. Cellular may seek to divest outright or include in exchanges for other wireless interests those markets and wireless interests that are not strategic to its long-term success.

U.S. Cellular is a limited partner in Carroll Wireless, L.P. ( Carroll Wireless ), an entity which participated in the auction of wireless spectrum designated by the FCC as Auction 58. Carroll Wireless was qualified to bid on spectrum which was available only to companies that fall under the FCC definition of designated entities, which are small businesses that have a limited amount of assets. Carroll Wireless was a successful bidder for 17 licensed areas in Auction 58, which ended on February 15, 2005. The aggregate amount paid to the FCC for the 17 licenses was $129.9 million, net of all bidding credits to which Carroll Wireless was entitled as a designated entity. These 17 licensed areas cover portions of 12 states and are in markets which are either adjacent to or overlap current U.S. Cellular licensed areas.

On January 6, 2006, the FCC granted Carroll Wireless applications with respect to 16 of the 17 licenses for which it had been the successful bidder and dismissed one application, relating to Walla Walla, Washington. Following the completion of Auction 58, the FCC determined that a portion of the Walla Walla license was already licensed to another party and should not have been included in Auction 58. Accordingly, in 2006, Carroll Wireless received a full refund of the $228,000 previously paid to the FCC with respect to the Walla Walla license.

Carroll Wireless is in the process of developing its long-term business and financing plans. As of March 31, 2006, U.S. Cellular made capital contributions and advances to Carroll Wireless and/or its general partner of approximately $129.9 million; $129.7 million of this amount is included in Licenses in the Consolidated Balance Sheets. U.S. Cellular consolidates Carroll Wireless and Carroll PCS, Inc., the general partner of Carroll Wireless, for financial reporting purposes, pursuant to the guidelines of FASB Interpretation No. 46R ( FIN 46R ), as U.S. Cellular anticipates benefiting from or absorbing a majority of Carroll Wireless expected gains or losses. Pending finalization of Carroll Wireless permanent financing plan, and upon request by Carroll Wireless, U.S. Cellular may make additional capital contributions and advances to Carroll Wireless and/or its general partner. In November 2005, U.S. Cellular approved additional funding of $1.4 million of which $0.1 million was provided to Carroll Wireless through March 31, 2006.

In the first quarter of 2005, U.S. Cellular adjusted the gain on investments related to its sale to ALLTEL of certain wireless properties on November 30, 2004. The adjustment of the gain, which resulted from a working capital adjustment that was finalized in the first quarter of 2005, increased the total gain on the sale by $0.6 million to $38.6 million.

In addition, in 2005, U.S. Cellular purchased one new wireless market and certain minority interests in other wireless markets in which it already owned a controlling interest for $6.9 million in cash.

## 17. Accumulated Other Comprehensive Income

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

| | Three Months Ended March 31, 2006 | 2005 |
|---|---|---|
| | (Dollars in thousands) | |
| **Marketable Equity Securities** | | |
| Balance, beginning of period | $ 41,287 | $ 77,573 |
| Add (deduct): | | |
| Unrealized gains (losses) on marketable equity securities | (5,803) | (8,750) |
| Income tax (expense) benefit | 2,130 | 3,217 |
| Net change in unrealized gains (losses) on marketable equity securities in comprehensive income | (3,673) | (5,533) |
| Balance, end of period | $ 37,614 | $ 72,040 |
| | | |
| **Derivative Instruments** | | |
| Balance, beginning of period | $ (16,343) | $ (44,770) |
| Add (deduct): | | |
| Unrealized gain on derivative instruments | 4,815 | 3,996 |
| Income tax (expense) | (1,767) | (1,470) |
| Net change in unrealized gains (losses) on derivative instruments included in comprehensive income | 3,048 | 2,526 |
| Balance, end of period | $ (13,295) | $ (42,244) |
| | | |
| **Accumulated Other Comprehensive Income** | | |
| Balance, beginning of period | $ 24,944 | $ 32,803 |
| Net change in marketable equity securities | (3,673) | (5,533) |
| Net change in derivative instruments | 3,048 | 2,526 |
| Net change in unrealized gains (losses) included in comprehensive income | (625) | (3,007) |
| Balance, end of period | $ 24,319 | $ 29,796 |

## 18. Commitments and Contingencies

Contingent obligations, including indemnities, litigation and other possible commitments are accounted for in accordance with SFAS No. 5, Accounting for Contingencies, which requires that an estimated loss be recorded if it is probable that an asset has been impaired or a liability has been incurred at the date of the financial statements and the amount of the loss can be reasonably estimated. Accordingly, those contingencies that are deemed to be probable and where the amount of such settlement is reasonably estimable are accrued in the financial statements. If only a range of loss can be determined, the best estimate within that range is accrued; if none of the estimates within that range is better than another, the low end of the range is accrued. Disclosure of a contingency is required if there is at least a reasonable possibility that a loss has been or will be incurred, even if the amount is not estimable. The assessment of contingencies is a highly subjective process that requires judgments about future events. Contingencies are reviewed at least quarterly to determine the adequacy of the accruals and related financial statement disclosure. The ultimate outcome of contingencies could materially impact the Consolidated Statements of Operations, Consolidated Balance Sheets and Consolidated Statements of Cash Flows.

Indemnifications

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

Legal Proceedings

U.S. Cellular is involved in a number of legal proceedings before the FCC and various state and federal courts. If U.S. Cellular believes that a loss arising from such legal proceedings is probable and can be reasonably estimated, an amount is accrued in the financial statements for the estimated loss. If only a range of loss can be determined, the best estimate within that range is accrued; if none of the estimates within that range is better than another, the low end of the range is accrued. The assessment of legal proceedings is a highly subjective process that requires judgments about future events. The legal proceedings are reviewed at least quarterly to determine the adequacy of the accruals and related financial statement disclosure. The ultimate outcome of legal proceedings could differ materially from amounts accrued in the financial statements.

## 19. Subsequent Events

U.S. Cellular owns approximately 14% of Midwest Wireless Communications, L.L.C., which interest is convertible into approximately an 11% interest in Midwest Wireless Holdings, L.L.C., a privately-held wireless telecommunications company that controls Midwest Wireless Communications. Midwest Wireless Holdings, through subsidiaries, holds FCC licenses and operates certain wireless markets in southern Minnesota, northern and eastern Iowa and western Wisconsin. On November 18, 2005, ALLTEL announced that it had entered into a definitive agreement to acquire Midwest Wireless Holdings for $1.075 billion in cash, subject to certain conditions, including approval by the FCC, other governmental authorities and the members of Midwest Wireless Holdings. On January 31, 2006, U.S. Cellular filed a petition to deny the FCC license transfer of control applications filed by ALLTEL and Midwest Wireless Holdings seeking FCC consent to their transaction. That petition is pending. Subject to the outcome of such petition, the satisfaction of certain conditions and the closing of the foregoing agreement, U.S. Cellular will be entitled to receive approximately $102.7 million in cash in consideration with respect to its interest in Midwest Wireless Communications upon the closing of the acquisition of Midwest Wireless Holdings by ALLTEL. In addition, U.S. Cellular owns 49% of an entity, accounted for under the equity method, which owns approximately 2.9% of Midwest Wireless Holdings. If the transaction with ALLTEL occurs, this entity will receive cash in consideration for its interest in Midwest Wireless Holdings. Following that, this entity will be dissolved and U.S. Cellular will be entitled to receive approximately $11.4 million in cash. The net aggregate carrying value of U.S. Cellular s investments in Midwest Wireless Communications and Midwest Wireless Holdings was approximately $21.7 million at March 31, 2006.

U.S. Cellular is a limited partner in Barat Wireless, L.P. ( Barat Wireless ), an entity which is participating in the auction of wireless spectrum designated by the FCC as Auction 66, which began in August 2006. Barat Wireless intends to qualify as a designated entity and be eligible for discounts with respect to spectrum purchased in Auction 66.

Barat Wireless is in the process of developing its long-term business and financing plans. As of August 25, 2006, U.S. Cellular has made capital contributions and advances to Barat Wireless and/or its general partner of $79.9 million to provide initial funding of Barat Wireless participation in Auction 66. U.S. Cellular will consolidate Barat Wireless and Barat Wireless, Inc., the general partner of Barat Wireless, for financial reporting purposes, pursuant to the guidelines of FIN 46R, as U.S. Cellular anticipates absorbing a majority of Barat Wireless expected gains or losses. Pending finalization of Barat Wireless permanent financing plan, and upon request by Barat Wireless, U.S. Cellular may agree to make additional capital contributions and advances to Barat Wireless and/or its general partner.

At an Extraordinary General Meeting held on July 25, 2006, shareholders of Vodafone approved a Return of Capital ( Special Distribution ) of £0.15 per share (£1.50 per American Depositary Receipt ( ADR )) and a Share Consolidation under which every 8 ADRs of Vodafone were consolidated into 7 ADRs.

The Share Consolidation was effective July 28, 2006 and the Special Distribution was paid on August 18, 2006. As a result of the Share Consolidation, U.S. Cellular s previous 10,245,370 ADRs were consolidated into 8,964,698 ADRs. Also, U.S. Cellular received approximately $28.6 million from the Special Distribution and will record dividend income, before taxes, of this amount in the third quarter of 2006.

Pursuant to terms of the forward contracts, the contract collars were adjusted to reflect the Special Dividend and the Share Consolidation. After adjustment, the collars had downside limits (floor) ranging from $17.22 to $18.37 and upside potential (ceiling) ranging from $17.22 to $19.11. In the case of one forward contract, U.S. Cellular made a dividend substitution payment in the amount of $0.2 million to the counterparty in lieu of further adjustments to the collars of such forward contract.

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

United States Cellular Corporation ( U.S. Cellular - AMEX symbol: USM) owns, operates and invests in wireless markets throughout the United States. U.S. Cellular is an 81.2%-owned subsidiary of Telephone and Data Systems, Inc. ( TDS ).

The following discussion and analysis should be read in conjunction with U.S. Cellular s interim consolidated financial statements included herein, and with its audited consolidated financial statements and Management s Discussion and Analysis of Financial Condition and Results of Operations included in its Annual Report on Form 10-K ( Form 10-K ) for the year ended December 31, 2005.

**SUMMARY OF HOLDINGS**

U.S. Cellular owned, or had the right to acquire pursuant to certain agreements, either majority or minority interests in 241 wireless markets at March 31, 2006. A summary of the number of markets U.S. Cellular owned or had rights to acquire as of March 31, 2006 follows:

| | Number of Markets |
|---|---|
| Consolidated markets (1) | 200 |
| Consolidated markets acquirable pursuant to existing agreements (2) | 17 |
| Minority interests accounted for using equity method (3) | 19 |
| Minority interests accounted for using cost method (4) | 5 |
| Total markets to be owned after completion of pending transactions | 241 |

(1) U.S. Cellular owns a controlling interest in each of these markets. These markets include controlling interests acquired in 11 licenses through Carroll Wireless, L.P. ( Carroll Wireless ), an entity in which U.S. Cellular owns a controlling interest for financial reporting purposes. Carroll Wireless was the winning bidder of 17 wireless licenses in the auction of wireless spectrum designated by the Federal Communications Commission ( FCC ) as Auction 58. On January 6, 2006, the FCC granted Carroll Wireless applications with respect to 16 of the 17 licenses for which it was the winning bidder and dismissed one application relating to Walla Walla, Washington. Following the completion of Auction 58, the FCC determined that a portion of the Walla Walla license was already licensed to another party and should not have been included in Auction 58. In March 2006, Carroll Wireless received a full refund of the amount paid to the FCC with respect to the Walla Walla license. Of the 16 licenses which were granted to Carroll Wireless, five are in markets in which U.S. Cellular currently owns spectrum. Only license acquisitions which add incremental territory to U.S. Cellular s consolidated operating markets are included in the number of consolidated markets to be acquired to avoid duplicate reporting of overlapping markets. The other 11 licenses represent markets which are incremental to U.S. Cellular s currently owned or acquirable markets.

U.S. Cellular s consolidated markets also include controlling interests acquired in 15 licenses and exclude controlling interests transferred in two licenses pursuant to the exchange transaction with ALLTEL Corporation ( ALLTEL ) that was completed on December 19, 2005.

(2) U.S. Cellular owns rights to acquire controlling interests in 17 wireless licenses resulting from an exchange transaction with AT&T Wireless Services, Inc. ( AT&T Wireless ), now Cingular Wireless L.L.C. ( Cingular ), which closed in August 2003. Pursuant to such exchange transaction, U.S. Cellular has up to five years from the transaction closing date to exercise its rights to acquire the licenses. Pursuant to such exchange transaction, U.S. Cellular also has the rights to acquire four additional licenses. However, those four licenses are in markets where U.S. Cellular currently owns spectrum. Therefore, the four licenses for which U.S. Cellular owns rights to acquire controlling interests are not included in the number of consolidated markets to be acquired.

(3) Represents licenses in which U.S. Cellular owns an interest that is not a controlling financial interest and which are accounted for using the equity method.

(4) Represents licenses in which U.S. Cellular owns an interest that is not a controlling financial interest and which are accounted for using the cost method.

**OVERVIEW**

The following is a summary of certain selected information from the complete management discussion that follows the overview and 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 this overview.

**Results of Operations**

U.S. Cellular positions itself as a regional operator, focusing its efforts on providing wireless service to customers in the geographic areas where it has licenses to provide such service. U.S. Cellular differentiates itself from its competitors through a customer satisfaction strategy, reflecting broad product distribution, a customer service focus and a high-quality wireless network.

U.S. Cellular s business development strategy is to operate controlling interests in wireless licenses in areas adjacent to or in proximity to its other wireless licenses, thereby building contiguous operating market areas. U.S. Cellular s operating strategy is to strengthen the geographic areas where it can continue to build long-term operating synergies and to exit those areas where it does not have opportunities to build such synergies.

U.S. Cellular s operating income in the three months ended March 31, 2006 increased $32.2 million, or 81%, to $71.7 million from $39.5 million in 2005. The operating income margin (as a percent of service revenues) was 9.3% in 2006 and 5.9% in 2005. Operating income and operating income margin are expected to improve slightly over the next few years, primarily due to anticipated increases in revenues generated by additional customers, data-related services and recently launched markets. Offsetting these increases are the anticipated effects of the following factors:

- costs of customer acquisition and retention;
- effects of competition;
- costs related to increased customer use of its services;
- costs of developing recently acquired and launched markets; and
- costs of additional enhancements to U.S. Cellular s wireless networks.

**Cash Flows and Investments**

At March 31, 2006, U.S. Cellular had cash and cash equivalents totaling $17.0 million and available borrowing capacity of $614.5 million under its revolving credit facility. Also, during the quarter ended March 31, 2006, U.S. Cellular generated cash flows from operating activities of $159.5 million. U.S. Cellular believes that cash on hand, expected future cash flows from operating activities and sources of external financing provide substantial financial flexibility and are sufficient to permit U.S. Cellular to finance its contractual obligations and anticipated capital expenditures for the foreseeable future. U.S. Cellular continues to seek to maintain a strong balance sheet and an investment grade rating.

U.S. Cellular is a limited partner in Barat Wireless, L.P. ( Barat Wireless ), an entity which is participating in the auction of wireless spectrum designated by the FCC as Auction 66, which began in August 2006. Barat Wireless intends to qualify as a designated entity and be eligible for discounts with respect to spectrum purchased in Auction 66.

Barat Wireless is in the process of developing its long-term business and financing plans. As of August 25, 2006, U.S. Cellular has made capital contributions and advances of $79.9 million to Barat Wireless and/or its general partner to provide initial funding of Barat Wireless participation in Auction 66. U.S. Cellular will consolidate Barat Wireless and Barat Wireless, Inc., the general partner of Barat Wireless, for financial reporting purposes, pursuant to the guidelines of Financial Accounting Standards Board ( FASB ) Interpretation No. 46R ( FIN 46R ), as U.S. Cellular anticipates absorbing a majority of Barat Wireless expected gains or losses. Pending finalization of Barat Wireless permanent financing plan, and upon request by Barat Wireless, U.S. Cellular may agree to make additional capital contributions and advances to Barat Wireless and/or its general partner.

See Financial Resources and Liquidity and Capital Resources.

**RESULTS OF OPERATIONS**

**Three Months Ended March 31, 2006 Compared to Three Months Ended March 31, 2005.**

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

| | Three Months Ended or At March 31, | |
|---|---|---|
| | 2006 | 2005 |
| As of March 31, (1a) | | |
| Total market population (2) | 55,164,000 | 44,576,000 |
| Customers (3) | 5,633,000 | 5,127,000 |
| Market penetration (4) | 10.21 | |