TELEPHONE & DATA SYSTEMS INC /DE/
Form ARS
April 18, 2014

Table of Contents

**TELEPHONE AND DATA SYSTEMS, INC.**

**ANNUAL REPORT TO SHAREHOLDERS FOR THE YEAR ENDED DECEMBER 31, 2013**
**Pursuant to SEC Rule 14a-3**

The following audited financial statements and certain other financial information for the year ended December 31, 2013, represent Telephone and Data Systems' annual report to shareholders as required by the rules and regulations of the Security and Exchange Commission ("SEC").

The following information was filed with the SEC on February 28, 2014 as Exhibit 13 to Telephone and Data Systems' Annual Report on Form 10-K for the year ended December 31, 2013. Such information has not been updated or revised since the date it was originally filed with the SEC. Accordingly, you are encouraged to review such information together with any subsequent information that we have filed with the SEC and other publicly available information.

Table of Contents

**Exhibit 13**

**Telephone and Data Systems, Inc.**

**Financial Reports Contents**

Table of Contents

**Telephone and Data Systems, Inc.**

**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 4.8 million wireless customers and 1.1 million wireline and cable connections at December 31, 2013. 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").

TDS conducts printing and distribution services through its majority-owned subsidiary, Suttle-Straus, Inc. ("Suttle-Straus") and provides wireless services through its wholly-owned subsidiary, Airadigm Communications, Inc. ("Airadigm"), a Wisconsin-based service provider. At this time, Airadigm operates independently from U.S. Cellular. Suttle-Straus and Airadigm's financial results were not significant to TDS' operations for the year ended December 31, 2013 and collectively represent the "Non-Reportable Segment."

The following discussion and analysis should be read in conjunction with TDS' audited consolidated financial statements and the description of TDS' business included in Item 1 of the TDS Annual Report on Form 10-K ("Form 10-K") for the year ended December 31, 2013. The discussion and analysis contained herein refers to consolidated data and results of operations, unless otherwise noted.

## 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.

Previously, TDS had reported the following reportable segments: U.S. Cellular, TDS Telecom's incumbent local exchange carrier ("ILEC"), its competitive local exchange carrier ("CLEC"), its HMS operations and the Non-Reportable Segment. As a result of recent acquisitions and changes in TDS' strategy, operations and internal reporting, TDS has reevaluated and changed its operating segments during the year ended December 31, 2013, which resulted in the following reportable segments: U.S. Cellular, TDS Telecom's Wireline, Cable and HMS operations, and the Non-Reportable Segment. The Wireline segment consists of the former ILEC and CLEC segments. The Cable segment consists of Baja Broadband, LLC ("Baja"), which was acquired in August 2013. The HMS segment remains unchanged. Periods presented for comparative purposes have been re-presented to conform to this revised presentation.

### U.S. Cellular

In its consolidated operating markets, U.S. Cellular serves approximately 4.8 million customers in 23 states. As of December 31, 2013, U.S. Cellular's average penetration rate in its consolidated operating markets was 15.0%. 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. U.S. Cellular's business development strategy is to obtain interests in and access to wireless licenses in its current operating markets and in areas that are adjacent to or in close proximity to its other wireless licenses, thereby building contiguous operating market areas with strong spectrum positions. U.S. Cellular believes that the acquisition of additional licenses within its current operating markets will enhance its network capacity to meet its customers' increased demand for data services. U.S. Cellular anticipates that grouping its operations into market areas will continue to provide it with certain economies in its capital and operating costs.

Financial and operating highlights in 2013 included the following:

- On April 3, 2013, U.S. Cellular entered into an agreement relating to St. Lawrence Seaway RSA Cellular Partnership ("NY1") and New York RSA 2 Cellular Partnership ("NY2" and, together with NY1,

**Telephone and Data Systems, Inc.**

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

the "Partnerships") with Cellco Partnership d/b/a Verizon Wireless, which required U.S. Cellular to deconsolidate the Partnerships and thereafter account for them as equity method investments (the "NY1 & NY2 Deconsolidation"). In connection with the deconsolidation, U.S. Cellular recognized a non-cash pre-tax gain of $18.5 million which was recorded in Gain on investments in the Consolidated Statement of Operations. See Note 7 Investments in Unconsolidated Entities in the Notes to Consolidated Financial Statements for additional information regarding this transaction.

On May 16, 2013, U.S. Cellular completed the sale of customers and certain PCS license spectrum in U.S. Cellular's Chicago, central Illinois, St. Louis and certain Indiana/Michigan/Ohio markets ("Divestiture Markets"), to Sprint Corp., fka Sprint Nextel Corporation, for $480 million in cash (the "Divestiture Transaction"). In connection with the sale, U.S. Cellular recognized a pre-tax gain of $266.4 million which was recorded in (Gain) loss on sale of business and other exit costs, net in the Consolidated Statement of Operations. See Note 5 Acquisitions, Divestitures and Exchanges in the Notes to Consolidated Financial Statements for additional information regarding this transaction.

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 as of June 11, 2013. Of the $482.3 million paid, TDS received $407.1 million while noncontrolling public shareholders received $75.2 million.

On October 4, 2013, U.S. Cellular sold the majority of its Mississippi Valley non-operating market license ("unbuilt license") for $308.0 million. A pre-tax gain of $250.6 million was recorded in (Gain) loss on license sales and exchanges in the Consolidated Statement of Operations.

In the fourth quarter of 2013, U.S. Cellular issued loyalty reward points with a value of $43.5 million as a loyalty bonus in recognition of the inconvenience experienced by customers during U.S. Cellular's recent billing system conversion. The loyalty bonus reduced Operating revenues in the Consolidated Statement of Operations and increased Customer deposits and deferred revenues in the Consolidated Balance Sheet.

Total consolidated customers were 4,774,000 at December 31, 2013, including 4,610,000 retail customers (97% of total).

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 Deconsolidated Markets. 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.

Retail customer net losses were 215,000 in 2013 compared to net additions of 32,000 in 2012. In the postpaid category, there were net losses of 217,000 in 2013, compared to net losses of 92,000 in 2012. Prepaid net additions were 2,000 in 2013 compared to net additions of 124,000 in 2012.

Postpaid customers comprised approximately 93% of U.S. Cellular's retail customers as of December 31, 2013 and December 31, 2012. The postpaid churn rate was 1.7% in 2013 and 1.5% in 2012. The prepaid churn rate was 6.7% in 2013 and 5.2% in 2012.

Billed average revenue per user ("ARPU") increased to $50.82 in 2013 from $50.54 in 2012 reflecting an increase in postpaid ARPU due to increases in smartphone adoption and corresponding revenues from data products and services, offset by a decrease in prepaid ARPU. Service revenue ARPU decreased to $57.66 in 2013 from $58.49 in 2012 due primarily to decreases in inbound roaming and eligible telecommunications carriers ("ETC") revenues. The special issuance of loyalty rewards points in the fourth quarter of 2013 negatively impacted both billed ARPU and service revenue ARPU by $0.73 in 2013.

Table of Contents

**Telephone and Data Systems, Inc.**

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

- Postpaid customers on smartphone service plans increased to 51% as of December 31, 2013 compared to 41% as of December 31, 2012. In addition, smartphones represented 69% of all devices sold in 2013 compared to 56% in 2012.

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

- Retail service revenues of $3,165.5 million decreased $382.5 million year-over-year, due to a decrease of 619,000 in the average number of customers (including approximately 550,000 due to the reductions caused by the Divestiture Transaction and NY1 & NY2 Deconsolidation).

- Total additions to Property, plant and equipment were $737.5 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, develop new billing and other customer management related systems and platforms, and enhance existing office systems. Total cell sites in service decreased 13% year-over-year to 6,975 primarily as a result of the NY1 & NY2 Deconsolidation and the deactivation of certain cell sites in the Divestiture Markets.

- Operating income decreased $9.8 million, or 6%, to $146.9 million in 2013 from $156.7 million in 2012, reflecting lower service revenues as discussed above as well as lower inbound roaming revenues, higher equipment subsidies and accelerated depreciation related to the Divestiture Transaction. The impacts of these items were offset by lower operating expenses in other categories and gains related to sales of the Divestiture Markets and spectrum licenses. See additional discussion below in "Results of Operations U.S. Cellular".

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

- Impacts of selling Apple iPhone products;

- Relative ability to attract and retain customers in a competitive marketplace in a cost effective manner;

- Effects of industry competition on service and equipment pricing as well as the impacts associated with the expanding presence of carriers and other retailers offering low-priced, unlimited prepaid service;

- 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 the use of 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;

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 under way at the Federal Communications Commission ("FCC");

The ability to negotiate satisfactory 4G LTE data roaming agreements with other wireless operators;

Table of Contents

**Telephone and Data Systems, Inc.**

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

- 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. This conversion caused billing delays, which were largely resolved in the fourth quarter of 2013. In addition, intermittent system outages and delayed system response times negatively impacted customer service and sales operations at certain times. Continuing operational problems associated with the conversion to 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; and

- On August 14, 2013 U.S. Cellular entered into a definitive agreement to sell the majority of its St. Louis area unbuilt license for $92.3 million. The sale will result in an estimated pre-tax gain of $76.2 million. This transaction is subject to regulatory approval and is expected to close in the first quarter of 2014 at which time, the gain on sale will be recorded. In accordance with GAAP, the book value of the license has been accounted for and disclosed as "held for sale" in the Consolidated Balance Sheet at December 31, 2013.

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 that meet or exceed 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 since the date of acquisition.

On August 1, 2013, TDS Telecom acquired substantially all of the assets of Baja Broadband, LLC ("Baja") for $264.1 million in cash. Baja operates in markets primarily in Colorado, New Mexico, Texas, and Utah. The operations of Baja are included in the Cable segment since the date of acquisition.

TDS Telecom acquired Vital Support Systems, LLC ("Vital") in June 2012 and OneNeck IT Services Corporation ("OneNeck IT Services") in July 2011. The operations of Vital and OneNeck IT Services are included in the HMS segment since their respective dates of acquisition.

All of these acquisitions impact the comparability of TDS Telecom operating results.

Financial and operating highlights in 2013 included the following:

- Operating revenues increased $92.5 million or 11% to $947.0 million in 2013. The increase was due primarily to $100.1 million from acquisitions of Vital in June 2012, Baja in August 2013 and MSN in October 2013, partially offset by a decrease in revenues due to declines in Wireline connections and a decline in Wireline wholesale revenues.

- Operating expenses increased $88.4 million or 11% to $902.2 million in 2013 due primarily to $101.2 million from the acquisitions noted above, partially offset by a decrease in Wireline expenses.

- Additions to Property, plant and equipment totaled $164.9 million in 2013 including strategic investment in increased network capabilities for broadband services, HMS expansion, IPTV expansion, 4

Table of Contents

**Telephone and Data Systems, Inc.**

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

and software tools that improve management of the network and support sales and customer service processes.

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 VoIP, DOCSIS 3.0 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 IPTV into additional market areas;
- Continued growth in hosted and managed services which may result in the need for additional investment in data centers;
- 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; 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 February 26, 2014 for pro forma financial information related to the Divestiture Transaction and the NY1 & NY2 Deconsolidation for the three and twelve months ended December 31, 2013, as if the transactions had occurred at the beginning of the respective periods. Also refer to TDS' Form 8-K filed on May 3, 2013 for pro forma financial information related to the Divestiture Transaction and the NY1 & NY2 Deconsolidation for the twelve months ended December 31, 2012.

**REGULATORY DEVELOPMENTS**

**FCC Reform Order**

In 2011, the FCC released an order ("Reform Order") to: reform its universal service and intercarrier compensation mechanisms; establish a new, broadband-focused support mechanism; and propose further rules to advance reform. Appeals of the Reform Order were consolidated and argued in the U.S. Court of Appeals for the 10th Circuit on November 19, 2013, with a decision anticipated in 2014.

There have been no significant changes to the Reform Order since December 31, 2012 that are expected to adversely affect U.S. Cellular or TDS Telecom. U.S. Cellular and TDS Telecom cannot predict the outcome of the consolidated appeals referred to above or any future rulemaking, reconsideration or legal challenges and, as a consequence, the impacts that such potential developments may have on U.S. Cellular's or TDS Telecom's business, financial condition or results of operations.

Table of Contents

**Telephone and Data Systems, Inc.**

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

**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 lays out a roadmap for the voluntary commitments of AT&T and DISH Network Corporation ("DISH") to become fully binding under a regulatory framework which will require the FCC to take additional actions proposed to be completed by the first quarter of 2014. Pursuant to this voluntary agreement, 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, collectively comprising "Band 12" under the standards of the 3rd Generation Partnership Project ("3GPP"). AT&T also agreed to support LTE roaming on its networks for carriers with compatible Band 12 devices, consistent with the FCC's rules on roaming. As outlined in its voluntary commitment, 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 its 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 only interoperate across 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.

Table of Contents

**Telephone and Data Systems, Inc.**

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

**RESULTS OF OPERATIONS CONSOLIDATED**

| Year Ended December 31, (Dollars in thousands, except per share amounts) | 2013 | Increase/(Decrease) | Percentage Change | 2012 | Increase/(Decrease) | Percentage Change | 2011 |
|---|---|---|---|---|---|---|---|
| **Operating revenues** | | | | | | | |
| U.S. Cellular | $3,918,836 | $(533,248) | (12)% | $4,452,084 | $ 108,738 | 3% | $4,343,346 |
| TDS Telecom | 947,003 | 92,497 | 11% | 854,506 | 39,118 | 5% | 815,388 |
| All other(1) | 35,397 | (3,290) | (9)% | 38,687 | 16,950 | 78% | 21,737 |
| Total operating revenues | 4,901,236 | (444,041) | (8)% | 5,345,277 | 164,806 | 3% | 5,180,471 |
| **Operating expenses** | | | | | | | |
| U.S. Cellular | 3,771,971 | (523,457) | (12)% | 4,295,428 | 232,862 | 6% | 4,062,566 |
| TDS Telecom | 902,171 | 88,407 | 11% | 813,764 | 97,027 | 14% | 716,737 |
| All other(1) | (8,265) | (60,487) | >(100)% | 52,222 | 13,556 | 35% | 38,666 |
| Total operating expenses | 4,665,877 | (495,537) | (10)% | 5,161,414 | 343,445 | 7% | 4,817,969 |
| **Operating income (loss)** | | | | | | | |
| U.S. Cellular | 146,865 | (9,791) | (6)% | 156,656 | (124,124) | (44)% | 280,780 |
| TDS Telecom | 44,832 | 4,090 | 10% | 40,742 | (57,909) | (59)% | 98,651 |
| All other(1) | 43,662 | 57,197 | >100% | (13,535) | 3,394 | 20% | (16,929) |
| Total operating income | 235,359 | 51,496 | 28% | 183,863 | (178,639) | (49)% | 362,502 |
| **Other income (expenses)** | | | | | | | |
| Equity in earnings of unconsolidated entities | 132,714 | 39,847 | 43% | 92,867 | 10,329 | 13% | 82,538 |
| Interest and dividend income | 9,092 | (156) | (2)% | 9,248 | 103 | 1% | 9,145 |
| Gain (loss) on investments | 14,547 | 18,265 | >100% | (3,718) | (27,821) | >(100)% | 24,103 |
| Interest expense | (98,811) | 12,066 | 14% | (86,745) | (31,456) | (27)% | (118,201) |
| Other, net | (37) | (757) | >(100)% | 720 | (2,938) | (80)% | 3,658 |
| Total other income (expenses) | 57,505 | 45,133 | >100% | 12,372 | 11,129 | >100% | 1,243 |
| **Income before income taxes** | 292,864 | 96,629 | 49% | 196,235 | (167,510) | (46)% | 363,745 |
| Income tax expense | 126,043 | 52,461 | 71% | 73,582 | (39,921) | (35)% | 113,503 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| **Net income** | 166,821 | 44,168 | 36% | 122,653 | (127,589) | (51)% | 250,242 |
| Less: Net income attributable to noncontrolling interests, net of tax | 24,894 | (15,898) | (39)% | 40,792 | (8,884) | (18)% | 49,676 |
| **Net income attributable to TDS shareholders** | 141,927 | 60,066 | 73% | 81,861 | (118,705) | (59)% | 200,566 |
| Preferred dividend requirement | (49) | (1) | (2)% | (50) | | | (50) |
| **Net income available to common shareholders** | $ 141,878 | $ 60,067 | 73% | $ 81,811 | $ (118,705) | (59)% | $ 200,516 |
| **Basic earnings per share attributable to TDS shareholders** | $ 1.31 | $ 0.56 | 75% | $ 0.75 | $ (1.10) | (59)% | $ 1.85 |
| **Diluted earnings per share attributable to TDS shareholders** | $ 1.29 | $ 0.54 | 72% | $ 0.75 | $ (1.08) | (59)% | $ 1.83 |

N/M Percentage 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. 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.

**Operating Revenues and Expenses**

See "Results of Operations U.S. Cellular" and "Results of Operations TDS Telecom" below for factors that affected Operating revenues and expenses.

**Telephone and Data Systems, Inc.**

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

**Equity in earnings of unconsolidated entities**

Equity in earnings of unconsolidated entities represents TDS' share of net income from entities in which it has a noncontrolling interest and that are accounted for by the equity method. TDS generally follows the equity method of accounting for unconsolidated entities in which its ownership interest is less than or equal to 50% but equals or exceeds 20% for corporations and 3% for partnerships and limited liability companies, or for unconsolidated entities in which its ownership is greater than 50% but TDS does not have a controlling financial interest.

TDS' investment in the Los Angeles SMSA Limited Partnership ("LA Partnership") contributed $78.4 million, $67.2 million and $55.3 million to Equity in earnings of unconsolidated entities in 2013, 2012 and 2011, respectively. TDS received cash distributions from the LA Partnership of $71.5 million in 2013 and $66.0 million in 2012 and 2011.

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. In 2013, TDS' investment in the NY1 & NY2 Partnerships contributed $24.7 million to Equity in earnings of unconsolidated entities subsequent to their deconsolidation. No amounts were included in 2012 or 2011 because the NY1 & NY2 Partnerships were consolidated in those years. Distributions from the NY1 & NY2 Partnerships of $29.4 million in 2013, after the deconsolidation on April 1, 2013, are included in Distributions from unconsolidated entities on the Consolidated Statement of Cash Flows.

**Gain (loss) on investments**

In connection with the deconsolidation of the NY1 & NY2 Partnerships, TDS recognized a non-cash pre-tax gain of $14.5 million which was recorded in Gain (loss) on investments in 2013. See Note 7 Investments in Unconsolidated Entities for additional information.

Loss on investment in 2012 includes a provision for loss of $3.7 million related to a note receivable and preferred stock acquired by U.S. Cellular in connection with an acquisition in 1998. Gain on investment in 2011 includes a gain of $12.7 million from TDS' acquisition of 63% of Airadigm in September 2011 and a $13.4 million gain recorded as a result of adjusting the carrying value of a pre-existing noncontrolling interest for which U.S. Cellular purchased the remaining interest in May 2011, as more fully described in Note 5 Acquisitions, Divestitures and Exchanges in the Notes to Consolidated Financial Statements.

**Interest expense**

Interest expense increased $12.1 million due primarily to the issuance of TDS' 5.875% Senior Notes in November 2012 for $195.0 million. This amount was partially offset by an increase in capitalized interest during 2013. TDS recorded $15.4 million in interest expense to write-off unamortized debt issuance costs related to TDS' $282.5 million, 7.6% Senior Notes, and U.S. Cellular's $330 million, 7.5% Senior Notes, redeemed on May 2, 2011 and June 20, 2011, respectively. The impact of these write-offs in 2011, along with lower effective interest rates on long-term debt and an increase in capitalized interest for multi-year projects during 2012, resulted in the year-over-year decrease of $31.5 million expense from 2011 to 2012.

**Income tax expense**

The effective tax rates on Income before income taxes and extraordinary items ("pre-tax income") for 2013, 2012 and 2011 were 43.0%, 37.5% and 31.2%, respectively. The following significant discrete and other items impacted income tax expense for these years:

2013 Includes tax expense of $14.9 million related to the NY1 & NY2 Deconsolidation and the Divestiture Transaction, and a tax benefit of $5.5 million resulting from statute of limitation expirations.

**Telephone and Data Systems, Inc.**

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

2012 Includes tax benefits of $11.3 million resulting from statute of limitation expirations and $6.1 million resulting from corrections relating to prior periods, offset by tax expense of $1.3 million related to state income tax audits and tax expense associated with increases to state deferred tax asset valuation allowances of $5.2 million.

2011 Includes a tax benefit of $26.9 million resulting from state tax law changes, a tax benefit of $9.0 million resulting from statute of limitation expirations and tax expense of $6.0 million resulting from correction of partnership tax basis relating to a prior period.

See Note 3 Income Taxes in the Notes to Consolidated Financial Statements for further information on the effective tax rate.

**Net income attributable to noncontrolling interests, net of tax**

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

| Year Ended December 31, (Dollars in thousands) | 2013 | 2012 | 2011 |
|---|---|---|---|
| Net income attributable to noncontrolling interest, net of tax U.S. Cellular | | | |
| Noncontrolling public shareholders' | $ 21,775 | $ 18,431 | $ 28,934 |
| Noncontrolling shareholders' or partners'(1) | 3,119 | 22,361 | 20,742 |
| | $ 24,894 | $ 40,792 | $ 49,676 |

(1) The large decrease in 2013 is primarily due to the elimination of the noncontrolling interest as a result of the NY1 & NY2 Deconsolidation on April 3, 2013.

Table of Contents

**Telephone and Data Systems, Inc.**

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

## 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 presented for subsequent divestitures or deconsolidations. Unless otherwise noted, figures reported in Results of Operations are representative of consolidated results.

| As of or for the Year Ended December 31, | 2013 | 2012 | 2011 |
|---|---|---|---|
| **Retail Customers** | | | |
| **Postpaid** | | | |
| Total at end of period | 4,267,000 | 5,134,000 | 5,302,000 |
| Gross additions | 697,000 | 880,000 | 836,000 |
| Net additions (losses) | (325,000) | (165,000) | (117,000) |
| ARPU(1) | $ 54.31 | $ 54.32 | $ 52.20 |
| Churn rate(2) | 1.8% | 1.7% | 1.5% |
| Smartphone penetration(3)(4) | 50.8% | 41.8% | 30.5% |
| **Prepaid** | | | |
| Total at end of period | 343,000 | 423,000 | 306,000 |
| Gross additions | 309,000 | 368,000 | 228,000 |
| Net additions (losses) | (21,000) | 118,000 | (8,000) |
| ARPU(1) | $ 31.44 | $ 33.26 | $ 33.42 |
| Churn rate(2) | 7.0% | 6.0% | 6.6% |
| **Total customers at end of period** | 4,774,000 | 5,798,000 | 5,891,000 |
| **Billed ARPU(1)** | $ 50.73 | $ 50.81 | $ 48.63 |
| **Service revenue ARPU(1)** | $ 57.61 | $ 58.70 | $ 56.54 |
| **Smartphones sold as a percent of total devices sold** | 68.4% | 55.8% | 44.0% |
| **Total Population** | | | |
| Consolidated markets(5) | 58,013,000 | 93,244,000 | 91,965,000 |
| Consolidated operating markets(5) | 31,759,000 | 46,966,000 | 46,888,000 |
| **Market penetration at end of period** | | | |
| Consolidated markets(6) | 8.2% | 6.2% | 6.4% |
| Consolidated operating markets(6) | 15.0% | 12.3% | 12.6% |
| **Capital expenditures (000s)** | $ 737,501 | $ 836,748 | $ 782,526 |
| **Total cell sites in service** | 6,975 | 8,028 | 7,882 |
| **Owned towers in service** | 4,448 | 4,408 | 4,311 |

Table of Contents

**Telephone and Data Systems, Inc.**

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

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

Following is a table of summarized operating data for U.S. Cellular's Core Markets (which excludes the Divestiture Markets and NY1 and NY2 markets) as of or for the year ended December 31, 2013 or 2012.

| As of or for the Year Ended December 31, | 2013 | 2012 |
|---|---|---|
| **Retail Customers** | | |
| **Postpaid** | | |
| Total at end of period | 4,267,000 | 4,496,000 |
| Gross additions | 682,000 | 746,000 |
| Net additions (losses) | (217,000) | (92,000) |
| ARPU(1) | $ 54.23 | $ 53.65 |
| Churn rate(2) | 1.7% | 1.5% |
| Smartphone penetration(3)(4) | 50.8% | 41.1% |
| **Prepaid** | | |
| Total at end of period | 343,000 | 342,000 |
| Gross additions | 295,000 | 288,000 |
| Net additions (losses) | 2,000 | 124,000 |
| ARPU(1) | $ 31.45 | $ 32.98 |
| Churn rate(2) | 6.7% | 5.2% |
| **Total customers at end of period** | 4,774,000 | 5,022,000 |
| **Billed ARPU(1)** | $ 50.82 | $ 50.54 |
| **Service revenue ARPU(1)** | $ 57.66 | $ 58.49 |
| **Smartphones sold as a percent of total devices sold** | 68.6% | 56.1% |
| **Total Population** | | |
| Consolidated markets(5) | 58,013,000 | 83,384,000 |
| Consolidated operating markets(5) | 31,759,000 | 31,445,000 |
| **Market penetration at end of period** | | |
| Consolidated markets(6) | 8.2% | 6.0% |
| Consolidated operating markets(6) | 15.0% | 16.0% |
| **Capital expenditures (000s)** | $ 735,082 | $ 768,884 |
| **Total cell sites in service** | 6,161 | 6,130 |
| **Owned towers in service** | 3,913 | 3,847 |

(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 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 disconnects 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.

Table of Contents

**Telephone and Data Systems, Inc.**

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

(4) Smartphone penetration is calculated by dividing postpaid smartphone customers by total postpaid customers.

(5) Used only to calculate market penetration of consolidated and core markets and consolidated and core operating markets, respectively. See footnote (6) below.

(6) Market penetration is calculated by dividing the number of wireless customers at the end of the period by the total population of consolidated and core markets and consolidated and core operating markets, respectively, estimated by Claritas.

**Components of Operating Income**

| Year Ended December 31, (Dollars in thousands) | 2013 | Increase/ (Decrease) | Percentage Change | 2012 | Increase/ (Decrease) | Percentage Change | 2011 |
|---|---|---|---|---|---|---|---|
| Retail service | $ 3,165,496 | $ (382,483) | (11)% | $ 3,547,979 | $ 61,457 | 2% | $ 3,486,522 |
| Inbound roaming | 263,186 | (85,531) | (25)% | 348,717 | 408 | N/M | 348,309 |
| Other | 166,091 | (36,069) | (18)% | 202,160 | (16,806) | (8)% | 218,966 |
| Service revenues | 3,594,773 | (504,083) | (12)% | 4,098,856 | 45,059 | 1% | 4,053,797 |
| Equipment sales | 324,063 | (29,165) | (8)% | 353,228 | 63,679 | 22% | 289,549 |
| Total operating revenues | 3,918,836 | (533,248) | (12)% | 4,452,084 | 108,738 | 3% | 4,343,346 |
| System operations (excluding Depreciation, amortization and accretion reported below) | 763,435 | (183,370) | (19)% | 946,805 | 17,426 | 2% | 929,379 |
| Cost of equipment sold | 999,000 | 63,053 | 7% | 935,947 | 144,145 | 18% | 791,802 |
| Selling, general and administrative | 1,677,395 | (87,538) | (5)% | 1,764,933 | (4,768) | N/M | 1,769,701 |
| Depreciation, amortization and accretion | 803,781 | 195,148 | 32% | 608,633 | 35,076 | 6% | 573,557 |
| (Gain) loss on asset disposals, net | 30,606 | (12,518) | (69)% | 18,088 | (8,199) | (83)% | 9,889 |
| (Gain) loss on sale of business and other exit costs, net | (246,767) | 267,789 | >100% | 21,022 | (21,022) | N/M | |
| (Gain) loss on license sales and exchanges | (255,479) | 255,479 | N/M | | (11,762) | N/M | (11,762) |
| Total operating expenses | 3,771,971 | (523,457) | (12)% | 4,295,428 | 232,862 | 6% | 4,062,566 |
| Operating income | $ 146,865 | $ (9,791) | (6)% | $ 156,656 | $ (124,124) | (44)% | $ 280,780 |

N/M Percentage change 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, including long-distance roaming ("inbound roaming"); and (iii) amounts received from the Federal USF.

***Retail service revenues***

Retail service revenues decreased by $382.5 million, or 11%, to $3,165.5 million due primarily to a decrease in U.S. Cellular's average customer base (including the reductions caused by the Divestiture Transaction and NY1 & NY2 Deconsolidation) and a slight decrease in billed ARPU. In 2012, retail service revenues increased by $61.5 million, or 2%, to $3,548.0 million due primarily to the impact of an increase in billed ARPU, partially offset by a decrease in U.S. Cellular's average customer base.

In the fourth quarter of 2013, U.S. Cellular issued loyalty reward points with a value of $43.5 million as a loyalty bonus in recognition of the inconvenience experienced by customers during U.S. Cellular's recent billing system conversion. The value of the loyalty bonus reduced Operating revenues in the Consolidated Statement of Operations and increased Customer deposits and deferred revenues in the Consolidated Balance Sheet.

Table of Contents

**Telephone and Data Systems, Inc.**

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

Billed ARPU of $50.73 in 2013 was relatively flat compared to $50.81 in 2012. The special issuance of loyalty rewards points in the fourth quarter of 2013 negatively impacted billed ARPU by $0.70 in 2013, which was partially offset by an increase in smartphone adoption and corresponding revenues from data products and services. The increase in billed ARPU in 2012 from $48.63 in 2011 also reflects the impact of a larger portion of the customer base using smartphones which drives incremental data access revenue.

U.S. Cellular expects continued pressure on 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.

***Inbound roaming revenues***

Inbound roaming revenues decreased by $85.5 million, or 25% in 2013 to $263.2 million. The decrease was due primarily to lower rates ($47.9 million) and the impacts of the Divestiture Transaction and NY1 & NY2 Deconsolidation ($37.6 million). Data volume increased year-over year but the impact of this increase was offset by the combined impacts of lower volume for voice and lower rates for both data and voice. The decline in roaming revenues was offset by a decline in roaming expense also due to lower rates. U.S. Cellular expects continued growth in data volume but also expects that the revenue impact of this growth will be offset by the impacts of decreases in data rates and voice volume.

Inbound roaming revenues of $348.7 million were flat in 2012 compared to 2011 as higher data revenues, reflecting significantly higher volumes but lower negotiated rates, were offset by lower voice revenues, reflecting both lower volumes and rates.

***Other revenues***

Other revenues decreased by $36.1 million, or 18%, in 2013 compared to 2012. In 2012, Other revenues decreased by $16.8 million, or 8%. The decreases in both years are due primarily to decreases in ETC support.

Pursuant to the FCC's Reform Order (See "Overview  FCC Reform Order"), U.S. Cellular's current ETC support is being phased down at the rate of 20% per year beginning July 1, 2012. If the Phase II Mobility Fund is not operational by July 2014, the phase down will halt at that time 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 wireless devices and accessories to agents. All Equipment sales revenues are recorded net of rebates.

U.S. Cellular offers a competitive portfolio 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.

**Telephone and Data Systems, Inc.**

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

The decrease in 2013 equipment sales revenues of $29.2 million, or 8%, to $324.1 million was driven primarily by selling fewer devices, partially due to the Divestiture Transaction. Declines in volume were offset by an increase of 12.0% in average revenue per device. The increase in 2012 equipment sales revenues of $63.7 million, or 22%, to $353.2 million was driven primarily by a 17% increase in average revenue per wireless device sold; an increase in equipment activation fees also was a factor. Average revenue per wireless device sold increased in both years due to a continued shift in customer preference to higher priced smartphones.

**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 $183.4 million, or 19%, to $763.4 million in 2013 and increased $17.4 million, or 2%, to $946.8 million in 2012. Key components of the net changes in System operations expenses were as follows:

- Expenses incurred when U.S. Cellular's customers used other carriers' networks while roaming decreased $64.1 million, or 27%, in 2013 and $11.1 million, or 4%, in 2012, due primarily to lower rates and the impacts of the Divestiture Transaction and NY1 & NY2 Deconsolidation. For both years, data roaming usage increased; however, the impact of the increase was more than offset by lower rates for both data and voice and lower voice volume.

- Maintenance, utility and cell site expenses decreased $61.6 million, or 15%, in 2013 and increased $24.4 million, or 6%, in 2012. The decrease in 2013 is driven primarily by impacts of the Divestiture Transaction and reductions in expenses related to 3G equipment support and network costs, offset by increases in charges related to 4G LTE equipment and network costs. The increase in 2012 is driven primarily by an increase in the number of cell sites within U.S. Cellular's network and costs related to the deployment and operation of LTE networks.

- Customer usage expenses decreased by $57.7 million, or 19%, in 2013, and increased by $4.1 million, or 1%, in 2012. The decrease in 2013 is driven by impacts of the Divestiture Transaction and decreases in intercarrier charges as a result of the FCC's Reform Order and certain data costs, partially offset by increases due to network costs for 4G LTE. The increase in 2012 is due primarily to an increase in data capacity and usage, offset by a decline in voice usage as well as reduced intercarrier compensation expenses as a result of the FCC's Reform Order.

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 4G LTE network from the 3G network.

***Cost of equipment sold***

Cost of equipment sold increased $63.1 million, or 7%, in 2013 and $144.1 million, or 18% in 2012. In both years, the increase was driven primarily by an increase in the average cost per wireless device sold (33% in 2013 and 18% in 2012). Average cost per device sold increased due to general customer preference for higher priced 4G LTE smartphones, including the introduction of Apple products in the fourth quarter of 2013. In 2013, total devices sold decreased by 18% partially due to the Divestiture Transaction; in 2012, total devices sold increased by 1%.

**Telephone and Data Systems, Inc.**

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

U.S. Cellular's loss on equipment, defined as equipment sales revenues less cost of equipment sold, was $674.9 million, $582.7 million and $502.3 million for 2013, 2012 and 2011, 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 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 is beginning to offer new equipment pricing constructs such as device financing to offset a higher proportion of increasing equipment costs.

***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.

Selling, general and administrative expenses decreased by $87.5 million to $1,677.4 million in 2013 and by $4.8 million to $1,764.9 in 2012. Key components of the net changes in Selling, general and administrative expenses were as follows:

2013

- Selling and marketing expenses decreased by $75.7 million, or 9%, primarily from lower commission expenses, more cost-effective advertising spending and reduced employee and facilities costs as a result of the Divestiture Transaction.

- General and administrative expenses decreased by $11.8 million, or 1%, driven by corporate cost containment and reduction initiatives and reduced spending as a result of the Divestiture Transaction, offset by costs associated with launching the new billing system of $55.8 million and higher bad debts expense of $31.5 million due to higher customer accounts receivable balances resulting from billing issues experienced after the system conversion.

2012

- Selling and marketing expenses decreased by $24.8 million, or 3%, primarily from more cost-effective advertising spending.

- General and administrative expenses increased by $20.1 million, or 2%, driven by increases in bad debts expense, Federal Universal Service Charge ("FUSC") expense and non-income tax expense. FUSC charges are assessed to customers and also included in Service revenues.

***Depreciation, amortization and accretion***

Depreciation, amortization and accretion expense increased $195.1 million, or 32%, in 2013, and $35.1 million, or 6%, in 2012 due primarily to the acceleration of depreciation, amortization and accretion in the Divestiture Markets. The impact of the acceleration year over year was $158.5 million in 2013. The accelerated depreciation, amortization and accretion in the Divestiture Markets is expected to conclude in the first quarter of 2014.

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

(Gain) loss on asset disposals, net was a loss of $30.6 million in 2013 and $18.1 million in 2012 due primarily to losses resulting from the write-off and disposals of certain network assets.

Table of Contents

**Telephone and Data Systems, Inc.**

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

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

(Gain) loss on sale of business and other exit costs, net was a gain of $246.8 million in 2013, primarily related to the closing of the Divestiture Transaction. The loss of $21.0 million in 2012 was due primarily to employee severance costs and asset write-offs in the Divestiture Markets, partially offset by a $4.2 million gain resulting from the sale of a wireless market in March 2012.

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

(Gain) loss on license sales and exchanges resulted from the sale of the Mississippi Valley non-operating market license for $308.0 million, which resulted in a pre-tax gain of $250.6 million.

**RESULTS OF OPERATIONS TDS TELECOM**

TDS conducts its Wireline, Cable and HMS operations through TDS Telecom, a wholly-owned subsidiary. The following table summarizes operating data for Wireline and Cable operations:

| As of December 31, | 2013 | 2012 | 2011 |
|---|---|---|---|
| **Wireline** | | | |
| **Residential connections** | | | |
| Voice(1) | 352,100 | 374,700 | 399,300 |
| Broadband(2) | 227,000 | 229,900 | 230,600 |
| IPTV | 13,800 | 7,900 | 4,600 |
| Wireline residential connections | 592,900 | 612,500 | 634,500 |
| **Commercial connections** | | | |
| Voice(1) | 218,400 | 243,100 | 271,700 |
| Broadband(2) | 27,100 | 29,700 | 32,800 |
| managedIP(3) | 127,600 | 94,600 | 53,500 |
| Wireline commercial connections | 373,100 | 367,400 | 358,000 |
| **Total Wireline connections** | 966,000 | 979,900 | 992,500 |
| Total residential revenue per connection(4) | $ 40.53 | $ 39.65 | $ 38.86 |
| Residential broadband penetration(5) | 66% | 63% | 60% |
| **Cable** | | | |

| | | |
|---|---|---|
| **Cable connections** | | |
| Video(6) | | 69,200 |
| Broadband(7) | | 61,000 |
| Voice(7) | | 17,200 |
| Cable connections | | 147,400 |
| Total residential revenue per connection(4) | $ | 55.43 |

(1) The individual circuit connecting a customer 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 telephone handsets, data lines and IP trunks providing communications using IP networking technology.

(4) Total residential revenue divided by the average number of total residential connections.

(5) Total number of broadband connections divided by total primary residential connections.

Table of Contents

**Telephone and Data Systems, Inc.**

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

(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.

**TDS Telecom Total (Wireline, Cable and HMS Operations)**

**Components of Operating Income**

| Year Ended December 31, (Dollars in thousands) | 2013 | Increase/ (Decrease) | Percentage Change | 2012 | Increase/ (Decrease) | Percentage Change | 2011 |
|---|---|---|---|---|---|---|---|
| **Operating revenues** | | | | | | | |
| Wireline | $ 726,567 | $ (15,181) | (2)% | $ 741,748 | $ (26,460) | (3)% | $ 768,208 |
| Cable | 35,883 | 35,883 | N/M | | | N/M | |
| HMS | 185,616 | 72,606 | 64% | 113,010 | 65,830 | >100% | 47,180 |
| Intra-company elimination | (1,063) | (811) | >(100)% | (252) | (252) | N/M | |
| TDS Telecom operating revenues | 947,003 | 92,497 | 11% | 854,506 | 39,118 | 5% | 815,388 |
| **Operating expenses** | | | | | | | |
| Wireline | 661,561 | (21,805) | (3)% | 683,366 | 18,760 | 3% | 664,606 |
| Cable | 35,927 | 35,927 | N/M | | | N/M | |
| HMS | 205,746 | 75,096 | 57% | 130,650 | 78,519 | >100% | 52,131 |
| Intra-company elimination | (1,063) | (811) | >(100)% | (252) | (252) | N/M | |
| TDS Telecom operating expenses | 902,171 | 88,407 | 11% | 813,764 | 97,027 | 14% | 716,737 |
| TDS Telecom operating income | $ 44,832 | $ 4,090 | 10% | $ 40,742 | $ (57,909) | (59)% | $ 98,651 |

N/M Not meaningful

Table of Contents

**Telephone and Data Systems, Inc.**

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

**Wireline Operations**

**Components of Operating Income**

| Year Ended December 31, (Dollars in thousands) | 2013 | Increase/ (Decrease) | Percentage Change | 2012 | Increase/ (Decrease) | Percentage Change | 2011 |
|---|---|---|---|---|---|---|---|
| **Operating revenues** | | | | | | | |
| Residential | $ 293,217 | $ (3,375) | (1)% | $ 296,592 | $ (5,272) | (2)% | $ 301,864 |
| Commercial | 232,910 | 2,436 | 1% | 230,474 | (951) | N/M | 231,425 |
| Wholesale | 200,440 | (14,242) | (7)% | 214,682 | (20,237) | (9)% | 234,919 |
| Total operating revenues | 726,567 | (15,181) | (2)% | 741,748 | (26,460) | (3)% | 768,208 |
| **Operating expenses** | | | | | | | |
| Cost of services and products (excluding depreciation, amortization and accretion reported below) | 270,466 | (3,599) | (1)% | 274,065 | (636) | N/M | 274,701 |
| Selling, general and administrative expenses | 220,097 | (15,619) | (7)% | 235,716 | 14,602 | 7% | 221,114 |
| Depreciation, amortization and accretion | 170,868 | (1,658) | (1)% | 172,526 | 4,863 | 3% | 167,663 |
| Loss on asset disposals, net | 130 | (890) | (87)% | 1,020 | (108) | (10)% | 1,128 |
| Loss on sale of business and other exit costs, net | | (39) | N/M | 39 | 39 | N/M | |
| Total operating expenses | 661,561 | (21,805) | (3)% | 683,366 | 18,760 | 3% | 664,606 |
| Total operating income | $ 65,006 | $ 6,624 | 11% | $ 58,382 | $ (45,220) | (44)% | $ 103,602 |

N/M Not meaningful

**Operating Revenues**

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

Residential revenues decreased $3.4 million or 1% to $293.2 million in 2013. A 3% reduction in the number of average residential connections reduced revenues by $7.9 million partially offset by a $5.2 million increase due to growth in average revenue per residential connection of 2%. The growth in average revenue was mainly driven by broadband price increases, growth in customers opting for faster broadband speeds and the growth of customers selecting higher tier IPTV packages.

Residential revenues decreased $5.3 million or 2% to $296.6 million in 2012. Reductions in the number of residential connections of 4% negatively impacted residential revenues by $9.8 million. Customers choosing higher speed data plans primarily drove a 2% increase in average revenue per residential connection in 2012, which increased residential revenues $6.6 million.

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

Commercial revenues increased $2.4 million or 1% to $232.9 million in 2013. A 2% increase in average commercial connections, which was driven by the 49% growth in managedIP as customers converted from traditional voice and data connections, increased revenues by $4.4 million. This increase was partially offset by a 1% decline in average revenue per commercial connection, primarily driven by lower managedIP rates, which decreased revenues $2.7 million.

Commercial revenues decreased $1.0 million to $230.5 million in 2012 due primarily to a $2.5 million decline in business systems sales and charges for directory assistance. A $4.8 million increase in revenue resulting from an increase in commercial connections was partially offset by a $3.2 million decrease in the average revenue per commercial connection primarily driven by lower managedIP rates.

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

Wholesale revenues decreased $14.2 million or 7% to $200.4 million in 2013. Network access revenues decreased $6.8 million in 2013 as a result of changes in support mechanisms and in intercarrier compensation resulting from the Reform Order released by the FCC in November 2011. Wholesale revenues also declined $5.3 million due to a 15% reduction in intra-state minutes-of-use.

Wholesale revenues decreased $20.2 million or 9% to $214.7 million in 2012. Wholesale revenues decreased $10.0 million in 2012 as a result of changes in support mechanisms and in intercarrier compensation resulting from the Reform Order. Revenues received through interstate and intrastate regulatory recovery mechanisms also decreased $5.7 million due to changes in eligible expense recovery thresholds and reductions in the pool earnings. Additionally, Wholesale revenues declined $5.1 million due to a 11% decline in intrastate minutes of use.

**Operating Expenses**

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

Cost of services and products decreased $3.6 million or 1% to $270.5 million in 2013 due primarily to a $5.4 million decrease in cost of goods sold related to long distance services and promotional giveaways. In addition, carrier interconnection charges decreased $2.3 million as a result of lower access charges that became effective related to the Reform Order. Employee expense decreased $1.1 million due to a reduction in employees. Offsetting the decreases were increases in charges related to IPTV expansion.

Cost of services and products of $274.1 million in 2012 were flat compared to 2011. Increases in employee related costs, charges related to IPTV expansion and network maintenance costs were mostly offset by decreased long-distance costs, lower circuit charges, lower purchased network services, and a decrease in reciprocal compensation expense related to the FCC Reform Order which mandated rate reductions that became effective in July of 2012.

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

Selling, general and administrative expenses decreased $15.6 million or 7% to $220.1 million in 2013 due primarily to decreases in employee expenses, Federal USF contributions due to lower revenues, bad debts, and property taxes.

Selling, general and administrative expenses increased $14.6 million or 7% to $235.7 million in 2012. Discrete benefits recorded in 2011 including receipt of insurance proceeds, the refund of certain prior year regulatory contributions and the settlement of a legal dispute, which decreased 2011 Selling, general and administrative expenses by $7.7 million. These discrete benefits in 2011 were the primary cause of the overall expense increase from 2011 to 2012. Additionally, higher employee related and contractor costs and Federal USF contributions added to the increase in 2012.

Table of Contents

**Telephone and Data Systems, Inc.**

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

**Cable Operations**

**Components of Operating Income**

| **Year Ended December 31, (Dollars in thousands)** | **2013(1)** |
|---|---|
| Operating revenues | |
| Residential | $ 29,016 |
| Commercial | 6,867 |
| Total operating revenues | 35,883 |
| Operating expenses | |
| Cost of services and products (excluding depreciation, amortization and accretion reported below) | 17,274 |
| Selling, general and administrative expenses | 11,054 |
| Depreciation, amortization and accretion | 7,571 |
| Loss on asset disposals, net | 28 |
| Total operating expenses | 35,927 |
| Total operating income (loss) | $ (44) |

(1) Represents the operations of Baja from August 1, 2013 (date of acquisition) to December 31, 2013.

**Operating Revenues**

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

Baja had 104,900 residential connections which generated revenues of $29.0 million since the acquisition of Baja on August 1, 2013.

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

Baja had 42,500 commercial connections which generated revenues of $6.9 million since the acquisition of Baja.

**Operating Expenses**

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

Cost of services and products (excluding Depreciation, amortization and accretion) of $17.3 million were incurred for programming costs and expenses related to the delivery and support of services since the acquisition of Baja.

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

Selling, general and administrative expenses of $11.1 million include legal and consulting costs of $2.0 million related to the acquisition.

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

Depreciation, amortization and accretion expense of $7.6 million was incurred since the acquisition of Baja. Amortization of the acquired customer list and trade name contributed $3.0 million of expense.

Table of Contents

**Telephone and Data Systems, Inc.**

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

**HMS Operations**

**Components of Operating Income**

| Year Ended December 31, (Dollars in thousands) | 2013 | Increase/ (Decrease) | Percentage Change | 2012 | Increase/ (Decrease) | Percentage Change | 2011 |
|---|---|---|---|---|---|---|---|
| Operating revenues | $ 185,616 | $ 72,606 | 64% | $ 113,010 | $ 65,830 | >100% | $ 47,180 |
| Operating expenses | | | | | | | |
| Cost of services and products (excluding depreciation, amortization and accretion reported below) | 136,414 | 60,633 | 80% | 75,781 | 52,279 | >100% | 23,502 |
| Selling, general and administrative expenses | 44,945 | 10,752 | 31% | 34,193 | 18,546 | >100% | 15,647 |
| Depreciation, amortization and accretion | 24,262 | 3,694 | 18% | 20,568 | 7,701 | 60% | 12,867 |
| Loss on asset disposals, net | 125 | 17 | 16% | 108 | (7) | (6)% | 115 |
| Total operating expenses | 205,746 | 75,096 | 57% | 130,650 | 78,519 | >100% | 52,131 |
| Total operating income (loss) | $ (20,130) | $ (2,490) | (14)% | $ (17,640) | $ (12,689) | >(100)% | $ (4,951) |

**Operating Revenues**

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

Operating revenues increased $72.6 million to $185.6 million in 2013. The acquisitions of Vital in June of 2012 and MSN in October of 2013 contributed $64.3 million of incremental revenues. The remaining increase was due to 10% growth in recurring services primarily consisting of colocation, cloud and hosted managed services, and application management.

Operating revenues increased $65.8 million to $113.0 million in 2012. The acquisitions of OneNeck IT Services in June of 2011 and Vital in June of 2012 contributed $64.1 million of incremental revenues.

**Operating Expenses**

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

Cost of services and products increased $60.6 million to $136.4 million in 2013 and increased $52.3 million to $75.8 million in 2012. Acquisitions increased Cost of services and products $52.8 million and $47.7 million in 2013 and 2012, respectively. Employee related expense also increased in 2013 by $5.7 million in addition to increased data center costs to support revenue growth.

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

Selling, general and administrative expense increased $10.8 million to $44.9 million in 2013 and increased $18.5 million to $34.2 million in 2012. Acquisitions increased Selling, general and administrative expense $10.6 million and $15.1 million in 2013 and 2012, respectively. Additional expenses were incurred in both 2013 and 2012 as TDS Telecom developed the infrastructure and products and services to support growth of the HMS operations.

**Telephone and Data Systems, Inc.**

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

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

Depreciation, amortization and accretion expense increased $3.7 million to $24.3 million in 2013 and increased $7.7 million to $20.6 million in 2012 due primarily to acquisitions. Customer list and trade name amortization contributed $2.2 million and $4.4 million of the increase in 2013 and 2012, respectively.

## INFLATION

Management believes that inflation affects TDS' business to no greater or lesser extent than the general economy.

## RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In general, recently issued accounting pronouncements did not have and are not expected to have a significant effect on TDS' financial condition and results of operations.

See Note 1  Summary of Significant Accounting Policies and Recent Accounting Pronouncements in the Notes to Consolidated Financial Statements for information on recently issued 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 in 2013, 2012 and 2011.

| **(Dollars in thousands)** | **2013** | **2012** | **2011** |
|---|---|---|---|
| Cash flows from (used in) | | | |
| Operating activities | $ 494,610 | $ 1,105,172 | $ 1,255,711 |
| Investing activities | (260,653) | (998,069) | (866,089) |
| Financing activities | (144,424) | 70,103 | (168,030) |
| Net increase in cash and cash equivalents | $ 89,533 | $ 177,206 | $ 221,592 |

**Cash Flows from Operating Activities**

Cash flows from operating activities were $494.6 million in 2013 and $1,105.2 million in 2012. Significant items to note are as follows:

Net income increased by $44.2 million. This increase resulted primarily from the gains recognized as a result of the closing of the Divestiture Transaction, the NY1& NY2 Deconsolidation and the Mississippi Valley license sale. These gains were partially offset by a decrease in Operating revenues, higher cost of equipment sold, and an increase in non-cash expenses, including depreciation expense.

Net income tax payments of $175.6 million were recorded in 2013 compared to net income tax refunds of $62.0 million in 2012. The 2013 tax payments were due primarily to the gain recognized as a result of the closing of the Divestiture Transaction and the Mississippi Valley license sale. Federal tax refunds of $71.5 million were received in 2012 primarily related to a federal net operating loss in 2011 largely attributable to 100% bonus depreciation applicable to qualified capital expenditures.

**Telephone and Data Systems, Inc.**

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

TDS carried back this federal net operating loss to prior tax years and received these refunds in 2012 for carrybacks to 2009 and 2010 tax years.

Changes in Accounts receivable combined with the impact of Bad debts expense required $188.7 million and $6.4 million in 2013 and 2012, respectively. Changes in Accounts receivable were driven primarily by billing delays encountered as a result of the conversion to a new U.S. Cellular billing system in the third quarter of 2013, which caused Accounts receivable to increase at December 31, 2013. Given these billing delays and the corresponding increase in Accounts receivable, U.S. Cellular believes it has made an adequate provision for allowance for doubtful accounts at December 31, 2013. However, such provision is an estimate, and U.S. Cellular's actual experience with uncollectible accounts in future periods could materially differ from the amounts provided in the allowance for doubtful accounts at December 31, 2013. Any such difference could have a material adverse impact on future results of operations and cash flow.

Changes in Inventory required $83.5 million in 2013 and required $29.9 million in 2012. This change was due primarily to higher costs per unit related to 4G LTE smartphones.

Changes in Accounts payable provided $86.0 million in 2013 and required $12.3 million in 2012. Changes in Accounts payable were driven primarily by payment timing differences related to operating expenses, capital expenditures and device purchases.

Cash flows from operating activities were $1,105.2 million in 2012 and $1,255.7 million in 2011. Significant items to note are as follows:

Net income decreased by $127.6 million. This decrease resulted primarily from increases in Cost of services and products and non-cash expenses, including depreciation expense.

Net income tax refunds of $62.0 million were recorded in 2012 compared to net income tax refunds of $67.0 million in 2011. Tax refunds received in 2012 were primarily for federal net operating loss carrybacks from the 2011 tax year to the 2009 and 2010 tax years. Tax refunds received in 2011 primarily represented federal refunds related to overpayment of 2010 taxes.

Changes in Accounts receivable combined with the impact of Bad debts expense required $6.4 million and $26.8 million in 2012 and 2011, respectively. Accounts receivable balances fluctuate based on the timing of customer payments, promotions and other factors.

Changes in Inventory required $29.9 million in 2012 and $13.4 million in 2011. This change was due primarily to higher inventory levels and a change in inventory mix, resulting in a higher cost per unit.

Changes in Accounts payable required $12.3 million in 2012 and provided $29.3 million in 2011. Changes in Accounts payable were primarily driven by payment timing differences related to network equipment and device purchases.

Changes in Other assets and liabilities required $30.5 million and $4.4 million in 2012 and 2011, respectively. This change was due primarily to an increase in LTE-related deferred charges.

**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 $909.7 million in 2013, $1,004.6 million in 2012 and $987.2 million in 2011. 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 December 31 of the current year and includes amounts received and/or paid in the

**Telephone and Data Systems, Inc.**

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

current period that were accrued at December 31 of the prior year. Cash used for additions to property, plant and equipment totaled $883.8 million, $995.5 million and $971.8 million in 2013, 2012 and 2011, respectively. These expenditures were made to provide for customer and usage growth (in recent periods, particularly with respect to data usage growth), to upgrade service and to take advantage of service-enhancing and cost-reducing technological developments in order to maintain competitive services.

U.S. Cellular's capital expenditures totaled $737.5 million in 2013, $836.7 million in 2012 and $782.5 million in 2011 representing expenditures made to construct new cell sites, build out 4G LTE networks in certain markets, increase capacity in existing cell sites and switches, develop new and enhance existing office systems such as the new Billing and Operational Support System ("B/OSS") and customer relationship management platforms, and construct new and remodel existing retail stores.

TDS Telecom's capital expenditures totaled $164.9 million, $173.9 million, and $191.2 million in 2013, 2012, and 2011, respectively. Capital expenditures for Wireline operations totaled $140.0 million in 2013, $158.6 million in 2012 and $164.2 million in 2011 primarily representing expenditures to upgrade plant and equipment to provide enhanced services. Capital expenditures for Cable operations totaled $8.4 million in 2013. Capital expenditures for HMS operations totaled $16.5 million in 2013, $15.3 million in 2012 and $27.0 million in 2011 representing expenditures to expand data center facilities and the purchase of IT-related equipment to deliver products and services.

Cash payments for acquisitions in 2013, 2012 and 2011 were as follows:

| **Cash Payments for Acquisitions (Dollars in thousands)** | **2013** | **2012** | **2011** |
|---|---|---|---|
| U.S. Cellular licenses | $ 16,540 | $ 122,690 | $ 4,406 |
| U.S. Cellular business | | | 19,367 |
| TDS Telecom HMS businesses | 33,961 | 40,692 | 95,865 |
| TDS Telecom cable business | 264,069 | | |
| Non-Reportable Segment(1) | | | (14,130) |
| **Total** | $ 314,570 | $ 163,382 | $ 105,508 |

(1) Cash held by Airadigm at acquisition. TDS acquired 63% of Airadigm on September 23, 2011.

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 (Dollars in thousands)** | **2013** | **2012** | **2011** |
|---|---|---|---|
| U.S. Cellular licenses | $ 311,989 | $ | $ |
| U.S. Cellular businesses | 499,131 | 49,932 | |
| TDS Telecom wireline business | | 250 | |

| | | | | | |
|---|---|---|---|---|---|
| **Total** | $ | 811,120 | $ | 50,182 | $ |

U.S. Cellular received $480.0 million in cash at the close of the Divestiture Transaction in May 2013. In addition, U.S. Cellular received $10.6 million in reimbursements for certain network decommissioning costs, network site lease rent and termination costs, network access termination costs, and employee termination benefits for specified engineering employees (the "Sprint Cost Reimbursement") in 2013.

On October 4, 2013, U.S. Cellular sold the majority of its Mississippi Valley unbuilt license for $308.0 million. This sale resulted in a $250.6 million gain which was recorded in the fourth quarter of 2013.

Table of Contents

**Telephone and Data Systems, Inc.**

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

On August 14, 2013 U.S. Cellular entered into a definitive agreement to sell the majority of its St. Louis area unbuilt license for $92.3 million. The sale will result in an estimated pre-tax gain of $76.2 million. This transaction is subject to regulatory approval and is expected to close in the first quarter of 2014.

TDS invested $120.0 million and $180.9 million in 2012 and 2011, respectively, in U.S. Treasury Notes and corporate notes with maturities greater than three months from the acquisition date. TDS realized cash proceeds of $115.0 million, $243.4 million and $393.2 million in 2013, 2012 and 2011, respectively, related to the maturities of its investments in U.S. Treasury Notes, corporate notes and certificates of deposit.

**Cash Flows from Financing Activities**

Cash flows from financing activities include repayments of and proceeds from 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 November 2012, TDS issued $195.0 million of 5.875% Senior Notes due 2061, and paid related debt issuance costs of $7.1 million.

In September 2011, Airadigm paid $32.7 million to the FCC in satisfaction of amounts due pursuant to Airadigm's plan of reorganization. See Note 5  Acquisitions, Divestitures and Exchanges in the Notes to Consolidated Financial Statements for additional information related to this acquisition.

In May 2011, U.S. Cellular issued $342.0 million of 6.95% Senior Notes due 2060, and paid related debt issuance costs of $11.0 million. The net proceeds from the 6.95% Senior Notes were used primarily to redeem $330.0 million of U.S. Cellular's 7.5% Senior Notes in June 2011. The redemption price of the 7.5% Senior Notes was equal to 100% of the principal amount plus accrued and unpaid interest thereon to the redemption date.

In March 2011, TDS issued $300.0 million of 7% Senior Notes due 2060, and paid related debt issuance costs of $9.7 million. The net proceeds from the 7% Senior Notes were primarily used to redeem $282.5 million of TDS' 7.6% Series A Notes in May 2011. The redemption price of the 7.6% Series A Notes was equal to 100% of the outstanding aggregate principal amount, plus accrued and unpaid interest thereon to the redemption date.

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 as of June 11, 2013. Of the $482.3 million paid, TDS received $407.1 million while noncontrolling public shareholders received $75.2 million. The cash paid to noncontrolling public shareholders is presented as U.S. Cellular dividends paid to noncontrolling public shareholders on the Consolidated Statement of Cash Flows.

TDS repurchased Common Shares for $9.7 million and $20.0 million in 2013 and 2012, respectively, and Special Common Shares for $21.5 million in 2011. U.S. Cellular repurchased Common Shares for $18.5 million, $20.0 million and $62.3 million in 2013, 2012 and 2011, respectively. See Note 15  Common Shareholders' Equity in the Notes to Consolidated Financial Statements for additional information related to these transactions.

**Free Cash Flow**

The following table presents Free cash flow. Free cash flow is defined as Cash flows from operating activities less Cash used for additions to property, plant and equipment. Free cash flow is a non-GAAP financial measure which TDS believes may be useful to investors and other users of its financial

Table of Contents

**Telephone and Data Systems, Inc.**

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

information in evaluating the amount of cash generated by business operations, after Cash used for additions to property, plant and equipment.

| (Dollars in thousands) | 2013 | 2012 | 2011 |
|---|---|---|---|
| Cash flows from operating activities | $ 494,610 | $ 1,105,172 | $ 1,255,711 |
| Cash used for additions to property, plant and equipment | (883,797) | (995,517) | (971,759) |
| Free cash flow | $ (389,187) | $ 109,655 | $ 283,952 |

See Cash flows from Operating Activities and Cash flows from Investing Activities for details on the changes to the components of 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. In addition, TDS and its subsidiaries may access public and private capital markets to help meet their financing needs.

U.S. Cellular's profitability historically has been lower in the fourth quarter as a result of significant marketing and promotional activity during the holiday season. Changes in these or other economic factors could have a material adverse effect on demand for TDS' products and services and on TDS' financial condition and results of operations.

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 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 December 31, 2013.

| (Dollars in thousands) | TDS | U.S. Cellular(1) |
|---|---|---|
| Cash and cash equivalents | $ 830,014 | $ 342,065 |
| Short-term investments | $ 50,104 | $ 50,104 |

(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 December 31, 2013, 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 and Long-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

Table of Contents

**Telephone and Data Systems, Inc.**

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

Note 2  Fair Value Measurements in the Notes to Consolidated Financial Statements for additional information on Short-term investments. As of December 31, 2013, TDS does not hold Long-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 December 31, 2013, no U.S. Cellular debt was subordinated pursuant to this subordination agreement.

TDS' and U.S. Cellular's interest cost on their revolving credit facilities is subject to increase if their current credit ratings from nationally recognized credit rating agencies are lowered, and is subject to decrease if the ratings are raised. The credit facilities would not cease to be available nor would the maturity date accelerate solely as a result of a downgrade in TDS' or U.S. Cellular's credit rating. However, a downgrade 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.

As of December 31, 2013, TDS' and U.S. Cellular's senior debt credit ratings from nationally recognized credit rating agencies remained at investment grade.

In June 2013, U.S. Cellular provided $17.4 million in letters of credit to the FCC in connection with U.S. Cellular's winning bids in Auction 901. See Note 19  Supplemental Cash Flow Disclosures in the Notes to Consolidated Financial Statements for additional information on Auction 901.

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 December 31, 2013 with all of the financial covenants and requirements set forth in their revolving credit facilities. TDS also has certain other non-material credit facilities from time to time.

See Note 10  Debt in the Notes to Consolidated Financial Statements for additional information regarding the revolving credit facilities.

**Long-Term Financing**

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 December 31, 2013 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 next four years represent less than 1% of the total long-term debt obligation at December 31, 2013. Refer to Market Risk  Long-Term Debt for additional information regarding required principal payments and the weighted average interest rates related to TDS' Long-term debt.

TDS and U.S. Cellular, at their discretion, may from time to time seek to retire or purchase their outstanding debt through cash purchases and/or exchanges for other securities, in open market purchases, privately negotiated transactions, tender offers, exchange offers or otherwise. Such repurchases or exchanges, if any, will depend on prevailing market conditions, liquidity requirements, contractual restrictions and other factors. The amounts involved may be material.

**Telephone and Data Systems, Inc.**

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

TDS and U.S. Cellular each have an effective shelf registration statement on Form S-3 to issue senior or subordinated debt securities. The proceeds from any such issuances may be used for general corporate purposes, including the possible reduction of other long-term debt; in connection with acquisition, construction and development programs; the reduction of short-term debt; for working capital; to provide additional investments in subsidiaries; or the repurchase of shares. The TDS shelf registration permits TDS to issue at any time and from time to time senior or subordinated debt securities in one or more offerings in an indeterminate amount. The U.S. Cellular shelf registration statement permits U.S. Cellular to issue at any time and from time to time senior or subordinated debt securities in one or more offerings up to an aggregate principal amount of $500 million. The ability of TDS or U.S. Cellular to complete an offering pursuant to such shelf registration statements is subject to market conditions and other factors at the time.

See Note 10 Debt in the Notes to Consolidated Financial Statements for additional information on Long-term financing.

**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:

- Fiber expansion in Wireline markets to support IPTV and super high speed data;
- Success-based spending to sustain managedIP, IPTV and HMS growth;
- Expansion of HMS data center facilities;
- Plant upgrades and success-based spending at Baja; and
- Process and productivity initiatives.

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.

TDS also 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 and Note 7 Investments in Unconsolidated Entities in the Notes to Consolidated Financial Statements for additional information related to significant transactions.

**Telephone and Data Systems, Inc.**

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

**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 13 Variable Interest Entities 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 2013, 2012 and 2011, see Note 15 Common Shareholders' Equity 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**

At December 31, 2013, the resources required for contractual obligations were as follows:

| | Payments Due by Period | | | | |
|---|---|---|---|---|---|
| **(Dollars in millions)** | **Total** | **Less Than 1 Year** | **1 - 3 Years** | **3 - 5 Years** | **More Than 5 Years** |
| Long-term debt obligations(1) | $ 1,728.7 | $ 1.5 | $ 3.9 | $ | $ 1,723.3 |
| Interest payments on long-term debt obligations | 4,336.2 | 116.1 | 232.1 | 231.8 | 3,756.2 |
| Operating leases(2) | 1,510.2 | 175.2 | 285.0 | 201.0 | 849.0 |
| Capital leases | 8.4 | 0.6 | 1.2 | 1.2 | 5.4 |
| Purchase obligations(3)(4) | 1,959.6 | 675.3 | 1,058.7 | 141.3 | 84.3 |
| | $ 9,543.1 | $ 968.7 | $ 1,580.9 | $ 575.3 | $ 6,418.2 |

(1) Includes current and long-term portions of debt obligations. The total long-term debt obligation differs from Long-term debt in the Consolidated Balance Sheet due to capital leases and the $11.6 million unamortized discount related to U.S. Cellular's 6.7% Senior Notes. See Note 10 Debt in the Notes to Consolidated Financial Statements for additional information.

(2) Includes future lease costs related to telecommunications plant facilities, office space, retail sites, cell sites, data centers and equipment. See Note 12 Commitments and Contingencies in the Notes to Consolidated Financial Statements for additional information.

(3) Includes obligations payable under non-cancellable contracts, commitments for network facilities and services, agreements for software licensing, long-term marketing programs, and an agreement with Apple to purchase Apple iPhone products. As described more fully in Note 5 Acquisitions, Divestitures and Exchanges in the Notes to Consolidated Financial Statements, U.S. Cellular expects

to incur network-related exit costs in the Divestiture Markets as a result of the transaction, including: (i) costs to decommission cell sites and mobile telephone switching office ("MTSO") sites, (ii) costs to terminate real property leases and (iii) costs to terminate certain network access arrangements in the subject markets. The impacts of these exit activities on TDS' purchase obligation are reflected in the table above only to the extent that agreements were consummated at December 31, 2013.

(4) Does not include reimbursable amounts TDS Telecom will provide to complete projects under the American Recovery and Reinvestment Act of 2009. TDS Telecom will receive $105.1 million in federal grants and will provide $30.9 million of its own funds to complete 44 projects. As of December 31, 2013, TDS Telecom has expended $24.8 million of the $30.9 million on these projects. Under the terms of the grants, the projects must be completed by June of 2015.

**Telephone and Data Systems, Inc.**

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

The table above excludes liabilities related to "unrecognized tax benefits" as defined by GAAP because TDS is unable to predict the period of settlement of such liabilities. Such unrecognized tax benefits were $30.4 million at December 31, 2013. See Note 3 Income Taxes in the Notes to Consolidated Financial Statements for additional information on unrecognized tax benefits.

Agreements

As previously disclosed, on August 17, 2010, TDS and Amdocs Software Systems Limited ("Amdocs") entered into a Software License and Maintenance Agreement ("SLMA") and a Master Service Agreement ("MSA") (collectively, the "Amdocs Agreements") to develop a Billing and Operational Support System ("B/OSS"). In July 2013, TDS implemented B/OSS, pursuant to an updated Statement of Work dated June 29, 2012. Total payments to Amdocs related to this implementation are estimated to be approximately $183.9 million (subject to certain potential adjustments) over the period from commencement of the SLMA through the first half of 2014. As of December 31, 2013, $136.8 million had been paid to Amdocs.

Apple iPhone Products Purchase Commitment

In March 2013, U.S. Cellular entered into an agreement with Apple to purchase certain minimum quantities of iPhone products over a three-year period beginning in November 2013. The minimum quantity of iPhone products to be purchased during the first contract year is fixed and is subject to adjustment for the second and third contract years based on the percentage growth in smartphone sales in the United States for the immediately preceding calendar year. Based on current forecasts, TDS estimates that the remaining contractual purchase commitment as of December 31, 2013 is approximately $950 million. At this time, TDS expects to meet its contractual commitment with Apple.

**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.

**Dividends**

TDS paid quarterly dividends per outstanding share of $0.1275 in 2013, $0.1225 in 2012 and $0.1175 in 2011. TDS increased the dividend per share to $0.1340 in the first quarter of 2014. The dividends per share amount for 2011 have not been retroactively adjusted to reflect the impact of the Share Consolidation Amendment. See Note 15 Common Shareholders' Equity in the Notes to Consolidated Financial Statements for additional information. TDS has no current plans to change its policy of paying dividends.

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 as of June 11, 2013. Of the $482.3 million paid, TDS received $407.1 million while noncontrolling public shareholders received $75.2 million.

## 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.

Management believes the application of the following critical accounting policies and the estimates required by such application reflect its most significant judgments and estimates used in the preparation of TDS' consolidated financial statements. Management has discussed the development and selection of each of the following accounting policies and related estimates and disclosures with the Audit Committee of TDS' Board of Directors.

Table of Contents

**Telephone and Data Systems, Inc.**

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

**Goodwill, Licenses and Franchise rights**

See the Goodwill, Licenses and Franchise rights Impairment Assessment section of Note 1 Summary of Significant Accounting Policies and Recent Accounting Pronouncements in the Notes to Consolidated Financial Statements for information on Goodwill, Licenses and Franchise rights impairment testing policies and methods. TDS performs annual impairment testing of Goodwill, Licenses and Franchise rights, as required by GAAP, in the fourth quarter of its fiscal year, based on fair values and net carrying values determined as of November 1.

See Note 6 Intangible Assets in the Notes to Consolidated Financial Statements for additional information related to Goodwill, Licenses and Franchise rights activity in 2013 and 2012.

Goodwill U.S. Cellular

U.S. Cellular tests Goodwill for impairment at the level of reporting referred to as a reporting unit. For purposes of impairment testing of Goodwill in 2013, U.S. Cellular identified four reporting units based on geographic service areas (all of which are included in TDS' wireless reportable operating segment). For purposes of the impairment testing of Goodwill in 2012, U.S. Cellular identified five reporting units based on geographic service areas. The change in reporting units resulted from the NY1 & NY2 Deconsolidation more fully described in Note 7 Investments in Unconsolidated Entities in the Notes to Consolidated Financial Statements. There were no changes to U.S. Cellular's overall Goodwill impairment testing methodology between November 1, 2013 and November 1, 2012.

A discounted cash flow approach was used to value each reporting unit, using value drivers and risks specific to the industry and current economic factors. The cash flow estimates incorporated assumptions that market participants would use in their estimates of fair value and may not be indicative of U.S. Cellular specific assumptions. The most significant assumptions made in this process were the revenue growth rate (shown as a ten year compound annual growth rate in the table below), the terminal revenue growth rate, the discount rate and capital expenditures as a percentage of revenue (shown as a simple average in the table below). The averages below are based on ten year projection periods. These assumptions were as follows for November 1, 2013 and 2012:

| Key Assumptions | November 1, 2013 | November 1, 2012 |
|---|---|---|
| Revenue growth rate | 2.2% | 2.2% |
| Terminal revenue growth rate | 2.0% | 2.0% |
| Discount rate | 10.0% | 11.0% |
| Capital expenditures as a percentage of revenue | 16.0% | 15.2% |

The carrying value of each U.S. Cellular reporting unit at TDS as of November 1, 2013 was as follows:

| Reporting Unit (Dollars in millions) | Carrying Value at TDS(1) |
|---|---|
| Central Region | $ 2,753 |
| Mid-Atlantic Region | 836 |
| New England Region | 269 |
| Northwest Region | 328 |
| **Total** | $ 4,186 |

(1) Under previous business combination guidance in effect prior to January 1, 2009, TDS had recorded Goodwill as a result of accounting for U.S. Cellular's purchases of U.S. Cellular Common Shares as step acquisitions using purchase accounting. As a result, the carrying values of the reporting units differ between U.S. Cellular and TDS. The carrying value of the reporting units at U.S. Cellular was $4,287 million at November 1, 2013.

**Telephone and Data Systems, Inc.**

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

As of November 1, 2013, the fair values of the reporting units exceeded their respective carrying values by amounts ranging from 18.4% to 33.4%. Therefore, no impairment of Goodwill existed. Given that the fair values of the respective reporting units exceed their respective carrying values, provided all other assumptions remained the same, the discount rate would have to increase to a range of 11.4% to 12.7% to yield estimated fair values of reporting units that equal their respective carrying values at November 1, 2013. Further, assuming all other assumptions remained the same, the terminal growth rate assumptions would need to decrease to amounts ranging from negative 5.3% to negative 1.3% to yield estimates of fair value equal to the carrying values of the respective reporting units at November 1, 2013.

Goodwill TDS Telecom

TDS Telecom has recorded Goodwill as a result of the acquisition of ILEC, HMS and cable companies. For purposes of Goodwill impairment testing, TDS Telecom has three reporting units: ILEC, HMS and Cable.

During the third quarter of 2013, due to continued competitive pressures and negative secular and regulatory trends in the ILEC industry, TDS determined that an interim impairment test of TDS Telecom's ILEC Goodwill was required. TDS performed the Step 1 Goodwill impairment test, as defined by GAAP, as of August 1, 2013, and determined that the fair value of the ILEC reporting unit exceeded its carrying value, and accordingly no Goodwill impairment resulted.

Prior to the third quarter of 2013, HMS was comprised of three reporting units: OneNeck IT Services, TEAM Technologies, LLC/VISI Incorporated ("TEAM/VISI") and Vital. Due to changes in the management of the HMS operations and related changes in internal financial reporting that culminated in the third quarter of 2013, the three separate HMS reporting units were combined into one HMS reporting unit. This change in reporting units required TDS to perform an interim impairment test of the Goodwill in the HMS reporting unit(s) in the third quarter of 2013. TDS performed the Step 1 Goodwill impairment test as of August 1, 2013 for the three historical HMS reporting units of OneNeck IT Services, TEAM/VISI, and Vital and the newly combined HMS reporting unit. In all four of these HMS-related Step 1 Goodwill impairment tests, TDS determined that the fair value of each of the reporting units exceeded its respective carrying value, and accordingly, no Goodwill impairment resulted.

In October 2013, TDS acquired MSN. MSN is included in the HMS reporting unit for purposes of Goodwill impairment testing. However, as MSN was acquired in the fourth quarter, the assumptions discussed below relate solely to the legacy HMS reporting unit. Consistent with fair value principles, as MSN was recently purchased from a third party in an arms-length transaction, management believes that MSN's purchase price of $44 million reflects fair value and carrying value at November 1, 2013. This amount was included in the overall HMS reporting unit fair value and carrying value.

The Cable reporting unit consists of Baja, which was acquired in August 2013. A qualitative assessment, as defined by GAAP, of the reporting unit was completed as of November 1, 2013. The qualitative assessment, which analyzed company, industry and economic trends, concluded that it was more likely than not that the fair value of this reporting unit was at least equal to its carrying value, and accordingly no Goodwill impairment resulted.

The discounted cash flow approach and publicly-traded guideline company method were used to value the ILEC and HMS reporting units. The discounted cash flow approach uses value drivers and risks specific to the industry and current economic factors. The cash flow estimates incorporated assumptions that market participants would use in their estimates of fair value and may not be indicative of TDS Telecom specific assumptions. The most significant assumptions made in this process were the revenue growth rate (shown as a compound annual growth rate in the table below), the terminal revenue growth rate, the discount rate and capital expenditures as a percentage of revenue (shown as a simple average in the table below).

Table of Contents

**Telephone and Data Systems, Inc.**

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

The publicly-traded guideline company method develops an indication of fair value by calculating average market pricing multiples for selected publicly-traded companies using multiples of: Revenue; Earnings before Interest, Taxes, and Depreciation and Amortization; and Earnings before Interest and Taxes. The developed multiples were applied to applicable financial measures of the respective reporting unit to determine fair value. The discounted cash flow approach and publicly-traded guideline company method were weighted to arrive at the total fair value used for impairment testing.

The following tables represent key assumptions used in estimating the fair value of the ILEC and HMS (excluding MSN, as previously discussed) reporting units as of November 1, 2013 and 2012, the annual impairment testing dates. The ILEC and HMS averages below are based on five and ten year projection periods, respectively. There are uncertainties associated with these key assumptions, and potential events and/or circumstances that could have a negative effect on the key assumptions, which are described below.

The assumptions were as follows for November 1, 2013:

| Key Assumptions | ILEC | HMS |
|---|---|---|
| Revenue growth rate | (0.5)% | 10.8% |
| Terminal revenue growth rate | 0.0% | 2.5% |
| Discount rate | 7.5% | 12.5% |
| Capital expenditures as a percentage of revenue | 15.0% | 11.2% |

The assumptions were as follows for November 1, 2012:

| Key Assumptions | ILEC | HMS |
|---|---|---|
| Revenue growth rate | (0.3)% | 6.3-16.3% |
| Terminal revenue growth rate | 0.0% | 1.5-3.0% |
| Discount rate | 7.0% | 11.0-13.0% |
| Capital expenditures as a percentage of revenue | 15.3% | 0.4-21.9% |

*Revenue growth rates*

The negative average expected growth rate for the ILEC reporting unit is due primarily to declines in voice and data market share and declines in regulatory and wholesale revenues.

The mix of products and services in the HMS reporting unit is diverse and offers the following services: colocation, dedicated hosting, hosted application management, cloud computing services and planning, engineering, procurement, installation, and sales and management of IT infrastructure hardware solutions. The following sources were used to generate projected revenues:

- Market participant growth rates
- Internally generated forecasts, which in addition to market participant growth rates, also considered:
  - Current and projected staffing of the sales teams and their reasonable potential for sales quota attainment
  - Observed customer demand
  - Market and competitive knowledge

There are risks that could negatively impact the projected revenue growth rates, including, but not limited to:

Sales process execution including the ability to attract and retain qualified sales professionals.

**Telephone and Data Systems, Inc.**

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

- Competition  competitors may gain advantages over the HMS business, and may have the ability to offer product and service offerings which TDS Telecom is not able to offer, or offer competitively.

- Operations  TDS Telecom could experience operational difficulties including service disruptions, security breaches, or other negative events that could harm the reputation of its HMS business and its future revenue prospects.

*Discount rates*

The discount rate of each reporting unit was computed by calculating the weighted average cost of capital ("WACC") of market participants with businesses reasonably comparable to each respective reporting unit. The following is a summary of the key components of the calculation:

- Each reporting unit used a separate set of market participants based upon the primary products offered by each respective reporting unit.

- The percentage of debt and equity in each market participant's capital structure was then computed. TDS then selected a capital allocation between debt and equity reflective of the corresponding market participant set. These relative debt and equity capital allocation percentages were then applied to the estimated after-tax cost of debt and estimated cost of equity of the market participants in each reporting unit to arrive at an estimated WACC of market participants, which was then used as the discount rate for each respective reporting unit.

The discount rate is dependent upon the cost of capital of other industry market participants. To the extent that the weighted average cost of capital of industry participants increases, this would decrease the estimated fair value of the reporting units. The weighted average cost of capital may increase if borrowing costs rise, market participants weight more of their capital structure towards equity (vs. debt), or other elements affecting the estimated cost of equity increase.

The WACC calculated for the ILEC reporting unit was lower than the WACC calculated for the HMS reporting unit as a result of the ILEC market participants having capital structures that are more heavily weighted toward debt (vs. higher cost equity) relative to the HMS market participants. ILEC market participants are more mature, capital intensive businesses than the HMS market participants. As a result, ILEC market participants generally have a higher ratio of debt relative to equity in their capital structures as compared to HMS market participants.

*Capital expenditures as a percentage of revenue*

Capital expenditures for the ILEC reporting unit primarily consist of upgrades to plant and equipment in the IPTV markets, general network support, IT infrastructure and the completion of broadband stimulus projects. To the extent costs associated with these capital expenditures increase at a rate higher than expected and disproportionate to forecasted future revenues, this could negatively impact future cash flows.

Capital expenditures for the HMS reporting unit primarily consist of buildings and improvements related to data center construction and information technology hardware. To the extent building capacity needs increase at a rate higher than expected and disproportionate to forecasted future revenues, this could negatively impact future cash flows. Further, should the cost of IT hardware increase at levels higher than expected, this could also cause future capital expenditures to exceed the amounts forecasted.

Table of Contents

**Telephone and Data Systems, Inc.**

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

*Results*

The following represents the carrying values of the reporting units tested for impairment as of November 1, 2013, and the results of the Step 1 Goodwill impairment tests.

| Reporting unit | Carrying value (in millions) | Percentage by which the estimated fair value of the reporting unit exceeded its carrying value |
|---|---|---|
| ILEC | $ 1,297 | 25.5% |
| HMS | $ 223 | 16.7% |

As of November 1, 2013, the fair value of the ILEC reporting unit exceeded its carrying value; therefore, no impairment of Goodwill existed. Given that the fair value of the reporting unit exceeded its respective carrying value, provided all other assumptions remained the same, the discount rate would have to increase to 9.7% for the discounted cash flow approach to yield an estimated fair value of the ILEC reporting unit that equals its carrying value at November 1, 2013. Further, provided all other assumptions remained the same, the terminal revenue growth rate assumption would need to decrease to negative 3.0%, for the discounted cash flow approach to yield an estimate of fair value equal to the carrying value of the ILEC reporting unit at November 1, 2013.

As of November 1, 2013 the fair value of the HMS reporting unit exceeded its carrying value; therefore, no impairment of Goodwill existed. Given that the fair value of the reporting unit exceeded its respective carrying value, provided all other assumptions remained the same, the discount rate would have to increase to 13.6% for the discounted cash flow approach to yield estimated fair value of the HMS reporting unit (excluding MSN, as previously discussed) that equals its carrying value at November 1, 2013. Further, provided all other assumptions remained the same, the terminal revenue growth rate assumption would need to decrease to negative 0.2%, for the discounted cash flow approach to yield an estimate of fair value equal to the carrying value of the HMS reporting unit (excluding MSN, as previously discussed) at November 1, 2013.

Licenses

U.S. Cellular tests licenses for impairment at the level of reporting referred to as a unit of accounting. For purposes of its impairment testing of licenses as of November 1, 2013, U.S. Cellular separated its FCC licenses into eleven units of accounting based on geographic service areas. As of November 1, 2012, U.S. Cellular separated its FCC licenses into thirteen units of accounting based on geographic service areas. The change in units of accounting resulted from (i) the Divestiture Transaction and the Mississippi Valley non-operating market license sale, both of which are more fully described in Note 5 Acquisitions, Divestitures and Exchanges in the Notes to Consolidated Financial Statements and (ii) the NY1 & NY2 Deconsolidation more fully described in Note 7 Investments in Unconsolidated Entities in the Notes to Consolidated Financial Statements. In both 2013 and 2012, seven of the units of accounting represented geographic groupings of licenses which, because they were not being utilized and, therefore, were not expected to generate cash flows from operating activities in the foreseeable future, were considered separate units of accounting for purposes of impairment testing.

**Telephone and Data Systems, Inc.**

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

*Developed operating market licenses ("built licenses")*

U.S. Cellular applies the build-out method to estimate the fair values of built licenses. The most significant assumptions applied for purposes of the November 1, 2013 and 2012 licenses impairment assessments were as follows:

| Key Assumptions | November 1, 2013 | November 1, 2012 |
|---|---|---|
| Build-out period | 5 years | 7 years |
| Discount rate | 8.5% | 8.5% |
| Terminal revenue growth rate | 2.0% | 2.0% |
| Terminal capital expenditures as a percentage of revenue | 13.6% | 13.2% |
| Customer penetration rates | 12.5-16.7% | 13.3-17.3% |

The shorter build-out period in 2013 reflects a change in management's expectations of the time required to build out the U.S. Cellular network and is based on recent company-specific experience and industry observation.

The discount rate used in the valuation of licenses is less than the discount rate used in the valuation of reporting units for purposes of goodwill impairment testing. The discount rate used for licenses does not include a company-specific risk premium as a wireless license would not be subject to such risk.

The discount rate is the most significant assumption used in the build-out method. The discount rate is estimated based on the overall risk-free interest rate adjusted for industry participant information, such as a typical capital structure (i.e., debt-equity ratio), the after-tax cost of debt and the cost of equity. The cost of equity takes into consideration the average risk specific to individual market participants.

As of November 1, 2013, the fair values of the built licenses units of accounting exceeded their respective carrying values by amounts ranging from 28.0% to 75.9%. Therefore, no impairment of Licenses existed. Given that the fair values of the licenses exceed their respective carrying values, the discount rate would have to increase to a range of 8.9% to 9.5% to yield estimated fair values of licenses in the respective units of accounting that equal their respective carrying values at November 1, 2013. An increase of 50 basis points to the assumed discount rate would cause an impairment of approximately $11 million.

*Non-operating market licenses ("unbuilt licenses")*

For purposes of performing impairment testing of unbuilt licenses, U.S. Cellular prepares estimates of fair value by reference to prices paid in recent auctions and market transactions where available. If such information is not available, the fair value of the unbuilt licenses is assumed to have changed by the same percentage, and in the same direction, that the fair value of built licenses measured using the build-out method changed during the period. There was no impairment loss recognized related to unbuilt licenses as a result of the November 1, 2013 licenses impairment test.

Table of Contents

**Telephone and Data Systems, Inc.**

**Management's Discussion and Analysis of Financial Condition and Results of Operat**