TELEPHONE & DATA SYSTEMS INC /DE/
Form 10-Q
February 23, 2007

# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 10-Q

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

**For the quarterly period ended September 30, 2006**

**OR**

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

**For the transition period from to**

Commission File Number **001-14157**

# TELEPHONE AND DATA SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| **Delaware** | **36-2669023** |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |

-

**30 North LaSalle Street, Chicago, Illinois 60602**
(Address of principal executive offices) (Zip Code)

Registrant s telephone number, including area code: **(312) 630-1900**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No o

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

Large accelerated filer x Accelerated filer o Non-accelerated filer

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

Yes o No x

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

| Class | **Outstanding at September 30, 2006** |
|---|---|
| Common Shares, $.01 par value | 51,433,050 Shares |
| Special Common Shares, $.01 par value | 57,782,076 Shares |
| Series A Common Shares, $.01 par value | 6,444,764 Shares |

TELEPHONE AND DATA SYSTEMS, INC.

QUARTERLY REPORT ON FORM 10-Q
FOR THE PERIOD ENDED SEPTEMBER 30, 2006

INDEX

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

TELEPHONE AND DATA SYSTEMS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

Unaudited

| | Three Months Ended September 30, 2006 | 2005 (As Restated) | Nine Months Ended September 30, 2006 | 2005 (As Restated) |
|---|---|---|---|---|
| | (Dollars in thousands, except per share amounts) | | | |
| **Operating Revenues** | $ 1,112,070 | $ 1,027,947 | $ 3,239,834 | $ 2,929,857 |
| | | | | |
| **Operating Expenses** | | | | |
| Cost of services and products (exclusive of depreciation, amortization and accretion expense shown below) | 390,182 | 373,967 | 1,136,047 | 1,059,777 |
| Selling, general and administrative expense | 424,234 | 380,252 | 1,228,221 | 1,078,031 |
| Depreciation, amortization and accretion expense | 187,279 | 169,243 | 550,698 | 507,295 |
| Total Operating Expenses | 1,001,695 | 923,462 | 2,914,966 | 2,645,103 |
| | | | | |
| **Operating Income** | 110,375 | 104,485 | 324,868 | 284,754 |
| | | | | |
| **Investment and Other Income (Expense)** | | | | |
| Equity in earnings of unconsolidated entities | 24,080 | 17,737 | 66,376 | 50,229 |
| Interest and dividend income | 16,323 | 14,204 | 174,351 | 141,514 |
| Interest expense | (59,365) | (53,852) | (177,185) | (160,240) |
| Fair value adjustment of derivative instruments | 34,619 | (4,429) | 22,881 | 495,294 |
| Gain on investments | | | 91,418 | 500 |
| Other expense | (4,319) | (3,204) | (6,187) | (14,280) |
| Total Investment and Other Income | 11,338 | (29,544) | 171,654 | 513,017 |
| | | | | |
| **Income Before Income Taxes and Minority Interest** | 121,713 | 74,941 | 496,522 | 797,771 |
| Income tax expense | 35,718 | 29,492 | 185,246 | 317,982 |
| **Income Before Minority Interest** | 85,995 | 45,449 | 311,276 | 479,789 |
| Minority share of income | (10,756) | (7,174) | (33,281) | (23,974) |
| **Income From Continuing Operations** | 75,239 | 38,275 | 277,995 | 455,815 |
| Discontinued Operations, Net of Tax | | 340 | | 340 |
| **Net Income** | 75,239 | 38,615 | 277,995 | 456,155 |
| Preferred dividend requirement | (51) | (50) | (152) | (152) |
| **Net Income Available To Common** | $ 75,188 | $ 38,565 | $ 277,843 | $ 456,003 |
| | | | | |
| **Basic Weighted Average Shares Outstanding (000s)** | 115,768 | 115,423 | 115,759 | 115,217 |
| **Basic Earnings Per Share (Note 6)** | $ 0.65 | $ 0.33 | $ 2.40 | $ 3.96 |
| | | | | |
| **Diluted Weighted Average Shares Outstanding (000s)** | 116,862 | 116,103 | 116,623 | 116,063 |
| **Diluted Earnings Per Share (Note 6)** | $ 0.64 | $ 0.33 | $ 2.38 | $ 3.92 |
| | | | | |
| **Dividends Per Share** | $ 0.0925 | $ 0.0875 | $ 0.2775 | $ 0.2625 |

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

Unaudited

| | Nine Months Ended September 30, 2006 | 2005 (As Restated) |
|---|---|---|
| | *(Dollars in thousands)* | |
| **Cash Flows from Operating Activities** | | |
| Net income | $ 277,995 | $ 456,155 |
| Add (Deduct) adjustments to reconcile net income to net cash provided by operating activities | | |
| Depreciation, amortization and accretion | 550,698 | 507,295 |
| Bad debts expense | 49,748 | 30,862 |
| Stock-based compensation expense | 27,650 | 6,978 |
| Deferred income taxes | (67,956) | 179,141 |
| Equity in earnings of unconsolidated entities | (66,376) | (50,229) |
| Distributions from unconsolidated entities | 39,692 | 31,192 |
| Minority share of income | 33,281 | 23,974 |
| Fair value adjustment of derivative instruments | (22,881) | (495,294) |
| (Gain) loss on investments | (91,418) | (500) |
| Discontinued operations | | (340) |
| Noncash interest expense | 15,981 | 15,242 |
| Other noncash expense | 5,821 | 7,318 |
| Other operating activities | 3,162 | |
| Changes in assets and liabilities | | |
| Change in accounts receivable | (67,149) | (46,438) |
| Change in materials and supplies | 15,431 | 22,154 |
| Change in accounts payable | (62,792) | (49,362) |
| Change in customer deposits and deferred revenues | 9,923 | 5,355 |
| Change in accrued taxes | 24,505 | 38,664 |
| Change in accrued interest | 6,971 | 4,766 |
| Change in other assets and liabilities | (11,286) | (10,785) |
| | 671,000 | 676,148 |
| **Cash Flows from Investing Activities** | | |
| Additions to property, plant and equipment | (516,610) | (464,958) |
| Cash received from divestitures | 722 | 500 |
| Cash paid for acquisitions | (98,353) | (126,160) |
| Sales of investments | 102,549 | |
| Return of investment | 36,202 | |
| Other investing activities | (6,168) | (4,660) |
| | (481,658) | (595,278) |
| **Cash Flows from Financing Activities** | | |
| Issuance of notes payable | 390,000 | 350,000 |
| Issuance of long-term debt | 560 | 112,835 |
| Repayment of notes payable | (375,000) | (380,000) |
| Repayment of long-term debt | (202,371) | (241,447) |
| Repayment of medium-term notes | (35,000) | (17,200) |
| TDS Common Shares and Special Common Shares issued for benefit plans | 3,047 | 18,150 |
| U.S. Cellular Common Shares issued for benefit plans | 3,856 | 22,228 |
| Capital (distributions) to minority partners | (10,085) | (1,581) |
| Dividends paid | (32,247) | (30,415) |
| Other financing activities | 1,863 | (5) |
| | (255,377) | (167,435) |
| **Net Increase (Decrease) in Cash and Cash Equivalents** | (66,035) | (86,565) |
| **Cash and Cash Equivalents** | | |

| | | |
|---|---|---|
| Beginning of period | 1,095,791 | 1,171,105 |
| End of period | $ 1,029,756 | $ 1,084,540 |

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

4

CONSOLIDATED BALANCE SHEETS

ASSETS

Unaudited

| | September 30, 2006 | December 31, 2005 (As Restated) |
|---|---|---|
| | *(Dollars in thousands)* | |
| **Current Assets** | | |
| Cash and cash equivalents | $ 1,029,756 | $ 1,095,791 |
| Accounts receivable | | |
| Due from customers, less allowance of $17,273 and $15,200, respectively | 346,868 | 332,278 |
| Other, principally connecting companies, less allowance of $7,490 and $5,620, respectively | 160,541 | 157,182 |
| Marketable equity securities | 975,957 | |
| Materials and supplies | 89,269 | 103,211 |
| Prepaid expenses | 45,916 | 41,746 |
| Deferred income tax asset | | 13,438 |
| Other current assets | 27,800 | 34,774 |
| | 2,676,107 | 1,778,420 |
| | | |
| **Investments** | | |
| Marketable equity securities | 1,427,864 | 2,531,690 |
| Licenses | 1,450,369 | 1,365,063 |
| Goodwill | 886,418 | 882,168 |
| Customer lists, net of accumulated amortization of $62,259 and $44,616, respectively | 32,048 | 47,649 |
| Investments in unconsolidated entities | 243,849 | 217,180 |
| Other investments, less valuation allowance of $55,144 in both periods | 11,528 | 12,274 |
| | 4,052,076 | 5,056,024 |
| | | |
| **Property, Plant and Equipment** | | |
| In service and under construction | 7,568,197 | 7,131,977 |
| Less accumulated depreciation | 4,021,844 | 3,602,217 |
| | 3,546,353 | 3,529,760 |
| | | |
| **Other Assets and Deferred Charges** | 55,913 | 55,830 |
| | $ 10,330,449 | $ 10,420,034 |

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

5

CONSOLIDATED BALANCE SHEETS

LIABILITIES AND STOCKHOLDERS EQUITY

Unaudited

| | September 30, 2006 (Dollars in thousands) | December 31, 2005 (As Restated) |
|---|---|---|
| **Current Liabilities** | | |
| Current portion of long-term debt | $ 3,091 | $ 237,948 |
| Forward contracts | 696,973 | |
| Notes payable | 150,000 | 135,000 |
| Accounts payable | 297,640 | 359,934 |
| Customer deposits and deferred revenues | 136,940 | 126,454 |
| Accrued interest | 35,917 | 28,946 |
| Accrued taxes | 58,023 | 46,061 |
| Accrued compensation | 66,891 | 67,443 |
| Derivative liability | 188,171 | |
| Deferred income tax liability | 226,435 | |
| Other current liabilities | 75,669 | 63,539 |
| | 1,935,750 | 1,065,325 |
| | | |
| **Deferred Liabilities and Credits** | | |
| Net deferred income tax liability | 995,808 | 1,337,716 |
| Derivative liability | 234,079 | 449,192 |
| Asset retirement obligation | 219,546 | 190,382 |
| Other deferred liabilities and credits | 116,939 | 107,924 |
| | 1,566,372 | 2,085,214 |
| | | |
| **Long-Term Debt** | | |
| Long-term debt, excluding current portion | 1,631,905 | 1,633,519 |
| Forward contracts | 1,024,053 | 1,707,282 |
| | 2,655,958 | 3,340,801 |
| | | |
| **Commitments and Contingencies** (See Note 22) | | |
| | | |
| **Minority Interest in Subsidiaries** | 577,175 | 546,833 |
| | | |
| **Preferred Shares** | 3,863 | 3,863 |
| | | |
| **Common Stockholders Equity** | | |
| Common Shares, par value $.01 per share; authorized 100,000,000 shares; issued 56,504,000 and 56,481,000 shares, respectively | 565 | 565 |
| Special Common Shares, par value $.01 per share; authorized 165,000,000 shares, issued 62,887,000 and 62,868,000 shares, respectively | 629 | 629 |
| Series A Common Shares, par value $.01 per share; authorized 25,000,000 shares; issued and outstanding 6,445,000 and 6,440,000 shares; respectively | 64 | 64 |
| Capital in excess of par value | 1,848,698 | 1,828,634 |
| Treasury Shares, at cost: | | |
| Common Shares, 5,071,000 and 5,105,000 shares, respectively | (207,524 ) | (208,156 ) |
| Special Common Shares 5,105,000 and 5,128,000 shares, respectively | (209,391 ) | (210,600 ) |
| Accumulated other comprehensive income | 309,321 | 363,641 |
| Retained earnings | 1,848,969 | 1,603,221 |
| | 3,591,331 | 3,377,998 |
| | $ 10,330,449 | $ 10,420,034 |

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

TELEPHONE AND DATA SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## 1. Basis of Presentation

The accounting policies of Telephone and Data Systems, Inc. ( TDS ) conform to accounting principles generally accepted in the United States of America ( U.S. GAAP ). The consolidated financial statements include the accounts of TDS and its majority-owned subsidiaries, including TDS s 81.2%-owned wireless telephone subsidiary, United States Cellular Corporation ( U.S. Cellular ), TDS s 100%-owned wireline telephone subsidiary, TDS Telecommunications Corporation ( TDS Telecom ) and TDS s 80%-owned printing and distribution company, Suttle Straus, Inc. In addition, the consolidated financial statements include all entities in which TDS has a variable interest that requires TDS to absorb a majority of the entity s expected gains or losses, or both. All material intercompany accounts and transactions have been eliminated.

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

The accompanying unaudited consolidated financial statements contain all adjustments (consisting of only normal recurring items unless otherwise disclosed) necessary to present fairly the financial position as of September 30, 2006 and December 31, 2005, and the results of operations for the three and nine months ended September 30, 2006 and 2005 and the cash flows for the nine months ended September 30, 2006 and 2005. The results of operations for the three and nine months ended September 30, 2006, are not necessarily indicative of the results to be expected for the full year.

**Restatement**

TDS and its audit committee concluded on November 6, 2006, that TDS would amend its Annual Report on Form 10-K for the year ended December 31, 2005 to restate its consolidated financial statements and financial information for each of the three years in the period ended December 31, 2005, including quarterly information for 2005 and 2004, and certain selected financial data for 2002. TDS and its audit committee also concluded that TDS would amend its Quarterly Reports on Form 10-Q for the quarterly periods ended March 31, 2006 and June 30, 2006 to restate the consolidated financial statements and financial information included therewith.

The restatement adjustments are described below.

- Forward contracts and related derivative instruments - In reviewing the accounting and disclosure of its prepaid forward contracts, TDS concluded that its continued designation of the embedded collars within the forward contracts as cash flow hedges of marketable equity securities was not appropriate. TDS did not contemporaneously de-designate, re-designate, and assess hedge effectiveness when the embedded collars were contractually modified for differences between the actual and expected dividend rates on the underlying securities in 2004, 2003 and 2002. As a result, the embedded collars no longer qualified for cash flow hedge accounting treatment upon the modification of the terms of the collars for changes in dividend rates and, from that point forward, must be accounted for as derivative instruments that do not qualify for cash flow hedge accounting treatment. Accordingly, all changes in the fair value of the embedded collars from the time of the contractual modification of each collar must be recognized in the statement of operations. The restatement adjustments represent reclassifications of unrealized gains or losses related to changes in the fair value of the embedded collars from other comprehensive income or loss, included in common stockholders equity, to the statement of operations.

- Expense reclassifications - Certain prior period amounts, primarily labor, maintenance, rent and utilities expenses at the competitive local exchange carriers ( CLEC ), previously reported in selling, general and administrative expense have been corrected to properly reflect the classification of the expenses in cost of service and products for the nine months ended September 30, 2005. Certain expenses, primarily universal service costs, at both the incumbent local exchange carriers ( ILEC ) and the CLEC previously reported in cost of service and products have been adjusted to properly reflect the classification of the expenses in selling, general and administrative expense. For the ILEC, cost of services and products decreased by $1.9 million and $5.2 million with a corresponding increase in selling, general and administrative expenses in the three and nine months ended September 30, 2005, respectively. For the CLEC, cost of services and products increased by $5.7 million and $17.4 million with a corresponding decrease in selling, general and administrative expenses in the three and nine months ended September 30, 2005, respectively. On a TDS consolidated basis, cost of services and products increased by $3.8 million and $12.2 million with a corresponding decrease in selling, general and administrative expenses in the three and nine months ended September 30, 2005, respectively. The adjustments did not affect previously reported revenues, operating income or net income.

- Establishment of an Asset Retirement Obligation ( ARO ) - Upon initial implementation of Statement of Financial Accounting Standards No. 143 Accounting for Asset Retirement Obligations ( SFAS No. 143 ) in 2003, TDS Telecom s ILEC operations concluded that it was not necessary to record an ARO asset and corresponding regulatory liability of equal amount. TDS Telecom's ILECs have their rates regulated by the respective state public utility commissions and the Federal Communications Commission ( FCC ), and therefore, reflect the effects of the rate-making actions of these regulatory bodies in their financial statements. In 2002, the FCC notified carriers by Order that it would not be adopting SFAS No. 143 since the FCC concluded that SFAS No. 143 conflicted with the FCC's current accounting rules that require ILECs to accrue for asset retirement obligations through prescribed depreciation rates. Upon adoption of SFAS No. 143, and pursuant to the FCC's order and the provisions of SFAS No. 71 Accounting for the Effects of Certain Types of Regulation, ( SFAS No. 71 ) the ILECs reclassified their existing remediation liabilities, previously recorded in accumulated depreciation, to an ARO liability and a separate regulatory liability. Upon further review, TDS has concluded that upon adoption of SFAS No. 143, and in accordance with SFAS No. 71, it should have recognized an ARO asset and a corresponding ARO liability, rather than establish the ARO liability through a reclassification of its existing remediation liabilities. The impact of establishing the ARO asset increased Property, Plant and Equipment and the corresponding ARO liability by $26.6 million and $27.3 million as of September 30, 2006 and December 31, 2005, respectively. The adjustment did not affect previously reported revenues, operating income or net income (loss).

- Contracts with maintenance and support services U.S. Cellular entered into certain equipment and software contracts that included maintenance and support services. In one case, U.S. Cellular did not properly allocate expenditures between equipment purchases and maintenance and support services. In other cases, U.S. Cellular did not properly record fees for maintenance and support services over the specified term of the agreement. The restatement adjustments properly record property, plant and equipment, related depreciation expense and fees for maintenance and support services in the correct periods.

- Classification of Asset Retirement Obligation on the Statement of Cash Flows The additions to property, plant and equipment and other deferred liabilities representing additional asset retirement obligations ( ARO ) should be treated as non-cash items in the statement of cash flows. From 2004 through the second quarter of 2006, U.S. Cellular included additional ARO liabilities as a change in other assets and liabilities in cash flows from operating activities and the increase in the ARO asset balance as a capital expenditure in cash flows from investing activities resulting in an overstatement of cash flows from operating activities and an overstatement of cash flows required by investing activities. In the restatement, adjustments were recorded in the statement of cash flows to offset the change in ARO liabilities against the ARO asset. The reduction in the change in other assets and liabilities in cash flows from operating activities and the reduction in additions to property, plant and equipment in cash flows from investing activities totaled $4.7 million in the nine months ended September 30, 2005.

• Income taxes In the restatement, TDS adjusted its income tax expense, income taxes payable, goodwill, deferred income tax assets and liabilities and related disclosures for the years ended December 31, 2005, 2004, 2003 and 2002 for items identified based on its annual analysis reconciling its 2005 income tax expense and income tax balance sheet accounts as determined in its comparison of the 2005 year-end income tax provision to the 2005 federal and state income tax returns. These adjustments included corrections for certain accounts that had not previously been included in the financial reporting basis used in determining the cumulative temporary differences in computing deferred income tax assets and liabilities, as well as adjustments to certain cumulative temporary differences that had historically been incorrectly associated with operating license assets which, in this restatement, have been correctly classified as investments in partnership assets. Accordingly, the company has adjusted the deferred tax liabilities related to these assets. Goodwill was adjusted by $10.2 million to record the income tax effect of the difference between the financial reporting basis and the income tax basis of certain acquisitions made prior to 2004.

TDS determined that the state deferred tax liabilities attributable to marketable equity securities, as presented in prior periods, should have been lower to reflect carryover of a higher stock basis than the federal basis for certain states that have not adopted the federal consolidated return regulations. TDS also identified a valuation allowance related to state net operating loss carry forwards for which deferred tax liabilities related to marketable equity securities provide positive evidence supporting reductions to previously established valuation allowances.

• Cash and interest income In reviewing cash accounts, it was determined that cash and interest income were overstated in the three months ended March 31, 2006 and six months ended June 30, 2006. In the restatement, TDS corrected the overstatement by reducing cash and interest income.

• Property, plant and equipment U.S. Cellular did not properly record certain transfers and disposals of equipment removed from service. Also, U.S. Cellular did not properly record depreciation expense for certain leasehold improvements and other equipment due to the use of incorrect asset lives. The restatement adjustments properly record equipment disposals and depreciation expense in the correct amounts and periods.

• Other items In addition to the adjustments described above, TDS recorded a number of other adjustments to correct and record revenues, expenses and equity in earnings of unconsolidated entities in the periods in which such revenues, expenses and equity in earnings of unconsolidated entities were earned or incurred. Adjustments were also made to correct certain balance sheet amounts, including $2.1 million corrections to purchase price accounting for certain acquisitions prior to 2003. These individual adjustments were not material.

The table below summarizes the impacts of the restatement on income before income taxes and minority interest.

| | **Three Month Ended September 30, 2005** | **Nine Months Ended September 30, 2005** |
|---|---|---|
| | **(Increase (decrease),** dollars in thousands) | |
| Income Before Income Taxes and Minority Interest, as previously reported | $ 83,223 | $ 312,601 |
| Forward contracts and related derivative instruments | (4,665) | 495,011 |
| Contracts with maintenance and support services | (123) | (458) |
| Property, plant and equipment | (1,827) | (1,750) |
| Other items | (1,667) | (7,633) |
| Total adjustment | (8,282) | 485,170 |
| Income Before Income Taxes and Minority Interest, as restated | $ 74,941 | $ 797,771 |

The table below summarizes the net income and diluted earnings per share impacts from the restatement.

| | Three Months Ended September 30, 2005 | | Nine Months Ended September 30, 2005 | |
|---|---|---|---|---|
| | Net Income | Diluted Earnings Per Share | Net Income | Diluted Earnings Per Share |
| | (Increase (decrease), dollars in thousands, except per share amounts) | | | |
| As previously reported | $ 41,566 | $ 0.36 | $ 161,671 | $ 1.39 |
| Forward contracts and related derivative instruments | (1,681 ) | (0.01 ) | 297,644 | 2.56 |
| Contracts with maintenance and support services | (48 ) | | (188 ) | |
| Income taxes | 549 | | 1,647 | 0.01 |
| Property, plant and equipment | (916 ) | (0.01 ) | (874 ) | (0.01 ) |
| Other items | (855 ) | (0.01 ) | (3,745 ) | (0.03 ) |
| Total adjustment | (2,951 ) | (0.03 ) | 294,484 | 2.53 |
| As restated | $ 38,615 | $ 0.33 | $ 456,155 | $ 3.92 |

The effect of the restatement on the previously reported Consolidated Statements of Operations is as follows:

| | Three Months Ended September 30, 2005 As Previously Reported | As Restated | Nine Months Ended September 30, 2005 As Previously Reported | As Restated |
|---|---|---|---|---|
| | (Dollars in thousands, except per share amounts) | | | |
| Operating Revenues | $ 1,028,751 | $ 1,027,947 | $ 2,934,397 | $ 2,929,857 |
| Operating Expenses | | | | |
| Cost of service and products (exclusive of depreciation, amortization and accretion shown separately below) | 369,889 | 373,967 | 1,046,113 | 1,059,777 |
| Selling, general and administrative expense | 383,500 | 380,252 | 1,088,428 | 1,078,031 |
| Depreciation, amortization and accretion expense | 167,588 | 169,243 | 505,911 | 507,295 |
| Total Operating Expenses | 920,977 | 923,462 | 2,640,452 | 2,645,103 |
| | | | | |
| Operating Income | 107,774 | 104,485 | 293,945 | 284,754 |
| Investment and Other Income (Expense) | | | | |
| Equity in earnings of unconsolidated entities | 18,065 | 17,737 | 51,007 | 50,229 |
| Interest and dividend income | 14,204 | 14,204 | 141,386 | 141,514 |
| Interest expense | (53,852) | (53,852) | (160,240) | (160,240) |
| Fair value adjustment of derivative instruments | 236 | (4,429) | 283 | 495,294 |
| Gain (loss) on investments | | | 500 | 500 |
| Other income (expense), net | (3,204) | (3,204) | (14,280) | (14,280) |
| Total Investment and Other Income (Expense) | (24,551) | (29,544) | 18,656 | 513,017 |
| | | | | |
| Income before Income Taxes and Minority Interest | 83,223 | 74,941 | 312,601 | 797,771 |
| Income tax expense | 32,766 | 29,492 | 127,141 | 317,982 |
| Income before Minority Interest | 50,457 | 45,449 | 185,460 | 479,789 |
| Minority share of income | (9,231) | (7,174) | (24,129) | (23,974) |
| Income From Continuing Operations | 41,226 | 38,275 | 161,331 | 455,815 |
| Discontinued Operations, Net of Tax | 340 | 340 | 340 | 340 |
| Net Income | 41,566 | 38,615 | 161,671 | 456,155 |
| Preferred dividend requirement | (50) | (50) | (152) | (152) |
| Net Income Available to Common | $ 41,516 | $ 38,565 | $ 161,519 | $ 456,003 |
| | | | | |
| Basic Earnings per Share | $ 0.36 | $ 0.33 | $ 1.40 | $ 3.96 |
| Diluted Earnings per Share | $ 0.36 | $ 0.33 | $ 1.39 | $ 3.92 |

The effect of the restatement on the previously reported Consolidated Statements of Cash Flows is as follows:

| | Nine Months Ended September 30, 2005 As Previously Reported (Dollars in thousands) | As Restated |
|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net income | $ 161,671 | $ 456,155 |
| Add (Deduct) adjustments to reconcile net income to net cash provided by operating activities | | |
| Depreciation, amortization and accretion | 505,911 | 507,295 |
| Bad debts expense | 30,862 | 30,862 |
| Stock based compensation expense | 6,978 | 6,978 |
| Deferred income taxes | (11,701) | 179,141 |
| Equity in earnings of unconsolidated entities | (51,007) | (50,229) |
| Distributions from unconsolidated entities | 31,488 | 31,192 |
| Minority share of income | 24,129 | 23,974 |
| Fair value adjustment of derivative instruments | (283) | (495,294) |
| Gain on investments | (500) | (500) |
| Discontinued operations | (340) | (340) |
| Noncash interest expense | 15,242 | 15,242 |
| Other noncash expense | 7,318 | 7,318 |
| Changes in assets and liabilities | | |
| Change in accounts receivable | (47,729) | (46,438) |
| Change in materials and supplies | 22,154 | 22,154 |
| Change in accounts payable | (49,362) | (49,362) |
| Change in customer deposits and deferred revenues | 1,778 | 5,355 |
| Change in accrued taxes | 38,664 | 38,664 |
| Change in accrued interest | 4,766 | 4,766 |
| Change in other assets and liabilities | (8,135) | (10,785) |
| | 681,904 | 676,148 |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Additions to property, plant and equipment | (470,714) | (464,958) |
| Cash received from divestitures | 500 | 500 |
| Cash paid for acquisitions | (126,160) | (126,160) |
| Other investing activities | (4,660) | (4,660) |
| | (601,034) | (595,278) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Issuance of notes payable | 350,000 | 350,000 |
| Issuance of long-term debt | 112,835 | 112,835 |
| Repayment of notes payable | (380,000) | (380,000) |
| Repayment of long-term debt | (241,447) | (241,447) |
| Repayment of medium-term notes | (17,200) | (17,200) |
| TDS Common Shares and Special Common Shares issued for benefit plans | 18,150 | 18,150 |
| U.S. Cellular Common Shares issued for benefit plans | 22,228 | 22,228 |
| Capital (distributions) to minority partners | (1,581) | (1,581) |
| Dividends paid | (30,415) | (30,415) |
| Other financing activities | (5) | (5) |
| | (167,435) | (167,435) |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | (86,565) | (86,565) |
| CASH AND CASH EQUIVALENTS | | |
| Beginning of period | 1,171,105 | 1,171,105 |
| End of period | $ 1,084,540 | $ 1,084,540 |

12

The effect of the restatement on the previously reported Consolidated Balance Sheets is as follows:

| | **December 31, 2005 As Previously Reported (Dollars in thousands)** | **As Restated** |
|---|---|---|
| CURRENT ASSETS | | |
| Cash and cash equivalents | $ 1,095,791 | $ 1,095,791 |
| Accounts receivable | | |
| Due from customers | 336,005 | 332,278 |
| Other, principally connecting companies | 160,577 | 157,182 |
| Materials and supplies, at average cost | 103,211 | 103,211 |
| Prepaid expenses | 40,704 | 41,746 |
| Deferred income tax asset | 13,438 | 13,438 |
| Other current assets | 29,243 | 34,774 |
| | 1,778,969 | 1,778,420 |
| | | |
| INVESTMENTS | | |
| Marketable equity securities | 2,531,690 | 2,531,690 |
| Licenses | 1,365,063 | 1,365,063 |
| Goodwill | 869,792 | 882,168 |
| Customer lists, net of accumulated amortization | 49,318 | 47,649 |
| Investments in unconsolidated entities | 215,424 | 217,180 |
| Other investments | 12,274 | 12,274 |
| | 5,043,561 | 5,056,024 |
| | | |
| PROPERTY, PLANT AND EQUIPMENT | | |
| In service and under construction | 7,140,447 | 7,131,977 |
| Less accumulated depreciation | 3,614,242 | 3,602,217 |
| | 3,526,205 | 3,529,760 |
| | | |
| OTHER DEFERRED CHARGES | 55,830 | 55,830 |
| | | |
| TOTAL ASSETS | $ 10,404,565 | $ 10,420,034 |

| | December 31, 2005 As Previously Reported (Dollars in thousands) | As Restated |
|---|---|---|
| CURRENT LIABILITIES | | |
| Current portion of long-term debt | $ 237,948 | $ 237,948 |
| Notes payable | 135,000 | 135,000 |
| Accounts payable | 357,273 | 359,934 |
| Customer deposits and deferred revenues | 121,228 | 126,454 |
| Accrued interest | 28,946 | 28,946 |
| Accrued taxes | 47,180 | 46,061 |
| Accrued compensation | 67,443 | 67,443 |
| Other current liabilities | 61,086 | 63,539 |
| | 1,056,104 | 1,065,325 |
| | | |
| DEFERRED LIABILITIES AND CREDITS | | |
| Net deferred income tax liability | 1,383,031 | 1,337,716 |
| Derivative liability | 449,192 | 449,192 |
| Asset retirement obligation | 163,093 | 190,382 |
| Other deferred liabilities and credits | 104,984 | 107,924 |
| | 2,100,300 | 2,085,214 |
| | | |
| LONG-TERM DEBT | | |
| Long-term debt, excluding current portion | 1,633,519 | 1,633,519 |
| Forward contracts | 1,707,282 | 1,707,282 |
| | 3,340,801 | 3,340,801 |
| | | |
| MINORITY INTEREST IN SUBSIDIARIES | 552,884 | 546,833 |
| | | |
| PREFERRED SHARES | 3,863 | 3,863 |
| | | |
| COMMON STOCKHOLDERS EQUITY | | |
| Common Shares, par value $.01 per share | 565 | 565 |
| Special Common Shares, par value $.01 per share | 629 | 629 |
| Series A Common Shares, par value $.01 per share | 64 | 64 |
| Additional paid-in capital | 1,826,420 | 1,828,634 |
| Treasury Shares, at cost: | | |
| Common Shares | (208,156 ) | (208,156 ) |
| Special Common Shares | (210,600 ) | (210,600 ) |
| Accumulated other comprehensive income | 309,009 | 363,641 |
| Retained earnings | 1,632,682 | 1,603,221 |
| | 3,350,613 | 3,377,998 |
| TOTAL LIABILITIES AND STOCKHOLDERS EQUITY | $ 10,404,565 | $ 10,420,034 |

## 2. Summary of Significant Accounting Policies

Change in Accounting Principle Stock-Based Compensation

TDS has established long-term incentive plans, employee stock purchase plans, dividend reinvestment plans, and a non-employee director compensation plan which are described more fully in Note 3 Stock-Based Compensation. Prior to January 1, 2006, TDS accounted for these plans under the recognition and measurement provisions of Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees ( APB 25 ), and related interpretations, as permitted by Financial Accounting Standards Board ( FASB ) Statement of Financial Accounting Standards ( SFAS ) No. 123, Accounting for Stock-Based Compensation ( SFAS 123 ). Total stock-based employee compensation cost recognized in the Consolidated Statements of Operations under APB 25 was $2.9 million and $7.0 million for the three and nine months ended September 30, 2005, primarily for restricted stock unit and deferred compensation stock unit awards. No compensation cost was recognized in the Consolidated Statements of Operations under APB 25 for stock option awards for the three and nine months ended September 30, 2005, because all outstanding options granted had an exercise price equal to the market value of the underlying common stock on the date of grant. The employee stock purchase plans and dividend reinvestment plans qualified as non-compensatory plans under APB 25; therefore, no compensation cost was recognized for these plans during the three and nine months ended September 30, 2005.

Effective January 1, 2006, TDS adopted the fair value recognition provisions of SFAS No. 123(R), Share-Based Payment ( SFAS 123(R) ), using the modified prospective transition method. In addition, TDS applied the provisions of Staff Accounting Bulletin No. 107 ( SAB 107 ), issued by the SEC in March 2005 in its adoption of SFAS 123(R). Under the modified prospective transition method, compensation cost recognized during the three and nine months ended September 30, 2006 includes: (a) compensation cost for all share-based payments granted prior to but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS 123, and (b) compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS 123(R). Results for prior periods have not been restated.

Under SFAS 123(R), the long-term incentive plans are considered compensatory plans; therefore, recognition of compensation costs for grants made under these plans is required.

Under SFAS 123(R), the employee stock purchase plans are considered compensatory plans; therefore, recognition of compensation costs for grants made under these plans is required. However, due to restrictions on activity under these plans that were in place during the nine months ended September 30, 2006, no compensation expense was recognized during this period.

Under SFAS 123(R), the dividend reinvestment plans are not considered compensatory plans, therefore recognition of compensation costs for grants made under these plans is not required.

Upon adoption of SFAS 123(R), TDS elected to continue to value its share-based payment transactions using a Black-Scholes valuation model, which was previously used by TDS for purposes of preparing the pro forma disclosures under SFAS 123. Under the provisions of SFAS 123(R), stock-based compensation cost recognized during the period is based on the portion of the share-based payment awards that is ultimately expected to vest. Accordingly, stock-based compensation cost recognized in 2006 has been reduced for estimated forfeitures. SFAS 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Pre-vesting forfeitures were estimated based on historical experience related to similar awards, giving consideration to the contractual terms of the stock-based awards, vesting schedules and expectations of future employee behavior. TDS believes that its historical experience is the best estimate of future expected life. In TDS s pro forma information required under SFAS 123, TDS also reduced stock-based compensation cost for estimated forfeitures. The expected life assumption was determined based on TDS s historical experience. For purposes of both SFAS 123 and SFAS 123(R), the expected volatility assumption was based on the historical volatility of TDS s common stock. The dividend yield was included in the assumptions. The risk-free interest rate assumption was determined using the implied yield currently available for zero-coupon U.S. government issues with a remaining term equal to the expected life of the stock options.

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

Certain employees were eligible for retirement at the time that compensatory stock options and restricted stock units were granted to them. Under the terms of the TDS option agreements, options granted to these individuals do not vest upon retirement. Under the terms of the U.S. Cellular option and restricted stock unit agreements, options and restricted stock units granted to retirement-eligible employees will fully vest upon their retirement if the employees have reached the age of 65. Similarly, under the terms of TDS s restricted stock unit agreements, restricted stock units vest upon retirement if the employee has reached the age of 66. Prior to the adoption of SFAS 123(R), TDS used the nominal vesting method to recognize the pro forma stock-based compensation cost related to options and restricted stock units awarded to retirement-eligible employees. This method does not take into account the effect of early vesting due to the retirement of eligible employees. Upon adoption of SFAS 123(R), TDS adopted the non-substantive vesting method , which requires accelerated recognition of the entire cost of options granted to retirement-eligible employees over the period of time from the date of grant to the date the employee reaches age 65. If the non-substantive vesting method had been applied in prior periods, the effect on previously disclosed pro forma stock-based compensation cost would not have been material.

On March 7, 2006, the TDS Compensation Committee approved amendments to stock option award agreements. The amendments modify current and future options to extend the exercise period until 30 days following (i) the lifting of a "suspension" if options otherwise would expire or be forfeited during the suspension period and (ii) the lifting of a blackout if options otherwise would expire or be forfeited during a blackout period. TDS temporarily suspended issuances of shares under the 2004 Long Term Incentive Plan between March 17, 2006 and October 10, 2006 as a consequence of late SEC filings. TDS became current with respect to its Form 10-K for the year then ended December 31, 2005 and other periodic SEC filings upon the filing of its Form 10-K for the year then ended December 31, 2005 and other periodic SEC filings upon the filing of its Form 10-Q for the quarter ended June 30, 2006, on October 10, 2006. As required under the provisions of SFAS 123(R), TDS evaluated the impact of this plan modification and originally determined that the adjustment to stock based compensation was not material. However, in connection with the restatement discussed in Note 1 above, TDS further reviewed the accounting for the plan modification. Upon such further review, TDS determined that it should have recognized stock-based compensation expense of $1.6 million in the three months ended March 31, 2006 as a result of this modification TDS recognized $0.0 million and $1.6 million in stock-based compensation expense in the three and nine months ended September 30, 2006, respectively, as a result of this modification.

Pension Plan

TDS sponsors a qualified noncontributory defined contribution pension plan. The plan provides benefits for the employees of TDS Corporate, TDS Telecom and U.S. Cellular. Under this plan, pension benefits and costs are calculated separately for each participant and are funded currently. Pension costs were $3.6 million and $11.5 million for the three and nine months ended September 30, 2006, respectively, and $3.3 million and $10.1 million for the three and nine months ended September 30, 2005, respectively.

TDS also sponsors an unfunded non-qualified deferred supplemental executive retirement plan for certain employees which supplements the benefits under the qualified plan to offset the reduction of benefits caused by the limitation on annual employer contributions under the tax laws.

Other Postretirement Benefits

TDS sponsors two contributory defined benefit postretirement plans that cover most employees of TDS Corporate, TDS Telecom and the subsidiaries of TDS Telecom. One plan provides medical benefits and the other plan provides life insurance benefits.

Net periodic benefit costs for the defined benefit postretirement plans include the following components:

| | Three Months Ended September 30, 2006 | Three Months Ended September 30, 2005 | Nine Months Ended September 30, 2006 | Nine Months Ended September 30, 2005 |
|---|---|---|---|---|
| | (Dollars in thousands) | | | |
| Service Cost | $ 544 | $ 553 | $ 1,633 | $ 1,659 |
| Interest on accumulated benefit obligation | 692 | 659 | 2,075 | 1,977 |
| Expected return on plan assets | (648 ) | (558 ) | (1,945 ) | (1,673 ) |
| Amortization of: | | | | |
| Prior service cost | (208 ) | (279 ) | (623 ) | (838 ) |
| Net loss | 292 | 288 | 876 | 865 |
| Net postretirement cost | $ 672 | $ 663 | $ 2,016 | $ 1,990 |

TDS contributed $5.3 million for its 2006 contribution to the postretirement plan assets.

Recent Accounting Pronouncements

The Securities and Exchange Commission ( SEC ) released Staff Accounting Bulletin No. 108, Considering the Effects of Prior Year Misstatements When Quantifying Misstatements in Current Year Financial Statements ( SAB 108 ), in September 2006. SAB 108 provides guidance on how the effects of the carryover or reversal of prior year financial statement misstatements should be considered in quantifying a current year misstatement. Prior practice allowed the evaluation of materiality on the basis of (1) the error quantified as the amount by which the current year income statement was misstated ( rollover method ) or (2) the cumulative error quantified as the cumulative amount by which the current year balance sheet was misstated ( iron curtain method ). Reliance on one or the other method in prior years could have resulted in misstatement of the financial statements. The guidance provided in SAB 108 requires both methods to be used in evaluating materiality. Immaterial prior year errors may be corrected with the first filing of prior year financial statements after adoption. The cumulative effect of the correction would be reflected in the opening balance sheet with appropriate disclosure of the nature and amount of each individual error corrected in the cumulative adjustment, as well as a disclosure of the cause of the error and that the error had been deemed to be immaterial in the past. SAB 108 is effective for TDS s opening balance sheet in 2007. TDS is currently evaluating the impact this Bulletin might have on its financial position or results of operations.

In September 2006, the FASB released Statement of Financial Accounting Standards No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R) ( SFAS 158 ). Under SFAS 158, companies must recognize a net liability or asset to report the funded status of their defined benefit pension and other postretirement benefit plans on their balance sheets. The recognition, disclosure and measurement provisions of SFAS 158 are effective for TDS as of December 31, 2006 on a prospective basis. The Company anticipates that the after-tax effect on the December 31, 2006 financial statements will be to increase liabilities and reduce stockholder s equity by approximately $11.4 million. This after-tax effect will be based on the plans projected valuations as of December 31, 2006. The actual effects will change based on refined analysis and actual measurement date assumptions as of December 31, 2006. The Company does not anticipate any other significant impact from the adoption of SFAS 158.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, Fair Value Measurements ( SFAS 157 ). This Statement defines fair value as used in numerous accounting pronouncements, establishes a framework for measuring fair value in generally accepted accounting principles ( GAAP ) and expands disclosure related to the use of fair value measures in financial statements. SFAS 157 does not expand the use of fair value measures in financial statements, but standardizes its definition and guidance in GAAP. The Statement emphasizes that fair value is a market-based measurement and not an entity-specific measurement based on an exchange transaction in which the entity sells an asset or transfers a liability (exit price). SFAS 157 establishes a fair value hierarchy from observable market data as the highest level to fair value based on an entity s own fair value assumptions as the lowest level. The Statement is effective for TDS s 2008 quarterly and annual financial statements; however, earlier application is encouraged. TDS is currently evaluating the timing of adoption and the impact that adoption might have on its financial position or results of operations.

The FASB issued Interpretation 48, *Accounting for Uncertainty in Income Taxes -an interpretation of FASB Statement No. 109* ( FIN 48 ) in July 2006. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes* ( SFAS 109 ). The interpretation applies to all tax positions accounted for in accordance with SFAS 109 and changes how tax positions are recognized and measured and how uncertainties related to income tax positions are disclosed. It provides guidance on recognition, derecognition and measurement of uncertain tax positions in a period subsequent to that in which a position is taken; the accounting for interest and penalties; the classification and presentation of recorded amounts; and disclosure requirements. TDS will adopt the provisions of FIN 48 effective January 1, 2007. Under FIN 48, TDS will evaluate the tax uncertainty, assess the probability of the ultimate settlement with the applicable taxing authority and record an amount based on that assessment. TDS had previously set up tax accruals, as needed, to cover its potential liability for income tax uncertainties pursuant to FASB Statement No. 5 *Accounting for Contingencies* . The FASB has issued preliminary guidance regarding ultimate settlement of tax uncertainties. This guidance, in the form of a FASB Staff Position, is not yet finalized. TDS will use the finalized guidance to determine the amount of its cumulative effect adjustment to be recorded to opening retained earnings upon adoption of FIN 48 effective January 1, 2007. TDS is currently reviewing the requirements of FIN 48 to determine the impact on its financial position or results of operations. The primary impact of FIN 48 on TDS s existing tax accounting policies and practices will be the documentation of all tax positions rather than only tax positions that TDS considers probable of incurring a loss.

## 3. Stock-Based Compensation

As a result of adopting SFAS 123(R) on January 1, 2006, TDS s income before income taxes and minority interest for the three and nine months ended September 30, 2006, was $9.7 million and $18.9 million lower, respectively, than if it had continued to account for share-based compensation under APB 25. Similarly, as a result of adopting SFAS 123(R) on January 1, 2006, TDS s net income for the three and nine months ended September 30, 2006, was $6.9 million and $10.5 million lower, basic earnings per share for the three and nine months ended September 30, 2006 was $0.06 and $0.09 lower, and diluted earnings per share for the three and nine months ended September 30, 2006 was $0.06 and $0.09 lower, respectively, than if TDS had continued to account for stock-based compensation expense under APB 25.

Stock-Based Compensation Expense

For comparison, the following table illustrates the pro forma effect on net income and earnings per share had TDS applied the fair value recognition provisions of SFAS 123(R) to its stock-based employee compensation plans for the three and nine months ended September 30, 2005:

| (Dollars in thousands, except per share amounts) | Three months ended September 30, 2005 (As Restated) | Nine months ended September 30, 2005 (As Restated) |
|---|---|---|
| Net income, as reported | $ 38,615 | $ 456,155 |
| Add: Stock-based compensation expense included in reported net income, net of related tax effects and minority interest | 1,535 | 3,554 |
| Deduct: Stock-based compensation expense determined under fair value based method for all awards, net of related tax effects and minority interest | (8,062 ) | (17,588 ) |
| Pro forma net income | $ 32,088 | $ 442,121 |
| | | |
| Earnings per share: | | |
| Basic as reported | $ 0.33 | $ 3.96 |
| Basic pro forma | 0.28 | 3.84 |
| Diluted as reported | 0.33 | 3.92 |
| Diluted pro forma | $ 0.27 | $ 3.80 |

Prior to the adoption of SFAS 123(R), TDS presented all tax benefits resulting from tax deductions associated with the exercise of stock options by employees as cash flows from operating activities in the Consolidated Statements of Cash Flows. SFAS 123(R) requires that excess tax benefits be classified as cash flows from financing activities in the Consolidated Statements of Cash Flows. For this purpose, the excess tax benefits are tax benefits related to teh difference between the total tax deduction associated witht eh exercise of stock options by employees and the amount of compensation cost recognized for those options. For the nine months ended September 30, 2006 excess tax benefits of $0.4million were included within Other Financing Activities of the Cash Flows from Financing Activitiespursuant to this requirement of SFAS 123(R).

The following table summarizes stock-based compensation expense recognized during the three and nine months ended September 30, 2006:

| | (Amounts in thousands) | |
|---|---|---|
| Stock option awards | $ 9,697 | $ 18,863 |
| Restricted stock unit awards | 3,487 | 9,574 |
| Deferred compensation matching stock unit awards | (187 ) | (789 ) |
| Employee stock purchase plans | | |
| Awards under non-employee director s compensation plan | | 2 |
| Total stock-based compensation, before income taxes | 12,997 | 27,650 |
| Income tax benefit | (3,202 ) | (10,289 ) |
| Total stock-based compensation expense, net of income taxes | $ 9,795 | $ 17,361 |

At September 30, 2006, unrecognized compensation cost for all stock-based compensation awards was $28.4 million. The unrecognized compensation cost for stock-based compensation awards at September 30, 2006 is expected to be recognized over a weighted average period of 0.7 years.

For the three and nine month period ended September 30, 2006, $12.7 million and $27.4 million of stock-based compensation was recorded in Selling, general and administrative expense and $0.3 million was recorded in cost of services and products, respectively.

**TDS**

The information in this section relates to stock-based compensation plans utilizing the equity instruments of TDS. Participants in these plans are generally employees of TDS Corporate and TDS Telecom, although U.S. Cellular employees are eligible to participate in the TDS Employee Stock Purchase Plan. Information related to plans utilizing the equity instruments of U.S. Cellular are shown in the U.S. Cellular section following the TDS section.

Under the TDS 2004 Long-Term Incentive Plan (and a predecessor plan), TDS may grant fixed and performance-based incentive and non-qualified stock options, restricted stock, restricted stock units, and deferred compensation stock unit awards to key employees. TDS had reserved 4,006,000 Common Shares and 11,893,000 Special Common Shares at September 30, 2006, for equity awards granted and to be granted under this plan. At September 30, 2006, the only types of awards outstanding are fixed non-qualified stock option awards, restricted stock unit awards, and deferred compensation stock unit awards. At September 30, 2006, TDS also had reserved 174,000 Common Shares and 323,000 Special Common Shares for issuance under the Automatic Dividend Reinvestment and Stock Purchase Plan and 49,000 Series A Common Shares for issuance under the Series A Common Share Automatic Dividend Reinvestment Plan, and 185,000 Common Shares and 320,000 Special Common Shares under an employee stock purchase plan. The maximum number of TDS Common Shares, TDS Special Common Shares and TDS Series A Common Shares that may be issued to employees under all stock-based compensation plans in effect at September 30, 2006 was 4,365,000, 12,536,000 and 49,000 shares, respectively. TDS currently utilizes treasury stock to satisfy stock option exercises, issuances under its employee stock purchase plan, restricted stock unit awards and deferred compensation stock unit awards. TDS has also created a Non-Employee Directors Plan under which it has reserved 33,000 Common Shares and 75,000 Special Common Shares of TDS stock for issuance as compensation to members of the board of directors who are not employees of TDS.

Stock Options Stock options granted to key employees are exercisable over a specified period not in excess of ten years. Stock options generally vest over periods up to four years from the date of grant. Stock options outstanding at September 30, 2006 expire between 2006 and 2016. However, vested stock options typically expire 30 days after the effective date of an employee s termination of employment for reasons other than retirement. Employees who leave at the age of retirement have 90 days (or one year if they satisfy certain requirements) within which to exercise their vested stock options. The exercise price of the option generally equals the market value of TDS common stock on the date of grant.

TDS did not grant any stock options during the three months ended September 30, 2006 and September 30, 2005, respectively. TDS granted 1,105,000 and 630,000 stock options during the nine months ended September 30, 2006 and September 30, 2005, respectively. TDS estimates the fair value of stock options granted using the Black-Scholes valuation model. The fair value is then recognized as compensation cost on a straight-line basis over the requisite service period, which is generally the vesting period, for each separately vesting portion of the awards as if the awards were, in-substance, multiple awards, which is the same attribution method that was used by TDS for purposes of its pro forma disclosures under SFAS 123. TDS used the assumptions shown in the table below in valuing the options granted in 2006:

| | |
|---|---|
| Expected Life | 4.9 Years |
| Expected Annual Volatility Rate | 25.9% |
| Dividend Yield | 1.0% |
| Risk-free Interest Rate | 4.8% |
| Estimated Annual Forfeiture Rate | 0.6% |

All TDS options outstanding at March 31, 2006 were granted prior to the distribution of the TDS Special Common Share Dividend in 2005, more fully described in TDS s 2005 Annual Report on Form 10-K/A. As a result of the Special Common Share Dividend, an employee will receive one Common Share and one Special Common Share per tandem option exercised. Each tandem option is exercisable at its original exercise price. TDS options granted after the distribution of the TDS Special Common Share Dividend will receive one Special Common Share per option exercised.

A summary of TDS stock options (total and portion exercisable) at September 30, 2006 and changes during the nine months then ended is presented in the table and narrative below:

Tandem Options

| | Number of Tandem Options(1) | Weighted Average Exercise Prices | Weighted Average Remaining Contractual Term | Aggregate Intrinsic Value |
|---|---|---|---|---|
| Outstanding at December 31, 2005 (2,461,000 exercisable) | 2,701,000 | $ 73.85 | 6.5 Years | $ 41,552,000 |
| Granted | | | | |
| Exercised | 23,000 | 52.28 | | 466,000 |
| Forfeited | 15,000 | 57.55 | | 402,000 |
| Expired | | | | |
| Outstanding at September 30, 2006 (2,599,000 exercisable) | 2,663,000 | $ 74.13 | 5.8 Years | $ 40,460,000 |

(1) Upon exercise, each tandem option is converted into one TDS Common Share and one TDS Special Common Share.

**Special Common Share Options**

| | Number of Options(2) | Weighted Average Exercise Prices | Weighted Average Remaining Contractual Term | Aggregate Intrinsic Value |
|---|---|---|---|---|
| Outstanding at December 31, 2005 (0 exercisable) | | | | |
| Granted | 1,105,000 | $ 38.01 | 10.0 Years | $ 3,143,000 |
| Exercised | | | | |
| Forfeited | 6,000 | 38.00 | | 16,000 |
| Expired | | | | |
| Outstanding at September 30, 2006 (6,000 exercisable) | 1,099,000 | $ 38.01 | 9.7 Years | $ 3,127,000 |

(2) Upon exercise, each Special Common share option is converted into one TDS Special Common Share.

The aggregate intrinsic value in the table above represents the total pretax intrinsic value (the difference between TDS s closing stock price on the last trading day of the period and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on September 30, 2006. This amount will change in future periods based on the market price of TDS s stock. TDS received $0.0 and $1.2 million in cash from the exercise of stock options during the three and nine months ended September 30, 2006.

21

A summary of TDS s nonvested stock options at September 30, 2006 and changes during the nine months then ended is presented in the tables that follow:

| **Tandem Options** | **Number of Stock Options**(1) | **Weighted Average Fair Values of Stock Options** |
|---|---|---|
| Nonvested at December 31, 2005 | 240,000 | $ 21.67 |
| Granted | | |
| Vested | 161,000 | 20.07 |
| Forfeited | 15,000 | 22.33 |
| Nonvested at September 30, 2006 | 64,000 | $ 25.55 |

(1) Upon exercise, each tandem stock option is converted into one TDS Common Share and one TDS Special Common Share.

| **Special Common Share Options** | **Number of Stock Options**(2) | **Weighted Average Fair Values of Stock Options** |
|---|---|---|
| Nonvested at December 31, 2005 | | |
| Granted | 1,105,000 | $ 11.00 |
| Vested | 6,000 | 11.18 |
| Forfeited | 6,000 | 11.00 |
| Nonvested at September 30, 2006 | 1,093,000 | $ 11.00 |

(2) Upon exercise, each Special Common share option is converted into one TDS Special Common Share.

Restricted Stock Units Beginning in April 2005, TDS granted restricted stock unit awards to key employees. These awards generally vest after three years. All TDS restricted stock units outstanding at March 31, 2006 were granted prior to the distribution of the TDS Special Common Share Dividend in 2005. As a result of the Special Common Share Dividend, an employee will receive one Common Share and one Special Common Share upon the vesting of such restricted stock units. The restricted stock unit awards outstanding at March 31, 2006 will vest in December 2007. When vested, employees will receive an equal number of TDS Common Shares and TDS Special Common Shares with respect to such restricted stock units. Restricted stock unit awards granted after the distribution of the TDS Special Common Share Dividend in 2005 are convertible into one Special Common Share upon the vesting of such restricted stock units. The restricted stock unit awards granted in 2006 will vest in December 2008. When vested, employees will receive one TDS Special Common Share for each restricted stock unit.

TDS estimates the fair value of restricted stock units based on the closing market price of TDS shares on the date of grant. The fair value is then recognized as compensation cost on a straight-line basis over the requisite service periods of the awards, which is generally the vesting period.

A summary of TDS nonvested restricted stock units at September 30, 2006 and changes during the nine months then ended is presented in the table that follows:

| **Tandem Restricted Stock Units** | **Number of Restricted Stock Units**(1) | **Weighted Average Grant-Date Fair Values of Restricted Stock Units** |
|---|---|---|
| Nonvested at December 31, 2005 | 90,000 | $ 77.55 |
| Granted | | |
| Vested | | |
| Forfeited | 1,000 | 78.10 |
| Nonvested at September 30, 2006 | 89,000 | $ 77.55 |

(1) Upon exercise, each tandem restricted stock unit is converted into one TDS Common Share and one TDS Special Common Share.

| **Special Common Restricted Stock Units** | **Number of Restricted Stock Units**(2) | **Weighted Average Grant-Date Fair Values of Restricted Stock Units** |
|---|---|---|
| Nonvested at December 31, 2005 | | |
| Granted | 105,000 | $ 38.05 |
| Vested | 2,000 | 38.62 |
| Forfeited | 1,000 | 38.00 |
| Nonvested at September 30, 2006 | 102,000 | $ 38.04 |

(2) Upon exercise, each Special Common restricted stock unit is converted into one TDS Special Common Share.

Deferred Compensation Stock Units Certain TDS employees may elect to defer receipt of all or a portion of their annual bonuses and to receive stock unit matches on the amount deferred up to $400,000. Deferred compensation, which is immediately vested, is deemed to be invested in TDS Common Share units or, at the election of the committee that administers the plan after the TDS Special Common Share Dividend in 2005, TDS Special Common Share units. TDS match amounts depend on the amount of annual bonus that is deferred into stock units. Participants receive a 25% stock unit match for amounts deferred up to 50% of their total annual bonus and a 33% match for amounts that exceed 50% of their total annual bonus. The matched stock units vest ratably at a rate of one-third per year over three years. When fully vested and upon distribution, employees will receive the vested TDS Common Shares and/or TDS Special Common Shares, as applicable.

TDS estimates the fair value of deferred compensation matching stock units based on the closing market price of TDS shares on the date of grant. The fair value of the matched stock units is then recognized as compensation cost on a straight-line basis over the requisite service periods of the awards, which is generally the vesting period.

A summary of TDS nonvested deferred compensation stock unit plans at September 30, 2006 and changes during the nine months then ended is presented in the table that follows:

| **Tandem Deferred Compensation Stock Units** | **Number of Tandem Stock Units**(1) | **Weighted Average Grant-Date Fair Values of Stock Units** |
|---|---|---|
| Nonvested at December 31, 2005 | 1,025 | $ 75.05 |
| Granted | | |
| Vested | | |
| Forfeited | | |
| Nonvested at September 30, 2006 | 1,025 | $ 75.05 |

(1) Upon exercise, each tandem deferred compensation stock unit outstanding at September 30, 2006 is converted into one TDS Common Share and one TDS Special Common Share.

| Special Common Deferred Compensation Stock Units | Number of Special Common Stock Units(2) | Weighted Average Grant-Date Fair Values of Stock Units |
|---|---|---|
| Nonvested at December 31, 2005 | | |
| Granted | 1,500 | $ 38.30 |
| Vested | | |
| Forfeited | | |
| Nonvested at September 30, 2006 | 1,500 | $ 38.30 |

(2) Upon exercise, each Special Common deferred compensation stock unit is converted into one TDS Special Common Share.

Employee Stock Purchase Plan Under the 2003 Employee Stock Purchase Plan, eligible employees of TDS and its subsidiaries may purchase a limited number of shares of TDS common stock on a quarterly basis. Prior to 2006, such common stock consisted of TDS Common Shares. Beginning in 2006, such common stock consisted of TDS Special Common Shares. TDS had reserved 185,000 Common Shares and 320,000 Special Common Shares at September 30, 2006 for issuance under this plan. The plan became effective on April 1, 2003 and will terminate on December 31, 2008. The per share cost to each participant is 85% of the market value of the Common Shares or Special Common Shares as of the issuance date. Under SFAS 123(R), the employee stock purchase plan is considered a compensatory plan; therefore recognition of compensation costs for stock issued under this plan is required. Compensation cost is measured as the difference between the cost of the shares to the plan participants and the fair market value of the shares on the date of issuance. However, due to restrictions on activity under these plans in place during the three and nine months ended September 30, 2006, no compensation expense was recognized during this period.

Compensation of Non-Employee Directors TDS issued 0 and 2,600 shares under its Non-Employee Directors plan in the three and nine months ended September 30, 2006.

Dividend Reinvestment Plans TDS had reserved 174,000 Common Shares and 323,000 Special Common Shares at September 30, 2006, for issuance under Automatic Dividend Reinvestment and Stock Purchase Plans and 49,000 Series A Common Shares for issuance under the Series A Common Share Automatic Dividend Reinvestment Plan. These plans enable holders of TDS s Common Shares, Special Common Shares and Preferred Shares to reinvest cash dividends in Common Shares and Special Common Shares and holders of Series A Common Shares to reinvest cash dividends in Series A Common Shares. The purchase price of the shares is 95% of the market value, based on the average of the daily high and low sales prices for TDS s Common Shares and Special Common Shares on the American Stock Exchange for the ten trading days preceding the date on which the purchase is made. Under SFAS 123(R) and SFAS 123, these plans are considered non-compensatory plans, therefore no compensation expense is recognized for stock issued under these plans.

**U.S. Cellular**

The information in this section relates to stock-based compensation plans utilizing the equity instruments of U.S. Cellular. Participants in these plans are employees of U.S. Cellular. U.S. Cellular employees are also eligible to participate in the TDS Employee Stock Purchase Plan. Information related to plans utilizing the equity instruments of TDS are shown in the previous section.

Under the U.S. Cellular 2005 Long-Term Incentive Plan, U.S. Cellular may grant fixed and performance-based incentive and non-qualified stock options, restricted stock, restricted stock units, and deferred compensation stock unit awards to key employees. At September 30, 2006, the only types of awards outstanding are fixed non-qualified stock option awards, restricted stock unit awards, and deferred compensation stock unit awards.

At September 30, 2006, U.S. Cellular had reserved 5,403,000 Common Shares for equity awards granted and to be granted under this plan and had also reserved 110,000 Common Shares for issuance to employees under an employee stock purchase plan. The maximum number of U.S. Cellular Common Shares that may be issued to employees under all stock-based compensation plans in effect at September 30, 2006 was 5,513,000 shares. U.S. Cellular currently utilizes treasury stock to satisfy stock option exercises, issuances under its employee stock purchase plan, restricted stock unit awards and deferred compensation stock unit awards. U.S. Cellular employees are also eligible to participate in the TDS Employee Stock Purchase Plan, which was described previously.

U.S. Cellular has also created a Non-Employee Director Compensation Plan under which it has reserved 4,900 Common Shares of U.S. Cellular at September 30, 2006 for issuance as compensation to members of the board of directors who are not employees of U.S. Cellular.

On March 7, 2006, the U.S. Cellular Compensation Committee, approved amendments to stock option award agreements. The amendments modify current and future options to extend the exercise period until 30 days following (i) the lifting of a suspension if options otherwise would expire or be forfeited during the suspension period and (ii) the lifting of a blackout if options otherwise would expire or be forfeited during a blackout period. U.S. Cellular temporarily suspended issuances of shares under the 2005 Long Term Incentive Plan between March 17, 2006 and October 10, 2006 as a consequence of late SEC filings. As required under the provisions of SFAS 123(R), U.S. Cellular evaluated the impact of this plan modification and originally determined that the adjustment to stock based compensation was not material. However, in connection with the restatement discussed in Note 1 above, U.S. Cellular further reviewed the accounting for the plan modification. Upon such further review, U.S. Cellular determined that it should have recognized Stock-Based compensation expense of $1.5 million in the three months ended March 31, 2006 as a result of this modification. U.S. Cellular recognized $0.0 million and $1.5 million in stock-based compensation expense in the three and nine months ended September 30, 2006, respectively, as a result of this modification.

Stock Options Stock options granted to key employees are exercisable over a specified period not in excess of ten years. Stock options generally vest over periods up to four years from the date of grant. Stock options outstanding at September 30, 2006 expire between 2006 and 2016. However, vested stock options typically expire 30 days after the effective date of an employee s termination of employment for reasons other than retirement. Employees who leave at the age of retirement have 90 days (or one year if they satisfy certain requirements) within which to exercise their vested stock options. The exercise price of the option generally equals the market value of U.S. Cellular Common Shares on the date of grant.

U.S. Cellular did not grant any stock options during the three months ended September 30, 2006 and September 30, 2005, respectively. U.S. Cellular granted 551,000 and 757,000 stock options during the nine months ended September 30, 2006 and September 30, 2005, respectively. U.S. Cellular estimates the fair value of stock options granted using the Black-Scholes valuation model. The fair value is then recognized as compensation cost on a straight-line basis over the requisite service period, which is generally the vesting period, for each separately vesting portion of the awards as if the awards were, in-substance, multiple awards, which is the same attribution method that was used by U.S. Cellular for purposes of its pro forma disclosures under SFAS 123. U.S. Cellular used the assumptions shown in the table below in valuing the options granted in 2006:

| | | |
|---|---|---|
| Expected Life | 3.0 Years | |
| Expected Annual Volatility Rate | 25.2 | % |
| Dividend Yield | | |
| Risk-free Interest Rate | 4.7 | % |
| Estimated Annual Forfeiture Rate | 4.4 | % |

25

A summary of U.S. Cellular stock options outstanding (total and portion exercisable) at September 30, 2006 and changes during the nine months then ended is presented in the table below:

| | **Number of Options** | **Weighted Average Exercise Prices** | **Weighted Average Remaining Contractual Term** | **Aggregate Intrinsic Value** |
|---|---|---|---|---|
| Outstanding at December 31, 2005 (877,000 exercisable) | 2,701,000 | $ 38.80 | 7.5 Years | $ 56,469,000 |
| Granted | 551,000 | 59.46 | | 132,000 |
| Exercised | 107,000 | 34.51 | | 2,259,000 |
| Forfeited | 37,000 | 38.65 | | 809,000 |
| Expired | 1,000 | | | |