

To Our Shareholders



Walter C. D. Carlson
Chairman of the Board, *left*

LeRoy T. (Ted) Carlson, Jr.
President and Chief Executive Officer, *right*

The year 2003 was an excellent one for TDS, marked by many achievements and impressive results.

Given the competitive nature of the telecommunications industry, the need for excellent service is more important than ever. That level of service is what we are committed to providing. At the same time, we are ensuring that we have the right strategies in place and are executing them effectively. In 2003, we not only executed our strategies, but we also generated impressive operating metrics and strong financial results.

TDS's consolidated operating revenues increased 15 percent for the year to \$3.4 billion, driven by strong revenue gains at U.S. Cellular and solid revenue growth at

TDS Telecom. Net income for 2003 totaled \$46 million, with basic earnings per share of \$0.80.

We are pleased to report that our stock price improved considerably in 2003, up 33 percent for the year, better than the performance of either the S&P 500 or the Dow Jones Industrial Average. Our annual dividend increased as well, to 62 cents for the year, an increase of 7 percent.

After TDS reported year-end 2003 results, the company announced in April the restatement of TDS's 2003 and 2002 financial statements related to the implementation of Statement of Financial Accounting Standards No. 142 "Goodwill and Other Intangible Assets." The restatement, which is discussed in detail in the financial discussion of this report, did not affect revenues, cash or cash flows.

Our business units continued to deliver on their strategies and improve their competitive positioning.

U.S. Cellular, our 82-percent owned wireless business, and TDS Telecom, our 100-percent owned traditional wireline business, both made excellent progress in 2003. The strategies of both business units are predicated on a customer-satisfaction philosophy. Satisfying our customers is the essence of our success, and the entire organizations at U.S. Cellular and TDS Telecom are dedicated to exceeding customer expectations by providing the highest possible level of service.

U.S. Cellular made great strides toward enhancing customer satisfaction in 2003. The company improved its geographic footprint—building on the major areas it serves and broadening its coverage and service, with an emphasis on its Midwest markets. The company also enhanced its wireless network during the year, the second of its three-year initiative to deploy Code Division Multiple Access (CDMA) 1X technology throughout its markets, making faster progress and at a lower cost than originally budgeted. In addition, the company added more than 500 cell sites to its already robust network.

Upgrading the network paved the way for the successful launch of U.S. Cellular's advanced data service, **easyedgeSM**. **easyedgeSM** provides customers more than 150 popular and easy-to-use data applications, such as ringtones, games, news and stock quotes.

U.S. Cellular also effectively managed the introduction of wireless number portability (WNP), an industry-wide legislative mandate that allows customers to change their service provider while retaining their existing telephone or cell phone number. Since the introduction of WNP in November, more customers have been moving to U.S. Cellular service than away from it. And despite WNP, U.S. Cellular's post-pay churn rate was an impressively low 1.5 percent for 2003, one of the lowest in the industry—a testimony to the success of U.S. Cellular's focus on customer satisfaction.

Other major accomplishments in 2003 included converting a third-party billing system, inherited with the acquisition of the Chicago market, to U.S. Cellular's own customer service and billing system. The conversion not only reduces operating costs going forward, but it also enhances the level of service provided to customers in this key market. The company completed the conversion in less time than normally required for such a project and with no disruption to service.

U.S. Cellular's operating results for the year reflect the impact of these and numerous other performance-enhancement initiatives. The company's marketing efforts generated 447,000 net new customers for the year. Less the 141,000 customers in the markets traded to AT&T Wireless, U.S. Cellular's customer base grew 7 percent over 2002, helping drive an 18 percent increase in operating revenues. The company posted net income of \$43 million, or \$0.50 per basic share.

In terms of the telecommunications industry environment, the long-awaited consolidation within the wireless segment appears to have begun, which should serve to improve the overall health of the segment. While a large number of competitors fosters more choice for consumers, too many carriers can erode financial returns and thus the ability and willingness of carriers to improve existing wireless services and develop new ones. This could ultimately have a negative impact on consumers. Our belief is that with fewer national carriers, there will still be substantial competition, but greater financial strength for industry participants.

TDS Telecom also had a good year. Operating revenues increased 8 percent, aided in great part by a 21 percent growth of the business's competitive local exchange carrier (CLEC) operations. The CLEC operations reached a milestone in 2003 when the sum of their full-year operating income plus depreciation, amortization and accretion expense turned positive for the first time. Total TDS Telecom operating income grew 42 percent.

TDS Telecom delivered successfully on its strategy to protect and grow its markets by introducing new products and services, and by promoting a favorable regulatory environment. TDS Telecom is very focused on promoting the profitable growth of its businesses and on addressing the competitive forces facing the wireline industry. These include wireless substitution, cable modem and the emerging Voice over Internet Protocol (VoIP) technology.

TDS Telecom's Digital Subscriber Line (DSL) service is proving to be a highly effective way to retain current customers and attract new ones. Both the incumbent local exchange carrier (ILEC) and CLEC operations offer this popular and fast-growing high-speed data service in most of their markets. TDS Telecom's DSL service has grown considerably, with total ILEC and CLEC DSL lines increasing 109 percent for the year—159 percent for the ILEC and 70 percent for the CLEC. The company continues to improve penetration of its DSL service, and plans to introduce service in several new markets in 2004.

Another way TDS Telecom is incenting customers to maintain and expand their landline connection is with

broader service packages. Service packages offer the convenience of customizing to customers' needs and paying for everything with one bill. During 2003, the ILEC business launched Total Talk—a service package that includes local, long-distance, Internet and other add-on features. TDS Telecom also offers a package that includes a satellite-video entertainment option.

While the ILEC wireline industry is experiencing a decline in access lines, these new service offerings are helping TDS Telecom stay highly competitive and increase its ILEC equivalent access lines. Unlike some of the Regional Bell operating companies, which suffered declines in access lines in 2003, TDS Telecom's ILEC equivalent access lines increased 1.5 percent, and CLEC equivalent access lines grew 25 percent for the year.

TDS Telecom continues to focus on controlling costs. In addition to ongoing initiatives to streamline its processes, TDS Telecom implemented a voluntary employee retirement incentive program late in 2003. This program is expected to reduce the company's cost structure by several

- Achieving a compound annual revenue growth over five years of 10 to 15 percent through internal growth and acquisitions
- Generating a return on capital, or ROC, in each business that is greater than the weighted average cost of capital for that business
- Maintaining our strong investment-grade credit ratings
- Generating a return for our shareholders that exceeds the return of comparable companies in the telecommunications industry over the long term

TDS made substantial progress on several of these objectives in 2003. TDS's five-year compound annual revenue growth rate was 14 percent, in line with the revenue growth rate objective. The business units continued to focus on their respective return-on-capital objectives and are committed to achieving them. And the credit ratings of both TDS and U.S. Cellular remain several levels above investment grade.

In addition, the company took steps in 2003 to enhance the return it provides its shareholders, while keeping the

million dollars a year in 2004 and beyond, without jeopardizing the quality of service.

TDS Telecom is considering the issues and opportunities that VoIP and fiber-to-the-premises (FTTP) technologies present. Specific initiatives include conducting technical trials for VoIP and planning efforts to assess the costs and benefits of offering FTTP in selected suburban markets. With its capital-intensive infrastructure requirements, however, FTTP technology will most likely not be appropriate for the company's more rural, spread-out markets in the near term.

We took steps to maintain the company's financial strength and improve shareholder returns.

The company's goal is to generate profitable growth and build shareholder value, while maintaining financial strength and liquidity. In support of this goal are four objectives:

company financially strong. TDS continued its common stock repurchase program, buying back nearly 2 million shares at a cost of \$92 million. The company plans to continue the program in 2004, contingent on market conditions, and has 1 million shares remaining on an existing authorization. TDS also increased the dividend 7 percent in 2003 and recently announced a further 6 percent increase for 2004, marking the 29th consecutive year of annual dividend increases.

Asset-allocation decisions are driven by the objective of keeping the company financially strong, with enough liquidity to pursue attractive business opportunities. During the year, TDS reduced its debt levels by redeeming \$371 million of debt and other obligations—actions that will save the company approximately \$31 million annually in interest expense. U.S. Cellular amended and increased its \$325 million revolving credit facility to \$700 million. Finally, U.S. Cellular completed a 30-year \$444 million offering of senior notes at a very attractive rate.

We improved the corporate governance structure.

In line with its commitment and accountability to shareholders, TDS continued to improve its corporate governance. Initiatives included:

- Proposing that shareholders approve eliminating the staggered terms of office for TDS board members so that all members are elected annually
- Forming a corporate governance committee of the board and adopting corporate governance guidelines
- Limiting to three the number of other public company boards on which members of the board may serve
- Instituting a policy that independent directors meet at least once annually without non-independent directors and management
- Giving the board and each of its committees the authority to retain, as they deem appropriate, outside advisers

TDS has a heritage of integrity and operating with high ethical standards. We are committed to providing our shareholders, customers and employees the corporate governance that supports the long-term growth and strength of the company.

One who exemplified this commitment to integrity and the company's long-term success was Lester O. Johnson, one of the founding directors. It is with great sadness that we note the passing of Mr. Johnson, whose many contributions during the 28 years he served as a corporate director helped make TDS the vibrant company it is today. He leaves an impressive legacy for all of us, one that we deeply appreciate and will work to live up to.

We remain focused on our strategies for continued growth and development.

2003 was marked by the successful accomplishments of our strategies throughout the company. For 2004, we are focused on the following strategies and goals:

U.S. Cellular

- Drive growth and profitability in new and established markets
- Continue improving the network coverage and service quality, with particular emphasis on completing the build-out of several markets U.S. Cellular acquired in the AT&T Wireless asset exchange
- Complete the deployment of CDMA 1X
- Continue to develop U.S. Cellular's line of data services, including launching its picture messaging service

TDS Telecom

- Strengthen existing ILEC markets by maintaining customer satisfaction and developing new revenue streams
- Continue to grow its CLEC operations, with a focus on profitable growth
- Create efficiencies and productivity improvements by optimizing cross-functional processes in the ILEC and CLEC operations
- Expand operating-cluster service areas where existing assets can best be leveraged
- Champion public-policy positions that are in customers' best interests

Telephone and Data Systems, Inc.

- Maintain TDS's strong investment-grade credit ratings
- Further improve the resource-allocation processes to enhance the long-term value of the company and shareholder returns
- Maintain sufficient liquidity to allow the business units to pursue strategic opportunities
- Continue the common stock repurchase program, as market conditions warrant

Going forward, TDS is well positioned for future growth and success. The company is a full-service provider with established wireless and wireline operations. It has disciplined, targeted strategies and is executing them. It is focused on profitable growth and long-term valuation creation, and it has a strong balance sheet. And, TDS has committed employees and associates dedicated to excellence in service and operating results.

We'd like to take this opportunity to thank all TDS employees and associates for the outstanding work they do. And, on behalf of all 10,900 of us at TDS, we thank you, our shareholders, for your continued support. We remain totally committed to fulfilling our mission at TDS, which is to provide outstanding communications services to our customers and meet the needs of our shareholders, our people and our communities.

Cordially yours,



LeRoy T. Carlson, Jr.
President and Chief Executive Officer



Walter C.D. Carlson
Chairman of the Board