

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

RESULTS OF OPERATIONS

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

Year Ended or At December 31, ⁽¹⁾	2003	2002	2001
Total market population ⁽²⁾	46,267,000	41,048,000	28,632,000
Customers	4,409,000	4,103,000	3,461,000
Market penetration ⁽³⁾	9.53%	10.00%	12.09%
Markets in operation	147	149	142
Total employees	6,225	6,100	5,150
Cell sites in service	4,184	3,914	2,925
Average monthly service revenue per customer ⁽⁴⁾	\$ 47.38	\$ 47.25	\$ 46.28
Post-pay churn rate per month ⁽⁵⁾	1.5%	1.8%	1.7%
Sales and marketing cost per gross customer addition ⁽⁶⁾	\$ 380	\$ 365	\$ 322

(1) Amounts in 2003 include the results of the 10 markets transferred to AT&T Wireless through July 31, and include the results of the 15 markets acquired and transferred from AT&T Wireless from the transfer date through December 31. Amounts in 2002 include the operations of USCOC of Chicago (as defined below) from August 7 – December 31.

(2) Represents 100% of the population of U.S. Cellular's consolidated markets, regardless of whether the market has begun marketing operations. Market penetration is calculated using 2002, 2001, and 2000 Claritas population estimates for 2003, 2002, and 2001, respectively.

(3) Market penetration is calculated by dividing customers by total market population.

(4) Average monthly service revenue per customer is calculated as follows:

Year Ended or At December 31,	2003	2002	2001
Service Revenue (000s)	\$2,423,789	\$2,098,893	\$1,826,385
Divided by average customers during period (000s)	4,263	3,702	3,289
Divided by twelve months in each period	12	12	12
Average monthly revenue per customer	\$ 47.38	\$ 47.25	\$ 46.28

(5) Post-pay churn rate per month represents the percentage of the customer base on post-pay service plans (i.e., service plans where customers are billed in arrears for service) which disconnects service each month. The calculation divides the total number of customers on post-pay service plans who disconnect service during the period by the number of months in such period, then divides that quotient by the average monthly post-pay service customer base for such period.

(6) For a discussion of the components of this calculation, see "Operating Expenses – Selling, General and Administrative."

On August 1, 2003, U.S. Cellular completed the transfer of the wireless assets and customers in 10 markets in Florida and Georgia to AT&T Wireless. In exchange, U.S. Cellular received rights to acquire controlling interests in 36 personal communication service licenses and approximately \$34 million in cash and minority interests in six markets in which it previously owned a controlling interest. Of the 36 licenses, 15 were transferred to U.S. Cellular in 2003. The assignment and development of the remaining 21 licenses yet to be transferred from AT&T Wireless will be deferred by U.S. Cellular for a period of up to five years from the original closing date of August 1, 2003. U.S. Cellular will take possession of the licenses in staggered closings over that five-year period to comply with the service requirements of the Federal Communications Commission ("FCC"). The Florida and Georgia markets that were transferred to AT&T Wireless are included in consolidated operations for the first seven months of 2003.

On August 7, 2002, U.S. Cellular completed the acquisition of the assets and certain liabilities of Chicago 20MHz, LLC, now known as United States Cellular Operating Company of Chicago, LLC ("USCOC of Chicago" or the "Chicago market") from PrimeCo Wireless Communications LLC. USCOC of Chicago operates a wireless system in the Chicago major trading area. USCOC of Chicago is the holder of certain FCC licenses, including a 20 megahertz personal communication service license in the Chicago major trading area (excluding Kenosha County, Wisconsin). The Chicago market's operations are included in consolidated operations for the entire year of 2003, but only for the period from August 7 – December 31 of 2002. The Chicago market's operations contributed to the increases in U.S. Cellular's operating revenues and expenses in both 2003 and 2002.

Prior to the fourth quarter of 2003, U.S. Cellular separately disclosed marketing and selling expenses and general and administrative expenses in its statements of operations. In the fourth quarter of 2003, U.S. Cellular combined the marketing and selling expense and general administrative expense captions into one caption designated as selling, general and administrative expense. Previously, costs for equipment sold to retain current customers were included in selling, general and administrative expense. Prior to the fourth quarter of 2003 and in part of 2002, these costs were partially offset by equipment sales revenues received from these customers. In part of 2002 and all of 2001, equipment sales revenues related to retaining current customers were included in equipment sales revenue. In the fourth quarter of 2003, U.S. Cellular changed its policy for classifying retention costs and has reclassified the equipment sales revenue and cost of equipment sold related to the retention of current customers out of selling, general and administrative expenses and into equipment sales revenues and cost of equipment sold, respectively, for each of the years presented. These reclassifications increased equipment sales revenues by \$27.3 million and \$13.1 million in 2003 and 2002, respectively, and increased cost of equipment sold by \$106.6 million, \$57.2 million and \$42.7 million in 2003, 2002 and 2001, respectively. Selling, general and administrative expenses were reduced by \$79.3 million, \$44.1 million and \$42.7 million in 2003, 2002, and 2001, respectively, to reflect the amounts reclassified to equipment sales revenues and cost of equipment sold. These reclassifications did not have any impact on income from operations, net income, earnings per share, financial position or cash flows of U.S. Cellular for any of the years presented.

Revenues

Year Ended December 31, (Dollars in thousands)	2003	2002	2001
Retail service	\$1,984,671	\$1,682,020	\$1,408,253
Inbound roaming	221,737	255,443	272,361
Long-distance and other	217,381	161,430	145,771
Service Revenues	2,423,789	2,098,893	1,826,385
Equipment sales	158,994	98,693	68,445
Total Operating Revenues	\$2,582,783	\$2,197,586	\$1,894,830

Operating revenues increased \$385.2 million, or 18%, to \$2,582.8 million in 2003 from \$2,197.6 million in 2002 and increased \$302.8 million, or 16%, in 2002 from \$1,894.8 million in 2001.

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Service revenues increased \$324.9 million, or 15%, to \$2,423.8 million in 2003 from \$2,098.9 million in 2002 and increased \$272.5 million, or 15%, in 2002 from \$1,826.4 million in 2001. Service revenues primarily consist of: (i) charges for access, airtime, roaming and value-added services provided to U.S. Cellular's retail customers ("retail service"); (ii) charges to other wireless carriers whose customers use U.S. Cellular's wireless systems when roaming ("inbound roaming"); and (iii) charges for long-distance calls made on U.S. Cellular's systems. The increases in both years were primarily due to the growth in the number of retail customers in each year. Monthly service revenue per customer averaged \$47.38 in 2003, \$47.25 in 2002 and \$46.28 in 2001.

Retail service revenues increased \$302.7 million, or 18%, to \$1,984.7 million in 2003 from \$1,682.0 million in 2002 and increased \$273.7 million, or 19%, in 2002 from \$1,408.3 million in 2001. Growth in U.S. Cellular's average customer base of 15% and 13% in 2003 and 2002, respectively, and an increase in average monthly retail service revenue per customer were the primary reasons for the increases in retail service revenue in both years. The average number of customers is affected by the timing of acquisitions and divestitures in both years, including the acquisition of the Chicago market in August 2002 and the disposition of markets to AT&T Wireless in August 2003.

Management anticipates that growth in the customer base in U.S. Cellular's wireless markets will be slower in the future, primarily as a result of the increased competition in its markets and continued penetration of the consumer market. However, as U.S. Cellular expands its operations in Chicago and into its other recently acquired markets in future years, it anticipates adding customers and revenues in those markets, increasing its overall customer and revenue growth rates.

Average monthly retail service revenue per customer increased 2% to \$38.80 in 2003 from \$37.86 in 2002 and increased 6% in 2002 from \$35.68 in 2001. These increases were driven by an increase in average minutes of use per customer, the effect of which was partially offset by a decline in average revenue per minute of use.

Monthly local retail minutes of use per customer averaged 422 in 2003, 304 in 2002 and 216 in 2001. The increases in monthly local retail minutes of use in both years were driven by U.S. Cellular's focus on designing sales incentive programs and customer billing rate plans to stimulate overall usage, as well as the acquisition of the Chicago market in 2002, whose customers used more minutes per month than the U.S. Cellular average. The impact on retail service revenue of the increased minutes of use in both years was partially offset by a decrease in average revenue per minute of use. The decrease in average revenue per minute of use reflects the effects of increasing competition, which has led to the inclusion of an increasing number of minutes in package pricing plans. Management anticipates that U.S. Cellular's average revenue per minute of use will continue to decline in the future, reflecting increased competition and continued penetration of the consumer market.

Inbound roaming revenue decreased \$33.7 million, or 13%, to \$221.7 million in 2003 from \$255.4 million in 2002 and decreased \$16.9 million, or 6%, from \$272.3 million in 2001. The decreases in revenue related to inbound roaming on U.S. Cellular's systems in both

years primarily resulted from a decrease in revenue per roaming minute of use, partially offset by an increase in roaming minutes used. Also contributing to the decrease in 2003 was the transfer of the Florida and Georgia markets to AT&T Wireless in August 2003; these markets had historically provided substantial amounts of inbound roaming revenue. The increases in inbound roaming minutes of use in both years were primarily driven by the overall growth in the number of customers throughout the wireless industry. The declines in revenue per minute of use in both years were primarily due to the general downward trend in negotiated rates.

Management anticipates that the future rate of growth in inbound roaming minutes of use will be reduced due to three factors:

- newer customers may roam less than existing customers, reflecting further penetration of the consumer market;
- the divestiture of U.S. Cellular's markets in Florida and Georgia in August 2003 and in southern Texas in February 2004, which have historically provided substantial inbound roaming minutes of use; and
- U.S. Cellular's roaming partners may switch their business from U.S. Cellular to other operators or to their own systems.

Management also anticipates that average inbound roaming revenue per minute of use will continue to decline, reflecting the continued general downward trend in negotiated rates.

Long-distance and other revenue increased \$55.9 million, or 35%, to \$217.4 million in 2003 from \$161.5 million in 2002 and increased \$15.7 million, or 11%, in 2002 from \$145.8 million in 2001. The increase in 2003 is primarily related to the \$47.2 million increase in amounts billed to U.S. Cellular's customers to offset costs related to certain regulatory mandates, such as universal service funding, wireless number portability and E-911 infrastructure. In particular, the amounts U.S. Cellular charges to its customers to offset universal service funding costs increased significantly due to changes in FCC regulations beginning April 1, 2003.

The remainder of the increases in long-distance and other revenue in both years were driven by an increase in the volume of long-distance calls billed by U.S. Cellular to other wireless carriers whose customers used U.S. Cellular's systems to make long-distance calls. This effect was partially offset in both years by price reductions primarily related to long-distance charges on roaming minutes of use as well as U.S. Cellular's increasing use of pricing plans for its customers which include long-distance calling at no additional charge.

Equipment sales revenues increased \$60.3 million, or 61%, to \$159.0 million in 2003 from \$98.7 million in 2002 and increased \$30.3 million, or 44%, in 2002 from \$68.4 million in 2001. The increases in equipment sales revenues in both years primarily reflect a change in U.S. Cellular's method of distributing handsets to its agent channel. Beginning in the second quarter of 2002, U.S. Cellular began selling handsets to its agents at a price approximately equal to U.S. Cellular's cost before applying any rebates. Previously, U.S. Cellular's agents purchased handsets from third parties. Selling handsets to agents enables U.S. Cellular to provide better control over handset quality, set roaming preferences and pass along quantity discounts. Management anticipates that U.S. Cellular will continue to sell handsets to agents in the

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future, and that it will continue to provide rebates to agents who sell handsets to new and current customers.

In these transactions, equipment sales revenue is recognized upon delivery of the related products to the agents, net of any anticipated agent rebates. In most cases, the agents receive a rebate from U.S. Cellular at the time these agents provide handsets to sign up new customers or retain current customers.

Handset sales to agents, net of all rebates, increased equipment sales revenues by \$52.7 million in 2003 and \$20.8 million in 2002. Equipment sales to customers through U.S. Cellular's non-agent channels increased \$7.6 million, or 10%, to \$85.5 million in 2003 from \$77.9 million in 2002 and increased \$9.5 million, or 14%, in 2002 from \$68.4 million in 2001. Customers added to U.S. Cellular's customer base through its marketing distribution channels ("gross customer activations"), the primary driver of equipment sales revenues, increased 9% in 2003 and 14% in 2002. Gross customer activations from non-agent channels increased 5% in 2003 and 8% in 2002.

The increases in gross customer activations from non-agent channels in both years were driven by an increase in store traffic in U.S. Cellular's markets and the acquisition of the Chicago market in August 2002, which added to U.S. Cellular's distribution network. The increases in equipment sales revenues from U.S. Cellular's non-agent channels in both years were primarily attributable to the increase in handsets sold to customers for retention purposes, as U.S. Cellular continued to focus on retaining customers by offering existing customers handset pricing similar to that offered to new customers, particularly as these customers near the expiration date of their service contracts. This impact was partially offset by lower revenue per handset in both years, reflecting the reduction in sales prices to end users as a result of increased competition.

Operating Expenses

Year Ended December 31,	2003 (as restated)	2002	2001
(Dollars in thousands)			
System operations (excluding depreciation shown below)	\$ 576,159	\$ 492,750	\$ 421,114
Cost of equipment sold	355,150	242,523	166,759
Selling, general and administrative	1,004,655	829,993	689,087
Depreciation	374,769	311,993	237,346
Amortization and accretion	57,564	39,161	63,312
Loss on impairment of intangible assets	49,595	—	—
Loss on assets held for sale	45,908	—	—
Total Operating Expenses	\$2,463,800	\$1,916,420	\$1,577,618

Operating expenses increased \$547.4 million, or 29%, to \$2,463.8 million in 2003 from \$1,916.4 million in 2002 and increased \$338.8 million, or 21%, in 2002 from \$1,577.6 million in 2001.

System operations expenses (excluding depreciation) increased \$83.4 million, or 17%, to \$576.2 million in 2003 from \$492.8 million in 2002 and increased \$71.7 million, or 17%, in 2002 from \$421.1 million in 2001. System operations expenses include charges from landline telecommunications service providers for U.S. Cellular's customers' use of their facilities, costs related to local interconnection to the landline

network, charges for maintenance of U.S. Cellular's network, long-distance charges and outbound roaming expenses. The increases in system operations expenses in both years were due to the following factors:

- increases of 7% and 34%, respectively, in the number of cell sites within U.S. Cellular's systems, to 4,184 in 2003 from 3,914 in 2002 and from 2,925 in 2001, as U.S. Cellular continues to expand and enhance coverage in its service areas both through acquisitions and internal growth; and
- increases in minutes of use both on U.S. Cellular's systems and by U.S. Cellular's customers using other systems while roaming.

The ongoing reductions both in the per-minute cost of usage on U.S. Cellular's systems and in negotiated roaming rates partially offset the above factors.

As a result of the above factors, the components of system operations expenses were affected as follows:

- the cost of minutes used on U.S. Cellular's systems increased \$46.5 million, or 38%, in 2003 and \$33.9 million, or 38%, in 2002;
- maintenance, utility and cell site expenses increased \$40.3 million, or 31%, in 2003 and \$28.1 million, or 27%, in 2002, as the average number of cell sites in service increased 17% and 30% in 2003 and 2002, respectively; in markets where U.S. Cellular maintains two digital radio equipment technologies, the related costs increased on a per cell site basis as well; and
- expenses incurred when U.S. Cellular's customers used other systems when roaming decreased \$3.4 million, or 1%, in 2003 and increased \$9.6 million, or 4%, in 2002.

System operations expenses increased in both years due to the August 2002 acquisition of the Chicago market, as a full year of activity in the Chicago market is included in 2003 compared to only the period from August 7 – December 31 in 2002. The increases in expenses in the Chicago market in both periods were partially offset by reductions in expenses in other markets, primarily in the Midwest, when certain customers in surrounding markets used the Chicago system. Prior to acquiring the Chicago market, U.S. Cellular paid roaming charges to third parties when any of its customers roamed in the Chicago market.

Monthly system operations expenses per customer increased 2% to \$11.26 in 2003 and increased 4% to \$11.09 in 2002 from \$10.67 in 2001. This measurement is calculated by dividing total system operations expenses as reported for each of the annual periods by 12, then dividing that quotient by average customers during each respective 12-month period as defined in footnote 4 to the table of summarized operating data shown on page 22. Management uses this measurement to assess the cost of customer usage and network usage and maintenance on a per unit basis.

In total, management expects system operations expenses to increase over the next few years, driven by the following factors:

- increases in the number of cell sites within U.S. Cellular's systems as it continues to add capacity and enhance quality in all markets, and begins development activities in new markets; and
- increases in minutes of use, both on U.S. Cellular's systems and by U.S. Cellular's customers on other systems when roaming.

These factors are expected to be partially offset by anticipated decreases in the per-minute cost of usage both on U.S. Cellular's systems and on other carriers' networks. The Chicago area has historically been a high-volume roaming destination for U.S. Cellular's customers. Management anticipates that the continued integration of the Chicago market into its operations will result in a further increase in minutes of use by U.S. Cellular's customers on its systems and a corresponding decrease in minutes of use by its customers on other systems, resulting in a lower overall increase in minutes of use by U.S. Cellular's customers on other systems. Such a shift in minutes of use would reduce U.S. Cellular's per-minute cost of usage in the future, to the extent that U.S. Cellular's customers use U.S. Cellular's systems rather than other carriers' networks. Additionally, U.S. Cellular's acquisition and subsequent buildout of licensed areas received in the AT&T Wireless exchange transaction may shift more minutes of use to U.S. Cellular's systems, as many of these licensed areas are major roaming destinations for U.S. Cellular's current customers.

Cost of equipment sold increased \$112.7 million, or 46%, to \$355.2 million in 2003 from \$242.5 million in 2002 and increased \$75.7 million, or 45%, in 2002 from \$166.8 million in 2001. The increases in both years are primarily due to the \$80.7 million and \$56.1 million increases, respectively, in handset costs related to the sale of handsets to agents beginning in the second quarter of 2002. Cost of equipment sold from non-agent channels increased \$31.9 million, or 17%, in 2003 and increased \$19.7 million, or 12%, in 2002. The increase in cost of equipment sold from non-agent channels in both years primarily reflects the increase in handsets sold to customers for retention purposes, as U.S. Cellular continued to focus on retaining customers by offering existing customers handset pricing similar to that offered to new customers as the expiration date of customers' service contracts approached. Also contributing were the respective 5% and 8% increases in gross customer activations from non-agent channels in 2003 and 2002.

Selling, general and administrative expenses increased \$174.7 million, or 21%, to \$1,004.7 million in 2003 from \$830.0 million in 2002 and increased \$140.9 million, or 20%, in 2002 from \$689.1 million in 2001. Selling, general and administrative expenses primarily consist of salaries, commissions and expenses of field sales and retail personnel and offices; agent commissions and related expenses; corporate marketing, merchandise management and telesales department salaries and expenses; advertising; and public relations expenses. Selling, general and administrative expenses also include the costs of operating U.S. Cellular's customer care centers, the costs of serving customers and the majority of U.S. Cellular's corporate expenses.

The increase in selling, general and administrative expenses in 2003 is primarily due to the following factors:

- a \$38.4 million increase in advertising costs, primarily related to the continued marketing of the U.S. Cellular brand in the Chicago market and the marketing of U.S. Cellular's data-related wireless services;

- a \$30.1 million increase in expenses related to payments into the federal universal service fund, based on an increase in rates due to changes in the FCC regulations, substantially all of which is offset by increases in long-distance and other revenue for amounts passed through to customers; and
- a \$29.3 million increase in billing-related expenses, primarily due to the expenses related to the maintenance of the Chicago market's billing system and the transition to the system used in U.S. Cellular's other operations in July 2003.

In 2002, the increase in selling, general and administrative expenses was primarily due to the following factors:

- a \$40.0 million increase in general and administrative expenses due to the acquisition and operation of the Chicago market;
- a \$35.0 million increase in bad debt expense; and
- a \$25.7 million increase in advertising costs, primarily related to the launch of the U.S. Cellular brand in the Chicago market.

In both years, increases were also attributable to the rise in salaries and other employee-related expenses associated with acquiring, serving and retaining customers, primarily as a result of the acquisition of the Chicago market as well as the increase in U.S. Cellular's customer base.

In 2003, the increase in salaries and other sales-related costs is also attributable to the expenses incurred in preparation for U.S. Cellular's launch of data-related wireless services in its markets. In 2002, the increase was also related to enhancements made to U.S. Cellular's merchandise management and telesales processes and the development of data services strategies.

In 2002, U.S. Cellular changed its accounting for commissions expenses, reflecting a change in its application of Staff Accounting Bulletin ("SAB") No. 101 "Revenue Recognition in Financial Statements." Effective January 1, 2002, U.S. Cellular began deferring expense recognition of a portion of its commissions expenses, equal to the amount of deferred activation fees revenue. U.S. Cellular recognizes the related commissions expense over the average customer service period, currently estimated to be 48 months. This change resulted in a reduction in selling, general and administrative expenses of \$2.8 million in 2002. Pursuant to this change, beginning in 2002 equivalent amounts of revenue and expense are deferred and amortized, which results in better matching for purposes of reporting operating income, net income and diluted earnings per share. See "Cumulative Effect of a Change in Accounting Principle" for more information on the impact of SAB No. 101 on U.S. Cellular's results.

Sales and marketing cost per gross customer activation totaled \$380 in 2003, \$365 in 2002 and \$322 in 2001. Sales and marketing cost per gross customer activation is not calculable using financial information derived directly from the statements of operations. The definition of sales and marketing cost per gross customer activation that U.S. Cellular uses as a measure of the cost to acquire additional customers through its marketing distribution channels may not be comparable to similarly titled measures that are reported by other companies. Below is a summary of sales and marketing cost per gross customer activation for each period:

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Year ended December 31,	2003	2002	2001
(Dollars in thousands, except per customer amounts)			
Components of cost			
Selling, general and administrative expenses related to the acquisition of new customers ⁽¹⁾	\$428,944	\$368,888	\$297,239
Cost of equipment sold to new customers ⁽²⁾	248,539	185,283	124,028
Less equipment sales revenues from new customers ⁽³⁾	(162,402)	(100,164)	(68,445)
Total cost	\$515,081	\$454,007	\$352,822
Gross customer activations (000s) ⁽⁴⁾	1,357	1,244	1,095
Sales and marketing cost per gross customer activation	\$ 380	\$ 365	\$ 322

(1) Selling, general and administrative expenses related to the acquisition of new customers is reconciled to total selling, general and administrative expenses as follows:

Year ended December 31,	2003	2002	2001
(Dollars in thousands)			
Selling, general and administrative expenses as reported	\$1,004,655	\$ 829,993	\$ 689,087
Less expenses related to serving and retaining customers	(575,711)	(461,105)	(391,848)
Selling, general and administrative expenses related to the acquisition of new customers	\$ 428,944	\$ 368,888	\$ 297,239

(2) Cost of equipment sold, excluding amounts related to the retention of existing customers is reconciled to total cost of equipment sold as follows:

Year ended December 31,	2003	2002	2001
(Dollars in thousands)			
Cost of equipment sold as reported	\$ 355,150	\$ 242,523	\$166,759
Less cost of equipment sold related to the retention of existing customers	(106,611)	(57,240)	(42,731)
Cost of equipment sold to new customers	\$ 248,539	\$ 185,283	\$124,028

(3) Equipment sales revenues, excluding amounts related to the retention of existing customers is reconciled to total equipment sales revenues as follows:

Year ended December 31,	2003	2002	2001
(Dollars in thousands)			
Equipment sales revenues as reported	\$158,994	\$ 98,693	\$ 68,445
Less equipment sales revenues related to the retention of existing customers, excluding agent rebates*	(27,328)	(13,108)	—
Add agent rebate reductions of equipment sales revenues related to the retention of existing customers	30,736	14,579	—
Equipment sales revenues from new customers	\$162,402	\$100,164	\$ 68,445

* In part of 2002 and all of 2001, equipment sales revenues related to retaining current customers were included in equipment sales revenues. In 2003 and part of 2002, these revenues were recorded in selling, general and administrative expenses as a reduction of the cost of equipment sold to retain current customers. In order to conform the operating results for 2003 and the part of 2002 for which these revenues were recorded in selling, general and administrative expenses to the current period presentation, U.S. Cellular reclassified the revenues related to retaining current customers in these periods as equipment sales revenues.

(4) Gross customer activations represent customers added to U.S. Cellular's customer base, during the respective periods presented, through its marketing distribution channels.

Monthly general and administrative expenses per customer, including the net costs related to the renewal or upgrade of service contracts of existing U.S. Cellular customers ("net customer retention costs"), increased 15% to \$13.40 in 2003 and increased 6% to \$11.70 in 2002

from \$11.01 in 2001. Management uses this measurement to assess the cost of serving and retaining its customers on a per unit basis.

This measurement is reconciled to total selling, general and administrative expenses as follows:

Year ended December 31,	2003	2002	2001
(Dollars in thousands, except per customer amounts)			
Components of cost ⁽¹⁾			
Selling, general and administrative expenses as reported	\$1,004,655	\$ 829,993	\$ 689,087
Less selling, general and administrative expenses related to the acquisition of new customers	(428,944)	(368,888)	(297,239)
Add cost of equipment sold related to the retention of existing customers	106,611	57,240	42,731
Less equipment sales revenues related to the retention of existing customers, excluding agent rebates	(27,328)	(13,108)	—
Add agent rebate reductions of equipment sales revenues related to the retention of existing customers	30,736	14,579	—
Net cost of serving and retaining customers	\$ 685,730	\$ 519,816	\$ 434,579
Divided by average customers during period (000s) ⁽²⁾	4,263	3,702	3,289
Divided by twelve months in each period	12	12	12
Average monthly general and administrative expenses per customer	\$ 13.40	\$ 11.70	\$ 11.01

(1) These components were previously identified in the table which calculates sales and marketing cost per customer activation and related footnotes shown above.

(2) Average customers for each respective period were previously defined in footnote 4 to the table of summarized operating data shown on page 22.

Depreciation expense increased \$62.8 million, or 20%, to \$374.8 million in 2003 from \$312.0 million in 2002 and increased \$74.7 million, or 31%, in 2002, from \$237.3 million in 2001. The increases in both years reflect rising average fixed asset balances, which increased 23% in 2003 and 31% in 2002. Increased fixed asset balances in both 2003 and 2002 resulted from the following factors:

- the addition of 507 and 437 new cell sites in 2003 and 2002, respectively, built to improve coverage and capacity in U.S. Cellular's markets;
- the acquisition of the Chicago market in 2002;
- U.S. Cellular's migration of its network toward a single digital equipment platform, which began during the second half of 2002;
- the addition of digital radio channels to U.S. Cellular's network to accommodate increased usage; and
- investments in U.S. Cellular's billing and office systems.

See "Liquidity and Capital Resources – Capital Expenditures" for further discussion of U.S. Cellular's capital expenditures.

In addition to the above factors, in 2003, U.S. Cellular took certain cell sites, in which its antennae were co-located on third parties' towers, out of service, writing off the remaining net book value of the related assets. This write-off increased depreciation expense \$7.0 million in 2003. These cell sites were acquired from another carrier in a 2001 transaction. U.S. Cellular recorded \$11.6 million less depreciation expense in

2003 than in 2002 as depreciation on the properties transferred to AT&T Wireless in the exchange transaction was only recorded through March 2003 in accordance with Statement of Financial Accounting Standards ("SFAS") No. 144 "Accounting for the Impairment or Disposal of Long-Lived Assets."

In 2002, depreciation expense increased \$15.0 million due to a charge to reflect the write-off of certain analog equipment based on fixed asset inventory reviews performed in 2002.

Amortization and accretion expense increased \$18.4 million, or 47%, to \$57.6 million in 2003 from \$39.2 million in 2002 and decreased \$24.2 million, or 38%, in 2002 from \$63.4 million in 2001. The increase in 2003 is primarily driven by the \$11.1 million increase in amortization related to the customer list intangible assets and other deferred charges acquired in the USCOC of Chicago transaction during 2002. The customer list assets are amortized based on the average customer retention periods related to each customer list.

In accordance with SFAS No. 143 "Accounting for Asset Retirement Obligations," as of January 1, 2003, U.S. Cellular began accreting liabilities for future remediation obligations associated with leased properties. Such accretion expense totaled \$4.4 million in 2003.

In accordance with SFAS No. 142 "Goodwill and Other Intangible Assets," effective January 1, 2002, U.S. Cellular no longer amortizes previously recorded goodwill and intangible assets with indefinite lives. These assets will be subject to periodic impairment tests, which will be conducted annually or more often if necessary. In 2001, amortization of these intangibles totaled \$36.5 million.

Loss on impairment of intangible assets totaled \$49.6 million in 2003. In conjunction with the restatement related to SFAS No. 142, U.S. Cellular reperformed the annual impairment test for its investment in licenses for 2003, which was originally performed during the second quarter of 2003. The carrying value of the licenses in each reporting unit was compared to the estimated fair value of the licenses in each reporting unit. The license values in two reporting units were determined to be impaired and a loss of \$49.6 million was recorded.

See "Application of Critical Accounting Policies and Estimates – Investment in Licenses and Goodwill" for further discussion of U.S. Cellular's intangible asset impairment testing.

Loss on assets held for sale totaled \$45.9 million in 2003. Of this total, \$23.9 million represents the difference between the fair value of the assets U.S. Cellular received and expects to receive in the AT&T Wireless exchange transaction completed on August 1, 2003, as determined by an independent valuation, and the recorded value of the Florida and Georgia market assets it transferred to AT&T Wireless. The loss also includes a \$22.0 million write-down related to the wireless assets to be sold to AT&T Wireless in February 2004.

Operating Income

Operating income decreased \$162.2 million, or 58%, to \$119.0 million in 2003 from \$281.2 million in 2002 and decreased \$36.0 million, or 11%, in 2002 from \$317.2 million in 2001. The operating income margins (as a percent of service revenues) were 4.9% in 2003, 13.4% in 2002 and 17.4% in 2001.

The declines in operating income and operating income margin in both years reflect the following:

- increased selling, general and administrative expenses, primarily driven by the acquisition and subsequent transition of the Chicago market's operations and billing system; and additional costs related to advertising and marketing the U.S. Cellular brand, especially in the Chicago market, and related to the launch of U.S. Cellular's data-related wireless services in certain markets;
- increased depreciation expense, driven by an increase in average fixed assets related to ongoing improvements to and the expansion of U.S. Cellular's wireless network;
- increased system operations expenses, primarily driven by increases in the number of cell sites in and the number of minutes used by U.S. Cellular's customers and roaming customers on U.S. Cellular's network; and
- increased equipment subsidies, primarily due to U.S. Cellular's practice of selling handsets to agents; this practice began in 2002 and increased the volume of handset sales, as well as the increase in customer retention-related equipment transactions.

Operating income and operating income margin in 2003 also reflect:

- the losses on assets held for sale related to both the exchange transaction and pending sale transaction involving AT&T Wireless; and
- the loss on impairment of intangible assets.

These expense increases were partially offset by increased service revenues, which were driven by growth in the number of customers served by U.S. Cellular's systems and increases in average monthly revenue per customer.

U.S. Cellular expects most of the above factors, except for those related to the transition of the Chicago market and the losses on assets held for sale and impairments, to continue to have an effect on operating income and operating margins for the next several quarters. Any changes in the above factors, as well as the effects of other drivers of U.S. Cellular's operating results, may cause operating income and operating margins to fluctuate over the next several quarters.

Related to U.S. Cellular's acquisition and subsequent transition of the Chicago market's operations, U.S. Cellular plans to incur additional expenses in 2004 as it competes in the Chicago market. Additionally, U.S. Cellular plans to build out its network into other as yet unserved portions of its licensed areas, and will begin sales and marketing operations in those areas in the next few years. U.S. Cellular also incurred additional expenses related to its launch of data-related wireless services in many of its markets in 2003, and expects to incur expenses related to its continued marketing of data-related wireless services in the next few years. As a result, depending on the timing and effectiveness of these initiatives, U.S. Cellular's operating income may range from \$160 million to \$210 million in 2004, compared to operating income of \$119 million in 2003. Its corresponding operating margins may range from 6% to 8% in 2004, compared to an operating margin of 4.9% in 2003.

U.S. Cellular anticipates that service revenues will total approximately \$2.5 billion in 2004, compared to service revenues of \$2.4 billion in 2003. The anticipated service revenue growth in 2004 reflects the effects of the sale of properties to AT&T Wireless in February 2004, the

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markets transferred to AT&T Wireless in the exchange transaction completed in August 2003, the continued growth in U.S. Cellular's customer base and the continued marketing of data-related wireless services in its markets.

Depending on the timing and effectiveness of its marketing efforts in new markets, U.S. Cellular anticipates that its customer base will grow by 7% to 8% in 2004, substantially all from net customer additions gained through its marketing channels. However, management anticipates that average monthly service revenue per customer will decrease slightly, as retail service revenue per minute of use and inbound roaming revenue per minute of use decline.

Depending on the timing and effectiveness of its marketing efforts in new markets, U.S. Cellular anticipates that its operating expenses will increase by a range of 3% to 5% during 2004. U.S. Cellular does not anticipate recording a significant adjustment to the loss on assets held for sale in 2004 related to the sale of properties to AT&T Wireless in February 2004. U.S. Cellular anticipates that its net costs associated with customer growth, service and retention, initiation of new services, launches in new markets and fixed asset additions will continue to grow, causing overall expenses to increase compared to 2003.

U.S. Cellular anticipates that its net customer retention costs will increase in the future as it migrates to a single digital technology platform and certain customers will require new handsets. In addition, continued competitive pressures and an increase in per unit handset costs will require U.S. Cellular to incur increased net customer retention costs.

Management believes there exists a seasonality in both service revenues, which tend to increase more slowly in the first and fourth quarters due to variations in customer usage patterns in those periods, and operating expenses, which tend to be higher in the fourth quarter due to increased marketing activities and customer growth, which may cause operating income to vary from quarter to quarter. Management anticipates that the impact of such seasonality may decrease in the future, particularly as it relates to operating expenses, as the proportion of full year customer activations derived from fourth quarter holiday sales is expected to decline to reflect ongoing, rather than seasonal, promotions of U.S. Cellular's products.

Effects of Competition on Operating Income

U.S. Cellular competes directly with several wireless communications services providers, including enhanced specialized mobile radio service providers, in each of its markets. In general, there are between five and seven competitors in each wireless market in which U.S. Cellular provides service. U.S. Cellular generally competes against each of the six near-nationwide wireless companies: Verizon Wireless, Sprint PCS (and affiliates), Cingular Wireless, AT&T Wireless, T-Mobile and Nextel. However, not all six competitors operate in each market where U.S. Cellular does business. U.S. Cellular believes that these competitors have substantially greater financial, technical, marketing, sales, purchasing and distribution resources than it does.

The use of national advertising and promotional programs by such national wireless operators may be a source of additional competitive and pricing pressures in all U.S. Cellular markets, even if those operators may not provide service in a particular market. U.S. Cellular provides wireless services comparable to the national competitors, but the other

wireless companies operate in a wider geographic area and are able to offer no- or low-cost roaming and long-distance calling packages over a wider area on their own networks than U.S. Cellular can offer on its network. If U.S. Cellular offers the same calling area as one of these competitors, it will incur roaming charges for calls made in portions of the calling area that are not part of its network.

In the Midwest, U.S. Cellular's largest contiguous service area, it can offer larger regional service packages without incurring significant roaming charges than it is able to offer in other parts of its network. U.S. Cellular also employs a customer satisfaction strategy throughout its markets which it believes has contributed to a relatively low churn rate and has had a positive impact on its cost to acquire and serve customers.

Some of U.S. Cellular's competitors bundle other services, such as landline telephone service and internet access, with their wireless communications services, which U.S. Cellular either does not have the ability to offer or has chosen not to offer.

In addition, U.S. Cellular competes against both larger and smaller regional wireless companies in certain areas, including ALLTEL, Western Wireless, Rural Cellular Corporation, and against resellers of wireless services. Since each of these competitors operates on systems using spectrum licensed by the FCC and has comparable technology and facilities, competition for customers among these systems in each market is principally on the basis of quality of service, price, size of area covered, services offered and responsiveness of customer service.

Since U.S. Cellular's competitors do not disclose their subscriber counts in specific regional service areas, market share for the competitors in each regional market cannot be accurately determined.

Effects of Wireless Number Portability on Operating Income

The FCC mandate requiring that all wireless carriers be capable of facilitating wireless number portability became effective on November 24, 2003. At that time, all wireless providers in the largest 100 metropolitan statistical areas in the United States allowed a customer to retain, subject to certain geographical limitations, their existing telephone number when switching from one telecommunications carrier to another. For metropolitan statistical areas outside the largest 100, wireless providers that receive a request to allow an end user to port their number must be capable of doing so within six months of receiving the request or within six months after November 24, 2003, whichever is later.

U.S. Cellular has been successful in facilitating number portability requests in a timely manner. The implementation of wireless number portability has not had a material effect on U.S. Cellular's results of operations to date. However, U.S. Cellular is unable to predict the impact that the implementation of number portability will have on its overall business. The implementation of wireless number portability will likely increase churn rates for U.S. Cellular and other wireless companies, as the ability of customers to retain their wireless telephone numbers removes a significant barrier for customers who wish to change wireless carriers. U.S. Cellular believes that it may be able to obtain additional new customers who wish to change their service from other wireless carriers as a result of wireless number portability. The future volume of any porting requests, and the processing costs related thereto, may increase U.S. Cellular's operating costs in the future. Any of the above

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factors could have an adverse effect on U.S. Cellular's competitive position, costs of obtaining new subscribers, liquidity, financial position and results of operations.

Investment and Other Income (Expense)

Investment and other income (expense) totaled (\$12.8) million in 2003, (\$293.6) million in 2002 and \$14.1 million in 2001.

Investment income was \$52.1 million in 2003, \$42.1 million in 2002 and \$41.9 million in 2001. Investment income primarily represents U.S. Cellular's share of net income from the markets managed by others that are accounted for by the equity method. The aggregate net income of these investment markets increased significantly in 2003, resulting in a corresponding increase in investment income.

Interest income totaled \$1.6 million in 2003, \$4.4 million in 2002 and \$10.3 million in 2001. The decreases in 2003 and 2002 are primarily due to lower average cash balances in those years than in the respective comparable years.

Interest expense totaled \$64.6 million in 2003, \$47.9 million in 2002 and \$35.2 million in 2001. Interest expense is summarized by related debt instrument in the following table:

Year Ended December 31, (Dollars in millions)	2003	2002	2001
7.25% Notes	\$18.5	\$18.5	\$18.5
8.75% Senior Notes	11.4	1.8	—
Revolving credit facilities	9.8	5.8	5.1
6% zero coupon convertible debentures	9.4	8.9	9.8
8.1% Intercompany Note ⁽¹⁾	8.6	3.5	—
Forward contracts ⁽²⁾	2.9	2.1	—
6.7% Notes	2.0	—	—
9% Series A Notes	—	4.6	—
Other	2.0	2.7	1.8
Total Interest Expense	\$64.6	\$47.9	\$35.2

(1) In August 2002, U.S. Cellular entered into a loan agreement with TDS under which it borrowed \$105 million. The loan bears interest at an annual rate of 8.1%, payable quarterly, and becomes due in August 2008, with prepayments optional. In February 2004, U.S. Cellular repaid all outstanding principal and interest related to this Note. For further information regarding this Note, see "Certain Relationships and Related Transactions."

(2) In May 2002, U.S. Cellular entered into the forward contracts, which were negotiated with third parties relating to its investment in 10.2 million Vodafone American Depository Receipts. Taken together, the forward contracts allowed U.S. Cellular to borrow an aggregate of \$159.9 million against the stock. The forward contracts bear interest, payable quarterly, at the London InterBank Offered Rate ("LIBOR") plus 0.5% for a rate of 1.65% based on the three-month LIBOR rate at December 31, 2003. For further information regarding the forward contracts, see "Market Risk."

In 2003, interest expense related to the revolving credit facilities increased primarily due to the increase in average borrowings outstanding. Interest expense on the 8.75% Senior Notes, 8.1% Intercompany Notes and 6.7% Notes increased due to the increased length of time they were outstanding in 2003 compared to 2002.

In 2002, interest expense related to the 8.75% Senior Notes, 8.1% Intercompany Note, Forward contracts and 9% Series A Notes increased due to the fact that none of these debt instruments were outstanding during 2001.

U.S. Cellular's \$250 million principal amount of 7.25% Notes are unsecured and become due in August 2007. Interest on the Notes is payable semi-annually on February 15 and August 15 of each year.

The zero coupon convertible debentures, also known as Liquid Yield Option Notes, accrete interest at 6% annually, but do not require current cash payments of interest. All accreted interest is added to the outstanding principal balance on June 15 and December 15 of each year for purposes of calculating interest expense.

For further information regarding U.S. Cellular's 8.75% Senior Notes, 6.7% Notes and 9% Series A Notes, see "Liquidity and Capital Resources – Long-Term Financing." For further information regarding U.S. Cellular's revolving credit facilities, see "Liquidity and Capital Resources – Revolving Credit Facilities." For further information on the forward contracts, see "Market Risk." For information regarding the 8.1% Intercompany Note, see "Certain Relationships and Related Transactions."

Loss on marketable equity securities and other investments totaled \$5.2 million in 2003 and \$295.5 million in 2002. In 2003, a \$3.5 million license impairment loss was recorded related to U.S. Cellular's investment in a non-operational market in Florida that remained with U.S. Cellular after the exchange with AT&T Wireless was completed. Also in 2003, a \$1.7 million impairment loss was recorded related to U.S. Cellular's minority investment in a wireless market that it accounts for using the cost method.

U.S. Cellular and its subsidiaries hold a substantial amount of marketable equity securities, the majority of which are the result of sales or trades of non-strategic assets. These securities are publicly traded and can have volatile share prices. U.S. Cellular and its subsidiaries do not make direct investments in publicly traded companies and all of these interests were acquired as a result of sales, trades or reorganizations of other assets. U.S. Cellular continues to hold these investments because their associated low tax basis would trigger a substantial taxable gain upon disposal. See "Liquidity and Capital Resources – Marketable Equity Securities and Forward Contracts" for a discussion of marketable equity securities.

In 2002, management determined that the decline in value of certain marketable equity securities relative to their book basis was other than temporary and charged a \$244.7 million loss to the statements of operations. U.S. Cellular has subsequently utilized derivative financial instruments to eliminate any future other than temporary losses related to these marketable equity securities. See "Market Risk" for a discussion of other than temporary losses.

Also in 2002, U.S. Cellular recorded a \$38.1 million write-down in the value of notes receivable related to the 2000 sales of certain minority interests. Additionally, U.S. Cellular recorded losses of \$8.5 million related to the withdrawal from a partnership in which it had owned an investment interest and \$4.2 million related to the reduction in value of a land purchase option.

Income Taxes

Income tax expense (benefit) totaled an expense of \$37.2 million in 2003, a benefit of \$7.5 million in 2002 and an expense of \$147.3 million in 2001. The overall effective tax expense (benefit) rate was 35% in 2003, (61%) in 2002 and 44% in 2001. The effective tax rates

in 2003 and 2002 were impacted by the losses on assets held for sale and the losses on investments, which have different tax rates than U.S. Cellular's overall operations. See Note 2 – Income Taxes in the Notes to Consolidated Financial Statements for further discussion of the effective tax rate.

TDS and U.S. Cellular are parties to a Tax Allocation Agreement, pursuant to which U.S. Cellular is included in a consolidated federal income tax return with other members of the TDS consolidated group.

For financial reporting purposes, U.S. Cellular computes federal income taxes as if it were filing a separate return as its own affiliated group and was not included in the TDS group.

Cumulative Effect of Accounting Changes

Cumulative effect of accounting changes, net of tax and minority interest, reduced income by \$14.3 million, net of taxes of \$9.7 million and minority interest of \$0.5 million, or \$0.17 per diluted share, in 2003, reflecting the implementation of SFAS No. 143, and \$8.6 million, or \$0.09 per diluted share, to income in 2002, reflecting an initial impairment upon adoption of SFAS No. 142 and U.S. Cellular's change in its application of SAB No. 101.

Effective January 1, 2003, U.S. Cellular implemented SFAS No. 143. The cumulative effect in 2003 represents the aggregate impact of this accounting change for periods prior to 2003.

Effective January 1, 2002, U.S. Cellular adopted SFAS No. 142 and determined that wireless licenses have indefinite lives. Upon initial adoption, U.S. Cellular reviewed its investment in licenses and determined there was an impairment loss on certain licenses. The cumulative effect of the initial impairment upon the adoption of SFAS No. 142 reduced net income in 2002 by \$12.7 million, net of taxes of \$8.2 million, or \$(0.14) per diluted share.

Effective January 1, 2002, U.S. Cellular began deferring expense recognition of a portion of its commissions expenses, in the amount of deferred activation fees revenue. The cumulative effect in 2002, representing the aggregate impact of this accounting change for periods prior to 2002, was recorded in 2002 increasing net income by \$4.1 million, net of tax of \$3.0 million, or \$0.05 per diluted share.

Net Income (Loss)

Net income (loss) totaled income of \$42.7 million in 2003, a loss of \$26.9 million in 2002 and income of \$173.9 million in 2001. Diluted earnings (loss) per share was \$0.49 in 2003, \$(0.31) in 2002 and \$1.99 in 2001. In 2002, reduced operating income, primarily related to the launch of U.S. Cellular's brand in the Chicago market, and losses on marketable equity securities and other investments led to the decline in net income and diluted earnings per share from 2001. In 2003, losses on investments were significantly reduced, leading to the increase in net income and diluted earnings per share.

Inflation

Management believes that inflation affects U.S. Cellular's business to no greater extent than the general economy.

RECENT ACCOUNTING PRONOUNCEMENTS

Financial Accounting Standards Board ("FASB") Interpretation No. 46 ("FIN 46"), "Consolidation of Variable Interest Entities," was issued in January 2003, and is effective for all variable interests in variable interest entities created after January 31, 2003, and is effective October 1, 2003 for variable interests in variable interest entities created before February 1, 2003. This Interpretation modifies the requirements for consolidation of investments previously contained in Accounting Research Bulletin No. 51 "Consolidated Financial Statements." Under FIN 46, certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties are considered variable interest entities and are potentially subject to consolidation by an investor other than the investor with the majority equity interest. In December 2003, the FASB issued FIN 46R, "Consolidation of Variable Interest Entities," which among other things, deferred the application of FIN 46 by public entities with interest in variable interest entities referred to as special purpose entities until periods ending after December 15, 2003 and by public entities for all other types of variable interest entities until periods ending after March 15, 2004. U.S. Cellular has reviewed the provisions of FIN 46R, and does not anticipate that the adoption of FIN 46R will have a material impact on U.S. Cellular's future financial position or results of operations.

FINANCIAL RESOURCES

U.S. Cellular operates a capital- and marketing-intensive business. In recent years, U.S. Cellular has generated cash from its operations, received cash proceeds from divestitures, used its short-term credit facilities and used long-term debt financing to fund its network construction costs and operating expenses. U.S. Cellular anticipates further increases in wireless customers, revenues, operating expenses, cash flows from operating activities and fixed assets in the future. Cash flows may fluctuate from quarter to quarter depending on the seasonality of each of these growth factors.

Cash flows from operating activities provided \$621.7 million in 2003, \$620.1 million in 2002 and \$440.3 million in 2001. Income excluding adjustments to reconcile income (loss) to net cash provided by operating activities, excluding noncash items and changes in assets and liabilities from operations ("noncash" items) totaled \$578.7 million in 2003, \$599.9 million in 2002 and \$505.0 million in 2001. Changes in assets and liabilities from operations provided \$42.9 million in 2003, provided \$20.2 million in 2002 and required \$64.7 million in 2001, reflecting primarily timing differences in the payment of accounts payable and accrued taxes and the receipt of accounts receivable. Income taxes and interest paid totaled \$22.3 million in 2003, \$69.9 million in 2002 and \$154.0 million in 2001.