TELEPHONE & DATA SYSTEMS INC /DE/
Form 10-Q
November 04, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
(Mark One)

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

For the quarterly period ended September 30, 2016

OR

[ ] 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) | (IRS Employer Identification No.) |

30 North LaSalle Street, Suite 4000, Chicago, Illinois 60602
(Address of principal executive offices) (Zip code)

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

| | Yes | No |
|---|---|---|
| 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. | [x] | [ ] |
| Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). | [x] | [ ] |

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Large accelerated filer | [x] | Accelerated filer | [ ] | Non-accelerated filer | [ ] | Smaller reporting company | [ ] |

| | | |
|---|---|---|
| Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). | [ ] | [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, 2016 |
|---|---|
| Common Shares, $0.01 par value | 102,720,328 Shares |
| Series A Common Shares, $0.01 par value | 7,222,450 Shares |

Telephone and Data Systems, Inc.

Quarterly Report on Form 10-Q
For the Quarterly Period Ended September 30, 2016

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Telephone and Data Systems, Inc.

Management’s Discussion and Analysis of

Financial Condition and Results of Operations

## Executive Overview

The following discussion and analysis should be read in conjunction with Telephone and Data Systems, Inc.’s (“TDS”) interim consolidated financial statements and notes included herein, and with the description of TDS’ business, its audited consolidated financial statements and Management's Discussion and Analysis (“MD&A”) of Financial Condition and Results of Operations included in TDS’ Annual Report on Form 10-K (“Form 10-K”) for the year ended December 31, 2015. Analysis of TDS’ financial results compares the three and nine months ended September 30, 2016 to the three and nine months ended September 30, 2015. Calculated amounts and percentages are based on the underlying actual numbers rather than the numbers rounded to millions as presented.

This report contains statements that are not based on historical facts, including the words “believes,” “anticipates,” “intends,” “expects” and similar words. These statements constitute and represent “forward looking statements” as this term is defined in the Private Securities Litigation Reform Act of 1995. Such forward looking statements involve known and unknown risks, uncertainties and other factors that may cause actual results, events or developments to be significantly different from any future results, events or developments expressed or implied by such forward looking statements. See Private Securities Litigation Reform Act of 1995 Safe Harbor Cautionary Statement for additional information.

TDS uses certain “non-GAAP financial measures” throughout the MD&A. A discussion of the reason TDS determines these metrics to be useful and a reconciliation of these measures to their most directly comparable measures determined in accordance with accounting principles generally accepted in the United States of America (“GAAP”) are included in the Supplemental Information Relating to Non-GAAP Financial Measures section within the MD&A of this Form 10-Q Report.

General

TDS is a diversified telecommunications company that provides high-quality communications services to approximately 6 million customers nationwide. TDS provides wireless services through its 83%-owned subsidiary, United States Cellular Corporation ("U.S. Cellular"). TDS also provides wireline services, cable services and hosted and managed services ("HMS"), through its wholly-owned subsidiary, TDS Telecommunications Corporation ("TDS Telecom"). TDS' segments operate almost entirely in the United States. See Note 11 — Business Segment Information in the Notes to Consolidated Financial Statements for summary financial information on each business segment.

TDS Mission and Strategy

TDS' mission is to provide outstanding communications services to its customers and meet the needs of its shareholders, its people, and its communities. In pursuing this mission, TDS seeks to profitably grow its businesses, create opportunities for its associates and employees, and steadily build value over the long-term for its shareholders. Across all of its businesses, TDS is focused on providing exceptional customer experiences through best-in-class services and products and superior customer service.

TDS' long-term strategy calls for the majority of its capital to be reinvested in its operating businesses to strengthen their competitive positions, while still returning value to TDS shareholders through the payment of a regular quarterly cash dividend and share repurchases.

In 2016, TDS is working to build shareholder value by continuing to execute on its strategies to build strong, competitive businesses providing high-quality, data-focused services and products. Strategic efforts include:

- ♦ U.S. Cellular deployed 4G LTE as a result of U.S. Cellular's strategic initiative to enhance its network. 4G LTE reaches 99% of postpaid connections and 98% of cell sites. The adoption of data-centric smartphones and connected devices is driving significant growth in data traffic. At the end of the third quarter of 2016, 77% of postpaid connections had 4G capable devices, with the LTE network handling 90% of data traffic. U.S. Cellular continues to devote efforts to enhance its network capabilities with the deployment of VoLTE technology and plans a multi-year roll out beginning with one market in early 2017. VoLTE, when deployed commercially, will enable customers to utilize the LTE network for both voice and data services, and will enable enhanced services such as high definition voice, video calling and simultaneous voice and data sessions. The deployment of VoLTE also will expand U.S. Cellular's ability to offer roaming services to additional carriers.
- ♦ U.S. Cellular continued to enhance its spectrum position and monetize non-strategic assets by entering into multiple agreements with third parties. Certain of these agreements involve the purchase of licenses for cash, while others involve the exchange of licenses in non-operating markets for other licenses in operating markets and cash. As a result of the closing of multiple exchange agreements in the nine months ended September 30, 2016, U.S. Cellular received $15 million of cash and recognized gains of $16 million. The remaining license

purchase and exchange transactions are expected to close in the fourth quarter of 2016, at which point U.S. Cellular expects to recognize additional gains.  See Note 5 — Acquisitions, Divestitures and Exchanges for additional information related to these transactions.

♦ U.S. Cellular is focused on expanding its solutions available to business and government customers, including a growing suite of machine-to-machine solutions across various categories.  U.S. Cellular will continue to enhance its advanced wireless services and connected solutions for consumer, business and government customers.
♦ U.S. Cellular is committed to continuous innovation so as to provide customers in the markets it serves with the latest technology that can enhance their lives or businesses.  During the third quarter of 2016, U.S. Cellular successfully tested 5G technology in both indoor and outdoor environments for the first time.  The company plans additional tests geared towards understanding the propagation characteristics of the new technology and contributing to the development of 5G standards.  When deployed commercially, 5G technology is expected to help address customers' growing demand for data services as well as create opportunities for new services requiring high speed and low latency.

♦ TDS Telecom's Wireline business has substantially completed its currently planned deployment of fiber technology in its existing markets to provide internet speeds of up to 1 Gigabit per second ("Gbps").  In certain non-fiber markets, TDS Telecom offers speeds reaching up to 50 Megabits per second ("Mbps") using bonded copper lines.  By leveraging its high-speed network, Wireline continues to drive growth in its IPTV, broadband, and managedIP services.
♦ TDS Telecom's Cable business has continued to make network capacity investments and offer more advanced services in its markets in line with its strategy to increase connections and grow broadband penetration.
♦ TDS Telecom's HMS business is focused on growing recurring service revenues through increased sales of IT solutions including hosted and managed services, colocation services, and cloud computing, and through increasing the utilization of its service delivery platform and data center assets.

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Terms Used by TDS

All defined terms in this MD&A are used as defined in the Notes to Consolidated Financial Statements, and additional terms are defined below:

- 4G LTE – fourth generation Long-Term Evolution which is a wireless broadband technology.
- 5G – fifth generation wireless broadband technology.
- Account – represents an individual or business financially responsible for one or multiple associated connections. An account may include a variety of types of connections such as handsets and connected devices.
- Auction 97 – An FCC auction of AWS-3 spectrum licenses that ended in January 2015.
- Auctions 1000, 1001, and 1002 – Auction 1000 is an FCC auction of 600 MHz spectrum licenses being held in 2016 involving: (1) a “reverse auction” in which broadcast television licensees submit bids to voluntarily relinquish spectrum usage rights in exchange for payments (referred to as Auction 1001); (2) a “repacking” of the broadcast television bands in order to free up certain broadcast spectrum for other uses; and (3) a “forward auction” of licenses for spectrum cleared through this process to be used for wireless communications (referred to as Auction 1002).
- Broadband Connections – refers to the number of Wireline customers provided high-capacity data circuits via various technologies, including fiber, DSL and dedicated internet circuit technologies or the Cable billable number of lines into a building for high-speed data services.
- Churn Rate – represents the percentage of the connections that disconnect service each month. These rates represent the average monthly churn rate for each respective period.
- FCC – Federal Communications Commission.
- Gross Additions – represents the total number of new connections added during the period, without regard to connections that were terminated during that period.
- IPTV Connections – represents the number of Wireline customers provided video services using IP networking technology.
- Machine-to-Machine or M2M – technology that involves the transmission of data between networked devices, as well as the performance of actions by devices without human intervention. U.S. Cellular sells and supports M2M solutions to customers, provides connectivity for M2M solutions via the U.S. Cellular network, and has partnerships with device manufacturers and software developers which offer M2M solutions.
- ManagedIP Connections – refers to the number of telephone handsets, data lines and IP trunks providing communications using IP networking technology.
- Net Additions – represents the total number of new connections added during the period, net of connections that were terminated during that period.
- Postpaid Average Billings per Account (“Postpaid ABPA”) – non-GAAP metric is calculated by dividing total postpaid service revenues plus equipment installment plan billings by the average number of postpaid accounts and by the number of months in the period.
- Postpaid Average Billings per User (“Postpaid ABPU”) – non-GAAP metric is calculated by dividing total postpaid service revenues plus equipment installment plan billings by the average number of postpaid connections and by the number of months in the period.
- Postpaid Average Revenue per Account (“Postpaid ARPA”) – metric is calculated by dividing total postpaid service revenues by the average number of postpaid accounts and by the number of months in the period.
- Postpaid Average Revenue per User (“Postpaid ARPU”) – metric is calculated by dividing total postpaid service revenues by the average number of postpaid connections and by the number of months in the period.
- Retail Connections – the sum of postpaid connections and prepaid connections.

- Smartphone Penetration – is calculated by dividing postpaid smartphone connections by postpaid handset connections.
- Universal Service Fund ("USF") – A system of telecommunications collected fees and support payments managed by the FCC intended to promote universal access to telecommunications services in the United States.
- U.S. Cellular Connections - individual lines of service associated with each device activated by a customer. This includes smartphones, feature phones, tablets, modems, and machine-to-machine devices.
- Video Connections – generally, a home or business receiving video programming counts as one video connection. In counting bulk residential or commercial connections, such as an apartment building or a hotel, connections are counted based on the number of units/rooms within the building receiving service.
- Voice Connections – refers to the individual circuits connecting a customer to Wireline's central office facilities or the Cable billable number of lines into a building for voice services.
- VoLTE – Voice over Long-Term Evolution is a technology specification that defines the standards and procedures for delivering voice communications and related services over 4G LTE networks.
- Wireline Residential Revenue per Connection – is calculated by dividing total Wireline residential revenue by the average number of total Wireline residential connections and by the number of months in the period.

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Results of Operations — TDS Consolidated

| | Three Months Ended September 30, | | | Nine Months Ended September 30, | | |
|---|---|---|---|---|---|---|
| | 2016 | 2015 | 2016 vs. 2015 | 2016 | 2015 | 2016 vs. 2015 |
| (Dollars in millions) | | | | | | |
| Operating revenues | | | | | | |
| U.S. Cellular | $1,010 | $1,069 | (6)% | $2,948 | $3,010 | (2)% |
| TDS Telecom | 287 | 299 | (4)% | 868 | 874 | (1)% |
| All other1 | 4 | 6 | (37)% | 10 | 18 | (43)% |
| Total operating revenues | 1,301 | 1,374 | (5)% | 3,826 | 3,902 | (2)% |
| Operating expenses | | | | | | |
| U.S. Cellular | 1,001 | 991 | 1% | 2,922 | 2,673 | 9% |
| TDS Telecom | 276 | 282 | (2)% | 816 | 810 | 1% |
| All other1 2 | 4 | 8 | (38)% | 12 | 11 | 25% |
| Total operating expenses | 1,281 | 1,281 | - | 3,750 | 3,494 | 7% |
| Operating income | | | | | | |
| U.S. Cellular | 9 | 78 | (88)% | 26 | 337 | (92)% |
| TDS Telecom | 12 | 17 | (32)% | 53 | 64 | (17)% |
| All other1 2 | (1) | (2) | 41% | (3) | 7 | >(100)% |
| Total operating income | 20 | 93 | (79)% | 76 | 408 | (81)% |
| Investment and other income (expense) | | | | | | |
| Equity in earnings of unconsolidated entities | 38 | 40 | (5)% | 109 | 110 | (1)% |
| Interest and dividend income | 15 | 10 | 56% | 44 | 28 | 57% |
| Interest expense | (42) | (35) | (20)% | (127) | (103) | (23)% |
| Other, net | (1) | – | >100% | 1 | – | >(100)% |
| Total investment and other income | 10 | 15 | (25)% | 27 | 35 | (24)% |

| | | | | | | |
|---|---|---|---|---|---|---|
| Income before income taxes | 30 | 108 | (72)% | 103 | 443 | (77)% |
| Income tax expense | 14 | 46 | (69)% | 45 | 178 | (75)% |
| Net income | 16 | 62 | (74)% | 58 | 265 | (78)% |
| Less: Net income attributable to noncontrolling interests, net of tax | 3 | 11 | (70)% | 9 | 45 | (79)% |
| Net income attributable to TDS shareholders | $13 | $51 | (75)% | $49 | $220 | (78)% |
| Capital expenditures | $145 | $194 | (25)% | $412 | $487 | (15)% |

1 Consists of corporate and other operations and intercompany eliminations.

2 For the nine months ended September 30, 2015, TDS recognized an incremental gain compared to U.S. Cellular of $12 million on a tower sale as a result of lower asset basis in the assets disposed.

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The decrease in operating revenues is due primarily to the impact of $58 million in revenue recognized by U.S. Cellular from expired rewards points in the third quarter of 2015.

The increase in operating expenses for the nine months ended September 30, 2016 was due primarily to the absence of significant offsetting gains recognized from sales and exchanges of businesses and licenses. Such gains were $277 million in 2015 compared to $17 million in 2016.

Refer to individual segment discussions in this MD&A for additional details on operating revenues and expenses at the segment level.

Equity in earnings of unconsolidated entities

Equity in earnings of unconsolidated entities represents TDS' share of net income from entities in which it has a noncontrolling interest and that are accounted for by the equity method. TDS' investment in the Los Angeles SMSA Limited Partnership ("LA Partnership") contributed $17 million and $19 million to Equity in earnings of unconsolidated entities for the three months ended September 30, 2016 and 2015, respectively, and $57 million and $58 million for the nine months ended September 30, 2016 and 2015, respectively. See Note 7 — Investments in Unconsolidated Entities in the Notes to Consolidated Financial Statements for additional information.

Interest and dividend income

Interest and dividend income increased due to imputed interest income recognized on equipment installment plans of $13 million and $9 million for the three months ended September 30, 2016 and 2015, respectively, and $37 million and $24 million for the nine months ended September 30, 2016 and 2015, respectively.

Interest expense

Interest expense increased due primarily to U.S. Cellular's issuance of $300 million of 7.25% Senior Notes due 2064 in November 2015 and borrowing of $225 million on U.S. Cellular's senior term loan facility that was drawn in July 2015.

Income tax expense

TDS' effective tax rate on Income before income taxes for the three and nine months ended September 30, 2016 was 46.6% and 43.6%, respectively, and for the three and nine months ended September 30, 2015 was 42.1% and 40.3%. The effective tax rates for the three and nine month periods primarily reflect a normalized combined rate of federal and state taxes, but are also affected by certain discrete items in each period which increase or decrease the effective tax rate for each period. Because certain discrete items are not annualized, these rates may not be indicative of the annual rate for 2016.

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Net income attributable to noncontrolling interests, net of tax

| | Three Months Ended September 30, 2016 | 2015 | Nine Months Ended September 30, 2016 | 2015 |
|---|---|---|---|---|
| (Dollars in millions) | | | | |
| Net income attributable to noncontrolling interests, net of tax | | | | |
| U.S. Cellular noncontrolling public shareholders’ | $ 3 | $ 10 | $ 9 | $ 39 |
| Noncontrolling shareholders’ or partners’ | – | 1 | – | 6 |
| | $ 3 | $ 11 | $ 9 | $ 45 |

Net income attributable to noncontrolling interests, net of tax includes the noncontrolling public shareholders’ share of U.S. Cellular’s net income and the noncontrolling shareholders’ or partners’ share of certain U.S. Cellular subsidiaries’ net income (loss). The decrease from 2015 to 2016 for both the three and nine month periods is due to lower income from U.S. Cellular and certain other partnerships in 2016.

Three Months Ended

Net income and Adjusted EBITDA decreased due primarily to the impact of revenue recognized from expired rewards points in the third quarter of 2015.

Nine Months Ended

In addition to the impact of the expired rewards points, Net income decreased due primarily to a lesser amount of gains from sales and exchanges of businesses and licenses recognized in 2016 compared to 2015. Such gains are not included as a component of Adjusted

EBITDA and, as a result, Adjusted EBITDA did not decline as much as Net income.

*Represents a non-GAAP financial measure. Refer to Supplemental Information Relating to Non-GAAP Financial Measures within this MD&A for a reconciliation of this measure.

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# U.S. CELLULAR OPERATIONS

## Business Overview

U.S. Cellular owns, operates, and invests in wireless markets throughout the United States. U.S. Cellular is an 83%-owned subsidiary of TDS. U.S. Cellular's strategy is to attract and retain wireless customers through a value proposition comprised of a high-quality network, outstanding customer service, and competitive devices, plans, and pricing, all provided with a local focus.

## OPERATIONS

- Serves customers with approximately 5.0 million connections including 4.5 million postpaid, 0.5 million prepaid and 0.1 million reseller and other connections
- Operates in 23 states

- ♦ Employs approximately 6,300 employees
- ♦ Headquartered in Chicago, Illinois
- ♦ 6,374 cell sites including 4,015 owned towers in service

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Operational Overview

| | YTD 2015 | YTD 2016 |
|---|---|---|
| Postpaid Connections | | |
| Gross Additions | 591,000 | 586,000 |
| Net Additions | 43,000 | 75,000 |
| Churn | 1.41% | 1.27% |
| Handsets | 1.32% | 1.17% |
| Connected Devices | 2.31% | 1.97% |
| Connections – end of period | 4,341,000 | 4,484,000 |
| Prepaid Net Additions | 32,000 | 93,000 |
| Retail Connections – end of period | 4,721,000 | 4,964,000 |

The increase in postpaid net additions in 2016 is driven by improvement in postpaid churn. Postpaid churn declined over the past two years due to enhancements in the customer experience and improvement in the overall credit mix of gross additions. In addition, U.S. Cellular continues to see growth in postpaid net additions from connected devices. The increase in prepaid net additions was due primarily to successful promotional activity.

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Smartphones represented 92% and 87% of total postpaid handset sales for the nine months ended September 30, 2016 and 2015, respectively. As a result, smartphone penetration increased to 78% of the postpaid handset base as of September 30, 2016, up from 72% a year ago. Smartphone customers generally use more data than feature phone customers, thereby driving growth in service revenues.

Continued growth in customer usage related to data services and products may result in increased operating expenses and the need for additional investment in spectrum, network capacity and network enhancements.

1 The discontinuation of the loyalty rewards points program had the effect of increasing Postpaid ARPU/ABPU and Postpaid ARPA/ABPA by $4.48 and $11.34 for the three months ended September 2015, respectively, and $1.50 and $3.74 for the nine months ended September 2015, respectively.

2 Postpaid ABPU and Postpaid ABPA are non-GAAP financial measures. Refer to Supplemental Information Relating to Non-GAAP Financial Measures within this MD&A for a reconciliation of this measure.

Postpaid ARPU and Postpaid ARPA decreased for the three and nine months ended September 30, 2016 due primarily to the impact of the loyalty rewards points program that was discontinued in September 2015, industry-wide price competition, and discounts on shared data plans provided to customers on equipment installment plans and those providing their own device at the time of activation or renewal.  Postpaid ARPU also decreased due to growth in the number of connected devices, which on a per unit basis contribute less revenue than handsets.  These factors were partially offset by the impacts of continued adoption of smartphones and the related increase in service revenues from data usage.

Equipment installment plans increase equipment sales revenue as customers pay for their wireless devices in installments at a total device price that is generally higher than the device price offered to customers in conjunction with alternative plans that are subject to a service contract.  Equipment installment plans also have the impact of reducing service revenues as many equipment installment plans provide for reduced monthly access charges.  In order to show the trends in total service and equipment revenues received, U.S. Cellular has presented Postpaid ABPU and Postpaid ABPA, which are calculated as Postpaid ARPU and Postpaid ARPA plus average monthly equipment installment plan billings per connection and account, respectively.

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Equipment installment plan billings increased for the three and nine months ended September 30, 2016 due to increased adoption of equipment installment plans by postpaid customers. Postpaid ABPU and ABPA decreased in 2016 as the increase in equipment installment plan billings was more than offset by the decline in Postpaid ARPU and ARPA discussed above. U.S. Cellular expects the adoption and penetration of equipment installment plans to continue to increase as plan offerings shift more toward equipment installment plans. Effective in September 2016, new postpaid handset sales to retail consumers are made under equipment installment plans; business and government customers may purchase equipment under either installment plans or alternative plans that are subject to a service contract.

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Financial Overview — U.S. Cellular

| | Three Months Ended September 30, | | | Nine Months Ended September 30, | | |
|---|---|---|---|---|---|---|
| | 2016 | 2015 | 2016 vs. 2015 | 2016 | 2015 | 2016 vs. 2015 |
| (Dollars in millions) | | | | | | |
| Retail service | $ 681 | $ 797 | (14)% | $ 2,044 | $ 2,278 | (10)% |
| Inbound roaming | 45 | 59 | (25)% | 118 | 149 | (20)% |
| Other | 45 | 40 | 12% | 131 | 122 | 7% |
| Service revenues | 771 | 896 | (14)% | 2,293 | 2,549 | (10)% |
| Equipment sales | 239 | 173 | 38% | 655 | 461 | 42% |
| Total operating revenues | 1,010 | 1,069 | (6)% | 2,948 | 3,010 | (2)% |
| | | | | | | |
| System operations (excluding Depreciation, amortization and accretion reported below) | 196 | 199 | (1)% | 572 | 586 | (2)% |
| Cost of equipment sold | 280 | 287 | (2)% | 799 | 779 | 2% |
| Selling, general and administrative | 370 | 375 | (1)% | 1,089 | 1,107 | (2)% |
| | 846 | 861 | (2)% | 2,460 | 2,472 | - |
| | | | | | | |
| Operating cash flow* | 164 | 208 | (21)% | 488 | 538 | (9)% |

| | | | | | | |
|---|---|---|---|---|---|---|
| Depreciation, amortization and accretion | 155 | 152 | 2% | 462 | 450 | 3% |
| (Gain) loss on asset disposals, net | 7 | 3 | >100% | 16 | 12 | 33% |
| (Gain) loss on sale of business and other exit costs, net | – | (1) | N/M | – | (114) | 100% |
| (Gain) loss on license sales and exchanges | (7) | (24) | 70% | (16) | (147) | 89% |
| Total operating expenses | 1,001 | 991 | 1% | 2,922 | 2,673 | 9% |
| Operating income | $ 9 | $ 78 | (88)% | $ 26 | $ 337 | (92)% |
| Net income | $ 18 | $ 65 | (73)% | $ 54 | $ 250 | (78)% |
| Adjusted EBITDA* | $ 216 | $ 257 | (16)% | $ 639 | $ 673 | (5)% |
| Capital expenditures | $ 103 | $ 135 | (23)% | $ 275 | $ 335 | (18)% |

* Represents a non-GAAP financial measure. Refer to Supplemental Information Relating to Non-GAAP Financial Measures within this MD&A for a reconciliation of this measure.

N/M - Percentage change not meaningful

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Service revenues consist of:

- ♦ Retail Service - Charges for access, airtime, roaming, recovery of regulatory costs and value added services, including data services and products
- ♦ Inbound Roaming - Charges to other wireless carriers whose customers use U.S. Cellular's wireless systems when roaming
- ♦ Other – Primarily amounts received from the Federal USF and tower rental revenues

Equipment revenues consist of:

- ♦ Sales of wireless devices and related accessories to new and existing customers, agents, and third-party distributors

Key components of changes in the statement of operations line items were as follows:

Total operating revenues

Service revenues decreased for the three and nine months ended September 30, 2016 as a result of (i) a decrease in retail service revenues driven by the $58 million impact of the loyalty rewards program that ended in September 2015; (ii) industry-wide price competition, including discounts on shared data plans provided to customers on equipment installment plans and those providing their own device at the time of activation or renewal; and (iii) reductions in inbound roaming revenues driven by lower roaming rates.  Such reductions were partially offset by an increase in the average connections base and continued adoption of smartphones and shared data plans.

Federal USF revenue was $23 million and $69 million for the three and nine months ended September 30, 2016, respectively, which remained flat when compared to the same periods last year. Pursuant to the FCC's Reform Order ("Reform Order"), U.S. Cellular's Federal USF support was to be phased down at the rate of 20% per year beginning July 1, 2012. The Phase II Mobility Fund was not operational as of July 2014 and, therefore, as provided by the Reform Order, the phase down was suspended at 60% of the baseline amount. U.S. Cellular will continue to receive USF support at the 60% level until the FCC takes further action. At this time, U.S. Cellular cannot predict the changes that the FCC might make to the USF high cost support program and, accordingly, cannot predict whether such changes will have a material adverse effect on U.S. Cellular's business, financial condition or results of operations.

Equipment sales revenues increased for the three months ended September 30, 2016 when compared to the three months ended September 30, 2015 due primarily to a shift in mix to sales under equipment installment plans together with an increase in average revenue per device sold under such plans. Equipment installment plan sales contributed $192 million and $89 million during the three months ended September 30, 2016 and 2015, respectively.

Equipment sales revenues increased for the nine months ended September 30, 2016 when compared to the nine months ended September 30, 2015 due to an overall increase in the number of devices sold, and a shift in mix to sales under equipment installment plans together with an increase in average revenue per device sold under such plans. Equipment installment plan sales contributed $501 million and $226 million during the nine months ended September 30, 2016 and 2015, respectively. Equipment installment plan connections represented 40% and 23% of total postpaid connections as of September 30, 2016 and 2015, respectively.

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System operations expenses

System operations expenses decreased by modest amounts for the three and nine months ended September 30, 2016 when compared to the same periods last year.

U.S. Cellular expects system operations expenses to increase in the future to support the continued growth in cell sites and other network facilities as it continues to add capacity, enhance quality and deploy new technologies as well as to support increases in total customer data usage.  However, these increases are expected to be offset to some extent by cost savings generated by shifting data traffic to the 4G LTE network from the 3G network.

Cost of equipment sold

Cost of equipment sold decreased for the three months ended September 30, 2016 when compared to the three months ended September 30, 2015 as a result of a decrease in the average cost per device sold driven by the lower cost of smartphones and to a lesser extent the lower sales of accessories.  Cost of equipment sold included $200 million and $113 million related to equipment installment plan sales for the three months ended September 30, 2016 and 2015, respectively.  Loss on equipment, defined as Equipment sales revenues less Cost of equipment sold, was $41 million and $114 million for the three months ended September 30, 2016 and 2015.

Cost of equipment sold increased for the nine months ended September 30, 2016 when compared to the nine months ended September 30, 2015 primarily as the result of a 4% increase in devices sold, partially offset by a decrease in the average cost per device sold.  Cost of equipment sold included $534 million and $305 million related to equipment installment plan sales for the nine months ended September 30, 2016 and 2015, respectively.  Loss on equipment was $144 million and $318 million for the nine months ended September 30, 2016 and 2015, respectively.

Selling, general and administrative expenses

Selling, general and administrative expenses decreased by modest amounts for the three and nine months ended September 30, 2016 when compared to the same periods last year.  This decrease was attributable to various expense reductions that were partially offset by a $13 million expense recognized in the three months ended September 30, 2016 as a result of the termination of a naming rights agreement.

Depreciation, amortization, and accretion expenses

The increases in Depreciation, amortization, and accretion expenses for the three and nine months ended September 30, 2016 were mainly driven by the increase in amortization expense related to billing system upgrades.

(Gain) loss on asset disposals, net

The increases in Loss on asset disposals were primarily driven by more disposals of certain network assets during the three and nine months ended September 30, 2016 when compared to the same periods last year.

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

The net gain for the nine months ended September 30, 2015 was due primarily to a $108 million gain recognized on sale of towers and certain related contracts, assets and liabilities.

(Gain) loss on license sales and exchanges, net

The net gains in 2016 and 2015 were due to gains recognized on license exchange transactions with third parties. See Note 5 — Acquisitions, Divestitures and Exchanges in the Notes to Consolidated Financial Statements for additional information.

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## TDS TELECOM OPERATIONS

### Business Overview

TDS Telecom operates in three reportable segments: Wireline, Cable and HMS. The overall strategy for the Wireline and Cable businesses is to own the best data pipes in each market in order to capitalize on data growth and the need for higher broadband speeds and leverage that growth by bundling services with video and voice. In addition, through its HMS business, TDS Telecom provides a wide range of Information Technology ("IT") services including colocation, dedicated hosting, hosted application management, cloud computing services and the planning, engineering, procurement, installation, sales and management of IT infrastructure hardware solutions.

### OPERATIONS

- ♦ Wireline and Cable serve approximately 1.2 million broadband, video and voice connections in 34 states.
- ♦ Wireline operates 105 incumbent local exchange carriers ("ILEC") in 25 states and competitive local exchange carriers ("CLEC") in 4 states.
- ♦ Cable operates primarily in Oregon, Utah, Colorado, New Mexico and Texas.
- ♦ HMS operates a total of eight data centers. It owns two data centers in Iowa, and one each in Minnesota, Wisconsin, Colorado and Oregon and it leases two data centers in Arizona.

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Financial Overview — TDS Telecom

| | Three Months Ended September 30, | | | Nine Months Ended September 30, | | |
|---|---|---|---|---|---|---|
| | 2016 | 2015 | 2016 vs. 2015 | 2016 | 2015 | 2016 vs. 2015 |
| (Dollars in millions) | | | | | | |
| Operating revenues | | | | | | |
| Wireline | $175 | $175 | - | $523 | $527 | (1)% |
| Cable | 46 | 44 | 5% | 137 | 132 | 3% |
| HMS | 68 | 82 | (17)% | 212 | 218 | (3)% |
| Intra-company elimination | (1) | (1) | 1% | (3) | (3) | (1)% |
| TDS Telecom operating revenues | 287 | 299 | (4)% | 868 | 874 | (1)% |
| | | | | | | |
| Operating expenses | | | | | | |
| Wireline | 159 | 157 | 1% | 462 | 460 | 1% |
| Cable | 46 | 43 | 8% | 136 | 126 | 8% |
| HMS | 72 | 84 | (14)% | 221 | 228 | (3)% |
| Intra-company elimination | (1) | (1) | 1% | (3) | (3) | (1)% |
| TDS Telecom operating expenses | 276 | 282 | (2)% | 816 | 810 | 1% |
| | | | | | | |
| TDS Telecom operating income | $12 | $17 | (32)% | $53 | $64 | (17)% |
| | | | | | | |
| Net income | $7 | $9 | (20)% | $32 | $38 | (15)% |
| | | | | | | |
| Adjusted EBITDA* | $71 | $76 | (7)% | $226 | $236 | (4)% |
| | | | | | | |
| Capital expenditures | $40 | $56 | (29)% | $128 | $146 | (12)% |

Numbers may not foot due to rounding.

* Represents a non-GAAP financial measure. Refer to Supplemental Information Relating to Non-GAAP Financial Measures within this MD&A for a reconciliation of this measure.

Three and Nine Months Ended

Operating revenues for the three and nine months ended September 30, 2016 decreased as declines in HMS equipment revenues were partially offset by increases in revenues from Cable operations.

Total operating expenses

Operating expenses for the three months ended September 30, 2016 decreased due to lower HMS cost of equipment and products on reduced equipment sales partially offset by higher video programming costs and employee expenses.

Operating expenses for the nine months ended September 30, 2016 increased due to higher video programming costs and employee expenses.

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## WIRELINE OPERATIONS

### Business Overview

TDS Telecom's Wireline business provides broadband, video and voice services. These services are provided to residential, commercial, and wholesale customers in a mix of rural, small town and suburban markets, with the largest concentration of its customers in the Upper Midwest and the Southeast. TDS Telecom's strategy is to offer its residential customers broadband, video, and voice services through value-added bundling. In its commercial business, TDS Telecom's strategic focus is on small- to medium-sized businesses and its sales efforts emphasize advanced IP-based voice and data services.

### Operational Overview

Wireline residential broadband customers, comprised mainly of ILEC connections, are increasingly choosing higher speeds.

In total, Wireline increased residential revenue per connection by 3% for the nine months ended September 30, 2016.

Total residential connections increased as a 44% increase in IPTV connections was partially offset by a 3% decline in voice connections.

Total commercial connections decreased by 3% as declines in voice and broadband connections outpaced the 4% growth in managedIP connections.

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Financial Overview — Wireline

| | Three Months Ended September 30, | | | Nine Months Ended September 30, | | |
|---|---|---|---|---|---|---|
| | 2016 | 2015 | 2016 vs. 2015 | 2016 | 2015 | 2016 vs. 2015 |
| (Dollars in millions) | | | | | | |
| Residential | $78 | $76 | 4% | $232 | $224 | 3% |
| Commercial | 53 | 55 | (4)% | 160 | 166 | (4)% |
| Wholesale | 43 | 44 | (2)% | 130 | 135 | (3)% |
| Service revenues | 174 | 175 | - | 522 | 526 | (1)% |
| Equipment and product sales | – | – | (9)% | 1 | 1 | (1)% |
| Total operating revenues | 175 | 175 | - | 523 | 527 | (1)% |
| | | | | | | |
| Cost of services (excluding Depreciation, amortization and accretion reported below) | 67 | 64 | 4% | 192 | 189 | 2% |
| Cost of equipment and products | 1 | 1 | 25% | 2 | 2 | (3)% |
| Selling, general and administrative | 50 | 50 | - | 148 | 145 | 2% |
| | 117 | 114 | 3% | 342 | 335 | 2% |
| | | | | | | |
| Operating cash flow* | 57 | 61 | (6)% | 182 | 192 | (5)% |
| | | | | | | |
| Depreciation, amortization and | 41 | 41 | (1)% | 119 | 124 | (4)% |

| | | | | | | |
|---|---|---|---|---|---|---|
| accretion | | | | | | |
| (Gain) loss on asset disposals, net | 1 | 2 | (65)% | 2 | 3 | (52)% |
| (Gain) loss on sale of business and other exit costs, net | – | – | N/M | – | (3) | >100% |
| Total operating expenses | 159 | 157 | 1% | 462 | 460 | 1% |
| Operating income | $16 | $18 | (10)% | $61 | $67 | (9)% |
| Income before income taxes | $17 | $19 | (9)% | $63 | $70 | (9)% |
| Adjusted EBITDA* | $58 | $61 | (6)% | $183 | $193 | (5)% |
| Capital expenditures | $27 | $38 | (30)% | $82 | $91 | (9)% |

Numbers may not foot due to rounding.

N/M - Not Meaningful

* Represents a non-GAAP financial measure. Refer to Supplemental Information Relating to Non-GAAP Financial Measures within this MD&A for a reconciliation of this measure.

Residential revenues consist of:

- ♦ Broadband services, including fiber-based and other digital, premium and enhanced data services
- ♦ IPTV and satellite video
- ♦ Voice services

Commercial revenues consist of:

- TDS managedIP voice and data services
- High-speed and dedicated business internet services
- Voice services

Wholesale revenues consist of:

- Network access services to interexchange carriers for the origination and termination of interstate and intrastate long distance phone calls on TDS Telecom’s network and special access services to carriers and others
- Amounts received from State and Federal USF support

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Key components of changes in the statement of operations items were as follows:

Total operating revenues

Residential revenues increased for the three and nine months ended September 30, 2016 as growth in IPTV and data connections more than offset the decline in legacy voice services. For both periods, IPTV average connections grew approximately 45%, offset by a 3% decline in average voice connections.

Commercial revenues decreased for the three and nine months ended September 30, 2016 as declining legacy voice and data connections reduced revenues, partially offset by an increase in revenue driven by 3% growth in average managedIP connections in both periods.

Wholesale revenues decreased for the three months ended September 30, 2016 due primarily to the effect of divestitures and a 14% reduction in intra-state minutes-of-use. For the nine months ended September 30, 2016, Wholesale revenues decreased due to the items which affected the three month period and lower special access revenue.

Cost of services

Cost of services increased for the three and nine months ended September 30, 2016 as increased charges related to employee expenses and growth in IPTV were offset by reduced costs of provisioning circuits, purchasing unbundled network elements and providing long-distance services.

Selling, general and administrative expenses

Selling, general and administrative expenses were relatively flat for the three months ended September 30, 2016. Expenses increased for the nine month period due to growth in employee expenses offset by a decrease in bad debts expense.

Depreciation, amortization and accretion

Depreciation, amortization and accretion were relatively flat for the three month period ended September 30, 2016. The decrease for the nine months ended September 30, 2016 was due primarily to a $4 million adjustment recorded in the three months ended June 30, 2016 for excess depreciation attributable to the third quarter of 2014 through the first quarter of 2016.

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## CABLE OPERATIONS

### Business Overview

TDS Telecom's cable strategy is to expand its broadband services and leverage that growth by bundling with video and voice services. TDS Telecom seeks to be the leading provider of broadband services in its targeted markets by leveraging its core competencies in network management and customer focus.

### Operational Overview

Cable connections grew 5% over 2015 with increases in broadband and voice outpacing declines in video.

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Financial Overview — Cable

| | Three Months Ended September 30, | | | Nine Months Ended September 30, | | |
|---|---|---|---|---|---|---|
| | 2016 | 2015 | 2016 vs. 2015 | 2016 | 2015 | 2016 vs. 2015 |
| (Dollars in millions) | | | | | | |
| Residential | $37 | $35 | 6% | $108 | $105 | 3% |
| Commercial | 9 | 9 | 4% | 28 | 27 | 4% |
| Total operating revenues | 46 | 44 | 5% | 137 | 132 | 3% |
| Cost of services (excluding Depreciation, amortization and accretion reported below) | 23 | 20 | 20% | 69 | 59 | 17% |
| Selling, general and administrative | 13 | 14 | (10)% | 37 | 41 | (8)% |
| | 36 | 34 | 7% | 107 | 100 | 7% |
| Operating cash flow* | 10 | 10 | - | 30 | 32 | (6)% |
| Depreciation, amortization and accretion | 9 | 9 | 6% | 27 | 26 | 5% |
| (Gain) loss on asset disposals, net | 1 | – | >100% | 2 | (1) | >100% |
| Total operating expenses | 46 | 43 | 8% | 136 | 126 | 8% |
| | $– | $1 | (98)% | $1 | $6 | (92)% |

| | | | | | | |
|---|---|---|---|---|---|---|
| Operating income | | | | | | |
| Income before income taxes | $– | $1 | (87)% | $1 | $7 | (86)% |
| Adjusted EBITDA* | $10 | $10 | - | $30 | $32 | (6)% |
| Capital expenditures | $11 | $13 | (16)% | $41 | $37 | 11% |

Numbers may not foot due to rounding.

* Represents a non-GAAP financial measure. Refer to Supplemental Information Relating to Non-GAAP Financial Measures within this MD&A for a reconciliation of this measure.

Residential and Commercial revenues consist of:

- Broadband services, including high-speed internet, security and support services
- Video services, including premium programming in HD, and multi-room and TV Everywhere offerings
- Voice services

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Key components of changes in the statement of operations items were as follows:

Total operating revenues

Residential revenues increased for the three and nine months ended September 30, 2016 due primarily to an 8% increase in year-to-date average residential connections partially offset by a decrease in revenue caused by promotional pricing.

Commercial revenues increased for the three and nine months ended September 30, 2016 due primarily to increases in high-speed data customers.

Cost of services

Cost of services increased for the three and nine months ended September 30, 2016 due primarily to increases in employee expenses and programming content costs.

Selling, general and administrative expenses

Selling, general and administrative expenses decreased for the three and nine months ended September 30, 2016 due to lower employee, customer service and advertising costs.

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## HMS OPERATIONS

### Business Overview

Under TDS Telecom's OneNeck IT Solutions brand, TDS Telecom offers a full-suite of IT solutions ranging from equipment resale to full management and hosting of a customer's IT infrastructure and applications. The goal of HMS operations is to create, deliver, and support a platform of IT products and services tailored for mid-market business customers.

### Financial Overview — HMS

| | Three Months Ended September 30, | | | Nine Months Ended September 30, | | |
|---|---|---|---|---|---|---|
| | 2016 | 2015 | 2016 vs. 2015 | 2016 | 2015 | 2016 vs. 2015 |
| (Dollars in millions) | | | | | | |
| Service revenues | $29 | $30 | (5)% | $91 | $88 | 3% |
| Equipment and product sales | 39 | 51 | (25)% | 121 | 130 | (7)% |
| Total operating revenues | 68 | 82 | (17)% | 212 | 218 | (3)% |
| Cost of services (excluding Depreciation, amortization and accretion reported below) | 21 | 21 | (1)% | 61 | 63 | (3)% |
| Cost of equipment and products | 33 | 43 | (25)% | 101 | 109 | (7)% |
| | 12 | 12 | (7)% | 37 | 36 | 2% |

| | | | | | | |
|---|---|---|---|---|---|---|
| Selling, general and administrative | 65 | 77 | (15)% | 199 | 208 | (4)% |
| Operating cash flow* | 3 | 5 | (47)% | 13 | 10 | 28% |
| Depreciation, amortization and accretion | 7 | 7 | 5% | 22 | 20 | 10% |
| Total operating expenses | 72 | 84 | (14)% | 221 | 228 | (3)% |
| Operating loss | $(5) | $(2) | >(100)% | $(9) | $(10) | 9% |
| Loss before income taxes | $(6) | $(2) | >(100)% | $(12) | $(11) | (4)% |
| Adjusted EBITDA* | $3 | $5 | (45)% | $13 | $10 | 31% |
| Capital expenditures | $2 | $5 | (58)% | $6 | $19 | (71)% |

Numbers may not foot due to rounding.

* Represents a non-GAAP financial measure. Refer to Supplemental Information Relating to Non-GAAP Financial Measures within this MD&A for a reconciliation of this measure.

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Service revenues consist of:

- Cloud and hosting solutions
- Managed services
- Enterprise Resource Planning ("ERP") application management
- Professional services
- Co-location services
- IT hardware maintenance services

Equipment revenues consist of:

- IT hardware sales

Key components of changes in the statement of operations items were as follows:

Total Operating revenues

Service revenues decreased for the three months ended September 30, 2016 due to lower professional service sales. For the nine months ended September 30, 2016, Service revenues increased due primarily to higher maintenance sales.

Equipment and product sales revenues from sales of IT infrastructure hardware solutions decreased for the three and nine months ended September 30, 2016 due primarily to lower spending by existing customers. There was a corresponding decrease in Cost of equipment and products.

Cost of services

Cost of services were flat for the three months ended September 30, 2016 and decreased for the nine months ended September 30, 2016 due primarily to reduced employee expenses offset by higher maintenance and support costs.

Selling, general and administrative expenses

Selling, general and administrative expenses were relatively flat for the three months ended September 30, 2016 and increased for the nine months ended September 30, 2016 due primarily to higher employee costs.

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## Liquidity and Capital Resources

### Sources of Liquidity

TDS and its subsidiaries operate capital-intensive businesses. Historically, TDS has used internally-generated funds and also has obtained substantial funds from external sources for general corporate purposes. In the past, TDS' existing cash and investment balances, funds available under its revolving credit facilities, funds from other financing sources, including a term loan and other long-term debt, and cash flows from operating, investing and financing activities, including sales of assets or businesses, provided sufficient liquidity and financial flexibility for TDS to meet its normal day-to-day operating needs and debt service requirements, to finance the build-out and enhancement of markets and to fund acquisitions. There is no assurance that this will be the case in the future.

TDS believes that existing cash and investment balances, funds available under its revolving credit facilities, and expected cash flows from operating and investing activities provide liquidity for TDS to meet its normal day-to-day operating needs and debt service requirements for the coming year. Although TDS currently has a significant cash balance, in certain recent periods, TDS has incurred negative free cash flow (defined as Cash flows from operating activities less Cash paid for additions to property, plant and equipment) and this will continue in the future if operating results do not improve or capital expenditures are not reduced. TDS currently expects to have minimal free cash flow in 2016 due to anticipated growth in equipment installment plan receivables combined with significant capital expenditures.

TDS may require substantial additional capital for, among other uses, funding day-to-day operating needs, working capital, acquisitions of providers of wireless or wireline telecommunications services, cable markets, IT services or other businesses, spectrum license or system acquisitions, system development and network capacity expansion, debt service requirements, the repurchase of shares, the payment of dividends, or making additional investments. It may be necessary from time-to-time to increase the size of the existing revolving credit facilities, to put in place new credit facilities, or to obtain other forms of financing in order to fund potential expenditures. TDS' liquidity would be adversely affected if, among other things, TDS is unable to obtain short or long-term financing on acceptable terms, TDS makes significant spectrum license purchases in FCC auctions or from other parties, TDS makes significant business acquisitions, the LA Partnership discontinues or reduces distributions compared to historical levels, or Federal USF and/or other regulatory support payments continue to decline. In addition, although sales of assets or businesses by TDS have been an important source of liquidity in recent periods, TDS does not expect a similar level of such sales in the future, which will reduce a source of liquidity. In recent years, TDS' credit rating has declined to sub-investment grade.

There can be no assurance that sufficient funds will continue to be available to TDS or its subsidiaries on terms or at prices acceptable to TDS. Insufficient cash flows from operating activities, further changes in its credit ratings, defaults of the terms of debt or credit agreements, uncertainty of access to capital, deterioration in the capital markets, reduced regulatory capital at banks which in turn limits their ability to borrow and lend, other changes in the performance of TDS or in market conditions or other factors could limit or restrict the availability of financing on terms and prices acceptable to TDS, which could require TDS to reduce its acquisition, capital expenditure and business development programs, reduce the acquisition of spectrum licenses, and/or reduce or cease share repurchases and/or the payment of dividends. TDS cannot provide assurance that circumstances that could have a material adverse effect on its liquidity or capital resources will not occur. Any of the foregoing would have an adverse impact on TDS' businesses, financial condition or results of operations.

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Cash and Cash Equivalents

Cash and cash equivalents include cash and money market investments. The primary objective of TDS' Cash and cash equivalents investment activities is to preserve principal. Cash held by U.S. Cellular is for its operational needs and acquisition, capital expenditure and business development programs. TDS does not have direct access to U.S. Cellular cash unless U.S. Cellular pays a dividend on its common stock. U.S. Cellular has no current intention to pay a dividend to its shareholders.

At September 30, 2016 and December 31, 2015, TDS' consolidated cash and cash equivalents totaled $985 million. The majority of TDS' Cash and cash equivalents was held in bank deposit accounts and in money market funds that invest exclusively in U.S. Treasury Notes or in repurchase agreements fully collateralized by such obligations. TDS monitors the financial viability of the money market funds and direct investments in which it invests and believes that the credit risk associated with these investments is low.

Financing

TDS and U.S. Cellular have revolving credit facilities available for general corporate purposes. In June 2016, TDS entered into a new $400 million revolving credit agreement with certain lenders and other parties and U.S. Cellular entered into a new $300 million revolving credit agreement with certain lenders and other parties. As a result of the new agreements, TDS' and U.S. Cellular's revolving credit agreements due to expire in December 2017 were terminated. Amounts under both of the new revolving credit facilities may be borrowed, repaid and reborrowed from time-to-time until maturity in June 2021. Certain TDS and U.S. Cellular wholly-owned subsidiaries have jointly and severally unconditionally guaranteed the payment and performance of the obligations of TDS and U.S. Cellular under the revolving credit agreements. As of September 30, 2016, there were no outstanding borrowings under the revolving credit facilities, except for letters of credit, and TDS and U.S. Cellular's unused capacity under their revolving credit facilities was $399 million and $284 million, respectively. The continued availability of the new revolving credit facilities requires TDS and U.S. Cellular to comply with certain negative and affirmative covenants, maintain certain financial ratios and provide representations on certain matters at the time of each borrowing. See Note 8 — Debt in the Notes to Consolidated Financial Statements for additional information.

In June 2016, U.S. Cellular also amended and restated its senior term loan credit facility. Certain modifications were made to the financial covenants and subsidiary guarantees were added in order to align with the new revolving credit agreements. There were no significant changes to the maturity date or other key terms of the agreement.

TDS and U.S. Cellular believe they were in compliance with all of the financial covenants and requirements set forth in their revolving credit facilities and the senior term loan credit facility as of September 30, 2016.

TDS and U.S. Cellular have in place effective shelf registration statements on Form S-3 to issue senior or subordinated debt securities.

The proceeds from any of the aforementioned financing facilities are available for general corporate purposes, including spectrum purchases and capital expenditures.

The long-term debt payments due for the remainder of 2016 and the next four years represent less than 3% of TDS' total long-term debt obligation measured as of September 30, 2016.

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Capital Expenditures

Capital expenditures (i.e., additions to property, plant and equipment and system development expenditures), which include accruals and capitalized interest, in 2016 and 2015 were as follows:

U.S. Cellular's capital expenditures for 2016 are expected to be approximately $500 million. These expenditures are expected to be for the following general purposes:

- Expand and enhance network coverage, including construction of a new regional connectivity center and provide additional capacity to accommodate increased network usage, principally data usage, by current customers;
- Deploy VoLTE technology;
- Expand and enhance the retail store network; and
- Develop and enhance business systems.

TDS Telecom's capital expenditures for 2016 are expected to be $180 million. These expenditures are expected to be for the following general purposes:

- Maintain and enhance existing infrastructure at Wireline, Cable and HMS;
- Complete currently planned fiber expansion in existing Wireline markets and upgrades in Cable markets to support video and super high-speed data; and
- Success-based spending to sustain managedIP, IPTV, Cable and HMS growth.

TDS plans to finance its capital expenditures program for 2016 using primarily Cash flows from operating activities and, as necessary, existing cash balances and borrowings under its revolving credit agreements and/or other long-term debt.

Acquisitions, Divestitures and Exchanges

TDS may be engaged from time-to-time in negotiations relating to the acquisition, divestiture or exchange of companies, properties, wireless spectrum and other possible businesses. In general, TDS may not disclose such transactions until there is a definitive agreement. TDS assesses its business interests on an ongoing basis with a goal of improving the competitiveness of its operations and maximizing its long-term return on capital. As part of this strategy, TDS reviews attractive opportunities to acquire additional wireless operating markets and wireless spectrum; and telecommunications, cable, HMS or other possible businesses. TDS also may seek to divest outright or include in exchanges for other interests those interests that are not strategic to its long-term success.

On July 15, 2016, the FCC announced U.S. Cellular as a qualified bidder in the FCC's forward auction of 600 MHz spectrum licenses, referred to as Auction 1002, which then commenced on August 16, 2016. In recent FCC auctions, U.S. Cellular has not been a bidder, but has participated as a limited partner in "designated entities" that qualified for a 25% bidding credit on licenses won in the auction. U.S. Cellular will not participate through a designated entity in Auction 1002. See "Regulatory Matters — FCC Auction 1002." Prior to becoming a qualified bidder, U.S. Cellular was required to make an upfront payment, the size of which established its initial bidding eligibility. Accordingly, in the second quarter of 2016, U.S. Cellular made an upfront payment to the FCC of $143 million. If U.S. Cellular becomes a winning bidder in the auction, it could be required to make additional payments to the FCC that could be substantial. In such event, U.S. Cellular could finance such payments from its existing cash balances, borrowings under its revolving credit agreement and/or additional long-term debt. Further, if U.S. Cellular is not the winning bidder for any licenses, or is the winning bidder for licenses with an aggregate bid price that is less than the upfront payment, all or a portion of the upfront payment will be refunded to U.S. Cellular.

In 2015 and 2016, U.S. Cellular entered into multiple spectrum license purchase agreements. The aggregate purchase price for these spectrum licenses is $56 million, of which $46 million closed in the nine months ended September 30, 2016. In 2016, U.S. Cellular also entered into multiple agreements with third parties to transfer FCC licenses in non-operating markets and receive FCC licenses in operating markets. The agreements provide for the transfer of certain AWS and PCS spectrum licenses and approximately $29 million, net, in cash to U.S. Cellular, in exchange for U.S. Cellular transferring certain AWS, PCS and 700 MHz spectrum licenses to the third parties. Through September 30, 2016, certain of the exchange transactions have closed and U.S. Cellular has received $15 million of cash in conjunction with such closed transactions. The remaining license purchase and exchange transactions are expected to close in the fourth quarter of 2016. See Note 5 — Acquisitions, Divestitures and Exchanges in the Notes to Consolidated Financial Statements for additional information related to these transactions.

Variable Interest Entities

TDS consolidates certain entities as "variable interest entities" under GAAP. See Note 9 — Variable Interest Entities in the Notes to Consolidated Financial Statements for additional information related to these variable interest entities. TDS may elect to make capital contributions and/or advances to variable interest entities in order to fund their operations.

Common Share Repurchase Programs

TDS and U.S. Cellular have repurchased and expect to continue to repurchase their Common Shares, in each case subject to any available repurchase program. Share repurchases made under these programs in 2016 and 2015 were as follows:

| Nine Months Ended September 30, | Number of Shares | Average Cost Per Share | Dollar Amount (in millions) |
|---|---|---|---|
| 2016 | | | |
| TDS Common Shares | 111,700 | $22.56 | $ 3 |
| U.S. Cellular Common Shares | 46,861 | $34.77 | $ 2 |
| | | | |
| 2015 | | | |
| TDS Common Shares | – | $– | $ – |
| U.S. Cellular Common Shares | 153,878 | $34.85 | $ 5 |

For additional information related to the current TDS repurchase authorization, see Unregistered Sales of Equity Securities and Use of Proceeds.

On November 17, 2009, the Board of Directors of U.S. Cellular authorized the repurchase of up to 1,300,000 Common Shares on an annual basis beginning in 2009 and continuing each year thereafter, on a cumulative basis. As of September 30, 2016, the cumulative maximum number of shares that may be repurchased under this program is 6,008,437 U.S. Cellular Common Shares. These purchases will be made pursuant to open market purchases, block purchases, private purchases or otherwise, depending on market conditions. This authorization does not have an expiration date.

Contractual and Other Obligations

There were no material changes outside the ordinary course of business between December 31, 2015 and September 30, 2016 to the Contractual and Other Obligations disclosed in Management's Discussion and Analysis of Financial Condition and Results of Operations included in TDS' Form 10-K for the year ended December 31, 2015.

Off-Balance Sheet Arrangements

TDS had no transactions, agreements or other contractual arrangements with unconsolidated entities involving "off-balance sheet arrangements," as defined by SEC rules, that had or are reasonably likely to have a material current or future effect on its financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

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Consolidated Cash Flow Analysis

TDS operates a capital- and marketing-intensive business. TDS makes substantial investments to acquire wireless licenses and properties and to construct and upgrade communications networks and facilities as a basis for creating long-term value for shareholders. In recent years, rapid changes in technology and new opportunities have required substantial investments in potentially revenue enhancing and cost-reducing upgrades to TDS' networks. TDS utilizes cash on hand, cash from operating activities, cash proceeds from divestitures and dispositions of investments, short-term credit facilities and long-term debt financing to fund its acquisitions (including licenses), construction costs, operating expenses and share repurchases. Cash flows may fluctuate from quarter-to-quarter and year-to-year due to seasonality, the timing of acquisitions and divestitures, capital expenditures and other factors. The following discussion summarizes TDS' cash flow activities for the nine months ended September 30, 2016 and 2015.

2016 Commentary

TDS' Cash and cash equivalents remained flat in since December 31, 2015. Net cash provided by operating activities was $638 million in 2016 due primarily to net income of $58 million plus non-cash items of $641 million and distributions received from unconsolidated entities of $55 million, including a $10 million distribution from the LA Partnership. This was partially offset by changes in working capital items which decreased cash by $116 million. The decrease in working capital items was due primarily to a $160 million increase in equipment installment plan receivables, which are expected to continue to increase and further require the use of working capital in the near term. This was partially offset by a federal tax refund of $63 million related to an overpayment of the 2015 tax liability, which resulted from the enactment of federal bonus depreciation in December 2015.

The net cash provided by operating activities was offset by Cash flows used for investing activities of $594 million. Cash paid in 2016 for additions to property, plant and equipment totaled $426 million. In June 2016, U.S. Cellular made a deposit of $143 million to the FCC for its participation in Auction 1002. Cash paid for acquisitions and licenses in 2016 was $46 million partially offset by Cash received from divestitures and exchanges of $20 million. See Note 5 — Acquisitions, Divestitures and Exchanges in the Notes to Consolidated Financial Statements for additional information related to these transactions.

Cash flows used for financing activities were $44 million, reflecting ordinary activity such as the payment of dividends and the scheduled repayments of debt.

2015 Commentary

TDS' Cash and cash equivalents increased $393 million in 2015. Net cash provided by operating activities was $727 million in 2015 due to net income of $265 million plus non-cash items of $329 million, distributions received of $45 million and positive changes in working capital items of $88 million. The LA Partnership did not make a distribution in 2015.

Cash flows used for investing activities were $514 million in 2015. Cash paid for additions to property, plant and equipment totaled $558 million in 2015. During 2015, a $278 million payment was made by Advantage Spectrum L.P. (see Note 9 — Variable Interest Entities in the Notes to Consolidated Financial Statements) to the FCC for licenses for which it was the provisional winning bidder in Auction 97. Cash received from divestitures and exchanges in 2015 included $145 million related to licenses and $142 million related to the sale of 359 towers and certain related contracts, assets and liabilities.

Cash flows from financing activities were $180 million due primarily to U.S. Cellular borrowing $225 million on its senior term loan credit facility in July 2015.

Other Information

In October 2016, U.S. Cellular was informed by the general partner of the LA Partnership that U.S. Cellular will receive a distribution of $19 million in November 2016.

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Consolidated Balance Sheet Analysis

The following discussion addresses certain captions in the consolidated balance sheet and changes therein. This discussion is intended to highlight the significant changes and is not intended to fully reconcile the changes. Changes in financial condition during 2016 are as follows:

Income taxes receivable

Income taxes receivable decreased $64 million due primarily to the receipt of a federal income tax refund of $63 million in March 2016.

Assets held for sale

Assets held for sale increased $16 million due to reclassification of Licenses to this account as a result of exchanges with third parties. The license exchange agreements are expected to close in the fourth quarter of 2016. See Note 5 — Acquisitions, Divestitures and Exchanges in the Notes to Consolidated Financial Statements for additional information.

Other assets and deferred charges

Other assets and deferred charges increased $195 million due primarily to an upfront payment of $143 million to the FCC to establish U.S. Cellular's initial bidding eligibility for its participation in Auction 1002 and a $75 million increase in the long-term portion of unbilled equipment installment plan receivables, net, due to the offering of longer term equipment installment plan contracts and the increased adoption of such contracts. See Note 3 — Equipment Installment Plans and Note 5 — Acquisitions, Divestitures and Exchanges in the Notes to Consolidated Financial Statements for additional information related to these balances.

Other current liabilities

Other current liabilities decreased $42 million due primarily to a decline in the amounts due to U.S. Cellular agents driven by lower sales volume and mix shift to lower cost devices.

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Supplemental Information Relating to Non-GAAP Financial Measures

TDS sometimes uses information derived from consolidated financial information but not presented in its financial statements prepared in accordance with U.S. GAAP to evaluate the performance of its business. Certain of these measures are considered “non-GAAP financial measures” under U.S. Securities and Exchange Commission Rules. Specifically, TDS has referred to the following measures in this Form 10-Q Report:

- EBITDA
- Adjusted EBITDA
- Operating cash flow
- Free cash flow
- Adjusted free cash flow
- Postpaid ABPU
- Postpaid ABPA

Following are explanations of each of these measures.

Adjusted EBITDA and Operating Cash Flow

Adjusted EBITDA (earnings before interest, taxes, depreciation, amortization and accretion) is defined as net income adjusted for the items set forth in the reconciliation below. Operating cash flow is defined as net income adjusted for the items set forth in the reconciliation below. Adjusted EBITDA and Operating cash flow are not measures of financial performance under GAAP and should not be considered as alternatives to Net income or Cash flows from operating activities, as indicators of cash flows or as measures of liquidity. TDS does not intend to imply that any such items set forth in the reconciliation below are non-recurring, infrequent or unusual; such items may occur in the future.

Adjusted EBITDA is a segment measure reported to the chief operating decision maker for purposes of making decisions about allocating resources to the segments and assessing their performance. See Note 11 — Business Segment Information in the Notes to Consolidated Financial Statements for additional information.

Management uses Adjusted EBITDA and Operating cash flow as measurements of profitability, and therefore reconciliations to applicable GAAP income measures are deemed appropriate. Management believes Adjusted EBITDA and Operating cash flow are useful measures of TDS’ operating results before significant recurring non-cash charges, gains and losses, and other items as presented below as they provide additional relevant and useful information to investors and other users of TDS’ financial data in evaluating the effectiveness of its operations and underlying business trends in a manner that is consistent with management’s evaluation of business performance. Adjusted EBITDA shows adjusted earnings before interest, taxes, depreciation, amortization and accretion, and gains and losses, while Operating cash flow reduces this measure further to exclude Equity in earnings of unconsolidated entities and Interest and dividend income in order to more effectively show the performance of operating activities excluding investment activities. The following table reconciles Adjusted EBITDA and Operating cash flow to the corresponding GAAP measure, Net income or Income (loss) before income taxes. Income tax expense is not provided at the individual segment level for Wireline, Cable and HMS. TDS calculates income tax expense for TDS Telecom in total.

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| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| TDS - CONSOLIDATED | 2016 | 2015 | 2016 | 2015 |
| (Dollars in millions) | | | | |
| Net income (GAAP) | $16 | $62 | $58 | $265 |
| Add back: | | | | |
| Income tax expense | 14 | 46 | 45 | 178 |
| Interest expense | 42 | 35 | 127 | 103 |
| Depreciation, amortization and accretion | 214 | 211 | 636 | 628 |
| EBITDA (Non-GAAP) | 286 | 354 | 866 | 1,174 |
| Add back or deduct: | | | | |
| (Gain) loss on sale of business and other exit costs, net | – | (1) | (1) | (130) |
| (Gain) loss on license sales and exchanges, net | (7) | (24) | (16) | (147) |
| (Gain) loss on asset disposals, net | 8 | 5 | 20 | 15 |
| Adjusted EBITDA (Non-GAAP) | 287 | 334 | 869 | 912 |
| Deduct: | | | | |
| Equity in earnings of unconsolidated entities | 38 | 40 | 109 | 110 |
| Interest and dividend income | 15 | 10 | 44 | 28 |
| Other, net | (1) | – | 1 | – |
| Operating cash flow (Non-GAAP) | 235 | 284 | 715 | 774 |
| Deduct: | | | | |
| | 214 | 211 | 636 | 628 |

| | | | | |
|---|---|---|---|---|
| Depreciation, amortization and accretion | | | | |
| (Gain) loss on sale of business and other exit costs, net | – | (1) | (1) | (130) |
| (Gain) loss on license sales and exchanges, net | (7) | (24) | (16) | (147) |
| (Gain) loss on asset disposals, net | 8 | 5 | 20 | 15 |
| Operating income (GAAP) | $20 | $93 | $76 | $408 |

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| U.S. CELLULAR | 2016 | 2015 | 2016 | 2015 |
| (Dollars in millions) | | | | |
| Net income (GAAP) | $18 | $65 | $54 | $250 |
| Add back: | | | | |
| Income tax expense | 15 | 41 | 39 | 161 |
| Interest expense | 28 | 21 | 84 | 61 |
| Depreciation, amortization and accretion | 155 | 152 | 462 | 450 |
| EBITDA (Non-GAAP) | 216 | 279 | 639 | 922 |
| Add back or deduct: | | | | |
| (Gain) loss on sale of business and other exit costs, net | – | (1) | – | (114) |
| (Gain) loss on license sales and exchanges, net | (7) | (24) | (16) | (147) |
| (Gain) loss on asset disposals, net | 7 | 3 | 16 | 12 |
| | 216 | 257 | 639 | 673 |

| | | | | |
|---|---|---|---|---|
| Adjusted EBITDA (Non-GAAP) | | | | |
| Deduct: | | | | |
| Equity in earnings of unconsolidated entities | 38 | 40 | 110 | 110 |
| Interest and dividend income | 14 | 9 | 41 | 26 |
| Other, net | – | – | – | (1) |
| Operating cash flow (Non-GAAP) | 164 | 208 | 488 | 538 |
| Deduct: | | | | |
| Depreciation, amortization and accretion | 155 | 152 | 462 | 450 |
| (Gain) loss on sale of business and other exit costs, net | – | (1) | – | (114) |
| (Gain) loss on license sales and exchanges, net | (7) | (24) | (16) | (147) |
| (Gain) loss on asset disposals, net | 7 | 3 | 16 | 12 |
| Operating income (GAAP) | $9 | $78 | $26 | $337 |

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| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| TDS TELECOM | 2016 | 2015 | 2016 | 2015 |
| (Dollars in millions) | | | | |
| Net income (GAAP) | $7 | $9 | $32 | $38 |
| Add back: | | | | |
| Income tax expense | 4 | 8 | 20 | 27 |
| Interest expense | 1 | – | 2 | – |
| Depreciation, amortization and accretion | 57 | 57 | 168 | 170 |
| EBITDA (Non-GAAP) | 69 | 74 | 223 | 236 |
| Add back or deduct: | | | | |
| (Gain) loss on sale of business and other exit costs, net | – | – | – | (3) |
| (Gain) loss on asset disposals, net | 2 | 2 | 4 | 3 |
| Adjusted EBITDA (Non-GAAP) | 71 | 76 | 226 | 236 |
| Deduct: | | | | |
| Interest and dividend income | 1 | 1 | 2 | 2 |
| Operating cash flow (Non-GAAP) | 70 | 76 | 225 | 234 |
| Deduct: | | | | |
| Depreciation, amortization and accretion | 57 | 57 | 168 | 170 |
| (Gain) loss on sale of | – | – | – | (3) |

| | | | | |
|---|---|---|---|---|
| business and other exit costs, net | | | | |
| (Gain) loss on asset disposals, net | 2 | 2 | 4 | 3 |
| Operating income (GAAP) | $12 | $17 | $53 | $64 |

Numbers may not foot due to rounding.

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | September 30, | | September 30, | |
| WIRELINE | 2016 | 2015 | 2016 | 2015 |
| (Dollars in millions) | | | | |
| Income before income taxes (GAAP) | $17 | $19 | $63 | $70 |
| Add back: | | | | |
| Interest expense | – | – | (1) | (1) |
| Depreciation, amortization and accretion | 41 | 41 | 119 | 124 |
| EBITDA (Non-GAAP) | 57 | 60 | 182 | 193 |
| Add back or deduct: | | | | |
| (Gain) loss on sale of business and other exit costs, net | – | – | – | (3) |
| (Gain) loss on asset disposals, net | 1 | 2 | 2 | 3 |
| Adjusted EBITDA (Non-GAAP) | 58 | 61 | 183 | 193 |
| Deduct: | | | | |
| Interest and dividend | 1 | 1 | 2 | 2 |

| | | | | |
|---|---|---|---|---|
| income | | | | |
| Operating cash flow (Non-GAAP) | 57 | 61 | 182 | 192 |
| Deduct: | | | | |
| Depreciation, amortization and accretion | 41 | 41 | 119 | 124 |
| (Gain) loss on sale of business and other exit costs, net | – | – | – | (3) |
| (Gain) loss on asset disposals, net | 1 | 2 | 2 | 3 |
| Operating income (GAAP) | $16 | $18 | $61 | $67 |

Numbers may not foot due to rounding.

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| CABLE (Dollars in millions) | Three Months Ended September 30, 2016 | 2015 | Nine Months Ended September 30, 2016 | 2015 |
|---|---|---|---|---|
| Income before income taxes (GAAP) | $– | $1 | $1 | $7 |
| Add back: | | | | |
| Depreciation, amortization and accretion | 9 | 9 | 27 | 26 |
| EBITDA (Non-GAAP) | 9 | 10 | 28 | 32 |
| Add back or deduct: | | | | |
| (Gain) loss on asset disposals, net | 1 | – | 2 | (1) |
| Adjusted EBITDA (Non-GAAP) | 10 | 10 | 30 | 32 |
| Deduct: | | | | |
| Other, net | – | – | – | – |
| Operating cash flow (Non-GAAP) | 10 | 10 | 30 | 32 |
| Deduct: | | | | |
| Depreciation, amortization and accretion | 9 | 9 | 27 | 26 |
| (Gain) loss on asset disposals, net | 1 | – | 2 | (1) |
| Operating income (GAAP) | $– | $1 | $1 | $6 |

Numbers may not foot due to rounding.

| HMS | Three Months Ended September 30, 2016 | 2015 | Nine Months Ended September 30, 2016 | 2015 |
|---|---|---|---|---|
| (Dollars in millions) | | | | |
| Loss before income taxes (GAAP) | $ (6) | $ (2) | $ (12) | $ (11) |
| Add back: | | | | |
| Interest expense | 1 | 1 | 3 | 2 |
| Depreciation, amortization and accretion | 7 | 7 | 22 | 20 |
| EBITDA (Non-GAAP) | 3 | 5 | 13 | 10 |
| Add back or deduct: | | | | |
| (Gain) loss on asset disposals, net | – | – | – | – |
| Adjusted EBITDA (Non-GAAP) | 3 | 5 | 13 | 10 |
| Deduct: | | | | |
| Other, net | – | – | – | – |
| Operating cash flow (Non-GAAP) | 3 | 5 | 13 | 10 |
| Deduct: | | | | |
| Depreciation, amortization and accretion | 7 | 7 | 22 | 20 |
| (Gain) loss on asset disposals, net | – | – | – | – |
| Operating loss (GAAP) | $ (5) | $ (2) | $ (9) | $ (10) |

Numbers may not foot due to rounding.

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Free Cash Flow and Adjusted Free Cash Flow

The following table presents Free cash flow and Adjusted free cash flow. Management uses Free cash flow as a liquidity measure and it is defined as Cash flows from operating activities less Cash paid for additions to property, plant and equipment. Adjusted free cash flow is defined as Cash flows from operating activities (which includes cash outflows related to the Sprint decommissioning), as adjusted for cash proceeds from the Sprint Cost Reimbursement (which are included in Cash flows from investing activities in the Consolidated Statement of Cash Flows), less Cash paid for additions to property, plant and equipment. Free cash flow and Adjusted free cash flow are non-GAAP financial measures which TDS believes may be useful to investors and other users of its financial information in evaluating liquidity, specifically, the amount of cash generated by business operations (including cash proceeds from the Sprint Cost Reimbursement), after Cash paid for additions to property, plant and equipment.

| | Nine Months Ended September 30, | |
|---|---|---|
| | 2016 | 2015 |
| (Dollars in millions) | | |
| Cash flows from operating activities (GAAP) | $ 638 | $ 727 |
| Less: Cash paid for additions to property, plant and equipment | 426 | 558 |
| Free cash flow (Non-GAAP) | $ 212 | $ 169 |
| Add: Sprint Cost Reimbursement[1] | 5 | 28 |
| Adjusted free cash flow (Non-GAAP) | $ 217 | $ 197 |

1 On May 16, 2013, pursuant to a Purchase and Sale Agreement, U.S. Cellular sold customers and certain PCS spectrum licenses to subsidiaries of Sprint Corp. fka Sprint Nextel Corporation (“Sprint”) in U.S. Cellular’s Chicago, central Illinois, St. Louis and certain Indiana/Michigan/Ohio markets in consideration for $480

million in cash. The Purchase and Sale Agreement also contemplated certain other agreements. These agreements require Sprint to reimburse U.S. Cellular up to $200 million (the “Sprint Cost Reimbursement”) for certain network decommissioning costs, network site lease rent and termination costs, network access termination costs, and employee termination benefits for specified engineering employees.

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Postpaid ABPU and Postpaid ABPA

U.S. Cellular presents Postpaid ABPU and Postpaid ABPA to reflect the revenue shift from Service revenues to Equipment and product sales resulting from the increased adoption of equipment installment plans. Postpaid ABPU and Postpaid ABPA, as previously defined, are non-GAAP financial measures which U.S. Cellular believes are useful to investors and other users of its financial information in showing trends in both service and equipment and product sales revenues received from customers.

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 |
| (Dollars and connection counts in millions) | | | | |
| Calculation of Postpaid ARPU | | | | |
| Postpaid service revenues | $635 | $755 | $1,910 | $2,156 |
| Average number of postpaid connections | 4.49 | 4.33 | 4.46 | 4.31 |
| Number of months in period | 3 | 3 | 9 | 9 |
| Postpaid ARPU (GAAP metric) | $47.08 | $58.12 | $47.54 | $55.54 |
| | | | | |
| Calculation of Postpaid ABPU | | | | |
| Postpaid service revenues | $635 | $755 | $1,910 | $2,156 |
| Equipment installment plan billings | 131 | 75 | 353 | 180 |
| Total billings to postpaid connections | $766 | $830 | $2,263 | $2,336 |
| Average number of postpaid connections | 4.49 | 4.33 | 4.46 | 4.31 |
| Number of months in period | 3 | 3 | 9 | 9 |
| | $56.79 | $63.88 | $56.34 | $60.15 |

| | | | | |
|---|---|---|---|---|
| Postpaid ABPU (Non-GAAP metric) | | | | |
| | | | | |
| Calculation of Postpaid ARPA | | | | |
| Postpaid service revenues | $635 | $755 | $1,910 | $2,156 |
| Average number of postpaid accounts | 1.69 | 1.71 | 1.69 | 1.73 |
| Number of months in period | 3 | 3 | 9 | 9 |
| Postpaid ARPA (GAAP metric) | $125.31 | $147.00 | $125.21 | $138.55 |
| | | | | |
| Calculation of Postpaid ABPA | | | | |
| Postpaid service revenues | $635 | $755 | $1,910 | $2,156 |
| Equipment installment plan billings | 131 | 75 | 353 | 180 |
| Total billings to postpaid accounts | $766 | $830 | $2,263 | $2,336 |
| Average number of postpaid accounts | 1.69 | 1.71 | 1.69 | 1.73 |
| Number of months in period | 3 | 3 | 9 | 9 |
| Postpaid ABPA (Non-GAAP metric) | $151.16 | $161.57 | $148.37 | $150.06 |

Application of Critical Accounting Policies and Estimates

TDS prepares its consolidated financial statements in accordance with GAAP.  TDS' significant accounting policies are discussed in detail in Note 1 — Summary of Significant Accounting Policies and Recent Accounting Pronouncements in the Notes to Consolidated Financial Statements and TDS' Application of Critical Accounting Policies and Estimates is discussed in detail in Management's Discussion and Analysis of Financial Condition and Results of Operations, both of which are included in TDS' Form 10-K for the year ended December 31, 2015.  There were no material changes to TDS' application of critical accounting policies and estimates during the nine months ended September 30, 2016.

Recent Accounting Pronouncements

See Note 1 — Basis of Presentation in the Notes to Consolidated Financial Statements for information on recent accounting pronouncements.

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## Regulatory Matters

The discussion below includes updates related to recent regulatory developments. These updates should be read in conjunction with the disclosures previously provided under "Regulatory Matters" in TDS' Form 10-K for the year ended December 31, 2015.

### FCC Auction 1002

On July 15, 2016, the FCC announced U.S. Cellular as a qualified bidder in the FCC's forward auction of 600 MHz spectrum licenses, referred to as Auction 1002. The first stage of forward auction bidding began on August 16, 2016 and ended on August 30, 2016 when the forward auction failed to reach the reserve price established by the FCC based on the first stage reverse auction. The second stage of the reverse auction began on September 13, 2016 and was followed by a second stage forward auction which began and ended on October 19, 2016. As necessary, the FCC will run additional reverse and forward auctions that will result in progressively lower prices in each reverse auction and less available spectrum for wireless carriers in each forward auction, until the prices in the reverse and forward auctions clear. Following a final and successful stage of the forward auction, the FCC will conduct an Assignment Phase Auction to assign specific frequencies to winners of licenses. It is expected that this process will continue into 2017. As a result of U.S. Cellular's application to participate in Auction 1002, since February 10, 2016, TDS has been subject to FCC anti-collusion rules that place certain restrictions on public disclosures and business communications with other companies relating to U.S. Cellular's participation. These restrictions will continue until the down payment deadline for Auction 1002, which will be ten business days after release of the FCC's Channel Reassignment Public Notice, following the end of the auction. These anti-collusion rules, which could last a year or more from February 10, 2016, may restrict the conduct of certain TDS activities with other auction applicants as well as with nationwide providers of wireless services which are not applicants. The restrictions could have an adverse effect on TDS' business, financial condition or results of operations.

### FCC Connect America Fund (CAF)

On March 30, 2016, the FCC released an order modifying the existing USF program under which TDS receives approximately $50 million in annual support. The modification extends the Connect America Fund (CAF) program to rate-of-return incumbent local exchange carriers for the purpose of extending broadband services, including standalone broadband, in underserved and unserved rural areas. The FCC is providing rate-of-return carriers with two paths to receive funds from the CAF. The first path includes a voluntary model-based approach and includes support for a ten-year period in exchange for meeting defined build-out obligations, referred to as the Alternative Connect America Cost Model ("A-CAM"). This election must be done at the state level. The second path is based on existing rate-of-return mechanisms, but with substantial modifications. This path also includes defined build-out obligations. In August 2016, TDS Telecom obtained an offer ("the Offer") from the FCC of the amount of support that would be received if it elected the A-CAM path. Under the Offer and replacing its current level of funding, TDS Telecom would receive $82 million of support revenue annually for ten years. Unlike the current program, this support comes with an obligation to build defined broadband speeds to reach approximately 159,600 homes and will require capital expenditures over the ten-year period that may be significant.

TDS Telecom notified the FCC of its decision to elect A-CAM support and the associated obligations for all of its states. On November 2, 2016, the FCC released a notice stating that 216 rate-of-return carriers elected the A-CAM model. Based upon carrier elections, the FCC's stated support funding level would not be sufficient to meet the demand. The FCC has requested that parties file recommendations on measures that should be considered to address the support funding shortfall. Comments are due to the FCC by November 14, 2016. If the FCC issues revised offers to those carriers initially electing A-CAM, the carriers will then need to make another decision based on the updated offers. TDS Telecom cannot predict the likelihood of a second offer from the FCC or the details of such an offer. There is no assurance that the final A-CAM option will provide TDS Telecom with the level of support it received under previous federal support mechanisms.

FCC Net Neutrality Order

TDS previously disclosed that the FCC adopted rules relating to net neutrality which reclassified broadband internet access service under Title II, and that lawsuits had been filed challenging such rules and reclassification. In June 2016, the U.S. Court of Appeals for the District of Columbia Circuit upheld the FCC's rules and reclassification. A request for a rehearing of this decision was filed in July 2016, and it is expected that this court decision also will be appealed and subject to further proceedings. TDS cannot predict the outcome of any further proceedings or the impact on its business.

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Private Securities Litigation Reform Act of 1995

Safe Harbor Cautionary Statement

This Form 10-Q, including exhibits, contains statements that are not based on historical facts and represent forward-looking statements, as this term is defined in the Private Securities Litigation Reform Act of 1995. All statements, other than statements of historical facts, that address activities, events or developments that TDS intends, expects, projects, believes, estimates, plans or anticipates will or may occur in the future are forward-looking statements. The words "believes," "anticipates," "estimates," "expects," "plans," "intends," "projects" and similar expressions intended to identify these forward-looking statements, but are not the exclusive means of identifying them. Such forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause actual results, events or developments to be significantly different from any future results, events or developments expressed or implied by such forward-looking statements. Such risks, uncertainties and other factors include those set forth below, as more fully described under "Risk Factors" in TDS' Form 10-K for the year ended December 31, 2015. However, such factors are not necessarily all of the important factors that could cause actual results, performance or achievements to differ materially from those expressed in, or implied by, the forward-looking statements contained in this document. Other unknown or unpredictable factors also could have material adverse effects on future results, performance or achievements. TDS undertakes no obligation to update publicly any forward-looking statements whether as a result of new information, future events or otherwise. You should carefully consider the Risk Factors in TDS' Form 10-K for the year ended December 31, 2015, the following factors and other information contained in, or incorporated by reference into, this Form 10-Q to understand the material risks relating to TDS' business.

- Intense competition in the markets in which TDS operates could adversely affect TDS' revenues or increase its costs to compete.
- A failure by TDS to successfully execute its business strategy (including planned acquisitions, spectrum acquisitions, divestitures and exchanges) or allocate resources or capital could have an adverse effect on TDS' business, financial condition or results of operations.
- Uncertainty in TDS' future cash flow and liquidity or in the ability to access capital, deterioration in the capital markets, other changes in TDS' performance or market conditions, changes in TDS' credit ratings or other factors could limit or restrict the availability of financing on terms and prices acceptable to TDS, which could require TDS to reduce its construction, development or acquisition programs, reduce the acquisition of spectrum licenses, and/or reduce or cease share repurchases and/or the payment of dividends.
- TDS has a significant amount of indebtedness which could adversely affect its financial performance and in turn adversely affect its ability to make payments on its indebtedness, comply with terms of debt covenants and incur additional debt.
- Changes in roaming practices or other factors could cause TDS' roaming revenues to decline from current levels, roaming expenses to increase from current levels and/or impact TDS' ability to service its customers in geographic areas where TDS does not have its own network, which could have an adverse effect on TDS' business, financial condition or results of operations.
- A failure by TDS to obtain access to adequate radio spectrum to meet current or anticipated future needs and/or to accurately predict future needs for radio spectrum could have an adverse effect on TDS' business, financial condition or results of operations.

- ♦ To the extent conducted by the FCC, TDS may participate in FCC auctions of additional spectrum in the future directly or indirectly and, during certain periods, will be subject to the FCC's anti-collusion rules, which could have an adverse effect on TDS.
- ♦ Changes in the regulatory environment or a failure by TDS to timely or fully comply with any applicable regulatory requirements could adversely affect TDS' business, financial condition or results of operations.
- ♦ An inability to attract people of outstanding potential, to develop their potential through education and assignments, and to retain them by keeping them engaged, challenged and properly rewarded could have an adverse effect on TDS' business, financial condition or results of operations.
- ♦ TDS' assets are concentrated primarily in the U.S. telecommunications industry. Consequently, its operating results may fluctuate based on factors related primarily to conditions in this industry.
- ♦ TDS' smaller scale relative to larger competitors that may have much greater financial and other resources than TDS could cause TDS to be unable to compete successfully, which could adversely affect its business, financial condition or results of operations.
- ♦ Changes in various business factors, including changes in demand, customer preferences and perceptions, price competition, churn from customer switching activity and other factors, could have an adverse effect on TDS' business, financial condition or results of operations.

- Advances or changes in technology could render certain technologies used by TDS obsolete, could put TDS at a competitive disadvantage, could reduce TDS' revenues or could increase its costs of doing business.
- Complexities associated with deploying new technologies present substantial risk and TDS' investments in unproven technologies may not produce the benefits that TDS expects.
- TDS receives regulatory support and is subject to numerous surcharges and fees from federal, state and local governments, and the applicability and the amount of the support and fees are subject to great uncertainty.
- Performance under device purchase agreements could have a material adverse impact on TDS' business, financial condition or results of operations.
- Changes in TDS' enterprise value, changes in the market supply or demand for wireless licenses, wireline or cable markets or IT service providers, adverse developments in the businesses or the industries in which TDS is involved and/or other factors could require TDS to recognize impairments in the carrying value of its licenses, goodwill, franchise rights and/or physical assets.
- Costs, integration problems or other factors associated with acquisitions, divestitures or exchanges of properties or licenses and/or expansion of TDS' businesses could have an adverse effect on TDS' business, financial condition or results of operations.
- TDS offers customers the option to purchase certain devices under installment contracts which, compared to fixed-term service contracts, includes risks that TDS may possibly incur greater churn, lower cash flows, increased costs and/or increased bad debts expense due to differences in contract terms, which could have an adverse impact on TDS' financial condition or results of operations.
- A failure by TDS to complete significant network construction and systems implementation activities as part of its plans to improve the quality, coverage, capabilities and capacity of its networks and support systems could have an adverse effect on its operations.
- Difficulties involving third parties with which TDS does business, including changes in TDS' relationships with or financial or operational difficulties of key suppliers or independent agents and third party national retailers who market TDS' services, could adversely affect TDS' business, financial condition or results of operations.
- TDS has significant investments in entities that it does not control. Losses in the value of such investments could have an adverse effect on TDS' financial condition or results of operations.
- A failure by TDS to maintain flexible and capable telecommunication networks or information technology, or a material disruption thereof, could have an adverse effect on TDS' business, financial condition or results of operations.
- TDS has experienced and, in the future, expects to experience cyber-attacks or other breaches of network or information technology security of varying degrees on a regular basis, which could have an adverse effect on TDS' business, financial condition or results of operations.
- The market price of TDS' Common Shares is subject to fluctuations due to a variety of factors.
- Changes in facts or circumstances, including new or additional information, could require TDS to record charges in excess of amounts accrued in the financial statements, which could have an adverse effect on TDS' business, financial condition or results of operations.
- Disruption in credit or other financial markets, a deterioration of U.S. or global economic conditions or other events could, among other things, impede TDS' access to or increase the cost of financing its operating and investment activities and/or result in reduced revenues and lower operating income and cash flows, which would have an adverse effect on TDS' business, financial condition or results of operations.
- Settlements, judgments, restraints on its current or future manner of doing business and/or legal costs resulting from pending and future litigation could have an adverse effect on TDS' business, financial condition or results of operations.

- ♦ The possible development of adverse precedent in litigation or conclusions in professional studies to the effect that radio frequency emissions from wireless devices and/or cell sites cause harmful health consequences, including cancer or tumors, or may interfere with various electronic medical devices such as pacemakers, could have an adverse effect on TDS' wireless business, financial condition or results of operations.
- ♦ Claims of infringement of intellectual property and proprietary rights of others, primarily involving patent infringement claims, could prevent TDS from using necessary technology to provide products or services or subject TDS to expensive intellectual property litigation or monetary penalties, which could have an adverse effect on TDS' business, financial condition or results of operations.

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- ♦ Certain matters, such as control by the TDS Voting Trust and provisions in the TDS Restated Certificate of Incorporation, may serve to discourage or make more difficult a change in control of TDS.
- ♦ Any of the foregoing events or other events could cause revenues, earnings, capital expenditures and/or any other financial or statistical information to vary from TDS' forward-looking estimates by a material amount.

Risk Factors

In addition to the information set forth in this Form 10-Q, you should carefully consider the factors discussed in Part I, "Item 1A. Risk Factors" in TDS' Annual Report on Form 10-K for the year ended December 31, 2015, which could materially affect TDS' business, financial condition or future results. The risks described in this Form 10-Q and the Form 10-K for the year ended December 31, 2015, may not be the only risks that could affect TDS. Additional unidentified or unrecognized risks and uncertainties could materially adversely affect TDS' business, financial condition and/or operating results. Subject to the foregoing, TDS has not identified for disclosure any material changes to the risk factors as previously disclosed in TDS' Annual Report on Form 10-K for the year ended December 31, 2015.

Quantitative and Qualitative Disclosures about Market Risk

MARKET RISK

Refer to the disclosure under Market Risk in TDS' Form 10-K for the year ended December 31, 2015 for additional information, including information regarding required principal payments and the weighted average interest rates related to TDS' Long-term debt. There have been no material changes to such information since December 31, 2015. See Note 8 — Debt in the Notes to Consolidated Financial Statements for additional information.

See Note 2 — Fair Value Measurements in the Notes to Consolidated Financial Statements for additional information related to the fair value of TDS' Long-term debt as of September 30, 2016.

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Financial Statements

Telephone and Data Systems, Inc.

Consolidated Statement of Operations

(Unaudited)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 |
| (Dollars and shares in millions, except per share amounts) | | | | |
| Operating revenues | | | | |
| Service | $1,013 | $1,138 | $3,021 | $3,282 |
| Equipment and product sales | 288 | 236 | 805 | 620 |
| Total operating revenues | 1,301 | 1,374 | 3,826 | 3,902 |
| | | | | |
| Operating expenses | | | | |
| Cost of services (excluding Depreciation, amortization and accretion reported below) | 305 | 303 | 891 | 897 |
| Cost of equipment and products | 321 | 337 | 921 | 907 |
| Selling, general and administrative | 440 | 450 | 1,299 | 1,324 |
| Depreciation, amortization and | 214 | 211 | 636 | 628 |

| | | | | |
|---|---|---|---|---|
| accretion | | | | |
| (Gain) loss on asset disposals, net | 8 | 5 | 20 | 15 |
| (Gain) loss on sale of business and other exit costs, net | – | (1) | (1) | (130) |
| (Gain) loss on license sales and exchanges, net | (7) | (24) | (16) | (147) |
| Total operating expenses | 1,281 | 1,281 | 3,750 | 3,494 |
| Operating income | 20 | 93 | 76 | 408 |
| Investment and other income (expense) | | | | |
| Equity in earnings of unconsolidated entities | 38 | 40 | 109 | 110 |
| Interest and dividend income | 15 | 10 | 44 | 28 |
| Interest expense | (42) | (35) | (127) | (103) |
| Other, net | (1) | – | 1 | – |
| Total investment and other income | 10 | 15 | 27 | 35 |
| Income before income taxes | 30 | 108 | 103 | 443 |
| Income tax expense | 14 | 46 | 45 | 178 |
| Net income | 16 | 62 | 58 | 265 |
| Less: Net income attributable to noncontrolling interests, net of tax | 3 | 11 | 9 | 45 |
| Net income attributable to TDS shareholders | 13 | 51 | 49 | 220 |
| TDS Preferred dividend requirement | – | – | – | – |
| Net income available to TDS | $13 | $51 | $49 | $220 |

| | | | | |
|---|---|---|---|---|
| common shareholders | | | | |
| Basic weighted average shares outstanding | 110 | 109 | 110 | 109 |
| Basic earnings per share available to TDS common shareholders | $0.12 | $0.47 | $0.44 | $2.03 |
| Diluted weighted average shares outstanding | 111 | 110 | 111 | 110 |
| Diluted earnings per share available to TDS common shareholders | $0.11 | $0.46 | $0.44 | $1.99 |
| Dividends per share to TDS shareholders | $0.148 | $0.141 | $0.444 | $0.423 |

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

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Telephone and Data Systems, Inc.

Consolidated Statement of Comprehensive Income

(Unaudited)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 |
| (Dollars in millions) | | | | |
| Net income | $16 | $62 | $58 | $265 |
| Net change in accumulated other comprehensive income | | | | |
| Change related to retirement plan | | | | |
| Amounts included in net periodic benefit cost for the period | | | | |
| Change in prior service cost | – | (8) | (1) | (10) |
| Change in unrecognized net loss | – | (1) | – | (1) |
| | – | (9) | (1) | (11) |
| Change in deferred income taxes | – | 3 | 1 | 4 |
| Change related to retirement plan, net of tax | – | (6) | – | (7) |
| Net change in accumulated other comprehensive income | – | (6) | – | (7) |
| Comprehensive income | 16 | 56 | 58 | 258 |
| Less: Net income attributable to noncontrolling interests, net of tax | 3 | 11 | 9 | 45 |
| Comprehensive income attributable to TDS shareholders | $13 | $45 | $49 | $213 |

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

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Telephone and Data Systems, Inc.

Consolidated Statement of Cash Flows

(Unaudited)

| | Nine Months Ended September 30, | |
|---|---|---|
| | 2016 | 2015 |
| (Dollars in millions) | | |
| Cash flows from operating activities | | |
| Net income | $58 | $265 |
| Add (deduct) adjustments to reconcile net income to net cash flows | | |
| from operating activities | | |
| Depreciation, amortization and accretion | 636 | 628 |
| Bad debts expense | 72 | 83 |
| Stock-based compensation expense | 29 | 29 |
| Deferred income taxes, net | 11 | (40) |
| Equity in earnings of unconsolidated entities | (109) | (110) |
| Distributions from unconsolidated entities | 55 | 45 |
| (Gain) loss on asset disposals, net | 20 | 15 |
| (Gain) loss on sale of business and other exit costs, net | (1) | (130) |
| (Gain) loss on license sales and exchanges, net | (16) | (147) |
| Noncash interest expense | 2 | 2 |
| Other operating activities | (3) | (1) |
| Changes in assets and liabilities from operations | | |
| Accounts receivable | (9) | (94) |
| Equipment installment plans receivable | (160) | (96) |
| Inventory | 3 | 90 |
| Accounts payable | 47 | 125 |
| Customer deposits and deferred revenues | (41) | (50) |
| Accrued taxes | 77 | 212 |
| Accrued interest | 7 | 11 |
| Other assets and liabilities | (40) | (110) |
| Net cash provided by operating activities | 638 | 727 |
| | | |
| Cash flows from investing activities | | |
| Cash paid for additions to property, plant and equipment | (426) | (558) |
| Cash paid for acquisitions and licenses | (46) | (287) |
| Cash received from divestitures and exchanges | 20 | 325 |
| Federal Communications Commission deposit | (143) | – |

| | | |
|---|---|---|
| Other investing activities | 1 | 6 |
| Net cash used in investing activities | (594) | (514) |
| | | |
| Cash flows from financing activities | | |
| Issuance of long-term debt | 2 | 225 |
| Repayment of long-term debt | (9) | (1) |
| TDS Common Shares reissued for benefit plans, net of tax payments | 7 | 11 |
| U.S. Cellular Common Shares reissued for benefit plans, net of tax payments | 4 | (1) |
| Repurchase of TDS Common Shares | (3) | – |
| Repurchase of U.S. Cellular Common Shares | (2) | (4) |
| Dividends paid to TDS shareholders | (49) | (46) |
| Payment of debt issuance costs | (4) | (3) |
| Distributions to noncontrolling interests | (1) | (6) |
| Other financing activities | 11 | 5 |
| Net cash provided by (used in) financing activities | (44) | 180 |
| | | |
| Net increase (decrease) in cash and cash equivalents | – | 393 |
| | | |
| Cash and cash equivalents | | |
| Beginning of period | 985 | 472 |
| End of period | $985 | $865 |

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

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Telephone and Data Systems, Inc.

Consolidated Balance Sheet — Assets

(Unaudited)

| (Dollars in millions) | September 30, 2016 | December 31, 2015 |
|---|---|---|
| Current assets | | |
| Cash and cash equivalents | $ 985 | $ 985 |
| Accounts receivable | | |
| Due from customers and agents, less allowances of $54 and $49, respectively | 725 | 705 |
| Other, less allowances of $1 and $1, respectively | 99 | 98 |
| Inventory, net | 148 | 158 |
| Prepaid expenses | 113 | 112 |
| Income taxes receivable | 6 | 70 |
| Other current assets | 34 | 30 |
| Total current assets | 2,110 | 2,158 |
| | | |
| Assets held for sale | 16 | – |
| | | |
| Licenses | 1,876 | 1,844 |
| Goodwill | 766 | 766 |
| Franchise rights | 244 | 244 |
| Other intangible assets, net of accumulated amortization of $150 and $144, respectively | 36 | 47 |
| Investments in unconsolidated entities | 459 | 402 |
| Other investments | 1 | – |
| | | |
| Property, plant and equipment | | |
| In service and under construction | 11,551 | 11,520 |
| Less: Accumulated depreciation and amortization | 8,002 | 7,756 |

| | | |
|---|---|---|
| Property, plant and equipment, net | 3,549 | 3,764 |
| Other assets and deferred charges | 392 | 197 |
| Total assets1 | $ 9,449 | $ 9,422 |

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

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Telephone and Data Systems, Inc.

Consolidated Balance Sheet — Liabilities and Equity

(Unaudited)

| | September 30, 2016 | December 31, 2015 |
|---|---|---|
| (Dollars and shares in millions, except per share amounts) | | |
| Current liabilities | | |
| Current portion of long-term debt | $ 12 | $ 14 |
| Accounts payable | 366 | 349 |
| Customer deposits and deferred revenues | 242 | 288 |
| Accrued interest | 19 | 12 |
| Accrued taxes | 48 | 41 |
| Accrued compensation | 115 | 113 |
| Other current liabilities | 85 | 127 |
| Total current liabilities | 887 | 944 |
| | | |
| Deferred liabilities and credits | | |
| Deferred income tax liability, net | 910 | 900 |
| Other deferred liabilities and credits | 461 | 433 |
| | | |
| Long-term debt, net | 2,436 | 2,440 |
| | | |
| Commitments and contingencies | | |
| | | |
| Noncontrolling interests with redemption features | 1 | 1 |
| | | |
| Equity | | |
| TDS shareholders' equity | | |
| Series A Common and Common Shares | | |
| Authorized 290 shares (25 Series A Common and 265 Common Shares) | | |
| Issued 133 shares (7 Series A Common and 126 Common Shares) | | |
| Outstanding 110 shares (7 Series A Common and 103 Common Shares) and 109 shares (7 Series A Common and 102 Common Shares), respectively | | |
| Par Value ($.01 per share) | 1 | 1 |
| Capital in excess of par value | 2,373 | 2,365 |
| Treasury shares, at cost, 23 and 24 Common Shares, respectively | (703) | (727) |
| Accumulated other comprehensive income (loss) | – | – |
| Retained earnings | 2,477 | 2,487 |

| | | |
|---|---|---|
| Total TDS shareholders' equity | 4,148 | 4,126 |
| Preferred shares | 1 | 1 |
| Noncontrolling interests | 605 | 577 |
| Total equity | 4,754 | 4,704 |
| Total liabilities and equity[1] | $ 9,449 | $ 9,422 |

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

1 The consolidated total assets as of September 30, 2016 and December 31, 2015 include assets held by consolidated VIEs of $805 million and $658 million, respectively, which are not available to be used to settle the obligations of TDS. The consolidated total liabilities as of September 30, 2016 and December 31, 2015 include certain liabilities of consolidated VIEs of $15 million and $1 million, respectively, for which the creditors of the VIEs have no recourse to the general credit of TDS. See Note 9 — Variable Interest Entities for additional information.

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Telephone and Data Systems, Inc.

Consolidated Statement of Changes in Equity

(Unaudited)

| | TDS Shareholders | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| (Dollars in millions) | Series A Common and Common shares | Capital in excess of par value | Treasury shares | Accumulated other comprehensive income (loss) | Retained earnings | Total TDS shareholders' equity | Preferred shares | Noncontrolling interests | Total equity |
| December 31, 2015 | $ 1 | $ 2,365 | $ (727) | $ – | $ 2,487 | $ 4,126 | $ 1 | $ 577 | $ 4,704 |
| Net income attributable to TDS shareholders | – | – | – | – | 49 | 49 | – | – | 49 |
| Net income attributable to noncontrolling interests classified | – | – | – | – | – | – | – | 9 | 9 |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| as equity TDS Common and Series A | – | – | – | – | (49) | (49) | – | – | (49) |
| Common share dividends Repurchase of Common | – | – | (3) | – | – | (3) | – | – | (3) |
| shares Dividend reinvestment plan | – | 2 | 5 | – | – | 7 | – | – | 7 |
| Incentive and compensation | – | (5) | 22 | – | (10) | 7 | – | – | 7 |
| plans Adjust investment in subsidiaries for repurchases, | – | 1 | – | – | – | 1 | – | 20 | 21 |
| issuances and other compensation plans Stock-based compensation | – | 10 | – | – | – | 10 | – | – | 10 |
| awards Distributions to | – | – | – | – | – | – | – | (1) | (1) |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| noncontrolling interests | | | | | | | | | |
| September 30, 2016 | $ 1 | $ 2,373 | $ (703) | $ – | $ 2,477 | $ 4,148 | $ 1 | $ 605 | $ 4,754 |

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

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Telephone and Data Systems, Inc.

Consolidated Statement of Changes in Equity

(Unaudited)

| | TDS Shareholders | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| (Dollars in millions) | Series A Common and Common shares | Capital in excess of par value | Treasury shares | Accumulated other comprehensive income (loss) | Retained earnings | Total TDS shareholders' equity | Preferred shares | Noncontrolling interests | Total equity |
| December 31, 2014 | $ 1 | $ 2,337 | $ (748) | $ 6 | $ 2,330 | $ 3,926 | $ 1 | $ 528 | $ 4,455 |
| Net income attributable to TDS shareholders | – | – | – | – | 220 | 220 | – | – | 220 |
| Net income attributable to noncontrolling interests classified as | – | – | – | – | – | – | – | 39 | 39 |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| equity | | | | | | | | | |
| Other comprehensive income | – | – | – | (7) | – | (7) | – | – | (7) |
| TDS Common and Series A Common share dividends | – | – | – | – | (46) | (46) | – | – | (46) |
| Dividend reinvestment plan | – | 2 | 6 | – | – | 8 | – | – | 8 |
| Incentive and compensation plans | – | 1 | 11 | – | – | 12 | – | – | 12 |
| Adjust investment in subsidiaries for repurchases, issuances and other compensation plans | – | 2 | – | – | – | 2 | – | 9 | 11 |
| Stock-based compensation awards | – | 11 | – | – | – | 11 | – | – | 11 |
| September 30, 2015 | $ 1 | $ 2,353 | $ (731) | $ (1) | $ 2,504 | $ 4,126 | $ 1 | $ 576 | $ 4,703 |

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

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Telephone and Data Systems, Inc.

Notes to Consolidated Financial Statements

Note 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 ("GAAP") as set forth in the Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC"). The consolidated financial statements include the accounts of TDS and subsidiaries in which it has a controlling financial interest, including TDS' 83%-owned wireless telephone subsidiary, United States Cellular Corporation ("U.S. Cellular") and TDS' wholly-owned subsidiary, TDS Telecommunications Corporation ("TDS Telecom"). In addition, the consolidated financial statements include certain entities in which TDS has a variable interest that require consolidation under GAAP. All material intercompany accounts and transactions have been eliminated.

The unaudited consolidated financial statements included herein have been prepared by TDS 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 GAAP have been condensed or omitted pursuant to such rules and regulations. However, TDS believes that the disclosures included herein are adequate to make the information presented not misleading. Calculated amounts and percentages are based on the underlying actual numbers rather than the numbers rounded to millions as presented. These unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in TDS' Annual Report on Form 10-K ("Form 10-K") for the year ended December 31, 2015.

TDS' business segments reflected in this Quarterly Report on Form 10-Q for the period ended September 30, 2016 are U.S. Cellular, Wireline, Cable, and Hosted and Managed Services ("HMS") operations. TDS' non-reportable other business activities are presented as "Corporate, Eliminations and Other", which includes the operations of TDS' wholly-owned subsidiary Suttle-Straus, Inc. ("Suttle-Straus"). Suttle-Straus' financial results were not significant to TDS' operations. All of TDS' segments operate only in the United States, except for HMS, which includes an insignificant foreign operation. See Note 11 — Business Segment Information for summary financial information on each business segment.

The accompanying unaudited consolidated financial statements contain all adjustments (consisting of normal recurring items, unless otherwise disclosed) necessary for the fair statement of TDS' financial position as of September 30, 2016 and December 31, 2015, its results of operations and comprehensive income for the three and nine months ended September 30, 2016 and 2015, and its cash flows and changes in equity for the nine months ended September 30, 2016 and 2015. These results are not necessarily indicative of the results to be expected for the full year.

Recently Issued Accounting Pronouncements

In May 2014, the FASB issued Accounting Standards Update 2014-09, Revenue from Contracts with Customers ("ASU 2014-09") and has since amended the standard with Accounting Standards Update 2015-14, Revenue from Contracts with Customers: Deferral of the Effective Date, Accounting Standards Update 2016-08, Revenue from

Contracts with Customers: Principal versus Agent Considerations (Reporting Revenue Gross versus Net), Accounting Standards Update 2016-10, Revenue from Contracts with Customers: Identifying Performance Obligations and Licensing, and Accounting Standards Update 2016-12, Revenue from Contracts with Customers: Narrow-Scope Improvements and Practical Expedients. These standards replace existing revenue recognition rules with a single comprehensive model to use in accounting for revenue arising from contracts with customers. TDS is required to adopt ASU 2014-09, as amended, on January 1, 2018. Early adoption as of January 1, 2017 is permitted; however, TDS does not intend to adopt early. ASU 2014-09, as amended, impacts TDS' revenue recognition related to the allocation of contract revenues between various services and equipment, and the timing of when those revenues are recognized. In addition, the new requirements require deferral of incremental contract acquisition and fulfillment costs and subsequent expense recognition over the contract period or expected customer life. TDS expects to transition to the new standard under the modified retrospective transition method whereby a cumulative effect adjustment is recognized upon adoption and the guidance is applied prospectively. TDS is currently evaluating the guidance, developing its implementation plan, and evaluating the effects ASU 2014-09, as amended, will have on its financial position and results of operations upon adoption.

In August 2014, the FASB issued Accounting Standards Update 2014-15, Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern ("ASU 2014-15"). ASU 2014-15 requires TDS to assess its ability to continue as a going concern each interim and annual reporting period and provide certain disclosures if there is substantial doubt about the entity's ability to continue as a going concern, including management's plan to alleviate the substantial doubt. TDS is required to adopt the provisions of ASU 2014-15 for the annual period ending December 31, 2016. The adoption of ASU 2014-15 will not impact TDS' financial position or results of operations but may impact future disclosures.

In July 2015, the FASB issued Accounting Standards Update 2015-11, Inventory: Simplifying the Measurement of Inventory ("ASU 2015-11"), which requires inventory to be measured at the lower of cost or net realizable value. TDS is required to adopt ASU 2015-11 on January 1, 2017. Early adoption is permitted. The adoption of ASU 2015-11 is not expected to have a significant impact on TDS' financial position or results of operations.

In January 2016, the FASB issued Accounting Standards Update 2016-01, Financial Instruments – Overall: Recognition and Measurement of Financial Assets and Financial Liabilities ("ASU 2016-01"). This ASU introduces changes to current accounting for equity investments and financial liabilities under the fair value option and the presentation and disclosure requirements for financial instruments. TDS is required to adopt ASU 2016-01 on January 1, 2018. Certain provisions are eligible for early adoption. The adoption of ASU 2016-01 is not expected to have a significant impact on TDS' financial position or results of operations.

In February 2016, the FASB issued Accounting Standards Update 2016-02, Leases ("ASU 2016-02"). ASU 2016-02 requires lessees to record a right-of-use asset and lease liability for almost all leases. This ASU does not substantially impact lessor accounting. TDS is required to adopt ASU 2016-02 on January 1, 2019. Early adoption is permitted. Upon adoption of ASU 2016-02, TDS expects a substantial increase to assets and liabilities on its balance sheet. TDS is evaluating the full effects that adoption of ASU 2016-02 will have on its financial position and results of operations.

In March 2016, the FASB issued Accounting Standards Update 2016-04, Liabilities – Extinguishments of Liabilities: Recognition of Breakage from Certain Prepaid Stored-Value Products ("ASU 2016-04"). ASU 2016-04 requires companies that sell prepaid stored-value products redeemable for goods, services or cash at third-party merchants to recognize breakage (i.e., the value that is ultimately not redeemed by the consumer) in a way that is consistent with how it will be recognized under the new revenue recognition standard. TDS is required to adopt ASU 2016-04 on January 1, 2018. Early adoption is permitted. The adoption of ASU 2016-04 is not expected to have a significant impact on TDS' financial position or results of operations.

In March 2016, the FASB issued Accounting Standards Update 2016-09, Compensation – Stock Compensation: Improvements to Employee Share-Based Payment Accounting ("ASU 2016-09"). ASU 2016-09 intends to simplify the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. TDS will adopt ASU 2016-09 on January 1, 2017. The adoption of ASU 2016-09 is not expected to have a significant impact on TDS' financial position, results of operations, or cash flows.

In June 2016, the FASB issued Accounting Standards Update 2016-13, Financial Instruments – Credit Losses: Measurement of Credit Losses on Financial Instruments ("ASU 2016-13"). ASU 2016-13 requires entities to use a new forward-looking, expected loss model to estimate credit losses. It also requires additional disclosure relating to the credit quality of trade and other receivables, including information relating to management's estimate of credit allowances. TDS is required to adopt ASU 2016-13 on January 1, 2020. Early adoption as of January 1, 2019 is permitted. TDS is evaluating the effects that adoption of ASU 2016-13 will have on its financial position, results of operations and disclosures.

In August 2016, the FASB issued Accounting Standards Update 2016-15, Statement of Cash Flows: Classification of Certain Cash Receipts and Cash Payments ("ASU 2016-15"). ASU 2016-15 provides guidance on eight targeted cash flow classification issues. TDS is required to adopt ASU 2016-15 on January 1, 2018. TDS is evaluating the effects that adoption of ASU 2016-15 will have on its statement of cash flows.

In October 2016, the FASB issued Accounting Standards Update 2016-16, Income Taxes: Intra-Entity Transfers of Assets Other Than Inventory ("ASU 2016-16"). ASU 2016-16 impacts the accounting for the income tax consequences of intra-entity transfers of assets other than inventory when the transfer occurs between entities in different tax jurisdictions. TDS is required to adopt ASU 2016-16 on January 1, 2018. Early adoption is permitted. The adoption of ASU 2016-16 is not expected to have a significant impact on TDS' financial position or results of operations.

In October 2016, the FASB issued Accounting Standards Update 2016-17, Consolidation: Interests Held through Related Parties That Are under Common Control ("ASU 2016-17"). ASU 2016-17 provides guidance on how a reporting entity that is the single decision maker of a VIE should treat indirect interests in an entity held through related parties that are under common control. TDS is required to adopt ASU 2016-17 on January 1, 2017. Early adoption is permitted. TDS is evaluating the effects that adoption of ASU 2016-17 will have on its financial position, results of operations and disclosures.

Amounts Collected from Customers and Remitted to Governmental Authorities

TDS records amounts collected from customers and remitted to governmental authorities net within a tax liability account if the tax is assessed upon the customer and TDS merely acts as an agent in collecting the tax on behalf of the imposing governmental authority. If the tax is assessed upon TDS, then amounts collected from customers as recovery of the tax are recorded in Service revenues and amounts remitted to governmental authorities are recorded in Selling, general and administrative expenses in the Consolidated Statement of Operations. The amounts recorded gross in revenues that are billed to customers and remitted to governmental authorities totaled $21 million and $65 million for the three and nine months ended September 30, 2016, respectively, and $24 million and $75 million for the three and nine months ended September 30, 2015, respectively.

Note 2 Fair Value Measurements

As of September 30, 2016 and December 31, 2015, TDS did not have any financial or nonfinancial assets or liabilities that were required to be recorded at fair value in its Consolidated Balance Sheet in accordance with GAAP.

The provisions of GAAP establish a fair value hierarchy that contains three levels for inputs used in fair value measurements. Level 1 inputs include quoted market prices for identical assets or liabilities in active markets. Level 2 inputs include quoted market prices for similar assets and liabilities in active markets or quoted market prices for identical assets and liabilities in inactive markets. Level 3 inputs are unobservable. A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. A financial instrument's level within the fair value hierarchy is not representative of its expected performance or its overall risk profile and, therefore, Level 3 assets are not necessarily higher risk than Level 2 or Level 1 assets.

TDS has applied the provisions of fair value accounting for purposes of computing the fair value of financial instruments for disclosure purposes as displayed below.

| | Level within the Fair Value Hierarchy | September 30, 2016 | | December 31, 2015 | |
|---|---|---|---|---|---|
| | | Book Value | Fair Value | Book Value | Fair Value |
| (Dollars in millions) | | | | | |
| Cash and cash equivalents | 1 | $985 | $985 | $985 | $985 |
| Long-term debt | | | | | |
| Retail | 2 | 1,753 | 1,841 | 1,753 | 1,766 |
| Institutional | 2 | 533 | 555 | 533 | 501 |
| Other | 2 | 211 | 210 | 216 | 215 |

The fair value of Cash and cash equivalents approximates the book value due to the short-term nature of these financial instruments. Long-term debt excludes capital lease obligations and the current portion of Long-term debt. The fair value of "Retail" Long-term debt was estimated using market prices for TDS' 7.0% Senior Notes, 6.875% Senior Notes, 6.625% Senior Notes and 5.875% Senior Notes, and U.S. Cellular's 6.95% Senior Notes, 7.25% Senior Notes due 2063 and 7.25% Senior Notes due 2064. TDS' "Institutional" debt consists of U.S. Cellular's 6.7% Senior Notes which are traded over the counter. TDS' "Other" debt consists of a senior term loan credit facility and other borrowings with financial institutions. TDS estimated the fair value of its Institutional and Other debt through a discounted cash flow analysis using the interest rates or estimated yield to maturity for each borrowing, which ranged from 0.00% to 6.50% and 0.00% to 7.51% at September 30, 2016 and December 31, 2015, respectively.

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Note 3 Equipment Installment Plans

TDS sells devices to customers, through its owned and agent distribution channels, under equipment installment contracts over a specified time period. For certain equipment installment plans ("EIP"), after a specified period of time or amount of payments, the customer may have the right to upgrade to a new device and have the remaining unpaid equipment installment contract balance waived, subject to certain conditions, including trading in the original device in good working condition and signing a new equipment installment contract. TDS values this trade-in right as a guarantee liability. The guarantee liability is initially measured at fair value and is determined based on assumptions including the probability and timing of the customer upgrading to a new device and the fair value of the device being traded-in at the time of trade-in. As of September 30, 2016 and December 31, 2015, the guarantee liability related to these plans was $44 million and $93 million, respectively, and is reflected in Customer deposits and deferred revenues in the Consolidated Balance Sheet.

TDS equipment installment plans do not provide for explicit interest charges. For equipment installment plans with a duration of greater than twelve months, TDS imputes interest. TDS records imputed interest as a reduction to the related accounts receivable and it is recognized over the term of the installment agreement. Equipment installment plan receivables had a weighted average effective imputed interest rate of 10.7% and 9.7% as of September 30, 2016 and December 31, 2015, respectively.

The following table summarizes unbilled equipment installment plan receivables as of September 30, 2016 and December 31, 2015. Such amounts are included in the Consolidated Balance Sheet as Accounts receivable – customers and agents and Other assets and deferred charges, where applicable.

| | September 30, 2016 | December 31, 2015 |
|---|---|---|
| (Dollars in millions) | | |
| Short-term portion of unbilled equipment installment plan receivables, gross | $ 339 | $ 279 |
| Short-term portion of unbilled deferred interest | (33) | (21) |
| Short-term portion of unbilled allowance for credit losses | (22) | (14) |

| | | |
|---|---|---|
| Short-term portion of unbilled equipment installment plan receivables, net | $ 284 | $ 244 |
| Long-term portion of unbilled equipment installment plan receivables, gross | $ 165 | $ 76 |
| Long-term portion of unbilled deferred interest | (9) | (2) |
| Long-term portion of unbilled allowance for credit losses | (13) | (6) |
| Long-term portion of unbilled equipment installment plan receivables, net | $ 143 | $ 68 |

TDS assesses the collectability of the equipment installment plan receivables based on historical payment experience, account aging and other qualitative factors and provides an allowance for estimated losses. The credit profiles of TDS customers on equipment installment plans are similar to those of TDS customers with traditional subsidized plans. Customers with a higher risk credit profile are required to make a down payment for equipment purchased through an installment contract.

TDS recorded out-of-period adjustments during the three and nine months ended September 30, 2016 due to errors related to equipment installment plan transactions occurring in 2015 and 2016 (“2016 EIP adjustments”). For the three months ended September 30, 2016, the 2016 EIP adjustments had the impact of increasing Equipment and product sales revenues by $4 million, decreasing bad debts expense, which is a component of Selling, general and administrative expense, by $2 million and increasing Income before income taxes by $6 million. For the nine months ended September 30, 2016, the 2016 EIP adjustments had the impact of increasing Equipment and product sales revenues by $2 million, decreasing bad debts expense by $2 million and increasing Income before income taxes by $4 million. Additionally, TDS recorded out-of-period adjustments during the nine months ended September 30, 2015 due to errors related to equipment installment plan transactions (“2015 EIP adjustments”) that were attributable to 2014. The 2015 EIP adjustments had the impact of reducing Equipment and product sales revenues and Income before income taxes by $6 million for the nine months ended September 30, 2015. The 2015 EIP adjustments were made in the first six months of 2015. TDS has determined that these adjustments were not material to any of the periods impacted.

Note 4 Earnings Per Share

Basic earnings per share available to TDS common shareholders is computed by dividing Net income available to TDS common shareholders by the weighted average number of common shares outstanding during the period. Diluted earnings per share available to TDS common shareholders is computed by dividing Net income available to TDS common shareholders by the weighted average number of common shares outstanding during the period adjusted to include the effects of potentially dilutive securities. Potentially dilutive securities primarily include incremental shares issuable upon the exercise of outstanding stock options and the vesting of restricted stock units.

The amounts used in computing earnings per common share and the effects of potentially dilutive securities on the weighted average number of common shares were as follows:

| Three Months Ended September | Nine Months Ended |
| --- | --- |