

UNITED STATES CELLULAR CORP  
Form 10-Q  
August 07, 2007

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

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

For the quarterly period ended **June 30, 2007**

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 **1-9712**

# UNITED STATES CELLULAR CORPORATION

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**62-1147325**

(I.R.S. Employer Identification No.)

**8410 West Bryn Mawr, Suite 700, Chicago, Illinois 60631**

(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: **(773) 399-8900**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

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

Large accelerated filer

Accelerated filer

Accelerated filer

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

Yes  No

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 June 30, 2007
Common Shares, \$1 par value	54,750,763 Shares
Series A Common Shares, \$1 par value	33,005,877 Shares

UNITED STATES CELLULAR CORPORATION

**QUARTERLY REPORT ON FORM 10-Q**

FOR THE PERIOD ENDED JUNE 30, 2007

**INDEX**

		<u>Page No.</u>
Part I.	Financial Information	
Item 1.	Financial Statements (Unaudited)	
	<u>Consolidated Statements of Operations Three and Six Months Ended June 30, 2007 and 2006</u>	3
	<u>Consolidated Statements of Cash Flows Six Months Ended June 30, 2007 and 2006</u>	4
	<u>Consolidated Balance Sheets June 30, 2007 and December 31, 2006</u>	5
	<u>Notes to Consolidated Financial Statements</u>	7
Item 2.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	22
	<u>Six Months Ended June 30, 2007 and 2006</u>	24
	<u>Three Months Ended June 30, 2007 and 2006</u>	32
	<u>Recent Accounting Pronouncements</u>	38
	<u>Financial Resources</u>	38
	<u>Liquidity and Capital Resources</u>	40
	<u>Application of Critical Accounting Policies and Estimates</u>	45
	<u>Certain Relationships and Related Transactions</u>	46
	<u>Safe Harbor Cautionary Statement</u>	47
Item 3.	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	50
Item 4.	<u>Controls and Procedures</u>	52
Part II.	Other Information	
Item 1.	<u>Legal Proceedings</u>	55
Item 1A.	<u>Risk Factors</u>	55
Item 2.	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	55
Item 4.	<u>Submission of Matters to a Vote of Security-Holders</u>	57
Item 5.	<u>Other Information</u>	57
Item 6.	<u>Exhibits</u>	58

Signatures

**PART I. FINANCIAL INFORMATION**

**ITEM I. FINANCIAL STATEMENTS**

**UNITED STATES CELLULAR CORPORATION AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF OPERATIONS****UNAUDITED**

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
<i>(Dollars in thousands, except per share amounts)</i>				
<b>OPERATING REVENUES</b>				
Service	\$ 906,218	\$ 791,705	\$ 1,766,801	\$ 1,560,927
Equipment sales	65,428	54,432	139,519	121,586
Total Operating Revenues	971,646	846,137	1,906,320	1,682,513
<b>OPERATING EXPENSES</b>				
System operations (excluding Depreciation, amortization and accretion shown separately below)	176,409	150,555	343,693	303,873
Cost of equipment sold	151,015	133,416	305,694	276,732
Selling, general and administrative (including charges from affiliates of \$30.9 million and \$25.3 million for the three months ended June 30, 2007 and 2006, respectively, and \$58.7 million and \$49.6 million for the six months ended June 30, 2007 and 2006, respectively)	371,894	342,769	726,825	670,473
Depreciation, amortization and accretion	148,856	140,486	298,113	282,511
Total Operating Expenses	848,174	767,226	1,674,325	1,533,589
<b>OPERATING INCOME</b>	123,472	78,911	231,995	148,924
<b>INVESTMENT AND OTHER INCOME (EXPENSE)</b>				
Equity in earnings of unconsolidated entities	22,980	21,957	46,078	41,440
Interest and dividend income	2,653	9,807	5,203	10,395
Fair value adjustment of derivative instruments	(17,849 )	(922 )	(5,388 )	3,893
Gain on sale of investments	131,686		131,686	
Interest expense	(21,325 )	(23,007 )	(45,009 )	(46,215 )
Other, net	91	(140 )	(494 )	62
Total Investment and Other Income (Expense)	118,236	7,695	132,076	9,575
<b>INCOME BEFORE INCOME TAXES AND MINORITY INTEREST</b>				
INTEREST	241,708	86,606	364,071	158,499
Income tax expense	91,500	33,683	135,388	62,393
<b>INCOME BEFORE MINORITY INTEREST</b>	150,208	52,923	228,683	96,106
Minority share of income	(2,637 )	(2,859 )	(6,711 )	(6,596 )
<b>NET INCOME</b>	\$ 147,571	\$ 50,064	\$ 221,972	\$ 89,510
<b>BASIC WEIGHTED AVERAGE SHARES OUTSTANDING (000s)</b>				
	87,590	87,281	87,735	87,247
<b>BASIC EARNINGS PER SHARE</b>	\$ 1.68	\$ 0.57	\$ 2.53	\$ 1.03
<b>DILUTED WEIGHTED AVERAGE SHARES OUTSTANDING (000s)</b>				
	88,410	88,083	88,615	87,994
<b>DILUTED EARNINGS PER SHARE</b>	\$ 1.67	\$ 0.57	\$ 2.50	\$ 1.02

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

**UNITED STATES CELLULAR CORPORATION AND SUBSIDIARIES**



**CONSOLIDATED STATEMENTS OF CASH FLOWS****UNAUDITED**

	<b>Six Months Ended June 30,</b>	
	<b>2007</b>	<b>2006</b>
	<i>(Dollars in thousands)</i>	
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	\$ 221,972	\$ 89,510
Add (deduct) adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, amortization and accretion	298,113	282,511
Bad debts expense	23,870	23,089
Stock-based compensation expense	8,177	10,457
Deferred income taxes, net	5,002	(978)
Equity in earnings of unconsolidated entities	(46,078)	(41,440)
Distributions from unconsolidated entities	43,169	37,176
Minority share of income	6,711	6,596
Unrealized fair value adjustment for derivative instruments	5,388	(3,893)
Gain on sale of assets	(5,000)	)
Gain on sale of investments	(131,686)	)
Noncash interest expense	890	890
Changes in assets and liabilities from operations:		
Change in accounts receivable	(30,103)	(51,819)
Change in inventory	(770)	10,770
Change in accounts payable	(7,311)	(33,462)
Change in customer deposits and deferred revenues	17,606	2,978
Change in accrued taxes	50,739	6,416
Change in accrued interest	(742)	749
Change in other assets and liabilities	(23,803)	(19,326)
	436,144	320,224
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Additions to property, plant and equipment	(246,790)	(268,607)
Proceeds from sale of investments	4,301	
Cash received from divestitures	4,277	
Cash paid for acquisitions	(18,283)	(18,546)
Other investing activities	(156)	(3,083)
	(256,651)	(290,236)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Issuance of notes payable	25,000	195,000
Repayment of notes payable	(60,000)	(225,000)
Common shares reissued	13,516	3,856
Common shares repurchased	(49,057)	)
Capital (distributions) to minority partners	(5,461)	(11,220)
Excess tax benefit from exercise of stock awards	9,679	342
	(66,323)	(37,022)
<b>NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>113,170</b>	<b>(7,034)</b>
<b>CASH AND CASH EQUIVALENTS</b>		
Beginning of period	32,912	29,003
End of period	\$ 146,082	\$ 21,969

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



**UNITED STATES CELLULAR CORPORATION AND SUBSIDIARIES**

**CONSOLIDATED BALANCE SHEETS****ASSETS****UNAUDITED**

	<b>June 30, 2007</b>	<b>December 31, 2006</b>
	<i>(Dollars in thousands)</i>	
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	\$ 146,082	\$ 32,912
Accounts receivable		
Customers, less allowance of \$9,864 and \$12,027, respectively	321,668	305,475
Roaming	36,745	30,396
Other, less allowance of \$356 and \$989, respectively	51,358	71,567
Marketable equity securities		249,039
Inventory	118,072	117,189
Prepaid expenses	46,277	34,955
Deferred tax asset	9,082	
Other current assets	10,734	13,385
	740,018	854,918
<b>INVESTMENTS</b>		
Licenses	1,500,092	1,494,327
Goodwill	491,316	485,452
Customer lists, net of accumulated amortization of \$74,486 and \$68,110, respectively	21,381	26,196
Marketable equity securities	16,248	4,873
Investments in unconsolidated entities	155,514	150,325
Notes and interest receivable long-term	4,482	4,541
	2,189,033	2,165,714
<b>PROPERTY, PLANT AND EQUIPMENT</b>		
In service and under construction	5,313,726	5,120,994
Less accumulated depreciation	2,715,722	2,492,146
	2,598,004	2,628,848
<b>OTHER ASSETS AND DEFERRED CHARGES</b>		
	30,356	31,136
<b>TOTAL ASSETS</b>	<b>\$ 5,557,411</b>	<b>\$ 5,680,616</b>

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

**UNITED STATES CELLULAR CORPORATION AND SUBSIDIARIES**

**CONSOLIDATED BALANCE SHEETS****LIABILITIES AND SHAREHOLDERS EQUITY****UNAUDITED**

	June 30, 2007	December 31, 2006
<i>(Dollars in thousands)</i>		
<b>CURRENT LIABILITIES</b>		
Notes payable	\$	\$ 35,000
Prepaid forward contracts		159,856
Accounts payable		
Affiliated	10,038	13,568
Trade	237,522	241,303
Customer deposits and deferred revenues	141,116	123,344
Accrued taxes	70,492	26,913
Derivative liability		88,840
Deferred income tax liability		26,326
Accrued compensation	38,635	47,842
Other current liabilities	90,632	93,718
	588,435	856,710
<b>DEFERRED LIABILITIES AND CREDITS</b>		
Net deferred income tax liability	582,343	601,535
Asset retirement obligation	136,643	127,639
Other deferred liabilities and credits	76,997	62,914
	795,983	792,088
<b>LONG-TERM DEBT</b>		
Long-term debt	1,002,066	1,001,839
<b>COMMITMENTS AND CONTINGENCIES</b>		
<b>MINORITY INTEREST</b>	39,518	36,700
<b>COMMON SHAREHOLDERS EQUITY</b>		
Common Shares, par value \$1 per share; authorized 140,000,000 shares; issued 55,045,685 shares	55,046	55,046
Series A Common Shares, par value \$1 per share; authorized 50,000,000 shares; issued and outstanding 33,005,877 shares	33,006	33,006
Additional paid-in capital	1,313,041	1,290,829
Treasury Shares, at cost, 294,922 and 329,934 Common Shares, respectively	(21,609 )	(14,462 )
Accumulated other comprehensive income	10,082	80,382
Retained earnings	1,741,843	1,548,478
	3,131,409	2,993,279
<b>TOTAL LIABILITIES AND SHAREHOLDERS EQUITY</b>	<b>\$ 5,557,411</b>	<b>\$ 5,680,616</b>

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



**UNITED STATES CELLULAR CORPORATION AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

1. Basis of Presentation

The accounting policies of United States Cellular Corporation ( U.S. Cellular ) conform to accounting principles generally accepted in the United States of America ( U.S. GAAP ). The consolidated financial statements include the accounts of U.S. Cellular, its majority-owned subsidiaries since acquisition, general partnerships in which U.S. Cellular has a majority partnership interest and any entity in which U.S. Cellular has a variable interest that requires U.S. Cellular to recognize a majority of the entity's expected gains or losses. All material intercompany accounts and transactions have been eliminated. Certain prior year amounts have been reclassified to conform to the 2007 presentation.

The consolidated financial statements included herein have been prepared by U.S. Cellular, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission ( SEC ). Certain information and disclosures normally included in financial statements prepared in accordance with U.S. GAAP have been condensed or omitted pursuant to such rules and regulations. However, U.S. Cellular believes that the disclosures included herein are adequate to make the information presented not misleading. It is suggested that these consolidated financial statements be read in conjunction with the consolidated financial statements and the notes thereto included in U.S. Cellular's Annual Report on Form 10-K for the year ended December 31, 2006 ( Form 10-K ).

The accompanying unaudited consolidated financial statements contain all adjustments (consisting of only normal recurring items unless otherwise disclosed) necessary to present fairly the financial position as of June 30, 2007 and December 31, 2006, the results of operations for the three and six months ended June 30, 2007 and 2006, and the cash flows for the six months ended June 30, 2007 and 2006. The results of operations for the three and six months ended June 30, 2007 are not necessarily indicative of the results to be expected for the full year.

2. Summary of Significant Accounting Policies

Pension Plan

U.S. Cellular participates in a qualified noncontributory defined contribution pension plan sponsored by Telephone and Data Systems, Inc. ( TDS ), U.S. Cellular's parent organization. The plan provides pension benefits for the employees of U.S. Cellular and its subsidiaries. Under this plan, pension benefits and costs are calculated separately for each participant and are funded currently. Pension costs were \$2.0 million and \$4.1 million for the three and six months ended June 30, 2007, respectively, and \$2.5 million and \$4.3 million for the three and six months ended June 30, 2006, respectively.

Amounts Collected from Customers and Remitted to Governmental Authorities

U.S. Cellular 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 U.S. Cellular merely acts as an agent in collecting the tax on behalf of the imposing governmental authority. If the tax is assessed upon U.S. Cellular, then amounts collected from customers as recovery of the tax are recorded in revenues and amounts remitted to governmental authorities are recorded in expenses. The amounts recorded gross in revenues that are billed to customers and remitted to governmental authorities totaled \$33.5 million and \$60.9 million for the three and six months ended June 30, 2007, respectively, and \$20.3 million and \$39.3 million for the three and six months ended June 30, 2006, respectively.



Recent Accounting Pronouncements

In September 2006, the FASB issued Statement of Financial Accounting Standards ( SFAS ) No. 157, *Fair Value Measurements* ( SFAS 157 ). This Statement defines fair value as used in numerous accounting pronouncements, establishes a framework for measuring fair value in U.S. GAAP and expands disclosure related to the use of fair value measures in financial statements. SFAS 157 does not expand the use of fair value measures in financial statements, but standardizes its definition and guidance in U.S. GAAP. The Statement emphasizes that fair value is a market-based measurement and not an entity-specific measurement, based on an exchange transaction in which the entity sells an asset or transfers a liability (exit price). SFAS 157 establishes a fair value hierarchy, from observable market data as the highest level to fair value based on an entity's own fair value assumptions as the lowest level. The Statement is effective for U.S. Cellular's 2008 financial statements. U.S. Cellular is currently reviewing the requirements of SFAS 157 and has not determined the impact, if any, on its financial position or results of operations.

In September 2006, FASB ratified Emerging Issues Task Force Issue No. 06-1, *Accounting for Consideration Given by a Service Provider to Manufacturers or Resellers of Equipment Necessary for an End-Customer to Receive Service from the Service Provider* ( EITF 06-1 ). This guidance requires the application of EITF 01-9, *Accounting for Consideration Given by a Vendor to a Customer* ( EITF 01-9 ), when consideration is given to a reseller or manufacturer for benefit to the service provider's end customer. EITF 01-9 requires the consideration given be recorded as a liability at the time of the sale of the equipment and also provides guidance for the classification of the expense. EITF 06-1 is effective for U.S. Cellular's 2008 financial statements. U.S. Cellular is currently reviewing the requirements of EITF 06-1 and has not yet determined the impact, if any, on its financial position or results of operations.

SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities, Including an Amendment of FASB Statement No. 115* ( SFAS 159 ), was issued in February 2007. SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value at specified election dates. Unrealized gains and losses on items for which the fair value option has been elected shall be reported in earnings at each subsequent reporting date. SFAS 159 also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. SFAS 159 is effective for U.S. Cellular's 2008 financial statements. U.S. Cellular is currently reviewing the requirements of SFAS 159 and has not yet determined the impact, if any, on its financial position or results of operations.

3. Acquisitions, Divestitures and Exchanges

U.S. Cellular assesses its existing wireless interests on an ongoing basis with a goal of improving competitiveness of its operations and maximizing its long-term return on investment. As part of this strategy, U.S. Cellular reviews attractive opportunities to acquire additional operating markets and wireless spectrum. In addition, U.S. Cellular may seek to divest outright or include in exchanges for other wireless interests those markets and wireless interests that are not strategic to its long-term success.

In the first six months of 2007, U.S. Cellular received \$4.3 million from an escrow that was set up in the fourth quarter of 2006 in conjunction with the sale of Midwest Wireless Communications to ALLTEL Corporation. U.S. Cellular had owned an interest in Midwest Wireless Communications prior to the purchase by ALLTEL.

On February 1, 2007, U.S. Cellular purchased 100% of the membership interests of Iowa 15 Wireless, LLC ( Iowa 15 ) and obtained the 25 megahertz Federal Communications Commission ( FCC ) cellular license to provide wireless service in Iowa Rural Service Area ( RSA ) 15 for approximately \$18.2 million in cash. This acquisition increased investments in licenses, goodwill and customer lists by \$7.9 million, \$5.9 million and \$1.6 million, respectively. Goodwill of \$5.9 million is deductible for income tax purposes.

U.S. Cellular is a limited partner in Barat Wireless, L.P. ( Barat Wireless ), an entity which participated in the auction of wireless spectrum designated by the FCC as Auction 66. Barat Wireless was qualified to receive a 25% discount available to very small businesses which were defined as having annual gross revenues of less than \$15 million. At the conclusion of the auction on September 18, 2006, Barat Wireless was the high bidder with respect to 17 licenses and had bid \$127.1 million, net of its discount. On April 30, 2007, the FCC granted Barat Wireless applications with respect to the 17 licenses for which it was the winning bidder.

Barat Wireless is in the process of developing its long-term business and financing plans. As of June 30, 2007, U.S. Cellular had made capital contributions and advances to Barat Wireless and/or its general partner of \$127.2 million. Barat Wireless used the funding to pay the FCC an initial deposit of \$79.9 million on July 14, 2006 to allow it to participate in Auction 66. On October 18, 2006, Barat Wireless paid the balance due at the conclusion of the auction for the licenses with respect to which Barat Wireless was the high bidder; such amount totaled \$47.1 million. For financial statement purposes, U.S. Cellular consolidates Barat Wireless and Barat Wireless, Inc., the general partner of Barat Wireless, pursuant to the guidelines of FASB Interpretation No. 46(R), *Consolidation of Variable Interest Entities*, an interpretation of ARB No. 51, ( FIN 46(R) ), as U.S. Cellular anticipates benefiting from or absorbing a majority of Barat Wireless' expected gains or losses. Pending finalization of Barat Wireless' permanent financing plan, and upon request by Barat Wireless, U.S. Cellular may agree to make additional capital contributions and advances to Barat Wireless and/or its general partner.

In April 2006, U.S. Cellular purchased the remaining ownership interest in a Tennessee wireless market, in which it had previously owned a 16.7% interest, for approximately \$18.8 million in cash. This acquisition increased investments in licenses, goodwill and customer lists by \$5.5 million, \$4.0 million and \$2.0 million, respectively. The \$4.0 million of goodwill is not deductible for income tax purposes.

U.S. Cellular is a limited partner in Carroll Wireless, an entity which participated in the auction of wireless spectrum designated by the FCC as Auction 58. Carroll Wireless was qualified to bid on closed licenses -spectrum that was available only to companies included under the FCC definition of entrepreneurs, which are small businesses that have a limited amount of assets and revenues. In addition, Carroll Wireless bid on open licenses that were not subject to restriction. With respect to these licenses, however, Carroll Wireless was qualified to receive a 25% discount available to very small businesses which were defined as having average annual gross revenues of less than \$15 million. Carroll Wireless was a successful bidder for 17 license areas in Auction 58, which ended on February 15, 2005. The aggregate amount paid to the FCC for the 17 licenses was \$129.9 million, net of the discounts to which Carroll Wireless was entitled. These 17 license areas cover portions of 12 states and are in markets which are either adjacent to or overlap current U.S. Cellular licensed areas.

On January 6, 2006, the FCC granted Carroll Wireless' applications with respect to 16 of the 17 licenses for which it had been the successful bidder and dismissed one application, relating to Walla Walla, Washington. Following the completion of Auction 58, the FCC determined that a portion of the Walla Walla license was already licensed to another party and should not have been included in Auction 58. Accordingly, in 2006, Carroll Wireless received a full refund of the \$228,000 previously paid to the FCC with respect to the Walla Walla license.

Carroll Wireless is in the process of developing its long-term business and financing plans. As of June 30, 2007, U.S. Cellular had made capital contributions and advances to Carroll Wireless and/or its general partner of approximately \$129.9 million; \$129.7 million of this amount is included in Licenses in the Consolidated Balance Sheets. For financial statement purposes, U.S. Cellular consolidates Carroll Wireless and Carroll PCS, Inc., the general partner of Carroll Wireless, pursuant to the guidelines of FIN 46(R), as U.S. Cellular anticipates benefiting from or absorbing a majority of Carroll Wireless' expected gains or losses. Pending finalization of Carroll Wireless' permanent financing plan, and upon request by Carroll Wireless, U.S. Cellular may make additional capital contributions and advances to Carroll Wireless and/or its general partner. In November 2005, U.S. Cellular approved additional funding of \$1.4 million of which \$0.1 million was provided to Carroll Wireless through June 30, 2007.

#### 4. Fair Value Adjustments of Derivative Instruments

Fair value adjustments of derivative instruments resulted in losses of \$17.8 million and \$5.4 million in the three and six months ended June 30, 2007, respectively, and a loss of \$0.9 million and a gain of \$3.9 million in the three and six months ended June 30, 2006, respectively. Fair value adjustments of derivative instruments for the period reflect the change in the fair value of the bifurcated embedded collars within the forward contracts related to the Vodafone marketable equity securities not designated as a hedge. See Note 9 Marketable Equity Securities and Forward Contracts and Note 12 Long-Term Debt and Forward Contracts for additional information related to the forward contracts.

The accounting for the embedded collars as derivative instruments not designated as a hedge resulted in increased volatility in the results of operations, as fluctuations in the market price of the underlying Vodafone marketable equity securities resulted in changes in the fair value of the embedded collars being recorded in the Consolidated Statements of Operations.

## 5. Income Taxes

The overall effective tax rate on income before income taxes and minority interest for the three and six months ended June 30, 2007 was 37.9% and 37.2%, respectively, and 38.9% and 39.4% for the three and six months ended June 30, 2006, respectively. The effective tax rate for the 2007 period is lower than 2006 primarily due to lower state income tax expense.

Effective January 1, 2007, U.S. Cellular adopted Financial Accounting Standards Board Interpretation No. 48 ( FIN 48 ), *Accounting for Uncertainty in Income Taxes*. In accordance with FIN 48, U.S. Cellular recognized a cumulative-effect adjustment of \$1.3 million, increasing its liability for unrecognized tax benefits, interest, and penalties and reducing the January 1, 2007 balance of Retained earnings.

At January 1, 2007, U.S. Cellular had \$25.8 million in unrecognized tax benefits, which, if recognized, would reduce income tax expense by \$19.3 million (\$12.6 million, net of the federal benefit from state income taxes). Included in the balance of unrecognized tax benefits at January 1, 2007, is an immaterial amount related to tax positions for which it is possible that the total amounts could change during the next twelve months. At June 30, 2007 U.S. Cellular had \$28.9 million in unrecognized tax benefits, which, if recognized, would reduce income tax expense by \$14.5 million, net of the federal benefit from state income taxes.

U.S. Cellular recognizes accrued interest and penalties related to unrecognized tax benefits in income tax expense. This amount totaled \$0.8 million and \$2.2 million for the three and six months ended June 30, 2007, respectively. Accrued interest and penalties were \$6.2 million and \$8.4 million as of January 1, 2007 and June 30, 2007, respectively.

U.S. Cellular is included in a consolidated federal income tax return with other members of the TDS consolidated group. TDS and U.S. Cellular are parties to a Tax Allocation Agreement which provides that U.S. Cellular and its subsidiaries be included with the TDS affiliated group in a consolidated federal income tax return and in state income or franchise tax returns in certain situations. For financial statement purposes, U.S. Cellular and its subsidiaries calculate their income, income taxes and credits as if they comprised a separate affiliated group. Under the Tax Allocation Agreement, U.S. Cellular remits its applicable income tax payments to TDS. U.S. Cellular had a tax payable balance with TDS of \$24.6 million as of June 30, 2007 and \$3.7 million as of December 31, 2006.

U.S. Cellular and its subsidiaries file federal and various state income tax returns. With few exceptions, U.S. Cellular is no longer subject to Federal, state and local income tax examinations by tax authorities for years prior to 2002. TDS's consolidated federal income tax returns for the years 2002 - 2005, which include U.S. Cellular, are currently under examination by the Internal Revenue Service. U.S. Cellular and its subsidiaries are also under examination by various state taxing authorities.

## 6. Earnings per Share

Basic earnings per share is computed by dividing net income by the weighted average number of common shares outstanding during the period. Diluted earnings per share is computed using net income and weighted average common shares adjusted to include the effect of potentially dilutive securities.

Edgar Filing: UNITED STATES CELLULAR CORP - Form 10-Q

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

	Three Months Ended June 30, 2007		Six Months Ended June 30, 2007	
		2006		2006
	<i>(Dollars and shares in thousands, except earnings per share)</i>			
Net income	\$ 147,571	\$ 50,064	\$ 221,972	\$ 89,510