TELEPHONE & DATA SYSTEMS INC /DE/
Form ARS
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TELEPHONE AND DATA SYSTEMS, INC.

ANNUAL REPORT TO SHAREHOLDERS FOR THE YEAR ENDED DECEMBER 31, 2009
Pursuant to SEC Rule 14a-3

The following audited financial statements and certain other financial information for the year ended December 31, 2009, represent Telephone and Data Systems' annual report to shareholders as required by the rules and regulations of the Securities and Exchange Commission ("SEC").

The following information was filed with the SEC on February 25, 2010 as Exhibit 13 to Telephone and Data Systems' Annual Report on Form 10-K for the year ended December 31, 2009. Such information has not been updated or revised since the date it was originally filed with the SEC. Accordingly, you are encouraged to review such information together with any subsequent information that we have filed with the SEC and other publicly available information.

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Exhibit 13

Telephone and Data Systems, Inc. and Subsidiaries

Financial Reports Contents

Telephone and Data Systems, Inc.

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

Telephone and Data Systems, Inc. ("TDS") is a diversified telecommunications company providing high-quality telecommunications services in 36 states to approximately 6.1 million wireless customers and 1.1 million wireline equivalent access lines at December 31, 2009. TDS conducts substantially all of its wireless operations through its 82%-owned subsidiary, United States Cellular Corporation ("U.S. Cellular"), and provides wireline services through its incumbent local exchange carrier ("ILEC") and competitive local exchange carrier ("CLEC") operations under its wholly owned subsidiary, TDS Telecommunications Corporation ("TDS Telecom"). TDS conducts printing and distribution services through its 80%-owned subsidiary, Suttle-Straus, Inc. ("Suttle-Straus") which represents a very small portion of TDS' operations.

The following discussion and analysis should be read in conjunction with TDS' audited consolidated financial statements and the description of TDS' business included in Item 1 of the TDS Annual Report on Form 10-K ("Form 10-K") for the year ended December 31, 2009.

OVERVIEW

The following is a summary of certain selected information contained in the comprehensive Management's Discussion and Analysis of Financial Condition and Results of Operations that follows. The summary does not contain all of the information that may be important. You should carefully read the entire Management's Discussion and Analysis of Financial Condition and Results of Operations and not rely solely on the overview.

U.S. Cellular

U.S. Cellular provides wireless telecommunications services to more than 6.1 million customers in five geographic market areas in 26 states. As of December 31, 2009, U.S. Cellular's average penetration rate in its consolidated operating markets, calculated by dividing U.S. Cellular's total customers by the total population of 46.3 million in such markets, was 13.3%. U.S. Cellular operates on a customer satisfaction strategy, meeting customer needs by providing a comprehensive range of wireless products and services, excellent customer support, and a high-quality network. U.S. Cellular's business development strategy is to operate controlling interests in wireless licenses in areas adjacent to or in proximity to its other wireless licenses, thereby building contiguous operating market areas. U.S. Cellular believes that operating in contiguous market areas will continue to provide it with certain economies in its capital and operating costs.

Financial and operating highlights in 2009 included the following:

- Total customers were 6,141,000 at December 31, 2009, including 5,744,000 retail customers.

- Retail customer net additions were 37,000 in 2009 compared to 149,000 in 2008. The decrease year-over-year reflected higher churn rates, due to the weak economy and very competitive industry conditions which included the initiation of service by unlimited prepay service providers in certain of U.S. Cellular's markets.

- Postpay customers comprised approximately 95% of U.S. Cellular's retail customer base as of December 31, 2009. Postpay net additions were 62,000 in 2009 compared to 158,000 in 2008. The postpay churn rate was 1.6% in 2009 compared to 1.5% in 2008.

- Service revenues of $3,927.9 million decreased $12.5 million year-over-year, due primarily to a decrease of $76.4 million (23%) in inbound roaming revenues. Retail service revenue grew by $33.2 million (1%) due primarily to an increase in the average monthly retail service revenue per customer, driven by higher data usage. Data revenues grew 33% year-over-year to $683.0 million.

- On June 30, 2009, U.S. Cellular entered into a new $300 million revolving credit agreement with certain lenders and other parties. As a result, U.S. Cellular's $700 million revolving credit agreement, which was due to expire in December 2009, was terminated on June 30, 2009 as a condition of entering into

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

the new agreement. The new revolving credit agreement provides U.S. Cellular with a $300 million senior revolving credit facility for working capital, acquisitions and other corporate purposes and to refinance any existing debt of U.S. Cellular.

On December 24, 2009, U.S. Cellular redeemed all of its outstanding 8.75% Senior Notes due November 1, 2032. The $130.0 million aggregate principal amount of the outstanding notes was redeemed at a redemption price equal to 100% of the principal amount plus accrued and unpaid interest, which resulted in a total redemption payment of $131.7 million.

Additions to property, plant and equipment totaled $546.8 million, including expenditures to construct cell sites, increase capacity in existing cell sites and switches, expand mobile broadband services based on third generation Evolution-Data Optimized technology ("3G") to additional markets, outfit new and remodel existing retail stores and continue the development and enhancement of U.S. Cellular's office systems. Total cell sites in service increased 6% year-over-year to 7,279.

As part of its customer satisfaction strategy and Believe in Something Better® brand message, U.S. Cellular launched its Battery Swap program in May 2009. Under this new program, a customer can exchange a battery that is dead or dying for one that is fully charged, at no cost to the customer. U.S. Cellular was the first wireless company to offer this service in the United States, and completed over one million battery swaps in 2009.

In November 2009, U.S. Cellular launched Overage Protection, a customer satisfaction strategy that allows customers to opt into receiving alerts when they come close to reaching their allowable plan minutes or text messages for the month in order to avoid overage charges. Approximately 600,000 of U.S. Cellular's customers signed up for this service in 2009.

U.S. Cellular began efforts on a number of multi-year initiatives including the development of: a Billing and Operational Support System ("BSS/OSS") including a new point-of-sale system to consolidate billing on one platform; an Electronic Data Warehouse/Customer Relationship Management System to collect and analyze information more efficiently to build and improve customer relationships; and a new Internet/Web platform to enable customers to complete a wide range of transactions and, eventually, to manage their accounts online.

U.S. Cellular recognized a loss on impairment of licenses of $14.0 million in 2009. In 2008, a loss on impairment of $386.7 million was recognized. See "Results of Operations Consolidated" and "Results of Operations Wireless" for a further discussion of losses on impairment. U.S. Cellular anticipates that future growth in its operating income will be affected by the following factors:

Overall demand for U.S. Cellular's products and services, including potential growth in revenues from data products and services;

Increasing penetration in the wireless industry;

Increased competition in the wireless industry, including potential reductions in pricing for products and services overall and impacts associated with the expanding presence of carriers offering low-priced, unlimited prepay service;

Uncertainty related to current economic conditions and their impact on customer purchasing and payment behaviors;

Costs of customer acquisition and retention, such as equipment subsidies and advertising;

Industry consolidation and the resultant effects on roaming revenues, service and equipment pricing and other effects of competition;

Providing service in recently launched areas or potential new market areas;

Potential increases or decreases in prepay and reseller customers as a percentage of U.S. Cellular's customer base;

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- Costs of developing and introducing new products and services;
- Costs of developing and enhancing office and customer support systems, including costs and risks associated with the completion of important multi-year initiatives such as those described above;
- Continued enhancements to its wireless networks, including expansion of 3G services and potential deployments of new technology;
- Increasing costs of regulatory compliance; and
- Uncertainty in future eligible telecommunication carrier ("ETC") funding.

See "Results of Operations Wireless."

2010 Wireless Estimates

U.S. Cellular expects the factors described above to impact revenues and operating income for the next several quarters. Any changes in the above factors, as well as the effects of other drivers of U.S. Cellular's operating results, may cause revenues and operating income to fluctuate over the next several quarters.

U.S. Cellular's estimates of full-year 2010 results are shown below. Such estimates represent U.S. Cellular's views as of the date of filing of U.S. Cellular's Form 10-K for the year ended December 31, 2009. Such forward-looking statements should not be assumed to be accurate as of any future date. U.S. Cellular undertakes no duty to update such information whether as a result of new information, future events or otherwise. There can be no assurance that final results will not differ materially from such estimated results.

	2010 Estimated Results	**2009 Actual Results**
Service revenues	$3,975 - $4,075 million	$3,927.9 million
Operating income	$250 - $350 million	$326.4 million
Depreciation, amortization and accretion expenses, and losses on disposals and impairment of assets(1)	Approx. $600 million	$599.8 million
Capital expenditures	Approx. $600 million	$546.8 million

(1) 2009 Actual Results include losses on asset disposals of $15.2 million and impairments of assets of $14.0 million. The 2010 Estimated Results include only the estimate for Depreciation, amortization and accretion expenses and losses on disposals of assets, and do not include any estimate for losses on impairment of assets (since these can not be predicted).

U.S. Cellular management believes that the foregoing estimates represent a reasonable view of what is achievable considering current economic and competitive conditions as well as actions that U.S. Cellular has taken and will be taking. U.S. Cellular expects to continue its focus on customer satisfaction by delivering a high quality network, attractively priced service plans, a broad line of handsets and other products, and outstanding customer service in its company-owned and agent retail stores and customer care centers. U.S. Cellular believes that future growth in its revenues will result primarily from selling additional products and services to its existing customers, increasing the number of multi-device users among its existing customers, and attracting wireless users switching from other wireless carriers, rather than by adding users that are new to wireless service. U.S. Cellular is focusing on opportunities to increase revenues, pursuing cost reduction initiatives in various areas and implementing a number of initiatives to enable future growth. The initiatives are intended, among other things, to allow U.S. Cellular to accelerate its introduction of new products and services, better segment its customers for new services and retention, sell additional services such as data, expand its Internet sales and customer service capabilities, and improve its prepay products and services.

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TDS Telecom

TDS Telecom provides high-quality telecommunication services, including full-service local exchange service, long-distance telephone service and broadband access, to rural and suburban area communities. TDS Telecom's business plan is designed for a full-service telecommunications company, including both ILEC and CLEC operations. TDS Telecom's strategy is to be the preferred provider of telecommunications services including voice, broadband and video services in its chosen markets. This strategy encompasses many components, including:

- Developing services and products;
- Formulating market and customer strategies;
- Investing in networks and deploying advanced technologies;
- Monitoring the competitive environment;
- Advocating with respect to state and federal regulations for positions that support its ability to provide advanced telecommunications services to its customers; and
- Exploring transactions to acquire or divest properties that would result in strengthening its operations.

Both ILECs and CLECs are faced with significant challenges, including the industry-wide decline in use of second lines by customers, growing competition from wireless and other wireline providers (other CLECs and cable providers), changes in regulation, technologies such as Voice over Internet Protocol ("VoIP"), and the uncertainty in the economy. These challenges could have a material adverse effect on the financial condition, results of operations and cash flows of TDS Telecom in the future.

Financial and operating highlights for 2009 include the following:

- Equivalent access lines decreased 3% to 1,131,800 as compared to December 31, 2008. Equivalent access lines are the sum of physical access lines and high-capacity data lines adjusted to estimate the equivalent number of physical access lines in terms of capacity. A physical access line is an individual circuit connecting a customer to a telephone company's central office facilities. Each digital subscriber line ("DSL") is treated as an equivalent access line in addition to a voice line that may operate on the same copper loop. Additionally, each managed IP handset is considered an equivalent access line.
- Operating revenues decreased $34.4 million or 4% to $789.9 million in 2009. The decrease was primarily due to a decline in ILEC and CLEC physical access lines as well as a decline in voice network usage by inter-exchange carriers. These decreases were partially offset by the increase in revenues derived from an increase in ILEC data customers and the acquisition of one ILEC company in 2009 and three ILEC companies in 2008.
- Operating expenses increased $15.2 million or 2% to $697.3 million in 2009. The increase was primarily due to an increase in legal, excise and sales tax expenses arising from discrete matters totaling $3.5 million and severance of $5.1 million incurred as a result of workforce reduction initiatives. Additional costs were also incurred from operating the four ILEC companies acquired in 2008 and 2009. Partially offsetting these increases in expenses were discrete events related to employee compensation modifications which reduced expenses by $4.1 million.

Operating income decreased to $92.6 million during 2009 compared to $142.2 million in 2008, as a result of decreased operating revenues and increased expenses noted above.

Additions to property, plant and equipment totaled $120.5 million in 2009.

See "Results of Operations Wireline."

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2010 Wireline Estimates

TDS Telecom's estimates of full-year 2010 results are shown below. Such forward-looking statements should not be assumed to be accurate as of any future date. Such estimates represent TDS Telecom's view as of the filing date of TDS' Form 10-K for the year ended December 31, 2009. TDS undertakes no duty to update such information whether as a result of new information, future events or otherwise. There can be no assurance that final results will not differ materially from these estimated results.

	2010 Estimated Results	2009 Actual Results
ILEC and CLEC operations:		
Operating revenues	$740 - $780 million	$789.9 million
Operating income	$70 - $100 million	$92.6 million
Depreciation, amortization and accretion expenses and losses on asset disposals(1)	Approx. $170 million	$169.7 million
Capital expenditures	Approx. $140 million	$120.5 million

(1) 2009 Actual Results include losses on disposals of $2.4 million. The 2010 Estimated Results include only the estimate for Depreciation, amortization and accretion expenses and losses on asset disposals, and do not include any estimate for losses on impairment of assets since these cannot be predicted.

The above estimates reflect the expectations of TDS Telecom's management considering the current general economic conditions. During this challenging business environment, TDS Telecom will continue to focus on its cost-reduction initiatives through product cost improvement and process efficiencies. TDS Telecom also plans to continue to focus on customer retention programs, including "triple-play" bundles involving voice, DSL and satellite TV.

Cash Flows and Investments TDS and its subsidiaries had cash and cash equivalents totaling $671.0 million, short-term investments in the form of certificates of deposit aggregating $113.3 million and borrowing capacity under their revolving credit facilities of $696.4 million as of December 31, 2009. In addition to U.S. Cellular's new $300 million revolving credit agreement, as previously discussed, on June 30, 2009, TDS entered into a new $400 million revolving credit agreement with certain lenders and other parties. As a result, TDS' $600 million revolving credit agreement, which was due to expire in December 2009, was terminated on June 30, 2009 as a condition of entering into the new agreement. TDS' and U.S. Cellular's new revolving credit agreements provide TDS with an aggregate $700 million of availability for general corporate purposes. Also, during 2009, TDS and its subsidiaries generated $1,102.6 million of cash flows from operating activities. Management believes that cash on hand, expected future cash flows from operating activities and sources of external financing provide substantial liquidity and financial flexibility and are sufficient to permit TDS and its subsidiaries to finance their contractual obligations and anticipated capital and operating expenditures for the foreseeable future.

See "Financial Resources" and "Liquidity and Capital Resources" below for additional information related to cash flows and investments, including information related to TDS' and U.S. Cellular's new revolving credit agreements.

Recent Developments Congress recently enacted the American Recovery and Reinvestment Act of 2009, or the Recovery Act, which provides, among other things, for an aggregate appropriation of $7.2 billion to fund grants and loans to provide broadband infrastructure, access and equipment to consumers residing in rural, unserved or underserved areas of the United States. TDS Telecom and U.S. Cellular submitted applications for grants in the first round of funding in the amounts of $62.6 million and $23.5 million, respectively. TDS Telecom received approval for two of its applications in the aggregate amount of $12.5 million while U.S. Cellular has been notified that none of its applications were granted. TDS Telecom and U.S. Cellular are currently considering submitting additional applications for grants in the second round of funding, which applications are due March 15, 2010. There is no assurance TDS Telecom and/or U.S. Cellular will receive any additional grants of Recovery Act funds. The distribution of Recovery Act funds to other telecommunications service providers could impact competition in certain of TDS Telecom's and U.S. Cellular's service areas.

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RESULTS OF OPERATIONS CONSOLIDATED

December 31,	2009	Increase/ (Decrease)	Percentage Change	2008	Increase/ (Decrease)	Percentage Change	2007
	(Dollars in thousands, except per share amounts)						
Operating revenues							
U.S. Cellular	$ 4,214,611	$ (28,574)	(1)%	$ 4,243,185	$ 296,921	8%	$ 3,946,264
TDS Telecom	789,852	(34,430)	(4)%	824,282	(35,929)	(4)%	860,211
All other(1)	16,211	(8,341)	(34)%	24,552	2,043	9%	22,509
Total operating revenues	5,020,674	(71,345)	(1)%	5,092,019	263,035	5%	4,828,984
Operating expenses							
U.S. Cellular	3,888,204	(327,271)	(8)%	4,215,475	665,410	19%	3,550,065
TDS Telecom	697,287	15,249	2%	682,038	(36,971)	(5)%	719,009
All other(1)	27,377	(38,975)	(59)%	66,352	34,340	>100%	32,012
Total operating expenses	4,612,868	(350,997)	(7)%	4,963,865	662,779	15%	4,301,086
Operating income (loss)							
U.S. Cellular	326,407	298,697	>100%	27,710	(368,489)	(93)%	396,199
TDS Telecom	92,565	(49,679)	(35)%	142,244	1,042	1%	141,202
All other(1)	(11,166)	30,634	73%	(41,800)	(32,297)	>100%	(9,503)
Total operating income	407,806	279,652	>100%	128,154	(399,744)	(76)%	527,898
Other income and (expenses)							
Equity in earnings of unconsolidated entities	90,732	920	1%	89,812	(2,019)	(2)%	91,831
Interest and dividend income	11,121	(28,010)	(72)%	39,131	(160,304)	(80)%	199,435
Interest expense	(124,557)	13,342	10%	(137,899)	70,837	34%	(208,736)
Gain on		(31,595)	N/M	31,595	(49,828)	(61)%	81,423

investments and financial instruments							
Other, net	2,000	(213)	(10)%	2,213	8,614	>100%	(6,401)