ALLTEL CORP
Form 10-Q
August 09, 2005

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D. C. 20549

FORM 10-Q

þ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE

SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2005

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE

SECURITIES EXCHANGE ACT OF 1934

Commission file number 1-4996

ALLTEL CORPORATION

(Exact name of registrant as specified in its charter)

Delaware

34-0868285

(State or other jurisdiction of
incorporation or organization)

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

One Allied Drive, Little Rock, Arkansas

72202

(Address of principal executive offices)

(Zip Code)

Registrant s telephone number, including area code (501) 905-8000

(Former name, former address and former fiscal year, if changed since last report)

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 X NO __

Indicate by check mark whether the registrant is an accelerated filer (as defined by Rule 12b-2 of the Act).

YES X NO __

Number of common shares outstanding as of July 29, 2005: 327,489,268

The Exhibit Index is located on page 44.

ALLTEL CORPORATION

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Other Information

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No reportable information under this item.

Forward-Looking Statements

This Report on Form 10-Q includes, and future filings by the Company on Form 10-K, Form 10-Q and Form 8-K and future oral and written statements by ALLTEL Corporation (Alltel) and its manageme may include, certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements are subject to uncertainties that could cause actual future events and results to differ materially from those expressed in the forward-looking statements. These forward-looking statements are based on estimates, projections, beliefs, and assumptions and are not guarantees of future events and results. Words such as expects , anticipates , intends , plans , believes , seeks , estimates , and should , and variations of these words and similar expressions, are intended to identify these forward-looking statements. Alltel disclaims any obligation to update or revise any forward-looking statement based on the occurrence of future events, the receipt of new information, or otherwise.

Actual future events and results may differ materially from those expressed in these forward-looking statements as a result of a number of important factors. Representative examples these factors include (without limitation) adverse changes in economic conditions in the markets served by Alltel; the extent, timing, and overall effects of competition in the communications business; material changes in the communications industry generally that could adversely affect vendor relationships with equipment and network suppliers and customer relationships with wholesa customers; changes in communications technology; the risks associated with pending acquisitions a dispositions and the integration of acquired businesses, including the integration of Western Wireless and the disposition of the Irish assets; the uncertainties related to any discussions or negotiations regarding the sale of any of the international assets, including the Austrian business; adverse changes in the terms and conditions of wireless roaming agreements of Alltel; the uncertainties related to Alltel s strategic investments; the effects of litigation; and the effects of federal and state legislation, rules, and regulations governing the communications industry.

In addition to these factors, actual future performance, outcomes and results may differ material because of more general factors including (without limitation) general industry and market conditions and growth rates, economic conditions, and governmental and public policy changes.

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ALLTEL CORPORATION

FORM 10-Q

PART I FINANCIAL INFORMATION

Item 1. Financial Statements

CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(Dollars in millions, except per share amounts)

June 30,

December 31,

Assets

2005

2004

Current Assets:

Cash and short-term investments

$
2,027.7

$
484.9

Accounts receivable (less allowance for doubtful accounts of $55.0 and $53.6, respectively)

929.0

912.7

Inventories

159.9

156.8

Prepaid expenses and other

89.1

62.4

Total current assets

3,205.7

1,616.8

Investments

207.1

804.9

Goodwill

5,151.9

4,875.7

Other intangibles

1,380.8

1,306.1

Property, Plant and Equipment:

Land

280.4

278.1

Buildings and improvements

1,147.1

1,134.8

Wireline

6,824.9

6,735.8

Wireless

6,057.5

5,764.0

Information processing

1,099.1

1,048.4

Other

495.4

489.9

Under construction

492.5

385.3

Total property, plant and equipment

16,396.9

15,836.3

Less accumulated depreciation

8,853.5

8,288.2

Net property, plant and equipment

7,543.4

7,548.1

Other assets

426.0

452.1

Total Assets

$
17,914.9

$
16,603.7

Liabilities and Shareholders Equity

Current Liabilities:

Current maturities of long-term debt

$
222.8

$
225.0

Accounts payable

422.4

448.2

Advance payments and customer deposits

219.4

219.3

Accrued taxes

286.3

158.2

Accrued dividends

124.6

105.9

Accrued interest

106.2

120.2

Other current liabilities

169.3

183.5

Total current liabilities

1,551.0

1,460.3

Long-term debt

4,954.0

5,352.4

Deferred income taxes

1,632.9

1,715.1

Other liabilities

922.0

947.2

Shareholders Equity:

Preferred stock, Series C, $2.06, no par value, 12,210 and 12,288 shares issued and outstandi
respectively

0.3

0.3

Common stock, par value $1 per share, 1.0 billion shares authorized, 327,323,194 and 302,267,959 shares issued and outstanding, respectively

327.3

302.3

Additional paid-in capital

1,577.5

197.9

Unrealized holding gain on investments

153.9

Foreign currency translation adjustment

0.5

0.5

Retained earnings

6,949.4

6,473.8

Total shareholders equity	8,855.0	7,128.7
Total Liabilities and Shareholders Equity	$ 17,914.9	$ 16,603.7

See the accompanying notes to the unaudited interim consolidated financial statements.

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CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

Three Months

Six Months

Ended June 30,

Ended June 30,

(Millions, except per share amounts)

2005

2004

2005

2004

Revenues and sales:

Service revenues	$ 1,989.2	$ 1,825.9	$ 3,887.5	$ 3,591.5
Product sales	270.9	216.2	498.6	411.8

Total revenues and sales

2,260.1

2,042.1

4,386.1

4,003.3

Costs and expenses:

Cost of services (excluding depreciation of $244.2, $231.7, $486.1 and $463.6, respectively, included below)

660.9

584.2

1,287.2

1,145.0

Cost of products sold

308.1

256.0

589.9

513.3

Selling, general, administrative and other

420.6

372.9

828.0

748.1

Depreciation and amortization

348.3

321.2

689.5

642.5

Restructuring and other charges

51.8

Total costs and expenses

1,737.9

1,534.3

3,394.6

3,100.7

Operating income

522.2

507.8

991.5

902.6

Equity earnings in unconsolidated partnerships

15.2

15.9

25.9

29.2

Minority interest in consolidated partnerships

(18.9
)

(21.6
)

(37.2
)

(37.2
)

Other income, net

8.0

2.9

128.7

7.5

Interest expense

(76.3
)

(86.6
)

(163.0
)

(178.3
)

Gain on exchange or disposal of assets and other

188.3

188.3

Income before income taxes

638.5

418.4

1,134.2

723.8

Income taxes

236.4

155.8

419.1

271.4

Net income

402.1

262.6

715.1

452.4

Preferred dividends

0.1

0.1

0.1

0.1

Net income applicable to common shares

$
402.0

$
262.5

$
715.0

$
452.3

Earnings per share:

Basic

$1.28

$.85

$2.32

$1.46

Diluted

$1.27

$.85

$2.31

$1.46

See the accompanying notes to the unaudited interim consolidated financial statements.

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CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

Six Months

Ended June 30,

(Millions)

2005

2004

Cash Provided from Operations:

Net income

$
715.1

$
452.4

Adjustments to reconcile net income to net cash provided from operations:

Depreciation and amortization

689.5

642.5

Provision for doubtful accounts

90.7

88.7

Non-cash portion of gain on exchange or disposal of assets and other

(202.2
)

Non-cash portion of restructuring and other charges

25.6

Increase in deferred income taxes

6.3

145.9

Other, net

11.1

(0.2
)

Changes in operating assets and liabilities, net of effects of acquisitions and dispositions:

Accounts receivable

(105.8
)

(65.6
)

Inventories

(2.3
)

25.8

Accounts payable

(31.3
)

(75.3
)

Other current liabilities

100.6

39.9

Other, net

(28.1
)

(31.6
)

Net cash provided from operations

1,243.6

1,248.1

Cash Flows from Investing Activities:

Additions to property, plant and equipment

(611.1
)

(480.5
)

Additions to capitalized software development costs

(26.9
)

(14.8
)

Additions to investments

(0.9
)

(2.5
)

Purchases of property, net of cash acquired

(223.7
)

Proceeds from the sale of assets

36.2

Proceeds from the sale of investments

353.4

Proceeds from the return on investments

20.4

36.9

Other, net

3.1

(4.2
)

Net cash used in investing activities

(449.5
)

(465.1
)

Cash Flows from Financing Activities:

Dividends on preferred and common stock

(220.7
)

(231.3
)

Reductions in long-term debt

(452.9
)

(252.9
)

Repurchases of common stock

(243.0
)

Distributions to minority investors

(27.0
)

(32.7
)

Long-term debt issued

50.0

Preferred stock redemptions

(0.1
)

Common stock issued

1,399.3

6.7

Net cash provided from (used in) financing activities

748.7

(753.3
)

Effect of exchange rate changes on cash and short-term investments

(0.1
)

Increase in cash and short-term investments

1,542.8

29.6

Cash and Short-term Investments:

Beginning of the period	484.9	657.8
End of period	$ 2,027.7	$ 687.4

Non-Cash Investing and Financing Activity:

Change in fair value of investments in equity securities	$ (236.8)	$ 23.7
Change in fair value of interest rate swap agreements	$ (1.2)	$ (33.4)

See the accompanying notes to the unaudited interim consolidated financial statements.

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CONSOLIDATED STATEMENT OF SHAREHOLDERS EQUITY (UNAUDITED)

Unrealized

Foreign

Additional

Holding

Currency

Preferred

Common

Paid-In

Gain On

Translation
Retained

(Millions)

Stock

Stock

Capital

Investments

Adjustment

Earnings

Total

Balance at December 31, 2004

$
0.3

$
302.3

$
197.9

$
153.9

$
0.5

$
6,473.8

$
7,128.7

Net income

715.1

715.1

Other comprehensive loss, net of
tax: (See Note 10)

Unrealized holding losses on
investments,

net of reclassification
adjustments

(153.9
)

(153.9
)

Foreign currency translation

adjustment

Comprehensive income

(153.9
)

715.1

561.2

Settle purchase obligation related to equity
units (See Note 4)

24.5

1,360.5

1,385.0

Employee plans, net

0.3

14.7

15.0

Restricted stock, net of unearned compensation

0.2

2.3

2.5

Tax benefit for non-qualified stock options

2.0

2.0

Conversion of preferred stock

0.1

0.1

Dividends:

Common $.76 per share

(239.4
)

(239.4
)

Preferred

(0.1
)

(0.1
)

Balance at June 30, 2005

$
0.3

$
327.3

$
1,577.5

$

$
0.5

$
6,949.4

$
8,855.0

See the accompanying notes to the unaudited interim consolidated financial statements.

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NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

1.

General:

Basis of Presentation   The consolidated financial statements at June 30, 2005 and December 31, 2004 and for the three and six month periods ended June 30, 2005 and 2004 of ALLTEL Corporation (Alltel or the Company) are unaudited. The consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial reporting and Securities and Exchange Commission rules and regulations. Certain information and footnote disclosures have been condensed or omitted in accordance with those rules and regulations. The consolidated financial statements reflect all adjustments (consisting only of normal recurring adjustments) which are, in the opinion of management, necessary for a fair presentation of the financial position and operating results for the interim periods presented.

2.

Acquisitions:

On April 15, 2005, Alltel and Cingular Wireless LLC (Cingular), a joint venture between SBC Communications, Inc. and BellSouth Corporation, exchanged certain wireless assets. Under the terms of the agreement, Alltel acquired former AT&T Wireless properties, including licenses, network assets, and subscribers, in select markets in Kentucky, Oklahoma, Texas, Connecticut and Mississippi covering approximately 2.7 million potential customers (POPs). Alltel also acquired 20MHz of spectrum and network assets owned by AT&T Wireless in Kansas and wireless spectrum in several counties in Georgia and Texas. In addition, Alltel and Cingular exchanged partnership interests, with Cingular receiving interests in markets in Kansas, Missouri and Texas, and Alltel receiving more ownership in majority-owned markets it manages in Michigan, Louisiana and Ohio. Alltel also paid Cingular approximately $165.0 million in cash. The accompanying consolidated financial statements include the accounts and results of operations of the acquired wireless properties from the date of acquisition. During the second quarter of 2005, Alltel completed the purchase price allocation for this exchange based upon a fair value analysis of the tangible and identifiable intangible assets acquired and the partnership interests relinquished. The excess of the aggregate purchase price over the fair market value of the tangible net assets acquired of $335.8 million was assigned to customer list ($10.9 million), cellular licenses ($91.0 million) and goodwill ($233.9 million). The customer list recorded in connection with this transaction is being amortized on a straight-line basis over its estimated useful life of three years. The cellular licenses are classified as indefinite-lived intangible assets and are not subject to amortization. In connection with this transaction, Alltel recorded a pretax gain of approximately $127.5 million in the second quarter of 2005 (see Note 9) and expects to record an additional gain of $29.0 million in the third quarter of 2005 (see Note 14).

On February 28, 2005, Alltel completed the purchase of certain wireless assets from Public Service Cellular, Inc. (PS Cellular) for $48.3 million in cash, acquiring wireless properties w service area covering approximately 900,000 POPs in Alabama and Georgia. The accompanying consolidated financial statements include the accounts and results of operations of the acquired wireless properties from the date of acquisition. During the first quarter of 2005, Alltel completed the purchase price allocation for this acquisition based upon a fair value analysis of the tangible and identifiable intangible assets acquired. The excess of the aggregate purchase price over the fair market value of the tangible net assets acquired of $37.9 million was assigned to customer list ($1.9 million), cellular licenses ($3.4 million) and goodwill ($32.6 million). The customer list recorded in connection with this transaction is being amortized on a straight-line basis over its estimated useful life of four years. The cellular licenses are classified as indefinite-lived intangible assets and are not subject to amortization.

During the first six months of 2005, Alltel also acquired additional ownership interests in wireless properties in Michigan, Ohio and Wisconsin in which the Company owned a majority interest. In connection with these acquisitions, the Company paid $10.4 million in cash and assigned the excess of the aggregate purchase price over the fair market value of the tangible net assets acquired of $4.9 million to goodwill.

The purchase prices paid for the wireless property acquisitions discussed above were based on estimates of future cash flows of the properties acquired. Alltel paid a premium (i.e. goodwill) over the fair value of the net tangible and identifiable intangible assets acquired because the purchase of wireless properties expanded the Company s wireless footprint into new markets in Alabama, Georgia, Kentucky, Oklahoma, Texas, Connecticut and Mississippi and added 266,000 new customers to Alltel s communications customer base. Additionally, in the wireless properties acquired, Alltel should realize, over time, accelerated customer growth and higher average revenue per customer as a result of the Company s higher revenue national rate plans.

3.

Goodwill and Other Intangible Assets:

Goodwill represents the excess of cost over the fair value of net identifiable tangible and intangible assets acquired through various business combinations. The Company has acquired identifiable intangible assets through its acquisitions of interests in various wireless and wireline properties. The cost of acquired entities at the date of the acquisition is allocated to identifiable assets, and the excess of the total purchase price over the amounts assigned to identifiable assets is recorded as goodwill.

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NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS-(Continued)

3.

Goodwill and Other Intangible Assets, Continued:

As of January 1, 2005, Alltel completed the annual impairment reviews of its goodwill and other indefinite-lived intangible assets and determined that no write-down in the carrying value of these assets was required. The changes in the carrying amount of goodwill by business segment for the six months ended June 30, 2005 were as follows:

Communications

Support

(Millions)

Wireless

Wireline

Services

Total

Balance at December 31, 2004

$
3,625.8

$

1,247.6

$
2.3

$
4,875.7

Acquired during the period

271.4

-

-

271.4

Other adjustments

4.8

-

-

4.8

Balance at June 30, 2005

$
3,902.0

$
1,247.6

$
2.3

$
5,151.9

The carrying values of indefinite-lived intangible assets other than goodwill were as follows:

June 30,

December 31, (Millions)	2005	2004
Cellular licenses	$ 870.0	$ 775.6
Personal Communications Services licenses	79.1	79.1
Franchise rights wireline	265.0	265.0

$
1,214.1

$
1,119.7

Intangible assets subject to amortization were as follows:

June 30, 2005

(Millions)	Gross Cost	Accumulated Amortization	Net Carrying Value
Customer lists	$ 410.4	$ (250.6)	$ 159.8
Franchise rights	22.5	(15.6)	6.9

$
432.9

$
(266.2
)

$
166.7

December 31, 2004

(Millions)	Gross Cost	Accumulated Amortization	Net Carrying Value
Customer lists	$ 397.6	$ (218.8)	$ 178.8
Franchise rights	22.5	(14.9)	7.6

$
420.1

$
(233.7
)

$
186.4

Amortization expense for intangible assets subject to amortization was $16.7 million and $32.5 million for the three and six month periods ended June 30, 2005, compared to $15.1 million and $30.2 million for the same periods of 2004. Amortization expense for intangible assets subject to amortization is estimated to be $66.5 million in 2005, $48.9 million in 2006, $32.2 million in 2007, $23.1 million in 2008 and $8.6 million in 2009.

4.

Equity Units

During 2002, Alltel issued and sold 27.7 million equity units in an underwritten public offering and received net proceeds of $1.34 billion. Each equity unit consisted of a corporate unit, with a $50 stated amount, comprised of a purchase contract and a $50 principal amount senior note. The purchase contract obligated the holder to purchase, and obligated Alltel to sell, on May 17, 2005, a variable number of newly-issued common shares of Alltel common stock for $50. The number of Alltel shares issued to the holders of each equity unit to settle the purchase contract was calculated by dividing $50 by the average closing price per share of Alltel s common stock for the 20 consecutive trading days that ended May 12, 2005. Upon settlement of the purchase contract obligation, Alltel received cash proceeds of approximately $1,385.0 million and delivered approximately 24.5 million shares of Alltel common stock in the aggregate to the holders of the equity units. The proceeds from the stock issuance were utilized to finance certain obligations associated with Alltel s merger with Western Wireless Corporation (Western Wireless), as further discussed in Note 14.

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NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS-(Continued)

4.

Equity Units, Continued:

The $50 principal amount senior notes become payable on May 17, 2007 and accrued interest through May 17, 2005 at an initial annual rate of 6.25 percent. On February 17, 2005, Alltel completed a remarketing of the senior notes that reset the annual interest rate on the notes to 4.656 percent for periods subsequent to May 17, 2005. The proceeds of the remarketed senior notes were used to purchase a portfolio of U.S. Treasury securities that were pledged to secure the corporate unit holders obligations under the purchase contract component of the corporate unit until settlement.

5.

Stock-Based Compensation:

Under the Company s stock-based compensation plans, Alltel may grant fixed and performance-based incentive and non-qualified stock options, restricted stock, and other equity securities to officers and other management employees. The Company accounts for these plans under the recognition and measurement principles of Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees and related Interpretations. For fixed stock options granted under these plans, the exercise price of the option equals the market value of Alltel s common stock on the date of grant. Accordingly, Alltel does not record compensation expense for any of the fixed stock options granted, and no compensation expense related to stock options was recognized in the three and six month periods ended June 30, 2005 or 2004. In January 2005 and 2004, the Company granted to certain senior management employees restricted stock of approximately 205,000 and 173,000 shares, respectively. The restricted shares granted in 2005 vest three years from the date of grant, except that one-third of the restricted shares may vest after each of the first two-year anniversaries from the grant date if the Company achieves a certain targeted total stockholder return for its peer group during the three-year period preceding each of those two years. The restricted shares granted in 2004 will vest in equal increments over a three-year period following the date of grant. Compensation expense related to the foregoing shares amounted to $1.6 million and $3.2 million and $0.7 million and $1.4 million for the three and six month periods ended June 30, 2005 and 2004, respectively. At June 30, 2005 and 2004, unrecognized compensation expense for the restricted shares amounted to $7.4 million and $7.1 million, respectively, and was included in additional paid-in capital in the accompanying consolidated balance sheet and statement of shareholders equity. The following table illustrates the effects on net income and earnings per share had the Company applied the fair value recognition provisions of SFAS No. 123, Accounting for Stock-Based Compensation , to its stock-based employee compensation plans for the three and six months ended June 30:

Three Months Ended

Six Months Ended

(Millions, except per share amounts)

2005

2004

2005

2004

Net income as reported

$
402.1

$
262.6

$
715.1

$
452.4

Add stock-based compensation expense included in
net income, net of related tax effects

1.0

0.5

2.0

0.9

Deduct stock-based employee compensation expense
determined under fair value method for all awards,

net of related tax effects

(6.4
)

(6.3
)

(13.0
)

(12.9
)

Pro forma net income

$
396.7

$
256.8

$
704.1

$
440.4

Basic earnings per share:
As reported

$1.28

$.85

$2.32

$1.46

Pro forma

$1.26

$.83

$2.28

$1.42

Diluted earnings per share:
As reported

$1.27

$.85

$2.31

$1.46

Pro forma

$1.26

$.83

$2.27

$1.42

The pro forma amounts presented above may not be representative of the future effects on reported net income and earnings per share, since the pro forma compensation expense is allocated over the periods in which options become exercisable, and new option awards may be granted each year.

On December 16, 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123(R), Share-Based Payment , which is a revision of SFAS No. 123 and supercedes APB Opinion No. 25. SFAS No. 123(R) requires all share-based payments to employees, including grants of employee stock options, to be valued at fair value on the date of grant, and to be expensed over the applicable vesting period. Pro forma disclosure of the income statement effects of share-based payments is no longer an alternative. SFAS No. 123(R) is effective for all stock-based awards granted on or after July 1, 2005. In addition, companies must also recognize compensation expense related to any awards that are not fully vested as of the effective date. Compensation expense for the unvested awards will be measured based on the fair value of the awards previously calculated in developing the pro forma disclosures in accordance with the provisions of SFAS No. 123. On
March 25, 2005, the SEC staff issued Staff Accounting Bulletin (SAB) 107, which summarizes the staff s views regarding the interaction between SFAS No. 123(R) and certain SEC rules and regulations and provides additional guidance regarding the valuation of share-based payment arrangements for public companies. In addition, on April 15, 2005, the SEC amended

5.

Stock-Based Compensation, Continued:

Rule 4-01(a) of Regulation S-X regarding the date public companies are required to comply with the provisions of SFAS No. 123(R), such that calendar year companies will now be required to comply with the standard beginning January 1, 2006. Alltel is currently assessing the impact of adopting SFAS No. 123(R), as interpreted by SAB 107, to its consolidated results of operations.

6.

Employee Benefit Plans and Postretirement Benefits Other Than Pensions:

Alltel maintains a qualified defined benefit pension plan, which covers substantially all employees. Prior to January 1, 2005, employees of the Company s directory publishing subsidiary did not participate in the plan. Alltel also maintains a supplemental executive retirement plan that provides unfunded, non-qualified supplemental retirement benefits to a select group of management employees. In addition, the Company has entered into individual retirement agreements with certain retired executives providing for unfunded supplemental pension benefits. The Company funds the accrued costs of the unfunded plans as benefits are paid. The components of pension expense, including provision for executive retirement agreements, were as follows for the three and six month periods ended June 30:

Three Months Ended

Six Months Ended

(Millions)

2005

2004

2005

2004

Benefits earned during the year

$
8.3

$
7.7

$
16.7

$
15.4

Interest cost on benefit obligation

14.6

12.9

29.2

25.9

Amortization of prior service cost

0.2

0.1

0.3

0.2

Recognized net actuarial loss

7.7

4.9

15.3

9.8

Expected return on plan assets

(20.7
)

(17.6
)

(41.4
)

(35.2
)

Net periodic benefit expense

$
10.1

$
8.0

$
20.1

$
16.1

Alltel disclosed in its financial statements for the year ended December 31, 2004 that it expected to contribute $5.2 million for retirement benefits in 2005 consisting solely of amounts necessary to fund the expected benefit payments related to the unfunded supplemental retirement plans. Primarily due to the timing of the required contributions to fund the supplemental retirement plans, actual contributions were $3.2 million for the six months ended June 30, 2005. Alltel does not expect that any contribution to the qualified defined pension plan calculated in accordance with the minimum funding requirements of the Employee Retirement Income Security Act of 1974 will be required in

2005. Future discretionary contributions to the plan will depend on various factors, including future investment performance, changes in future discount rates and changes in the demographics of the population participating in Alltel s qualified pension plan.

The Company provides postretirement healthcare and life insurance benefits for eligible employees. Employees share in the cost of these benefits. The Company funds the accrued costs of these plans as benefits are paid. The components of postretirement expense were as follows for the three and six month periods ended June 30:

Three Months Ended

Six Months Ended

(Millions)

2005

2004

2005

2004

Benefits earned during the year

$
0.1

$
0.2

$
0.2

$
0.4

Interest cost on benefit obligation

3.5

4.0

7.0

7.9

Amortization of transition obligation

0.2

0.2

0.4

0.4

Amortization of prior service cost

0.5

0.4

1.0

0.8

Recognized net actuarial loss

1.7

2.2

3.4

4.4

Expected return on plan assets

-

-

-

-

Net periodic benefit expense

$
6.0

$
7.0

$
12.0

$
13.9

Under the Medicare Prescription Drug, Improvement and Modernization Act of 2003, (the Act) beginning in 2006, the Act will provide a prescription drug benefit under Medicare Part D, as well as a federal subsidy to plan sponsors of retiree healthcare plans that provide a prescription drug benefit to their participants that is at least actuarially equivalent to the benefit that will be available under Medicare. The amount of the federal subsidy will be based on 28 percent of an individual beneficiary s annual eligible prescription drug costs ranging between $250 and $5,000. On May 19, 2004, the FASB issued

Staff Position No. 106-2, Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (FSP No. 106-2). FSP No. 106-2 clarified that the federal subsidy provided under the Act should be accounted for as an actuarial gain in calculating the accumulated postretirement benefit obligation and annual postretirement expense. Based on its understanding of the Act, Alltel determined that a substantial

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NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS-(Continued)

6.

Employee Benefit Plans and Postretirement Benefits Other Than Pension, Continued:

portion of the prescription drug benefits provided under its postretirement benefit plan would be deemed actuarially equivalent to the benefits provided under Medicare Part D. Effective July 1, 2004, Alltel prospectively adopted FSP No. 106-2 and remeasured its accumulated postretirement benefit obligation as of that date to account for the federal subsidy, the effects of which resulted in an $18.3 million reduction in the Company s accumulated postretirement obligation and a $2.9 million reduction in the Company s 2004 postretirement expense. On January 21, 2005, the Department of Health and Human Services issued final federal regulations related to the federal subsidy. Alltel is currently evaluating the effects, if any, that these final rules may have on its future benefit costs and accumulated postretirement benefit obligation.

7.

Restructuring and Other Charges:

A summary of the restructuring and other charges recorded during the six months ended June 30, 2004 was as follows:

Communications

Support

Corporate

(Millions)

Wireless

Wireline

Services

Operations

Total

Severance and employee benefit costs

$
8.8

$
11.2

$ 0.5

$ 2.1

$
22.6

Relocation costs

3.2

1.4

0.1

0.1

4.8

Lease and contract termination costs

0.5

(1.9
)

-

(0.1
)

(1.5
)

Write-down in carrying value of certain
facilities

0.7

-

-

24.1

24.8

Other exit costs

0.4

0.7

-

-

1.1

Total restructuring and other charges

$
13.6

$
11.4

$ 0.6

$ 26.2

$
51.8

In January 2004, the Company announced its plans to reorganize its operations and support teams. Also, during February 2004, the Company announced its plans to exit its competitive local exchange carrier (CLEC) operations in the Jacksonville, Florida market due to the continued unprofitability of these operations. In connection with these activities, the Company recorded a restructuring charge of $29.3 million consisting of $22.9 million in severance and employee benefit costs related to a planned workforce reduction, $4.8 million of employee relocation expenses, $0.5 million in lease termination costs and $1.1 million of other exit costs. The severance and employee benefit costs included a $1.2 million payment to a former employee of the Company s sold financial services division that became payable in the first quarter of 2004 pursuant to the terms of a change in control agreement between the employee and Alltel. During the fourth quarter of 2004, the Company recorded a $0.9 million reduction in the liabilities associated with the restructuring efforts initiated in the first quarter of 2004, consisting of $0.7 million in employee relocation expenses and $0.2 million in severance and employee benefit costs. The reductions primarily reflected differences between estimated and actual costs paid in completing the employee relocations and terminations. As of June 30, 2005, the Company had paid $22.6 million in severance and employee-related expenses, and all of the employee reductions and relocations had been completed.

During the first quarter of 2004, Alltel also recorded a $2.3 million reduction in the liabilities associated with various restructuring activities initiated prior to 2003, consisting of $2.0 million in lease and contract termination costs and $0.3 million in severance and employee benefit costs. The reductions primarily reflected differences between estimated and actual costs paid in completing the previous planned workforce reductions and lease and contract terminations. During the first quarter of 2004, the Company also recorded a write-down in the carrying value of certain corporate and regional facilities to fair value in conjunction with the 2004 organizational changes and the 2003 sale of the Company s financial services division to Fidelity National Financial, Inc. (Fidelity National).

At June 30, 2005, the remaining unpaid liability related to Alltel s first quarter 2004 restructuring activities was $0.3 million, primarily consisting of lease and contract termination costs, and is included in other current liabilities in the accompanying consolidated balance sheets.

8.

Investments Special Cash Dividend:

On March 28, 2005, Alltel received a special $10 per share cash dividend from Fidelity National totaling $111.0 million, related to the shares of Fidelity National common stock received as partial consideration for the sale of Alltel s financial services business to Fidelity National on April 1, 2003. As further discussed in Note 9, on April 6, 2005, Alltel completed the sale of all of its shares of Fidelity National common stock. The special cash dividend is included in other income, net in the accompanying consolidated statement of income for the six months ended June 30, 2005.

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NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS-(Continued)

9.

Gain on Exchange or Disposal of Assets and Other

As previously discussed in Note 2, on April 15, 2005, Alltel and Cingular exchanged certain wireless assets. In connection with this transaction, Alltel recorded a pretax gain of approximately $127.5 million. On April 6, 2005, Alltel completed the sale of all of its shares of Fidelity National common stock to Goldman Sachs for approximately $350.8 million and recognized a pretax gain of approximately $75.8 million. On April 8, 2005, Alltel redeemed all of the issued and outstanding 7.50 percent senior notes due March 1, 2006, representing an aggregate principal amount of $450.0 million. Concurrent with the debt redemption, Alltel also terminated the related pay variable/receive fixed, interest rate swap agreement that had been designated as a fair value hedge against the $450.0 million senior notes. In connection with the early termination of the debt and interest rate swap agreement, Alltel incurred net pretax termination fees of approximately $15.0 million. These transactions increased net income $118.0 million or $.38 per share in the three and six month periods ended June 30, 2005.

10.

Comprehensive Income:

Comprehensive income was as follows for the three and six month periods ended June 30:

Three Months Ended

Six Months Ended

(Millions)

2005

2004

2005

2004

Net income

$
402.1

$
262.6

$
715.1

$
452.4

Other comprehensive income (loss):

Unrealized holding gains (losses) on investments:

Unrealized holding gains (losses) arising in the period

(18.4
)

(25.4
)

(161.0
)

23.7

Income tax expense (benefit)

(6.5
)

(8.9
)

(56.4
)

3.5

(11.9
)

(16.5
)

(104.6
)

20.2

Reclassification adjustments for gains included
in net income for the period

(75.8
)

-

(75.8
)

-

Income tax expense

26.5

-

26.5

-

(49.3
)

-

(49.3
)

-

Net unrealized gains (losses) in the period

(94.2
)

(25.4
)

(236.8
)

23.7

Income tax expense (benefit)

(33.0
)

(8.9
)

(82.9
)

3.5

(61.2
)

(16.5
)

(153.9
)

20.2

Foreign currency translation adjustment

-

(0.3
)

-

(0.1
)

Other comprehensive income (loss) before tax

(94.2
)

(25.7
)

(236.8
)

23.6

Income tax expense (benefit)

(33.0
)

(8.9
)

(82.9
)

3.5

Other comprehensive income (loss)

(61.2
)

(16.8
)

(153.9
)

20.1

Comprehensive income

$
340.9

$
245.8

$
561.2

$
472.5

11.

Earnings per Share:

Basic earnings per share was computed by dividing net income applicable to common shares by the weighted average number of common shares outstanding during the period. Diluted earnings per share reflects the potential dilution that could occur assuming conversion or exercise of all dilutive unexercised stock options and outstanding preferred stock. For both the three and six months ended June 30, 2005, stock options totaling 7.1 million shares were not included in the computation of diluted earnings per share because the exercise price of the stock options was greater than the average market price of the common stock. The number of stock options not included in the computation of diluted earnings per share was 11.1 million for both the three and six months ended June 30, 2004. A reconciliation of the net income and number of shares used in computing basic and diluted earnings per share was as follows for the three and six month periods ended June 30:

Three Months Ended

Six Months Ended

(Millions, except per share amounts)

2005

2004

2005

2004

Basic earnings per share:

Net income

$

402.1

$
262.6

$
715.1

$
452.4

Less preferred dividends

(0.1
)

(0.1
)

(0.1
)

(0.1
)

Net income applicable to common shares

$
402.0

$
262.5

$
715.0

$
452.3

Weighted average common shares outstanding for the period

314.5

308.2

308.3

309.8

Basic earnings per share

$1.28

$.85

$2.32

$1.46

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NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS-(Continued)

11.

Earnings per Share, Continued:

Three Months Ended

Six Months Ended

(Millions, except per share amounts)

2005

2004

2005

2004

Diluted earnings per share:

Net income applicable to common shares

$
402.0

$
262.5

$
715.0

$
452.3

Adjustment for convertible preferred stock dividends

0.1

0.1

0.1

0.1

Net income applicable to common shares

assuming conversion of preferred stock

$
402.1

$
262.6

$
715.1

$
452.4

Weighted average common shares outstanding for the period

314.5

308.2

308.3

309.8

Increase in shares resulting from:

Assumed exercise of stock options

1.0

0.6

1.0

0.6

Assumed conversion of preferred stock

0.2

0.3

0.2

0.3

Non-vested restricted stock awards

0.1

-

0.1

-

Weighted average common shares assuming conversion

315.8

309.1

309.6

310.7

Diluted earnings per share

$1.27

$.85

$2.31

$1.46

12.

Commitments and Contingencies:

The Company currently has outstanding various indemnifications related to the April 1, 2003 sale of the financial services division to Fidelity National. In conjunction with the sale, Alltel agreed to indemnify Fidelity National for any damages resulting from Alltel s breach of warranty or non-fulfillment of certain covenants under the sales agreement, that exceed 1.5 percent of the purchase price, or $15.75 million, up to a maximum of 15 percent of the purchase price, or $157.5 million. Because of the low probability of being required to pay any amount under this indemnification, Alltel determined the fair value of this obligation to be immaterial to the consolidated results of operations, cash flows and financial condition of the Company. Accordingly, the Company has not recorded a liability related to it. Alltel also agreed to indemnify Fidelity National from any future tax liability imposed on the financial services division related to periods prior to the date of sale. Alltel s obligation to Fidelity National under this indemnification is not subject to a maximum amount. The Company has recorded a liability for tax contingencies of approximately $8.3 million related to the operations of the financial services division for periods prior to the date of sale that management has assessed as probable and estimable, which should adequately cover any obligation under this indemnification.

13.

Business Segment Information:

Alltel manages its business operations based on differences in products and services. The Company evaluates performance of the segments based on segment income, which is computed as revenues and sales less operating expenses, excluding the effects of the items discussed in

Notes 7, 8 and 9, respectively. These items are not allocated to the segments and are included in corporate operations. Segment operating results were as follows for the three and six month periods ended June 30:

(Millions)	Three Months Ended		Six Months Ended	
	2005	2004	2005	2004
Revenues and Sales from External Customers:				

Wireless	$ 1,455.3	$ 1,253.1	$ 2,807.3	$ 2,437.6
Wireline	555.9	564.7	1,111.9	1,126.1
Communications support services	202.8	179.0		

375.1

337.8

Total business segments

$
2,214.0

$
1,996.8

$
4,294.3

$
3,901.5

Intersegment Revenues and Sales:

Wireless

$
-

$
-

$
-

$
-

Wireline

39.2

44.9

76.8

83.0

Communications support services

58.4

50.2

110.8

110.4

Total business segments

$
97.6

$
95.1

$
187.6

$
193.4

Total Revenues and Sales:

Wireless	$ 1,455.3	$ 1,253.1	$ 2,807.3	$ 2,437.6
Wireline	595.1	609.6	1,188.7	1,209.1
Communications support services	261.2	229.2	485.9	448.2

Total business segments	2,311.6	2,091.9	4,481.9	4,094.9
Less intercompany eliminations	(51.5)	(49.8)	(95.8)	(91.6)

Total revenues and sales	$ 2,260.1	$ 2,042.1	$ 4,386.1	$ 4,003.3

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NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS-(Continued)

13.

Business Segment Information, Continued:

(Millions)	Three Months Ended		Six Months Ended	
	2005	2004	2005	2004

Segment Income:

Wireless	$ 306.9	$ 261.6	$ 578.5	$ 472.5
Wireline	215.3	234.4	429.8	462.6
Communications support services	11.6			

20.8

23.5

37.3