CHINA AUTOMOTIVE SYSTEMS INC
Form 10-Q
August 11, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark one)

x QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2016

Or

¨ TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ________ to _________

Commission file number: **000-33123**

China Automotive Systems, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**33-0885775**
(State or other jurisdiction of incorporation or organization)	(I.R.S. employer identification number)

No. 1 Henglong Road, Yu Qiao Development Zone, Shashi District

Jing Zhou City, Hubei Province, the People's Republic of China

(Address of principal executive offices)

(86) 716- 412- 7912
Issuer's telephone number

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the 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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes x No ¨

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

Large accelerated filer	¨	Accelerated filer	¨
Non-accelerated filer (Do not check if a smaller reporting company)	¨	Smaller reporting company	x

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

Yes ¨ No x

As of August 11, 2016, the Company had 32,006,310 shares of common stock issued and outstanding.

CHINA AUTOMOTIVE SYSTEMS, INC.

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Cautionary Statement

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, and Section 21E of the Securities Exchange Act of 1934. These statements relate to future events or the Company’s future financial performance. The Company has attempted to identify forward-looking statements by terminology including “anticipates,” “believes,” “expects,” “can,” “continues,” “could,” “estimates,” “expects,” “ “may,” “plans,” “potential,” “predicts,” “should” or “will” or the negative of these terms or other comparable terminology. Suc statements are subject to certain risks and uncertainties, including the matters set forth in this Quarterly Report or other reports or documents the Company files with the Securities and Exchange Commission from time to time, which could cause actual results or outcomes to differ materially from those projected. Although the Company believes that the expectations reflected in the forward-looking statements are reasonable, the Company cannot guarantee future results, levels of activity, performance or achievements. Undue reliance should not be placed on these forward-looking statements, which speak only as of the date hereof. The Company’s expectations are as of the date this Form 10-Q is filed, and the Company does not intend to update any of the forward-looking statements after the date this Quarterly Report on Form 10-Q is filed to conform these statements to actual results, unless required by law. All of the forward-looking statements are qualified in their entirety by reference to the factors discussed under Item 1A. “Risk Factors” in the Company’s Annual Report on Form 10-K for the year ended December 31, 2015, as filed with the Securities and Exchange Commission.

PART I — FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS.

China Automotive Systems, Inc. and Subsidiaries

Condensed Unaudited Consolidated Statements of Operations and Comprehensive Income

(In thousands of USD, except share and per share amounts)

	Three Months Ended June 30, 2016	2015
Net product sales ($10,054 and $11,640 sold to related parties for the three months ended June 30, 2016 and 2015)	$ 101,017	$ 109,167
Cost of products sold ($6,168 and $5,630 purchased from related parties for the three months ended June 30, 2016 and 2015)	82,869	87,374
Gross profit	18,148	21,793
Gain on other sales	1,185	713
Less: Operating expenses		
Selling expenses	4,128	4,046
General and administrative expenses	3,942	3,787
Research and development expenses	5,987	6,413
Total operating expenses	14,057	14,246
Income from operations	5,276	8,260
Other income, net	1,219	271
Interest expense	(127)	(65)
Financial income, net	148	709
Income before income tax expenses and equity in earnings of affiliated companies	6,516	9,175
Less: Income taxes	1,196	1,645
Equity in earnings of affiliated companies	195	98
Net income	5,515	7,628
Net income/(loss) attributable to non-controlling interests	151	(31)
Net income attributable to parent company's common shareholders	$ 5,364	$ 7,659
Comprehensive income:		
Net income	$ 5,515	$ 7,628
Other comprehensive income:		
Foreign currency translation (loss)/gain, net of tax	(7,946)	1,436
Comprehensive (loss)/income	(2,431)	9,064
Comprehensive (loss)/income attributable to non-controlling interests	(164)	34
Comprehensive (loss)/income attributable to parent company	$ (2,267)	$ 9,030

Net income attributable to parent company's common shareholders per share

Basic –	$ 0.17	$ 0.24
Diluted-	$ 0.17	$ 0.24
Weighted average number of common shares outstanding		
Basic	32,085,822	32,121,019
Diluted	32,087,634	32,138,438

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

China Automotive Systems, Inc. and Subsidiaries

Condensed Unaudited Consolidated Statements of Operations and Comprehensive Income

(In thousands of USD, except share and per share amounts)

	Six Months Ended June 30, 2016	Six Months Ended June 30, 2015
Net product sales ($18,639 and $19,939 sold to related parties for the six months ended June 30, 2016 and 2015)	$217,871	$232,610
Cost of products sold ($13,043 and $12,638 purchased from related parties for the six months ended June 30, 2016 and 2015)	178,711	189,146
Gross profit	39,160	43,464
Gain on other sales	1,986	2,371
Less: Operating expenses		
Selling expenses	8,433	7,670
General and administrative expenses	8,257	8,235
Research and development expenses	12,126	12,306
Total operating expenses	28,816	28,211
Income from operations	12,330	17,624
Other income, net	575	365
Interest expense	(323)	(540)
Financial income, net	470	1,463
Income before income tax expenses and equity in earnings of affiliated companies	13,052	18,912
Less: Income taxes	2,249	3,055
Equity in earnings of affiliated companies	257	164
Net income	11,060	16,021
Net loss attributable to non-controlling interests	(13)	(150)
Net income attributable to parent company’s common shareholders	$11,073	$16,171
Comprehensive income:		
Net income	$11,060	$16,021
Other comprehensive income:		
Foreign currency translation (loss)/gain, net of tax	(6,296)	161
Comprehensive income	4,764	16,182
Comprehensive loss attributable to non-controlling interests	(249)	(167)
Comprehensive income attributable to parent company	$5,013	$16,349
Net income attributable to parent company’s common shareholders per share		
Basic –	$0.34	$0.50
Diluted-	$0.34	$0.50
Weighted average number of common shares outstanding		
Basic	32,103,420	32,121,019
Diluted	32,105,611	32,136,585

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

China Automotive Systems, Inc. and Subsidiaries

Condensed Unaudited Consolidated Balance Sheets

(In thousands of USD unless otherwise indicated)

	June 30, 2016	December 31, 2015
ASSETS		
Current assets:		
Cash and cash equivalents	$ 37,864	$ 69,676
Pledged cash	24,430	31,402
Short-term investments	33,553	21,209
Accounts and notes receivable, net - unrelated parties	293,135	254,397
Accounts and notes receivable, net - related parties	20,947	21,918
Advance payments and others - unrelated parties	11,250	4,381
Advance payments and others - related parties	386	544
Inventories	63,086	65,570
Current deferred tax assets	6,500	6,962
Total current assets	491,151	476,059
Non-current assets:		
Long-term time deposits	4,976	5,082
Property, plant and equipment, net	86,695	84,151
Intangible assets, net	659	2,793
Other receivables, net - unrelated parties	2,148	3,882
Other receivables, net - related parties	-	14
Advance payment for property, plant and equipment - unrelated parties	14,669	15,192
Advance payment for property, plant and equipment - related parties	10,055	8,863
Long-term investments	9,294	6,152
Goodwill	-	608
Non-current deferred tax assets	4,959	4,899
Total assets	$ 624,606	$ 607,695
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Bank and government loans	$ 42,239	$ 40,929
Accounts and notes payable - unrelated parties	214,586	197,105
Accounts and notes payable - related parties	6,698	6,363
Customer deposits	449	1,613
Accrued payroll and related costs	6,271	6,332
Accrued expenses and other payables	29,828	31,383
Accrued pension costs	4,967	4,664
Taxes payable	9,154	9,284
Amounts due to shareholders/directors	335	345
Advances payable (current portion)	324	-

Current deferred tax liabilities	164	194
Total current liabilities	315,015	298,212
Long-term liabilities:		
Long-term loan	65	-
Advances payable	535	1,922
Non-current deferred tax liabilities	-	266
Total liabilities	$ 315,615	$ 300,400
Commitments and Contingencies (See Note 29)		
Stockholders' equity:		
Common stock, $0.0001 par value - Authorized - 80,000,000 shares; Issued – 32,338,302 and 32,338,302 shares as of June 30, 2016 and December 31, 2015, respectively	$ 3	$ 3
Additional paid-in capital	64,627	64,627
Retained earnings-		
Appropriated	10,521	10,379
Unappropriated	217,553	206,622
Accumulated other comprehensive income	12,352	18,412
Treasury stock – 331,992 and 217,283 shares as of June 30, 2016 and December 31, 2015, respectively	(1,454)	(1,000)
Total parent company stockholders' equity	303,602	299,043
Non-controlling interests	5,389	8,252
Total stockholders' equity	308,991	307,295
Total liabilities and stockholders' equity	$ 624,606	$ 607,695

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

China Automotive Systems, Inc. and Subsidiaries

Condensed Unaudited Consolidated Statements of Cash Flows

(In thousands of USD unless otherwise indicated)

	Six Months Ended June 30,	
	2016	2015
Cash flows from operating activities:		
Net income	$ 11,060	$ 16,021
Adjustments to reconcile net income from operations to net cash provided by operating activities:		
Depreciation and amortization	7,351	7,897
Reversal of provision for doubtful accounts	(49)	(32)
Inventory write downs	1,902	1,307
Deferred income taxes	(27)	(849)
Equity in earnings of affiliated companies	(257)	(164)
Gain on disposal of Fujian Qiaolong	(698)	-
Gain/loss on fixed assets disposals	(14)	1
Changes in operating assets and liabilities (net of the impact of disposal of Fujian Qiaolong):		
(Increase) decrease in:		
Pledged cash	6,528	840
Accounts and notes receivable	(50,973)	1,843
Advance payments and others	(1,437)	(449)
Inventories	(5,956)	(4,604)
Increase (decrease) in:		
Accounts and notes payable	25,885	(2,951)
Customer deposits	(908)	(661)
Accrued payroll and related costs	152	(1,595)
Accrued expenses and other payables	456	1,268
Accrued pension costs	407	(140)
Taxes payable	276	(3,237)
Advances payable	(75)	-
Net cash (used in) provided by operating activities	(6,377)	14,495
Cash flows from investing activities:		
(Increase)/decrease in other receivables	1,438	(153)
Proceeds from disposition of a subsidiary, net of cash disposed of $1,063	1,953	-
Cash received from property, plant and equipment sales	719	570
Payments to acquire property, plant and equipment	(18,454)	(13,705)
Payments to acquire intangible assets	(60)	(825)
Purchase of short-term investments	(14,797)	(11,388)
Proceeds from maturities of short-term investments	1,827	14,672
Investment under equity method	(3,013)	(1,636)
Net cash used in investing activities	(30,387)	(12,465)

Cash flows from financing activities:		
Proceeds from bank and government loans	11,541	6,420
Repayments of bank and government loans	(5,138)	(5,048)
Dividends paid to the non-controlling interests holders	-	(814)
Dividends paid to the holders of the Company’s common stock	-	(252)
Repurchase of common stock	(454)	-
Net cash provided by financing activities	5,949	306
Effects of exchange rate on cash and cash equivalents	(997)	48
Net decrease in cash and cash equivalents	(31,812)	2,384
Cash and cash equivalents at beginning of period	69,676	68,505
Cash and cash equivalents at end of period	$ 37,864	$ 70,889

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

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China Automotive Systems, Inc. and Subsidiaries

Condensed Unaudited Consolidated Statements of Cash Flows (continued)

(In thousands of USD unless otherwise indicated)

SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:

	Six Months Ended June 30,	
	2016	2015
Cash paid for interest	$ 180	$ 561
Cash paid for income taxes	1,253	5,487

SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING ACTIVITIES:

	Six Months Ended June 30,	
	2016	2015
Property, plant and equipment recorded during the period for which there previously were advance payments	$ 7,580	$ 6,732
Accounts payable for acquiring property, plant and equipment	845	238
Dividends payable to non-controlling interests	464	318

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

China Automotive Systems, Inc. and Subsidiaries

Notes to Condensed Unaudited Consolidated Financial Statements

Three Months and Six Months Ended June 30, 2016 and 2015

1. Organization and business

China Automotive Systems, Inc., “China Automotive,” was incorporated in the State of Delaware on June 29, 1999 under the name Visions-In-Glass, Inc. China Automotive, including, when the context so requires, its subsidiaries and the joint ventures described below, is referred to herein as the “Company.” The Company is primarily engaged in the manufacture and sale of automotive systems and components, as described below.

Great Genesis Holdings Limited, a company incorporated in Hong Kong on January 3, 2003 under the Companies Ordinance in Hong Kong as a limited liability company, “Genesis,” is a wholly-owned subsidiary of the Company. Great Genesis is mainly engaged in the manufacture and sale of automotive systems and components through its controlled subsidiaries and the joint ventures, as described below.

Henglong USA Corporation, “HLUSA,” incorporated on January 8, 2007 in Troy, Michigan, is a wholly-owned subsidiary of the Company, and is mainly engaged in marketing of automotive parts in North America, and provides after-sales service and research and development support accordingly.

The Company owns the following aggregate net interests in the entities established in the People's Republic of China, the “PRC,” and Brazil as of June 30, 2016 and December 31, 2015.

Name of Entity	Percentage Interest June 30, 2016	Percentage Interest December 31, 2015
Shashi Jiulong Power Steering Gears Co., Ltd., “Jiulong”[1]	100.00 %	100.00 %
Jingzhou Henglong Automotive Parts Co., Ltd., “Henglong”[2]	100.00 %	100.00 %
Shenyang Jinbei Henglong Automotive Steering System Co., Ltd., “Shenyang”[3]	70.00 %	70.00 %
Universal Sensor Application Inc., “USAI”[4]	83.34 %	83.34 %
Wuhan Jielong Electric Power Steering Co., Ltd., “Jielong”[5]	85.00 %	85.00 %
Wuhu HengLong Automotive Steering System Co., Ltd., “Wuhu”[6]	77.33 %	77.33 %
Hubei Henglong Automotive System Group Co., Ltd, “Hubei Henglong”[7]	100.00 %	100.00 %

Jingzhou Henglong Automotive Technology (Testing) Center, “Testing Center”[8]	100.00 %	100.00 %
Beijing Henglong Automotive System Co., Ltd., “Beijing Henglong”[9]	50.00 %	50.00 %
Chongqing Henglong Hongyan Automotive System Co., Ltd., “Chongqing Henglong”[10]	70.00 %	70.00 %
CAAS Brazil’s Imports And Trade In Automotive Parts Ltd., “Brazil Henglong”[11]	80.00 %	80.00 %
Fujian Qiaolong Special Purpose Vehicle Co., Ltd., “Fujian Qiaolong”[12]	0.00 %	51.00 %
Wuhan Chuguanjie Automotive Science and Technology Ltd., “Wuhan Chuguanjie”[13]	85.00 %	85.00 %
Hubei Henglong Group Shanghai Automotive Electronics Research and Development Ltd., “Shanghai Henglong”[14]	100.00 %	100.00 %

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1. Jiulong was established in 1993 and mainly engages in the production of integral power steering gears for heavy-duty vehicles.
2. Henglong was established in 1997 and mainly engages in the production of rack and pinion power steering gears for cars and light duty vehicles.
3. Shenyang was established in 2002 and focuses on power steering parts for light duty vehicles.
4. USAI was established in 2005 and mainly engages in the production and sales of sensor modules.
5. Jielong was established in 2006 and mainly engages in the production and sales of automotive steering columns.
6. Wuhu was established in 2006 and mainly engages in the production and sales of automobile steering systems.
7. On March 7, 2007, Genesis established Hubei Henglong, formerly known as Jingzhou Hengsheng Automotive System Co., Ltd., its wholly-owned subsidiary, to engage in the production and sales of automotive steering systems. On July 8, 2012, Hubei Henglong changed its name to Hubei Henglong Automotive System Group Co., Ltd.
8. In December 2009, Henglong, a subsidiary of Genesis, formed the Testing Center, which mainly engages in the research and development of new products.
9. Beijing Henglong was established in 2010 and mainly engages in the design, development and manufacture of both hydraulic and electric power steering systems and parts. According to the joint venture agreement, the Company does not have voting control of Beijing Henglong. Therefore, the Company’s consolidated financial statements do not include Beijing Henglong, and such investment is accounted for using the equity accounting method.
10. On February 21, 2012, Hubei Henglong and SAIC-IVECO Hongyan Company, “SAIC-IVECO,” established a Sino-foreign joint venture company, Chongqing Henglong, to design, develop and manufacture both hydraulic and electric power steering systems and parts.
11. On August 21, 2012, Brazil Henglong was established as a Sino-foreign joint venture company by Hubei Henglong and two Brazilian citizens, Ozias Gaia Da Silva and Ademir Dal’ Evedove. Brazil Henglong engages mainly in the import and sales of automotive parts in Brazil.
12. In the second quarter of 2014, the Company acquired a 51.0% ownership interest in Fujian Qiaolong Special Purpose Vehicle Co., Ltd., “Fujian Qiaolong”, a special purpose vehicle manufacturer and dealer with automobile repacking qualifications, based in Fujian, China. Fujian Qiaolong mainly manufactures and distributes drainage and rescue vehicles with mass flow, drainage vehicles with vertical downhole operation, crawler-type mobile pump stations, high-altitude water supply and discharge drainage vehicles, long-range control crawler-type mobile pump stations and other vehicles. On April 17, 2016, Hubei Henglong entered into a share purchase agreement (“Share Purchase Agreement”) with Longyan Huanyu Emergency Equipment Technology Co., Ltd. (“Longyan Huanyu”). Pursuant to the Share Purchase Agreement, Hubei Henglong transferred its 51% equity interests in Fujian Qiaolong to Longyan Huanyu for total consideration of RMB 20.0 million, equivalent to $3.0 million in the second quarter of 2016. The Company recognized a gain on disposal of Fujian Qiaolong of $0.7 million, which is included in other income in the consolidated statements of operations and comprehensive income for the three and six months ended June 30, 2016.
13. In May 2014, together with Hubei Wanlong, Jielong formed a subsidiary, Wuhan Chuguanjie Automotive Science and Technology Ltd., “Wuhan Chuguanjie”, which mainly engages in research and development, manufacture and sales of automobile electronic systems and parts. Wuhan Chuguanjie is located in Wuhan, China.
14. In January 2015, Hubei Henglong formed Hubei Henglong Group Shanghai Automotive Electronics Research and Development Ltd., “Shanghai Henglong”, which mainly engages in the design and sales of automotive electronics.

2. Basis of presentation and significant accounting policies

(a) Basis of Presentation

Basis of Presentation – The accompanying condensed unaudited consolidated financial statements include the accounts of the Company and its subsidiaries. The details of subsidiaries are disclosed in Note 1. Significant inter-company balances and transactions have been eliminated upon consolidation. The condensed unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America ("U.S. GAAP") for interim financial information and with the instructions in Article 10 of Regulation S-X. Accordingly they do not include all of the information and footnotes required by such accounting principles for complete financial statements. These financial statements should be read in conjunction with the consolidated financial statements and related footnotes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2015.

The accompanying interim condensed consolidated financial statements are unaudited, but in the opinion of the Company's management, contain all necessary adjustments, which include normal recurring adjustments, for a fair statement of the results of operations, financial position and cash flows for the interim periods presented.

The condensed consolidated balance sheet as of December 31, 2015 is derived from the Company's audited financial statements at that date but does not include all of the information and footnotes required by U.S. GAAP for complete financial statements.

Certain information and footnote disclosures normally included in financial statements that have been prepared in accordance with U.S. GAAP have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission, although the Company's management believes that the disclosures contained in these financial statements are adequate to make the information presented herein not misleading. For further information, please refer to the financial statements and the notes thereto included in the Company's 2015 Annual Report on Form 10-K, as filed with the Securities and Exchange Commission.

The results of operations for the three months and six months ended June 30, 2016 are not necessarily indicative of the results of operations to be expected for the full fiscal year ending December 31, 2016.

Estimation - The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the dates of the financial statements, and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

(b) Recent Accounting Pronouncements

In May 2014, the FASB and the International Accounting Standards Board (IASB) jointly issued ASU No. 2014-9, Revenue from Contracts with Customers (Topic 606), which was further updated by ASU No. 2016-08 in March 2016, ASU No.2016-10 in April 2016 and ASU No.2016-11 in May 2016. The new guidance clarifies the principles for recognizing revenue and develops a common revenue standard for GAAP and International Financial Reporting Standards (IFRS). The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and services. In July 2015, the FASB approved a deferral of the ASU effective date from annual and interim periods beginning after December 15, 2016 to annual and interim periods beginning after December 15, 2017. The Company is in the process of evaluating the impact of the ASU on its consolidated financial statements.

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments, which eliminates the probable recognition threshold for credit impairments. The new guidance broadens the information that an entity must consider in developing its expected credit loss estimate for assets measured either collectively or individually to include forecasted information, as well as past events and current conditions. There is no specified method for measuring expected credit losses, and an entity is allowed to apply methods that reasonably reflect its expectations of the credit loss estimate. This ASU is effective for the Company on December 15, 2019. The Company is in the process of evaluating the impact of the ASU on its consolidated financial statements.

In March 2016, the FASB issued ASU No. 2016-09, Compensation - Stock Compensation (Topic 718), Improvements to Employee Share-Based Payment Accounting. The ASU was issued as part of the FASB Simplification Initiative and involves several aspects of accounting for share-based payment transactions, including the income tax consequences and classification on the statement of cash flows. The guidance is effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. Early adoption is permitted for any entity in any interim or annual period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. An entity that elects early adoption must adopt all of the amendments in the same period. The Company is in the process of evaluating the impact of the ASU on its consolidated financial statements.

(c) Significant Accounting Policies

There have been no updates to the significant accounting policies set forth in the notes to the consolidated financial statements for the year ended December 31, 2015.

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3. Pledged cash

Pledged cash is used as guarantees for the Company’s notes payable and its use is restricted. The Company regularly pays some of its suppliers by bank notes. The Company has to make a cash deposit, generally equivalent to 40% - 100% of the face value of the relevant bank note, in order to obtain the bank note.

4. Short-term investments

Short-term investments are comprised of time deposits with terms of three months or more which are due within one year and wealth management financial products with maturity within one year. The carrying values of time deposits approximate fair value because of their short maturities. The interest earned is recognized in the consolidated statements of income over the contractual term of the deposits. The wealth management financial products are measured at fair value and classified as Level 2 within the fair value measurement hierarchy. The fair value was measured by using directly or indirectly observable inputs in the marketplace. Changes in the fair value are reflected in other income in the consolidated statements of operations and comprehensive income.

The Company’s short-term investments as of June 30, 2016 and December 31, 2015 are summarized as follows (figures are in thousands of USD):

	June 30, 2016	December 31, 2015
Time deposits	$ 24,279	$ 21,209
Wealth management financial products measured at fair value	9,274	-
Total	$ 33,553	$ 21,209

As of June 30, 2016, the Company had pledged short-term investments of RMB 75.7 million, equivalent to approximately $11.4 million, to secure standby letters of credit and notes payable under China CITIC Bank, China Postal Savings Bank and Bank of China. The use of the pledged short-term investments is restricted.

5. Accounts and notes receivable, net

The Company’s accounts and notes receivable as of June 30, 2016 and December 31, 2015 are summarized as follows (figures are in thousands of USD):

	June 30, 2016	December 31, 2015

Accounts receivable - unrelated parties [1]	$ 135,491	$ 141,828
Notes receivable - unrelated parties [2] [3]	158,719	113,777
Total accounts and notes receivable- unrelated parties	294,210	255,605
Less: allowance for doubtful accounts - unrelated parties	(1,075)	(1,208)
Accounts and notes receivable, net - unrelated parties	293,135	254,397
Accounts and notes receivable, net - related parties	20,947	21,918
Accounts and notes receivable, net	$ 314,082	$ 276,315

(1) As of June 30, 2016 and December 31, 2015, the Company has pledged nil and $32.3 million, respectively, of accounts receivable as security for its comprehensive credit facilities with banks in China.

(2) Notes receivable represent accounts receivable in the form of bills of exchange for which acceptances are guaranteed and settlements are handled by banks.

As of June 30, 2016, Henglong collateralized its notes receivable in an amount of RMB 232.5 million, equivalent to approximately $35.1 million, as security for the credit facilities with banks in China and the Chinese government, including RMB 207.4 million, equivalent to approximately $31.3 million, in favor of Industrial and Commercial Bank of China, Jingzhou Branch, "ICBC Jingzhou", for the purpose of obtaining the Henglong Standby Letter of Credit (as defined in Note 13) which is used as security for the non-revolving credit facility in the amount of $30.0 million provided by Industrial and Commercial Bank of China (Macau) Limited, "ICBC Macau", and RMB 25.1 million, equivalent to approximately $3.8 million, as security in favor of the Chinese government for the low-interest government loan (See Note13).

(3)

As of December 31, 2015, Henglong collateralized its notes receivable in an amount of RMB 232.9 million, equivalent to approximately $35.8 million, as security for the credit facilities with banks in China and the Chinese government, including RMB 207.4 million, equivalent to approximately $31.9 million, in favor of Industrial and Commercial Bank of China, Jingzhou Branch, "ICBC Jingzhou," for the purpose of obtaining the Henglong Standby Letter of Credit (as defined in Note 13) which is used as security for the non-revolving credit facility in the amount of $30.0 million provided by Industrial and Commercial Bank of China (Macau) Limited, "ICBC Macau," and RMB 25.5 million, equivalent to approximately $3.9 million, in favor of the Chinese government as security for the low-interest government loan. (See Note 13).

6. Inventories

The Company's inventories as of June 30, 2016 and December 31, 2015 consisted of the following (figures are in thousands of USD):

	June 30, 2016	December 31, 2015
Raw materials	$ 14,775	$ 15,653
Work in process	11,059	14,222
Finished goods	37,252	35,695
Total	$ 63,086	$ 65,570

Provision for inventories amounted to $1.9 million and $1.3 million for the six months ended June 30, 2016 and 2015, respectively.

7. Other receivables, net

The Company’s other receivables as of June 30, 2016 and December 31, 2015 are summarized as follows (figures are in thousands of USD):

	June 30, 2016	December 31, 2015
Other receivables - unrelated parties (1)	$ 312	$ 1,770
Other receivables - employee housing loans (2)	1,898	2,175
Less: allowance for doubtful accounts - unrelated parties	(62)	(63)
Other receivables, net - unrelated parties	$ 2,148	$ 3,882

	June 30, 2016	December 31, 2015
Other receivables - related parties [1]	$ 608	$ 621
Less: allowance for doubtful accounts - related parties	(608)	(607)
Other receivables, net - related parties	$ -	$ 14

(1) Other receivables consist of amounts advanced to both related and unrelated parties, primarily as unsecured demand loans. These receivables originate as part of the Company's normal operating activities and are periodically settled in cash.

(2) On May 28, 2014, the board of directors of the Company approved a loan program under which the Company will lend an aggregate of up to RMB50.0 million, equivalent to approximately $7.5 million, to the employees of the Company to assist them in purchasing houses. Employees are required to pay interest at an annual rate of 6.4%. These loans are unsecured and the term of the loans is generally five years.

8. Long-term time deposits

In July 2015, the Company purchased long-term time deposits of RMB33.0 million, equivalent to approximately $5.0 million, with an annual interest rate of 3.12%.

As of June 30, 2016 and December 31, 2015, the Company had pledged long-term time deposits of RMB33.0 million, equivalent to approximately $5.0 million, to secure loans under the credit facility issued by HSBC Bank (China) Company Limited Hong Kong branch (“HSBC HK”) and the use of the pledged long-term time deposits is restricted (See Note 13).

9. Long-term investments

On January 24, 2010, the Company invested $3.1 million to establish a joint venture company, Beijing Henglong, with Hainachuan. The Company owns 50% of the equity in Beijing Henglong and can exercise significant influence over Beijing Henglong’s operating and financial policies. The Company accounted for Beijing Henglong’s operational results using the equity method. As of both June 30, 2016 and December 31, 2015, the Company had $3.8 million of net equity in Beijing Henglong.

On September 22, 2014, Hubei Henglong entered into an agreement with other parties to establish a venture capital fund, the “Venture Fund”, which mainly focuses on investments in emerging automobiles and parts industries. As of June 30, 2016, Hubei Henglong has completed a capital contribution of RMB35.0 million, equivalent to approximately $5.3 million, representing 14.7% of the Venture Fund’s shares. As a limited partner, Hubei Henglong has more than virtually no influence over the Venture Fund’s operating and financial policies. The investment is accounted for using the equity method. As of June 30, 2016 and December 31, 2015, the Company had $5.5 million and $2.4 million of net equity in the Venture Fund, respectively.

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The Company's consolidated financial statements reflect the net income of non-consolidated affiliates of $0.26 million and $0.16 million for the six months ended June 30, 2016 and 2015, respectively.

10. Property, plant and equipment, net

The Company's property, plant and equipment as of June 30, 2016 and December 31, 2015 are summarized as follows (figures are in thousands of USD):

	June 30, 2016	December 31, 2015
Land use rights and buildings	$ 48,063	$ 51,384
Machinery and equipment	127,515	120,706
Electronic equipment	7,376	7,527
Motor vehicles	4,525	4,526
Construction in progress	14,287	11,225
Total amount of property, plant and equipment	201,766	195,368
Less: Accumulated depreciation (1)	(115,071)	(111,217)
Total amount of property, plant and equipment, net (2)(3)	$ 86,695	$ 84,151

(1) As of June 30, 2016 and December 31, 2015, the Company had pledged property, plant and equipment with net book value of $29.4 million and $34.1 million, respectively, for its comprehensive credit facilities with banks in China.

(2) Depreciation charges were $3.5 million and $3.6 million for the three months ended June 30, 2016 and 2015, respectively, and $7.1 million and $7.4 million for the six months ended June 30, 2016 and 2015, respectively.

(3) During the three and six months ended June 30, 2016, nil and $1.1 million, respectively, of government subsidies were recorded as a reduction of the cost of property, plant and equipment.

(4) Interest costs capitalized for the three and six months ended June 30, 2016 were $0.1 million and $0.2 million respectively. No interest costs were capitalized for the three and six months ended June 30, 2015 since they were not significant.

11. Intangible assets

The Company's intangible assets as of June 30, 2016 and December 31, 2015 are summarized as follows (figures are in thousands of USD):

	June 30, 2016	December 31, 2015
Costs:		
Patent technology(1)	$ 2,050	$ 4,605

Management software license	1,073	1,036
Total intangible assets	3,123	5,641
Less: Amortization [1][2]	(2,464)	(2,848)
Total intangible assets, net	$ 659	$ 2,793

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(1) In the three months ended June 30, 2016, patent technology with a cost of $2.5 million and accumulated amortization of $0.5 million was disposed of along with the disposal of Fujian Qiaolong as disclosed in Note 1 to these condensed consolidated financial statements. As a result of the disposal, goodwill which has arisen during the acquisition of Fujian Qiaolong was also reduced to zero.

(2) Amortization expenses were $0.1 million and $0.3 million for the three months ended June 30, 2016 and 2015, respectively, and $0.2 million and $0.5 million for the six months ended June 30, 2016 and 2015, respectively.

12. Deferred income tax assets

In accordance with the provisions of *ASC Topic 740, "Income Taxes",* the Company assesses, on a quarterly basis, its ability to realize its deferred tax assets. Based on the more likely than not standard in the guidance and the weight of available evidence, the Company believes a valuation allowance against its deferred tax assets is necessary. In determining the need for a valuation allowance, the Company considered the following significant factors: an assessment of recent years' profitability and losses by tax authorities; the Company's expectation of profits based on margins and volumes expected to be realized, which are based on current pricing and volume trends; the long period in all significant operating jurisdictions before the expiry of net operating losses, noting further that a portion of the deferred tax asset is composed of deductible temporary differences that are subject to an expiry period until realized under tax law. The Company will continue to evaluate the provision of valuation allowance in future periods.

The components of estimated deferred income tax assets as of June 30, 2016 and December 31, 2015 are as follows (figures are in thousands of USD):

	June 30, 2016	December 31, 2015
Losses carry forward (U.S.) [1]	$ 7,278	$ 6,498
Losses carry forward (Non-US) [1]	2,637	2,901
Product warranties and other reserves	4,031	4,344
Property, plant and equipment	4,576	4,656
Share-based compensation	222	222
Bonus accrual	484	379
Other accruals	810	995
Deductible temporary difference related to revenue recognition	33	-
Others	1,140	1,350
Total deferred tax assets	21,211	21,345
Less: taxable temporary difference related to revenue recognition	-	(105)
Total deferred tax assets, net	21,211	21,240
Less: Valuation allowance	(9,752)	(9,379)
Total deferred tax assets, net of valuation allowance [2]	$ 11,459	$ 11,861

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(1) The net operating losses carry forward for the U.S. entities for income tax purposes are available to reduce future years' taxable income. These losses will expire, if not utilized, in 20 years. Net operating losses carry forward for China entities can be carried forward for 5 years to offset taxable income. However, as of June 30, 2016, the valuation allowance was $9.8 million, including $7.5 million allowance for the Company's deferred tax assets in the United States and $2.3 million allowance for the Company's non-U.S. deferred tax assets in China. Based on the Company's current operations in the United States, management believes that the deferred tax assets in the United States are not likely to be realized in the future. For the deferred tax assets in other countries, pursuant to certain tax laws and regulations, the management believes such amount will not be used to offset future taxable income.

(2) Approximately $5.0 million and $4.9 million of net deferred income tax asset as of June 30, 2016 and December 31, 2015, respectively, are included in non-current deferred tax assets in the accompanying condensed unaudited consolidated balance sheets. The remaining $6.5 million and $7.0 million of net deferred income tax assets as of June 30, 2016 and December 31, 2015, respectively, are included in current deferred tax assets.

13. Bank and government loans

Loans consist of the following as of June 30, 2016 and December 31, 2015 (figures are in thousands of USD):

	June 30, 2016	December 31, 2015
Short-term bank loan (1)	$ 2,263	$ 2,079
Short-term bank loan (2) (3)	35,000	35,000
Short-term government loan (4)	4,976	3,850
Bank and government loans	$ 42,239	$ 40,929

(1) These loans are secured by property, plant and equipment of the Company and are repayable within one year (See Note 10). As of June 30, 2016 and December 31, 2015, the weighted average interest rate was 5.3% and 8.0% per annum, respectively. Interest is to be paid monthly or quarterly on the twentieth day of the applicable month or quarter and the principal repayment is at maturity.

(2) On May 18, 2012, the Company entered into a credit facility agreement, the "Credit Agreement," with ICBC Macau to obtain a non-revolving credit facility in the amount of $30.0 million, the "Credit Facility". The Credit Facility would have expired on November 3, 2012 unless the Company drew down the line of credit in full prior to such expiration date, and the maturity date for the loan drawdown was the earlier of (i) 18 months from the drawdown or (ii) 1 month before the expiry of the standby letter of credit obtained by Henglong from ICBC Jingzhou as security for the Credit Facility, the "Henglong Standby Letter of Credit". The interest rate of the Credit Facility is calculated based on a three-month LIBOR plus 2.25% per annum, subject to the availability of funds and fluctuation at ICBC Macau's discretion. The interest is calculated daily based on a 360-day year and it is fixed one day before the first day of each interest period. The interest period is defined as three months from the date of drawdown. As security for the Credit Facility, the Company was required to provide ICBC Macau with the Henglong Standby Letter of Credit for a total amount not less than $31.6 million if the Credit Facility is fully drawn.

On May 22, 2012, the Company drew down the full amount of $30.0 million under the Credit Facility and provided the Henglong Standby Letter of Credit for an amount of $31.6 million in favor of ICBC Macau. The Henglong Standby Letter of Credit issued by ICBC Jingzhou is collateralized by Henglong's notes receivable of RMB207.1 million, equivalent to approximately $32.6 million. The Company also paid an arrangement fee of $0.1 million to ICBC Macau and $0.1 million to ICBC Jingzhou. The original maturity date of the Credit Facility was May 22, 2013 and it was extended to May 12, 2017 after being extended four times. The Company is expected to extend the loan for another year upon its maturity. The interest rate of the Credit Facility under the extended term is three-month LIBOR plus 0.7% per annum. Except for the above, all other terms and conditions as stipulated in the Credit Agreement remain unchanged. As of June 30, 2016, the interest rate of the Credit Facility was 1.35% per annum.

(3) On July 16, 2014, Great Genesis entered into a credit facility agreement with HSBC HK to obtain a non-revolving credit facility in the amount of $5.0 million, the “HSBC Credit Facility”. The HSBC Credit Facility expired on July 1, 2015, and had an annual interest rate of 1.7%. Interest was paid on the twentieth day of each month and the principal repayment was at maturity. As security for the HSBC Credit Facility, the Company’s subsidiary Hubei Henglong was required to provide HSBC HK with the Standby Letter of Credit for a total amount of not less than $5.4 million if the HSBC Credit Facility was fully drawn.

On July 22, 2014, Great Genesis drew down a loan amounting to $5.0 million provided by HSBC HK and Hubei Henglong provided a Standby Letter of Credit for an amount of $5.4 million in favor of HSBC HK. Hubei Henglong’s Standby Letter of Credit was issued by HSBC Bank (China) Company Limited Wuhan branch and is collateralized by long-term time deposits of Hubei Henglong of RMB33.0 million, equivalent to approximately $5.4 million.

On July 7, 2016, HSBC HK agreed to extend the maturity date of the Credit Facility to July 1, 2017. Hubei Henglong provided a Standby Letter of Credit in an amount of $5.1 million in favor of HSBC HK. The Standby Letter of Credit was issued by HSBC Bank (China) Company Limited Wuhan branch and is collateralized by long-term time deposits of Hubei Henglong of RMB36.0 million, equivalent to approximately $5.4 million. The interest rate of the Credit Facility under the extended term is revised as three-month LIBOR plus 0.8% per annum, i.e.1.45% per annum. Except for the above, all other terms and conditions as stipulated in the Credit Agreement remained unchanged.

On March 31, 2015, the Company received a Chinese government loan of RMB25.0 million, equivalent to approximately $3.9 million, with an interest rate of 2.5% per annum, which matured on April 20, 2016. On June 10, 2016, the Chinese Government agreed to extend the maturity date to June 10, 2017. The interest rate of the government loan under the extended term is 1.5%. Except for the above, all other terms and conditions of the loan remain unchanged. Henglong pledged RMB 25.1 million, equivalent to approximately $3.8 million, of notes receivable as security for such Chinese government loan (See Note 5).

(4)

On April 1, 2016, the Company received an entrusted Chinese government loan of RMB 8.0 million, equivalent to approximately $1.2 million, with a zero interest rate, which will mature on December 10, 2016. The entrusted government loan was issued by China Construction Bank Jingzhou branch, and Hubei Wiselink Equipment Manufacturing Co., Ltd., “Hubei Wiselink”, pledged its land use rights and buildings with an assessed value of approximately $5.1 million as security for this entrusted government loan.

14. Accounts and notes payable

The Company’s accounts and notes payable as of June 30, 2016 and December 31, 2015 are summarized as follows (figures are in thousands of USD):

	June 30, 2016	December 31, 2015
Accounts payable - unrelated parties	$ 131,558	$ 126,759
Notes payable - unrelated parties [(1)]	83,028	70,346
Accounts and notes payable - unrelated parties	214,586	197,105
Accounts payable - related parties	5,813	5,578
Notes payable-related parties	885	785
Accounts and notes payable - related parties	6,698	6,363
Balance at end of period	$ 221,284	$ 203,468

(1) Notes payable represent accounts payable in the form of bills of exchange whose acceptances are guaranteed and settlements are handled by banks. The Company has pledged cash deposits, short-term investments, notes receivable and certain property, plant and equipment to secure notes payable granted by banks.

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15. Accrued expenses and other payables

The Company's accrued expenses and other payables as of June 30, 2016 and December 31, 2015 are summarized as follows (figures are in thousands of USD):

	June 30, 2016	December 31, 2015
Accrued expenses	$ 6,185	$ 6,186
Accrued interest	33	116
Other payables	1,403	1,517
Dividends payable to common shareholders [1]	505	505
Dividends payable to non-controlling interests[2]	464	-
Warranty reserves [3]	21,238	23,059
Total	$ 29,828	$ 31,383

(1) On May 27, 2014, the Company announced the payment of a special cash dividend of $0.18 per common share to the Company's shareholders of record as of the close of business on June 26, 2014. As of June 30, 2016, dividends payable of $0.5 million remained unpaid.

(2) In accordance with the resolution of the Board of Directors of Shenyang, in the second quarter of 2016, Shenyang declared a dividend amounting to $1.5 million to its shareholders, of which $0.5 million was payable to the holder of the non-controlling interests. As of June 30, 2016, the dividends have not yet been paid to the holder of the non-controlling interests.

(3) The Company provides for the estimated cost of product warranties when the products are sold. Such estimates of product warranties are based on, among other things, historical experience, product changes, material expenses, services and transportation expenses arising from the manufactured products. Estimates will be adjusted on the basis of actual claims and circumstances.

For the three months ended June 30, 2016 and 2015, the warranties activities were as follows (figures are in thousands of USD):

	Three Months Ended June 30,	
	2016	2015
Balance at beginning of the period	$ 23,187	$ 25,918
Additions during the period	1,945	2,324
Settlement within period, by cash or actual materials	(4,505)	(2,354)
Foreign currency translation loss	611	116
Balance at end of the period	$ 21,238	$ 26,004

For the six months ended June 30, 2016 and 2015, and for the year ended December 31, 2015, the warranties activities were as follows (figures are in thousands of USD):

	Six Months Ended June 30,		Year Ended December 31,
	2016	2015	2015
Balance at beginning of the period	$ 23,059	$ 25,011	$ 25,011
Additions during the period	3,740	4,419	9,758
Settlement within period, by cash or actual materials	(6,056)	(3,448)	(10,179)
Foreign currency translation loss	495	22	(1,531)
Balance at end of the period	$ 21,238	$ 26,004	$ 23,059

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16. Taxes payable

The Company's taxes payable as of June 30, 2016 and December 31, 2015 are summarized as follows (figures are in thousands of USD):

	June 30, 2016	December 31, 2015
Value-added tax payable	$ 6,480	$ 7,016
Income tax payable	2,096	1,744
Other tax payable	578	524
Total	$ 9,154	$ 9,284

17. Advances payable

As of June 30, 2016 and December 31, 2015, advances payable by the Company were $0.9 million and $1.9 million, respectively.

The amounts are special subsidies made by the Chinese government to the Company to offset the costs and charges related to the improvement of production capacities and improvement of the quality of products. For the government subsidies with no further conditions to be met, the amounts are recorded as other income when received; for the amounts with certain operating conditions, the government subsidies are recorded as advances payable when received and will be recorded as a deduction of related expenses and cost of acquired assets when the conditions are met.

The balances are unsecured, interest-free and will be repayable to the Chinese government if the usage of such advance does not continue to qualify for the subsidy.

18. Additional paid-in capital

The Company's positions in respect of the amounts of additional paid-in capital for the six months ended June 30, 2016 and 2015, and the year ended December 31, 2015 are summarized as follows (figures are in thousands of USD):

	Six Months Ended June 30,		Year Ended December 31,
	2016	2015	2015
Balance at beginning of the period	$ 64,627	$ 64,522	$ 64,522
Share-based compensation [(1)]	-	-	105
Balance at end of the period	$ 64,627	$ 64,522	$ 64,627

(1) On December 11, 2015, the Company granted 22,500 stock options to the Company's independent directors, with the exercise price equal to the closing price of the Company's common stock traded on NASDAQ on the date of grant. The fair value of stock options was determined at the date of grant using the Black-Scholes option pricing model. The Black-Scholes option model requires management to make various estimates and assumptions, including expected term, expected volatility, risk-free rate and dividend yield. The expected term represents the period of time that stock-based compensation awards granted are expected to be outstanding and is estimated based on considerations including the vesting period, contractual term and anticipated employee exercise patterns. Expected volatility is based on the historical volatility of the Company's stock. The risk-free rate is based on the U.S. Treasury yield curve in relation to the contractual life of stock-based compensation instruments. The dividend yield assumption is based on historical patterns and future expectations for the Company's dividends.

Assumptions used to estimate the fair value of stock options on the grant dates are as follows:

Issuance Date	Expected volatility	Risk-free rate	Expected term (years)	Dividend yield
December 11, 2015	126.25 %	1.62 %	5	0.00 %

The above stock options were vested and exercisable immediately. Their fair value on the grant date of December 11, 2015 using the Black-Scholes option pricing model was $0.1 million. For the year ended December 31, 2015, the Company recognized stock-based compensation expenses of $0.1 million.

19. Retained earnings

Appropriated

Pursuant to the relevant PRC laws and regulations, the profits distribution of the Company's PRC subsidiaries, which are based on their PRC statutory financial statements, rather than the financial statement that was prepared in accordance with U.S. GAAP, are available for distribution in the form of cash dividends after these subsidiaries have paid all relevant PRC tax liabilities, provided for losses in previous years, and made appropriations to statutory surplus at 10%.

When the statutory surplus reserve reaches 50% of the registered capital of a company, additional reserve is no longer required. However, the reserve cannot be distributed to venture partners. Based on the business licenses of the PRC subsidiaries, the registered capital of Henglong, Jiulong, Shenyang, USAI, Jielong, Wuhu, Hubei Henglong and Chongqing are $10.0 million, $4.2 million (equivalent to RMB35.0 million), $8.1 million (equivalent to RMB67.5 million), $2.6 million, $6.0 million, $3.8 million (equivalent to RMB30.0 million), $39.0 million and $9.5 million (equivalent to RMB60.0 million), respectively.

The Company's activities in respect of the amounts of appropriated retained earnings for the six months ended June 30, 2016 and 2015, and the year ended December 31, 2015 are summarized as follows (figures are in thousands of USD):

	Six Months Ended June 30,		Year Ended December 31,
	2016	2015	2015
Balance at beginning of the period	$ 10,379	$ 10,178	$ 10,178
Appropriation of retained earnings	142	171	201
Balance at end of the period	$ 10,521	$ 10,349	$ 10,379

Unappropriated

The Company's activities in respect of the amounts of the unappropriated retained earnings for the six months ended June 30, 2016 and 2015, and the year ended December 31, 2015 are summarized as follows (figures are in thousands of USD):

	Six Months Ended June 30,		Year Ended December 31,
	2016	2015	2015
Balance at beginning of the period	$ 206,622	$ 179,435	$ 179,435
Net income attributable to parent company	11,073	16,170	27,388
Appropriation of retained earnings	(142)	(171)	(201)
Balance at end of the period	$ 217,553	$ 195,434	$ 206,622

20. Accumulated other comprehensive income

The Company's activities in respect of the amounts of the accumulated other comprehensive income for the six months ended June 30, 2016 and 2015, and the year ended December 31, 2015 are summarized as follows (figures are in thousands of USD):

	Six Months Ended June 30,		Year Ended December 31,
	2016	2015	2015
Balance at beginning of the period	$ 18,412	$ 36,119	$ 36,119
Foreign currency translation adjustment attributable to parent company	(6,060)	178	(17,707)
Balance at end of the period	$ 12,352	$ 36,297	$ 18,412

21. Treasury stock

Treasury stock represents shares repurchased by the Company that are no longer outstanding and are held by the Company. Treasury stock is accounted for under the cost method. On December 18, 2015, the Board of Directors of the Company approved a share repurchase program under which the Company may repurchase up to $5.0 million of its common stock from time to time in the open market at prevailing market prices or in privately negotiated transactions through December 17, 2016. The repurchase program shall continue unless and until (a) revoked by the Board, (b) any further repurchases at available prices would cause the Company to be unable to pay its debts as they become due in the ordinary course of its business, or (c) December 17, 2016, whichever is the earliest. During the three and six months ended June 30, 2016, under the repurchase program, the Company had repurchased 114,709 shares of the Company's common stock for cash consideration of $0.5 million on the open market. The repurchased shares are presented as "treasury stock" on the balance sheet.

22. Non-controlling interests

The Company's activities in respect of the amounts of the non-controlling interests' equity for the six months ended June 30, 2016 and 2015, and the year ended December 31, 2015 are summarized as follows (figures are in thousands of USD):

	Six Months Ended June 30,		Year Ended December 31,
	2016	2015	2015
Balance at beginning of the period	$ 8,252	$ 8,912	$ 8,912
(Loss)/income attributable to non-controlling interests	(13)	(150)	509
Dividends declared to the non-controlling interest holders of joint-venture companies (See Note 15)	(464)	(318)	(317)
Non-controlling interests change due to the disposal of Fujian Qiaolong	(2,150)	-	-
Foreign currency translation adjustment attributable to non-controlling interests	(236)	(17)	(852)
Balance at end of the period	$ 5,389	$ 8,427	$ 8,252

23. Gain on other sales

Gain on other sales mainly consisted of net amount retained from sales of materials, property, plant and equipment, and scraps. For the six months ended June 30, 2016, gain on other sales amounted to 2.0 million as compared to $2.4 million for the six months ended June 30, 2015, representing a decrease of 0.4 million.

24. Financial income, net

During the six months ended June 30, 2016 and 2015, the Company recorded financial income, net which is summarized as follows (figures are in thousands of USD):

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	Six Months Ended June 30,	
	2016	2015
Interest income	$ (1,342)	$ (1,386)
Foreign exchange loss/(gain), net	548	(377)
Gain of cash discount, net	(3)	(28)
Bank fees	327	328
Total financial income, net	$ (470)	$ (1,463)

25. Income tax rate

The Company's subsidiaries registered in the PRC are subject to national and local income taxes within the PRC at the applicable tax rate of 25% on the taxable income as reported in their PRC statutory financial statements in accordance with the relevant income tax laws applicable to foreign invested enterprise, unless preferential tax treatment is granted by local tax authorities. If the enterprise meets certain preferential terms according to the China income tax law, such as assessment as a "High & New Technology Enterprise" by the government, then, the enterprise will be subject to enterprise income tax at a rate of 15%.

Pursuant to the New China Income Tax Law and the Implementing Rules, "New CIT", which became effective as of January 1, 2008, dividends generated after January 1, 2008 and payable by a foreign-invested enterprise to its foreign investors will be subject to a 10% withholding tax if the foreign investors are considered as non-resident enterprises without any establishment or place within China or if the dividends payable have no connection with the establishment or place of the foreign investors within China, unless any such foreign investor's jurisdiction of incorporation has a tax treaty with China that provides for a different withholding arrangement.

Genesis, the Company's wholly-owned subsidiary and the direct holder of the equity interests in the Company's subsidiaries in China, is incorporated in Hong Kong. According to the Mainland China and Hong Kong Taxation Arrangement, dividends paid by a foreign-invested enterprise in China to its direct holding company in Hong Kong will be subject to withholding tax at a rate of no more than 5%, if the foreign investor owns directly at least 25% of the shares of the foreign-invested enterprise. Under the New CIT, if Genesis is regarded as a non-resident enterprise, it is required to pay an additional 5% withholding tax for any dividends payable to it from the PRC subsidiaries.

According to PRC tax regulation, the Company should withhold income taxes for the profits distributed from the PRC subsidiaries to Genesis, the subsidiaries' holding company incorporated in Hong Kong. For the profits that the PRC subsidiaries intended to distribute to Genesis, the Company accrues the withholding income tax as deferred tax liabilities. As of June 30, 2016, the Company has recognized deferred tax liabilities of $0.2 million for the remaining undistributed profits to Genesis of $4.0 million. The Company intended to re-invest the remaining undistributed profits generated from the PRC subsidiaries in those subsidiaries permanently. As of June 30, 2016 and December 31, 2015, the Company still has undistributed earnings of approximately $236.5 million and $228.7 million, respectively, from investment in the PRC subsidiaries that are considered permanently reinvested. Had the undistributed earnings been distributed to Genesis and not permanently reinvested, the tax provision as of June 30, 2016 and December 31, 2015 of approximately $11.8 million and $11.4 million, respectively, would have been recorded. Such undistributed profits will be reinvested in Genesis and not further distributed to the parent company incorporated in the United States going forward.

In 2014, Jiulong was awarded the title of “High & New Technology Enterprise” and, based on the PRC income tax law, it is subject to enterprise income tax at a rate of 15% from 2014 to 2016.

In 2014, Henglong was awarded the title of “High & New Technology Enterprise” and, based on the PRC income tax law, it is subject to enterprise income tax at a rate of 15% from 2014 to 2016.

In 2009, Shenyang was awarded the title of “High & New Technology Enterprise” and, based on the PRC income tax law, it was subject to enterprise income tax at a rate of 15% for 2009, 2010 and 2011. In 2012, the Company passed the re-assessment of the government based on PRC income tax laws. Accordingly, it continued to be taxed at the 15% tax rate in 2012, 2013 and 2014. In 2015, the Company passed the re-assessment of the government based on PRC income tax laws. Accordingly, it continues to be taxed at the 15% tax rate in 2015, 2016 and 2017.

In 2012, Wuhu was awarded the title of “High & New Technology Enterprise” and, based on the PRC income tax law, it was subject to enterprise income tax at a rate of 15% for 2013 and 2014. In 2015, the Company passed the re-assessment of the government based on PRC income tax laws. Accordingly, it continues to be taxed at the 15% tax rate in 2015 and 2016.

In 2013, Jielong was awarded the title of “High & New Technology Enterprise” and, based on the PRC income tax law, it is subject to enterprise income tax at a rate of 15% for 2013, 2014 and 2015. The Company estimated the applied tax rate in 2016 to be 15% as it is likely to pass the re-assessment in 2016 and continue to qualify as “High & New Technology Enterprise”.

In 2011, Hubei Henglong was awarded the title of “High & New Technology Enterprise”. Based on the PRC income tax law, it was subject to enterprise income tax at a rate of 15% for 2013. The Company has passed the re-assessment in 2014 and continues to qualify as a “High & New Technology Enterprise”. Accordingly, it continues to be taxed at the 15% tax rate in 2014, 2015 and 2016.

According to the New CIT, USAI and Testing Center are subject to income tax at a rate of 25% in 2015 and 2016.

Chongqing Henglong was established in 2012. According to the New CIT, Chongqing Henglong is subject to income tax at a uniform rate of 25%. No provision for Chongqing Henglong is made as it had no assessable income for the six months ended June 30, 2016 and 2015.

Based on Brazilian income tax laws, Brazil Henglong is subject to income tax at a uniform rate of 15%, and a resident legal person is subject to additional tax at a rate of 10% for the part of taxable income over $0.12 million, equivalent to approximately BRL 0.24 million. The Company had no assessable income in Brazil for the six months ended June 30, 2016 and 2015.

The profits tax rate of Hong Kong is 16.5%. No provision for Hong Kong tax is made as Genesis is an investment holding company, and had no assessable income in Hong Kong for the six months ended June 30, 2016 and 2015.

The enterprise income tax rate of the United States is 35%. No provision for U.S. tax is made for CAAS and HLUSA as a whole, as the Company had no assessable income in the United States for the six months ended June 30, 2016 and 2015.

The Company’s effective tax rate was 18.4% and 17.2% for the three months and six months ended June 30, 2016, respectively, compared with 17.9% and 16.2% for the three months and six months ended June 30, 2015, respectively.

26. Income per share

Basic income per share is calculated by dividing net income by the weighted average number of common shares outstanding during the period. Diluted income per share is calculated using the weighted average number of ordinary shares and dilutive ordinary share equivalents outstanding during the period. The dilutive effect of outstanding stock options is determined based on the treasury stock method.

The calculation of basic and diluted income per share attributable to the parent company for the three months ended June 30, 2016 and 2015, was (figures are in thousands of USD, except share and per share amounts):

	Three Months Ended June 30,	
	2016	2015
Numerator:		

Net income attributable to the parent company’s common shareholders – Basic and Diluted	$ 5,364	$ 7,659
Denominator:		
Weighted average shares outstanding	32,085,822	32,121,019
Dilutive effects of stock options	1,812	17,419
Denominator for dilutive income per share – Diluted	32,087,634	32,138,438
Net income per share attributable to parent company’s common shareholders – Basic	$ 0.17	$ 0.24
Net income per share attributable to parent company’s common shareholders – Diluted	$ 0.17	$ 0.24

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The calculation of basic and diluted income per share attributable to the parent company for the six months ended June 30, 2016 and 2015, was (figures are in thousands of USD, except share and per share amounts):

	Six Months Ended June 30,	
	2016	2015
Numerator:		
Net income attributable to the parent company's common shareholders – Basic and Diluted	$11,073	$16,171
Denominator:		
Weighted average shares outstanding	32,103,420	32,121,019
Dilutive effects of stock options	2,191	15,566
Denominator for dilutive income per share – Diluted	32,105,611	32,136,585
Net income per share attributable to parent company's common shareholders – Basic	$0.34	$0.50
Net income per share attributable to parent company's common shareholders – Diluted	$0.34	$0.50

As of June 30, 2016 and 2015, the exercise prices for 82,500 shares and 60,000 shares, respectively, of outstanding stock options were above the weighted average market price of the Company's common stock during the six months ended June 30, 2016 and 2015, respectively, and these stock options were excluded from the calculation of the diluted income per share for the corresponding periods presented.

27. Significant concentrations

A significant portion of the Company's business is conducted in China where the currency is the RMB. Regulations in China permit foreign owned entities to freely convert the RMB into foreign currency for transactions that fall under the "current account," which includes trade related receipts and payments, interest and dividends. Accordingly, the Company's Chinese subsidiaries may use RMB to purchase foreign exchange for settlement of such "current account" transactions without pre-approval. However, pursuant to applicable regulations, foreign-invested enterprises in China may pay dividends only out of their accumulated profits, if any, determined in accordance with the PRC law. In calculating accumulated profits, foreign investment enterprises in China are required to allocate at least 10% of their annual net income each year, if any, to fund certain reserve funds, including mandated employee benefits funds, unless these reserves have reached 50% of the registered capital of the enterprises.

Transactions other than those that fall under the "current account" and that involve conversion of RMB into foreign currency are classified as "capital account" transactions; examples of "capital account" transactions include repatriations of investment by or loans to foreign owners, or direct equity investments in a foreign entity by a China domiciled entity. "Capital account" transactions require prior approval from China's State Administration of Foreign Exchange, or SAFE, or its provincial branch to convert a remittance into a foreign currency, such as USD, and transmit the foreign currency outside of China.

This system could be changed at any time and any such change may affect the ability of the Company or its subsidiaries in China to repatriate capital or profits, if any, outside China. Furthermore, SAFE has a significant degree of administrative discretion in implementing the laws and has used this discretion to limit convertibility of current account payments out of China. Whether as a result of a deterioration in the Chinese balance of payments, a shift in the Chinese macroeconomic prospects or any number of other reasons, China could impose additional restrictions on capital remittances abroad. As a result of these and other restrictions under the laws and regulations of the PRC, the Company’s PRC subsidiaries are restricted in their ability to transfer a portion of their net assets to the parent. The Company has no assurance that the relevant Chinese governmental authorities in the future will not limit further or eliminate the ability of the Company’s PRC subsidiaries to purchase foreign currencies and transfer such funds to the Company to meet its liquidity or other business needs. Any inability to access funds in China, if and when needed for use by the Company outside of China, could have a material and adverse effect on the Company’s liquidity and its business.

The Company grants credit to its customers including Xiamen Joylon, Xiamen Automotive Parts, Shanghai Fenglong and Jingzhou Yude, which are related parties of the Company. The Company’s customers are mostly located in the PRC.

During the six months ended June 30, 2016, the Company’s ten largest customers accounted for 69.4% of its consolidated net product sales, with two customers individually accounting for more than 10% of consolidated net sales i.e., 12.9% and 10.1%. As of June 30, 2016, approximately 3.3% and 2.7%, respectively, of accounts receivable were from trade transactions with the aforementioned two customers.

During the six months ended June 30, 2015, the Company’s ten largest customers accounted for 70.4% of its consolidated net product sales, with one customer individually accounting for more than 10% of consolidated net sales, i.e., 12.8%. As of June 30, 2015, approximately 5.8% of accounts receivable were from trade transactions with the aforementioned one customer, and there was one individual customer with a receivables balance of more than 10% of total accounts receivable, i.e. 11.4%.

28. Related party transactions and balances

Related party transactions are as follows (figures are in thousands of USD):

Related sales

	Three Months Ended June 30,	
	2016	2015
Merchandise sold to related parties	$ 10,054	$ 11,640
Rental income obtained from related parties	38	23
Materials and others sold to related parties	457	563
Total	$ 10,549	$ 12,226

	Six Months Ended June 30,	
	2016	2015
Merchandise sold to related parties	$ 18,639	$ 19,939
Rental income obtained from related parties	69	56
Materials and others sold to related parties	680	992
Total	$ 19,388	$ 20,987

Related purchases

	Three Months Ended June 30,	
	2016	2015
Materials purchased from related parties	$ 6,168	$ 5,630
Technology purchased from related parties	227	147
Equipment purchased from related parties	1,015	826
Others purchased from related parties	110	136
Total	$ 7,520	$ 6,739

	Six Months Ended June 30,	
	2016	2015
Materials purchased from related parties	$ 13,043	$ 12,638
Technology purchased from related parties	227	147
Equipment purchased from related parties	3,530	3,070
Others purchased from related parties	375	354
Total	$ 17,175	$ 16,209

Related receivables

	June 30, 2016	December 31, 2015
Accounts and notes receivable from related parties	$ 20,947	$ 21,918
Other receivables from related parties	-	14
Total	$ 20,947	$ 21,932

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Related advances

	June 30, 2016	December 31, 2015
Advance payments for property, plant and equipment to related parties	$ 10,055	$ 8,863
Advance payments and others to related parties	386	544
Total	$ 10,441	$ 9,407

Related payables

	June 30, 2016	December 31, 2015
Accounts and notes payable	$ 6,698	$ 6,363

These transactions were consummated under similar terms as those with the Company's third party customers and suppliers.

Hubei Wiselink pledged its land use rights and buildings with an assessed value of approximately $5.1 million as security for the Company’s entrusted government loan (See Note 13).

As of August 11, 2016, Hanlin Chen, the Company’s Chairman, owns 55.8% of the common stock of the Company and has the effective power to control the vote on substantially all significant matters without the approval of other stockholders.

29. Commitments and contingencies

Legal proceedings

The Company is not a party to any pending or, to the best of the Company’s knowledge, any threatened legal proceedings. In addition, no director, officer or affiliate of the Company, or owner of record of more than five percent of the securities of the Company, or any associate of any such director, officer or security holder is a party adverse to the Company or has a material interest adverse to the Company in reference to pending litigation.

Other commitments and contingencies

In addition to the bank loans, notes payables and the related interest, the following table summarizes the Company’s major commitments and contingencies as of June 30, 2016 (figures are in thousands of USD):

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	Payment obligations by period					
	2016 [1]	2017	2018	2019	Thereafter	Total
Obligations for investment contracts [1][2]	7,239	$7,691	$5,429	$ -	$ -	$20,359
Obligations for purchasing and service agreements	11,969	2,020	5,827	-	-	19,816
Total	$19,208	$9,711	$11,256	$ -	$ -	$40,175

(1) On September 22, 2014, Hubei Henglong entered into an agreement with other parties to establish the Venture Fund, under which Hubei Henglong has committed to make investments of RMB 50.0 million, equivalent to approximately $7.6 million, into the Venture Fund in three installments. As of June 30, 2016, Hubei Henglong has completed a capital contribution of RMB 35 million, equivalent to approximately $5.3 million, representing 14.7% of the Venture Fund's shares. According to the agreement, the remaining capital commitment of RMB15.0 million, equivalent to approximately $2.3 million, will be paid upon capital calls received from the Venture Fund.

(2) In May 2016, Hubei Henglong entered into an agreement with other parties to establish a venture capital fund, the "Chongqing Venture Fund". Hubei Henglong has committed to make investments of RMB120.0 million, equivalent to approximately $18.1 million, representing 17.14% of Chongqing Venture Fund's shares. The capital contribution will be paid in three installments. As of June 30, 2016, no capital contribution has been made by Hubei Henglong. Pursuant to the agreement, the capital contribution will be made in installments from 2016 to 2018.

30. Off-balance sheet arrangements

As of June 30, 2016 and December 31, 2015, the Company did not have any significant transactions, obligations or relationships that could be considered off-balance sheet arrangements.

31. Segment reporting

The accounting policies of the product sectors are the same as those described in the summary of significant accounting policies except that the disaggregated financial results for the product sectors have been prepared using a management approach, which is consistent with the basis and manner in which management internally disaggregates financial information for the purposes of assisting them in making internal operating decisions. Generally, the Company evaluates performance based on stand-alone product sector operating income and accounts for inter segment sales and transfers as if the sales or transfers were to third parties, at current market prices.

As of June 30, 2016, the Company had 11 product sectors, five of which were principal profit makers and were reported as separate sectors and engaged in the production and sales of power steering (Henglong, Jiulong, Shenyang, Wuhu and Hubei Henglong), and one holding company (Genesis). The other six sectors were engaged in the production and sale of sensor modular (USAI), automobile steering columns (Jielong), provision of after sales and R&D services (HLUSA), production and sale of power steering (Chongqing Henglong), trade (Brazil Henglong), and manufacture and sales of automobile electronic systems and parts (Wuhan Chuguanjie). Since the revenues, net income and net assets of these six sectors collectively are less than 10% of consolidated revenues, net income and net assets, respectively, in the condensed unaudited consolidated financial statements, the Company incorporated these six sectors into “Other Sectors.”

As of June 30, 2015, the Company had 12 product sectors, five of which were principal profit makers and were reported as separate sectors and engaged in the production and sales of power steering (Henglong, Jiulong, Shenyang, Wuhu and Hubei Henglong), and one holding company (Genesis). The other seven sectors were engaged in the production and sale of sensor modular (USAI), automobile steering columns (Jielong), provision of after sales and R&D services (HLUSA), production and sale of power steering (Chongqing Henglong), trade (Brazil Henglong), commercial vehicle repacking and sales (Fujian Qiaolong), and manufacture and sales of automobile electronic systems and parts (Wuhan Chuguanjie). Since the revenues, net income and net assets of these seven sectors collectively are less than 10% of consolidated revenues, net income and net assets, respectively, in the condensed unaudited consolidated financial statements, the Company incorporated these seven sectors into “Other Sectors.”

The Company’s product sector information for the three months and six months ended June 30, 2016 and 2015, is as follows (figures are in thousands of USD):

	Net Product Sales Three Months Ended June 30		Net Income (Loss) Three Months Ended June 30	
	2016	2015	2016	2015
Henglong	$62,517	$68,327	$3,903	$5,298
Jiulong	20,449	19,287	1,110	328
Shenyang	9,438	8,578	485	515
Wuhu	5,429	6,014	147	93
Hubei Henglong	14,525	15,753	1,581	2,289
Other Sectors	6,814	9,851	(23)	67
Total Segments	119,172	127,810	7, 203	8,590
Corporate	-	-	(1,684)	(1,021)
Eliminations	(18,155)	(18,643)	(4)	59
Total	$101,017	$109,167	$5,515	$7,628

	Net Product Sales Six Months Ended June 30		Net Income (Loss) Six Months Ended June 30	
	2016	2015	2016	2015
Henglong	$138,411	$152,130	$9,618	$12,848
Jiulong	37,189	37,068	1,136	(150)
Shenyang	16,659	16,540	538	824
Wuhu	10,808	12,171	75	(68)
Hubei Henglong	28,902	30,645	1,551	3,880
Other Sectors	17,969	18,777	430	378
Total Segments	249,938	267,331	13,348	17,712
Corporate	-	-	(2,125)	(1,788)
Eliminations	(32,067)	(34,721)	(163)	97
Total	$217,871	$232,610	$11,060	$16,021

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

The following discussion and analysis should be read in conjunction with the Company's condensed unaudited consolidated financial statements and the related notes thereto and the other financial information contained elsewhere in this Report.

General Overview

China Automotive Systems, Inc. is a leading power steering systems supplier for the China automobile industry. The Company has business relations with more than sixty vehicle manufacturers, including JAC Motors, Changan Automobile Group, BAIC Group, SAIC Group and Dongfeng Auto Group, the five largest automobile manufacturers in China; Shenyang Brilliance Jinbei Co., Ltd., the largest light vehicle manufacturer in China; Chery Automobile Co., Ltd., the largest state owned car manufacturer in China; BYD Auto Co., Ltd. and Zhejiang Geely Automobile Co., Ltd., the largest privately owned car manufacturers in China. The PRC-based joint ventures of General Motors (GM), Volkswagen, Citroen and Chrysler North America are all key customers. Starting in 2008, the Company has supplied power steering pumps and power steering gear to the Sino-foreign joint ventures established by GM, Citroen and Volkswagen in China. The Company has supplied power steering gears to Chrysler North America since 2009.

Most of the Company's production and research and development institutes are located in China. The Company has approximately 3,000 employees dedicated to design, development, manufacture and sales of its products. By leveraging its extensive experience, innovative technology and geographic strengths, the Company aims to grow leading positions in automotive power steering systems and to further improve overall margins, long-term operating profitability and cash flows. To achieve these goals and to respond to industry factors and trends, the Company is continuing work to improve its operations and business structure and achieve profitable growth.

Corporate Structure

The Company, through its subsidiaries, engages in the manufacture and sales of automotive systems and components. Great Genesis Holdings Limited, a company incorporated in Hong Kong on January 3, 2003 under the Companies Ordinance of Hong Kong as a limited liability company, “Genesis,” is a wholly-owned subsidiary of the Company and the holding company of the Company’s joint ventures in the PRC. Henglong USA Corporation, “HLUSA,” incorporated on January 8, 2007 in Troy, Michigan, is a wholly-owned subsidiary of the Company, and mainly engages in marketing of automotive parts in North America, and provides after-sales service and research and development support. CAAS Brazil’s Imports And Trade In Automotive Parts Ltd., “Brazil Henglong,” was established by Hubei Henglong Automotive System Group Co., Ltd., formerly known as Jingzhou Hengsheng Automotive System Co., Ltd., “ Hubei Henglong,” as a Sino-foreign joint venture company with two Brazilian citizens in Brazil in August 2012. Fujian Qiaolong was acquired by the Company in the second quarter of 2014, as a joint venture company that mainly manufactures and distributes drainage and rescue vehicles with mass flow, drainage vehicles with vertical downhole operation, crawler-type mobile pump stations, high-altitude water supply and discharge drainage vehicles, long-range control crawler-type mobile pump stations and other vehicles, which was disposed of by the Company in the second quarter of 2016.

Critical Accounting Estimates

The Company prepares its condensed consolidated financial statements in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amount of revenues and expenses during the reporting periods. Management periodically evaluates the estimates and judgments made. Management bases its estimates and judgments on historical experience and on various factors that are believed to be reasonable under the circumstances. Actual results may differ from these estimates as a result of different assumptions or conditions. The following critical accounting policies affect the more significant judgments and estimates used in the preparation of the Company’s condensed consolidated financial statements.

The Company considers an accounting estimate to be critical if:

- It requires the Company to make assumptions about matters that were uncertain at the time it was making the estimate, and

- Changes in the estimate or different estimates that the Company could have selected would have had a material impact on the Company’s financial condition or results of operations.

The table below presents information about the nature and rationale for the Company's critical accounting estimates:

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Balance Sheet Caption	Critical Estimate Item	Nature of Estimates Required	Assumptions/Approaches Used	Key Factors
Accrued liabilities and other long-term liabilities	Warranty obligations	Estimating warranty requires the Company to forecast the resolution of existing claims and expected future claims on products sold. OEMs (Original Equipment Manufacturers) are increasingly seeking to hold suppliers responsible for product warranties, which may impact the Company's exposure to these costs.	The Company bases its estimate on historical trends of units sold and payment amounts, combined with its current understanding of the status of existing claims and discussions with its customers.	·OEM sourcing ·OEM policy decisions regarding warranty claims
Property, plant and equipment, intangible assets and other long-term assets	Valuation of long- lived assets and investments	The Company is required from time to time to review the recoverability of certain of its assets based on projections of anticipated future cash flows, including future profitability assessments of various product lines.	The Company estimates cash flows using internal budgets based on recent sales data, independent automotive production volume estimates and customer commitments.	·Future production estimates ·Customer preferences and decisions
Inventory	Write-down of inventory	The Company is required from time to time to review the cashability of inventory based on projections of anticipated future cash flows, including write-down of inventory for prices that are higher than market price and undesirable inventories.	The Company estimates cash flows using internal budgets based on recent sales data, independent automotive production volume estimates and customer commitments.	·Future production estimates ·Customer preferences and decisions

Deferred income taxes	Recoverability of deferred tax assets	The Company is required to estimate whether recoverability of its deferred tax assets is more likely than not based on forecasts of taxable earnings in the related tax jurisdiction.	The Company uses historical and projected future operating results, based upon approved business plans, including a review of the eligible carry forward period, tax planning opportunities and other relevant considerations.	·Tax law changes ·Variances in future projected profitability, including by taxing entity
Tax payable and deferred tax assets/liabilities	Uncertain tax positions	The Company is required to determine and assess all material positions, including all significant uncertain positions in all tax years that are still subject to assessment or challenge under relevant tax statutes.	The Company applies a more likely than not threshold and a two-step approach for tax position measurement and financial statement recognition. For the two-step approach, the first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the position will be sustained, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount that is more than 50% likely to be realized upon settlement.	·An allocation or a shift of income between jurisdictions ·The characterization of income or a decision to exclude reporting taxable income in a tax return ·A decision to classify a transaction, entity, or other position in a tax return as tax exempt

In addition, there are other items within the Company’s financial statements that require estimation, but are not as critical as those discussed above, including provision of accounts and notes receivable. Although not significant in recent years, changes in estimates used in these and other items could have a significant effect on the Company’s consolidated financial statements.

Recent Accounting Pronouncements

Please see Note 2 to the consolidated financial statements under Item 1 of Part I of this Report.

Results of Operations

Results of Operations—Three Months Ended June 30, 2016 and 2015

	Net Product Sales (in thousands of USD, except percentages)				Cost of Products Sold (in thousands of USD, except percentages)			
	2016	2015	Change		2016	2015	Change	
Henglong	$62,517	$68,327	(5,810)	-8.5 %	$53,689	$56,239	$(2,550)	-4.5 %
Jiulong	20,449	19,287	1,162	6.0	17,579	17,159	420	2.4
Shenyang	9,438	8,578	860	10.0	8,221	7,260	961	13.2
Wuhu	5,429	6,014	(585)	-9.7	4,904	5,567	(663)	-11. 9
Hubei Henglong	14,525	15,753	(1,228)	-7.8	11,033	11,547	(514)	-4.5
Other Sectors	6,814	9,851	(3,037)	-30.8	5,594	8,304	(2,710)	-32.6
Total Segments	119,172	127,810	(8,638)	-6.8	101,020	106,076	(5,056)	-4.8
Elimination	(18,155)	(18,643)	488	-2.6	(18,151)	(18,702)	551	-3.0
Total	$101,017	$109,167	$(8,150)	-7. 5 %	$82,869	$87,374	$(4,505)	-5.2 %

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Net Product Sales

Net product sales were $101.0 million for the three months ended June 30, 2016, compared to $109.2 million for the same period in 2015, representing a decrease of $8.2 million, or 7.5%. The decrease was mainly due to the economic slowdown in China. The GDP growth rate was 6.7% in the second quarter of 2016, the lowest since 2009. As the major part of the Company's business is conducted in China, China's slow economy led to decreased vehicle sales which correspondingly led to decreased sales volumes of the Company as an auto parts supplier.

The product mix change also caused a decline in the Company's net product sales. With more passenger vehicles assembling electric power steering systems (EPS), the share of hydraulic power steering gears (HPS), the Company's traditional products, is shrinking. Although the Company's sales of EPS increased substantially, they only partially offset the decline in sales of HPS due to the low percentage of EPS in the product mix. Net sales of traditional steering products were $49.4 million for the three months ended June 30, 2016, compared to $63.8 million for the same period in 2015, representing a decrease of $14.4 million, or 22.6%. Net sales of EPS were $28.0 million for the three months ended June 30, 2016, compared to $18.8 million for the same period in 2015, representing an increase of $9.2 million, or 48.9%. As a percentage of net sales, sales of EPS were 27.8% for the three months ended June 30, 2016, compared to 17.2% for the same period in 2015.

The depreciation of China's currency, RMB, against the U.S. dollar in the second quarter of 2016 as compared to the second quarter of 2015 also caused a decrease in net sales as more than 80% of the Company's business is conducted in China.

In summary, the Company had a decrease in sales volume leading to a sales decrease of $1.4 million, an increase in average selling price of steering gears leading to a sales increase of $1.0 million, and the effect of foreign currency translation of the RMB against the U.S. dollar, which led to a sales decrease of $7.8 million.

Further analysis by segment (before elimination) is as follows:

- Net product sales for Henglong were $62.5 million for the three months ended June 30, 2016, compared with $68.3 million for the three months ended June 30, 2015, representing a decrease of $5.8 million, or 8.5%, which was mainly due to the decrease in sales of hydraulic power steering gears, partially offset by the increase in sales of EPS. An increase in sales volume led to a sales increase of $4.5 million, a decrease in average selling price led to a sales decrease of $6.0 million, and the effect of foreign currency translation of the RMB against the U.S. dollar led to a sales decrease of $4.3 million.

- Net product sales for Jiulong were $20.4 million for the three months ended June 30, 2016, compared with $19.3 million for the three months ended June 30, 2015, representing an increase of $1.1 million, or 5.7%. Jiulong is gradually shifting its strategy from focusing on sales volume to focusing on high gross margin products and developing new markets such as exports. A decrease in sales volume led to a sales decrease of $4.7 million, an increase in average selling price led to a sales increase of $6.8 million, and the effect of foreign currency translation of the RMB against the U.S. dollar led to a sales decrease of $1.0 million.

- Net product sales for Shenyang were $9.4 million for the three months ended June 30, 2016, compared to $8.6 million for the same period in 2015, representing an increase of $0.8 million, or 9.3%. Shenyang's products are mainly sold to Shenyang Brilliance Jinbei Co., Ltd. ("Brilliance Jinbei"), one of China's largest commercial car manufacturers. The sales of Shenyang are mainly impacted by the demand of Brilliance Jinbei. An increase in sales volumes led to a sales increase of $2.8 million, a decrease in average selling price led to a sales decrease of $1.5 million, and the effect of foreign currency translation of the RMB against the U.S. dollar led to a sales decrease of $0.5 million.

- Net product sales for Wuhu were $5.4 million for the three months ended June 30, 2016, compared to $6.0 million for the same period in 2015, representing a decrease of $0.6 million, or 10.0%. The products of Wuhu are mainly sold to Chery Automobile Co., Ltd., "Chery". Sales volumes of Chery have decreased continuously since 2012. Therefore, Wuhu's ability to increase its sales is limited. A decrease in sales volumes led to a sales decrease of $0.5 million, an increase in average selling price led to a sales increase of $0.3 million, and the effect of foreign currency translation of the RMB against the U.S. dollar led to a sales decrease of $0.4 million.

- Net product sales for Hubei Henglong were $14.5 million for the three months ended June 30, 2016, compared to $15.8 million for the same period in 2015, representing a decrease of $1.3 million, or 8.2%. Hubei Henglong's products are mainly sold to Chrysler. Chrysler's demand and prices were quite stable, so the impact of sales volumes and prices were not significant. An increase in sales volumes led to a sales increase of $0.5 million, a decrease in average selling price led to a sales decrease of $0.7 million, and the effect of foreign currency translation of the RMB against the U.S. dollar led to a sales decrease of $1.1 million.

- Net product sales for Other Sectors were $6.8 million for the three months ended June 30, 2016, compared to $9.9 million for the same period in 2015, representing a decrease of $3.1 million, or 31.3%, primarily due to a decrease of $2.2 million in the sales of Jielong, which engages in the production and sales of automotive steering columns, and the disposal of Fujian Qiaolong.

Cost of Products Sold

For the three months ended June 30, 2016, the cost of products sold was $82.9 million, compared to $87.4 million for the same period of 2015, representing a decrease of $4.5 million, or 5.2%. The decrease in the cost of products sold was mainly due to the net effect of a net decrease in sales volumes which led to a cost of products sold decrease of $2.7 million, an increase in unit cost which led to a cost of products sold increase of $2.3 million, and the effect of foreign currency translation of the RMB against the U.S. dollar which led to a cost of products sold decrease of $4.1

million. Further analysis is as follows:

- Cost of products sold for Henglong was $53.7 million for the three months ended June 30, 2016, compared to $56.2 million for the same period of 2015, representing a decrease of $2.5 million, or 4.5%. An increase in sales volumes led to a cost of products sold increase of $4.8 million, a decrease in unit cost led to a cost of products sold decrease of $4.7 million, and the effect of foreign currency translation of the RMB against the U.S. dollar led to a cost of products sold decrease of $2.6 million.

- Cost of products sold for Jiulong was $17.6 million for the three months ended June 30, 2016, compared to $17.2 million for the same period of 2015, representing an increase of $0.4 million, or 2.3%. A decrease in sales volumes led to a cost of products sold decrease of $4.8 million, and an increase in unit cost led to a cost of products sold increase of $5.9 million, and the effect of foreign currency translation of the RMB against the U.S. dollar led to a cost of products sold decrease of $0.7 million.

- Cost of products sold for Shenyang was $8.2 million for the three months ended June 30, 2016, compared to $7.3 million for the same period of 2015, representing an increase of

$0.9 million, or 12.3%. The increase in cost of products sold was mainly due to an increase in sales volumes, which led to a cost of products sold increase of $2.4 million, a decrease in unit cost, which led to a cost of products sold decrease of $1.1 million, and the effect of foreign currency translation of the RMB against the U.S. dollar, which led to a cost of products sold decrease of $0.4 million.

- Cost of products sold for Wuhu was $4.9 million for the three months ended June 30, 2016, compared to $5.6 million for the same period of 2015, representing a decrease of $0.7 million, or 12.5%. The decrease in cost of products sold was mainly due to a decrease in sales volumes, which led to a cost of products sold decrease of $0.4 million, and the effect of foreign currency translation of the RMB against the U.S. dollar, which led to a cost of products sold decrease of $0.3 million.

- Cost of products sold for Hubei Henglong was $11.0 million for the three months ended June 30, 2016, compared to $11.5 million for the same period of 2015, representing a decrease of $0.5 million, or 4.4%. The decrease in cost of products sold was mainly due to a decrease in unit cost, which led to a cost of products sold decrease of $0.2 million, and the effect of foreign currency translation of the RMB against the U.S. dollar, which led to a cost of products sold decrease of $0.3 million.

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Equity				
U.S. Cellular shareholders' equity				
Series A Common and Common Shares				
Authorized 190,000 shares (50,000 Series A Common and 140,000 Common Shares)				
Issued 88,074 shares (33,006 Series A Common and 55,068 Common Shares)				
Outstanding 84,307 shares (33,006 Series A Common and 51,301 Common Shares) and 84,205 shares (33,006 Series A Common and 51,199 Common Shares), respectively				
Par Value ($1 per share) ($33,006 Series A Common and $55,068 Common Shares)		88,074		88,074
Additional paid-in capital		1,434,045		1,424,729
Treasury shares, at cost, 3,767 and 3,869 Common Shares, respectively		(161,137)		(164,692)
Retained earnings		2,032,355		2,043,095
Total U.S. Cellular shareholders' equity		3,393,337		3,391,206
Noncontrolling interests		15,796		18,391
Total equity		3,409,133		3,409,597
Total liabilities and equity	$	6,298,967	$	6,445,708

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

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United States Cellular Corporation

Consolidated Statement of Changes in Equity

(Unaudited)

	U.S. Cellular Shareholders						
(Dollars in thousands)	**Series A Common and Common Shares**	**Additional Paid-In Capital**	**Treasury Shares**	**Retained Earnings**	**Total U.S. Cellular Shareholders' Equity**	**Noncontrolling Interests**	**Total Equity**
Balance, December 31, 2013	$ 88,074	$ 1,424,729	$ (164,692)	$ 2,043,095	$ 3,391,206	$ 18,391	$ 3,409,597
Add (Deduct)							
Net income attributable to U.S. Cellular shareholders	-	-	-	693	693	-	693
Net income (loss) attributable to noncontrolling interests classified as equity	-	-	-	-	-	(2,136)	(2,136)
Repurchase of Common Shares	-	-	(8,598)	-	(8,598)	-	(8,598)
Incentive and compensation plans	-	-	12,153	(11,433)	720	-	720
Stock-based compensation	-	9,845	-	-	9,845	-	9,845

awards														
Tax windfall (shortfall) from stock awards		-		(529)		-		-		(529)		-		(529)
Distributions to noncontrolling interests		-		-		-		-		-		(459)		(459)
Balance, June 30, 2014	$	88,074	$	1,434,045	$	(161,137)	$	2,032,355	$	3,393,337	$	15,796	$	3,409,133

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

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United States Cellular Corporation								
Consolidated Statement of Changes in Equity **(Unaudited)**								
	U.S. Cellular Shareholders							
(Dollars in thousands)	**Series A Common and Common Shares**	**Additional Paid-In Capital**	**Treasury Shares**	**Retained Earnings**	**Total U.S. Cellular Shareholders' Equity**	**Noncontrolling Interests**	**Total Equity**
Balance, December 31, 2012	$ 88,074	$ 1,412,453	$ (165,724)	$ 2,399,052	$ 3,733,855	$ 61,392	$ 3,795,247
Add (Deduct)							
Net income attributable to U.S. Cellular shareholders	-	-	-	148,305	148,305	-	148,305
Net income attributable to noncontrolling interests classified as equity	-	-	-	-	-	6,061	6,061
Common and Series A Common Shares dividends	-	-	-	(482,270)	(482,270)		(482,270)
Repurchase of Common Shares	-	-	(18,425)	-	(18,425)	-	(18,425)
	-	222	6,976	(9,182)	(1,984)	-	(1,984)

Incentive and compensation plans								
Stock-based compensation awards		-	6,530	-	-	6,530	-	6,530
Tax windfall (shortfall) from stock awards		-	(746)	-	-	(746)	-	(746)
Distributions to noncontrolling interests		-	-	-	-	-	(3,292)	(3,292)
Adjust investment in subsidiaries for noncontrolling interest purchases		-	(31)	-	-	(31)	-	(31)
Deconsolidation of partnerships		-	-	-	-	-	(43,770)	(43,770)
Balance, June 30, 2013	$	88,074	$ 1,418,428	$ (177,173)	$ 2,055,905	$ 3,385,234	$ 20,391	$ 3,405,625

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

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United States Cellular Corporation

Notes to Consolidated Financial Statements

1. Basis of Presentation

United States Cellular Corporation ("U.S. Cellular"), a Delaware Corporation, is an 84%-owned subsidiary of Telephone and Data Systems, Inc. ("TDS").

The accounting policies of U.S. Cellular conform to accounting principles generally accepted in the United States of America ("GAAP") as set forth in the Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC"). The consolidated financial statements include the accounts of U.S. Cellular, subsidiaries in which it has a controlling financial interest, general partnerships in which U.S. Cellular has a majority partnership interest and certain entities in which U.S. Cellular has a variable interest that require consolidation under GAAP. All material intercompany accounts and transactions have been eliminated.

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 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. These consolidated financial statements should 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 ("Form 10-K") for the year ended December 31, 2013.

The accompanying unaudited consolidated financial statements contain all adjustments (consisting of only normal recurring items, unless otherwise disclosed) necessary for a fair statement of the financial position as of June 30, 2014 and December 31, 2013, the results of operations for the three and six months ended June 30, 2014 and 2013, and cash flows and changes in equity for the six months ended June 30, 2014 and 2013. The Consolidated Statement of Comprehensive Income was not included because comprehensive income for the three and six months ended June 30, 2014 and 2013 equaled net income. These results are not necessarily indicative of the results to be expected for the full year.

Recently Issued Accounting Pronouncements

On April 10, 2014, the FASB issued Accounting Standards Update 2014-08, *Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity* (“ASU 2014-08”). ASU 2014-08 changes the requirements and disclosures for reporting discontinued operations. U.S. Cellular is required to adopt the provisions of ASU 2014-08 effective January 1, 2015, but early adoption is permitted. U.S. Cellular adopted the provisions of ASU 2014-08 upon its issuance. The adoption of ASU 2014-08 did not have a significant impact on U.S. Cellular’s financial position or results of operations.

On May 28, 2014, the FASB issued Accounting Standards Update 2014-09, *Revenue from Contracts with Customers* (“ASU 2014-09”). ASU 2014-09 outlines a single comprehensive model to use in accounting for revenue arising from contracts with customers. U.S. Cellular is required to adopt the provisions of ASU 2014-09 effective January 1, 2017. Early adoption is prohibited. U.S. Cellular is evaluating what effects the adoption of ASU 2014-09 will have on U.S. Cellular’s financial position and results of operations.

Equipment Installment Plans

U.S. Cellular offers customers the option to purchase certain devices under installment contracts over a period of up to 24 months. Equipment revenue under these contracts is recognized at the time the device is delivered to the end-user customer for the selling price of the device, net of any deferred imputed interest or guarantee liability, if applicable. For certain installment plans, after a specified period of time, the customer may have the right to upgrade to a new device and have the remaining unpaid installment contract balance waived, subject to certain conditions, including trading in the original device in good working condition and signing a new equipment installment contract. U.S. Cellular values this trade-in right as a guarantee liability. The guarantee liability is initially measured at fair value and is determined based on assumptions including the probability and timing of the customer upgrading to a new device, the customer’s estimated remaining installment contract balance at the time of trade-in and the fair value of the device being traded-in at the time of trade-in. As of June 30, 2014, the short-term guarantee liability and imputed interest liability related to equipment installment plans of $15.3 million is recorded in Customer deposits and deferred revenues in the Consolidated Balance Sheet and the long-term imputed interest liability related to equipment installment plans of $0.7 million is recorded in Other deferred liabilities and credits in the Consolidated Balance Sheet. As of June 30, 2014, short-term equipment installment plan receivables of $23.9 million are included in Accounts receivable – customers and agents in the Consolidated Balance Sheet and long-term equipment installment plan receivables of $19.8 million are included in Other assets and deferred charges in the Consolidated Balance Sheet.

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U.S. Cellular equipment installment plans do not provide for explicit interest charges. For equipment installment plans with a duration of twelve months or less, U.S. Cellular does not impute interest. For equipment installment plans with a duration of greater than twelve months, U.S. Cellular imputes interest and recognizes such interest income over the duration of the plan as a component of Interest and dividend income.

Amounts Collected from Customers and Remitted to Governmental Authorities

If a 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, then amounts collected from customers and remitted to governmental authorities are recorded on a net basis within a tax liability account in the Consolidated Balance Sheet. If the tax is assessed upon U.S. Cellular, then amounts collected from customers as recovery of the tax are recorded in Service revenues and amounts remitted to governmental authorities are recorded in Selling, general and administrative expenses in the Consolidated Statement of Operations. The amounts recorded gross in revenues that are billed to customers and remitted to governmental authorities totaled $25.4 million and $51.8 million for the three and six months ended June 30, 2014, respectively, and $28.1 million and $60.2 million for the three and six months ended June 30, 2013, respectively.

2. Fair Value Measurements

As of June 30, 2014 and December 31, 2013, U.S. Cellular did not have any financial or nonfinancial assets or liabilities that were required to be recorded at fair value in its Consolidated Balance Sheet in accordance with GAAP. However, U.S. Cellular has applied the provisions of fair value accounting for purposes of computing the fair value of financial instruments for disclosure purposes as displayed below.

	Level within the Fair Value Hierarchy	June 30, 2014		December 31, 2013	
		Book Value	**Fair Value**	**Book Value**	**Fair Value**
(Dollars in thousands)					
Cash and cash equivalents	1	$ 404,058	$ 404,058	$ 342,065	$ 342,065
Short-term investments					
U.S. Treasury Notes	1	40,035	40,035	50,104	50,104
Long-term debt					
	1	342,000	348,703	342,000	309,852

	6.95% Senior Notes					
	6.7% Senior Notes	2	532,583	550,727	532,449	507,697

Short-term investments are designated as held-to-maturity investments and recorded at amortized cost in the Consolidated Balance Sheet. Long-term debt excludes capital lease obligations and the current portion of Long-term debt.

The fair values of Cash and cash equivalents and Short-term investments approximate their book values due to the short-term nature of these financial instruments. The fair value of Long-term debt was estimated using market prices for the 6.95% Senior Notes, and discounted cash flow analysis using an estimated yield to maturity of 6.59% for the 6.7% Senior Notes at June 30, 2014.

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3. Income Taxes

U.S. Cellular is included in a consolidated federal income tax return and in certain state income tax returns with other members of the TDS consolidated group. For financial statement purposes, U.S. Cellular and its subsidiaries compute their income tax expense as if they comprised a separate affiliated group and were not included in the TDS consolidated group.

U.S. Cellular's overall effective tax rate on Income (loss) before income taxes for the three and six months ended June 30, 2014 was 34.8% and 190.4%, respectively, and for the three and six months ended June 30, 2013 was 45.7% and 45.3%, respectively.

The unusually high effective tax rate for the six months ended June 30, 2014 resulted from the relatively low amount of Income (loss) before income taxes in this period, which magnified the effective rate impact of discrete tax expense items.

The effective tax rates for the three and six months ended June 30, 2013 reflected incremental deferred tax expense related to the NY1 & NY2 Deconsolidation (as described in Note 7 — Investments in Unconsolidated Entities) and the Divestiture Transaction (as described in Note 5 — Acquisitions, Divestitures and Exchanges) in 2013.

4. Earnings Per Share

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	**2013**	**2014**	**2013**
(Dollars and shares in thousands, except per share amounts)				
Net income (loss) attributable to U.S. Cellular shareholders	$ (18,789)	$ 143,391	$ 693	$ 148,305
Weighted average number of shares used in basic earnings (loss) per share	84,341	83,845	84,277	83,842
Effects of dilutive securities:				
Stock options	-	226	193	201
Restricted stock units	-	590	571	612
Weighted average number of shares used in diluted earnings (loss) per share	84,341	84,661	85,041	84,655
Basic earnings (loss) per share attributable to U.S. Cellular shareholders	$ (0.22)	$ 1.71	$ 0.01	$ 1.77
Diluted earnings (loss) per share attributable to U.S. Cellular shareholders	$ (0.22)	$ 1.69	$ 0.01	$ 1.75

Certain Common Shares issuable upon the exercise of stock options or vesting of restricted stock units were not included in average diluted shares outstanding for the calculation of Diluted earnings (loss) per share attributable to U.S. Cellular shareholders because their effects were antidilutive. The number of such Common Shares excluded, if any, is shown in the table below.

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	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
(Shares in thousands)				
Stock options	3,559	2,437	1,820	2,041
Restricted stock units	1,191	208	141	221

5. Acquisitions, Divestitures and Exchanges

Divestiture Transaction

On November 6, 2012, U.S. Cellular entered into a Purchase and Sale Agreement with subsidiaries of Sprint Corp., fka Sprint Nextel Corporation ("Sprint"). Pursuant to the Purchase and Sale Agreement, on May 16, 2013, U.S. Cellular transferred customers and certain PCS license spectrum to Sprint in U.S. Cellular's Chicago, central Illinois, St. Louis and certain Indiana/Michigan/Ohio markets ("Divestiture Markets") in consideration for $480 million in cash. The Purchase and Sale Agreement also contemplated certain other agreements, together with the Purchase and Sale Agreement collectively referred to as the "Divestiture Transaction."

Pursuant to the Purchase and Sale Agreement, U.S. Cellular and Sprint also entered into certain other agreements, including customer and network transition services agreements, which require U.S. Cellular to provide customer, billing and network services to Sprint for a period of up to 24 months after the May 16, 2013 closing date. Sprint will reimburse U.S. Cellular for providing such services at an amount equal to U.S. Cellular's estimated costs, including applicable overhead allocations. These services were substantially complete as of March 31, 2014. In addition, these agreements require Sprint to reimburse U.S. Cellular up to $200 million (the "Sprint Cost Reimbursement") for certain network decommissioning costs, network site lease rent and termination costs, network access termination costs, and employee termination benefits for specified engineering employees. It is estimated that up to $175 million of the Sprint Cost Reimbursement will be recorded in (Gain) loss on sale of business and other exit costs, net and up to $25 million of the Sprint Cost Reimbursement will be recorded in System operations in the Consolidated Statement of Operations. For the six months ended June 30, 2014, $34.1 million of the Sprint Cost Reimbursement had been received and recorded in Cash received from divestitures in the Consolidated Statement of Cash Flows.

Financial impacts of the Divestiture Transaction are classified in the Consolidated Statement of Operations within Operating income. The table below describes the amounts U.S. Cellular has recognized and expects to recognize in the Consolidated Statement of Operations between the date the Purchase and Sale Agreement was signed and the end of the transition services period.

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(Dollars in thousands)	Expected Period of Recognition	Projected Range		Cumulative Amount Recognized as of June 30, 2014	Actual Amount Recognized Six Months Ended June 30, 2014	Actual Amount Recognized Six Months Ended June 30, 2013	Actual Amount Recognized Three Months Ended June 30, 2014	R E
(Gain) loss on sale of business and other exit costs, net								
Proceeds from Sprint								
Purchase price	2013	$ (480,000)	$ (480,000)	$ (480,000)	$ -	$ (480,000)	$ -	$
Sprint Cost Reimbursement	2013-2015	(120,000)	(175,000)	(96,835)	(49,194)	(8)	(4,563)	
Net assets transferred	2013	213,593	213,593	213,593	-	213,593	-	
Non-cash charges for the write-off and write-down of property under construction and related assets	2012-2015	10,000	15,000	11,013	338	81	(5)	
Employee related costs including severance, retention and outplacement	2012-2014	13,000	16,000	14,129	(133)	3,103	(71)	
Contract termination costs	2012-2015	90,000	120,000	90,417	30,833	16,605	(6,254)	
Transaction costs	2012-2014	5,000	7,000	6,027	462	3,719	253	
Total (Gain) loss on sale of		$ (268,407)	$ (283,407)	$ (241,656)	$ (17,694)	$ (242,907)	$ (10,640)	$

business and other exit costs, net																		
Depreciation, amortization and accretion expense																		
Incremental depreciation, amortization and accretion, net of salvage values	2012-2014		211,656			211,656			211,656			13,085			88,324		-	
(Increase) decrease in Operating income		$	(56,751)		$	(71,751)		$	(30,000)		$	(4,609)		$	(154,583)	$	(10,640)	$

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Incremental depreciation, amortization and accretion, net of salvage values represents amounts recorded in the specified time periods as a result of a change in estimate for the remaining useful life and salvage value of certain assets and a change in estimate which accelerated the settlement dates of certain asset retirement obligations in conjunction with the Divestiture Transaction. Specifically, for the periods indicated, this is estimated depreciation, amortization and accretion recorded on assets and liabilities of the Divestiture Markets after the execution of the Purchase and Sale Agreement on November 6, 2012 less depreciation, amortization and accretion that would have been recorded on such assets and liabilities in the normal course, absent the Divestiture Transaction.

As a result of the transaction, U.S. Cellular recognized the following amounts in the Consolidated Balance Sheet:

	Six Months Ended June 30, 2014				
(Dollars in thousands)	**Balance December 31, 2013**	**Costs Incurred**	**Cash Settlements (1)**	**Adjustments (2)**	**Balance June 30, 2014**
Accrued compensation					
Employee related costs including severance, retention, outplacement	$ 2,053	$ 180	$ (908)	$ (313)	$ 1,012
Other current liabilities					
Contract termination costs	$ 13,992	$ 16,691	$ (12,887)	$ 2,091	$ 19,887
Other deferred liabilities and credits					
Contract termination costs	$ 30,849	$ 23,773	$ (2,424)	$ (19,898)	$ 32,300

(1) Cash settlement amounts are included in either the Net income or changes in Other assets and liabilities line items as part of Cash flows from operating activities on the Consolidated Statement of Cash Flows.

(2) Adjustment to liability represents changes to previously accrued amounts.

Other Acquisitions, Divestitures and Exchanges

On May 23, 2014, U.S. Cellular entered into a License Purchase and Customer Recommendation Agreement with Airadigm Communications, Inc. ("Airadigm"). TDS owns 100% of the common stock of Airadigm. The Agreement provides that Airadigm will transfer to U.S. Cellular FCC spectrum licenses and certain tower assets in certain markets in Wisconsin, Iowa, Minnesota and Michigan, in consideration for $91.5 million in cash at closing. The transaction also includes a program in which Airadigm would earn a migration fee from U.S. Cellular for each Airadigm customer who becomes a U.S. Cellular customer. Since both parties to this transaction are controlled by TDS, upon closing, U.S. Cellular will record the transferred assets at Airadigm's net book value of $15.2 million. The difference between the consideration paid and the net book value of the transferred assets will be recorded as a reduction of U.S. Cellular's Retained earnings. The transaction is subject to certain conditions. Subject to the satisfaction or (if permitted) waiver of all conditions, the transaction is expected to close during the third quarter of 2014.

On March 5, 2014, U.S. Cellular sold the majority of its St. Louis area non-operating market spectrum license for $92.3 million. A gain of $75.8 million was recorded in (Gain) loss on license sales and exchanges in the Consolidated Statement of Operations in the first quarter of 2014.

On February 14, 2014, U.S. Cellular completed an exchange whereby U.S. Cellular received one E block PCS spectrum license covering Milwaukee, WI in exchange for one D block PCS spectrum license covering Milwaukee, WI. The exchange of licenses provided U.S. Cellular with spectrum to meet anticipated future capacity and coverage requirements. No cash, customers, network assets, other assets or liabilities were included in the exchange. As a result of this transaction, U.S. Cellular recognized a gain of $15.7 million, representing the difference between the $15.9 million fair value of the license surrendered, calculated using a market approach valuation method, and the $0.2 million carrying value of the license surrendered. This gain was recorded in (Gain) loss on license sales and exchanges in the Consolidated Statement of Operations in the first quarter of 2014.

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6. Intangible Assets

Changes in U.S. Cellular's Licenses for the six months ended June 30, 2014 are presented below. There was no change to Goodwill during the six months ended June 30, 2014.

Licenses		
(Dollars in thousands)		
Balance, beginning of period	$	1,401,126
Acquisitions		20,986
Exchanges, net		15,719
Balance, end of period	$	1,437,831

7. Investments in Unconsolidated Entities

Investments in unconsolidated entities consist of amounts invested in wireless entities in which U.S. Cellular holds a noncontrolling interest. These investments are accounted for using either the equity or cost method.

The following table, which is based on information provided in part by third parties, summarizes the combined results of operations of U.S. Cellular's equity method investments.

	Three Months Ended June 30,				Six Months Ended June 30,			
	2014		2013		2014		2013	
(Dollars in thousands)								
Revenues	$	1,629,724	$	1,544,564	$	3,250,114	$	3,015,756
Operating expenses		1,204,588		1,095,809		2,334,226		2,130,433
Operating income		425,136		448,755		915,888		885,323
Other income, net		640		1,113		2,403		1,711
Net income	$	425,776	$	449,868	$	918,291	$	887,034

NY1 & NY2 Deconsolidation

U.S. Cellular holds a 60.00% interest in St. Lawrence Seaway RSA Cellular Partnership ("NY1") and a 57.14% interest in New York RSA 2 Cellular Partnership ("NY2") (together with NY1, the "Partnerships"). The remaining interests in the Partnerships are held by Cellco Partnership d/b/a Verizon Wireless ("Verizon Wireless"). Prior to April 3, 2013, because U.S. Cellular owned a greater than 50% interest in each of these Partnerships and based on U.S. Cellular's rights under the Partnership Agreements, U.S. Cellular consolidated the financial results of these Partnerships in accordance with GAAP.

On April 3, 2013, U.S. Cellular entered into an agreement with Verizon Wireless relating to the Partnerships. The agreement amends the Partnership Agreements in several ways which provide Verizon Wireless with substantive participating rights that allow Verizon Wireless to make decisions that are in the ordinary course of business of the Partnerships and which are significant to directing and executing the activities of the business. Accordingly, as required by GAAP, U.S. Cellular deconsolidated the Partnerships effective as of April 3, 2013 and thereafter reported them as equity method investments in its consolidated financial statements ("NY1 & NY2 Deconsolidation"). After the NY1 & NY2 Deconsolidation, U.S. Cellular retained the same ownership percentages in the Partnerships and continues to report the same percentages of income from the Partnerships. Effective April 3, 2013, U.S. Cellular's income from the Partnerships is reported in Equity in earnings of unconsolidated entities in the Consolidated Statement of Operations.

8. Variable Interest Entities (VIEs)

U.S. Cellular consolidates variable interest entities in which it has a controlling financial interest and is the primary beneficiary. A controlling financial interest will have both of the following characteristics: (a) the power to direct the VIE activities that most significantly impact economic performance and (b) the obligation to absorb VIE losses and the right to receive benefits that are significant to the VIE. U.S. Cellular reviews these criteria initially at the time it enters into agreements and subsequently when reconsideration events occur.

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Consolidated VIEs

As of June 30, 2014, U.S. Cellular holds a variable interest in and consolidates the following VIEs under GAAP:

- Aquinas Wireless L.P. (“Aquinas Wireless”); and
- King Street Wireless L.P. (“King Street Wireless”) and King Street Wireless, Inc., the general partner of King Street Wireless.

The power to direct the activities that most significantly impact the economic performance of Aquinas Wireless and King Street Wireless (collectively, the “limited partnerships”) is shared. Specifically, the general partner of these VIEs has the exclusive right to manage, operate and control the limited partnerships and make all decisions to carry on the business of the partnerships; however, the general partner of each partnership needs consent of the limited partner, a U.S. Cellular subsidiary, to sell or lease certain licenses, to make certain large expenditures, admit other partners or liquidate the limited partnerships. Although the power to direct the activities of the VIEs is shared, U.S. Cellular has a disproportionate level of exposure to the variability associated with the economic performance of the VIEs, indicating that U.S. Cellular is the primary beneficiary of the VIEs in accordance with GAAP. Accordingly, these VIEs are consolidated.

The following table presents the classification of the consolidated VIEs’ assets and liabilities in U.S. Cellular’s Consolidated Balance Sheet.

			June 30, 2014		December 31, 2013	
(Dollars in thousands)						
Assets						
	Cash and cash equivalents		$	2,466	$	2,076
	Other current assets			71		1,184
	Licenses			311,476		310,475
	Property, plant and equipment, net			15,311		18,600
	Other assets and deferred charges			148		511
		Total assets	$	329,472	$	332,846
Liabilities						
	Current liabilities		$	29	$	46

	Deferred liabilities and credits		1,689		3,139
	Total liabilities	$	1,718	$	3,185

Other Related Matters

Aquinas Wireless and King Street Wireless were formed to participate in Federal Communications Commission (“FCC”) auctions of wireless spectrum and to fund, establish, and provide wireless service with respect to any FCC licenses won in the auctions. As such, these entities have risks similar to those described in the “Risk Factors” in U.S. Cellular’s Form 10-K for the year ended December 31, 2013.

U.S. Cellular currently provides 4G LTE service in conjunction with King Street Wireless.

U.S. Cellular may agree to make additional capital contributions and/or advances to Aquinas Wireless and King Street Wireless and/or to their general partners to provide additional funding for the development of licenses granted in various auctions. U.S. Cellular may finance such amounts with a combination of cash on hand, borrowings under its revolving credit agreement and/or long-term debt. There is no assurance that U.S. Cellular will be able to obtain additional financing on commercially reasonable terms or at all to provide such financial support.

There were no capital contributions or advances made to Aquinas Wireless or King Street Wireless or their general partners in the six months ended June 30, 2014 and 2013.

9. Common Share Repurchases

On November 17, 2009, the Board of Directors of U.S. Cellular authorized the repurchase of up to 1,300,000 Common Shares on an annual basis beginning in 2009 and continuing each year thereafter, on a cumulative basis. These purchases will be made pursuant to open market purchases, block purchases, private purchases or otherwise, depending on market conditions. This authorization does not have an expiration date.

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Share repurchases made under this authorization were as follows:

	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013
(Dollar amounts and shares in thousands)		
Number of shares	212	496
Average cost per share	$ 40.49	$ 37.16
Amount	$ 8,598	$ 18,425

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

United States Cellular Corporation ("U.S. Cellular") owns, operates and invests in wireless markets throughout the United States. U.S. Cellular is an 84%-owned subsidiary of Telephone and Data Systems, Inc. ("TDS") as of June 30, 2014.

U.S. Cellular provides wireless telecommunications services to approximately 4.7 million customers in 23 states. As of June 30, 2014, U.S. Cellular's average penetration rate in its consolidated operating markets was 14.7%. U.S. Cellular operates on a customer satisfaction strategy, striving to meet or exceed customer needs by providing a comprehensive range of wireless products and services, excellent customer support, and a high-quality network.

The following discussion and analysis should be read in conjunction with U.S. Cellular's interim consolidated financial statements and notes included in Item 1 above, and with the description of U.S. Cellular's business, its audited consolidated financial statements and Management's Discussion and Analysis of Financial Condition and Results of Operations included in U.S. Cellular's Annual Report on Form 10-K ("Form 10-K") for the year ended December 31, 2013.

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 overview 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.

Financial and operating highlights in the six months ended June 30, 2014 included the following:

- In March 2014, U.S. Cellular sold the majority of its St. Louis area non-operating market license for $92.3 million. As a result of this sale, a gain of $75.8 million was recorded in (Gain) loss on license sales and exchanges in the Consolidated Statement of Operations.

- In February 2014, U.S. Cellular completed a license exchange in Milwaukee. As a result of this transaction, a gain of $15.7 million was recorded in (Gain) loss on license sales and exchanges in the Consolidated Statement of

Operations.

The following operating information is presented for Core Markets. As used here, Core Markets is defined as all consolidated markets in which U.S. Cellular currently conducts business and, therefore, excludes the Divestiture Markets and the NY1 & NY2 Partnerships. Core Markets as defined also includes any other income or expenses due to U.S. Cellular's direct or indirect ownership interests in other spectrum in the Divestiture Markets which was not included in the Divestiture Transaction and other retained assets from the Divestiture Markets. See Note 5 — Acquisitions, Divestitures and Exchanges and Note 7 — Investments in Unconsolidated Entities in the Notes to Consolidated Financial Statements for additional information.

• Total customers were 4,653,000 at June 30, 2014, including 4,500,000 retail customers (97% of total).

• Retail customer net losses were 110,000 in the first six months of 2014 compared to net losses of 47,000 in 2013. In the postpaid category, there were net losses of 119,000 in 2014, compared to net losses of 86,000 in 2013. Postpaid defections increased due to billing system conversion issues and aggressive promotions by other carriers. Prepaid net additions were 9,000 in 2014 compared to net additions of 39,000 in 2013. The decline resulted from lower net additions in the national retail channel.

• Postpaid customers comprised approximately 92% of U.S. Cellular's retail customers as of June 30, 2014. The postpaid churn rate was 2.0% in 2014 compared to 1.6% in 2013. Billing system conversion issues and aggressive competitive offerings contributed to the increase in postpaid churn. The prepaid churn rate was 6.7% in 2014 compared to 5.8% in 2013.

• Billed average revenue per user ("ARPU") increased to $53.62 in 2014 from $50.97 in 2013 reflecting an increase in postpaid ARPU due to increases in smartphone adoption and corresponding revenues from data products and services. Service revenue ARPU increased to $60.23 in 2014 from $57.52 in 2013 due primarily to an increase in postpaid ARPU, offset by a decrease in inbound roaming revenue.

• Postpaid customers on smartphone service plans increased to 55% as of June 30, 2014 compared to 46% as of June 30, 2013. In addition, smartphones represented 73% of all devices sold in 2014 compared to 64% in 2013.

• Beginning in the second quarter of 2014, U.S. Cellular expanded its offerings for equipment installment plans. For the three months ended June 30, 2014, 15% of total smartphone sales to customers were made under an equipment installment plan.

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The following financial information is presented for U.S. Cellular consolidated results:

- Retail service revenues of $1,510.9 million decreased $175.5 million, or 10%, in 2014 due to a decrease of 799,000 in the average number of customers (including approximately 500,000 due to the reductions caused by the Divestiture Transaction and NY1 & NY2 Deconsolidation) partially offset by an increase in billed ARPU.

- Cash flows from operating activities were $212.9 million. At June 30, 2014, Cash and cash equivalents and Short-term investments totaled $444.1 million and there were no outstanding borrowings under the revolving credit facility.

- Total additions to Property, plant and equipment were $233.5 million, including expenditures to deploy fourth generation Long-term Evolution ("4G LTE") equipment, construct cell sites, increase capacity in existing cell sites and switches, outfit new and remodel existing retail stores, and enhance billing and other customer management related systems and platforms. Total cell sites in service decreased 20% year-over-year to 6,183 primarily as a result of the NY1 & NY2 Deconsolidation and the deactivation of certain cell sites in the Divestiture Markets.

- Operating income (loss) decreased $263.0 million, to a loss of $42.5 million in 2014. The (Gain) loss on license sales and exchanges and the (Gain) loss on sale of business and other exit costs contributed $108.9 million and $242.1 million to operating income in 2014 and 2013, respectively. Without these items, operating income decreased $129.8 million due to lower service revenues and higher equipment subsidies, which were partially offset by lower system operations, selling, general and administrative, and depreciation, amortization and accretion expense.

- Net income (loss) attributable to U.S. Cellular shareholders decreased $147.6 million to $0.7 million in 2014 compared to $148.3 million in 2013, due primarily to the net impact of lower operating income and a decrease in Gain (loss) on investments. Basic earnings (loss) per share and Diluted earnings (loss) per share were $0.01 in 2014, which was $1.76 and $1.74 lower, respectively, than in 2013.

U.S. Cellular anticipates that its future results may be affected by the following factors:

- Effects of industry competition on service and equipment pricing;

- U.S. Cellular completed the migration of its customers to a new Billing and Operational Support System ("B/OSS") in the third quarter of 2013. Intermittent system outages and delayed system response times negatively impacted customer service and sales operations at certain times. System enhancements continue to be implemented to address these issues, and customer service and sales operations response times have improved. However, any future operational problems associated with the new billing system could have adverse effects on U.S. Cellular's business (in areas such as overall customer satisfaction, customer attrition, uncollectible accounts receivable, gross customer additions, or operating expenses). All of these factors could have a material adverse effect on U.S. Cellular's results of operations or cash flows;

- Impacts of selling Apple iPhone products;

- Impacts of selling devices under equipment installment plans;

- Relative ability to attract and retain customers in a competitive marketplace in a cost effective manner;

- Expanded distribution of products and services in third-party national retailers;

- Potential increases in prepaid customers, who generally generate lower ARPU and higher churn, as a percentage of U.S. Cellular's customer base in response to changes in customer preferences and industry dynamics;

- The nature and rate of growth in the wireless industry, requiring U.S. Cellular to grow revenues primarily from selling additional products and services to its existing customers, increasing the number of multi-device users among its existing customers, increasing data products and services and attracting wireless customers switching from other wireless carriers;

- Continued growth in revenues and costs related to data products and services and declines in revenues from voice services;

- Rapid growth in the demand for new data devices and services which may result in increased cost of equipment sold and other operating expenses and the need for additional investment in network capacity and enhancements;

- Further consolidation among carriers in the wireless industry, which could result in increased competition for customers and/or cause roaming revenues to decline;

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- Uncertainty related to various rulemaking proceedings underway at the Federal Communications Commission (“FCC”);

- The ability to negotiate satisfactory 4G LTE data roaming agreements with other wireless operators.

Pro Forma Financial Information

Refer to U.S. Cellular’s Form 8-K filed on August 2, 2013 for pro forma financial information related to the Divestiture Transaction and the NY1 & NY2 Deconsolidation for the three and six months ended June 30, 2013, as if the transactions had occurred at the beginning of the period.

REGULATORY DEVELOPMENTS

FCC Interoperability Order

On October 25, 2013, the FCC adopted a Report and Order and Order of Proposed Modification confirming a voluntary industry agreement on interoperability in the Lower 700 MHz spectrum band. The FCC's Report and Order laid out a roadmap for the voluntary commitments of AT&T and DISH Network Corporation ("DISH") to become fully binding. The FCC implemented the AT&T commitments in an Order adopted in the first quarter of 2014 that modified AT&T’s Lower 700 MHz licenses. Pursuant to these commitments, AT&T will begin incorporating changes in its network and devices that will foster interoperability across all paired spectrum blocks in the Lower 700 MHz Band and support LTE roaming on AT&T networks for carriers with compatible Band 12 devices, consistent with the FCC’s rules on roaming. AT&T will be implementing the foregoing changes in phases starting with network software enhancement taking place possibly through the third quarter of 2015 with the AT&T Band 12 device roll-out to follow. In addition, the FCC has adopted changes in its technical rules for certain unpaired spectrum licensed to AT&T and DISH in the Lower 700 MHz band to enhance prospects for Lower 700 MHz interoperability. AT&T’s network and devices currently interoperate across only two of the three paired blocks in the Lower 700 MHz band. U.S. Cellular’s LTE deployment, carried out in conjunction with its partner, King Street Wireless, utilizes spectrum in all three of these blocks and, consequently, was not interoperable with the AT&T configuration. U.S. Cellular believes that the FCC action will broaden the ecosystem of devices available to U.S. Cellular’s customers over time.

FCC Net Neutrality Proposal

In May 2014, the FCC issued a notice of proposed rulemaking seeking comments on revised net neutrality rules. The revised proposed rules are substantially similar to rules adopted in 2010 that were vacated by a U.S. Court of Appeals in January 2014 (as described in our Form 10-K for the year ended December 31, 2013), except that they include certain changes intended to allow the revised proposed rules to be sustained considering the Court's decision. In particular, whereas the vacated rules prohibited fixed (i.e., cable and telephone) Internet Service Providers from engaging in "unreasonable discrimination" in transmitting internet traffic, the revised proposed rules would prohibit those carriers from engaging in "commercially unreasonable practices." The FCC is also considering applying that standard to wireless Internet Service Providers, which were not subject to the former "unreasonable discrimination" standard. All types of Internet Service Providers previously were and would again be prohibited from "blocking" access to lawful Internet services, and remain subject to "transparency" requirements which were not vacated by the Court of Appeals. The FCC also now proposes to "enhance" those transparency requirements to provide for greater disclosure of network management practices. The FCC proceeding is currently pending, and we cannot predict the outcome of the proceeding.

FCC Spectrum Auction 97

The FCC has scheduled an auction of AWS-3 spectrum licenses, referred to as Auction 97, to begin on November 13, 2014. U.S. Cellular evaluates opportunities to acquire additional spectrum in FCC auctions and may participate as a bidder or member of a bidding group. If U.S. Cellular participates, information relating to this will be disclosed at a later time, subject to FCC rules. In such event, applicable FCC anti-collusion rules will place certain restrictions on public disclosures and business communications with other companies relating to U.S. Cellular's participation, commencing on the application deadline of September 12, 2014 until the down payment deadline for Auction 97, which will be the later of January 7, 2015 or ten business days after release of the auction closing public notice. These anti-collusion rules, which could last three to four months or more, may restrict the normal conduct of U.S. Cellular's disclosures and/or business communications by U.S. Cellular relating to the auction. The restrictions could have an adverse effect on U.S. Cellular's business, financial condition or results of operations.

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RESULTS OF OPERATIONS

Summary Operating Data for U.S. Cellular Consolidated Markets

Following is a table of summarized operating data for U.S. Cellular's Consolidated Markets. Consolidated Markets herein refers to markets which U.S. Cellular currently consolidates, or previously consolidated in the periods presented, and is not adjusted in prior periods for subsequent divestitures or deconsolidations. Unless otherwise noted, figures reported in Results of Operations are representative of consolidated results.

As of or for Six Months Ended June 30,			2014		2013	
Retail Customers						
	Postpaid					
		Total at end of period	4,148,000		4,412,000	
		Gross additions	387,000		356,000	
		Net additions (losses)	(119,000)		(194,000)	
		ARPU(1)	$ 57.18		$ 54.80	
		Churn rate(2)	2.0	%	1.9	%
		Smartphone penetration(3)	55.3	%	45.5	%
	Prepaid					
		Total at end of period	352,000		381,000	
		Gross additions	150,000		181,000	
		Net additions (losses)	9,000		16,000	
		ARPU(1)	$ 33.18		$ 32.76	
		Churn rate(2)	6.7	%	6.6	%
Total customers at end of period			4,653,000		4,968,000	
Billed ARPU(1)			$ 53.62		$ 51.15	
Service revenue ARPU(1)			$ 60.23		$ 57.85	
Smartphones sold as a percent of total devices sold			72.8	%	63.7	%
Total Population						
	Consolidated markets(4)		54,817,000		84,025,000	
	Consolidated operating markets(4)		31,729,000		31,822,000	
Market penetration at end of period						
	Consolidated markets(5)		8.5	%	5.9	%
	Consolidated operating markets(5)		14.7	%	15.6	%
Capital expenditures (000s)			$ 233,508		$ 286,907	
Total cell sites in service			6,183		7,748	

Owned towers		4,457			4,411	

Summary Operating Data for U.S. Cellular Core Markets

Following is a table of summarized operating data for U.S. Cellular's Core Markets. For comparability, Core Markets as presented here excludes the results of the Divestiture Markets and NY1 and NY2 Partnerships as of or for the six months ended June 30, 2013.

As of or for Six Months Ended June 30,		**2014**			**2013**	
Retail Customers						
Postpaid						
Total at end of period		4,148,000			4,412,000	
Gross additions		387,000			341,000	
Net additions (losses)		(119,000)			(86,000)	
ARPU(1)	$	57.18		$	54.34	
Churn rate(2)		2.0	%		1.6	%
Smartphone penetration(3)		55.3	%		45.5	%
Prepaid						
Total at end of period		352,000			381,000	
Gross additions		150,000			167,000	
Net additions (losses)		9,000			39,000	
ARPU(1)	$	33.18		$	32.36	
Churn rate(2)		6.7	%		5.8	%
Total customers at end of period		4,653,000			4,968,000	
Billed ARPU(1)	$	53.62		$	50.97	
Service revenue ARPU(1)	$	60.23		$	57.52	
Smartphones sold as a percent of total devices sold		72.8	%		64.0	%
Total Population						
Consolidated markets(4)		54,817,000			84,025,000	
Consolidated operating markets(4)		31,729,000			31,822,000	
Market penetration at end of period						
Consolidated markets(5)		8.5	%		5.9	%
Consolidated operating markets(5)		14.7	%		15.6	%
Capital expenditures (000s)	$	233,508		$	279,073	
Total cell sites in service		6,183			6,113	
Owned towers		3,892			3,846	

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(1) ARPU metrics are calculated by dividing a revenue base by an average number of customers by the number of months in the period. These revenue bases and customer populations are shown below:

a. Postpaid ARPU consists of total postpaid service revenues and postpaid customers.

b. Prepaid ARPU consists of total prepaid service revenues and prepaid customers.

c. Billed ARPU consists of total retail service or “billed” revenues (total postpaid, prepaid and reseller service revenues) and postpaid, prepaid and reseller customers.

d. Service revenue ARPU consists of total retail service revenues, inbound roaming and other service revenues and postpaid, prepaid and reseller customers.

(2) Churn metrics represent the percentage of the postpaid or prepaid customers that disconnect service each month. These metrics represent the average monthly postpaid or prepaid churn rate for each respective period.

(3) Smartphones represent wireless devices which run on an Android, Apple, BlackBerry or Windows Mobile operating system, excluding tablets. Smartphone penetration is calculated by dividing postpaid smartphone customers by total postpaid customers.

(4) The decrease in the population of Consolidated markets is due primarily to the divestiture of the Mississippi Valley non-operating license in October 2013 and the majority of the St. Louis area non-operating market license in March 2014. Total Population is used only to calculate market penetration of consolidated markets and consolidated operating markets, respectively. See footnote (5) below.

(5) Market penetration is calculated by dividing the number of wireless customers at the end of the period by the total population of consolidated markets and consolidated operating markets, respectively, as estimated by Claritas. The increase in penetration is due primarily to a lower denominator as a result of the license divestitures described in footnote (4) above.

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Components of Operating Income										
Six Months Ended June 30,		**2014**		**2013**		**Change**		**Percentage Change**	
(Dollars in thousands)									
Retail service	$	1,510,918	$	1,686,399	$	(175,481)		(10)	%
Inbound roaming		107,706		130,907		(23,201)		(18)	%
Other		78,462		90,009		(11,547)		(13)	%
Service revenues		1,697,086		1,907,315		(210,229)		(11)	%
Equipment sales		186,498		169,561		16,937		10	%
Total operating revenues		1,883,584		2,076,876		(193,292)		(9)	%
System operations (excluding Depreciation, amortization and accretion reported below)		367,738		408,566		(40,828)		(10)	%
Cost of equipment sold		542,452		458,761		83,691		18	%
Selling, general and administrative		799,816		824,207		(24,391)		(3)	%
Depreciation, amortization and accretion		316,090		392,425		(76,335)		(19)	%
(Gain) loss on asset disposals, net		8,827		14,452		(5,625)		(39)	%
(Gain) loss on sale of business and other exit costs, net		(17,411)		(242,093)		224,682		93	%
(Gain) loss on license sales and exchanges		(91,446)		-		(91,446)		N/M	
Total operating expenses		1,926,066		1,856,318		69,748		4	%
Operating income (loss)	$	(42,482)	$	220,558	$	(263,040)		>(100)	%
N/M - Not meaningful									

Operating Revenues

Service revenues

Service revenues consist primarily of: (i) charges for access, airtime, roaming, recovery of regulatory costs and value added services, including data products and services, provided to U.S. Cellular's retail customers and to end users through third party resellers ("retail service"); (ii) charges to other wireless carriers whose customers use U.S. Cellular's wireless systems when roaming; and (iii) amounts received from the Federal Universal Service Fund ("USF").

Retail service revenues

Retail service revenues decreased by $175.5 million, or 10%, in 2014 to $1,510.9 million due to a decrease in U.S. Cellular's average customer base (including the reductions caused by the Divestiture Transaction and NY1 & NY2 Deconsolidation) partially offset by an increase in billed ARPU.

Billed ARPU increased to $53.62 in 2014 from $51.15 in 2013. This overall increase is due primarily to an increase in postpaid ARPU to $57.18 in 2014 from $54.80 in 2013, reflecting increases in smartphone adoption and corresponding revenues from data products and services.

U.S. Cellular expects continued pressure on retail service revenues in the foreseeable future due to industry competition for customers and related effects on pricing of service plan offerings offset to some degree by continued adoption of smartphones and data usage. In addition, beginning in the second quarter of 2014, U.S. Cellular expanded its offerings of equipment installment plans. To the extent that customers adopt these plans, U.S. Cellular expects an increase in equipment sales revenues. In addition, certain of the equipment installment plans provide the customer with a reduction in the monthly access charge for the device; thus, to the extent that existing customers adopt such plans, U.S. Cellular expects a reduction in retail service revenues and ARPU.

Inbound roaming revenues

Inbound roaming revenues decreased by $23.2 million, or 18%, in 2014 to $107.7 million. The decrease was due primarily to a $17.6 million impact related to the Divestiture Transaction and NY1 & NY2 Deconsolidation. The remaining decrease in the Core Markets was due to a decrease in rates and a decline in voice volume, partially offset by higher data usage.

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Other revenues

Other revenues decreased by $11.5 million, or 13%, in 2014 compared to 2013, due primarily to a $14.2 million decrease in eligible telecommunications carriers ("ETC") support.

Pursuant to the FCC's Reform Order ("Reform Order"), U.S. Cellular's current ETC support is being phased down at the rate of 20% per year beginning July 1, 2012. The Phase II Mobility Fund was not operational by July 2014. Therefore, as provided by the Reform Order, the phase down is currently suspended and U.S. Cellular will continue to receive 60% of its baseline support until the Phase II Mobility Fund is operational. At this time, U.S. Cellular cannot predict the net effect of the FCC's changes to the USF high cost support program in the Reform Order. Accordingly, U.S. Cellular cannot predict whether such changes will have a material adverse effect on U.S. Cellular's business, financial condition or results of operations.

Equipment sales revenues

Equipment sales revenues include revenues from sales of wireless devices and related accessories to both new and existing customers, as well as revenues from sales of devices and accessories to agents. All Equipment sales revenues are recorded net of rebates.

U.S. Cellular offers a competitive line of quality wireless devices to both new and existing customers. U.S. Cellular's customer acquisition and retention efforts include offering new wireless devices to customers at discounted prices; in addition, customers on currently offered rate plans receive loyalty reward points that may be used to purchase a new wireless device or accelerate the timing of a customer's eligibility for a wireless device upgrade at promotional pricing. U.S. Cellular also continues to sell wireless devices to agents including national retailers; this practice enables U.S. Cellular to provide better control over the quality of wireless devices sold to its customers, establish roaming preferences and earn quantity discounts from wireless device manufacturers which are passed along to agents and other retailers.

Beginning in the second quarter of 2014, U.S. Cellular expanded its offerings of equipment installment plans. To the extent that customers adopt these plans, U.S. Cellular expects an increase in equipment sales revenues. In addition, certain of the equipment installment plans provide the customer with a reduction in the monthly access charge for the device; thus, to the extent that existing customers adopt such plans, U.S. Cellular expects a reduction in retail service revenues and ARPU.

Equipment sales revenues increased $16.9 million, or 10%, in 2014 to $186.5 million. In the Core Markets, equipment sales revenues increased by $24.6 million due primarily to an increase in average revenue per device sold (including the impact of sales under equipment installment plans), partially offset by the sale of fewer devices, primarily in the feature phone category. The increase in equipment sales revenues in the Core Markets was partially offset by the effects of the Divestiture Transaction and the NY1 & NY2 Deconsolidation.

Operating Expenses

System operations expenses (excluding Depreciation, amortization and accretion)

System operations expenses (excluding Depreciation, amortization, and accretion) include charges from telecommunications service providers for U.S. Cellular's customers' use of their facilities, costs related to local interconnection to the wireline network, charges for cell site rent and maintenance of U.S. Cellular's network, long-distance charges, outbound roaming expenses and payments to third party data product and platform developers.

System operations expenses decreased $40.8 million, or 10%, to $367.7 million. Key components of the net changes in System operations expense were as follows:

- Customer usage expenses decreased by $24.4 million, or 19%, driven by impacts of the Divestiture Transaction and NY1 & NY2 Deconsolidation and decreases in network costs due to lower rates for long distance usage and lower fees for platform and content providers.

- Maintenance, utility and cell site expenses decreased $13.2 million, or 7%, driven primarily by impacts of the Divestiture Transaction and NY1 & NY2 Deconsolidation and lower headcount, partially offset by costs related to 4G LTE support.

- Expenses incurred when U.S. Cellular's customers used other carriers' networks while roaming decreased $3.2 million, or 4%, due primarily to the Divestiture Transaction and NY1 & NY2 Deconsolidation, lower voice usage and lower rates, offset by higher data roaming usage in the Core Markets.

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

Cost of equipment sold

Cost of equipment sold increased by $83.7 million, or 18%, in 2014 to $542.5 million. The increase was driven by a 36% increase in the average cost per device sold, which more than offset the impact of selling fewer devices. Average cost per device sold increased due to general customer preference for higher-priced 4G LTE smartphones. Smartphones sold as a percentage of total devices sold were 73% and 64% in 2014 and 2013, respectively. The total number of devices sold decreased by 11%, partially due to the Divestiture Transaction.

U.S. Cellular's loss on equipment, defined as equipment sales revenues less cost of equipment sold, was $356.0 million and $289.2 million for 2014 and 2013, respectively. U.S. Cellular expects loss on equipment to continue to be a significant cost in the foreseeable future as wireless carriers continue to use device availability and pricing as a means of competitive differentiation. In addition, U.S. Cellular expects increasing sales of data centric wireless devices to result in higher equipment subsidies over time; these devices generally have higher purchase costs which cannot be recovered through proportionately higher selling prices to customers under the standard contract/subsidy model the industry has operated with for many years. However, U.S. Cellular expects the introduction of the equipment installment plans to offset the increases in loss on equipment to some degree.

Selling, general and administrative expenses

Selling, general and administrative expenses include salaries, commissions and expenses of field sales and retail personnel and facilities; telesales department salaries and expenses; agent commissions and related expenses; corporate marketing and merchandise management; and advertising expenses. Selling, general and administrative expenses also include bad debts expense, costs of operating customer care centers and corporate expenses.

Key components of the $24.4 million, or 3%, decrease to $799.8 million were as follows:

- Selling and marketing expense decreased by $7.0 million, or 2%, due primarily to the effects of the Divestiture Transaction and NY1 & NY2 Deconsolidation, offset by increases in advertising and commissions expenses.

- General and administrative expense decreased by $17.4 million, or 4%, due primarily to the Divestiture Transaction and NY1 & NY2 Deconsolidation and lower consulting expenses related to the billing system conversion in the prior year, offset by an increase in bad debts expense.

Depreciation, amortization and accretion

Depreciation, amortization and accretion decreased $76.3 million, or 19%, in 2014 to $316.1 million due primarily to the higher amount of accelerated depreciation, amortization and accretion in the Divestiture Markets that occurred in 2013. The impact of the acceleration was $13.1 million in 2014 compared to $88.3 million in 2013. The accelerated depreciation, amortization and accretion in the Divestiture Markets was completed in the first quarter of 2014.

(Gain) loss on asset disposals, net

(Gain) loss on asset disposals, net was a loss in both 2014 and 2013 due primarily to the write-off and disposals of certain network assets.

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

The net gain in both 2014 and 2013 resulted from the Divestiture Transaction. See Note 5 — Acquisitions, Divestitures and Exchanges in the Notes to Consolidated Financial Statements for additional information.

(Gain) loss on license sales and exchanges

The net gain in 2014 resulted from the sale of the St. Louis area non-operating market license and the license exchange in Milwaukee. See Note 5 — Acquisitions, Divestitures and Exchanges in the Notes to Consolidated Financial Statements for additional information.

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Components of Other Income (Expense)								
Six Months Ended June 30,		**2014**		**2013**		**Change**	**Percentage Change**	
(Dollars in thousands, except per share amounts)								
Operating income (loss)	$	(42,482)	$	220,558	$	(263,040)	>(100)	%
Equity in earnings of unconsolidated entities		70,195		62,437		7,758	12	%
Interest and dividend income		2,457		1,872		585	31	%
Gain (loss) on investments		-		18,527		(18,527)	N/M	
Interest expense		(29,198)		(21,064)		(8,134)	(39)	%
Other, net		186		106		80	75	%
Total investment and other income		43,640		61,878		(18,238)	(29)	%
Income before income taxes		1,158		282,436		(281,278)	(100)	%
Income tax expense		2,205		128,051		(125,846)	(98)	%
Net income		(1,047)		154,385		(155,432)	>(100)	%
Less: Net income (loss) attributable to noncontrolling interests, net of tax		(1,740)		6,080		(7,820)	>(100)	%
Net income attributable to U.S. Cellular shareholders	$	693	$	148,305	$	(147,612)	(100)	%
Basic earnings per share attributable to U.S. Cellular shareholders	$	0.01	$	1.77	$	(1.76)	(99)	%
Diluted earnings per share attributable to U.S. Cellular shareholders	$	0.01	$	1.75	$	(1.74)	(99)	%
N/M - Not meaningful								

Equity in earnings of unconsolidated entities

U.S. Cellular's investment in the Los Angeles SMSA Limited Partnership ("LA Partnership") contributed $39.6 million and $40.4 million to Equity in earnings of unconsolidated entities in 2014 and 2013, respectively.

On April 3, 2013, U.S. Cellular deconsolidated the NY1 & NY2 Partnerships and began reporting them as equity method investments in its consolidated financial statements as of that date. Equity in earnings of the NY1 & NY2 Partnerships was $13.7 million and $8.6 million in 2014 and 2013, respectively. See Note 7 – Investments in Unconsolidated Entities in the Notes to Consolidated Financial Statements for additional information.

Gain (loss) on investments

In 2013, in connection with the deconsolidation of the NY1 & NY2 Partnerships, U.S. Cellular recognized a non-cash pre-tax gain of $18.5 million.

Interest expense

The increase in interest expense was due primarily to a decrease in capitalized interest related to network and systems projects. Interest cost capitalized was $2.0 million and $10.2 million for 2014 and 2013, respectively.

Income tax expense

See Note 3 — Income Taxes in the Notes to Consolidated Financial Statements for a discussion of the overall effective tax rate on Income before income taxes.

Net income (loss) attributable to noncontrolling interests, net of tax

The decrease from 2013 to 2014 is due primarily to the elimination of the noncontrolling interest as a result of the NY1 & NY2 Deconsolidation on April 3, 2013.

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Three Months Ended June 30, 2014 Compared to Three Months Ended June 30, 2013

Components of Operating Income (Loss)				
Three Months Ended June 30,	**2014**	**2013**	**Change**	**Percentage Change**
(Dollars in thousands)				
Retail service	$ 746,117	$ 802,408	$ (56,291)	(7)%
Inbound roaming	57,580	65,033	(7,453)	(11)%
Other	39,776	43,525	(3,749)	(9)%
Service revenues	843,473	910,966	(67,493)	(7)%
Equipment sales	114,300	84,164	30,136	36 %
Total operating revenues	957,773	995,130	(37,357)	(4)%
System operations (excluding Depreciation, amortization and accretion reported below)	187,131	192,267	(5,136)	(3)%
Cost of equipment sold	271,978	217,070	54,908	25 %
Selling, general and administrative	404,252	404,127	125	-
Depreciation, amortization and accretion	148,337	202,580	(54,243)	(27)%
(Gain) loss on asset disposals, net	6,893	9,018	(2,125)	(24)%
(Gain) loss on sale of business and other exit costs, net	(10,511)	(249,024)	238,513	96 %
Total operating expenses	1,008,080	776,038	232,042	30 %
Operating income (loss)	$ (50,307)	$ 219,092	$ (269,399)	>(100)%

Operating Revenues

Retail service revenues

Retail service revenues decreased $56.3 million, or 7%, to $746.1 million in 2014 due primarily to a decrease in U.S. Cellular’s average customer base (including the reductions caused by the Divestiture Transaction) partially offset by an increase in billed ARPU.

Billed ARPU increased to $53.36 in 2014 compared to $50.60 in 2013. The overall increase is due primarily to an increase in postpaid ARPU to $56.82 in 2014 from $54.18 in 2013, reflecting increases in smartphone adoption and corresponding revenues from data products and services.

Inbound roaming revenues

Inbound roaming revenues decreased by $7.5 million, or 11%, to $57.6 million in 2014 compared to 2013. The decrease was due in part to a $3.4 million impact related to the Divestiture Transaction. The remaining decrease in the Core Markets was due to a decrease in rates and a decline in voice volume, partially offset by higher data usage.

Other revenues

Other revenues decreased by $3.7 million, or 9%, to $39.8 million, due primarily to a $6.4 million decrease in ETC revenues. ETC revenues decreased due to the phase down of USF support as described in Results of Operations – U.S. Cellular for the six months ended June 30, 2014.

Equipment sales revenues

Equipment sales revenues increased by $30.1 million, or 36%, in 2014 to $114.3 million. The increase was due primarily to activity in the Core Markets, which reflected an increase in the average revenue per device sold (including the impact of sales under equipment installment plans), partially offset by the sale of fewer devices, primarily in the feature phone category. The increase in equipment sales revenues in the Core Markets was partially offset by the effects of the Divestiture Transaction.

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Operating Expenses

System operations expenses (excluding Depreciation, amortization and accretion)

Key components of the $5.1 million, or 3%, decrease to $187.1 million were as follows:

- Customer usage expense decreased $6.8 million, or 11%, driven by the impacts of the Divestiture Transaction and lower fees for platform and content providers.

- Maintenance, utility and cell site expenses decreased $1.1 million, or 1%, due primarily to the impacts of the Divestiture Transaction and lower headcount, partially offset by costs related to 4G LTE support.

- Expenses incurred when U.S. Cellular's customers used other carriers' networks while roaming increased $2.7 million, or 7%, due primarily to an increase in data usage, partially offset by a decrease in voice usage, lower rates, and the impacts of the Divestiture Transaction.

Cost of equipment sold

Cost of equipment sold increased by $54.9 million, or 25%, to $272.0 million in 2014 due primarily to an increase of 34% in the average cost per device sold due to general customer preference for higher-priced 4G LTE smartphones. The increase in average cost per device sold was partially offset by fewer device sales in the Core Markets and impacts of the Divestiture Transaction.

Selling, general and administrative expenses

Selling, general and administrative expenses were essentially flat year over year. Key components of Selling, general and administrative expenses were as follows:

- Selling and marketing expense increased by $2.5 million, or 1%, due primarily to an increase in commission and personnel expenses, partially offset by the effects of the Divestiture Transaction.

- General and administrative expense decreased by $2.4 million, or 1%, due primarily to the Divestiture Transaction and lower consulting expenses related to the billing system conversion in the prior year, offset by an increase in bad debts expense.

Depreciation, amortization and accretion

Depreciation, amortization and accretion decreased $54.2 million, or 27%, in 2014 to $148.3 million due primarily to the higher amount of accelerated depreciation, amortization and accretion in the Divestiture Markets that occurred in 2013. The impact of the acceleration was $50.3 million in 2013.

(Gain) loss on asset disposals, net

(Gain) loss on asset disposals, net was a loss in both 2014 and 2013 due primarily to the write-off and disposals of certain network assets.

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

The net gain in both 2014 and 2013 resulted from the Divestiture Transaction. See Note 5 — Acquisitions, Divestitures and Exchanges in the Notes to Consolidated Financial Statements for additional information.

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Components of Other Income (Expense)									
Three Months Ended June 30,		**2014**		**2013**		**Change**		**Percentage Change**	
(Dollars in thousands, except per share amounts)									
Operating income (loss)	$	(50,307)	$	219,092	$	(269,399)		>(100	)%
Equity in earnings from unconsolidated entities		33,120		35,602		(2,482)		(7	)%
Interest and dividend income		1,573		969		604		62	%
Gain (loss) on investments		-		18,527		(18,527)		N/M	
Interest expense		(14,336)		(10,154)		(4,182)		41	%
Other, net		100		321		(221)		(69	)%
Total investment and other income		20,457		45,265		(24,808)		(55	)%
Income (loss) before income taxes		(29,850)		264,357		(294,207)		>(100	)%
Income tax expense (benefit)		(10,399)		120,682		(131,081)		>(100	)%
Net income (loss)		(19,451)		143,675		(163,126)		>(100	)%
Less: Net income (loss) attributable to noncontrolling interests, net of tax		(662)		284		(946)		>(100	)%
Net income (loss) attributable to U.S. Cellular	$	(18,789)	$	143,391	$	(162,180)		>(100	)%
Basic earnings (loss) per share attributable to U.S. Cellular shareholders	$	(0.22)	$	1.71	$	(1.93)		>(100	)%
Diluted earnings (loss) per share attributable to U.S. Cellular shareholders	$	(0.22)	$	1.69	$	(1.91)		>(100	)%
N/M - Not meaningful									

Equity in earnings of unconsolidated entities

U.S. Cellular's investment in the LA Partnership contributed $18.4 million and $19.8 million to Equity in earnings of unconsolidated entities in 2014 and 2013, respectively.

Interest expense

The increase in interest expense was due primarily to a decrease in capitalized interest related to network and systems projects. Capitalized interest was $1.1 million and $5.5 million for 2014 and 2013, respectively.

Net income (loss) attributable to noncontrolling interests, net of tax

The decrease from 2013 to 2014 is due primarily to lower income in certain partnerships in 2014.

Income tax expense (benefit)

See Note 3 — Income Taxes in the Notes to Consolidated Financial Statements for a discussion of the change in income tax expense (benefit) and the overall effective tax rate on Income (loss) before income taxes.

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RECENT ACCOUNTING PRONOUNCEMENTS

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

FINANCIAL RESOURCES

U.S. Cellular operates a capital- and marketing-intensive business. U.S. Cellular utilizes cash on hand, cash from operating activities, cash proceeds from divestitures and disposition of investments, short-term credit facilities and long-term debt financing to fund its acquisitions (including licenses), construction costs, operating expenses and share repurchases. Cash flows may fluctuate from quarter to quarter and year to year due to seasonality, the timing of acquisitions, capital expenditures and other factors. The table below and the following discussion in this Financial Resources section summarize U.S. Cellular's cash flow activities for the six months ended June 30, 2014 and 2013.

			2014			2013
(Dollars in thousands)						
Cash flows from (used in):						
	Operating activities	$	212,860		$	448,585
	Investing activities		(142,901)			146,686
	Financing activities		(7,966)			(506,208)
Net increase in cash and cash equivalents		$	61,993		$	89,063

Cash Flows from Operating Activities

Cash flows from operating activities were $212.9 million in 2014 and $448.6 million in 2013. This decrease was due primarily to lower earnings excluding gains recognized on sale of business and license sales and exchanges. Also contributing to this decrease were changes in Accounts payable balances driven primarily by payment timing differences related to operating expenses and device purchases. The above decreases in Cash flows from operating activities were partially offset by a decrease in inventory levels and a decrease in Accounts receivable balances in 2014. The decrease in Accounts receivable balances was driven by the high receivables at December 31, 2013 resulting from the conversion to a new billing system in the third quarter of 2013, and the subsequent decrease of Accounts receivable balances to more normal levels during 2014. This decrease in Accounts receivable balances during 2014 was partially offset by increases in equipment installment plan receivables.

Cash Flows from Investing Activities

U.S. Cellular makes substantial investments to acquire wireless licenses and properties and to construct and upgrade wireless telecommunications networks and facilities as a basis for creating long-term value for shareholders. In recent years, rapid changes in technology and new opportunities have required substantial investments in potentially revenue enhancing and cost-reducing upgrades of U.S. Cellular’s networks.

Capital expenditures (i.e., additions to property, plant and equipment and system development expenditures) totaled $233.5 million in 2014 and $286.9 million in 2013. Cash used for additions to property, plant and equipment is reported in the Consolidated Statement of Cash Flows and excludes amounts accrued in Accounts payable for capital expenditures at June 30, 2014 and includes amounts paid in the current period that were accrued at December 31, 2013. Cash used for additions to property, plant and equipment totaled $262.4 million in 2014 and $323.2 million in 2013. See “Capital Expenditures” in Liquidity and Capital Resources below for additional information on capital expenditures.

Cash payments for acquisitions of licenses were $17.2 million and $14.2 million in 2014 and 2013, respectively.

Cash received from divestitures in 2014 and 2013 was as follows.

Cash Received from Divestitures	**2014**			**2013**	
(Dollars in thousands)					
Licenses	$	91,789		$	-
Businesses		34,116			480,000
Total	$	125,905		$	480,000

See Note 5 — Acquisitions, Divestitures and Exchanges in the Notes to Consolidated Financial Statements for additional information related to these divestitures.

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In 2014, U.S. Cellular realized proceeds of $10.0 million related to the maturities of certain of its investments in U.S. Treasury Notes.

Cash Flows from Financing Activities

Cash flows from financing activities include proceeds from and repayments of short-term and long-term debt, dividends to shareholders, distributions to noncontrolling interests, cash used to repurchase Common Shares and cash proceeds from reissuance of Common Shares pursuant to stock-based compensation plans.

Payments for repurchases of Common Shares required $8.3 million and $18.4 million in 2014 and 2013, respectively. See Note 9 — Common Share Repurchases in the Notes to Consolidated Financial Statements for additional information related to these transactions.

U.S. Cellular did not pay any dividends in 2014. On June 25, 2013, U.S. Cellular paid a special cash dividend of $5.75 per share, for an aggregate amount of $482.3 million, to all holders of U.S. Cellular Common Shares and Series A Common Shares.

Adjusted Free Cash Flow

The following table presents Adjusted free cash flow. Adjusted free cash flow is defined as Cash flows from operating activities, as adjusted for cash proceeds from the Sprint Cost Reimbursement (which are included in Cash flows from investing activities in the Consolidated Statement of Cash Flows), less Cash used for additions to property, plant and equipment. Adjusted free cash flow is a non-GAAP financial measure which U.S. Cellular believes may be useful to investors and other users of its financial information in evaluating the amount of cash generated by business operations (including cash proceeds from the Sprint Cost Reimbursement), after Cash used for additions to property, plant and equipment. The prior manner of calculating free cash flow has been adjusted to include the Sprint Cost Reimbursement. The reason for this is that the Sprint decommissioning cash outflows are included in "Cash flows from operating activities," but the reimbursements from Sprint related to those outflows are not included in this caption.

Six Months Ended June 30,	2014			2013	
(Dollars in thousands)					
Cash flows from operating activities	$	212,860		$	448,585

Add: Sprint Cost Reimbursement (1)			34,116			-
Less: Cash used for additions to property, plant and equipment			262,397			323,157
	Adjusted free cash flow	$	(15,421)		$	125,428
(1)	See Note 5 — Acquisitions, Divestitures and Exchanges in the Notes to Consolidated Financial Statements for additional information related to the Sprint Cost Reimbursement.					
See Cash Flows from Operating Activities and Cash Flows from Investing Activities for additional information related to the components of Adjusted free cash flow.						

LIQUIDITY AND CAPITAL RESOURCES

U.S. Cellular believes that existing cash and investment balances, funds available under its revolving credit facility and expected cash flows from operating and investing activities provide substantial liquidity and financial flexibility for U.S. Cellular to meet its normal financing needs for the foreseeable future. However, these sources may not be adequate to fund future expenditures, including spectrum license auctions, that the company could potentially elect to make. It may be necessary to increase the size of the existing revolving credit facility, to put in place new facilities, or to obtain other forms of financing in order to fund these potential expenditures. To the extent that sufficient funds are not available to U.S. Cellular or its subsidiaries on terms or at prices acceptable to U.S. Cellular, it could require U.S. Cellular to reduce its construction, development and acquisition programs.

U.S. Cellular cannot provide assurances that circumstances that could have a material adverse effect on its liquidity or capital resources will not occur. Economic conditions, changes in financial markets, U.S. Cellular financial performance and/or prospects or other factors could restrict U.S. Cellular's liquidity and availability of financing on terms and prices acceptable to U.S. Cellular, which could require U.S. Cellular to reduce its capital expenditure, acquisition or share repurchase programs. Such reductions could have a material adverse effect on U.S. Cellular's business, financial condition or results of operations.

The following table summarizes U.S. Cellular's cash and investments as of June 30, 2014.		
(Dollars in thousands)		
Cash and cash equivalents	$	404,058
Short-term investments	$	40,035

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Cash and Cash Equivalents

Cash and cash equivalents include cash and short-term, highly liquid investments with original maturities of three months or less. The primary objective of U.S. Cellular's Cash and cash equivalents investment activities is to preserve principal. At June 30, 2014, the majority of U.S. Cellular's Cash and cash equivalents was held in bank deposit accounts and in money market funds that invest exclusively in U.S. Treasury Notes or in repurchase agreements fully collateralized by such obligations. U.S. Cellular monitors the financial viability of the money market funds and direct investments in which it invests and believes that the credit risk associated with these investments is low.

Short-term Investments

Short-term investments consist of U.S. Treasury Notes which are designated as held-to-maturity investments and are recorded at amortized cost in the Consolidated Balance Sheet. For these investments, U.S. Cellular's objective is to earn a higher rate of return on funds that are not anticipated to be required to meet liquidity needs in the near term, while maintaining a low level of investment risk. See Note 2 — Fair Value Measurements in the Notes to Consolidated Financial Statements for additional information on Short-term investments.

Revolving Credit Facility

U.S. Cellular has a revolving credit facility available for general corporate purposes.

In connection with U.S. Cellular's revolving credit facility, TDS and U.S. Cellular entered into a subordination agreement dated December 17, 2010 together with the administrative agent for the lenders under U.S. Cellular's revolving credit facility. At June 30, 2014, no U.S. Cellular debt was subordinated pursuant to this subordination agreement.

In April 2014, two of the nationally recognized credit rating agencies downgraded the U.S. Cellular corporate and senior debt credit ratings. In July 2014, one of the nationally recognized credit rating agencies downgraded the U.S. Cellular corporate and senior debt credit ratings. After these downgrades, two of the nationally recognized credit rating agencies rated U.S. Cellular at sub-investment grade. One of the nationally recognized credit rating agencies rated U.S. Cellular at investment grade.

U.S. Cellular's interest cost on its revolving credit facility may be subject to increase if its current credit rating from nationally recognized credit rating agencies is lowered, and may be subject to decrease if the rating is raised. The April and July 2014 downgrades will increase the commitment fee on the revolving credit facility by 0.075% per annum. The downgrades also will increase the interest rate on any borrowings by 0.25% per annum. The credit facility does not cease to be available nor does the maturity date accelerate solely as a result of a downgrade in U.S. Cellular's credit rating. However, downgrades in U.S. Cellular's credit rating could adversely affect its ability to renew the credit facility or obtain access to other credit facilities in the future.

The following table summarizes the terms of U.S. Cellular's revolving credit facility as of June 30, 2014:

(Dollars in millions)		
Maximum borrowing capacity	$	300.0
Letters of credit outstanding	$	17.5
Amount borrowed	$	-
Amount available for use	$	282.5
Agreement date		December 2010
Maturity date		December 2017

The continued availability of the revolving credit facility requires U.S. Cellular to comply with certain negative and affirmative covenants, maintain certain financial ratios and make representations regarding certain matters at the time of each borrowing. The covenants also prescribe certain terms associated with intercompany loans from TDS or TDS subsidiaries to U.S. Cellular or U.S. Cellular subsidiaries. There were no intercompany loans at June 30, 2014 or 2013. U.S. Cellular believes that it was in compliance as of June 30, 2014 with all of the financial covenants and requirements set forth in its revolving credit facility.

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As more fully described on U.S. Cellular's Form 8-K dated July 24, 2014, to provide for additional financial flexibility, U.S. Cellular entered into an amendment to the revolving credit facility agreement which increased the Consolidated Leverage Ratio (the ratio of Consolidated Funded Indebtedness to Consolidated Earnings before interest, taxes, depreciation and amortization ("EBITDA")) that U.S. Cellular is required to maintain. Beginning July 1, 2014, U.S. Cellular is required to maintain the Consolidated Leverage Ratio at a level not to exceed 3.75 to 1.00 for the period of the four fiscal quarters most recently ended (this was 3.00 to 1.00 prior to July 1, 2014). The terms of the amendment decrease the maximum permitted Consolidated Leverage Ratio beginning January 1, 2016, with further decreases effective July 1, 2016 and January 1, 2017 (and will return to 3.00 to 1.00 at that time). For the twelve months ended June 30, 2014, the actual Consolidated Leverage Ratio was 2.00 to 1.00. Future changes in U.S. Cellular's financial condition could negatively impact its ability to meet the financial covenants and requirements in its revolving credit facility agreement.

Long-Term Financing

There were no material changes to Long-Term Financing as disclosed in Management's Discussion and Analysis of Financial Condition and Results of Operations included in U.S. Cellular's Form 10-K for the year ended December 31, 2013.

U.S. Cellular's long-term debt indentures do not contain any provisions resulting in acceleration of the maturities of outstanding debt in the event of a change in U.S. Cellular's credit rating. However, a downgrade in U.S. Cellular's credit rating could adversely affect its ability to obtain long-term debt financing in the future. U.S. Cellular believes that it was in compliance as of June 30, 2014 with all financial covenants and other requirements set forth in its long-term debt indentures. U.S. Cellular has not failed to make nor does it expect to fail to make any scheduled payment of principal or interest under such indentures.

The long-term debt principal payments due for the remainder of 2014 and the next four years represent less than 1% of the total long-term debt obligation at June 30, 2014. Refer to Market Risk — Long-Term Debt in U.S. Cellular's Form 10-K for the year ended December 31, 2013 for additional information regarding required principal payments and the weighted average interest rates related to U.S. Cellular's Long-term debt.

Capital Expenditures

U.S. Cellular's capital expenditures for 2014 are expected to be approximately $640 million. These expenditures are expected to be for the following general purposes:

- Expand and enhance network coverage in its service areas, including providing additional capacity to accommodate increased network usage, principally data usage, by current customers;
- Continue to deploy 4G LTE technology in certain markets;
- Expand and enhance the retail store network; and
- Develop and enhance office systems.

U.S. Cellular plans to finance its capital expenditures program for 2014 using primarily Cash flows from operating activities and, as necessary, existing cash balances and short-term investments.

Acquisitions, Divestitures and Exchanges

U.S. Cellular assesses its existing wireless interests on an ongoing basis with a goal of improving the 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 wireless operating markets and wireless spectrum. In addition, U.S. Cellular may seek to divest outright or include in exchanges for other wireless interests those interests that are not strategic to its long-term success. As a result, U.S. Cellular may be engaged from time to time in negotiations relating to the acquisition, divestiture or exchange of companies, properties or wireless spectrum. In general, U.S. Cellular may not disclose such transactions until there is a definitive agreement. See Note 5 — Acquisitions, Divestitures and Exchanges in the Notes to Consolidated Financial Statements for additional information related to significant transactions.

Variable Interest Entities

U.S. Cellular consolidates certain entities because they are “variable interest entities” under accounting principles generally accepted in the United States of America (“GAAP”). See Note 8 — Variable Interest Entities (VIEs) in the Notes to Consolidated Financial Statements for additional information related to these variable interest entities. U.S. Cellular may elect to make additional capital contributions and/or advances to these variable interest entities in future periods in order to fund their operations.

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Common Share Repurchase Program

In the past year, U.S. Cellular has repurchased and expects to continue to repurchase its Common Shares, subject to its repurchase program. For additional information related to the current repurchase authorization and repurchases made during 2014 and 2013, see Note 9 — Common Share Repurchases in the Notes to Consolidated Financial Statements and Part II, Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

Contractual and Other Obligations

There were no material changes outside the ordinary course of business between December 31, 2013 and June 30, 2014 to the Contractual and Other Obligations disclosed in Management's Discussion and Analysis of Financial Condition and Results of Operations included in U.S. Cellular's Form 10-K for the year ended December 31, 2013.

Off-Balance Sheet Arrangements

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

APPLICATION OF CRITICAL ACCOUNTING POLICIES AND ESTIMATES

U.S. Cellular prepares its consolidated financial statements in accordance with GAAP. U.S. Cellular's significant accounting policies are discussed in detail in Note 1 — Summary of Significant Accounting Policies and Recent Accounting Pronouncements in the Notes to Consolidated Financial Statements and U.S. Cellular's Application of Critical Accounting Policies and Estimates is discussed in detail in Management's Discussion and Analysis of Financial Condition and Results of Operations, both of which are included in U.S. Cellular's Form 10-K for the year ended December 31, 2013. There were no material changes to U.S. Cellular's application of critical accounting policies and estimates during the six months ended June 30, 2014.

CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

As previously disclosed, in December 2013, TDS initially proposed to have Airadigm Communications, Inc. ("Airadigm") sell to U.S. Cellular the FCC spectrum licenses, towers and customers in certain Airadigm markets for $110 million in cash. Because TDS owns 100% of the common stock of Airadigm and approximately 84% of the common stock of U.S. Cellular, this proposal was a related party transaction. Accordingly, the U.S. Cellular Board of Directors formed a Special Committee comprised entirely of independent and disinterested directors with exclusive authority to consider, negotiate and, if appropriate, approve any such transaction with Airadigm without any further involvement of the full board. The U.S. Cellular Special Committee engaged independent financial advisors and legal counsel. The transaction was negotiated between representatives of TDS and Airadigm, on the one hand, and the Special Committee and its representatives, on the other hand. The U.S. Cellular Special Committee also received a fairness opinion from its independent financial advisor. Following these events, the Special Committee approved a License Purchase and Customer Recommendation Agreement between U.S. Cellular and Airadigm, which was entered into on May 23, 2014, as disclosed in Note 5 – Acquisitions, Divestitures and Exchanges in the Notes to the Consolidated Financial Statements.

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PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

SAFE HARBOR CAUTIONARY STATEMENT

This Form 10-Q, including exhibits, contains statements that are not based on historical facts and represent forward-looking statements, as this term is defined in the Private Securities Litigation Reform Act of 1995. All statements, other than statements of historical facts, that address activities, events or developments that U.S. Cellular intends, expects, projects, believes, estimates, plans or anticipates will or may occur in the future are forward-looking statements. The words “believes,” “anticipates,” “estimates,” “expects,” “plans,” “intends,” “projects” and similar expressions intended to identify these forward-looking statements, but are not the exclusive means of identifying them. Such forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause actual results, events or developments to be significantly different from any future results, events or developments expressed or implied by such forward-looking statements. Such risks, uncertainties and other factors include those set forth below, as more fully described under “Risk Factors” in U.S. Cellular’s Form 10-K for the year ended December 31, 2013. However, such factors are not necessarily all of the important factors that could cause actual results, performance or achievements to differ materially from those expressed in, or implied by, the forward-looking statements contained in this document. Other unknown or unpredictable factors also could have material adverse effects on future results, performance or achievements. U.S. Cellular undertakes no obligation to update publicly any forward-looking statements whether as a result of new information, future events or otherwise. You should carefully consider the Risk Factors in U.S. Cellular’s Form 10-K for the year ended December 31, 2013, the following factors and other information contained in, or incorporated by reference into, this Form 10-Q to understand the material risks relating to U.S. Cellular’s business.

- *Intense competition in the markets in which U.S. Cellular operates could adversely affect U.S. Cellular’s revenues or increase its costs to compete.*

- *A failure by U.S. Cellular to successfully execute its business strategy (including planned acquisitions, divestitures and exchanges) or allocate resources or capital could have an adverse effect on U.S. Cellular’s business, financial condition or results of operations.*

- *A failure by U.S. Cellular’s service offerings to meet customer expectations, including any continuing issues relating to the conversion to the new Billing and Operational Support System ("B/OSS") in the third quarter of 2013, could limit U.S. Cellular’s ability to attract and retain customers and could have an adverse effect on U.S. Cellular’s business, financial condition or results of operations.*

- *U.S. Cellular offers customers the option to purchase certain devices under installment contracts, which could result in higher churn and higher bad debts expense.*

- *U.S. Cellular’s system infrastructure may not be capable of supporting changes in technologies and services expected by customers, which could result in a loss of existing customers and revenues and impair U.S. Cellular's ability to add new customers and revenues.*

- *Changes in roaming practices or other factors could cause U.S. Cellular's roaming revenues to decline from current levels and/or impact U.S. Cellular's ability to service its customers in geographic areas where U.S. Cellular does not have its own network, which would have an adverse effect on U.S. Cellular's business, financial condition or results of operations.*

- *A failure by U.S. Cellular to obtain access to adequate radio spectrum to meet current or anticipated future needs and/or to accurately predict future needs for radio spectrum could have an adverse effect on U.S. Cellular’s business, financial condition or results of operations.*

- *To the extent conducted by the Federal Communications Commission (“FCC”), U.S. Cellular is likely to participate in FCC auctions of additional spectrum in the future as an applicant or as a noncontrolling partner in another auction applicant and, during certain periods, will be subject to the FCC’s anti-collusion rules, which could have an adverse effect on U.S. Cellular.*

- *Changes in the regulatory environment or a failure by U.S. Cellular to timely or fully comply with any applicable regulatory requirements could adversely affect U.S. Cellular’s business, financial condition or results of operations.*

- *Changes in Universal Service Fund (“USF”) funding and/or intercarrier compensation could have an adverse impact on U.S. Cellular’s business, financial condition or results of operations.*

- *An inability to attract and/or retain highly competent management, technical, sales and other personnel could have an adverse effect on U.S. Cellular’s business, financial condition or results of operations.*

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- *U.S. Cellular’s assets are concentrated in the U.S. wireless telecommunications industry. As a result, its results of operations may fluctuate based on factors related primarily to conditions in this industry.*

- *U.S. Cellular’s lower scale relative to larger competitors could adversely affect its business, financial condition or results of operations.*

- *Changes in various business factors could have an adverse effect on U.S. Cellular’s business, financial condition or results of operations.*

- *Advances or changes in technology could render certain technologies used by U.S. Cellular obsolete, could put U.S. Cellular at a competitive disadvantage, could reduce U.S. Cellular’s revenues or could increase its costs of doing business.*

- *Complexities associated with deploying new technologies present substantial risk.*

- *U.S. Cellular is subject to numerous surcharges and fees from federal, state and local governments, and the applicability and the amount of these fees are subject to great uncertainty.*

- *Performance under device purchase agreements could have a material adverse impact on U.S. Cellular's business, financial condition or results of operations.*

- *Changes in U.S. Cellular’s enterprise value, changes in the market supply or demand for wireless licenses, adverse developments in the business or the industry in which U.S. Cellular is involved and/or other factors could require U.S. Cellular to recognize impairments in the carrying value of its licenses, goodwill and/or physical assets.*

- *Costs, integration problems or other factors associated with acquisitions, divestitures or exchanges of properties or licenses and/or expansion of U.S. Cellular’s business could have an adverse effect on U.S. Cellular’s business, financial condition or results of operations.*

- *A significant portion of U.S. Cellular's revenues is derived from customers who buy services through independent agents and third-party national retailers who market U.S. Cellular's services on a commission basis. If U.S. Cellular's relationships with these agents or third-party national retailers are seriously harmed, its business, financial condition or results of operations could be adversely affected.*

- *U.S. Cellular's investments in unproven technologies may not produce the benefits that U.S. Cellular expects.*

- *A failure by U.S. Cellular to complete significant network construction and systems implementation activities as part of its plans to improve the quality, coverage, capabilities and capacity of its network, support and other systems and infrastructure could have an adverse effect on its operations.*

- *Financial difficulties (including bankruptcy proceedings) or other operational difficulties of U.S. Cellular's key suppliers, termination or impairment of U.S. Cellular's relationships with such suppliers, or a failure by U.S. Cellular to manage its supply chain effectively could result in delays or termination of U.S. Cellular's receipt of required equipment or services, or could result in excess quantities of required equipment or services, any of which could adversely affect U.S. Cellular's business, financial condition or results of operations.*

- *U.S. Cellular has significant investments in entities that it does not control. Losses in the value of such investments could have an adverse effect on U.S. Cellular's financial condition or results of operations.*

- *A failure by U.S. Cellular to maintain flexible and capable telecommunication networks or information technology, or a material disruption thereof, including breaches of network or information technology security, could have an adverse effect on U.S. Cellular's business, financial condition or results of operations.*

- *Wars, conflicts, hostilities and/or terrorist attacks or equipment failures, power outages, natural disasters or other events could have an adverse effect on U.S. Cellular's business, financial condition or results of operations.*

- *The market price of U.S. Cellular's Common Shares is subject to fluctuations due to a variety of factors.*

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- *Identification of errors in financial information or disclosures could require amendments to or restatements of financial information or disclosures included in this or prior filings with the Securities and Exchange Commission ("SEC"). Such amendments or restatements and related matters, including resulting delays in filing periodic reports with the SEC, could have an adverse effect on U.S. Cellular's business, financial condition or results of operations.*

- *The existence of material weaknesses in the effectiveness of internal control over financial reporting could result in inaccurate financial statements or other disclosures or failure to prevent fraud, which could have an adverse effect on U.S. Cellular's business, financial condition or results of operations.*

- *Changes in facts or circumstances, including new or additional information that affects the calculation of potential liabilities for contingent obligations under guarantees, indemnities, claims, litigation or otherwise, could require U.S. Cellular to record charges in excess of amounts accrued in the financial statements, which could have an adverse effect on U.S. Cellular's business, financial condition or results of operations.*

- *Disruption in credit or other financial markets, a deterioration of U.S. or global economic conditions or other events could, among other things, impede U.S. Cellular's access to or increase the cost of financing its operating and investment activities and/or result in reduced revenues and lower operating income and cash flows, which would have an adverse effect on U.S. Cellular's business, financial condition or results of operations.*

- *Uncertainty of U.S. Cellular's ability to access capital, deterioration in the capital markets, other changes in market conditions, changes in U.S. Cellular's credit ratings or other factors could limit or restrict the availability of financing on terms and prices acceptable to U.S. Cellular, which could require U.S. Cellular to reduce its construction, development or acquisition programs.*

- *Settlements, judgments, restraints on its current or future manner of doing business and/or legal costs resulting from pending and future litigation could have an adverse effect on U.S. Cellular's business, financial condition or results of operations.*

- *The possible development of adverse precedent in litigation or conclusions in professional studies to the effect that radio frequency emissions from wireless devices and/or cell sites cause harmful health consequences, including cancer or tumors, or may interfere with various electronic medical devices such as pacemakers, could have an adverse effect on U.S. Cellular's business, financial condition or results of operations.*

- *Claims of infringement of intellectual property and proprietary rights of others, primarily involving patent infringement claims, could prevent U.S. Cellular from using necessary technology to provide products or services or subject U.S. Cellular to expensive intellectual property litigation or monetary penalties, which could have an adverse effect on U.S. Cellular's business, financial condition or results of operations.*

- *There are potential conflicts of interests between TDS and U.S. Cellular.*

- *Certain matters, such as control by TDS and provisions in the U.S. Cellular Restated Certificate of Incorporation, may serve to discourage or make more difficult a change in control of U.S. Cellular.*

- *Any of the foregoing events or other events could cause revenues, earnings, capital expenditures and/or any other financial or statistical information to vary from U.S. Cellular's forward-looking estimates by a material amount.*

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

MARKET RISK

Refer to the disclosure under Market Risk in U.S. Cellular's Form 10-K for the year ended December 31, 2013 for additional information, including information regarding required principal payments and the weighted average interest rates related to U.S. Cellular's Long-term debt. There have been no material changes to such information since December 31, 2013.

See Note 2 — Fair Value Measurements in the Notes to Consolidated Financial Statements for additional information related to the fair value of U.S. Cellular's Long-term debt as of June 30, 2014.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

U.S. Cellular maintains disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) that are designed to ensure that information required to be disclosed in its reports filed or submitted under the Exchange Act is processed, recorded, summarized and reported within the time periods specified in the Securities and Exchange Commission's ("SEC") rules and forms, and that such information is accumulated and communicated to U.S. Cellular's management, including its principal executive officer and principal financial officer, as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives.

As required by SEC Rule 13a-15(b), U.S. Cellular carried out an evaluation, under the supervision and with the participation of management, including its principal executive officer and principal financial officer, of the effectiveness of the design and operation of U.S. Cellular's disclosure controls and procedures as of the end of the period covered by this Quarterly Report. Based on this evaluation, U.S. Cellular's principal executive officer and principal financial officer concluded that U.S. Cellular's disclosure controls and procedures were effective as of June 30, 2014, at the reasonable assurance level.

Changes in Internal Control Over Financial Reporting

Internal controls over financial reporting are updated as necessary to accommodate modifications to our business processes and accounting procedures. There have been no changes in U.S. Cellular's internal control over financial reporting during the quarter ended June 30, 2014 that have materially affected, or are reasonably likely to materially affect, U.S. Cellular's internal control over financial reporting.

Part II. Other Information

Item 1. Legal Proceedings.

Refer to the disclosure under Legal Proceedings in U.S. Cellular's Form 10-K for the year ended December 31, 2013. There have been no material changes to such information since December 31, 2013.

Item 1A. Risk Factors.

In addition to the information set forth in this Form 10-Q, you should carefully consider the factors discussed in Part I, "Item 1A. Risk Factors" in U.S. Cellular's Annual Report on Form 10-K for the year ended December 31, 2013, which could materially affect U.S. Cellular's business, financial condition or future results. The risks described in this Form 10-Q and the Form 10-K for the year ended December 31, 2013, may not be the only risks that could affect U.S. Cellular. Additional unidentified or unrecognized risks and uncertainties could materially adversely affect U.S. Cellular's business, financial condition and/or operating results. Subject to the foregoing, U.S. Cellular has not identified for disclosure any material changes to the risk factors as previously disclosed in U.S. Cellular's Annual Report on Form 10-K for the year ended December 31, 2013, except as follows:

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U.S. Cellular offers customers the option to purchase certain devices under installment contracts, which could result in higher churn and higher bad debts expense.

Beginning in the second quarter of 2014, U.S. Cellular expanded its offerings of equipment installment plans. Such plans offer customers the option to purchase certain devices under installment contracts over a period of up to 24 months. U.S. Cellular expects that sales of devices under these plans, when compared to sales of devices made under the traditional subsidy model, will reduce retail service revenue and ARPU but increase equipment revenue. Compared to equipment sales made under the traditional subsidy model, these equipment installment plans involve different considerations regarding marketing, sales, customer retention and renewal, device replacement, customer churn, cash flows, accounting and other business considerations, including business risks. U.S. Cellular does not have significant experience in these new plans or a sufficient history to determine how these plans will affect U.S. Cellular's business, financial position or results of operations. In particular, customers on such plans can discontinue their service at any time without penalty, other than the obligation of any residual commitment they may have for unpaid service or for amounts due under the installment contract for the device. U.S. Cellular could experience reduced revenues and increased marketing costs to acquire new customers if it experiences an increase in churn, which could reduce its margins and operational and financial performance. In addition, customers who purchase their devices through equipment installment plans have the option to pay for their devices in installments over a period of up to 24 months. As a result, these plans subject U.S. Cellular to increased risks relating to consumer credit, which could result in an increase in bad debts expense. These plans may be particularly sensitive to changes in general economic conditions and declines in the credit quality of customers. There is no assurance that such plans will not have an adverse effect on U.S. Cellular's business, financial position or results of operations.

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Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

On November 17, 2009, the Board of Directors of U.S. Cellular authorized the repurchase of up to 1,300,000 Common Shares on an annual basis beginning in 2009 and continuing each year thereafter, on a cumulative basis. Depending on market conditions, such shares may be repurchased in compliance with Rule 10b-18 of the Securities Exchange Act of 1934, as amended ("Exchange Act"), pursuant to Rule 10b5-1 under the Exchange Act, or pursuant to accelerated share repurchase arrangements, prepaid share repurchases, private transactions or as otherwise authorized. This authorization does not have an expiration date.

The following table provides certain information with respect to all purchases made by or on behalf of U.S. Cellular, and any open market purchases made by any “affiliated purchaser” (as defined by the SEC) of U.S. Cellular, of U.S. Cellular Common Shares during the quarter covered by this Form 10-Q.

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
April 1 – 30, 2014	51,169	$ 41.04	51,169	4,018,917
May 1 – 31, 2014	50,439	41.58	50,439	3,968,478
June 1 – 30, 2014	51,950	40.44	51,950	3,916,528
Total for or as of the end of the quarter ended June 30, 2014	153,558	$ 41.01	153,558	3,916,528

The following is additional information with respect to the foregoing authorization:

i. The date the program was announced was November 20, 2009 by Form 8-K.

ii. The amount approved was up to 1,300,000 U.S. Cellular Common Shares on an annual basis in 2009 and continuing each year thereafter on a cumulative basis.

iii. There is no expiration date for the program.

iv. The authorization did not expire during the second quarter of 2014.

v. U.S. Cellular did not determine to terminate the foregoing Common Share repurchase program, or cease making further purchases thereunder, during the second quarter of 2014.

Item 5. Other Information.

The following information is being provided to update prior disclosures made pursuant to the requirements of Form 8-K, Item 2.03 — Creation of a Direct Financial Obligation or an Obligation Under an Off-Balance Sheet Arrangement of a Registrant.

U.S. Cellular did not borrow or repay any amounts under its revolving credit facility in the second quarter of 2014. U.S. Cellular had no borrowings outstanding under its revolving credit facility as of June 30, 2014.

A description of U.S. Cellular's revolving credit facility is included under Item 1.01 in U.S. Cellular's Current Report on Form 8-K dated December 17, 2010, as such description is amended by Item 1.01 in U.S. Cellular's Current Report on Form 8-K dated July 24, 2014, and is incorporated by reference herein.

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Item 6. Exhibits.

Exhibit 2.1 — License Purchase and Customer Recommendation Agreement dated as of May 23, 2014 by and between United States Cellular Corporation and Airadigm Communications Inc., is hereby incorporated by reference to Exhibit 2.1 to U.S. Cellular's Current Report on Form 8-K dated May 23, 2014.

Exhibit 4.1 — Third Amendment dated July 24, 2014 to Revolving Credit Agreement dated December 17, 2010, is hereby incorporated by reference to U.S. Cellular's Current Report on Form 8-K dated July 24, 2014.

Exhibit 10.1 — Form of Long-Term Incentive Plan Restricted Stock Unit Award Agreement for Kenneth R. Meyers, is hereby incorporated by reference to Exhibit 10.1 to U.S. Cellular's Quarterly Report on Form 10-Q for the quarter ended March 31, 2014.

Exhibit 10.2 — Form of Long-Term Incentive Plan Stock Option Award Agreement for Kenneth R. Meyers, is hereby incorporated by reference to Exhibit 10.2 to U.S. Cellular's Quarterly Report on Form 10-Q for the quarter ended March 31, 2014.

Exhibit 11 — Statement regarding computation of per share earnings is included herein as Note 4 — Earnings Per Share in the Notes to Consolidated Financial Statements.

Exhibit 12 — Statement regarding computation of ratio of earnings to fixed charges.

Exhibit 31.1 — Principal executive officer certification pursuant to Rule 13a-14 of the Securities Exchange Act of 1934.

Exhibit 31.2 — Principal financial officer certification pursuant to Rule 13a-14 of the Securities Exchange Act of 1934.

Exhibit 32.1 — Principal executive officer certification pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code.

Exhibit 32.2 — Principal financial officer certification pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code.

Exhibit 101.INS — XBRL Instance Document

Exhibit 101.SCH — XBRL Taxonomy Extension Schema Document

Exhibit 101.PRE — XBRL Taxonomy Presentation Linkbase Document

Exhibit 101.CAL — XBRL Taxonomy Calculation Linkbase Document

Exhibit 101.LAB — XBRL Taxonomy Label Linkbase Document

Exhibit 101.DEF — XBRL Taxonomy Extension Definition Linkbase Document

The foregoing exhibits include only the exhibits that relate specifically to this Form 10-Q or that supplement the exhibits identified in U.S. Cellular's Form 10-K for the year ended December 31, 2013. Reference is made to U.S. Cellular's Form 10-K for the year ended December 31, 2013 for a complete list of exhibits, which are incorporated herein except to the extent supplemented or superseded above.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

		UNITED STATES CELLULAR CORPORATION		
		(Registrant)		
Date:	August 1, 2014		/s/ Kenneth R. Meyers	
			Kenneth R. Meyers President and Chief Executive Officer (principal executive officer)	
Date:	August 1, 2014		/s/ Steven T. Campbell	
			Steven T. Campbell Executive Vice President-Finance, Chief Financial Officer and Treasurer (principal financial officer)	
Date:	August 1, 2014		/s/ Douglas D. Shuma	
			Douglas D. Shuma Chief Accounting Officer (principal accounting officer)	
Date:	August 1, 2014		/s/ Kristin A. MacCarthy	
			Kristin A. MacCarthy	

			Vice President and Controller	