

UNITED STATES CELLULAR CORP
Form 10-Q
August 03, 2018

UNITED STATES
SECURITIES AND
EXCHANGE
COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark One)

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

For the quarterly period
ended June 30, 2018

OR

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

For the transition period
from
to

Commission file number
001-09712

UNITED STATES
CELLULAR
CORPORATION
(Exact name of Registrant
as specified in its charter)
Delaware 62-1147325
(State or (IRS Employer
other Identification

jurisdictionNo.)
of
incorporation
or
organization)

8410 West Bryn Mawr,
Chicago, Illinois 60631
(Address of principal
executive offices) (Zip
code)

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

Yes No

Indicate by check
mark whether the
registrant (1) has
filed all reports
required to be
filed by Section
13 or 15(d) of the
Securities
Exchange Act of
1934 during the
preceding 12
months (or for
such shorter
period that the
registrant was
required to file
such reports), and
(2) has been
subject to such
filing
requirements for
the past 90 days.

[x] []

Indicate by check [x] []
mark whether the
registrant has
submitted
electronically
every Interactive
Data File required
to be submitted
and posted
pursuant to Rule
405 of Regulation

S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit such files).

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

Large accelerated filer	Accelerated filer	<input checked="" type="checkbox"/>
Non-accelerated filer	Smaller reporting company	<input type="checkbox"/>
	Emerging growth company	<input type="checkbox"/>

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

Exchange Act).

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding at June 30, 2018
Common Shares, \$1 par value	52,545,519 Shares
Series A Common Shares, \$1 par value	33,005,877 Shares

United States Cellular Corporation

Quarterly Report on Form 10-Q
For the Period Ended June 30, 2018

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Signatures

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United States Cellular Corporation

Management's Discussion and Analysis of

Financial Condition and Results of Operations

Executive Overview

The following discussion and analysis compares United States Cellular Corporation's (U.S. Cellular) financial results for the three and six months ended June 30, 2018, to the three and six months ended June 30, 2017. It should be read in conjunction with U.S. Cellular's interim consolidated financial statements and notes included herein, and with the description of U.S. Cellular's business, its audited consolidated financial statements and Management's Discussion and Analysis (MD&A) 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, 2017. Certain numbers included herein are rounded to millions for ease of presentation; however, calculated amounts and percentages are determined using the unrounded numbers.

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

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

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General

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

OPERATIONS

- ◆ Serves customers with approximately 5.1 million connections including 4.5 million postpaid, 0.5 million prepaid and 0.1 million reseller and other connections
- ◆ Operates in 22 states
- ◆ Employs approximately 5,700 associates
- ◆ 6,478 cell sites including 4,105 owned towers in service

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U.S. Cellular Mission and Strategy

U.S. Cellular's mission is to provide exceptional wireless communication services which enhance consumers' lives, increase the competitiveness of local businesses, and improve the efficiency of government operations in the mid-sized and rural markets served.

In 2018, U.S. Cellular continues to execute on its strategies to protect its current customer base, grow revenues, drive improvements in the overall cost structure, and invest in its network and online platforms. Strategic efforts include:

- ◆ U.S. Cellular continues to offer economical and competitively priced service plans and devices to its customers, and is focused on increasing revenues from sales of related products such as accessories and device protection plans and from new services such as fixed wireless broadband. In addition, U.S. Cellular is focused on expanding its solutions available to business and government customers, including a growing suite of connected machine-to-machine solutions and software applications across various categories.
- ◆ U.S. Cellular continues to devote efforts to enhance its network capabilities. To date, VoLTE technology has been launched successfully in California, Iowa, Oregon, Washington and Wisconsin, and deployments in several additional operating markets will occur later this year. VoLTE technology allows customers to utilize a 4G LTE network for both voice and data services, and offers enhanced services such as high definition voice and simultaneous voice and data sessions. In addition, the deployment of VoLTE technology expands U.S. Cellular's ability to offer roaming services to other wireless carriers.
- ◆ U.S. Cellular is committed to continuous technology innovation as demonstrated by its ongoing evaluation of 5G technology. U.S. Cellular has successfully tested 5G technology in both indoor and outdoor environments and is currently engaged in efforts related to the development of 5G standards and identifying potential use cases for the technology. When deployed commercially, 5G technology is expected to help address customers' growing demand for data services as well as create opportunities for new services requiring high speed and reliability as well as low latency.
- ◆ 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 capital. As part of this strategy, U.S. Cellular actively seeks attractive opportunities to acquire wireless spectrum, including pursuant to FCC auctions.

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Terms Used by U.S. Cellular

The following is a list of definitions of certain industry terms that are used throughout this document:

- ◆ 4G LTE – fourth generation Long-Term Evolution which is a wireless broadband technology.
- ◆ 5G – fifth generation wireless broadband technology.
- ◆ Account – represents an individual or business financially responsible for one or multiple associated connections. An account may include a variety of types of connections such as handsets and connected devices.
- ◆ Auctions 1000, 1001, and 1002 – Auction 1000 is an FCC auction of 600 MHz spectrum licenses that started in 2016 and concluded in 2017 involving: (1) a “reverse auction” in which broadcast television licensees submitted bids to voluntarily relinquish spectrum usage rights in exchange for payments (referred to as Auction 1001); (2) a “repacking” of the broadcast television bands in order to free up certain broadcast spectrum for other uses; and (3) a “forward auction” of licenses for spectrum cleared through this process to be used for wireless communications (referred to as Auction 1002).
- ◆ ASU 2014-09 – the Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) 2014-09, Revenue from Contracts with Customers, including any subsequent modifications to such guidance. This ASU replaces existing revenue recognition rules with a single comprehensive model to use in accounting for revenue arising from contracts with customers.
- ◆ Churn Rate – represents the percentage of the connections that disconnect service each month. These rates represent the average monthly churn rate for each respective period.
- ◆ Connections – individual lines of service associated with each device activated by a customer. Connections include all types of devices that connect directly to the U.S. Cellular network.
- ◆ Connected Devices – non-handset devices that connect directly to the U.S. Cellular network. Connected devices include products such as tablets, watches, modems, and hotspots.
- ◆ EBITDA – refers to earnings before interest, taxes, depreciation, amortization and accretion and is used in the non-GAAP metric Adjusted EBITDA throughout this document. See Supplemental Information Relating to Non-GAAP Financial Measures within this MD&A for additional information.
- ◆ Eligible Telecommunications Carrier (ETC) – designation by states for providing specified services in “high cost” areas which enables participation in universal service support mechanisms.
- ◆ Free Cash Flow – non-GAAP metric defined as Cash flows from operating activities less Cash paid for additions to property, plant and equipment.
- ◆ Gross Additions – represents the total number of new connections added during the period, without regard to connections that were terminated during that period.
- ◆ Machine-to-Machine or M2M – technology that involves the transmission of data between networked devices, as well as the performance of actions by devices without human intervention. U.S. Cellular sells and supports M2M solutions to customers, provides connectivity for M2M solutions via the U.S. Cellular network, and has agreements with device manufacturers and software developers which offer M2M solutions.
- ◆ Net Additions – represents the total number of new connections added during the period, net of connections that were terminated during that period.
- ◆ OIBDA – refers to operating income before depreciation, amortization and accretion and is used in the non-GAAP metric Adjusted OIBDA throughout this document. See Supplemental Information Relating to Non-GAAP Financial Measures within this MD&A for additional information.
- ◆ Postpaid Average Billings per Account (Postpaid ABPA) – non-GAAP metric which is calculated by dividing total postpaid service revenues plus equipment installment plan billings by the average number of postpaid accounts and by the number of months in the period.

- ◆ Postpaid Average Billings per User (Postpaid ABPU) – non-GAAP metric which is calculated by dividing total postpaid service revenues plus equipment installment plan billings by the average number of postpaid connections and by the number of months in the period.
- ◆ Postpaid Average Revenue per Account (Postpaid ARPA) – metric which is calculated by dividing total postpaid service revenues by the average number of postpaid accounts and by the number of months in the period.
- ◆ Postpaid Average Revenue per User (Postpaid ARPU) – metric which is calculated by dividing total postpaid service revenues by the average number of postpaid connections and by the number of months in the period.
- ◆ Retail Connections – the sum of postpaid connections and prepaid connections.
- ◆ Tax Act – refers to comprehensive federal tax legislation enacted on December 22, 2017, which made broad and complex changes to the U.S. tax code. Now titled H.R.1, the Tax Act was originally identified as the Tax Cuts and Jobs Act of 2017.
- ◆ Universal Service Fund (USF) – a system of telecommunications collected fees and support payments managed by the FCC intended to promote universal access to telecommunications services in the United States.
- ◆ VoLTE – Voice over Long-Term Evolution is a technology specification that defines the standards and procedures for delivering voice communications and related services over 4G LTE networks.

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Operational Overview

As of June 30, Retail Connections – End of Period		2018	2017
Postpaid		4,468,000	4,478,000
Prepaid		527,000	484,000
Total		4,995,000	4,962,000
	Q2 2018	Q2 2017	YTD 2018 YTD 2017
Postpaid Activity:			
Gross Additions	146,000	174,000	275,000 320,000
Net Additions (Losses)	(13,000)	23,000	(50,000) (4,000)
Churn	1.19%	1.13%	1.21% 1.21%

The decrease in postpaid net additions for the three months ended June 30, 2018, when compared to the same period last year, was driven mainly by both lower handset and tablet gross additions as well as an increase in tablet churn. The decline in tablet gross additions reflects U.S. Cellular's decision to curtail promotions of heavily discounted tablets.

The increase in postpaid net losses for the six months ended June 30, 2018, when compared to the same period last year, was driven mainly by lower tablet gross additions and higher tablet churn.

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Postpaid Revenue

	Three Months Ended June 30, 2018		Six Months Ended June 30, 2017	
Average Revenue Per User (ARPU)	\$44.74	\$44.60	\$44.54	\$45.00
Average Billings Per User (ABPU) ¹	\$57.75	\$55.19	\$57.42	\$55.49
Average Revenue Per Account (ARPA)	\$118.57	\$119.73	\$118.38	\$120.46
Average Billings Per Account (ABPA) ¹	\$153.03	\$148.15	\$152.63	\$148.54

¹ Postpaid ABPU and Postpaid ABPA are non-GAAP financial measures. Refer to Supplemental Information Relating to Non-GAAP Financial Measures within this MD&A for a reconciliation of these measures.

On January 1, 2018, U.S. Cellular adopted the provisions of ASU 2014-09, using a modified retrospective method. Under this method, the new accounting standard is applied only to the most recent period presented, recognizing the cumulative effect of the accounting change as an adjustment to retained earnings at January 1, 2018. See Note 2 — Revenue Recognition in the Notes to Consolidated Financial Statements for additional details.

Postpaid ARPU increased for the three months ended June 30, 2018, when compared to the same period last year, driven by increases in device protection plan and regulatory recovery revenues. Such factors were partially offset by the impact of adopting the provisions of ASU 2014-09. Postpaid ARPA decreased for the three months ended June 30, 2018, when compared to the same period last year, due primarily to a decrease in postpaid connections per account driven by higher tablet churn. Application of the new accounting standard had the impact of reducing ARPU and ARPA for the three months ended June 30, 2018, by \$0.41 and \$1.07, respectively.

Postpaid ARPU and Postpaid ARPA decreased for the six months ended June 30, 2018, when compared to the same periods last year, due primarily to the impact of adopting the provisions of ASU 2014-09, as well as the impact of overall price reductions on plan offerings. Such factors were partially offset by the increases in device protection plan and regulatory recovery revenues. Application of the new accounting standard had the impact of reducing ARPU and ARPA for the six months ended June 30, 2018, by \$0.47 and \$1.24, respectively.

Under equipment installment plans, customers pay for their wireless devices in installments over a period of time. In order to show the trend in estimated cash collections from postpaid customer billings for both service and equipment, U.S. Cellular has presented Postpaid ABPU and Postpaid ABPA, which are calculated as Postpaid ARPU and Postpaid ARPA plus average monthly equipment installment plan billings per connection and account, respectively.

Postpaid ABPU and ABPA increased for the three and six months ended June 30, 2018, due primarily to an increase in equipment installment plan billings driven primarily by increased penetration of equipment installment plans.

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Financial Overview

	Three Months Ended June 30,			Six Months Ended June 30,		
	2018 ¹	2017	2018 vs. 2017	2018 ¹	2017	2018 vs. 2017
(Dollars in millions)						
Retail service	\$ 652	\$ 647	1%	\$ 1,301	\$ 1,304	–
Inbound roaming	39	31	26%	66	58	15%
Other	50	62	(20)%	98	124	(22)%
Service revenues	741	740	–	1,465	1,486	(1)%
Equipment sales	233	223	5%	450	413	9%
Total operating revenues	974	963	1%	1,915	1,899	1%
System operations (excluding depreciation, amortization and accretion reported below)						
Cost of equipment sold	240	260	(8)%	459	488	(6)%
Selling, general and administrative	342	351	(2)%	668	691	(3)%
Depreciation, amortization and accretion	159	155	3%	317	307	3%
(Gain) loss on asset disposals, net	1	5	(84)%	2	9	(75)%
(Gain) loss on license sales and exchanges, net	(11)	(2)	>(100)%	(17)	(19)	8%
Total operating	918	958	(4)%	1,794	1,840	(2)%

expenses

Operating income	\$ 56	\$ 5	>100%	\$ 121	\$ 59	>100%
Net income	\$ 52	\$ 12	>100%	\$ 107	\$ 40	>100%
Adjusted OIBDA (Non-GAAP) ²	\$ 205	\$ 163	26%	\$ 423	\$ 356	19%
Adjusted EBITDA (Non-GAAP) ²	\$ 248	\$ 198	25%	\$ 507	\$ 426	19%
Capital expenditures	\$ 86	\$ 84	2%	\$ 155	\$ 145	7%

As of January 1, 2018, U.S. Cellular adopted ASU 2014-09 using a modified retrospective approach. Under this method, the new accounting standard is applied only to the most recent period presented. See Note 2 — Revenue Recognition in the Notes to Consolidated Financial Statements for additional information.

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

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Service revenues consist of:

- ◆ Retail Service – Charges for access, airtime, recovery of regulatory costs and value added services, including data services and products

- ◆ Inbound Roaming – Charges to other wireless carriers whose customers use U.S. Cellular’s wireless systems when roaming

- ◆ Other Service – Amounts received from the Federal USF and tower rental revenues. Imputed interest on equipment installment plan contracts is included in 2017; however, it is not included in 2018 due to the impact of adopting the provisions of ASU 2014-09

Equipment revenues consist of:

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

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

Total operating revenues

Retail service revenues increased for the three months ended June 30, 2018, and decreased for the six months ended June 30, 2018, as a result of the changes in Postpaid ARPU as previously discussed in the Operational Overview section.

Inbound roaming revenues increased for the three and six months ended June 30, 2018, primarily driven by higher data roaming usage.

Other service revenues decreased for the three and six months ended June 30, 2018, reflecting the exclusion of imputed interest income in 2018 due to the impact of adopting the provisions of ASU 2014-09. Federal USF revenues remained flat at \$23 million and \$46 million for the three and six months ended June 30, 2018. See the Regulatory Matters section in this MD&A for a description of the FCC Mobility Fund II Order (MF2 Order) and its expected impacts on U.S. Cellular's current Federal USF support.

Equipment sales revenues increased for the three and six months ended June 30, 2018, due to the impact of adopting the provisions of ASU 2014-09, an increase in the average revenue per device sold, a mix shift from feature phones and connected devices to higher end smartphone devices, and an increase in accessories revenue. Such factors were partially offset by a decrease in the number of devices sold and a reduction in guarantee liability amortization for equipment installment contracts as a result of changes in plan offerings.

See Note 2 — Revenue Recognition in the Notes to Consolidated Financial Statements for additional details on the financial statement impact of ASU 2014-09.

Cost of equipment sold

Cost of equipment sold decreased for the three and six months ended June 30, 2018, due primarily to a decrease in the number of devices sold, as well as the impact of adopting the provisions of ASU 2014-09. Such factors were partially offset by increases due to a higher average cost per device sold, an increase in accessories cost, and a mix shift from feature phones and connected devices to higher cost smartphones.

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Selling, general and administrative expenses

Selling, general and administrative expenses decreased by \$9 million and \$23 million for the three and six months ended June 30, 2018, respectively, due to lower commissions, advertising and bad debts expenses.

Depreciation, amortization and accretion

Depreciation, amortization, and accretion increased for the three and six months ended June 30, 2018, due primarily to an increase in amortization expense related to billing system upgrades.

(Gain) loss on asset disposals, net

Loss on asset disposals, net decreased primarily as a result of fewer disposals of certain network assets.

(Gain) loss on license sales and exchanges, net

Net gains in 2018 and 2017 were due to gains recognized on license sale and exchange transactions with various third parties.

Components of
Other Income
(Expense)

	Three Months Ended			Six Months Ended		
	June 30,		2018 vs. 2017	June 30,		2018 vs. 2017
	2018 ¹	2017		2018 ¹	2017	
(Dollars in millions)						
Operating income	\$56	\$5	>100%	\$121	\$59	>100%
Equity in earnings of unconsolidated entities	40	33	20%	78	66	18%
Interest and dividend income	3	2	63%	7	5	45%
Interest expense	(29)	(28)	(2)%			