

UNITED STATES

# United States Cellular

24 July 2009

**USM US** **Underperform**

Relative to

Stock price as of 23 Jul 09	US\$	39.21
12-month target	US\$	35.00
12-month TSR	%	-10.7
Valuation	US\$	35.22
- DCF (WACC 9.5%)		

GICS sector	telecommunication services		
Market cap	US\$m	2,114	
30-day avg turnover	US\$m	4.0	
Number shares on issue	m	53.93	

### Investment fundamentals

Year end 31 Dec		2008A	2009E	2010E	2011E
Sales revenue	m	4,243.2	4,180.4	4,201.6	4,254.0
EBIT	m	137.6	462.8	433.5	473.4
Reported profit	m	33.0	245.5	216.6	242.0
Adjusted profit	m	33.0	245.5	216.6	242.0
EPS adj	US\$	0.38	2.81	2.48	2.75
EPS adj growth	%	-87.6	nmf	-11.8	11.1
PE adj	x	104.3	14.0	15.8	14.3
ROA	%	2.5	8.5	8.1	8.9
ROE	%	1.0	7.8	6.9	7.4
EV/EBITDA	x	4.2	4.6	4.6	4.3
Net debt/equity	%	25.7	23.2	18.7	12.1
Price/book	x	1.1	1.1	1.1	1.0

### USM US vs S&P 500 - US, & rec history



Source: FactSet, Macquarie Capital (USA), July 2009 (all figures in USD unless noted)

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## Squeezed in the Windy City; downgrading to Underperform Event

- We are downgrading US Cellular (USM) and Telephone & Data Systems (TDS) to Underperform from Neutral given the weak operating metrics reported by US Cellular on Thursday. While we were pleasantly surprised by the business's strength in 1Q09, in 2Q adds seem to have come off dramatically. We believe this is a combination of increased competition from the low-end from the likes of Leap Wireless, Boost, and T-mobile, as well as a stale handset lineup that makes USM uncompetitive at the high end. Our price target is US\$35 for USM and US\$30 for TDS.

### Impact

- Low-end will get tougher.** Boost and Leap launched in Chicago in February and March, respectively, and we believe that both had strong quarters. While the share loss to those carriers should ease in coming quarters, we believe both have a compelling offer at the US\$40-50 level – exactly the sweet spot of USM's core offering. USM may need to respond with more aggressive prepaid and postpaid pricing, which could pressure ARPU.
- High-end is all about handsets.** USM is trying to compete with headline handsets like the iPhone, Pre, and Storm with a line-up where the best phones are the Curve, HTC Touch and TouchPro, and Samsung Delve (ie, Instinct) – all at least a year behind the major carriers in a space that is moving quickly. While USM has historically focused on strong customer relationships, customer service has gotten better at many major carriers and most differentiation today is around handsets and footprint – both areas where USM lags. We believe USM will struggle to improve its handset line-up and may see it weaken against a fast-moving smartphone line-up at the Big-4 in 2H09.
- Acquisition potential fading.** We believe that Verizon (VZ) and AT&T (T) would both like to own parts of USM's cellular spectrum, and may have bid for the company in the past. This year, however, with a new FCC and DoJ there seems to be a renewed focus on promoting competition in Washington, and we believe neither T nor VZ want to be the test case for consolidation so we don't anticipate any bids forthcoming. This spectrum may also become less valuable over the next few years as T and VZ roll out their LTE networks in the high-quality 700 MHz band.

### Earnings revision

- We are raising our 2009 EPS estimate to US\$2.81 from US\$2.78.

### Price catalyst

- 12-month price target: US\$35.00 based on a DCF methodology.
- Catalyst: 2Q09 full earnings release on 6 August.

### Action and recommendation

- We are downgrading USM to Underperform (from Neutral) and decreasing our target price to US\$35 from US\$40. Our DCF model assumes a WACC of 9.5% and a 1.0% terminal growth rate.

**Fig 1 US Cellular – 2Q09 estimate changes**

US Cellular	2Q09E	1Q09	% Change	2Q09E - Prev.	% Variance
Net subscriber additions	(69)	47	-247%	15	-560%
Retail	(59)	63	-194%	30	-297%
Postpaid	(32)	60	-153%	35	-191%
Prepaid	(27)	3	-1000%	(5)	440%
Wholesale	(10)	(16)	-38%	(15)	-33%
Gross additions	341	404	-16%	390	-13%
Retail	351	366	-4%	321	9%
Postpaid	237	299	-21%	274	-13%
Prepaid	104	105	-1%	116	-11%
Ending subscribers	6,174	6,243	-1%	6,258	-1%
Retail	5,711	5,770	-1%	5,800	-2%
Postpaid	5,252	5,284	-1%	5,319	-1%
Prepaid	459	486	-6%	481	-5%
Wholesale	463	473	-2%	458	1%
Churn	2.2%	1.9%		2.0%	
Retail	2.4%	2.1%		2.2%	
Postpaid	1.7%	1.5%		1.5%	
Prepaid	10.0%	8.1%		9.4%	
Reported ARPU	\$52	\$53	0%	\$52	0%
Local service revenue	874	874	0%	880	-1%
LD & other revenue	42	48	-12%	42	-1%
Roaming revenue	59	60	-1%	59	0%
Total service revenue	976	982	-1%	982	-1%
Total revenue	1,040	1,053	-1%	1,056	-1%
CCPU, calculated	\$23.54	\$23.41	1%	\$23.54	0%
CPGA, reported	\$710	\$565	26%	\$660	8%
Cost of service	201	200	0%	202	-1%
General & administrative	237	237	0%	239	-1%
Cost of equipment	169	186	-9%	185	-9%
Marketing costs	198	176	12%	207	-4%
EBITDA	236	255	-7%	223	6%
EBITDA margin	24.1%	25.9%		22.7%	
EPS	\$0.70	\$0.97	-28%	\$0.61	14%
Capital expenditures	145	138	5%	145	0%

Source: Company data, Macquarie Capital (USA), July 2009

**Fig 2 US Cellular – estimate changes, 2009 vs. 2008**

US Cellular	2009E	2008	% Change	2009E - Prev	% Variance
Net subscriber additions	(47)	94	-150%	87	-154%
Retail	4	152	-97%	148	-97%
Postpaid	63	157	-60%	160	-61%
Prepaid	(59)	(8)	638%	(12)	392%
Wholesale	(51)	(49)	4%	(61)	-16%
Gross additions	1,495	1,536	-3%	1,589	-6%
Retail	1,492	1,355	10%	1,353	10%
Postpaid	1,076	1,088	-1%	1,151	-6%
Prepaid	419	448	-7%	439	-5%
Ending subscribers	6,149	6,196	-1%	6,283	-2%
Retail	5,711	5,707	0%	5,855	-2%
Postpaid	5,287	5,224	1%	5,384	-2%
Prepaid	424	483	-12%	471	-10%
Wholesale	438	489	-10%	428	2%
Churn	2.1%	1.9%		2.0%	
Retail	2.2%	2.1%		2.2%	
Postpaid	1.6%	1.5%		1.6%	
Prepaid	9.7%	8.6%		8.9%	
ARPU	\$53	\$53	-1%	\$53	0%
Local service revenue	3,489	3,446	1%	3,526	-1%
LD & other revenue	173	165	4%	174	-1%
Roaming revenue	240	329	-27%	240	0%
Total service revenue	3,902	3,940	-1%	3,941	-1%
Total revenue	4,180	4,243	-1%	4,237	-1%
CCPU, calculated	\$23.54	\$23.14	2%	\$23.53	0%
CPGA, reported	\$664	\$631	5%	\$636	4%
Cost of service	802	784	2%	810	-1%
General & administrative	945	930	2%	955	-1%
Cost of equipment	713	730	-2%	745	-4%
Marketing costs	794	784	1%	804	-1%
EBITDA	928	1,015	-9%	923	0%
EBITDA margin	23.8%	25.8%		23.4%	
EPS	\$2.81	\$0.36	679%	\$2.78	1%
Capital expenditures	575	586	-2%	575	0%

Source: Company data, Macquarie Capital (USA), July 2009

Fig 3 US Cellular – income statement

	1Q08	2Q08	3Q08	4Q08	2008	1Q09	2Q09E	3Q09E	4Q09E	2009E	1Q10E	2Q10E	3Q10E	4Q10E	2010E
Local revenue	850	862	872	861	3,446	874	874	877	864	3,489	875	880	890	880	3,525
Other revenue	39	41	48	38	165	48	42	42	41	173	42	42	43	43	170
Roaming revenue	73	84	93	79	329	60	59	63	58	240	48	51	57	55	211
Total service revenue	962	987	1,014	977	3,940	982	976	982	963	3,902	966	973	990	978	3,906
Equipment revenue	76	73	78	76	303	71	65	72	71	278	73	71	73	77	295
<b>Total revenue</b>	<b>1,038</b>	<b>1,061</b>	<b>1,092</b>	<b>1,053</b>	<b>4,243</b>	<b>1,053</b>	<b>1,040</b>	<b>1,054</b>	<b>1,034</b>	<b>4,180</b>	<b>1,039</b>	<b>1,045</b>	<b>1,063</b>	<b>1,055</b>	<b>4,202</b>
% change, y-t-y	11%	9%	7%	3%	8%	1%	-2%	-4%	-2%	-1%	-1%	0%	1%	2%	1%
Cost of service	191	197	197	199	784	200	201	202	198	802	199	200	204	201	805
General & administrative	228	231	236	235	930	237	237	236	235	945	231	232	232	233	928
Pre-marketing cash flow	543	560	580	543	2,226	545	537	544	529	2,156	536	541	554	544	2,174
Pre-marketing cash flow margin	56.5%	56.7%	57.2%	55.5%	56.5%	55.5%	55.1%	55.4%	55.0%	55.2%	55.5%	55.6%	56.0%	55.6%	55.6%
% change, y-t-y	10%	8%	10%	-1%	7%	0%	-4%	-6%	-2%	-3%	-2%	1%	2%	3%	1%
Cost of equipment	174	172	181	203	730	186	169	180	179	713	183	180	183	190	735
Marketing costs	180	192	206	207	784	176	198	211	209	794	203	197	202	214	816
Non-cash compensation (pre-tax)	0	0	0	0	0	0	0	0	0	0	0	0	0	0	
Total operating expenses	773	791	820	845	3,229	798	805	828	821	3,253	816	810	820	837	3,284
<b>EBITDA (operating cash flow)</b>	<b>265</b>	<b>269</b>	<b>272</b>	<b>208</b>	<b>1,015</b>	<b>255</b>	<b>236</b>	<b>225</b>	<b>212</b>	<b>928</b>	<b>223</b>	<b>235</b>	<b>242</b>	<b>218</b>	<b>918</b>
EBITDA margin	27.6%	27.3%	26.9%	21.3%	25.8%	25.9%	24.1%	22.9%	22.1%	23.8%	23.1%	24.1%	24.5%	22.2%	23.5%
% change, y-t-y	3%	-1%	9%	-18%	-2%	-4%	-13%	-17%	2%	-9%	-12%	0%	8%	2%	-1%
Depreciation and amortization	143	145	145	144	577	138	138	139	141	555	142	143	144	145	573
Gain/(loss) on asset disposals, net	(4)	(6)	(7)	(393)	(410)	(2)	0	0	0	(2)	0	0	0	0	0
<b>Operating income</b>	<b>119</b>	<b>118</b>	<b>120</b>	<b>(329)</b>	<b>28</b>	<b>115</b>	<b>98</b>	<b>87</b>	<b>72</b>	<b>371</b>	<b>82</b>	<b>92</b>	<b>99</b>	<b>73</b>	<b>345</b>
Investment income	2	1	1	1	6	0	0	0	0	2	0	0	0	0	2
Interest expense	(20)	(21)	(20)	(17)	(77)	(19)	(19)	(19)	(19)	(76)	(19)	(19)	(19)	(19)	(76)
Gain/(loss) on investments	0	0	17	0	17	0	0	0	0	0	0	0	0	0	0
Other income	21	23	23	26	93	25	22	22	22	91	22	22	22	22	88
Minority interests	(4)	(5)	(5)	(10)	(25)	(6)	(4)	(4)	(3)	(18)	(4)	(4)	(4)	(3)	(16)
Income before extraordinary gains	118	117	135	(329)	41	116	97	86	72	371	81	91	98	73	344
Extraordinary income/loss	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Income before income taxes	118	117	135	(329)	41	116	97	86	72	371	81	91	98	73	344
Tax benefit/(expense)	(48)	(44)	(46)	129	(8)	(31)	(36)	(32)	(27)	(126)	(30)	(34)	(36)	(27)	(127)
<b>Net income, continuing</b>	<b>71</b>	<b>73</b>	<b>90</b>	<b>(200)</b>	<b>33</b>	<b>85</b>	<b>61</b>	<b>54</b>	<b>45</b>	<b>246</b>	<b>51</b>	<b>58</b>	<b>62</b>	<b>46</b>	<b>217</b>
Net income, reported	71	73	90	(200)	33	85	61	54	45	246	51	58	62	46	217
Cash net income, continuing	73	75	92	(198)	41	87	63	56	47	254	53	60	64	48	225
Cash net income, reported	73	75	92	(198)	41	87	63	56	47	254	53	60	64	48	225
Weighted avg shares out. (basic)	88	88	87	87	87	87	87	87	87	87	87	87	87	87	87
Weighted avg shares out. (fully diluted)	88	88	88	87	88	87	87	87	87	87	87	87	87	87	87
Cash EPS, basic	\$0.83	\$0.85	\$1.05	(\$2.27)	\$0.47	\$1.00	\$0.72	\$0.65	\$0.54	\$2.91	\$0.61	\$0.68	\$0.73	\$0.55	\$2.58
Cash EPS, diluted	\$0.82	\$0.85	\$1.05	(\$2.27)	\$0.45	\$0.99	\$0.72	\$0.64	\$0.54	\$2.90	\$0.61	\$0.68	\$0.73	\$0.55	\$2.57
% change, y-t-y	-4%	-50%	42%	-1167%	-85%	20%	-15%	-38%	NM	540%	-39%	-5%	13%	2%	-11%
EPS, continuing	\$0.80	\$0.83	\$1.02	(\$2.29)	\$0.36	\$0.97	\$0.70	\$0.62	\$0.52	\$2.81	\$0.59	\$0.66	\$0.70	\$0.53	\$2.48
Reported EPS	\$0.80	\$0.83	\$1.02	(\$2.29)	\$0.36	\$0.97	\$0.70	\$0.62	\$0.52	\$2.81	\$0.59	\$0.66	\$0.70	\$0.53	\$2.48
EPS, continuing post-option	\$0.80	\$0.83	\$1.02	(\$2.29)	\$0.36	\$0.97	\$0.70	\$0.62	\$0.52	\$2.81	\$0.59	\$0.66	\$0.70	\$0.53	\$2.48
Reported EPS, post-option	\$0.80	\$0.83	\$1.02	(\$2.29)	\$0.36	\$0.97	\$0.70	\$0.62	\$0.52	\$2.81	\$0.59	\$0.66	\$0.70	\$0.53	\$2.48

Source: Company data, Macquarie Capital (USA), July 2009

**Fig 4 US Cellular – balance sheet**

	1Q08	2Q08	3Q08	4Q08	2008	1Q09	2Q09E	3Q09E	4Q09E	2009E	1Q10E	2Q10E	3Q10E	4Q10E	2010E
Cash and cash equivalents	216	101	178	171	171	192	192	192	192	192	192	192	192	192	192
Other current assets	639	674	651	644	644	608	601	608	597	597	600	603	614	609	609
<b>Total current assets</b>	<b>856</b>	<b>775</b>	<b>828</b>	<b>815</b>	<b>815</b>	<b>800</b>	<b>793</b>	<b>800</b>	<b>789</b>	<b>789</b>	<b>792</b>	<b>795</b>	<b>806</b>	<b>801</b>	<b>801</b>
Investment in affiliates	173	157	175	157	157	176	176	176	176	176	119	119	119	119	119
Net PP&E	2,568	2,567	2,575	2,620	2,620	2,623	2,639	2,657	2,670	2,670	2,682	2,694	2,704	2,713	2,713
Intangibles, net	2,295	2,299	2,299	1,937	1,937	1,948	1,667	1,658	1,649	1,649	1,640	1,631	1,622	1,613	1,613
Notes, interest receivables	4	4	4	4	4	4	4	4	4	4	4	4	4	4	4
Other assets	30	30	31	33	33	69	69	69	69	69	69	69	69	69	69
<b>Total assets</b>	<b>5,926</b>	<b>5,833</b>	<b>5,914</b>	<b>5,566</b>	<b>5,566</b>	<b>5,620</b>	<b>5,348</b>	<b>5,364</b>	<b>5,357</b>	<b>5,357</b>	<b>5,307</b>	<b>5,312</b>	<b>5,324</b>	<b>5,320</b>	<b>5,320</b>
Current portion of debt	0	50	0	10	10	10	10	10	10	10	10	10	10	10	10
Other current liabilities	827	596	615	592	592	560	551	556	543	543	544	545	554	547	547
<b>Total current liabilities</b>	<b>827</b>	<b>646</b>	<b>615</b>	<b>602</b>	<b>602</b>	<b>570</b>	<b>561</b>	<b>566</b>	<b>553</b>	<b>553</b>	<b>554</b>	<b>555</b>	<b>564</b>	<b>557</b>	<b>557</b>
Long-term debt/(cash)	1,006	1,007	1,006	997	997	998	964	938	918	918	890	855	815	789	789
Minority Interest	45	48	52	49	49	53	54	54	54	54	55	55	55	56	56
Other non-current liabilities	786	800	833	712	712	718	718	718	718	718	718	718	718	718	718
<b>Total liabilities</b>	<b>2,664</b>	<b>2,501</b>	<b>2,505</b>	<b>2,359</b>	<b>2,359</b>	<b>2,338</b>	<b>2,296</b>	<b>2,276</b>	<b>2,242</b>	<b>2,242</b>	<b>2,216</b>	<b>2,183</b>	<b>2,152</b>	<b>2,120</b>	<b>2,120</b>
Common shareholders' equity	3,262	3,332	3,409	3,207	3,207	3,282	3,052	3,088	3,115	3,115	3,091	3,130	3,173	3,200	3,200
<b>Total liabilities and shareholders' equity</b>	<b>5,926</b>	<b>5,833</b>	<b>5,914</b>	<b>5,566</b>	<b>5,566</b>	<b>5,620</b>	<b>5,348</b>	<b>5,364</b>	<b>5,357</b>	<b>5,357</b>	<b>5,307</b>	<b>5,312</b>	<b>5,324</b>	<b>5,320</b>	<b>5,320</b>

Source: Company data, Macquarie Capital (USA), July 2009

**Fig 5 US Cellular – cash flow statement**

	1Q08	2Q08	3Q08	4Q08	2008	1Q09	2Q09E	3Q09E	4Q09E	2009E	1Q10E	2Q10E	3Q10E	4Q10E	2010E
Cash EBITDA	269	273	275	211	1,028	257	239	229	216	941	227	238	246	221	932
Investment income	2	1	1	1	5	0	0	0	0	2	0	0	0	0	2
Minority interest payments	(4)	(5)	(5)	(9)	(23)	(5)	(4)	(4)	(3)	(16)	(3)	(4)	(4)	(3)	(14)
Change in working capital	(2)	(2)	(2)	(2)	(8)	(2)	(2)	(2)	(2)	(8)	(2)	(2)	(2)	(2)	(8)
Interest expense	(20)	(21)	(20)	(17)	(77)	(19)	(19)	(19)	(19)	(76)	(19)	(19)	(19)	(19)	(76)
Taxes expense	(48)	(44)	(46)	129	(8)	(31)	(36)	(32)	(27)	(126)	(30)	(34)	(36)	(27)	(127)
Capital expenditures	(112)	(138)	(146)	(190)	(586)	(138)	(145)	(147)	(145)	(575)	(145)	(145)	(145)	(145)	(580)
<b>Discretionary cash flow</b>	<b>85</b>	<b>65</b>	<b>58</b>	<b>123</b>	<b>332</b>	<b>62</b>	<b>34</b>	<b>26</b>	<b>21</b>	<b>142</b>	<b>28</b>	<b>35</b>	<b>40</b>	<b>25</b>	<b>128</b>
Assets (purchased)/sold	(150)	(150)			(300)					0					0
Other investments/(sales)					0					0					0
Equity issued/(repurchased)	(11)	(8)	(4)	(5)	(28)	(13)				(13)					0
<b>Net cash flow</b>	<b>(75)</b>	<b>(94)</b>	<b>54</b>	<b>118</b>	<b>3</b>	<b>49</b>	<b>34</b>	<b>26</b>	<b>21</b>	<b>129</b>	<b>28</b>	<b>35</b>	<b>40</b>	<b>25</b>	<b>128</b>
Debt, beginning	1,002	1,006	1,007	1,006	1,002	997	998	964	938	997	918	890	855	815	918
Net debt added/(retired)	4	1	(1)	(10)	(6)	1	(34)	(26)	(21)	(79)	(28)	(35)	(40)	(25)	(128)
<b>Ending debt</b>	<b>1,006</b>	<b>1,007</b>	<b>1,006</b>	<b>997</b>	<b>997</b>	<b>998</b>	<b>964</b>	<b>938</b>	<b>918</b>	<b>918</b>	<b>890</b>	<b>855</b>	<b>815</b>	<b>789</b>	<b>789</b>

Source: Company data, Macquarie Capital (USA), July 2009

Fig 6 US Cellular – valuation sheet

	2002	2003	2004	2005	2006	2007	2008	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	CAGR 08-16E
<b>Subscribers</b>	4,103	4,409	4,945	5,482	5,815	6,102	6,196	6,149	6,219	6,314	6,398	6,471	6,534	6,590	6,638	1%
% change, y-t-y	19%	7%	12%	11%	6%	5%	2%	-1%	1%	2%	1%	1%	1%	1%	1%	
Penetration	11.2%	9.5%	11.1%	12.1%	12.6%	13.0%	13.0%	12.8%	12.8%	12.9%	13.0%	13.0%	13.0%	12.9%	12.9%	
Net additional subscribers	310	447	627	477	310	281	94	(47)	70	95	84	73	64	55	48	-8%
% change, y-t-y	-12%	44%	40%	-24%	-35%	-9%	-67%	NM	NM	36%	-12%	-12%	-13%	-13%	-14%	
Penetration gain	0.85%	0.97%	1.41%	1.05%	0.67%	0.60%	0.20%	-0.10%	0.14%	0.19%	0.17%	0.15%	0.13%	0.11%	0.09%	
Churn rate, monthly	2.1%	1.8%	1.7%	1.7%	1.8%	2.1%	1.9%	2.1%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	
<b>Revenue</b>	2,198	2,583	2,819	3,036	3,473	3,946	4,243	4,180	4,202	4,254	4,308	4,366	4,418	4,465	4,508	1%
% change, y-t-y	16%	18%	9%	8%	14%	14%	8%	-1%	1%	1%	1%	1%	1%	1%	1%	
Local ARPU, monthly	\$42	\$40	\$41	\$40	\$41	\$44	\$47	\$47	\$47	\$48	\$48	\$48	\$49	\$49	\$49	1%
% change, y-t-y	6%	-5%	3%	-2%	4%	7%	5%	1%	1%	1%	0%	0%	0%	0%	0%	
<b>EBITDA (operating cash flow)</b>	634	632	652	695	865	1,033	1,015	928	918	987	994	1,019	1,042	1,064	1,085	1%
% change, y-t-y	4%	0%	3%	7%	24%	19%	-2%	-9%	-1%	7%	1%	2%	2%	2%	2%	
EBITDA margin	30.2%	26.1%	24.8%	24.5%	26.9%	28.1%	25.8%	23.8%	23.5%	25.0%	24.8%	25.1%	25.4%	25.6%	25.9%	0%
<b>Depreciation &amp; Amortization</b>																
Depreciation	312	375	450	480	539	554	541	519	537	564	574	565	570	580	549	0%
% change, y-t-y	31%	20%	20%	7%	12%	3%	-2%	-4%	3%	5%	2%	-1%	1%	2%	-5%	
Amortization	39	58	48	36	36	36	36	36	36	37	37	37	37	37	37	0%
<b>Taxes Paid</b>	8	(37)	(76)	(88)	(120)	(217)	(8)	(126)	(127)	(142)	(143)	(156)	(166)	(174)	(198)	49%
% change, y-t-y	NM	NM	-105%	-16%	-36%	-80%	96%	-1460%	-1%	-12%	0%	-10%	-6%	-5%	-14%	
<b>Capital Expenditures</b>	731	633	655	586	584	566	586	575	580	568	520	528	534	540	546	-1%
Capital expenditures/service revenue	34.8%	26.1%	24.9%	20.7%	18.2%	15.4%	14.9%	14.7%	14.8%	14.4%	13.0%	13.0%	13.0%	13.0%	13.0%	
<b>EPS</b>																
Cash EPS, diluted	(\$0.11)	\$1.76	\$1.09	\$1.03	\$2.11	\$3.12	\$0.45	\$2.90	\$2.57	\$2.84	\$2.83	\$3.06	\$3.21	\$3.33	\$3.73	30%
Reported EPS, post-option	(\$0.07)	\$0.39	\$1.16	\$1.42	\$2.00	\$3.02	\$0.36	\$2.81	\$2.48	\$2.75	\$2.73	\$2.97	\$3.12	\$3.24	\$3.65	34%

## Private Market Valuation Summary

	2009E
NPV of cash EBITDA 10E -- 16E	5,048
NPV of taxes paid 10E -- 16E	(764)
NPV of capex 10E -- 16E	(2,709)
NPV of free cash flow 10E -- 16E	1,575
NPV of 2016 terminal value @ 2x EBITDA	2,181
<b>PMV of consolidated operations</b>	<b>3,756</b>
PMV -- minority stakes	447
<b>Total PMV of Cellular Operations</b>	<b>4,203</b>
Less: net long-term debt, end of period (1)	(736)
<b>PMV -- Equity</b>	<b>3,467</b>
Current shares outstanding	87
Shares to be issued/warrants/options (2)	1
Fully diluted shares outstanding	89
PMV per share	\$39.14
Private to public discount	10%
<b>12-month DCF value per share</b>	<b>\$35.22</b>

## Valuation Multiples @

	\$39.15	2007	2008	2009E	2010E	2011E	2012E
Current EV/EBITDA	4.204	4.1x	4.1x	4.5x	4.6x	4.3x	4.2x
Current PER		12.5x	86.3x	13.5x	15.2x	13.8x	13.9x
Price Target EV/EBITDA	3.857	3.7x	3.8x	4.2x	4.2x	3.9x	3.9x
Target PER		11.3x	77.7x	12.1x	13.7x	12.4x	12.5x

## Valuation Grid - 2009E DCF Value per Share

Terminal Growth Rate (across) on 2016 EBITDA, Discount Rate (down)

	35	0.0%	0.5%	1.0%	1.5%	2.0%
7.5%	42	45	47	50	54	
8.5%	37	39	40	43	45	
9.5%	33	34	<b>\$35.22</b>	37	39	
10.5%	29	30	31	32	34	
11.5%	26	27	28	29	30	

Source: Company data, Macquarie Capital (USA), July 2009

## Valuation and risks

**Telephone & Data Systems (TDS, US\$28.47, Underperform, TP: US\$30):** We are downgrading TDS to Underperform (from Neutral) and decreasing our target price to US\$30 from US\$33. Our target price is based on our DCF analysis, which assumes a WACC of 9.5% and a 1.0% terminal growth rate. Risks to our target price include increased wireless competition and macro weakness.

**US Cellular (USM, US\$39.21, Underperform, TP: US\$35):** We are downgrading US Cellular to Underperform from Neutral and decreasing our target price to US\$35 from US\$40. Our target price is based on our DCF analysis, which assumes a WACC of 9.5% and a 1.0% terminal growth rate. Risks to our target price include increased wireless competition and macro weakness.

**AT&T. (T, US\$25.48, Outperform, TP: US\$31).** We reiterate our Outperform rating and US\$31 target price based upon our DCF analysis, which uses a WACC of 8.5% and a 1.5% terminal growth rate. Key risks to our target price are a wireless slowdown and increased wireline competition.

**Verizon Communications. (VZ, US\$31.27, Neutral, TP: US\$36).** We reiterate our Neutral rating and US\$36 target price based upon our DCF analysis, which uses a WACC of 8.5% and a 1.0% terminal growth rate. Key risks to our target prices are a wireless slowdown and increased wireline competition.

**Leap Wireless (LEAP, US\$25.88, Outperform, TP: US\$45).** We reiterate our Outperform rating and US\$45 target price based on our DCF analysis, which uses a WACC of 11.0% and a 2.5% terminal growth rate. Risks include increased competition from incumbents and high balance sheet leverage, as well as ramping churn in new markets.

**MetroPCS (PCS, US\$12.49, Outperform, TP: US\$18).** We reiterate our Outperform rating and US\$18 target price based on our DCF analysis, which uses a WACC of 11.0% and a 2.5% terminal growth rate. Key risks to our price target are a wireless slowdown and high leverage.

## Important disclosures:

## Recommendation definitions

**Macquarie - Australia/New Zealand**

Outperform – return >5% in excess of benchmark return  
 Neutral – return within 5% of benchmark return  
 Underperform – return >5% below benchmark return

**Macquarie – Asia/Europe**

Outperform – expected return >+10%  
 Neutral – expected return from -10% to +10%  
 Underperform – expected return <-10%

**Macquarie First South - South Africa**

Outperform – expected return >+10%  
 Neutral – expected return from -10% to +10%  
 Underperform – expected return <-10%

**Macquarie - Canada**

Outperform – return >5% in excess of benchmark return  
 Neutral – return within 5% of benchmark return  
 Underperform – return >5% below benchmark return

**Macquarie - USA**

Outperform (Buy) – return >5% in excess of benchmark return (Russell 3000)  
 Neutral (Hold) – return within 5% of benchmark return (Russell 3000)  
 Underperform (Sell) – return >5% below benchmark return (Russell 3000)

**Recommendations** – 12 months

**Note:** Quant recommendations may differ from Fundamental Analyst recommendations

## Volatility index definition\*

This is calculated from the volatility of historical price movements.

**Very high–highest risk** – Stock should be expected to move up or down 60–100% in a year – investors should be aware this stock is highly speculative.

**High** – stock should be expected to move up or down at least 40–60% in a year – investors should be aware this stock could be speculative.

**Medium** – stock should be expected to move up or down at least 30–40% in a year.

**Low–medium** – stock should be expected to move up or down at least 25–30% in a year.

**Low** – stock should be expected to move up or down at least 15–25% in a year.

\* Applicable to Australian/NZ/Canada stocks only

## Financial definitions

All "Adjusted" data items have had the following adjustments made:  
 Added back: goodwill amortisation, provision for catastrophe reserves, IFRS derivatives & hedging, IFRS impairments & IFRS interest expense  
 Excluded: non recurring items, asset revals, property revals, appraisal value uplift, preference dividends & minority interests

**EPS** = adjusted net profit / efpowa\*

**ROA** = adjusted ebit / average total assets

**ROA Banks/Insurance** = adjusted net profit / average total assets

**ROE** = adjusted net profit / average shareholders funds

**Gross cashflow** = adjusted net profit + depreciation  
 \*equivalent fully paid ordinary weighted average number of shares

All Reported numbers for Australian/NZ listed stocks are modelled under IFRS (International Financial Reporting Standards).

## Recommendation proportions – For quarter ending 30 June 2009

	AU/NZ	Asia	RSA	USA	CA	EUR	
Outperform	40.38%	48.53%	40.00%	44.02%	57.42%	40.20%	(for US coverage by MCUSA, 1.54% of stocks followed are investment banking clients)
Neutral	39.25%	17.08%	45.00%	37.45%	32.90%	39.21%	(for US coverage by MCUSA, 1.16% of stocks followed are investment banking clients)
Underperform	20.38%	34.40%	15.00%	18.53%	9.68%	20.59%	(for US coverage by MCUSA, 0.77% of stocks followed are investment banking clients)

Within the past 12 months, MCUSA has entered into an investment banking client relationship with Verizon Communications.

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