

LEAP WIRELESS INTERNATIONAL INC

Form 10-Q

August 08, 2006

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**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, 2006**

**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 0-29752**

**Leap Wireless International, Inc.**

**(Exact name of registrant as specified in its charter)**

**Delaware  
(State or other jurisdiction of  
incorporation or organization)**

**33-0811062  
(I.R.S. Employer  
Identification No.)**

**10307 Pacific Center Court, San Diego, CA  
(Address of principal executive offices)**

**92121  
(Zip Code)**

**(858) 882-6000**

**(Registrant's telephone number, including area code)**

**Not applicable**

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

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

90 days. Yes  No

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes  No

The number of shares of registrant's common stock outstanding on August 1, 2006 was 61,254,519.

**LEAP WIRELESS INTERNATIONAL, INC.**  
**QUARTERLY REPORT ON FORM 10-Q**  
**For the Quarter Ended June 30, 2006**  
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**PART I**  
**FINANCIAL INFORMATION**

**Item 1. Financial Statements.**

**LEAP WIRELESS INTERNATIONAL, INC.**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
**(In thousands, except share amounts)**

	<b>June 30, 2006</b>	<b>December 31, 2005</b>
	<b>(Unaudited)</b>	
<b>Assets</b>		
Cash and cash equivalents	\$ 553,038	\$ 293,073
Short-term investments	57,382	90,981
Restricted cash, cash equivalents and short-term investments	9,758	13,759
Inventories	63,820	37,320
Other current assets	40,545	29,237
Total current assets	724,543	464,370
Property and equipment, net	780,852	621,946
Wireless licenses	795,046	821,288
Assets held for sale (Note 7)	38,658	15,145
Goodwill	431,896	431,896
Other intangible assets, net	96,690	113,554
Other assets	35,852	38,119
Total assets	\$ 2,903,537	\$ 2,506,318
<b>Liabilities and Stockholders Equity</b>		
Accounts payable and accrued liabilities	\$ 210,274	\$ 167,770
Current maturities of long-term debt (Note 4)	9,000	6,111
Other current liabilities	53,007	49,627
Total current liabilities	272,281	223,508
Long-term debt (Note 4)	891,000	588,333
Deferred tax liabilities	141,935	141,935
Other long-term liabilities	41,837	36,424
Total liabilities	1,347,053	990,200
Minority interest	4,151	1,761
Commitments and contingencies (Notes 4 and 8)		
Stockholders equity:		
Preferred stock authorized 10,000,000 shares; \$.0001 par value, no shares issued and outstanding		
	6	6

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Common stock authorized 160,000,000 shares; \$.0001 par value,  
61,256,800 and 61,202,806 shares issued and outstanding at June 30,  
2006 and December 31, 2005, respectively

Additional paid-in capital	1,500,154	1,490,638
Retained earnings	46,809	21,575
Accumulated other comprehensive income	5,364	2,138
Total stockholders equity	1,552,333	1,514,357
Total liabilities and stockholders equity	\$ 2,903,537	\$ 2,506,318

See accompanying notes to condensed consolidated financial statements.

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**LEAP WIRELESS INTERNATIONAL, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
**(UNAUDITED)**

(In thousands, except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
<b>Revenues:</b>				
Service revenues	\$ 230,786	\$ 189,704	\$ 446,626	\$ 375,685
Equipment revenues	37,068	37,125	87,916	79,514
Total revenues	267,854	226,829	534,542	455,199
<b>Operating expenses:</b>				
Cost of service (exclusive of items shown separately below)	(60,255)	(49,608)	(115,459)	(99,805)
Cost of equipment	(52,081)	(42,799)	(110,967)	(91,977)
Selling and marketing	(35,942)	(24,810)	(65,044)	(47,805)
General and administrative	(46,576)	(42,423)	(96,158)	(78,458)
Depreciation and amortization	(53,337)	(47,281)	(107,373)	(95,385)
Impairment of indefinite-lived intangible assets	(3,211)	(11,354)	(3,211)	(11,354)
Total operating expenses	(251,402)	(218,275)	(498,212)	(424,784)
Operating income	16,452	8,554	36,330	30,415
Minority interest in loss of consolidated subsidiary	(134)		(209)	
Interest income	5,533	1,176	9,727	3,079
Interest expense	(8,423)	(7,566)	(15,854)	(16,689)
Other income (expense), net	(5,918)	(39)	(5,383)	(1,325)
Income before income taxes	7,510	2,125	24,611	15,480
Income taxes		(1,022)		(6,861)
Income before cumulative effect of change in accounting principle	7,510	1,103	24,611	8,619
Cumulative effect of change in accounting principle			623	
Net income	\$ 7,510	\$ 1,103	\$ 25,234	\$ 8,619
<b>Basic net income per share:</b>				
Income before cumulative effect of change in accounting principle	\$ 0.12	\$ 0.02	\$ 0.41	\$ 0.14
Cumulative effect of change in accounting principle			0.01	
Basic net income per share	\$ 0.12	\$ 0.02	\$ 0.42	\$ 0.14

<b>Diluted net income per share:</b>				
Income before cumulative effect of change in accounting principle	\$ 0.12	\$ 0.02	\$ 0.40	\$ 0.14
Cumulative effect of change in accounting principle			0.01	
Diluted net income per share	\$ 0.12	\$ 0.02	\$ 0.41	\$ 0.14
<b>Shares used in per share calculations:</b>				
Basic	60,282	60,030	60,282	60,015
Diluted	61,757	60,242	61,651	60,234

See accompanying notes to condensed consolidated financial statements.

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**LEAP WIRELESS INTERNATIONAL, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(UNAUDITED)**  
**(In thousands)**

	<b>Six Months Ended June 30,</b>	
	<b>2006</b>	<b>2005</b>
<b>Operating activities:</b>		
Net cash provided by operating activities	\$ 101,781	\$ 108,536
<b>Investing activities:</b>		
Purchases of property and equipment	(187,004)	(45,498)
Change in prepayments for purchases of property and equipment	5,683	
Purchases of and deposits for wireless licenses	(532)	(239,168)
Purchases of investments	(88,535)	(103,057)
Sales and maturities of investments	123,657	142,296
Restricted cash, cash equivalents and short-term investments, net	(101)	326
Net cash used in investing activities	(146,832)	(245,101)
<b>Financing activities:</b>		
Proceeds from long-term debt	900,000	500,000
Repayment of long-term debt	(594,444)	(415,229)
Minority interest	2,222	
Proceeds from issuance of common stock	725	
Payment of debt issuance costs	(3,268)	(6,951)
Payment of fees related to forward equity sale	(219)	
Net cash provided by financing activities	305,016	77,820
Net increase (decrease) in cash and cash equivalents	259,965	(58,745)
Cash and cash equivalents at beginning of period	293,073	141,141
Cash and cash equivalents at end of period	\$ 553,038	\$ 82,396
<b>Supplementary disclosure of cash flow information:</b>		
Cash paid for interest	\$ 23,641	\$ 35,072
Cash paid for income taxes	\$ 218	\$ 228

See accompanying notes to condensed consolidated financial statements.



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**LEAP WIRELESS INTERNATIONAL, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**Note 1. The Company and Nature of Business**

Leap Wireless International, Inc. ( Leap ), a Delaware corporation, together with its wholly owned subsidiaries, is a wireless communications carrier that offers digital wireless service in the United States of America under the Cricket® and Jump® Mobile brands. Leap conducts operations through its subsidiaries and has no independent operations or sources of operating revenue other than through dividends, if any, from its operating subsidiaries. Cricket and Jump Mobile services are offered by Leap's wholly owned subsidiary, Cricket Communications, Inc. ( Cricket ). Leap, Cricket and their subsidiaries are collectively referred to herein as the Company. Cricket and Jump Mobile services are also offered in certain markets by Alaska Native Broadband 1 License, LLC ( ANB 1 License ), a joint venture in which Cricket indirectly owns a 75% non-controlling interest, through a 75% non-controlling interest in Alaska Native Broadband 1, LLC ( ANB 1 ). The Company consolidates its 75% non-controlling interest in ANB 1 (see Note 2). In July 2006, Cricket acquired a 72% non-controlling interest in LCW Wireless, LLC ( LCW Wireless ) and LCW Wireless also began offering Cricket and Jump Mobile services in certain markets (see Note 7).

The Company operates in a single operating segment as a wireless communications carrier that offers digital wireless service in the United States of America. As of and for the six months ended June 30, 2006, all of the Company's revenues and long-lived assets related to operations in the United States.

**Note 2. Basis of Presentation and Significant Accounting Policies*****Basis of Presentation***

The accompanying interim condensed consolidated financial statements have been prepared by the Company without audit, in accordance with the instructions to Form 10-Q and, therefore, do not include all information and footnotes required by accounting principles generally accepted in the United States of America for a complete set of financial statements. These condensed consolidated financial statements and notes thereto should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2005. In the opinion of management, the unaudited financial information for the interim periods presented reflects all adjustments necessary for a fair statement of the results for the periods presented, with such adjustments consisting only of normal recurring adjustments. Operating results for interim periods are not necessarily indicative of operating results for an entire fiscal year.

The condensed consolidated financial statements include the accounts of Leap and its wholly owned subsidiaries as well as the accounts of ANB 1 and its wholly owned subsidiary ANB 1 License. The Company consolidates its interest in ANB 1 in accordance with Financial Accounting Standards Board ( FASB ) Interpretation ( FIN ) No. 46-R, Consolidation of Variable Interest Entities, because ANB 1 is a variable interest entity and the Company will absorb a majority of ANB 1's expected losses. All significant intercompany accounts and transactions have been eliminated in the consolidated financial statements.

***Revenues and Cost of Revenues***

Cricket's business revenues principally arise from the sale of wireless services, handsets and accessories. Wireless services are generally provided on a month-to-month basis. Amounts received in advance for wireless services from customers who pay in advance of their billing cycle are initially recorded as deferred revenues and are recognized as service revenues as services are rendered. Service revenues for customers who pay in arrears are recognized only after the service has been rendered and payment has been received. This is because the Company does not require any of its customers to sign fixed-term service commitments or submit to a credit check, and therefore some of its customers may be more likely to terminate service for inability to pay than the customers of other wireless providers. The Company also charges customers for service plan changes,

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activation fees and other service fees. Revenues from service plan change fees are deferred and recorded to revenue over the estimated customer relationship period, and other service fees are recognized when received. Activation fees for new customers who purchase handsets from the Company are allocated to the separate units of accounting of the multiple element arrangement (including service and equipment) on a relative fair value basis. Because the fair values of the Company's handsets are higher than the total consideration received for the handsets and activation fees combined, the Company allocates the activation fees entirely to equipment revenues and recognizes the activation fees when received. Activation fees included in equipment revenues during the three months ended June 30, 2006 and 2005 totaled \$1.5 million and \$4.3 million, respectively. Activation fees included in equipment revenues during the six months ended June 30, 2006 and 2005 totaled \$7.7 million and \$8.9 million, respectively. Starting in May 2006, all new and reactivating customers pay for their service in advance, and the Company no longer charges activation fees to new customers who purchase handsets from the Company. Direct costs associated with customer activations are expensed as incurred.

Equipment revenues arise from the sale of handsets and accessories, and activation fees as described above. Revenues and related costs from the sale of handsets are recognized when service is activated by customers. Revenues and related costs from the sale of accessories are recognized at the point of sale. The costs of handsets and accessories sold are recorded in cost of equipment. Sales of handsets to third-party dealers and distributors are recognized as equipment revenues when service is activated by customers, as the Company does not yet have sufficient relevant historical experience to establish reliable estimates of returns by such dealers and distributors. Handsets sold by third-party dealers and distributors are recorded as inventory until they are sold to and activated by customers. Once the Company believes it has sufficient relevant historical experience for which to establish reliable estimates of returns, it will begin to recognize equipment revenues upon sale to third-party dealers and distributors.

Sales incentives offered without charge to customers and volume-based incentives paid to the Company's third-party dealers and distributors are recognized as a reduction of revenue and as a liability when the related service or equipment revenue is recognized. Customers have limited rights to return handsets and accessories based on time and/or usage. Customer returns of handsets and accessories have historically been insignificant.

**Costs and Expenses**

The Company's costs and expenses include:

*Cost of Service.* The major components of cost of service are: charges from other communications companies for long distance, roaming and content download services provided to the Company's customers; charges from other communications companies for their transport and termination of calls originated by the Company's customers and destined for customers of other networks; and expenses for the rent of towers, network facilities, engineering operations, field technicians and related utility and maintenance charges, and salary and overhead charges associated with these functions.

*Cost of Equipment.* Cost of equipment primarily includes the cost of handsets and accessories purchased from third-party vendors and resold to the Company's customers in connection with its services, as well as lower-of-cost-or-market write-downs associated with excess and damaged handsets and accessories.

*Selling and Marketing.* Selling and marketing expenses primarily include advertising, promotional and public relations costs associated with acquiring new customers, store operating costs such as retail associates' salaries and rent, and overhead charges associated with selling and marketing functions.

*General and Administrative.* General and administrative expenses primarily include call center and other customer care program costs and salary and overhead costs associated with the Company's customer care, billing, information technology, finance, human resources, accounting, legal and executive functions.

**Property and Equipment**

Property and equipment are initially recorded at cost. Additions and improvements are capitalized, while expenditures that do not enhance the asset or extend its useful life are charged to operating expenses as

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incurred. Depreciation is applied using the straight-line method over the estimated useful lives of the assets once the assets are placed in service.

The following table summarizes the depreciable lives for property and equipment (in years):

	<b>Depreciable Life</b>
Network equipment:	
Switches	10
Switch power equipment	15
Cell site equipment and site acquisitions and improvements	7
Towers	15
Antennae	3
Computer hardware and software	3-5
Furniture, fixtures, retail and office equipment	3-7

The Company's network construction expenditures are recorded as construction-in-progress until the network or assets are placed in service, at which time the assets are transferred to the appropriate property or equipment category. As a component of construction-in-progress, the Company capitalizes interest and salaries and related costs of engineering and technical operations employees, to the extent time and expense are contributed to the construction effort, during the construction period. Interest is capitalized on the carrying values of both wireless licenses and equipment during the construction period. During the three and six months ended June 30, 2006, the Company capitalized \$4.5 million and \$8.9 million, respectively, of interest to property and equipment. During the three months ended June 30, 2005, no interest was capitalized. During the six months ended June 30, 2005, the Company capitalized \$0.8 million of interest to property and equipment. Starting on January 1, 2006, site rental costs incurred during the construction period are recognized as rental expense in accordance with FASB Staff Position ( FSP ) No. FAS 13-1, Accounting for Rental Costs Incurred During a Construction Period. Prior to fiscal 2006, such rental costs were capitalized as construction-in-progress.

Property and equipment to be disposed of by sale is not depreciated and is carried at the lower of carrying value or fair value less costs to sell. At June 30, 2006 and December 31, 2005, property and equipment with a net book value of \$5.4 million was classified in assets held for sale.

***Impairment of Long-Lived Assets***

The Company assesses potential impairments to its long-lived assets, including property and equipment and certain intangible assets, when there is evidence that events or changes in circumstances indicate that the carrying value may not be recoverable. An impairment loss may be required to be recognized when the undiscounted cash flows expected to be generated by a long-lived asset (or group of such assets) is less than its carrying value. Any required impairment loss would be measured as the amount by which the asset's carrying value exceeds its fair value and would be recorded as a reduction in the carrying value of the related asset and charged to results of operations.

***Wireless Licenses***

Wireless licenses are initially recorded at cost and are not amortized. Wireless licenses are considered to be indefinite-lived intangible assets because the Company expects to continue to provide wireless service using the relevant licenses for the foreseeable future and the wireless licenses may be renewed every ten years for a nominal fee. Wireless licenses to be disposed of by sale are carried at the lower of carrying value or fair value less costs to sell. At June 30, 2006 and December 31, 2005, wireless licenses with a carrying value of \$31.7 million and \$8.2 million, respectively, were classified in assets held for sale.

**Table of Contents*****Goodwill and Other Intangible Assets***

Goodwill represents the excess of reorganization value over the fair value of identified tangible and intangible assets recorded in connection with fresh-start reporting as of July 31, 2004. Other intangible assets were recorded upon adoption of fresh-start reporting and consist of customer relationships and trademarks, which are being amortized on a straight-line basis over their estimated useful lives of four and fourteen years, respectively. At June 30, 2006 and December 31, 2005, intangible assets with a net book value of \$1.5 million were classified in assets held for sale.

***Impairment of Indefinite-Lived Intangible Assets***

The Company assesses potential impairments to its indefinite-lived intangible assets, including goodwill and wireless licenses, annually and when there is evidence that events or changes in circumstances indicate that an impairment condition may exist. The Company's wireless licenses in its operating markets are combined into a single unit of accounting for purposes of testing impairment because management believes that these wireless licenses as a group represent the highest and best use of the assets and the value of the wireless licenses would not be significantly impacted by a sale of one or a portion of the wireless licenses, among other factors. An impairment loss is recognized when the fair value of the asset is less than its carrying value, and would be measured as the amount by which the asset's carrying value exceeds its fair value. Any required impairment loss would be recorded as a reduction in the carrying value of the related asset and charged to results of operations. The Company conducts its annual tests for impairment during the third quarter of each year. Estimates of the fair value of the Company's wireless licenses are based primarily on available market prices, including successful bid prices in FCC auctions and selling prices observed in wireless license transactions.

During the three and six months ended June 30, 2006, the Company recorded impairment charges of \$3.2 million to reduce the carrying values of certain non-operating wireless licenses to their estimated fair values (see Note 7). During the three and six months ended June 30, 2005, the Company recorded impairment charges of \$11.4 million to reduce the carrying values of certain non-operating wireless licenses to their estimated fair values.

***Basic and Diluted Earnings Per Share***

Basic earnings per share is calculated by dividing net income by the weighted-average number of common shares outstanding during the reporting period. Diluted earnings per share reflect the potential dilutive effect of additional common shares that are issuable upon exercise of outstanding stock options, restricted stock awards and warrants calculated using the treasury stock method.

A reconciliation of weighted-average shares outstanding used in calculating basic and diluted net income per share is as follows (unaudited) (in thousands):

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
Weighted-average shares outstanding	60,282	60,030	60,282	60,015
Effect of dilutive securities:				
Non-qualified stock options	176		96	
Restricted stock awards	926	1	913	
Warrants	&n			