

LEAP WIRELESS INTERNATIONAL INC

Form 10-Q

May 10, 2007

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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 March 31, 2007

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.

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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 May 4, 2007 was 68,086,879.

LEAP WIRELESS INTERNATIONAL, INC.

QUARTERLY REPORT ON FORM 10-Q
For the Quarter Ended March 31, 2007

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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)

	March 31, 2007 (Unaudited)	December 31, 2006
Assets		
Cash and cash equivalents	\$ 303,784	\$ 374,939
Short-term investments	25,432	66,400
Restricted cash, cash equivalents and short-term investments	12,479	13,581
Inventories	75,985	90,185
Other current assets	55,038	53,527
Total current assets	472,718	598,632
Property and equipment, net	1,107,314	1,077,755
Wireless licenses	1,564,381	1,563,958
Assets held for sale		8,070
Goodwill	431,896	431,896
Other intangible assets, net	71,397	79,828
Deposits for wireless licenses	274,084	274,084
Other assets	39,054	58,745
Total assets	\$ 3,960,844	\$ 4,092,968
Liabilities and Stockholders Equity		
Accounts payable and accrued liabilities	\$ 173,606	\$ 316,494
Current maturities of long-term debt	9,000	9,000
Other current liabilities	96,897	74,637
Total current liabilities	279,503	400,131
Long-term debt	1,674,250	1,676,500
Deferred tax liabilities	141,439	149,728
Other long-term liabilities	49,038	47,608
Total liabilities	2,144,230	2,273,967
Minority interests	23,849	30,000

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Commitments and contingencies (Note 7)

Stockholders' equity:

Preferred stock authorized 10,000,000 shares; \$.0001 par value, no shares issued and outstanding

Common stock authorized 160,000,000 shares; \$.0001 par value, 68,051,029 and 67,892,512 shares issued and outstanding at March 31, 2007 and

December 31, 2006, respectively

Additional paid-in capital

Retained earnings

Accumulated other comprehensive income

Total stockholders' equity

Total liabilities and stockholders' equity

	7	7
	1,782,880	1,769,772
	9,313	17,436
	565	1,786
	1,792,765	1,789,001
	\$ 3,960,844	\$ 4,092,968

See accompanying notes to condensed consolidated financial statements.

Table of Contents**LEAP WIRELESS INTERNATIONAL, INC.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(Unaudited and in thousands, except per share data)**

	Three Months Ended March 31,	
	2007	2006
Revenues:		
Service revenues	\$ 326,809	\$ 215,840
Equipment revenues	62,613	50,848
Total revenues	389,422	266,688
Operating expenses:		
Cost of service (exclusive of items shown separately below)	(90,949)	(55,204)
Cost of equipment	(112,482)	(58,886)
Selling and marketing	(48,560)	(29,102)
General and administrative	(65,199)	(49,582)
Depreciation and amortization	(68,800)	(54,036)
Total operating expenses	(385,990)	(246,810)
Net gain on sale of wireless licenses and disposal of operating assets	940	
Operating income	4,372	19,878
Minority interests in consolidated subsidiaries	1,520	(75)
Interest income	5,285	4,194
Interest expense	(26,496)	(7,431)
Other income (expense), net	(637)	535
Income (loss) before income taxes and cumulative effect of change in accounting principle	(15,956)	17,101
Income tax benefit	7,833	
Income (loss) before cumulative effect of change in accounting principle	(8,123)	17,101
Cumulative effect of change in accounting principle		623
Net income (loss)	\$ (8,123)	\$ 17,724
Basic earnings (loss) per share:		
Earnings (loss) before cumulative effect of change in accounting principle	\$ (0.12)	\$ 0.28
Cumulative effect of change in accounting principle		0.01
Basic earnings (loss) per share	\$ (0.12)	\$ 0.29
Diluted earnings (loss) per share:		
Earnings (loss) before cumulative effect of change in accounting principle	\$ (0.12)	\$ 0.28

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Cumulative effect of change in accounting principle			0.01
Diluted earnings (loss) per share	\$	(0.12)	\$ 0.29
Shares used in per share calculations:			
Basic		66,870	61,203
Diluted		66,870	61,961

See accompanying notes to condensed consolidated financial statements.

Table of Contents**LEAP WIRELESS INTERNATIONAL, INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited and in thousands)**

	Three Months Ended March 31,	
	2007	2006
Operating activities:		
Net cash provided by operating activities	\$ 4,900	\$ 38,290
Investing activities:		
Purchases of property and equipment	(131,737)	(60,894)
Change in prepayments for purchases of property and equipment	7,409	4,573
Purchases of and deposits for wireless licenses	(423)	(91)
Proceeds from sale of wireless licenses	9,500	
Purchases of investments	(42,727)	(46,865)
Sales and maturities of investments	84,293	72,657
Purchase of minority interest	(4,706)	
Changes in restricted cash, cash equivalents and short-term investments, net	1,102	(50)
Net cash used in investing activities	(77,289)	(30,670)
Financing activities:		
Repayment of long-term debt	(2,250)	(1,527)
Payment of debt issuance costs	(881)	(91)
Minority interest contributions		668
Proceeds from issuance of common stock, net	4,365	233
Net cash provided by (used in) financing activities	1,234	(717)
Net increase (decrease) in cash and cash equivalents	(71,155)	6,903
Cash and cash equivalents at beginning of period	374,939	293,073
Cash and cash equivalents at end of period	\$ 303,784	\$ 299,976
Supplementary cash flow information:		
Cash paid for interest	\$ 18,373	\$ 11,098
Cash paid for income taxes	\$ 332	\$ 168

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

Leap Wireless International, Inc. (Leap), a Delaware corporation, together with its subsidiaries, is a wireless communications carrier that offers digital wireless service in the United States of America under the Cricket® and Jump™ Mobile brands. Cricket service offers customers unlimited wireless service in their Cricket service area for a flat monthly rate without requiring a fixed-term contract or credit check. Jump Mobile service offers customers a per-minute prepaid wireless service. Leap conducts operations through its subsidiaries and has no independent operations or sources of operating revenue other than through dividends, if any, from its subsidiaries. Cricket and Jump Mobile services are offered by Cricket Communications, Inc. (Cricket), a wholly owned subsidiary of Leap, and Alaska Native Broadband 1 License, LLC (ANB 1 License), an indirect wholly owned subsidiary of Leap. Leap, Cricket, ANB 1 License and their subsidiaries are collectively referred to herein as the Company. Cricket and Jump Mobile services are also offered in Oregon by LCW Wireless Operations, LLC (LCW Operations), a designated entity under Federal Communications Commission (FCC) regulations. Cricket owns an indirect 73.3% non-controlling interest in LCW Operations through a 73.3% non-controlling interest in LCW Wireless, LLC (LCW Wireless). Cricket also owns an 82.5% non-controlling interest in Denali Spectrum, LLC (Denali), which participated in the FCC's auction for Advanced Wireless Service licenses (Auction #66) as a designated entity through its wholly owned subsidiary, Denali Spectrum License, LLC (Denali License).

On March 5, 2007, Cricket acquired the remaining 25% of the membership interests in Alaska Native Broadband 1, LLC (ANB 1), following Alaska Native Broadband, LLC's exercise of its option to sell its entire 25% controlling interest in ANB 1 to Cricket for \$4.7 million. As a result of the acquisition, ANB 1 and its wholly owned subsidiary, ANB 1 License, became direct and indirect wholly owned subsidiaries, respectively, of Cricket.

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 three months ended March 31, 2007, all of the Company's revenues and long-lived assets related to operations in the United States of America.

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, 2006. 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 LCW Wireless and Denali and their wholly owned subsidiaries. The Company consolidates its interests in LCW Wireless and Denali in accordance with Financial Accounting Standards Board (FASB) Interpretation No. (FIN) 46-R, Consolidation of Variable Interest Entities, because these entities are variable interest

entities and the Company will absorb a majority of their expected losses. All significant intercompany accounts and transactions have been eliminated in the condensed consolidated financial statements.

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. Cricket service offers customers unlimited

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wireless service in their Cricket service area for a flat monthly rate, and Jump Mobile service offers customers a per-minute prepaid wireless service. 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. 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. Starting in May 2006, all new and reactivating customers are required to pay for their service in advance.

Equipment revenues arise from the sale of handsets and accessories. 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 is currently unable to reliably estimate the level of price reductions ultimately available to such dealers and distributors until the handsets are sold through to customers. Handsets sold to third-party dealers and distributors are recorded as inventory until they are sold to and activated by customers.

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 tower and network facility rent, 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 incurred. Depreciation is

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

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

	Depreciable Life
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 and is depreciated over an estimated useful life of 10 years. During the three months ended March 31, 2007 and 2006, the Company capitalized interest of \$10.7 million and \$4.4 million, respectively, to property and equipment.

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 March 31, 2007 and December 31, 2006, there was no property and equipment classified as assets held for sale.

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 wireless licenses may be renewed every ten to fifteen 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 March 31, 2007, there were no wireless licenses classified as assets held for sale. At December 31, 2006, wireless licenses with a carrying value of \$8.1 million were classified as assets held for sale.

Concentrations

The Company generally relies on one key vendor for billing services and one key vendor for handset logistics. Loss or disruption of these services could adversely affect the Company's business.

Share-Based Compensation

The Company accounts for share-based awards exchanged for employee services in accordance with Statement of Financial Accounting Standards (SFAS) No. 123R, Share-Based Payment (SFAS 123R). Under SFAS 123R, share-based compensation cost is measured at the grant date, based on the estimated fair value of the award, and is recognized as expense, net of estimated forfeitures, over the employee's requisite service period.

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Total share-based compensation expense related to all of the Company's share-based awards for the three months ended March 31, 2007 and 2006 was allocated as follows (in thousands, except per share data):

	Three Months Ended March 31,	
	2007	2006
Cost of service	\$ 679	\$ 258
Selling and marketing expenses	1,001	327
General and administrative expenses	7,063	4,141
Share-based compensation expense before tax	8,743	