LEAP WIRELESS INTERNATIONAL INC
Form 10-Q
June 15, 2005

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**
For the quarterly period ended March 31, 2005
OR
o **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 ninety days. Yes þ No o

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes o No þ

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 þ No o

The number of shares of registrant s common stock outstanding on June 14, 2005 was 60,000,000.

LEAP WIRELESS INTERNATIONAL, INC
QUARTERLY REPORT ON FORM 10-Q
For the Quarter Ended March 31, 2005
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PART I
FINANCIAL INFORMATION

Item 1. Financial Statements.

LEAP WIRELESS INTERNATIONAL, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands)

	Successor Company	
	March 31, 2005	**December 31, 2004**
	(Unaudited)	
Assets		
Cash and cash equivalents	$ 22,211	$ 141,141
Short-term investments	99,402	113,083
Restricted cash, cash equivalents and short-term investments	30,903	31,427
Inventories	28,982	25,816
Other current assets	34,275	35,144
Total current assets	215,773	346,611
Property and equipment, net	548,166	576,352
Wireless licenses	581,828	652,653
Assets held for sale (Note 7)	88,057	
Goodwill	329,619	329,619
Other intangible assets, net	140,824	151,461
Deposits for wireless licenses (Notes 7 and 8)	236,845	24,750
Other assets	14,184	9,036
Total assets	$ 2,155,296	$ 2,090,482
Liabilities and Stockholders Equity		
Accounts payable and accrued liabilities	$ 73,421	$ 91,093
Current maturities of long-term debt (Note 5)	5,000	40,373
Other current liabilities	70,753	72,741
Total current liabilities	149,174	204,207
Long-term debt (Note 5)	493,750	371,355
Other long-term liabilities	28,951	45,070
Total liabilities	671,875	620,632
Minority interest	1,000	
Commitments and contingencies (Notes 2, 5 and 8)		
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, 60,000,000 shares issued and outstanding	6	6
Additional paid-in capital	1,478,392	1,478,392

Retained earnings (accumulated deficit)	4,017	(8,629)
Accumulated other comprehensive income	6	81
Total stockholders equity	1,482,421	1,469,850
Total liabilities and stockholders equity	$ 2,155,296	$ 2,090,482

See accompanying notes to condensed consolidated financial statements.

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LEAP WIRELESS INTERNATIONAL, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)
(UNAUDITED)
(In thousands, except per share data)

	Successor Company	Predecessor Company
	Three Months Ended March 31,	
	2005	2004
Revenues:		
Service revenues	$ 185,981	$ 169,051
Equipment revenues	42,389	37,771
Total revenues	228,370	206,822
Operating expenses:		
Cost of service (exclusive of items shown separately below)	(50,197)	(48,000)
Cost of equipment	(49,178)	(43,755)
Selling and marketing	(22,995)	(23,253)
General and administrative	(36,035)	(38,610)
Depreciation and amortization	(48,104)	(75,461)
Total operating expenses	(206,509)	(229,079)
Operating income (loss)	21,861	(22,257)
Interest income	1,903	
Interest expense (contractual interest expense was $66.4 million for the three months ended March 31, 2004)	(9,123)	(1,823)
Other income (expense), net	(1,286)	19
Income (loss) before reorganization items and income taxes	13,355	(24,061)
Reorganization items, net		(2,025)
Income (loss) before income taxes	13,355	(26,086)
Income taxes	(709)	(1,944)
Net income (loss)	12,646	(28,030)
Other comprehensive income (loss):		
Unrealized holding gains on investments, net	6	265
Comprehensive income (loss)	$ 12,652	$ (27,765)
Net income (loss) per share:		
Basic	$ 0.21	$ (0.48)

Diluted	$	0.21	$	(0.48)
Shares used in per share calculations:				
Basic		60,000		58,645
Diluted		60,236		58,645

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)

	Successor Company	Predecessor Company
	Three Months Ended March 31,	
	2005	2004
Operating activities:		
Net cash provided by operating activities	$ 23,462	$ 40,760
Investing activities:		
Purchase of property and equipment	(24,487)	(16,157)
Deposits for wireless licenses	(212,095)	
Purchase of investments	(69,025)	(33,651)
Sale and maturity of investments	83,568	16,850
Restricted cash, cash equivalents and investments, net	407	2,600
Net cash used in investing activities	(221,632)	(30,358)
Financing activities:		
Proceeds from long-term debt	500,000	
Repayment of long-term debt	(413,979)	
Payment of debt financing costs	(6,781)	
Net cash provided by financing activities	79,240	
Net increase (decrease) in cash and cash equivalents	(118,930)	10,402
Cash and cash equivalents at beginning of year	141,141	84,070
Cash and cash equivalents at end of period	$ 22,211	$ 94,472

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 brand Cricket®. 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 service is operated by Leap s wholly owned subsidiary, Cricket Communications, Inc. (Cricket). Leap and Cricket and their subsidiaries are collectively referred to herein as the Company. As of March 31, 2005, the Company provided wireless service in 39 markets.

In November 2004, the Company acquired a 75% non-controlling membership interest in Alaska Native Broadband 1, LLC (ANB 1) for the purpose of participating in the FCC s Auction #58 (Note 7) through ANB 1 s wholly owned subsidiary, Alaska Native Broadband 1 License, LLC (ANB 1 License). The Company consolidates its investment in ANB 1.

Note 2. Reorganization and Fresh-Start Reporting

On April 13, 2003 (the Petition Date), Leap, Cricket and substantially all of their subsidiaries filed voluntary petitions for relief under Chapter 11 of the United States Bankruptcy Code (Chapter 11) in the United States Bankruptcy Court for the Southern District of California (the Bankruptcy Court). On October 22, 2003, the Bankruptcy Court confirmed the Fifth Amended Joint Plan of Reorganization (the Plan of Reorganization) of Leap, Cricket and their debtor subsidiaries. All material conditions to the effectiveness of the Plan of Reorganization were resolved on August 5, 2004, the Plan of Reorganization became effective on August 16, 2004 (the Effective Date), and the Company emerged from Chapter 11 bankruptcy. On that date, a new Board of Directors of Leap was appointed, Leap s previously existing stock, options and warrants were cancelled, and Leap issued 60 million shares of new Leap common stock for distribution to two classes of creditors. The Plan of Reorganization implemented a comprehensive financial reorganization that significantly reduced the Company s outstanding indebtedness. On the Effective Date of the Plan of Reorganization, the Company s long-term debt was reduced from a book value of more than $2.4 billion to debt with an estimated fair value of $412.8 million, consisting of new Cricket 13% senior secured pay-in-kind notes due 2011 with a face value of $350 million and an estimated fair value of $372.8 million, issued on the Effective Date, and approximately $40 million of remaining indebtedness to the FCC (net of the repayment of $45 million of principal and accrued interest to the FCC on the Effective Date). A summary of the material actions that occurred during the bankruptcy process and as of the Effective Date of the Plan of Reorganization is included in the Company s Annual Report on Form 10-K for the year ended December 31, 2004 filed with the Securities and Exchange Commission (SEC) on May 16, 2005.

As of the Petition Date and through the adoption of fresh-start reporting on July 31, 2004, the Company implemented American Institute of Certified Public Accountants Statement of Position (SOP) 90-7, Financial Reporting by Entities in Reorganization under the Bankruptcy Code. In accordance with SOP 90-7, the Company separately reported certain expenses, realized gains and losses and provisions for losses related to the Chapter 11 filings as reorganization items. In addition, commencing as of the Petition Date and continuing while in bankruptcy, the Company ceased accruing interest and amortizing debt discounts and debt issuance costs for its pre-petition debt that was subject to compromise, which included debt with a book value totaling approximately $2.4 billion as of the Petition Date.

The Company adopted the fresh-start accounting provisions of SOP 90-7 as of July 31, 2004. Under fresh-start reporting, a new entity is deemed to be created for financial reporting purposes. Therefore, as used in these condensed consolidated financial statements, the Company is referred to as the Predecessor Company for periods on or prior to July 31, 2004 and is referred to as the Successor Company for periods after July 31, 2004, after giving effect to the implementation of fresh-start reporting. The financial statements

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of the Successor Company are not comparable in many respects to the financial statements of the Predecessor Company because of the effects of the consummation of the Plan of Reorganization as well as the adjustments for fresh-start accounting.

Under SOP 90-7, reorganization value represents the fair value of the entity before considering liabilities and approximates the amount a willing buyer would pay for the assets of the entity immediately after the reorganization. In implementing fresh-start reporting, the Company allocated its reorganization value to the fair value of its assets in conformity with procedures specified by Statement of Financial Accounting Standards (SFAS) No. 141, Business Combinations, and stated its liabilities, other than deferred taxes, at the present value of amounts expected to be paid. The amount remaining after allocation of the reorganization value to the fair value of the Company s identified tangible and intangible assets is reflected as goodwill, which is subject to periodic evaluation for impairment. In addition, under fresh-start reporting, the Company s accumulated deficit was eliminated and new equity was issued according to the Plan of Reorganization. The determination of reorganization value and the adjustments to the Predecessor Company s consolidated balance sheet at July 31, 2004 resulting from the application of fresh-start accounting are summarized in the Company s Annual Report on Form 10-K for the year ended December 31, 2004.

The fair values of goodwill and intangible assets reported in the Successor Company s consolidated balance sheet were estimated based upon the Company s estimates of future cash flows and other factors including discount rates. If these estimates or the assumptions underlying these estimates change in the future, the Company may be required to record impairment charges. In addition, a permanent and sustained decline in the market value of the Company s outstanding common stock could also result in the requirement to recognize impairment charges in future periods.

Note 3. Basis of Presentation and Significant Accounting Policies

Interim Financial Statements

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, 2004. 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.

Principles of Consolidation

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 FASB Interpretation No. 46-R, Consolidation of Variable Interest Entities, because the Company will absorb a majority of ANB 1 s expected losses. The Company records 100% of the losses of ANB 1 to the extent of its investment in and loans to ANB 1 and ANB 1 License, since the Company expects to be a primary financing source for ANB 1 License. All significant intercompany accounts and transactions have been eliminated in the condensed consolidated financial statements.

Reorganization Items

Reorganization items represent amounts incurred by the Predecessor Company as a direct result of the Chapter 11 filings and are presented separately in the Predecessor Company s condensed consolidated statements of operations. For the three months ended March 31, 2004, reorganization items consisted primarily of professional fees for legal, financial advisory and valuation services directly associated with the Company s Chapter 11 filings and reorganization process.

Restricted Cash, Cash Equivalents and Short-Term Investments

Restricted cash, cash equivalents and short-term investments include funds set aside or pledged to satisfy remaining administrative claims and priority claims against Leap and Cricket following their emergence from bankruptcy, and cash restricted for other purposes.

Revenues and Cost of Revenues

Cricket s business revenues 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 are initially recorded as deferred revenues and are recognized as service revenue 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 long-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, 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 are allocated to the other elements 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 March 31, 2005 and 2004 totaled $4.6 million and $5.8 million, respectively. Direct costs associated with customer activations are expensed as incurred. Cost of service generally includes direct costs and related overhead, excluding depreciation and amortization, of operating the Company s networks.

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. Amounts due from third-party dealers and distributors for handsets are recorded as deferred revenue upon shipment of the handsets by the Company to such dealers and distributors and are recognized as equipment revenues when service is activated by customers. Handsets sold by 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. Returns of handsets and accessories have historically been insignificant.

Property and Equipment

Property and equipment are initially recorded at cost. Additions and improvements, including interest and certain labor costs, 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.

Upon emergence from Chapter 11 and adoption of fresh-start reporting, the Company re-assessed the carrying values and useful lives of its property and equipment. As a result of this re-assessment, which included a review of the Company s historical usage of and expected future service from existing property and equipment, and a review of industry averages for similar property and equipment, the Company changed the depreciable lives for certain network equipment assets. These network equipment assets that were previously

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depreciated over periods ranging from two to five years are now depreciated over periods ranging from three to fifteen years. As a result of this change, depreciation expense was reduced and net income increased by approximately $30.8 million, or $0.51 per diluted share, for the three months ended March 31, 2005 compared to what they would have been if the useful lives had not been revised. The estimated useful lives for the Company s other property and equipment, which have remained unchanged, are three to five years for computer hardware and software, and three to seven years for furniture, fixtures and retail and office 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.

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 and 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.

At March 31, 2005, equipment with a net book value in the amount of $15.3 million was classified in assets held for sale (see Note 7). At December 31, 2004, there was no equipment to be disposed of by sale.

Impairment of Long-Lived Assets

In accordance with SFAS No. 144, Accounting for the Impairment or Disposal 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. The Company has determined that its wireless licenses meet the definition of indefinite-lived intangible assets under SFAS No. 142, Goodwill and Other Intangible Assets. 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, 2005, wireless licenses with a carrying value of $70.8 million were classified in assets held for sale (see Note 7). At December 31, 2004, wireless licenses to be disposed of by sale were not significant. In connection with the adoption of fresh-start reporting, the Company increased the carrying value of its wireless licenses to their estimated fair market values.

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 accounting. Other intangible assets were recorded upon adoption of fresh-start accounting 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 March 31, 2005, intangible assets with a carrying value of $1.9 million were classified in assets held for sale (see Note 7). At December 31, 2004, there were no intangible assets to be disposed of by sale.

Impairment of Indefinite-lived Intangible Assets

In accordance with SFAS No. 142, 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 Successor Company has chosen to conduct its annual test for impairment during the third quarter of each year. 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.

Basic and Diluted Net Income (Loss) Per Share

Basic earnings per share is calculated by dividing net income (loss) 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 and warrants calculated using the treasury stock method.

A reconciliation of weighted average shares outstanding used in calculating basic and diluted net income (loss) per share for the three months ended March 31, 2005 and 2004 is as follows (unaudited) (in thousands):

	Successor Company	Predecessor Company
	Three Months Ended March 31,	
	2005	2004
Weighted average shares outstanding basic earnings per share	60,000	58,645
Effect of dilutive securities:		
Employee stock options	9	
Warrants to MCG	227	
Adjusted weighted average shares outstanding diluted earning per share	60,236	58,645

The number of shares not included in the computation of diluted net loss per share because their effect would have been antidilutive totaled 13.3 million for the three months ended March 31, 2004.

Stock-based Compensation

The Company measures compensation expense for its employee and director stock-based compensation plans using the intrinsic value method. All outstanding stock options of the Predecessor Company were cancelled upon emergence from bankruptcy in accordance with the Plan of Reorganization. During the first quarter of 2005, under the terms of the Leap Wireless International, Inc. 2004 Stock Option, Restricted Stock and Deferred Stock Unit Plan (the 2004 Plan), the Company granted a total of 839,658 non-qualified stock options to directors, executive officers and other employees of the Company. A total of 4,800,000 shares of Leap common stock are reserved for issuance under the 2004 Plan. There were no stock options issued during the three months ended March 31, 2004.

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The following table shows the effects on net income (loss) and net income (loss) per share if the Company had applied the fair value provisions of SFAS No. 123, Accounting for Stock-Based Compensation in measuring compensation expense for its stock-based compensation plans (unaudited) (in thousands, except per share data):

	Successor Company	Predecessor Company
	Three Months Ended March 31,	
	2005	2004
As reported net income (loss)	$ 12,646	$ (28,030)
Add back stock-based compensation benefit included in net loss		(654)
Less net pro forma compensation (expense) benefit	(1,526)	6,677
Pro forma net income (loss)	$ 11,120	$ (22,007)
Basic net income (loss) per share:		
As reported	$ 0.21	$ (0.48)
Pro forma	$ 0.19	$ (0.38)
Diluted net income (loss) per share:		
As reported	$ 0.21	$ (0.48)
Pro forma	$ 0.18	$ (0.38)

The weighted average grant date fair value per share of the stock options granted during the three months ended March 31, 2005 was $18.85, which was estimated using the Black-Scholes option-pricing model and the following weighted average assumptions:

	Three Months Ended March 31, 2005
Risk free interest rate	3.48%
Expected dividend yield	
Expected volatility	87%
Expected life (in years)	5.4

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Reclassifications

Certain prior period amounts have been reclassified to conform to the current period presentation.

Note 4. Supplementary Financial Information

Supplementary Balance Sheet Information (in thousands):

	Successor Company	
	March 31, 2005	December 31, 2004
	(Unaudited)	
Property and equipmen		