

LEAP WIRELESS INTERNATIONAL INC

Form 10-Q

May 10, 2010

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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, 2010

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: 000-29752

**Leap Wireless International, Inc.
(Exact name of registrant as specified in its charter)**

**Delaware
(State or other jurisdiction of
incorporation or organization)
5887 Copley Drive, San Diego, CA
(Address of Principal Executive Offices)
Delaware**

**33-0811062
(I.R.S. Employer
Identification No.)
92111
(Zip Code)
33-0811062**

**(858) 882-6000
(Registrant's telephone number, including area code)**

**Not Applicable
(Former name, former address and former fiscal year, if changed since last report)**

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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required

to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company)

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

The number of shares outstanding of the registrant's common stock on April 30, 2010 was 78,216,420.

LEAP WIRELESS INTERNATIONAL, INC.

**QUARTERLY REPORT ON FORM 10-Q
For the Quarter Ended March 31, 2010**

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Table of Contents**PART I****FINANCIAL INFORMATION****Item 1. Financial Statements.****LEAP WIRELESS INTERNATIONAL, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS****(In thousands, except share amounts)**

	March 31, 2010 (Unaudited)	December 31, 2009
Assets		
Cash and cash equivalents	\$ 173,121	\$ 174,999
Short-term investments	352,807	389,154
Restricted cash, cash equivalents and short-term investments	3,866	3,866
Inventories	55,189	107,912
Deferred charges	35,998	38,872
Other current assets	83,956	73,204
Total current assets	704,937	788,007
Property and equipment, net	2,093,904	2,121,094
Wireless licenses	1,923,097	1,921,973
Assets held for sale		2,381
Goodwill	430,101	430,101
Intangible assets, net	23,399	24,535
Other assets	84,268	83,630
Total assets	\$ 5,259,706	\$ 5,371,721
Liabilities and Stockholders Equity		
Accounts payable and accrued liabilities	\$ 228,575	\$ 310,386
Current maturities of long-term debt	16,096	8,000
Other current liabilities	231,363	196,647
Total current liabilities	476,034	515,033
Long-term debt	2,725,772	2,735,318
Deferred tax liabilities	271,369	259,512
Other long-term liabilities	105,357	99,696
Total liabilities	3,578,532	3,609,559
Redeemable non-controlling interests	51,768	71,632

Commitments and contingencies (Note 9)

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, 78,226,957 and 77,524,040 shares issued and outstanding at March 31, 2010 and

December 31, 2009, respectively

	8	8
Additional paid-in capital	2,152,772	2,148,194
Accumulated deficit	(524,132)	(458,685)
Accumulated other comprehensive income	758	1,013
Total stockholders' equity	1,629,406	1,690,530
Total liabilities and stockholders' equity	\$ 5,259,706	\$ 5,371,721

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,	
	2010	2009
Revenues:		
Service revenues	\$ 584,822	\$ 514,005
Equipment revenues	69,132	72,982
Total revenues	653,954	586,987
Operating expenses:		
Cost of service (exclusive of items shown separately below)	165,934	144,344
Cost of equipment	168,053	157,796
Selling and marketing	111,884	103,523
General and administrative	92,256	96,177
Depreciation and amortization	109,246	89,733
Total operating expenses	647,373	591,573
Gain (loss) on sale or disposal of assets	(1,453)	3,581
Operating income (loss)	5,128	(1,005)
Equity in net income of investees, net	571	1,479
Interest income	428	945
Interest expense	(60,295)	(41,851)
Other income (expense), net	15	(63)
Loss before income taxes	(54,153)	(40,495)
Income tax expense	(11,294)	(6,865)
Net loss	(65,447)	(47,360)
Accretion of redeemable non-controlling interests, net of tax	(2,587)	(2,936)
Net loss attributable to common stockholders	\$ (68,034)	\$ (50,296)
Loss per share attributable to common stockholders:		
Basic	\$ (0.90)	\$ (0.74)
Diluted	\$ (0.90)	\$ (0.74)
Shares used in per share calculations:		
Basic	75,794	68,189
Diluted	75,794	68,189

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,	
	2010	2009
Operating activities:		
Net cash provided by operating activities	\$ 93,551	\$ 99,952
Investing activities:		
Purchases of property and equipment	(107,206)	(201,785)
Change in prepayments for purchases of property and equipment	234	(1,494)
Purchases of and deposits for wireless licenses and spectrum clearing costs	(1,124)	(2,545)
Proceeds from sale of wireless licenses and operating assets		2,965
Purchases of investments	(122,483)	(234,563)
Sales and maturities of investments	158,425	165,914
Change in restricted cash	185	(1,134)
Net cash used in investing activities	(71,969)	(272,642)
Financing activities:		
Repayment of long-term debt	(2,000)	(3,654)
Purchase of non-controlling interest	(20,973)	
Proceeds from the issuance of common stock, net		853
Other	(487)	(334)
Net cash used in financing activities	(23,460)	(3,135)
Net decrease in cash and cash equivalents	(1,878)	(175,825)
Cash and cash equivalents at beginning of period	174,999	357,708
Cash and cash equivalents at end of period	\$ 173,121	\$ 181,883
Supplementary disclosure of cash flow information:		
Cash paid for interest	\$ 20,993	\$ 41,187
Cash paid for income taxes	\$ 79	\$ 3
Non-cash investing and financing activities:		
Contribution of wireless licenses in exchange for an equity interest	\$ 2,381	\$

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 services in the United States under the Cricket® brand. Cricket service offerings provide customers with unlimited wireless services for a flat rate without requiring a fixed-term contract or a credit check. The Company's primary service is Cricket Wireless, which offers customers unlimited wireless voice and data services for a flat monthly rate. Leap conducts operations through its subsidiaries and has no independent operations or sources of income other than interest income and through dividends, if any, from its subsidiaries. Cricket service is offered by Cricket Communications, Inc. (Cricket), a wholly owned subsidiary of Leap, and is also offered in Oregon by LCW Wireless Operations, LLC (LCW Operations), a wholly owned subsidiary of LCW Wireless, LLC (LCW Wireless), and in the upper Midwest by Denali Spectrum Operations, LLC (Denali Operations), an indirect wholly owned subsidiary of Denali Spectrum, LLC (Denali). LCW Wireless and Denali are designated entities under Federal Communications Commission (FCC) regulations. Cricket owns an indirect 94.6% non-controlling interest in LCW Operations through a 94.6% non-controlling interest in LCW Wireless, and owns an indirect 82.5% non-controlling interest in Denali Operations through an 82.5% non-controlling interest in Denali. Leap, Cricket and their subsidiaries and consolidated joint ventures, including LCW Wireless and Denali, are collectively referred to herein as the Company.

Note 2. Basis of Presentation and Significant Accounting Policies

Basis of Presentation

The accompanying interim condensed consolidated financial statements have been prepared 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 (GAAP) for a complete set of financial statements. These condensed consolidated financial statements 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, 2009. In the opinion of management, the unaudited financial information for the interim periods presented reflects all adjustments necessary for a fair presentation of the Company's results for the periods presented, with such adjustments consisting only of normal recurring adjustments. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities and the reported amounts of revenues and expenses. By their nature, estimates are subject to an inherent degree of uncertainty. Actual results could differ from management's estimates and operating results for interim periods are not necessarily indicative of operating results for an entire fiscal year.

The condensed consolidated financial statements include the operating results and financial position of Leap and its wholly owned subsidiaries as well as the operating results and financial position of LCW Wireless and Denali and their wholly owned subsidiaries. The Company consolidates its non-controlling interests in LCW Wireless and Denali in accordance with the authoritative guidance for the consolidation of variable interest entities because these entities are variable interest entities and the Company has entered into agreements with the entities' other members which establish a specified, minimum purchase price in the event that they offer or elect to sell their membership interests to the Company. All intercompany accounts and transactions have been eliminated in the condensed consolidated financial statements.

Segment and Geographic Data

The Company operates in a single operating segment and a single reporting unit as a wireless communications carrier that offers digital wireless services in the United States. As of and for the three months ended March 31, 2010, all of the Company's revenues and long-lived assets related to operations in the United States.

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Revenues

The Company's business revenues principally arise from the sale of wireless services, devices (including handsets and broadband modems) and accessories. Wireless services are generally provided on a month-to-month basis. In general, the Company's customers are required to pay for their service in advance. Because the Company does not require customers to sign fixed-term contracts or pass a credit check, its services are available to a broader customer base than many other wireless providers and, as a result, some of its customers may be more likely to have service terminated due to an inability to pay. Consequently, the Company has concluded that collectability of its revenues is not reasonably assured until payment has been received. Accordingly, service revenues are recognized only after services have been rendered and payment has been received.

When the Company activates service for a new customer, it frequently sells that customer a device bundled with a period of free service. Under the authoritative guidance for revenue arrangements with multiple deliverables, the sale of a device along with a free period of service constitutes a multiple element arrangement. Under the guidance, once a company has determined the fair value of the elements in the sales transaction, the total consideration received from the customer must be allocated among those elements on a relative fair value basis. Applying the guidance to these transactions results in the Company recognizing the total consideration received, less revenue for the free wireless service period (at the customer's stated rate plan), as equipment revenue.

Equipment revenues and related costs from the sale of devices 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 devices and accessories sold are recorded in cost of equipment. In addition to devices that the Company sells directly to its customers at Cricket-owned stores, the Company also sells devices to third-party dealers, including mass-merchant retailers. These dealers then sell the devices to the ultimate Cricket customer, and that customer receives a free period of service in a bundled transaction (similar to the sale made at a Cricket-owned store). Sales of devices to third-party dealers are recognized as equipment revenues only when service is activated by customers, since the level of price reductions ultimately available to such dealers is not reliably estimable until the devices are sold by such dealers to customers. Thus, revenues from devices sold to third-party dealers are recorded as deferred equipment revenue and the related costs of the devices are recorded as deferred charges upon shipment by the Company. The deferred charges are recognized as equipment costs when the related equipment revenue is recognized, which occurs when service is activated by the customer.

Through a third-party provider, the Company's customers may elect to participate in an extended-warranty program for devices they purchase. The Company recognizes revenue on replacement devices sold to its customers under the program when the customer purchases the device.

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

Amounts billed by the Company in advance of customers' wireless service periods are not reflected in accounts receivable or deferred revenue since collectability of such amounts is not reasonably assured. Deferred revenue consists primarily of cash received from customers in advance of their service period and deferred equipment revenue related to devices sold to third-party dealers.

Universal Service Fund, E-911 and other fees are assessed by various governmental authorities in connection with the services that the Company provides to its customers. The Company reports these fees, as well as sales, use and excise

taxes that are assessed and collected, net of amounts remitted, in the condensed consolidated statements of operations.

Fair Value of Financial Instruments

The authoritative guidance for fair value measurements defines fair value for accounting purposes, establishes a framework for measuring fair value and provides disclosure requirements regarding fair value measurements. The guidance defines fair value as an exit price, which is the price that would be received upon sale of an asset or paid upon transfer of a liability in an orderly transaction between market participants at the measurement date. The

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degree of judgment utilized in measuring the fair value of assets and liabilities generally correlates to the level of pricing observability. Assets and liabilities with readily available, actively quoted prices or for which fair value can be measured from actively quoted prices in active markets generally have more pricing observability and require less judgment in measuring fair value. Conversely, assets and liabilities that are rarely traded or not quoted have less pricing observability and are generally measured at fair value using valuation models that require more judgment. These valuation techniques involve some level of management estimation and judgment, the degree of which is dependent on the price transparency of the asset, liability or market and the nature of the asset or liability. The Company has categorized its assets and liabilities measured at fair value into a three-level hierarchy in accordance with this guidance. See Note 5 for a further discussion regarding the Company's measurement of assets and liabilities at fair value.

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.

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 improvements	7
Towers	15
Antennae	5
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 other asset is placed in service, at which time the asset is transferred to the appropriate property or equipment category. The Company capitalizes salaries and related costs of engineering and technical operations employees as components of construction-in-progress during the construction period to the extent time and expense are contributed to the construction effort. The Company also capitalizes certain telecommunications and other related costs as construction-in-progress during the construction period to the extent they are incremental and directly related to the network under construction. In addition, 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 ten years. During the three months ended March 31, 2010 the Company did not capitalize interest to property and equipment. During the three months ended March 31, 2009, the Company capitalized interest of \$12.2 million to property and equipment.

In accordance with the authoritative guidance for accounting for costs of computer software developed or obtained for internal use, certain costs related to the development of internal use software are capitalized and amortized over the estimated useful life of the software. For the three months ended March 31, 2010 and 2009, the Company capitalized approximately \$24.5 million and \$10.9 million, respectively, of these costs. The Company amortized software costs of

approximately \$6.1 million and \$5.0 million for the three months ended March 31, 2010 and 2009, respectively.

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. As of March 31, 2010 and December 31, 2009, there was no property or equipment classified as assets held for sale.

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The Company, LCW Wireless and Denali operate Personal Communications Services (PCS) and Advanced Wireless Services (AWS) networks under PCS and AWS wireless licenses granted by the FCC that are specific to a particular geographic area on spectrum that has been allocated by the FCC for such services. Wireless licenses are initially recorded at cost and are not amortized. Although FCC licenses are issued with a stated term (ten years in the case of PCS licenses and fifteen years in the case of AWS licenses), wireless licenses are considered to be indefinite-lived intangible assets because the Company expects its subsidiaries and consolidated joint ventures to provide wireless service using the relevant licenses for the foreseeable future, PCS and AWS licenses are routinely renewed for either no or a nominal fee, and management has determined that no legal, regulatory, contractual, competitive, economic or other factors currently exist that limit the useful life of the Company s or its consolidated joint ventures PCS and AWS licenses. On a quarterly basis, the Company evaluates the remaining useful life of its indefinite-lived wireless licenses to determine whether events and circumstances, such as legal, regulatory, contractual, competitive, economic or other factors, continue to support an indefinite useful life. If a wireless license is subsequently determined to have a finite useful life, the Company would first test the wireless license for impairment and the wireless license would then be amortized prospectively over its estimated remaining useful life. In addition, on a quarterly basis, the Company evaluates the triggering event criteria outlined in the authoritative guidance for the impairment or disposal of long-lived assets to determine whether events or changes in circumstances indicate that an impairment condition may exist. In addition to these quarterly evaluations, the Company also tests its wireless licenses for impairment on an annual basis in accordance with the authoritative guidance for goodwill and other intangible assets. As of March 31, 2010 and December 31, 2009, the carrying value of the Company s and its consolidated joint ventures wireless licenses was \$1.9 billion. Wireless licenses to be disposed of by sale are carried at the lower of their carrying value or fair value less costs to sell. As of December 31, 2009, wireless licenses with a carrying value of \$2.4 million were classified as assets held for sale, as more fully described in Note 7. As of March 31, 2010, there were no wireless licenses classified as assets held for sale.

Portions of the AWS spectrum that the Company and Denali Spectrum License Sub, LLC (Denali License Sub) (an indirect wholly owned subsidiary of Denali) were awarded in Auction #66 were subject to use by U.S. federal government and/or incumbent commercial licensees. FCC rules require winning bidders to avoid interfering with these existing users or to clear the incumbent users from the spectrum through specified relocation procedures. In connection with the launch of new markets over the past two years, the Company and Denali worked with several incumbent government and commercial licensees to clear AWS spectrum. The Company s and Denali s spectrum clearing costs have been capitalized to wireless licenses as incurred. During the three months ended March 31, 2010 and 2009, the Company and Denali incurred approximately \$1.1 million and \$2.5 million, respectively, in spectrum clearing costs.

Goodwill and Other Intangible Assets

Goodwill primarily 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. Certain of the Company s other intangible assets were also recorded upon adoption of fresh-start reporting and now consist of trademarks which are being amortized on a straight-line basis over their estimated useful lives of fourteen years. Customer relationships acquired in connection with the Company s acquisition of Hargray Wireless, LLC (Hargray Wireless) in 2008 are amortized on an accelerated basis over a useful life of up to four years.

Impairment of Indefinite-Lived Intangible Assets

The Company assesses potential impairments to its indefinite-lived intangible assets, including wireless licenses and goodwill, on an annual basis or when there is evidence that events or changes in circumstances indicate that an impairment condition may exist. In addition, and as more fully described below, on a quarterly basis, the Company evaluates the triggering event criteria outlined in the authoritative guidance for goodwill and other intangible assets to determine whether events or changes in circumstances indicate that an impairment condition may exist. The annual impairment test is conducted during the third quarter of each year.

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Wireless Licenses

The Company's wireless licenses in its operating markets are combined into a single unit of account for purposes of testing impairment because management believes that utilizing these wireless licenses as a group represents 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. The Company's non-operating licenses are tested for impairment on an individual basis because these licenses are not functioning as part of a group with licenses in the Company's operating markets. As of March 31, 2010, the carrying values of the Company's operating and non-operating wireless licenses were \$1,892.0 million and \$31.1 million, respectively. An impairment loss is recognized on the Company's operating wireless licenses when the aggregate fair value of the wireless licenses is less than their aggregate carrying value and is measured as the amount by which the licenses' aggregate carrying value exceeds their aggregate fair value. An impairment loss is recognized on the Company's non-operating wireless licenses when the fair value of a wireless license is less than its carrying value and is measured as the amount by which the license's carrying value exceeds its fair value. Any required impairment loss is recorded as a reduction in the carrying value of the relevant wireless license and charged to results of operations.

The valuation method the Company uses to determine the fair value of its wireless licenses is the market approach. Under this method, the Company determines fair value by comparing its wireless licenses to sales prices of other wireless licenses of similar size and type that have been recently sold through government auctions and private transactions. As part of this market-level analysis, the fair value of each wireless license is evaluated and adjusted for developments or changes in legal, regulatory and technical matters, and for demographic and economic factors, such as population size, composition, growth ra