

LEAP WIRELESS INTERNATIONAL INC

Form 10-K

April 15, 2003

Table of Contents

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

FOR ANNUAL AND TRANSITION REPORTS

**PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934**

(Mark One)

- ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2002

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)

Securities registered pursuant to Section 12(b) of the Act:

None.

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, \$.0001 par value

(Title of Class)

Preferred Stock Purchase Rights

Edgar Filing: LEAP WIRELESS INTERNATIONAL INC - Form 10-K

(Title of Class)

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 twelve 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). YES NO

The aggregate market value of common stock held by non-affiliates of the registrant as of June 28, 2002 was approximately \$40.6 million.

As of April 10, 2003, the aggregate market value of the registrant's voting stock held by non-affiliates of the registrant was approximately \$6.2 million, based on the closing price of Leap's Common Stock on the OTC Bulletin Board on April 10, 2003, of \$0.17 per share.

As of April 10, 2003, 58,704,192 shares of the registrant's Common Stock, \$.0001 par value per share, were outstanding.

TABLE OF CONTENTS

PART I

Item 1. Business

Item 2. Properties

Item 3. Legal Proceedings

Item 4. Submission of Matters to a Vote of Security Holders

PART II

Item 5. Market for Registrant's Common Equity and Related Stockholder Matters

Securities Authorized For Issuance Under Equity Compensation Plans

Item 6. Selected Financial Data

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Item 8. Financial Statements and Supplementary Data

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

PART III

Item 10. Directors and Executive Officers of the Registrant

Item 11. Executive Compensation

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Item 13. Certain Relationships and Related Transactions

Item 14. Controls and Procedures

PART IV

Item 15. Exhibits, Financial Statement Schedules and Reports on Form 8-K

EXHIBIT 4.6.3

EXHIBIT 10.13

EXHIBIT 10.13.1

EXHIBIT 10.32

EXHIBIT 21.1

EXHIBIT 23.1

Table of Contents

LEAP WIRELESS INTERNATIONAL, INC.

ANNUAL REPORT ON FORM 10-K

For the Year Ended December 31, 2002

TABLE OF CONTENTS

| | Page |
|---|-------------|
| PART I | |
| Item 1. Business | 2 |
| Item 2. Properties | 26 |
| Item 3. Legal Proceedings | 26 |
| Item 4. Submission of Matters to a Vote of Security Holders | 28 |
| PART II | |
| Item 5. Market for Registrant's Common Equity and Related Stockholder Matters | 29 |
| Item 6. Selected Financial Data | 31 |
| Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations | 33 |
| Item 7A. Quantitative and Qualitative Disclosures About Market Risk | 54 |
| Item 8. Financial Statements and Supplementary Data | 55 |
| Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure | 104 |
| PART III | |
| Item 10. Directors and Executive Officers of the Registrant | 104 |
| Item 11. Executive Compensation | 107 |
| Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters | 114 |
| Item 13. Certain Relationships and Related Transactions | 115 |
| Item 14. Controls and Procedures | 117 |
| PART IV | |
| Item 15. Exhibits, Financial Statement Schedules and Reports on Form 8-K | 119 |

Table of Contents

PART I

As used in this report, the terms we, our, ours and us refer to Leap Wireless, Inc. and its subsidiaries, unless the context suggests otherwise. Leap refers to Leap Wireless International, Inc. Cricket refers to Cricket Communications, Inc. Cricket and the subsidiaries of Cricket and Leap that hold assets that are used in the Cricket business or that hold assets pledged as security under Cricket's senior secured vendor credit facilities are collectively referred to herein as the Cricket companies. Unless otherwise specified, information relating to population and potential customers, or POPs, is based on 2002 population estimates provided by Claritas Inc.

Forward-Looking Statements; Cautionary Statement

Except for the historical information contained herein, this document contains forward-looking statements reflecting management's current forecast of certain aspects of Leap's future. These forward-looking statements are subject to a number of risks, uncertainties and assumptions about Leap, including, among other things:

our ability to cause a Chapter 11 plan of reorganization to be finalized and to be confirmed by the Bankruptcy Court, and our ability to successfully implement the plan;

our ability to continue as a going concern;

our ability to obtain Bankruptcy Court approval with respect to motions prosecuted by us in our Chapter 11 cases from time to time;

risks associated with third parties seeking and obtaining Bankruptcy Court approval to terminate or shorten the exclusivity period for Leap, Cricket and substantially all of their subsidiaries to propose and confirm one or more plans of reorganization, for the appointment of a Chapter 11 trustee or to convert the Chapter 11 cases of Leap, Cricket and substantially all of their subsidiaries to Chapter 7 cases;

our ability to obtain and maintain normal terms with vendors and service providers;

our ability to maintain contracts that are critical to our operations;

the potential adverse impacts of the Chapter 11 cases on the liquidity or results of operations of Leap and Cricket;

our ability to attract, motivate and/or retain key executives and other employees;

our ability to attract and retain customers;

the unsettled nature of the wireless market, the current economic slowdown, service offerings of increasingly large bundles of minutes of use at increasingly low prices by some major carriers, other issues facing the telecommunications industry in general, and our announcement of restructuring discussions, and our subsequent Chapter 11 filing, which have created a level of uncertainty that adversely affects our ability to predict future customer growth, as well as other key operating metrics;

changes in economic conditions that could adversely affect the market for wireless services;

the acceptance of our product offering by our prospective customers;

the effects of actions beyond our control in our distribution network;

rulings by courts or the Federal Communications Commission (FCC) adversely affecting our rights to own and/or operate certain wireless licenses, or changes in our ownership that could adversely affect our status as an entrepreneur under FCC rules and regulations;

our ability to maintain our cost, market penetration and pricing structure in the face of competition;

Edgar Filing: LEAP WIRELESS INTERNATIONAL INC - Form 10-K

failure of network systems to perform according to expectations;

the effects of competition;

1

Table of Contents

global political unrest, including the threat or occurrence of war or acts of terrorism; and

other factors detailed in the section entitled *Risk Factors* included in this report.

You can identify these forward-looking statements by forward-looking words such as *believe, may, could, will, estimate, continue, anticipate, intend, seek, plan, expect, should, would* and similar expressions in this report.

We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. In light of these risks and uncertainties, the forward-looking events and circumstances discussed in this report may not occur and actual results could differ materially from those anticipated or implied in the forward-looking statements.

Item 1. *Business*

Company Overview

Leap conducts operations through its subsidiaries. Leap has no independent operations or sources of operating revenue other than through dividends, if any, from its operating subsidiaries. Cricket Communications, Inc. is Leap's subsidiary that operates the Cricket business, together with subsidiaries of Cricket and Leap that hold assets that are used in the Cricket business or that hold assets pledged as security under Cricket's senior secured vendor credit facilities. The Cricket companies operate together as a wireless communications carrier that provides innovative, affordable, simple wireless services designed to accelerate the transformation of wireless service into a mass consumer product.

Proceedings Under Chapter 11 of the Bankruptcy Code

On April 13, 2003 (the *Petition Date*), Leap, Cricket Communications, Inc. 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 (jointly administered as Case Nos. 03-03470-LA to 03-03535-LA). Each of the debtors continues to manage its properties and operate its business as a *debtor-in-possession* under the jurisdiction of the Bankruptcy Court and in accordance with Sections 1107(a) and 1108 of Chapter 11.

Plan of Reorganization Procedures

As provided by Chapter 11, for 120 days after the *Petition Date* the debtors have the exclusive right to propose and file a plan of reorganization with the Bankruptcy Court and an additional 60 days within which to solicit acceptance by creditors and equity security holders of any such plan. The Bankruptcy Court may shorten or extend the period of exclusivity for cause shown and, as long as the period of exclusivity continues, no other party may file a plan of reorganization. In addition, the debtors may request an extension of the exclusivity period. However, there can be no assurance that the Bankruptcy Court will grant such an extension. If the debtors fail to obtain confirmation of their proposed plan of reorganization and the Bankruptcy Court terminates the exclusivity period, any party in interest, including a creditor, an equity security holder or a committee of creditors, following the expiration of the exclusivity period, may file a plan of reorganization for the debtors. Even if the debtors file a plan of reorganization within the period of exclusivity, there can be no assurance that the proposed plan of reorganization will be confirmed by the Bankruptcy Court, or that such plan will be consummated. Conversely, the Bankruptcy Court may confirm a plan even though it was not accepted by one or more impaired classes of creditors, if certain requirements of Chapter 11 are met.

Under Chapter 11, the debtor files a disclosure statement with the Bankruptcy Court at the time it files a plan of reorganization. The disclosure statement summarizes the terms of the debtor's plan of reorganization and contains information concerning, among other matters, the debtor's history, business, results of operations, management, properties and liabilities and the assets available for distribution under its plan, as well as the anticipated organization and operation of the reorganized company. The disclosure statement also describes certain effects of plan confirmation, certain risk factors associated with the plan, the manner in which distributions will be made to the debtor's creditors under the plan for all amounts that were owed to such

Table of Contents

parties on the petition date, and the confirmation process and voting procedures that holders of claims in impaired classes must follow for their votes to be counted.

On April 14, 2003, we filed a preliminary draft of a plan of reorganization and disclosure statement (the Draft Plan) with the Bankruptcy Court. The Draft Plan and disclosure statement reflect the general parameters of terms that are under negotiation between Leap and Cricket, an informal committee of Leap noteholders, and an informal committee of Cricket senior secured vendor debtholders. We filed the Draft Plan and disclosure statement at the request of the informal committee of Leap s noteholders.

We continue to negotiate with our creditors and with potential investors to reach agreement on a plan of reorganization, and hope to finalize negotiations on the plan and disclosure statement with the informal creditors committees in the next few weeks. However, there can be no assurance that such an agreement will be reached. The terms of any plan of reorganization agreed to could differ materially from the Draft Plan.

Under any plan of reorganization in the Chapter 11 proceedings, management of Leap expects that there will be very limited or no value flowing to Leap as a result of its ownership interests in Cricket and its related companies, and that there will be little or no value available for distribution to the common stockholders of Leap.

Under the general parameters set forth in the Draft Plan, Cricket s senior vendor debtholders would receive, on a pro rata basis, (1) \$300-500 million of senior secured notes issued by reorganized Cricket, and (2) newly-issued shares of reorganized Leap common stock constituting 93-97% of the issued and outstanding equity of reorganized Leap. Holders of general unsecured claims against Leap (including the unsecured claims of holders of Leap s senior notes and senior discount notes) would receive, on a pro rata basis, (1) the unsecured cash, cash equivalents and short-term investments at the Leap level (which aggregated approximately \$82.4 million as of February 28, 2003) and interest thereon, (2) newly issued shares of reorganized Leap common stock constituting 3-5% of the issued and outstanding equity of reorganized Leap, and (3) other assets not used in the Cricket business to be transferred to a creditor trust and liquidated. Holders of secured claims with respect to Leap s senior notes also would receive, on a pro rata basis, approximately \$14 million in cash previously pledged to secure payments of interest to the senior noteholders. Holders of outstanding shares of Leap common stock could potentially receive, on a pro rata basis, newly issued shares of reorganized Leap common stock constituting 0-2% of the issued and outstanding equity of reorganized Leap. The terms of any plan of reorganization agreed to could differ materially from the Draft Plan.

The Draft Plan contains other customary terms and conditions, and would require FCC approval to become effective.

The foregoing summary does not purport to be complete and is qualified in its entirety by reference to the Petitions and the motions, pleadings and papers on file with the Bankruptcy Court.

First Day Motions and Other Chapter 11 Matters

At hearings held on April 14, 2003, the Bankruptcy Court granted the debtors first day motions for various relief designed to continue their operations and business relationships with customers, vendors, employees and others and entered orders authorizing the debtors to pay pre-petition and post-petition employee wages, salaries, benefits and certain other employee obligations during the pendency of the Chapter 11 proceedings. In addition, the Bankruptcy Court granted Cricket s first day motion for an interim order authorizing the use of its cash collateral pursuant to a budget approved by the informal committee of Cricket s senior secured vendor creditors and its financial advisor. A hearing to consider approval of the order on a final basis has been scheduled for May 7, 2003.

Although the debtors are authorized to operate their business and manage their properties as debtors-in-possession, they may not engage in transactions outside the ordinary course of business without complying with the notice and hearing provisions of Chapter 11 and obtaining prior Bankruptcy Court approval. An official committee of Leap s unsecured creditors will likely be formed by the United States Trustee. The unsecured creditors committee and various other parties in interest, including creditors holding pre-petition

Table of Contents

claims, such as Leap's bondholders and Cricket's senior secured vendor creditors, have the right to appear and be heard on all matters that come before the Bankruptcy Court.

Shortly after the Petition Date, the debtors began notifying all known or potential creditors of the Chapter 11 filing. The Chapter 11 filing triggered defaults on substantially all debt and lease obligations of the debtors. Under Section 362 of Chapter 11, most pending pre-petition claims and litigation against the debtors are stayed automatically, and absent further order of the Bankruptcy Court, no party may take any action to recover such pre-petition claims, enforce any pre-petition lien against or obtain possession of any property from the debtors. In addition, pursuant to Section 365 of Chapter 11, the debtors may reject or assume pre-petition executory contracts and unexpired nonresidential real property leases, and parties affected by rejections of these contracts or leases may file claims with the Bankruptcy Court in accordance with Chapter 11. Unless otherwise agreed, the assumption of an executory contract or lease generally will require the debtors to cure all prior defaults under the related executory contract or lease, including all pre-petition liabilities. In this regard, we expect that liabilities subject to the proceedings will arise in the future as a result of the rejection of additional executory contracts and leases, and from the determination of the Bankruptcy Court (or agreement by parties in interest) of allowed claims for contingencies and other disputed amounts. Due to the uncertain nature of many of the potential claims, we are unable to project the magnitude of such claims with any degree of certainty.

Under Chapter 11, the rights and treatment of pre-petition creditors and equity security holders may be substantially altered. At this time, it is not possible to predict the outcome of either the Chapter 11 proceedings or the effect such proceedings will have on the debtors' creditors and common stockholders. Under the priority scheme established by Chapter 11, certain post-petition liabilities and pre-petition liabilities need to be satisfied before stockholders are entitled to receive any distribution. The ultimate recovery to the debtors' creditors and common stockholders, if any, will not be determined until confirmation of a plan of reorganization. Under any plan of reorganization in the Chapter 11 proceedings, management of Leap expects that there will be very limited or no value flowing to Leap as a result of its ownership interests in the Cricket companies, that unsecured claims against Leap will be satisfied at a fraction of their face value, and that there will be little or no value available for distribution to the common stockholders of Leap. Because of this possibility, any investment in Leap or Cricket is highly speculative. Accordingly, we urge that appropriate caution be exercised with respect to existing and future investments in any equity or debt securities of Leap or Cricket.

We currently expect that the Chapter 11 proceedings will not affect our ability to provide uninterrupted service to our customers. We expect that we will experience some loss of customers and some failure to attract new customers as a result of the Chapter 11 filing in the near term, but do not expect this impact to be significant beyond the near term. The rights of our creditors and equity security holders will be determined through the Chapter 11 proceedings. However, we cannot provide any assurances on the effect of the Chapter 11 proceedings on our business, creditors or security holders. Our future results are dependent upon our finalizing, filing, confirming and implementing, on a timely basis, a plan of reorganization with the Bankruptcy Court.

We have incurred, and will continue to incur, significant costs associated with the Chapter 11 proceedings. We believe that our existing cash assets and cash from operations should provide us with adequate liquidity to conduct our business during the pendency of the Chapter 11 proceedings. However, we can provide no assurances in this regard. See Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources.

Cricket Business Overview

The Cricket companies offer wireless service in the U.S. under the brand Cricket®, which is marketed as Comfortable Wireless®. Our innovative Cricket strategy is designed to extend the benefits of mobility to the mass market by offering wireless service that is as simple to use and understand as, and is a competitive mobile alternative to, traditional landline service. In each Cricket market, the Cricket companies are deploying 100% digital, CDMA networks that we believe provide higher capacity and more efficient

Table of Contents

deployment of capital than competing technologies. CDMA technology, combined with our efforts to streamline operations and distribution, allows the Cricket companies to be a low-cost provider of wireless services in each Cricket market.

Cricket service allows customers to make virtually unlimited calls within a local calling area and receive virtually unlimited calls from any area for a flat monthly rate. Cricket customers can also make long distance calls on a per-minute basis or as part of a packaged offering. The simplicity of the Cricket service allows Cricket to sustain lower operating costs per customer compared to traditional wireless providers. Cricket's networks are designed and built to provide coverage in the local calling area where our target customers live, work and play. As a result, we believe that Cricket's per minute network operating costs are lower than, or comparable to, the lowest costs incurred by traditional wireless providers.

We continue to focus on enhancing our Cricket service with new products and services designed to meet the needs of our growing customer base. We offer competitively priced long distance offers for calls to all parts of the United States, Canada and Mexico. We have Spanish language marketing and advertising campaigns, Spanish directory assistance and Spanish language billing as part of our ongoing focus on the growing Hispanic market. We offer unlimited inter-carrier text messaging in all of our markets. We also offer a service called Cricket TalkSM that bundles certain features, 500 minutes of available long distance and virtually unlimited local service for a fixed monthly fee to more effectively compete with other telecommunications providers. Since its launch, Cricket Talk has represented a significant portion of our gross customer additions.

Under a license from Leap, Chase Telecommunications, a company that we acquired in March 2000, introduced the Cricket service in Chattanooga, Tennessee in March 1999. As of December 31, 2002, Cricket offered service in 40 markets covering a total population of approximately 25.5 million potential customers. These markets are located in 48 basic trading areas, or BTAs, and make up all of the markets that we refer to as our 40 Market Plan. As of December 31, 2002, Cricket had:

approximately 1,512,000 customers in its markets across the U.S.; and

acquired wireless licenses covering approximately 53.1 million potential customers in 33 states.

Arbitration Award

In August 2002, Leap issued 21,020,431 shares of its common stock to MCG PCS, Inc. pursuant to a binding arbitration award. The issuance of these shares constituted an event of default under Cricket's senior secured vendor credit facilities. After issuance of these shares, the lenders under Cricket's senior secured vendor credit facilities ceased funding new loan requests, including requests to fund interest payments that previously had been financed through draws under the credit facilities.

Nasdaq Delisting

On December 11, 2002, our common stock was delisted from the Nasdaq National Market and began trading on the OTC Bulletin Board. Our common stock was delisted because:

we did not comply with Nasdaq's shareholder approval requirements before issuing shares to MCG;

we did not comply with the net tangible assets or stockholders' equity requirement for continued listing; and

we did not meet the minimum bid price requirement for continued listing as a result of our common stock having traded below \$1.00 per share for 30 consecutive trading days.

Sale of Pegaso

In September 2002, Leap completed the sale of its 20.1% interest in Pegaso Telecomunicaciones, S.A. de C.V., a company providing wireless service in Mexico, to Telefónica Móviles, S.A. At the closing, Leap received cash proceeds of approximately \$22.2 million for the sale of its shares. In October 2002, Leap received approximately \$15.8 million of additional cash from a loan repayment related to the sale.

Table of Contents

Cricket Business Strategy

We believe that the Cricket service offering will help transform wireless phone service from a luxury product into a mass consumer product. The Cricket strategy is to provide digital wireless service to the mass market with a simple, easy to understand approach. As a part of the Cricket strategy, we intend to:

Enhance the Mass Market Appeal of Wireless Service. We are working to remove the price and complexity barriers that we believe have prevented many potential customers from using wireless service. We believe that large segments of the population do not use wireless service because they view wireless service as an expensive luxury item, believe they cannot control the cost of service, or find existing service plans too confusing. Our service plans are designed to attract new customers by offering simple, predictable affordable wireless services that are a competitive mobile alternative to landline service.

Offer an Appealing Value Proposition. We strive to provide service offerings that combine high quality and advanced features with simplicity and attractive pricing to create a high value/reasonable price proposition and broaden the market for wireless services. We offer Cricket service plans at flat rates, as a mobile alternative to traditional landline service.

Control and Minimize Costs. To become one of the lowest-cost providers in the wireless industry, we minimize our capital costs by engineering high-quality, efficient networks to cover only the urban and suburban areas of our markets where most of our potential customers live, work and play, while avoiding rural areas and corridors between distant markets. This strategy also allows us to acquire only those wireless licenses that we deem to be appropriately priced and to avoid acquiring wireless licenses that may be overpriced or cost ineffective in a local calling area simply to provide expansive geographic coverage and roaming capability. We minimize operating costs per customer through reduced network operation costs, streamlined billing procedures, the control of customer care expenses and lower customer investigation costs. We also are focused on streamlining marketing, distribution and customer support operations. We strive to maintain lower customer acquisition costs by offering simple service plans with a limited choice of handsets, and by distributing our product through company stores, cost effective third-party retail stores where the mass market shops and our website while maintaining appropriate levels of advertising.

Leverage CDMA Technology. We have deployed state-of-the-art CDMA networks that are designed to provide higher capacity at a lower capital cost that can be easily upgraded to support enhanced capacity. We believe this enables us to operate superior networks that support planned customer growth and high usage. In addition, we believe our CDMA networks provide a better platform to expand into other wireless information services based on advances in second and third generation digital technology in the future.

Cricket Business Operations

General. Our business strategy is different from existing models used by typical cellular or PCS wireless providers. Most of these providers offer consumers a complex array of rate plans that include additional charges for minutes above a set maximum, as well as fees for roaming, that may result in monthly service charges that are higher than expected. Approximately 50% of the U.S. population currently does not subscribe to wireless service, and we believe that many of these potential customers perceive wireless service as too expensive and complicated. The Cricket service is based on our vision that the mass market wants wireless service to be predictable, affordable and as simple to understand and use as traditional landline telephone service, but with the benefits of mobility.

We have designed the Cricket service to appeal to consumers who make the majority of their calls from within the local areas in which they live, work and play. The Cricket service allows customers to make and receive virtually unlimited calls within a local calling area for a flat monthly rate, as shown on a simple, straightforward bill, that is a competitive mobile alternative to traditional landline service. Through September 2002, Cricket customers paid in advance each month's service. Commencing in October 2002, we no longer

Table of Contents

include a first month of service with the handset purchase and new Cricket customers pay for their service in arrears. Because we recognize revenues for customers who pay in arrears only when received, we do not record a reserve for bad debt for service revenues. Commencing in September 2002, we also began charging customers for service plan changes, and commencing in November 2002, we began charging activation fees and began requiring new customers on our Cricket Talk plan to maintain active service for 12 months or be subject to an early termination fee. In addition to local calling, directory assistance calls and long distance minutes can be purchased in advance and direct dialed without the use of a special code or card, or can be purchased as part of a packaged offering. We also generate equipment revenues from the sale of handsets and accessories through our retail sales locations, third-party dealers and distributors and our website.

We continue to focus on enhancing our Cricket service with new products and services designed to meet the needs of our growing customer base. We have expanded our competitively priced long distance offers which now include Canadian and Mexican long distance. We have also introduced Spanish language marketing and advertising campaigns, Spanish directory assistance and Spanish language billing as part of our ongoing focus on the growing Hispanic market. In June and July 2002, we launched unlimited inter-carrier text messaging in all 40 of our markets. In August 2002, we launched a new service named Cricket Talk that bundles caller ID, call waiting, three-way calling, 500 minutes of available long distance and virtually unlimited local service for a fixed monthly fee to more effectively compete with other telecommunications providers. Since its launch, Cricket Talk has represented a significant portion of our gross customer additions.

Market Opportunity. Wireless penetration was approximately 50% in the U.S. at the end of December 2002. Traditional wireless companies have generally focused their U.S. marketing on highly mobile customers, including business users, who are likely to generate the highest revenues. Their customers are typically offered multiple service plans with prices based on the customer's minutes of use during the billing period. Leap believes that the numerous plans offered by wireless companies have tended to confuse many potential customers. Market research indicates that many people are interested in a wireless product but are concerned about the cost, complexity and unpredictability of traditional wireless pricing plans.

Sales and Distribution. We differentiate the Cricket service concept and seek to increase our market share through promoting a simplified buying process and focusing marketing efforts on potential customers in the communities covered by our local wireless networks. The Cricket approach is to penetrate our target markets while minimizing our sales and marketing expenses, primarily by keeping the customer's purchase decision simple, thus minimizing the need for sales commissions and associated residuals.

The Cricket service and wireless handsets are sold through three main channels:

Cricket retail stores in high-traffic locations and Cricket kiosks;

the local stores of national retail chains; and

independent third-party dealers who are well positioned through their principal lines of business to reach our target potential customers.

The Cricket service plan is designed so that a potential customer can make a purchase decision with little or no sales assistance. Customers can read about the Cricket service at the point of sale and learn virtually all they need to know about the service without consulting a complicated plan summary or a specialized sales person. We simplify the customer's decision process by limiting the number of Cricket handset models available. We believe the sales costs for the Cricket service are lower than traditional wireless providers because of this streamlined sales approach.

We combine mass marketing strategies and tactics to build awareness of the Cricket service concept and brand name within the communities we serve. Because the Cricket service is offered in distinct island markets, we advertise in local publications, on local radio stations and in local television commercials. In addition to local advertising efforts, we maintain an informational Web site for the Cricket service. Some third-party Internet retailers sell the Cricket service over the Internet, and we are developing our own direct Internet sales strategy.

Table of Contents

Network and Operations. The Cricket service is based on providing customers with levels of usage equivalent to landline and at prices substantially lower than most of our wireless competitors for similar usage. We believe our success depends on operating our networks to provide high, concentrated capacity with good in-building coverage rather than the broad, geographically dispersed coverage provided by traditional wireless carriers. Our Cricket networks are in local population centers of self-contained communities where we believe roaming is not an important component of service for our target customers. Unlike traditional wireless providers who build networks covering wide areas to permit roaming by their customers, we believe that we can deploy our capital more efficiently by tailoring our networks only to our target population centers and omitting underutilized roaming sites between those population centers.

The appeal of our service in any given market is not dependent on the Cricket service having ubiquitous coverage in the rest of the country or region surrounding the market. Because our business model is scalable, we can launch our networks on a market-by-market basis.

Cricket Communications, Inc. has infrastructure equipment purchase agreements with Lucent Technologies Inc., Nortel Networks Inc. and Ericsson Wireless Communications Inc. for the purchase of equipment and services necessary to maintain and increase the capacity of our Cricket networks for the 40 Market Plan. However, because Cricket has not paid certain amounts it owes to Lucent, Nortel and Ericsson under its respective equipment purchase agreements with these suppliers, Cricket's purchase agreements with Lucent and Nortel now require that Cricket pay for purchases in advance, and Ericsson has indicated to Cricket that it requires similar payment terms. Further, as a result of events of default and terminations of commitments, Cricket is no longer able to borrow under its senior secured vendor credit agreements to pay for purchases of equipment and services, and Cricket may not have cash available for purchases from these vendors that are necessary to improve the coverage and capacity of its existing networks. See Risk Factors If We Are Unable to Find Suppliers Willing to Supply or Finance New Equipment and Services, We May Be Unable to Maintain or Expand Our Telecommunications Networks. During the pendency of the Chapter 11 proceedings, we intend to seek a negotiated agreement with these suppliers that settles amounts currently due and allows Cricket to purchase equipment and services on appropriate terms for the restructured company. We cannot guarantee that we will be able to obtain such agreements.

In connection with Cricket's purchase of equipment and services from Lucent, Nortel and Ericsson, these vendors previously agreed to provide financing for the equipment and services they provide and for certain other related expenses. At December 31, 2002, Cricket had \$1,541.3 million, net of discount, of debt under its senior secured vendor credit agreements, and \$55.1 million payable to Lucent, Nortel and Ericsson for the purchase of equipment and services. Borrowings under the senior secured vendor credit agreements at December 31, 2002 had a weighted-average interest rate of 9.9% per annum. Cricket is currently in default under the senior secured vendor credit agreements. These agreements are described in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources Credit Facilities and Other Financing Arrangements.

Wireless Licenses. The following table shows the wireless licenses that we owned as of December 31, 2002, which cover approximately 53.1 million potential customers. Each wireless license listed is pledged to secure Cricket's senior secured vendor credit facilities, unless otherwise noted.

| Market | Population(1) | MHz |
|----------------------|---------------|-----|
| Anchorage, AK(4) | 467,422 | 30 |
| Birmingham, AL(4) | 1,338,096 | 15 |
| Tuscaloosa, AL(4) | 258,085 | 15 |
| Blytheville, AR | 71,440 | 15 |
| Fayetteville, AR(2) | 340,740 | 30 |
| Fort Smith, AR(2) | 333,623 | 30 |
| Hot Springs, AR(2) | 142,209 | 15 |
| Jonesboro, AR(2) | 184,285 | 10 |
| Little Rock, AR(2) | 979,869 | 20 |
| Pine Buff, AR(2) | 155,312 | 20 |
| Russellville, AR(4) | 100,881 | 15 |
| Nogales, AZ(4) | 39,695 | 20 |
| Phoenix, AZ(2) | 3,622,225 | 10 |
| Tucson, AZ(2) | 870,435 | 15 |
| Merced, CA(2) | 232,925 | 15 |
| Modesto, CA(2) | 513,881 | 15 |
| Redding, CA(3)(4)(6) | 280,109 | 15 |
| Visalia, CA(2) | 509,867 | 15 |

Edgar Filing: LEAP WIRELESS INTERNATIONAL INC - Form 10-K

| | | |
|------------------------|-----------|----|
| Denver/ Boulder, CO(2) | 2,808,808 | 10 |
| Ft. Collins, CO(2) | 261,360 | 10 |
| Greeley, CO(2) | 188,382 | 10 |
| Pueblo, CO(2)(3)(6) | 319,522 | 30 |
| Lakeland, FL(3) | 495,740 | 10 |
| Albany, GA(4) | 360,228 | 15 |
| Columbus, GA(2) | 367,939 | 30 |
| Macon, GA(2) | 674,123 | 30 |

Table of Contents

| Market | Population(1) | MHz |
|---|---------------|-----|
| Boise, ID(2) | 609,200 | 30 |
| Idaho Falls, ID(3)(4) | 277,941 | 15 |
| Twin Falls, ID(3)(4) | 166,241 | 15 |
| Lewiston, ID(3)(4)(6) | 125,512 | 30 |
| Peoria, IL(4) | 462,956 | 15 |
| Evansville, IN | 525,972 | 10 |
| Ft. Wayne, IN(4) | 725,696 | 10 |
| Coffeyville, KS(4) | 61,192 | 15 |
| Wichita, KS(2)(5)(6) | 664,523 | 30 |
| Owensboro, KY(4) | 165,683 | 10 |
| Adrian, MI | 99,900 | 25 |
| Battle Creek, MI(2) | 242,434 | 25 |
| Escanaba, MI(3)(6) | 47,595 | 10 |
| Flint, MI(2) | 508,715 | 10 |
| Grand Rapids, MI | 1,104,294 | 25 |
| Jackson, MI(2) | 207,485 | 25 |
| Kalamazoo, MI(2) | 382,152 | 10 |
| Lansing, MI | 512,321 | 10 |
| Mount Pleasant, MI | 139,616 | 10 |
| Muskegon, MI | 227,988 | 15 |
| Saginaw-Bay City, MI | 642,409 | 10 |
| Traverse City, MI | 252,833 | 10 |
| Bemidji, MN(3)(6) | 67,792 | 10 |
| Brainerd, MN(3)(6) | 100,428 | 10 |
| Duluth, MN | 415,862 | 10 |
| Jackson, MS | 687,415 | 10 |
| Vicksburg, MS | 61,792 | 10 |
| Bozeman, MT(3)(4)(6) | 86,277 | 20 |
| Charlotte/ Gastonia, NC(2) | 2,139,136 | 10 |
| Greensboro/ Winston-Salem/ High Point, NC(2) | 1,485,806 | 10 |
| Hickory, NC(2) | 349,288 | 10 |
| Fargo, ND(4) | 319,099 | 15 |
| Grand Forks, ND(4) | 202,277 | 15 |
| Lincoln, NE(2) | 352,539 | 15 |
| Omaha, NE(2) | 1,004,837 | 10 |
| Albuquerque, NM(2) | 853,280 | 15 |
| Gallup, NM(4) | 147,508 | 15 |
| Roswell, NM(4) | 82,349 | 15 |
| Santa Fe, NM(2) | 225,450 | 15 |
| Reno, NV(2) | 612,437 | 10 |
| Buffalo, NY(2) | 1,210,156 | 10 |
| Plattsburgh, NY(7) | 119,353 | 10 |
| Syracuse, NY(2) | 779,144 | 15 |
| Utica, NY | 299,377 | 10 |
| Watertown, NY(7) | 302,692 | 15 |
| Dayton/ Springfield, OH(2) | 1,221,241 | 10 |
| Marion, OH | 98,612 | 10 |
| Sandusky, OH(2) | 139,506 | 15 |
| Steubenville, OH | 130,317 | 10 |
| Toledo, OH(2) | 790,134 | 15 |
| Tulsa, OK(2) | 966,936 | 15 |
| Eugene, OR(2) | 328,965 | 10 |
| Salem/ Corvallis, OR(2)(3)(6) | 541,410 | 20 |
| Johnstown, PA | 230,890 | 10 |
| Pittsburgh/ Butler/ Uniontown/ Washington/ Latrobe, PA(2) | 2,464,811 | 10 |
| Chattanooga, TN(2) | 576,867 | 15 |

Edgar Filing: LEAP WIRELESS INTERNATIONAL INC - Form 10-K

| | | |
|---|-----------|----|
| Clarksville, TN(2) | 272,253 | 15 |
| Knoxville, TN(2) | 1,144,419 | 15 |
| Memphis, TN(2) | 1,579,375 | 15 |
| Nashville/ Murfreesboro, TN(2) | 1,811,753 | 15 |
| Eagle Pass, TX(4) | 119,697 | 15 |
| Lufkin, TX | 164,791 | 10 |
| Provo, UT(2) | 392,981 | 15 |
| Salt Lake City/ Ogden, UT(2) | 1,677,325 | 15 |
| Kennewick/ Pasco/ Richland, WA(4)(5)(6) | 198,099 | 15 |
| Spokane, WA(2) | 760,885 | 15 |
| Yakima, WA(4)(5)(6) | 262,053 | 15 |
| Appleton-Oshkosh, WI | 460,186 | 10 |
| Eau Claire, WI | 197,655 | 10 |
| La Crosse, WI-Winona, MN | 324,039 | 10 |
| Stevens Point-Marshfield-Wisconsin Rapids, WI | 216,597 | 20 |
| Casper, WY(3)(4)(6) | 147,826 | 30 |
| | <hr/> | |
| Total | | |