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MEASUREMENT SPECIALTIES INC

Form 10-K

May 27, 2004

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

FORM 10-K

(Mark One)

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

FOR THE FISCAL YEAR ENDED MARCH 31, 2004  
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 1-11906

MEASUREMENT SPECIALTIES, INC.

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

NEW JERSEY  
(STATE OR OTHER JURISDICTION OF  
INCORPORATION OR ORGANIZATION)

22-2378738  
(I.R.S. EMPLOYER  
IDENTIFICATION NO.)

710 ROUTE 46 EAST, SUITE 206,  
FAIRFIELD, NEW JERSEY  
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)

07004  
(ZIP CODE)

REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE (973) 808-3020

SECURITIES REGISTERED UNDER SECTION 12(b) OF THE ACT:

TITLE OF EACH CLASS COMMON STOCK, NO PAR VALUE	NAME OF EACH EXCHANGE ON WHICH REGISTERED AMERICAN STOCK EXCHANGE
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SECURITIES REGISTERED UNDER SECTION 12(g) OF THE ACT: NONE

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 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

At September 30, 2003, the aggregate market value of the voting and

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non-voting common equity held by non-affiliates was approximately \$166.9 million based on the closing price of the registrant's common stock on September 30, 2003.

At May 13, 2004, 13,265,724 shares of the registrant's common stock were outstanding.

## DOCUMENTS INCORPORATED BY REFERENCE

THE INFORMATION REQUIRED TO BE FURNISHED PURSUANT TO PART III OF THIS FORM 10-K IS SET FORTH IN, AND IS HEREBY INCORPORATED BY REFERENCE HEREIN FROM, THE REGISTRANT'S DEFINITIVE PROXY STATEMENT FOR THE ANNUAL MEETING OF SHAREHOLDERS TO BE HELD ON AUGUST 31, 2004 TO BE FILED BY THE REGISTRANT WITH THE SECURITIES AND EXCHANGE COMMISSION PURSUANT TO REGULATION 14A NOT

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LATER THAN 120 DAYS AFTER THE FISCAL YEAR ENDED MARCH 31, 2004.

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PART I

ITEM 1. BUSINESS

INTRODUCTION

NOTES:

- (1) AS MORE FULLY DESCRIBED BELOW UNDER "CHANGES TO OUR BUSINESS," WE DISCONTINUED CERTAIN OF OUR BUSINESSES DURING THE FISCAL YEAR ENDED MARCH 31, 2003, AND SOLD ASSETS DURING THE FISCAL YEARS ENDED MARCH 31, 2003 AND 2004. EXCEPT AS OTHERWISE NOTED, THE DESCRIPTIONS OF OUR BUSINESS, RESULTS AND OPERATIONS CONTAINED IN THIS REPORT REFLECT ONLY OUR CONTINUING OPERATIONS.
- (2) AS MORE FULLY DESCRIBED IN OUR ANNUAL REPORT ON FORM 10-K FOR THE FISCAL YEAR ENDED MARCH 31, 2002, OUR FINANCIAL STATEMENTS FOR THE FISCAL YEAR ENDED MARCH 31, 2001 AND FOR THE FIRST THREE QUARTERS OF THE FISCAL YEAR ENDED MARCH 31, 2002 WERE RESTATED. ALL AMOUNTS INCLUDED IN THIS ANNUAL REPORT ON FORM 10-K REFLECT THIS RESTATEMENT.
- (3) ALL DOLLAR AMOUNTS IN THIS REPORT ARE IN THOUSANDS, EXCEPT PER SHARE AMOUNTS AND PRODUCT PRICES.

We are a designer and manufacturer of sensors and sensor-based consumer products. We produce a wide variety of sensors that use advanced technologies to measure precise ranges of physical characteristics, including pressure, motion, force, displacement, tilt / angle, flow, and distance. We have two businesses, a Sensor business and a Consumer Products business. We are a New Jersey corporation organized in 1981.

Our Sensor segment designs and manufacturers sensors for original equipment manufacturers (OEMs). These sensors are used for automotive, medical, consumer, military/aerospace and industrial applications. Our sensor products include piezoresistive pressure sensors, transducers and transmitters, electromagnetic displacement sensors, piezoelectric polymer film sensors, tilt sensors, membrane switch panel sensors, custom microstructures, load cells and accelerometers.

Our Consumer Products segment designs and manufactures sensor-based consumer products. Our sensor-based consumer bath and kitchen scale products are sold and marketed primarily under the brand names of our original equipment manufacturer customers. Our tire pressure gauges and distance measurement products are sold and marketed under our own brand names, as well as those of our OEM and private label customers.

Each of our businesses benefits from the same core technology base. Our advanced technologies include piezoresistive silicon sensors, application-specific integrated circuits, micro-electromechanical systems (MEMS), piezoelectric polymers, foil strain gauges, force balance systems, fluid capacitive devices, linear and rotational variable differential transformers, electromagnetic displacement sensors and ultrasonics. These technologies allow our sensors to operate precisely and cost effectively. We have a global operation with facilities located in North America, Europe and Asia. By functioning globally, we have been able to enhance our applications engineering capabilities and increase our geographic proximity to our customers.

We are focusing our development efforts in both our Sensor business and Consumer Products business on the OEM market. In particular, we are focused on

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aggressively growing our Sensor segment, which management believes has greater growth potential. We expect that growth of our Sensor business will come through a combination of organic growth and acquisitions.

In the Consumer Products segment, having both a branded and OEM consumer scale business has created channel conflicts. As part of our effort to focus on the OEM market, we sold certain assets associated with our Thinner branded bathroom and kitchen scale business to Conair Corporation on January 30, 2004. We previously sold our Thinner branded scales directly to retailers, predominately in the U.S. and Canada. On a going-forward basis, we expect to supply these scales directly to Conair and intend to continue our efforts in the design, development and manufacture of innovative scale products for sale to our worldwide base of OEM customers. Although our development focus is on the OEM market, we intend to continue to develop and manufacture our tire pressure gauges and distance measurement products for sale to both retail customers and OEM customers.

Key to executing our strategy is to utilize our expertise in sensor technologies to target expanding market segments and to develop new products and applications, thereby increasing demand for our sensors and sensor-based consumer products. Our global design teams support our production facilities and engineering resources in the United States and in China. By combining our manufacturing expertise with our core technology, we strive to provide our global customers with an advantageous price-value relationship.

### OUR SENSORS

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The majority of our sensors are devices, sense elements and transducers that convert mechanical information into a proportionate electronic signal for display, processing, interpretation, or control. Sensors are essential to the accurate measurement, resolution, and display of pressure, motion, force, displacement, angle, flow, and distance. Our other Sensor products are transducers that convert an applied electrical signal into a mechanical motion corresponding to the amplitude and frequency of the electrical input.

### MARKETS

Sensor manufacturers are moving toward smart sensors that use digital intelligence to enhance measurement and control signals. The shift toward sensors utilizing digital signal processing technologies has enhanced applications in the automotive, medical, military, and consumer products markets. Examples of our sensor applications include:

- automotive applications in braking, transmission, fuel pressure, diesel common rail pressure monitoring, security sensing, and onboard tire pressure monitoring;
- industrial sensors for regulating flow in industrial paint sprayers and agricultural equipment, monitoring pressures in refrigeration and heating/ventilating/air conditioning compressors, controlling valves in process control and electrical power generation equipment and traffic monitoring, vehicle speed and traffic light enforcement;
- medical sensors for invasive blood pressure measurement, drug infusion flow monitoring, electronic stethoscopes, vascular health diagnostics, sleep disorder sensing, and body activity feedback in heart pacemakers;

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- military applications, which continue to drive sensor development, with new systems requiring small, high performance sensors for smart systems such as navigation and weapons control systems, pressure monitoring, and collision avoidance systems; and
- consumer products applications including the measurement of weight, distance, and movement, digitizing information for electronic white boards and pen input devices for laptops, acoustic devices for musical instruments and speakers, and imbalance sensors for appliances.

### TECHNOLOGY

In the rapidly evolving markets for sensors and sensor-based consumer products, there is an increasing demand for technologies such as:

**Piezoresistive Technology.** Piezoresistive materials, most often silicon, respond to changes in applied mechanical variables such as stress, strain, or pressure by changing electrical conductivity. Changes in electrical conductivity can be readily detected in circuits by changes in current with a constant applied voltage, or conversely by changes in voltage with a constant supplied current. Piezoresistive technology is widely used for the measurement of pressure, load and acceleration, and its use in these applications is expanding significantly.

**Application Specific Integrated Circuits (ASICs).** These circuits convert analog electrical signals into digital signals for measurement, computation, or transmission. Application specific integrated circuits are well suited for use in consumer products because they can be designed to operate from a relatively small power source and are inexpensive.

**Micro-Electromechanical Systems (MEMS).** Micro-electromechanical systems and related silicon micromachining technology are used to manufacture components for physical measurement and control. Silicon micromachining is an ideal technology to use in the construction of miniature systems involving electronic, sensing, and mechanical components because it is inexpensive and has excellent physical properties. Micro-electromechanical systems have several advantages over their conventionally manufactured counterparts. For example, by leveraging existing silicon manufacturing technology, micro-electromechanical systems allow for the cost-effective manufacture of small devices with high reliability and superior performance.

**Piezoelectric Polymer Technology.** Piezoelectric materials convert mechanical stress or strain into proportionate electrical energy, and conversely, these materials mechanically expand or contract when voltages of opposite polarities are applied. Piezoelectric polymer films are also pyroelectric, converting heat into electrical charge. These polymer films offer unique sensor design and performance opportunities because they are thin, flexible, inert, broadband, and relatively inexpensive. This technology is ideal for applications where the use of rigid sensors would not be possible or cost-effective.

**Strain Gauge Technology.** A strain gauge consists of metallic foil that is impregnated into an insulating material and bonded to a sensing element. The foil is etched to produce a grid pattern that is sensitive to changes in geometry, usually length, along the sensitive axis producing a change in resistance. The gauge operates through a direct conversion of strain to a change in gauge resistance. This

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technology is useful for the construction of reliable pressure sensors.

**Force Balance Technology.** A force-balanced accelerometer is a mass referenced device that under the application of tilt or linear acceleration, detects the resulting change in position of the internal mass by a position sensor and an error signal is produced. This error signal is passed to a servo amplifier and a current developed is fed back into a moving coil. This current is proportional to the applied tilt angle or applied linear acceleration and will balance the mass back to its original position. These devices are used in military and industrial applications where high accuracy is required.

**Fluid Capacitive Technology.** This technology is also referred to as fluid filled, variable capacitance. The output from the sensing element is two variable capacitance signals per axis. Rotation of the sensor about its sensitive axis produces a linear change in capacitance. This change in capacitance is electronically converted into angular data, and provides the user with a choice of ratiometric, analog, digital, or serial output signals. These signals can be easily interfaced to a number of readout and/or data collection systems.

**Linear Variable Differential Transformers (LVDT).** An LVDT is an electromechanical sensor that produces an electrical signal proportional to the displacement of a separate movable core. LVDT's are widely used as measurement and control sensors wherever displacements of a few micro inches to several feet can be measured directly, or where mechanical input, such as force or pressure, can be converted into linear displacement. LVDT's are capable of extremely accurate and repeatable measurements in severe environments.

**Ultrasonic Technology.** Ultrasonic sensors measure distance by calculating the time delay between transmitting and receiving an acoustic signal that is inaudible to the human ear. This technology allows for the quick, easy, and accurate measurement of distances between two points without physical contact.

### BUSINESS SEGMENTS

Our financial results by business segment for the fiscal years ended March 31, 2004, 2003 and 2002 are presented in Note 16 to the consolidated financial statements included in this Annual Report on Form 10-K.

### PRODUCTS

Sensors. A summary of our Sensor business product offerings as of March 31, 2004 is presented in the following table:

PRODUCT	TECHNOLOGY	BRAND NAME	APPLICATIONS
Pressure Sensors	Micro-Electromechanical Systems (MEMS)	IC Sensors	Disposable catheter blood pressure, altimeter, dive tank pressure, process instrumentation, fluid level, measurement and intravenous drug administration monitoring
	Piezoresistive	microFused	Fertilizer and paint spraying, diesel engine control, hydraulics, refrigeration and automotive power train

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	Strain Gauge	Schaevitz	Instrumentation-grade aerospace and weapon control systems, sub-sea pressure, ship cargo level, and steel mills
Accelerometers	Piezoelectric Polymer	PiezoSensors	Transportation shipment monitoring, audio speaker feedback, appliance imbalance and consumer exercise monitoring
	Micro-Electromechanical Systems (MEMS)	IC Sensors	Traffic alert and collision avoidance systems, railroad, tilt, and instrumentation
	Force Balance	Schaevitz	Aerospace, weapon fire control, inertial navigation, angle, and tilt
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Rotary Displacement Sensors	Linear and Rotary Variable Displacement Transducer	Schaevitz	Aerospace, machine control systems, knitting machines, industrial process control, and hydraulic actuators
Tilt/Angle Sensors	Fluid Capacitive	Schaevitz	Tire balancing, heavy equipment level measurement, and consumer electronic level measurement
Traffic Sensors	Piezoelectric Polymer	PiezoSensors	Traffic survey, speed and traffic light enforcement, toll, and in-motion vehicle weight measurement
Custom Piezofilm Sensors	Piezoelectric Polymer	PiezoSensors	Medical diagnostics, ultrasound, consumer electronic, electronic stethoscope, and sonar
Custom Microstructures	Micro-Electromechanical Systems (MEMS)	IC Sensors	Atomic force microscopes, optical switching, hydrogen and humidity sensors

Consumer Products. A summary of our sensor-based consumer products as of March 31, 2004 is presented in the following table:

PRODUCT	TECHNOLOGY	BRAND NAMES (1)	TYPES OF PRODUCTS	PRICE RANGE
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effective on March 21, 2004. The settlement agreement may be terminated by Leap if a third party objects to the Company's wireless license transfer applications filed with the FCC in connection with the Plan of Reorganization. As of March 31, 2004, no objections to Leap's transfer applications had been filed with the FCC. As of March 31, 2004, no adjustments have been made in the Company's condensed consolidated financial statements related to the ultimate outcome of this matter.

American Wireless Group, LLC ( AWG ) has filed a claim for \$28 million against Leap in the Bankruptcy Court based on the same general claims made by the plaintiffs in the AWG Lawsuit, as discussed below. On October 6, 2003, Leap filed an action in the Bankruptcy Court against AWG and certain of its members seeking to subordinate AWG's alleged general unsecured claims to

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the same priority as that of other common stockholders under section 510(b) of the Bankruptcy Code. AWG agreed to subordinate its claim and on March 8, 2004 the Bankruptcy Court entered its order approving the Stipulation and Consent Judgment subordinating AWG's claim.

From April 1999 to the date of sale on June 2, 2000, Leap owned 100% of Smartcom, S.A. ( Smartcom ), a Chilean corporation that operates a nationwide wireless network in Chile. On June 2, 2000, Leap completed the sale of Smartcom to Endesa, S.A., ( Endesa ) a Spanish company. Leap has a \$35.0 million promissory note payable by Endesa as of June 2, 2001. That note is subject to a right of set-off to secure indemnification claims under the purchase agreement. Endesa has asserted claims of up to approximately \$49.0 million against Leap for breach of representations and warranties under the purchase agreement and has notified Leap that it is offsetting the claims against the entire unpaid balance of the note. The note matured on June 2, 2001 and Leap expects it to remain unpaid until the issues related to the claims are resolved. Proceedings relating to the resolution of these claims were initiated by Endesa in June 2001 and remain pending before the 19th Civil Court of Santiago in the Republic of Chile. Leap believes Endesa's claims are without merit, and is defending Endesa's lawsuit and therefore has made no provisions against the value of the note in its condensed consolidated financial statements. Management of Leap believes that the ultimate outcome of this matter will not have a material adverse effect on Leap's consolidated financial position or results of operations. Leap also filed an action against Endesa in the Bankruptcy Court with respect to the promissory note, seeking to collect the amount due under the note. On March 11, 2004, the Bankruptcy Court rendered a decision to abstain from taking any further action in the matter before it. The Bankruptcy Court stayed that action and lifted the automatic stay so that the litigation could proceed in Chile. The order became effective March 21, 2004. However the Bankruptcy Court's order allowed Endesa only to seek set-offs against the amount it owes under the promissory note and Endesa is precluded from seeking any affirmative relief against Leap. In accordance with the Plan of Reorganization, the note will be transferred to the Leap Creditor Trust on the effective date.

Between December 5, 2002 and February 7, 2003, nine securities class action lawsuits were filed against Leap, and certain of its officers and directors, in the United States District Court for the Southern District of California on behalf of all persons who purchased or otherwise acquired Leap's common stock from February 11, 2002 through July 24, 2002 (the Class Period ). Those lawsuits were all virtually identical to one another. On March 14, 2003, the court entered plaintiffs' stipulation and order for the appointment of lead plaintiffs and approval of lead plaintiffs' selection of lead counsel and ordered the cases consolidated into a single action entitled In re Leap Wireless Securities Litigation, Case No. 02-CV-2388J (AJB). On May 23, 2003, the plaintiffs filed an amended complaint which named only Harvey White and Susan Swenson as defendants. The amended complaint alleges that the defendants were responsible for the dissemination of a series of material misrepresentations to the market during the Class Period, thereby artificially inflating the price of Leap's common stock in violation of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, and Rule 10b-5 promulgated thereunder. Plaintiffs allege that defendants concealed the deteriorated value of Leap's wireless licenses by relying upon a fraudulent impairment test of those assets, which resulted in a gross and material overstatement of the value of Leap's assets in its consolidated financial statements. The amended complaint also claims that misrepresentations were made regarding certain business metrics related to the operation of Leap's subsidiary, Cricket Communications. The complaint seeks an unspecified amount of damages, plus costs and expenses related to bringing the actions. No class has yet been certified in the lawsuit. On July 29, 2003, the defendants filed a motion to dismiss the amended complaint. The defendants' motion to dismiss states, among other matters, that the amended complaint fails to plead any facts which show that any representations made by Leap or the defendants were false or that any of the alleged misrepresentations caused a change in the value of Leap's shares. Plaintiffs filed an opposition to the motion to dismiss and the defendants have filed a reply. The court has taken the matter under submission and will decide the motion based on the papers filed. Although Leap is not a defendant in the case, plaintiffs continue to pursue the individual defendants. The two named defendants have asserted claims for indemnity against the debtors, including Leap. Management believes that the liability, if any, from the indemnity claims filed by the defendants against the Company is not probable and estimable; therefore, no accrual has been made in the Company's condensed consolidated financial statements as of March 31, 2004 related to this contingency.

On December 31, 2002, several members of AWG filed a lawsuit against various officers and directors of Leap in the Circuit Court of the First Judicial District of Hinds County, Mississippi (the Whittington Lawsuit ). Leap purchased certain FCC wireless licenses from AWG and paid for those licenses with shares of Leap stock. The complaint alleges that Leap failed to disclose to AWG material facts regarding a dispute between Leap and MCG relating to MCG's claim that it was entitled to an increase in the purchase price for certain wireless licenses it sold to Leap. The dispute with MCG resulted in an award against Leap in an arbitration proceeding in 2002. Leap satisfied the award by issuing 21,020,431 of Leap shares to MCG. Plaintiffs claim that the result in the arbitration and subsequent issuance of shares to MCG, caused a decrease in the value of the shares transferred to AWG for the FCC licenses. Leap is not a defendant in the Whittington Lawsuit. Instead, plaintiffs contend that the named defendants are the controlling group that was responsible for Leap's alleged fraudulent failure to disclose the material facts regarding the MCG dispute and the risk that the shares held by the plaintiffs might be diluted if MCG was successful in the arbitration. On May 16,

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2003, plaintiffs filed an amended complaint which set forth the same allegations against the defendants, but added several additional plaintiffs. On May 29, 2003, the defendants removed the Whittington Lawsuit from state court in Mississippi to the United States District Court for the Southern District of Mississippi in Jackson. Plaintiffs filed a motion to remand the case to state court. Defendants have filed a motion to dismiss the Whittington Lawsuit noting, among other matters, that plaintiffs failed to plead facts which show that they are entitled to relief, that Leap made adequate disclosure of the relevant facts regarding the MCG dispute, and that any failure to disclose such information did not cause any damage to the plaintiffs. The named defendants have asserted claims of indemnity against the debtors, including Leap.

In a related action, on June 6, 2003, AWG filed a lawsuit in the Circuit Court of the First Judicial District of Hinds County, Mississippi (the AWG Lawsuit ) against the same individual defendants named in the Whittington Lawsuit. The complaint generally sets forth the same claims made by the plaintiffs in the Whittington Lawsuit. Leap is not a defendant in the AWG Lawsuit. On June 26, 2003, the defendants removed the AWG Lawsuit from state court in Mississippi to the United States District Court for the Southern District of Mississippi in Jackson. Plaintiffs filed a motion to remand the case to state court. Defendants have filed a motion to dismiss the AWG Lawsuit, making arguments similar to these made in their motion to dismiss the Whittington Lawsuit. The named defendants have asserted claims for indemnity against the debtors, including Leap.

A new judge was recently appointed in the Whittington and AWG Lawsuits. As a result, delays may occur before the pending motions are decided. Management believes that the liability, if any, from the AWG and Whittington Lawsuits and the related indemnity claims filed by the defendants against the debtors is not probable and estimable; therefore, no accrual has been made in the Company's condensed consolidated financial statements as of March 31, 2004 related to these contingencies.

On February 24, 2003, plaintiff Steven Zawalick filed a purported derivative action in the Supreme Court of the State of New York, Case No. 03600591, on behalf of Leap against Morgan Stanley & Co., Inc., Donaldson Lufkin Jenrette Securities Corporation, Bear Stearns & Co., Inc., ABN AMRO Incorporated and Credit Suisse First Boston Corp., each of whom were initial purchasers in the private placement of Leap's debt securities on February 23, 2000. Leap was also named as a nominal defendant in the lawsuit. The complaint alleges that the sales were disguised brokerage transactions and that the investment banking firms charged excessive brokerage fees in violation of New York General Obligations Law Section 5-531, which limits the fees payable to loan brokers. The complaint sought compensatory damages, costs and fees in connection with bringing suit, and other remedies. Leap believes the plaintiff lacked a right to bring the claim and that any action taken in the lawsuit after the April 13, 2003 commencement of the bankruptcy is in violation of the automatic stay of the bankruptcy code. On June 23, 2003, plaintiff served the complaint on Leap as a nominal defendant. In response, Leap filed with the court a notice of commencement of the bankruptcy and automatic stay of all proceedings against it. Plaintiff did not take any action to proceed with the lawsuit or to lift the stay. The New York court entered an order on November 25, 2003 that the Plaintiff's pursuit of the case be discontinued. Upon the effectiveness of the Plan of Reorganization, any rights Leap may have under this action will be transferred to the Leap Creditor Trust.

In March 2000, the Company completed the acquisition of substantially all of the assets of Chase Telecommunications Holdings, Inc., including wireless licenses. The purchase price included \$6.3 million in cash, the assumption of principal amounts of liabilities that totaled \$138.0 million (with a fair value of \$131.3 million), a warrant to purchase 202,566 shares of Leap common stock at an aggregate exercise price of \$1.0 million (of which 94,999 shares remain exercisable at March 31, 2004), and contingent earn out payments of up to \$41.0 million (plus certain expenses) based on the earnings of the business acquired during the fifth full year following the closing of the acquisition. The obligation to pay the contingent earn-out payment was generally assigned to and assumed by Cricket in 1999. However, the Company rejected all remaining obligations under the asset purchase agreement, including the earn-out obligations, in bankruptcy.

The Company is often involved in various claims arising in the course of business, seeking monetary damages and other relief. The amount of the liability, if any, from such claims cannot currently be reasonably estimated; therefore, no accruals have been made in the Company's condensed consolidated financial statements as of March 31, 2004 for such claims. In the opinion of the Company's management, the ultimate liability for such claims will not have a material adverse effect on the Company's condensed consolidated financial position, results of operations or cash flows.

In addition to the monthly fees paid by the Company to the financial advisor to the Official Unsecured Creditors Committee of Leap and the financial advisor to the informal committee of Cricket's senior secured vendor debtholders, the Company has agreed to pay up to \$7.0 million to these advisors and the Company's financial advisor upon the effectiveness of the Plan of Reorganization.

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**Note 8. Subsidiary Guarantee**

The Company's Senior Notes and Senior Discount Notes are guaranteed by Cricket Communications Holdings, Inc., Backwire.com, Inc. and Telephone Entertainment Network, Inc., all of which are subsidiaries of Leap. Because the guarantor subsidiaries are wholly owned subsidiaries of the Company and the guarantee provided by the guarantor subsidiaries is full, unconditional and joint and several among the guarantor subsidiaries, full financial statements of the guarantor subsidiaries are not required to be issued. Condensed consolidating financial information of Leap, the guarantor subsidiaries and non-guarantor subsidiaries of Leap as of March 31, 2004 and December 31, 2003 and for the three months ended March 31, 2004 and 2003 is presented below. The subsidiaries of Cricket Communications Holdings are not guarantors of the Senior Notes and Senior Discount Notes and are therefore reflected as investments accounted for under the equity method of accounting in the guarantor subsidiaries financial information.

**Table of Contents****Balance Sheet Information as of March 31, 2004 (unaudited) (in thousands):**

	<b>Leap</b>	<b>Guarantor Subsidiaries</b>	<b>Non-Guarantor Subsidiaries</b>	<b>Eliminations</b>	<b>Consolidated</b>
<b>Assets</b>					
Cash and cash equivalents	\$	\$	\$ 94,472	\$	\$ 94,472
Short-term investments			80,251		80,251
Restricted cash, cash equivalents and short-term investments	12,928		42,743		55,671
Funds distributed to Leap Creditor Trust	68,790				68,790
Inventories			19,042		19,042
Other current assets	434		45,719		46,153
<b>Total current assets</b>	<b>82,152</b>		<b>282,227</b>		<b>364,379</b>
Property and equipment, net	2,102		758,667		760,769
Investment in subsidiaries	(273,410)	(804,779)		1,078,189	
Wireless licenses, net	914		559,142		560,056
Other assets	38,833	13	14,601		53,447
<b>Total assets</b>	<b>\$ (149,409)</b>	<b>\$ (804,766)</b>	<b>\$ 1,614,637</b>	<b>\$ 1,078,189</b>	<b>\$ 1,738,651</b>
<b>Liabilities and Stockholders Deficit</b>					
Accounts payable and accrued liabilities	\$ 2,892	\$	\$ 67,300	\$	\$ 70,192
Debt in default			74,218		74,218
Other current liabilities	3,288		68,599		71,887
<b>Total current liabilities not subject to compromise</b>	<b>6,180</b>		<b>210,117</b>		<b>216,297</b>
Other long-term liabilities	21,951		35,746		57,697
<b>Total liabilities not subject to compromise</b>	<b>28,131</b>		<b>245,863</b>		<b>273,994</b>
Liabilities subject to compromise	744,235	4,458	1,650,464	(12,725)	2,386,432
Stockholders deficit:					
Common stock	6				6

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Additional paid-in capital	1,155,528	730,332	1,316,050	(2,046,382)	1,155,528
Unearned stock-based compensation	(193)		(193)	193	(193)
Accumulated deficit	(2,076,461)	(1,539,556)	(1,596,558)	3,136,114	(2,076,461)
Accumulated other comprehensive loss	(655)		(989)	989	(655)
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Total stockholders deficit	<u>(921,775)</u>	<u>(809,224)</u>	<u>(281,690)</u>	<u>1,090,914</u>	<u>(921,775)</u>
Total liabilities and stockholders deficit	<u>\$ (149,409)</u>	<u>\$ (804,766)</u>	<u>\$ 1,614,637</u>	<u>\$ 1,078,189</u>	<u>\$ 1,738,651</u>



**Table of Contents****Balance Sheet Information as of December 31, 2003 (unaudited) (in thousands):**

	<u>Leap</u>	<u>Guarantor Subsidiaries</u>	<u>Non-Guarantor Subsidiaries</u>	<u>Eliminations</u>	<u>Consolidated</u>
<b>Assets</b>					
Cash and cash equivalents	\$	\$	\$ 84,070	\$	\$ 84,070
Short-term investments			65,811		65,811
Restricted cash, cash equivalents and short-term investments	13,841		42,113		55,954
Funds distributed to Leap Creditor Trust	67,800				67,800
Inventories			17,680		17,680
Other current assets	668		38,477		39,145
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Total current assets	82,309		248,151		330,460
Property and equipment, net	2,515		814,560		817,075
Investments in subsidiaries	(248,931)	(774,970)		1,023,901	
Wireless licenses, net	914		559,142		560,056
Other assets	39,562	28	9,662		49,252
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Total assets	\$ (123,631)	\$ (774,942)	\$ 1,631,515	\$ 1,023,901	\$ 1,756,843
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
<b>Liabilities and Stockholders Deficit</b>					
Accounts payable and accrued liabilities	\$ 2,162	\$	\$ 62,323	\$	\$ 64,485
Debt in default			74,112		74,112
Other current liabilities	3,271		65,681		68,952
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Total current liabilities not subject to compromise	5,433		202,116		207,549
Other long-term liabilities	20,023		35,134		55,157
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Total liabilities not subject to compromise	25,456		237,250		262,706
Liabilities subject to compromise	744,269	4,541	1,651,374	(12,691)	2,387,493
Stockholders deficit:					
Common stock	6				6

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Additional paid-in capital	1,156,410	730,332	1,316,777	(2,047,109)	1,156,410
Unearned stock-based compensation	(421)	(69)	(352)	421	(421)
Accumulated deficit	(2,048,431)	(1,509,746)	(1,572,484)	3,082,230	(2,048,431)
Accumulated other comprehensive loss	(920)		(1,050)	1,050	(920)
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Total stockholders deficit	<u>(893,356)</u>	<u>(779,483)</u>	<u>(257,109)</u>	<u>1,036,592</u>	<u>(893,356)</u>
Total liabilities and stockholders deficit	<u>\$ (123,631)</u>	<u>\$ (774,942)</u>	<u>\$ 1,631,515</u>	<u>\$ 1,023,901</u>	<u>\$ 1,756,843</u>

**Table of Contents****Statement of Operations Information for the Three Months Ended March 31, 2004 (unaudited) (in thousands):**

	<b>Leap</b>	<b>Guarantor Subsidiaries</b>	<b>Non-Guarantor Subsidiaries</b>	<b>Eliminations</b>	<b>Consolidated</b>
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Revenues:					
Service revenues	\$	\$	\$ 169,051	\$	\$ 169,051
Equipment revenues			37,771		37,771
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Total revenues			206,822		206,822
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Operating expenses:					
Cost of service (exclusive of items shown separately below)			(55,558)	7,558	(48,000)
Cost of equipment			(43,755)		(43,755)
Selling, general and administrative	(763)		(61,100)		(61,863)
Depreciation and amortization	(414)		(75,047)		(75,461)
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Total operating expenses	(1,177)		(235,460)	7,558	(229,079)
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Operating loss	(1,177)		(28,638)	7,558	(22,257)
Equity in net loss of subsidiaries	(24,074)	(29,810)		53,884	
Interest expense			(1,823)		(1,823)
Other income (expense), net	19		7,558	(7,558)	19
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Loss before reorganization items and income taxes	(25,232)	(29,810)	(22,903)	53,884	(24,061)
Reorganization items	(869)		(1,156)		(2,025)
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Loss before income taxes	(26,101)	(29,810)	(24,059)	53,884	(26,086)
Income taxes	(1,929)		(15)		(1,944)
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Net loss	\$ (28,030)	\$ (29,810)	\$ (24,074)	\$ 53,884	\$ (28,030)
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>

**Statement of Operations Information for the Three Months Ended March 31, 2003 (unaudited) (in thousands):**

**Guarantor    Non-Guarantor**

	<u>Leap</u>	<u>Subsidiaries</u>	<u>Subsidiaries</u>	<u>Eliminations</u>	<u>Consolidated</u>
Revenues:					
Service revenues	\$	\$	\$ 160,648	\$	\$ 160,648
Equipment revenues			23,199		23,199
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Total revenues			183,847		183,847
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Operating expenses:					
Cost of service (exclusive of items shown separately below)			(60,013)	7,265	(52,748)
Cost of equipment			(42,440)		(42,440)
Selling, general and administrative	(3,809)		(64,870)		(68,679)
Depreciation and amortization	(594)		(76,021)		(76,615)
Impairment of long-lived assets			(8,725)		(8,725)
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Total operating expenses	(4,403)		(252,069)	7,265	(249,207)
Gain on sale of wireless license			1,472		1,472
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Operating loss	(4,403)		(66,750)	7,265	(63,888)
Equity in net loss of subsidiaries	(99,236)	(106,069)		205,305	
Interest income	360		334		694
Interest expense	(28,133)		(40,014)		(68,147)
Other income (expense), net	(197)		7,194	(7,265)	(268)
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Loss before income taxes	(131,609)	(106,069)	(99,236)	205,305	(131,609)
Income taxes	(1,929)				(1,929)
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Net loss	<u>\$ (133,538)</u>	<u>\$ (106,069)</u>	<u>\$ (99,236)</u>	<u>\$ 205,305</u>	<u>\$ (133,538)</u>

**Table of Contents****Cash Flow Information for the Three Months Ended March 31, 2004 (unaudited) (in thousands):**

	<b>Leap</b>	<b>Guarantor Subsidiaries</b>	<b>Non-Guarantor Subsidiaries</b>	<b>Eliminations</b>	<b>Consolidated</b>
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
<b>Operating activities:</b>					
Net cash provided by (used in) operating activities	\$ (877)	\$ —	\$ 41,637	\$ —	\$ 40,760
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
<b>Investing activities:</b>					
Purchase of property and equipment			(16,157)		(16,157)
Purchase of investments	(2,265)		(31,386)		(33,651)
Sale and maturity of investments			16,850		16,850
Restricted cash, cash equivalents and investments, net	3,142		(542)		2,600
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Net cash provided by (used in) investing activities	877		(31,235)		(30,358)
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Net increase in cash and cash equivalents			10,402		10,402
Cash and cash equivalents at beginning of period			84,070		84,070
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Cash and cash equivalents at end of period	\$ —	\$ —	\$ 94,472	\$ —	\$ 94,472
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>

**Cash Flow Information for the Three Months Ended March 31, 2003 (unaudited) (in thousands):**

	<b>Leap</b>	<b>Guarantor Subsidiaries</b>	<b>Non-Guarantor Subsidiaries</b>	<b>Eliminations</b>	<b>Consolidated</b>
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
<b>Operating activities:</b>					
Net cash provided by operating activities	\$ 15,107	\$ —	\$ 14,074	\$ —	\$ 29,181
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
<b>Investing activities:</b>					
Purchase of property and equipment			(4,222)		(4,222)
Net proceeds from sale of wireless license			1,472		1,472
Purchase of investments	(8,836)		(13,604)		(22,440)
Sale and maturity of investments	7,387		17,867		25,254
	(105)		(176)		(281)

Restricted cash, cash equivalents and investments, net					
Other	91	—	(91)	—	—
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Net cash provided by (used in) investing activities	(1,463)	—	1,246	—	(217)
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Financing activities:					
Repayment of long-term debt	—	—	(4,365)	—	(4,365)
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Net cash used in financing activities	—	—	(4,365)	—	(4,365)
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Net increase in cash and cash equivalents	13,644	—	10,955	—	24,599
Cash and cash equivalents at beginning of period	36,675	—	64,185	—	100,860
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Cash and cash equivalents at end of period	\$50,319	\$	\$ 75,140	\$	\$125,459
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>

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**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

*As used in this report, the terms we, our, ours and us refer to Leap Wireless International, Inc., a Delaware corporation, 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 2004 population estimates provided by Claritas Inc.*

The following information should be read in conjunction with the condensed consolidated financial statements and notes thereto included in Item 1 of this Quarterly Report and the audited consolidated financial statements and notes thereto and Management's Discussion and Analysis of Financial Condition and Results of Operations included in our Annual Report on Form 10-K for the year ended December 31, 2003 filed with the Securities and Exchange Commission on May 13, 2004.

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, including, among other things:

limitations on our ability to predict the future performance and actions of Leap because we will have new stockholders and a new Board of Directors if and when we emerge from bankruptcy, and we expect that a new CEO will be appointed in the near future. Changes in management or direction implemented by the new stockholders, the new Board or new management may cause actual results to differ materially from those anticipated or implied in our forward-looking statements;

our ability to obtain approval from the Federal Communications Commission, or FCC, for the change of control of our wireless licenses that will occur upon our emergence from bankruptcy, and our ability to successfully implement our Fifth Amended Joint Plan of Reorganization dated as of July 30, 2003, including certain technical amendments thereto, referred to herein as the Plan of Reorganization, which has been confirmed by the United States Bankruptcy Court for the Southern District of California, or the Bankruptcy Court;

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 convert the Chapter 11 cases of Leap, Cricket and substantially all of their subsidiaries to Chapter 7 cases if our Plan of Reorganization does not become effective in a timely fashion;

the potential continuing adverse impacts of the Chapter 11 cases on the liquidity or results of operations of Leap and Cricket and on our ability to predict future customer growth and other key operating metrics;

our ability to attract and retain customers in an extremely competitive marketplace;

our ability to attract, motivate and/or retain an experienced workforce;

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

rulings or actions by courts or the 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;

failure of network systems to perform according to expectations;

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



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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 the

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.

## **Overview**

A new Board of Directors of Leap will be appointed as of the effective date of the Plan of Reorganization. We cannot assure you that the new Board of Directors, new management or the new stockholders will maintain our current operations or business plans. Accordingly, when reviewing the description of our business, the condensed consolidated financial statements and financial data, and any forward-looking information included in this report, you should consider the possibility that there may be significant changes to our operations and business plans in the future following our emergence from bankruptcy.

The Cricket Companies offer wireless service in the United States under the brand **Cricket®**. We market Cricket service as **Comfortable Wireless®**. On March 31, 2004, Cricket had approximately 1,538,000 customers located in 39 markets throughout the United States. These markets are located in 47 BTA's covering a total population of approximately 25.9 million potential customers. At March 31, 2004, we owned wireless licenses covering approximately 53.8 million potential customers in 33 states.

Cricket generates revenues from the sale of wireless services, handsets and accessories. Our service allows customers to make and receive 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. During the fourth quarter of 2003, we simplified our service offerings to offer three service plans to our new customers. Our basic Cricket service offers virtually unlimited local calls at a flat price. We also offer a plan that bundles certain additional features (such as voicemail and call waiting) at a slightly higher price. Additionally, we offer a premium plan which includes virtually unlimited local service, multiple calling features and a large block of available long distance minutes per month. We continually review our service offering portfolio and make modifications that we believe will deliver high-value services to our customers. As part of this process, on March 16, 2004, we introduced a plan that includes virtually unlimited local and long distance calling for a flat rate and also introduced a plan that provides discounts on additional lines added to an existing qualified account. See **Risk Factors - If Call Volume Under Our Cricket Flat Rate Plans Exceeds Our Expectations, Our Cost of Providing Service Could Increase, Which Could Have a Material Adverse Effect On Our Competitive Position.**

On April 13, 2003, Leap, Cricket and substantially all of their subsidiaries filed voluntary petitions for relief under Chapter 11 in the U.S. Bankruptcy Court for the Southern District of California. Each of the debtors continues to manage its properties and operate its business as a debtor-in-possession. Our Plan of Reorganization was confirmed by the Bankruptcy Court on October 22, 2003. We expect to emerge from bankruptcy promptly after the FCC approves the change of control of our wireless licenses that will occur when we emerge from bankruptcy.

Our Plan of Reorganization implements a comprehensive financial reorganization that significantly reduces our outstanding indebtedness. In connection with the Plan of Reorganization, our long-term debt will be reduced from a book value of more than \$2.4 billion to a principal amount of approximately \$426.7 million as of the effective date of the Plan of Reorganization, including \$350.0 million of new senior secured pay-in-kind notes that will be issued by reorganized Cricket to the holders of Cricket's senior secured vendor debt and approximately \$76.7 million of debt

owed to the FCC in connection with prior wireless license auctions. Under the Plan of Reorganization, all of the outstanding shares of Leap common stock, options and warrants will be cancelled; the holders of Leap common stock, warrants and options will not receive any distributions under the Plan of Reorganization. On the effective date of the Plan of Reorganization, the new common stock of reorganized Leap will be distributed to two classes of creditors: 96.5% to the holders of Cricket's senior secured vendor debt and 3.5% to Leap's general unsecured creditors. Under the Plan of Reorganization, Leap's remaining cash and certain other assets not used in the Cricket business will be transferred to the Leap Creditor Trust, the proceeds of which will be distributed to Leap's general unsecured creditors. On November 3, 2003, Leap transferred to the Leap Creditor Trust an initial cash distribution in the amount of \$67.8 million pursuant to the Plan of Reorganization. In March 2004, Leap transferred an additional \$990,000 to the Leap Creditor Trust in connection with the agreement with the informal committee of holders of Cricket's senior secured vendor debt that Cricket would pay 100% of the

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success fee payable to the debtors' financial advisor upon the debtors' emergence from bankruptcy. The total transferred to the Leap Creditor Trust through March 31, 2004 was \$68.8 million.

At March 31, 2004, we had approximately 1,538,000 customers compared to approximately 1,513,000 at March 31, 2003. Although we increased the total number of customers from the prior year, our total number of customers fluctuated from quarter to quarter in 2003. Prior to the second quarter of 2003, Cricket had not experienced a decline in total customers from one quarter to another, but in the second quarter of 2003 we lost approximately 54,000 net customers. Promotional activity resulted in a net increase in our customers of approximately 18,000 during the three months ended September 30, 2003, but during the fourth quarter of 2003, we lost approximately 4,000 net customers. During the first quarter of 2004, we experienced a net increase of approximately 65,700 customers as a result of increased promotional activity and decreased churn.

Because of their Chapter 11 filings, Leap and the Cricket Companies are operating separately and cash flows are not being shared between Leap and Cricket. As a result, following emergence from bankruptcy, our reorganized operations will be conducted through the Cricket Companies and our reorganized liquidity and capital resources will come primarily from the assets, operations and credit of the Cricket Companies.

During the Chapter 11 process, the Cricket Companies have achieved significant expense reductions resulting from our continued focus on minimizing costs, the renegotiation of key contracts and the rejection of executory contracts and leases deemed no longer necessary for the operation of the Cricket business. The Cricket Companies have experienced corresponding improvements in their results of operations and financial condition as well. For the three months ended March 31, 2004, consolidated net cash provided by operating activities which primarily related to the Cricket Companies was approximately \$40.8 million (including \$2.2 million of net cash used for reorganization activities), compared to consolidated net cash provided by operating activities of approximately \$29.2 million for the comparable period of the prior year. At March 31, 2004, the Cricket Companies had approximately \$174.7 million in cash, cash equivalents and short-term investments, an increase of \$24.8 million compared to their \$149.9 million in cash, cash equivalents and short-term investments at December 31, 2003.

This overview is intended to be only a summary of significant matters concerning our results of operations and financial condition. It should be read in conjunction with the management discussion below and all of the financial information and the condensed consolidated financial statements included in Part I-Item 1 of this report.

## **Chapter 11 Proceedings Under the Bankruptcy Code**

On April 13, 2003, Leap, Cricket and substantially all of their subsidiaries filed voluntary petitions for relief under Chapter 11 of the United States Bankruptcy Code in the United States Bankruptcy Court for the Southern District of California. Each of the debtors continues to manage its properties and operate its business as a debtor-in-possession. Our Plan of Reorganization was confirmed by the Bankruptcy Court in October 2003. We expect to emerge from bankruptcy promptly after the FCC approves the change of control of our wireless licenses that will occur when we emerge from bankruptcy. For a more detailed description of our bankruptcy proceedings, see Note 2 to the condensed consolidated financial statements included in Part I-Item 1 of this report.

## **Results of Operations**

To the extent that the matters discussed under this caption—Results of Operations—relate to future events or expectations, they may be significantly affected by the Chapter 11 proceedings at Leap and the Cricket Companies. The Chapter 11 proceedings involve various restrictions on business activities, limitations on financings and the need to obtain Bankruptcy Court approval for various matters, and may result in uncertainty as to relationships with employees, vendors, suppliers, customers and others with whom Leap or the Cricket Companies conduct or may seek

to conduct business.

In addition, a new Board of Directors of Leap will be appointed as of the effective date of the Plan of Reorganization. We cannot assure you that the new Board of Directors, new management or the new stockholders will maintain our current operations or business plans. Accordingly, when reviewing the descriptions of our business, the results of operations, the condensed consolidated financial statements and financial data, and any forward-looking information included in this report, you should consider the possibility that there may be significant changes to our operations and business plans in the future following our emergence from bankruptcy.

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The following table presents condensed consolidated results of operations data for the periods indicated (unaudited) (in thousands):

	<b>Three Months Ended March 31,</b>	
	<b>2004</b>	<b>2003</b>
Revenues:		
Service revenues	\$ 169,051	\$ 160,648
Equipment revenues	37,771	23,199
	<hr/>	<hr/>
Total revenues	206,822	183,847
	<hr/>	<hr/>
Operating expenses:		
Cost of service (exclusive of items shown separately below)	(48,000)	(52,748)
Cost of equipment	(43,755)	(42,440)
Selling and marketing	(23,253)	(21,265)
General and administrative	(38,610)	(47,414)
Depreciation and amortization	(75,461)	(76,615)
Impairment of long-lived assets		(8,725)
	<hr/>	<hr/>
Total operating expenses	(229,079)	(249,207)
Gains on sale of wireless licenses		1,472
	<hr/>	<hr/>
Operating loss	(22,257)	(63,888)
Interest income		694
Interest expense	(1,823)	(68,147)
Other income (expense), net	19	(268)
	<hr/>	<hr/>
Loss before reorganization items and income taxes	(24,061)	(131,609)
Reorganization items	(2,025)	
	<hr/>	<hr/>
Loss before income taxes	(26,086)	(131,609)
Income taxes	(1,944)	(1,929)
	<hr/>	<hr/>
Net loss	\$ (28,030)	\$ (133,538)
	<hr/>	<hr/>

*Three Months Ended March 31, 2004 Compared to the Three Months Ended March 31, 2003*

At March 31, 2004, customers of our Cricket service were approximately 1,538,000 compared to approximately 1,513,000 at March 31, 2003. During the three months ended March 31, 2004, gross and net customer additions were approximately 207,000 and 65,700, respectively, however, the number of net additions of subscribers fluctuated on a quarterly basis in 2003. See Part I-Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations Overview. At March 31, 2004, the total potential customer base covered under our 39 operating markets was approximately 25.9 million.

During the three months ended March 31, 2004, service revenues increased \$8.4 million, or 5%, compared to the corresponding period of the prior year. During the fourth quarter of 2003, we simplified our service offerings to offer three service plans. Our basic Cricket service offers virtually unlimited local calls at a flat price and we also offer two other higher priced plans which include different levels of bundled features. We continually review our service offering portfolio and make modifications that we believe will deliver high-value services to our customers. As part of this process, on March 16, 2004, we introduced a plan that includes virtually unlimited local and long distance calling for a flat rate and also introduced a plan that provides discounts on additional lines added to an existing qualified account. Since their introduction, these higher priced service plans have represented a significant portion of our gross customer additions and have increased our average service revenue per subscriber. The effect that our higher priced service offering mix had on service revenues for the three months ending March 31, 2004, as compared to the three months ended March 31, 2003, was partially offset by a decrease in activation fees which were included in service revenues until our adoption of Emerging Issues Task Force Issue No. 00-21, Accounting for Revenue Arrangements with Multiple Deliverables in July 2003.

During the three months ended March 31, 2004, equipment revenues increased \$14.6 million, or 63%, compared to the corresponding period of the prior year. This increase was due to an increase in the number of handsets sold of approximately 61,000, or 23%, compared to the corresponding period of the prior year, an increase of \$5.8 million of activation fees due to our adoption of EITF Issue No. 00-21 on July 1, 2003, at which time we began immediately recognizing activation fees as equipment revenues and an increase in our average net revenue per handset sold. We expect that the inclusion of activation fees in equipment revenues will continue on a going-forward basis in future periods.

During the three months ended March 31, 2004, cost of service decreased \$4.7 million, or 9%, compared to the corresponding period of the prior year. The decrease in cost of service was primarily attributable to a decrease of \$2.6 million in our long distance costs and a decrease of \$2.1 million related to network interconnection costs, each resulting from a decrease in the average number

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of subscribers and the renegotiation of several supply agreements during the course of our bankruptcy. In addition, we experienced a decrease of \$2.1 million related to property taxes and a decrease of \$1.2 million related to cell site lease costs for leases we rejected in bankruptcy. These decreases in cost of service were offset by an increase in software maintenance expenses of \$1.2 million and an increase in payroll and related costs of \$1.4 million.

During the three months ended March 31, 2004, cost of equipment increased \$1.3 million, or 3%, compared to the corresponding period of the prior year. The increase in cost of equipment during the three months ended March 31, 2004, resulting from the increase in the number of handsets sold as discussed above, was partially offset by a reduction in the average cost per handset.

Equipment revenues increased 63% during the three months ended March 31, 2004 compared to the three months ended March 31, 2003, while at the same time cost of equipment increased 3% compared to the prior period, in each case for the reasons described above. We do not believe that the different rates of increase in these amounts represent a trend in the relationship between equipment revenues and cost of equipment. Instead, we believe the difference arose in large part as a result of our adoption of EITF 00-21 on July 1, 2003, which resulted in the inclusion of activation fees in equipment revenues. When comparing periods that begin after July 1, 2003, we expect cost of equipment and equipment revenues to increase at generally similar rates, subject to future pricing changes. However, under our current handset pricing and marketing practices, which we generally expect to continue, the difference between cost of equipment and equipment revenue has narrowed from previous periods.

For the three months ended March 31, 2004, selling and marketing expenses increased \$2.0 million, or 9%, compared to the corresponding period of the prior year. The increase in selling and marketing expenses was primarily due to an increase of \$3.1 million in payroll and related costs, partially offset by a decrease in advertising and related costs of \$1.4 million.

For the three months ended March 31, 2004, general and administrative expenses decreased \$8.8 million, or 19%, compared to the corresponding period of the prior year. The decrease in general and administrative expenses was primarily due to a decrease of \$4.0 million in legal costs reflecting the classification of costs directly related to our bankruptcy filings as reorganization costs subsequent to the Petition Date in accordance with Statement of Position 90-7, Financial Reporting by Entities in Reorganization under the Bankruptcy Code, a decrease in insurance costs of \$0.9 million, a decrease of \$0.7 million in payroll and related costs, and reductions of \$1.4 million in call center costs and \$1.0 million in billing costs resulting from cost reductions negotiated during the course of our bankruptcy.

For the three months ended March 31, 2004, depreciation and amortization remained relatively constant compared to the corresponding period of the prior year. An increase in depreciation and amortization resulting from capital purchases during the three months ended March 31, 2004 was offset by an increase of computer equipment in service that has been fully depreciated. It is probable that depreciation expense will decrease significantly once we emerge from bankruptcy and apply the fresh start reporting provisions of SOP 90-7, as we expect the carrying value of our property and equipment to be reduced.

For the three months ended March 31, 2004, interest income decreased \$0.7 million, or 100%, compared to the corresponding period of the prior year. The decrease in interest income resulted from the application of SOP 90-7 which requires that we classify interest earned during our bankruptcy proceedings as a reorganization item.

For the three months ended March 31, 2004, interest expense decreased \$66.3 million, or 97%, compared to the corresponding period of the prior year. The decrease in interest expense resulted from the application of SOP 90-7 which requires that, commencing on the Petition Date, we cease accruing interest and amortizing debt discounts and debt issuance costs on pre-petition liabilities that are subject to compromise. As a result, we ceased to accrue interest and to amortize our debt discounts and debt issuance costs for our senior notes, senior discount notes, senior secured

vendor credit facilities, note payable to GLH, and Qualcomm term loan. We are currently in default of all of our long-term financing agreements. See Liquidity and Capital Resources.

Reorganization items for the three months ended March 31, 2004, consisted primarily of \$2.2 million of professional fees for legal, financial, advisory and valuation services and related expenses directly associated with our Chapter 11 filings and reorganization process.

For the three months ended March 31, 2004, income tax expense remained relatively constant as compared to the corresponding period of the prior year.



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In managing our business and assessing our financial performance, management supplements the information provided by financial statement measures with several customer focused performance metrics that are widely used in the telecommunications industry. These metrics include average revenue per user per month (ARPU), which measures service revenue per customer; cost per gross customer addition (CPGA), which measures the average cost of acquiring a new customer; cash costs per user per month (CCU), which measures the non-selling cash cost of operating our business on a per customer basis; and churn, which measures turnover in our customer base. CPGA and CCU are non-GAAP financial measures. A non-GAAP financial measure, within the meaning of Item 10 of Regulation S-K promulgated by the Securities and Exchange Commission, is a numerical measure of a company's financial performance that (a) excludes amounts, or is subject to adjustments that have the effect of excluding amounts, that are included in the comparable measure calculated and presented in accordance with Generally Accepted Accounting Principals in the consolidated statement of operations or consolidated statement of cash flows; or (b) includes amounts, or is subject to adjustments that have the effect of including amounts, that are excluded from the comparable measure so calculated and presented.

ARPU is an industry metric that measures service revenue divided by the weighted average number of customers, divided by the number of months during the period being measured. Management uses ARPU to identify average revenue per customer, to track changes in average customer revenues over time, to help evaluate how changes in our business, including changes in our service offerings and fees, affect average revenue per customer, and to forecast future service revenue. In addition, ARPU provides management with a useful measure to compare our subscriber revenue to that of other wireless communications providers. We believe investors use ARPU primarily as a tool to track changes in our average revenue per customer and to compare our per customer service revenues to those of other wireless providers. For the three months ended March 31, 2004 and 2003, our consolidated ARPU was approximately \$37.45 and \$35.12, respectively.

CPGA is an industry metric that represents selling and marketing costs and the loss on sale of handsets (generally defined as cost of equipment less equipment revenue), excluding costs unrelated to initial customer acquisition, divided by the total number of gross new customer additions during the period being measured. Costs unrelated to initial customer acquisition include the revenues and costs associated with the sale of handsets to existing customers as well as costs associated with handset replacements and repairs (other than warranty costs relating to handsets). We deduct customers who do not pay their first monthly bill from our gross customer additions, which tends to increase CPGA because we incur the costs associated with this customer without receiving the benefit of a gross customer addition. Management uses CPGA to measure the efficiency of our customer acquisition efforts, to track changes in our average cost of acquiring new subscribers over time, and to help evaluate how changes in our sales and distribution strategies affect the cost-efficiency of our customer acquisition efforts. In addition, CPGA provides management with a useful measure to compare our per customer acquisition costs with those of other wireless communications providers. We believe investors use CPGA primarily as a tool to track changes in our average cost of acquiring new customers and to compare our per customer acquisition costs to those of other wireless providers. For the three months ended March 31, 2004 and 2003, our consolidated CPGA was approximately \$124 and \$177, respectively.

CCU is an industry metric that measures cost of service, general and administrative costs, gain or loss on sale of handsets to existing customers and costs associated with handset replacements and repairs (other than warranty costs relating to handsets), divided by the weighted average number of customers, divided by the number of months during the period being measured. CCU does not include any depreciation and amortization expense. Management uses CCU as a tool to evaluate the non-selling cash expenses associated with ongoing business operations on a per customer basis, to track changes in these non-selling cash costs over time, and to help evaluate how changes in our business operations affect non-selling cash costs per customer. In addition, CCU provides management with a useful measure

to compare our non-selling cash costs per customer with those of other wireless communications providers. We believe investors use CCU primarily as a tool to track changes in our non-selling cash costs over time and to compare our non-selling cash costs to those of other wireless providers. For the three months ended March 31, 2004 and 2003, our consolidated CCU was approximately \$20.08 and \$23.76, respectively.

Churn, an industry metric that measures customer turnover, is calculated as the net number of customers that disconnect from our service divided by the weighted average number of customers divided by the number of months during the period being measured. As noted above, customers who do not pay their first monthly bill are deducted from our gross customer additions; as a result, these customers are not included in churn. Management uses churn to measure our retention of customers, to measure changes in customer retention over time, and to help evaluate how changes in our business affect customer retention. In addition, churn provides management with a useful measure to compare our customer turnover activity to that of other wireless communications providers. We believe investors use churn primarily as a tool to track changes in our customer retention over time

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and to compare our customer retention to that of other wireless providers. For the three months ended March 31, 2004 and 2003, our consolidated churn was approximately 3.1% and 4.1%, respectively.

The following table shows metric information for the three months ended March 31, 2004 and 2003:

	<b>Three Months Ended March 31,</b>	
	<b>2004</b>	<b>2003</b>
ARPU	\$37.45	\$35.12
CPGA	\$ 124	\$ 177
CCU	\$20.08	\$23.76
Churn	3.1%	4.1%

During the first quarter of 2004, we modified our definitions of CPGA and CCU so that handset replacement and repair costs (other than warranty costs relating to handsets) are now included in the calculation of CCU and are excluded from the calculation of CPGA. We modified the definition because we decided that it was more appropriate to include these costs in CCU rather than including them in CPGA with handset costs related to the acquisition of new customers. The metric information for the three months ending March 31, 2003 presented in the table above has been calculated using the modified definitions of CPGA and CCU. As a result of the revised definitions, the CPGA and CCU metric information presented in this report and presented in future reports will not be comparable with CPGA and CCU measures calculated using the definitions in place prior to January 1, 2004. If calculated under our definitions of CPGA and CCU that existed prior to the first quarter of 2004, CPGA would have been \$207, and CCU would have been \$22.53, in the first quarter of 2003.

In addition, we adopted EITF Issue No. 00-21 on July 1, 2003. Prior to the adoption of EITF Issue No. 00-21, activation fees were included in ARPU as service revenue and deferred over the estimated customer relationship period. Upon the adoption of EITF Issue No. 00-21, we began recognizing activation fees immediately as equipment revenue, which reduced ARPU and CPGA by \$0.75 and \$28, respectively, for the three months ended March 31, 2004, compared to the ARPU and CPGA results that would have been reflected if EITF Issue No. 00-21 had not been adopted.

***Reconciliation of Non-GAAP Financial Measures***

We utilize certain financial measures, as described above, that are calculated based on industry conventions and are not calculated based on GAAP. Certain of these financial measures are considered non-GAAP financial measures within the meaning of Item 10 of Regulation S-K promulgated by the SEC. Following are reconciliations of the non-GAAP financial measures used in this report to the most directly comparable GAAP financial measures.

**CPGA** The following table reconciles total costs used in the calculation of CPGA to selling and marketing expense, which we consider to be the most directly comparable GAAP financial measure to CPGA (in thousands, except gross additions and CPGA):

**Three Months Ended,  
March 31,**

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	<u>2004</u>	<u>2003</u>
Selling and marketing expense	\$ 23,253	\$ 21,265
Plus cost of equipment	43,755	42,440
Less equipment revenue	(37,771)	(23,199)
Less net loss on equipment transactions unrelated to initial customer acquisition	<u>(3,667)</u>	<u>(7,627)</u>
Total costs used in the calculation of CPGA	\$ 25,570	\$ 32,879
Gross additions	<u>206,941</u>	<u>185,388</u>
CPGA	<u>\$ 124</u>	<u>\$ 177</u>

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CCU The following table reconciles total costs used in the calculation of CCU to cost of service, which we consider to be the most directly comparable GAAP financial measure to CCU(in thousands, except weighted-average customers and CCU):

	<b>Three Months Ended March 31,</b>	
	<b>2004</b>	<b>2003</b>
Cost of service	\$ 48,000	\$ 52,748
Plus general and administrative expense	38,610	47,414
Plus net loss on equipment transactions unrelated to initial customer acquisition	3,667	7,627
	<hr/>	<hr/>
Total costs used in the calculation of CCU	\$ 90,277	\$ 107,789
Weighted-average customers	1,498,449	1,512,043
	<hr/>	<hr/>
CCU	\$ 20.08	\$ 23.76
	<hr/>	<hr/>

**Liquidity and Capital Resources**

Because of their Chapter 11 filings, Leap and the Cricket Companies are operating separately and cash flows are not being shared between Leap and Cricket. As a result, we have presented liquidity and capital resources information for each of Leap and the Cricket Companies separately below, rather than on a consolidated basis.

To the extent that the matters discussed under this section Liquidity and Capital Resources, relate to future events or expectations, they may be significantly affected by the Chapter 11 proceedings at Leap and the Cricket Companies. The Chapter 11 proceedings involve various restrictions on business activities, limitations on financings and the need to obtain Bankruptcy Court approval for various matters, and have created uncertainty with respect to relationships with employees, vendors, suppliers, customers and others with whom Leap or the Cricket Companies conduct or may seek to conduct business. The Chapter 11 filings, combined with our cumulative net losses, raise substantial doubt about our ability to continue as a going concern.

A new Board of Directors of Leap will be appointed as of the effective date of the Plan of Reorganization. We cannot assure you that the new Board of Directors, the new management or the new stockholders will maintain our current operations or business plans. Accordingly, when reviewing the description of the our business, the condensed consolidated financial statements and financial data, and any forward-looking information included in this report, you should consider the possibility that there may be significant changes to our operations and business plans in the future following our emergence from bankruptcy.

**Leap**

In accordance with the Plan of Reorganization, on November 3, 2003, Leap transferred to the Leap Creditor Trust a cash distribution in the amount of \$67.8 million. This amount consisted of substantially all of Leap's unrestricted cash,

cash equivalents and short-term investments less a reserve for allowed administrative claims and allowed priority claims in the amount of approximately \$16 million (which reserve amount was agreed upon by the debtors and the Official Unsecured Creditors Committee of Leap prior to such distribution). In March 2004, Leap transferred an additional \$990,000 to the Leap Creditor Trust in connection with the agreement with the informal committee of holders of Cricket's senior secured vendor debt that Cricket would pay 100% of the success fee payable to the debtors financial advisor upon the debtors emergence from bankruptcy. The total transferred to the Leap Creditor Trust through March 31, 2004 was \$68.8 million. At March 31, 2004, Leap had \$12.9 million of cash, cash equivalents and short-term investments, all of which were included in consolidated restricted cash, cash equivalents and short-term investments in our condensed consolidated financial statements. Leap currently expects that its cash, cash equivalents and short-term investments will be sufficient to cover its expenses through emergence from bankruptcy. However, because of the uncertainties related to Leap's bankruptcy, including the ultimate date of emergence, actual expenses may vary materially from current expectations and we cannot provide assurances that Leap's funds will be adequate to cover its expenses through emergence. These expenses may be funded only from existing cash at Leap or by funds that have been distributed to the Leap Creditor Trust but not yet distributed to creditors holding beneficial interests in the Leap Creditor Trust.

At March 31, 2004, Leap had \$224.6 million of outstanding principal under its 12.5% senior notes and approximately \$504.4 million in accreted value of principal and accrued interest outstanding under its 14.5% senior discount notes. The senior notes and senior discount notes ceased accruing interest as of the Petition Date, and all payments of principal and interest due under the notes are stayed during the pendency of the Chapter 11 proceedings except as otherwise ordered by the Bankruptcy Court. The outstanding indebtedness under Leap's senior notes and senior discount notes will be cancelled under the Plan of Reorganization.

At March 31, 2004, Leap also had an \$8.6 million note payable to GLH. The note is secured by a pledge of the stock of a Leap subsidiary that owns certain wireless licenses not used in the Cricket business. During the three months ended March 31, 2004, the holder of the note foreclosed on the pledged stock of the Leap subsidiary, and Leap expects to transfer such stock to the noteholder

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once the FCC approves the change of control of wireless licenses associated with the foreclosure. The noteholder will have an unsecured claim against Leap in the bankruptcy proceedings for the difference between its bid in the foreclosure proceedings of approximately \$877,000 and the \$8.6 million principal and accrued interest due under the note.

Leap has a \$35.0 million promissory note receivable from Endesa related to Leap's sale of Smartcom, subject to a right of set-off to secure indemnification claims under the purchase agreement. Endesa has asserted claims of up to approximately \$49.0 million against Leap and its former subsidiary, Inversiones Leap Wireless Chile, S.A., for breach of representations and warranties under the purchase agreement and has notified Leap that it is offsetting the claims against the entire unpaid balance of the note. Proceedings relating to the resolution of these claims are currently pending in Chile. Leap believes Endesa's claims are without merit and is contesting Endesa's claims. The note matured on June 2, 2001, and Leap expects it to remain unpaid until the issues related to the claims are resolved. The note was previously held by Inversiones Leap Wireless Chile, which has been merged with and into Leap. Therefore, the \$35.0 million note is owned by Leap, and the claims of Endesa are against Leap. (However, Endesa has questioned the validity of the merger.) Leap filed an action against Endesa in the Bankruptcy Court, seeking to resolve the issues related to the note in the Bankruptcy Court. In March 2004, the Bankruptcy Court stayed that action and lifted the automatic stay so that the litigation could proceed in Chile; however, the Bankruptcy Court's order allowed Endesa only to seek set-offs against the amount it owes under the promissory note. In accordance with the Plan of Reorganization, the note will be transferred to the Leap Creditor Trust on the effective date of the Plan of Reorganization.

### ***The Cricket Companies***

The Cricket Companies' principal sources of liquidity are cash from operations and their existing cash, cash equivalents and short-term investments. As of March 31, 2004, the Cricket Companies had a total of approximately \$174.7 million in cash, cash equivalents and short-term investments, all subject to security interests in favor of Cricket's senior secured vendor debtholders. In addition, Cricket had restricted cash and cash equivalents of \$42.7 million as of March 31, 2004 that have been set aside or pledged to satisfy operating obligations.

At March 31, 2004, Cricket had \$1,485.1 million of principal and \$133.2 million of accrued interest and fees outstanding under its senior secured vendor credit facilities. The senior secured vendor credit facilities ceased accruing interest as of the Petition Date. All payments of principal, interest and fees payable under the senior secured vendor credit facilities are stayed during the pendency of the Chapter 11 proceedings. The outstanding indebtedness under Cricket's senior secured vendor credit facilities will be cancelled on the effective date of the Plan of Reorganization and Cricket will issue \$350.0 million of new senior secured pay-in-kind notes.

In addition, at March 31, 2004, the Cricket Companies owed approximately \$76.7 million (\$74.2 million, net of discount) of outstanding principal on wireless license acquisition indebtedness to the FCC. This obligation, which is secured by the wireless licenses purchased at the time the debt was incurred, is to be reinstated upon our emergence from bankruptcy. The Cricket Companies will pay the amounts then in arrears to the FCC upon their emergence from bankruptcy. At March 31, 2004, approximately \$23.1 million of such indebtedness was in arrears. The arrearage will increase by approximately \$5.8 million each quarter until we emerge from bankruptcy. At March 31, 2004, the Cricket Companies also had substantial general unsecured trade and other obligations.

Following our emergence from bankruptcy, we may seek to refinance our then existing indebtedness on more favorable terms, to the extent available.

We have filed schedules with the Bankruptcy Court indicating which of our executory contracts and unexpired real property leases we are assuming under the Plan of Reorganization. Unless otherwise agreed, our assumption of an

executory contract or lease will require us to cure all existing defaults under the contract or lease, including all pre-petition liabilities. Under the Plan of Reorganization, any such cure amounts are the responsibility of reorganized Cricket. Unless otherwise agreed by the parties to the assumed contracts and leases, the cure amounts are to be paid by Cricket on or shortly after the effective date of the Plan of Reorganization. Our pre-petition executory contracts and unexpired leases that were not listed on the assumption schedules were rejected as of October 22, 2003 (or the later date listed in a rejection schedule). As part of the bankruptcy process, we have successfully renegotiated numerous executory contracts and real estate leases and expect to realize substantial cost savings going forward.

On October 21, 2003, the debtors and the informal committee of Cricket's senior secured vendor debtholders agreed, pursuant to Section 8.05(e) of the Plan of Reorganization, to establish a reserve at Cricket in the amount of \$70.1 million to satisfy (1)



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allowed administrative claims, including approximately \$55 million of estimated cure payments in connection with assumed executory contracts and leases, and (2) allowed priority claims against the Cricket Companies through the effective date of the Plan of Reorganization. As of March 31, 2004, the Cricket Companies had paid approximately \$40 million of cure payments to vendors whose contracts were assumed by the Cricket Companies in the bankruptcy proceedings, and approximately \$30 million of the \$70.1 million reserve remained which is included in restricted cash, cash equivalents and short-term investments in our condensed consolidated financial statements. Our estimate of cure payments could vary materially after we have finally negotiated or resolved any disputed amounts.

If Cricket becomes unable to use cash collateral or if the Plan of Reorganization does not become effective, the Cricket Companies may be forced to liquidate under the applicable provisions of the United States Bankruptcy Code. There can be no assurance of the level of recovery the Cricket senior secured vendor debtholders would receive in such a liquidation, and it is unlikely that any unsecured creditors of Cricket would receive any recovery in a liquidation.

***Certain Contractual Obligations, Commitments and Contingencies***

The two tables below summarize information as of March 31, 2004 regarding certain future minimum contractual obligations for the next five years and thereafter for each of Leap and the Cricket Companies. The following amounts reflect certain pre-petition obligations as of March 31, 2004. As a result of the Chapter 11 filings, the long-term debt of Leap and the Cricket Companies is in default and the obligations under such debt are immediately due and payable. Therefore, the long-term debt of Leap and the Cricket Companies has been classified as current in the tables below. Under Chapter 11, actions to collect pre-petition indebtedness, as well as most other pending litigation, are stayed and other contractual obligations against us may not be enforced. Under Chapter 11, the rights and interests of our various creditors will be substantially altered. In addition, under Chapter 11 we will reject certain additional executory contracts and unexpired leases which will affect the amount of our liabilities. Therefore, the contractual obligations and commitments presented in the tables below do not reflect our expected cash outlays in future periods.

*Leap (unaudited) (in thousands):*

	<b>Total</b>	<b>Remainder of 2004</b>	<b>Year Ending December 31,</b>				<b>Thereafter</b>
			<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	
Long-term debt (1)	\$739,200	\$739,200	\$	\$	\$	\$	\$
Operating leases	1,975	952	1,023	-	-	-	-
<b>Total</b>	<b>\$741,175</b>	<b>\$740,152</b>	<b>\$1,023</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>

(1) Amounts shown for Leap's long-term debt include principal and interest accrued under the facilities.  
*The Cricket Companies (unaudited) (in thousands)*

<b>Total</b>	<b>Remainder of 2004</b>	<b>Year Ending December 31,</b>				<b>Thereafter</b>
		<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	

Long-term debt(1)	\$1,701,214	\$1,701,214	\$	\$	\$	\$	\$
Operating Leases	150,343	42,051	52,159	27,999	9,652	6,676	11,806
Chase earn-out(2)	41,000			41,000			
Total	\$1,892,557	\$1,743,265	\$52,159	\$68,999	\$9,652	\$6,676	\$11,806

(1) Amounts shown for the Cricket Companies' senior secured vendor credit facilities and U.S. government financing included in long-term debt, include principal, interest and fees accrued under the facilities, and do not include payments under Leap's senior notes and senior discount notes, which are guaranteed by Cricket Communications Holdings, Inc.

(2) Leap's March 2000 acquisition of substantially all of the assets of Chase Telecommunications Holdings, Inc. included contingent earn-out payments of up to \$41.0 million (plus certain expenses) based on the earnings of the business acquired during the fifth full year following the closing of the acquisition. This obligation was generally assigned to and assumed by Cricket in 1999. We believe that the earn-out will be earned at significantly less than \$41.0 million, if at all. Leap and Cricket rejected this agreement in bankruptcy.

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***Off-Balance Sheet Arrangements***

We had no off-balance sheet arrangements at March 31, 2004.

***Credit Facilities and Other Financing Arrangements***

***New Senior Secured Notes to be Issued Upon Emergence from Bankruptcy***

On the effective date of the Plan of Reorganization, Cricket will issue \$350.0 million of new senior secured pay-in-kind notes. The notes will mature on the seventh anniversary of the effective date of the Plan of Reorganization. The notes bear interest at 13% per annum. Interest on the notes is payable semi-annually. Interest is payable in cash, except Cricket may elect to pay up to 12% interest on each of the first four regularly scheduled interest payment dates by issuing additional notes in a principal amount equal to the amount of interest not paid in cash. Each note will be issued in denominations of \$100 principal amount and larger integral multiples thereof.

The notes will be secured by all of the personal property and any owned real property of Leap and its direct and indirect subsidiaries. The notes will also be secured by all of the stock of Leap's direct and indirect subsidiaries and will be guaranteed by Leap and all of its direct and indirect subsidiaries (in each case, other than Cricket which is the primary obligor under the notes).

Cricket may redeem the outstanding notes in whole or in part at any time, in cash at a redemption price equal to: 106.5% of their principal amount plus accrued and unpaid interest during the first full year following the effective date of the Plan of Reorganization, declining gradually to 100% in the fifth full year thereafter and at any time thereafter.

The indenture that will govern the new notes will contain significant limitations on our ability to incur additional debt or to grant additional liens on our assets. We must meet certain financial ratios in order to incur additional unsecured indebtedness, subject to certain limited exceptions. In addition, the indenture permits us to incur up to \$50 million of additional debt outstanding at any one time to procure equipment, inventory and telecommunications network assets. This additional debt may be secured, but only by the equipment, inventory or network assets financed with the proceeds of the debt. The terms of the notes include other covenants that restrict our ability to, among other things:

- pay dividends;
- make investments;
- sell assets;
- issue or sell the stock of some of Leap's subsidiaries;
- enter into transactions with affiliates; and
- effect a consolidation or merger.

These limitations are subject to certain qualifications and exceptions contained in the indenture governing the new notes.

Upon the occurrence of events constituting a change of control of the Company, Cricket must make an offer to all noteholders to repurchase all or part of each holder's notes in cash at a purchase price equal to 101% of their principal amount plus accrued and unpaid interest. In addition, in some cases if we sell assets and do not use the net proceeds of

the sale either to retire secured debt or to reinvest in other assets that are used in our business, Cricket must offer to repurchase the notes at a purchase price equal to 101% of their principal amount plus accrued and unpaid interest.

Events of default under the notes include, among others, our failure to make payments under the notes when due, our failure to comply with covenants or other provisions under the indenture governing the notes or the related security documents, our defaulting under other indebtedness with an aggregate principal amount in excess of \$10.0 million and which default gives the holder thereof the right to accelerate payment of the debt, a final judgment or order not covered by insurance for the payment of money of \$10.0 million or more is rendered against us and the judgment or order is not stayed or discharged for a period of 30 consecutive days after entry, the bankruptcy or insolvency of Leap or Cricket or their subsidiaries, any security document or guaranty of the notes ceases to be in full force and effect, or the loss, suspension, revocation or non-renewal of wireless licenses covering 50% or more of the total potential customers covered by all of our wireless licenses. In the case of an event of default

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arising from bankruptcy or insolvency, all outstanding notes become immediately due and payable.

### *Units Offering*

As a result of Leap's Chapter 11 filing, Leap is currently in default under the indenture governing its senior notes and senior discount notes and the obligations under those notes have been accelerated. At March 31, 2004, Leap had \$224.6 million of principal outstanding under its 12.5% senior notes and approximately \$504.4 million in accreted value of principal and accrued interest outstanding under its 14.5% senior discount notes. The senior notes and senior discount notes ceased accruing interest as of the Petition Date, and payments of principal and interest due under the notes have been stayed during the pendency of the Chapter 11 proceedings. The indebtedness under the senior notes and the senior discount notes will be cancelled on the effective date of the Plan of Reorganization.

In February 2000, Leap completed an offering of 225,000 senior units, each senior unit consisting of one 12.5% senior note due 2010 and one warrant to purchase Leap common stock, and 668,000 senior discount units, each senior discount unit consisting of one 14.5% senior discount note due 2010 and one warrant to purchase Leap common stock. The total gross proceeds from the sale of the senior units and senior discount units were \$225.0 million and \$325.1 million, respectively, of which \$164.4 million was allocated to the fair value of the warrants, estimated using the Black-Scholes option pricing model. The warrants issued in the units offering are exercisable for an aggregate of 2,829,854 shares of Leap common stock at an exercise price of \$96.80 per share. All of these warrants will be cancelled under the Plan of Reorganization.

Leap has outstanding 225,000 senior notes and 668,000 senior discount notes. Each note has a principal amount at maturity of \$1,000. Except while Leap is in bankruptcy, interest on the senior notes was payable semi-annually, and would have begun accruing cash interest on April 15, 2005 with the first semi-annual interest payment due October 15, 2005. Each senior discount note had an initial accreted value of \$486.68 and a principal amount at maturity of \$1,000. Cricket Communications Holdings, Inc., Backwire.com Inc. and Telephone Entertainment Network, Inc. guarantee the notes. The terms and conditions of the notes are more fully described in the indenture for the notes, which is filed with the SEC as an exhibit to our Annual Report on Form 10-K for the year ended December 31, 2003.

### *Vendor Financing*

Cricket had entered into senior secured vendor credit facilities with each of Lucent Technologies Inc., Nortel Networks Inc. and Ericsson Credit AB (and an affiliate) for the purchase of network infrastructure products and services and the financing of purchases, interest expense and other costs, and origination and commitment fees related to the credit facilities.

Cricket is currently in default under each of its senior secured vendor credit facilities and, as a result of the bankruptcy filings, the indebtedness under these facilities has been accelerated. At March 31, 2004, Cricket had \$1,618.3 million outstanding under its senior secured vendor credit facilities. The senior secured vendor credit facilities ceased accruing interest as of the Petition Date. Payments of principal, interest and fees due under the senior secured vendor credit facilities have been stayed during the pendency of the Chapter 11 proceedings.

Because of the events of default under the senior secured vendor credit facilities, each of the lenders under those facilities terminated their commitments under the facilities. The defaults also provide the credit facility lenders with various rights under their credit agreements and related security agreements, including the right to foreclose on the collateral pledged to secure the outstanding loans, which includes all of the stock and personal property assets of the Cricket Companies (other than the stock of Cricket Communications Holdings, Inc.), subject to the requisite approval of the Bankruptcy Court. However, under the Plan of Reorganization confirmed by the Bankruptcy Court, amounts

owed under these facilities will be cancelled and the holders of secured debt associated with these facilities will receive their pro rata portion of 96.5% of the outstanding shares in reorganized Leap as of the effective date of the Plan of Reorganization and new senior secured pay-in-kind notes from Cricket with an aggregate face value of \$350.0 million.

Except while the Cricket Companies are in bankruptcy, borrowings under each of the credit facilities accrued interest at a rate equal to LIBOR plus 3.5% to 4.25% or a bank base rate plus 2.5% to 3.25%, in each case with the specific rate based on the ratio of total indebtedness to EBITDA, as defined in the credit agreements. Due to the event of default for non-payment of principal and interest, the Cricket Companies were no longer able to make new LIBOR borrowings and, prior to the Petition Date, existing base rate loans bore an additional default interest rate of 2%. The vendor financing facilities provide that principal payments under the credit agreements were scheduled to begin in December 2002 for Lucent and were scheduled to begin in December 2003 for Nortel

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and Ericsson, with a final maturity in June 2007 for Lucent and in September 2008 for Nortel and Ericsson. Repayment of principal was required in 20 quarterly payments, with the annual principal repayments totaling 10%, 15%, 20%, 25% and 30% of the principal outstanding at the end of the availability period, respectively, during the first through fifth years following the end of the scheduled availability period. Cricket has not made any principal or interest payments due under the credit agreements, which constituted events of default under the agreements.

Fees payable by Cricket under the senior secured vendor credit facilities include (i) commitment fees of 0.75% to 1.25% per annum on the unused commitments under the facilities, with the rate applicable to each facility based on the total borrowings under that facility, and (ii) origination fees totaling \$49.8 million, of which approximately \$10.0 million had been paid through borrowings under the senior secured vendor credit facilities. The origination fees are currently payable to the vendors, as the availability period under all of the credit facilities ended upon termination of the commitments in September 2002.

Each of the credit agreements contains various covenants and conditions. The credit agreements, as amended, are filed with the SEC as exhibits to our Annual Report on Form 10-K for the year ended December 31, 2003.

### *Debt Obligations to the FCC and Note Payable to GLH*

The Cricket Companies have assumed debt obligations to the FCC as part of the purchase price for wireless licenses. At March 31, 2004, the Cricket Companies had \$76.7 million (\$74.2 million, net of discount) outstanding under their FCC debt. The original terms of the notes include interest rates ranging from 6.25% to 7.0% per annum and quarterly principal and interest payments until maturity through July 2007. The notes were discounted using management's best estimate of the prevailing market interest rate at the time of purchase of the wireless licenses ranging from 9.75% to 10.75% per annum. Payments of principal and interest under these obligations are generally stayed during the pendency of the Chapter 11 proceedings. However, under the Plan of Reorganization, our U.S. government financing is to be reinstated on the effective date of the Plan of Reorganization, with past due payments of principal and any accrued interest due and payable on such date. In addition, if in conjunction with our emergence from bankruptcy, the FCC determines that we are no longer qualified to hold C-Block and F-Block licenses under applicable FCC rules or that we are not entitled to the benefits afforded to a small business or very small business when we emerge from bankruptcy our \$76.7 million of indebtedness to the FCC may become immediately due and payable.

In April 2002, we completed the exchange of certain wireless licenses with GLH. Pursuant to the agreement, GLH assumed our FCC debt totaling \$8.4 million related to certain of the wireless licenses provided in the exchange. In consideration for GLH's assumption of the FCC debt, we provided to GLH a note payable totaling \$8.4 million. The original terms of our note payable were parallel to the payment terms under the assumed FCC debt. The note is secured by a pledge of the stock of a Leap subsidiary that owns certain wireless licenses not used in the Cricket business. In January 2003, Leap chose not to make a payment of principal and accrued interest that was due on the note, which constituted an event of default. During the three months ended March 31, 2004, the holder of the note foreclosed on the pledged stock of the Leap subsidiary, and Leap expects to transfer such stock to the noteholder once the FCC approves the change of control of wireless licenses associated with the foreclosure. The noteholder will have an unsecured claim against Leap in the bankruptcy proceedings for the difference between its bid in the foreclosure proceedings of approximately \$877,000 and the \$8.6 million principal and accrued interest due under the note.

## **Operating Activities**

Cash provided by operating activities, net of net cash used for reorganization activities of \$2.2 million, totaled \$40.8 million during the three months ended March 31, 2004 compared to cash provided by operating activities of \$29.2 million in the corresponding period of the prior year. The increase was primarily attributable to a decrease in net

loss, adjusted for non-cash items, including depreciation, amortization and non-cash interest expense, of \$33.2 million, combined with a change in working capital of \$19.4 million, offset by net cash used for reorganization items of \$2.2 million.

### **Investing Activities**

Cash used in investing activities was \$30.4 million during the three months ended March 31, 2004 compared to cash used in investing activities of \$0.2 million in the corresponding period of the prior year. Investing activities during the three months ended March 31, 2004 consisted primarily of the purchase of investments of \$33.7 million and the purchase of property and equipment of \$16.2 million, offset by the sale and maturity of investments of \$16.9 million and the maturity of restricted cash equivalents and investments of \$2.6 million. Investing activities during the three months ended March 31, 2003 consisted primarily of the purchase of investments of \$22.5 million, the purchase of property and equipment of \$4.2 million and the maturity of restricted cash



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equivalents and investments of \$0.3 million, offset by the sale and maturity of investments of \$25.3 million and \$1.5 million in proceeds from the sale of wireless licenses.

**Financing Activities**

There was no cash provided by or used in financing activities during the three months ended March 31, 2004. Cash used in financing activities in the corresponding period of the prior year was \$4.4 million and consisted entirely of payments on our debt obligations to the FCC.

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**RISK FACTORS**

**Changes in Our Board of Directors, Management and Stockholders Upon Our Emergence from Bankruptcy May Lead to Significant Changes in Our Operations, Business Plans and Results**

On the effective date of the Plan of Reorganization, a new Board of Directors will be appointed for Leap and Leap will have a new stockholder base. In addition, we expect that a new CEO will be appointed in the near future. The new Board of Directors, new management or the new stockholders may change the current operations or business plans of the Company. As a result, when reviewing the description of our business, the condensed consolidated financial statements and financial data, and any forward-looking information included in this report, you should consider the possibility that there may be significant changes to the our operations, business plans, results and expectations following our emergence from bankruptcy.

**Leap Common Stock, Warrants and Options Will Be Cancelled Upon Our Emergence From Bankruptcy, and the Holders of Claims and Interests in Several Classes Will Receive Substantially Reduced or No Distributions Under the Plan of Reorganization**

Our confirmed Plan of Reorganization provides that Leap's outstanding shares of common stock, warrants and options will be cancelled upon our emergence from bankruptcy and that the holders of Leap common stock, warrants and options will receive no distributions under the Plan of Reorganization. In addition, the Plan of Reorganization provides that the holders of allowed general unsecured claims against Leap will receive distributions representing a fraction of the amount of their claims, and the holders of general unsecured claims against Cricket will receive de minimus or no distributions in respect of their claims. Holders of general unsecured claims against the other subsidiaries of Leap and Cricket will receive no distributions under the Plan of Reorganization.

As a result, 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.

**Our Plan of Reorganization May Not Receive Required FCC Approval on a Timely Basis, and May Not Be Successfully Consummated**

We can complete our Plan of Reorganization only after we satisfy a number of conditions typical in reorganizations and obtain FCC approval of the change of control of our wireless licenses that will occur upon our emergence from bankruptcy. It may take several months from the filing date of this report to obtain FCC approval. If the FCC approves the change of control of our wireless licenses but determines that we will no longer be qualified to own C-Block and F-Block licenses when we emerge from bankruptcy or that we will no longer be entitled to the benefits afforded to a small business or very small business then, upon our emergence from bankruptcy: (1) we may forfeit our right to continue to own our C-Block and F-Block licenses for which we have not then met the FCC's minimum coverage requirements; (2) our \$76.7 million of indebtedness to the FCC may become immediately due and payable; and/or (3) we may be required to pay approximately \$2-\$4 million of unjust enrichment penalties. As of March 31, 2004, the carrying value of our C-Block and F-Block licenses for which we had not yet met the minimum coverage requirement was approximately \$33.3 million.

We expect that the FCC will approve the proposed transfer of control of our wireless licenses. However, we cannot provide assurances that the FCC will grant such approval or will determine that we will remain qualified to hold C-Block and F-Block licenses upon our emergence from bankruptcy or that we will otherwise avoid acceleration of our FCC indebtedness or other unjust enrichment penalties. Lengthy Chapter 11 proceedings would result in additional costs and are likely to adversely affect our operating results and our relationships with customers and suppliers. If the Plan of Reorganization is not consummated, it could result in our Chapter 11 proceedings becoming

protracted or, although unlikely, being converted into Chapter 7 liquidation proceedings, either of which would substantially erode the value of our enterprise to the detriment of stakeholders who are to receive a distribution in connection with our bankruptcy.

**Our Shares May Not Be Listed on NASDAQ or Any Other Stock Exchange Following Completion of Our Bankruptcy Proceedings**

Under our Plan of Reorganization, new equity securities of Leap will be issued to two classes of our creditors upon our emergence from Chapter 11. We currently contemplate that Leap's new equity securities will trade publicly after they are issued. If Leap's new equity securities trade publicly after our emergence from bankruptcy, they may not be listed on NASDAQ or any stock exchange and their liquidity may be limited. If the liquidity of Leap's common stock is limited after our emergence from

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bankruptcy, our ability to access capital markets may be restricted.

### **We Believe Our Chapter 11 Proceedings Resulted in a Negative Public Perception of Leap and Cricket That Has Adversely Affected Our Relationships with Customers and Suppliers, As Well As Our Business, Results of Operations and Financial Condition**

We believe our Chapter 11 filings negatively impacted the public perception of Leap, Cricket and their subsidiaries. Although we believe our public perception has improved substantially as a result of the continued operation of our business and the confirmation of our Plan of Reorganization, if our current and potential customers perceive us as a company with financial difficulties because of negative press articles, extensive delays in the process of receiving approval from the FCC to transfer control, or other reasons, they may decide not to purchase our products or services. At March 31, 2004, we had approximately 1,538,000 customers compared to approximately 1,513,000 at March 31, 2003. Although we increased the total number of customers from the prior year, our total number of customers fluctuated from quarter to quarter in 2003. Prior to the second quarter of 2003, Cricket had not experienced a decline in total customers from one quarter to another, but in the second quarter of 2003 we lost approximately 54,000 net customers. Promotional activity resulted in a net increase in our customers of approximately 18,000 during the three months ended September 30, 2003, but during the fourth quarter of 2003, we lost approximately 4,000 net customers. During the first quarter of 2004, we experienced a net increase of approximately 65,700 customers as a result of increased promotional activity and decreased churn. Our ability to attract and retain customers may continue to be adversely affected by our Chapter 11 proceedings, which could have a material negative impact on our liquidity and results of operations. Similarly, because of our bankruptcy filings, many of our suppliers continue to sell to us only on less favorable terms. Negative public perception could also adversely impact our future access to additional capital and have other material adverse effects on our business, results of operations and financial condition.

### **In Their Audit Report, Our Independent Auditors Express Substantial Doubt About Our Ability to Continue as a Going Concern**

Our independent auditors included a going concern paragraph in their audit report on our audited 2003 annual consolidated financial statements. The audit report states that the uncertainties inherent in the bankruptcy process and our recurring losses from operations raise substantial doubt about our ability to continue as a going concern. Our consolidated financial statements assume we will continue as a going concern, but our ability to do so will require a successful reorganization of our outstanding indebtedness. If our Plan of Reorganization does not become effective in a timely fashion, our reorganization efforts may be unsuccessful which could lead to the financial failure of our company.

### **Implementation of Number Portability Could Negatively Impact Our Business**

The FCC has mandated that telecommunications carriers permit customers to keep their existing telephone numbers when they switch from one carrier to another. Wireless carriers were required to implement the number portability mandate in the largest 100 markets by November 24, 2003 and will be required to implement the mandate nationwide by May 24, 2004. As a result of standard processes adopted by wireless carriers, we have implemented the FCC's order with wireless carriers in our markets which are within the 100 largest metropolitan areas. We are also implementing portability with landline carriers in those markets but, because of variability in the processes used by landline carriers, porting with wireline carriers takes longer periods of time and requires substantial manual efforts. We expect to implement nationwide number portability on May 24, 2004. However, our ability to implement number portability in additional markets depends in part on the readiness of other wireless carriers in those markets.

We have long supported number portability and believe that the FCC's order will benefit us in the long term. However, since we do not have long-term contracts, our customers are free to change service providers at any time. In

contrast, many of our competitors require their customers to sign long-term contracts, which may limit their ability to transfer their number to other carriers, including Cricket. The ultimate effects of number portability are uncertain and could result in a loss of customers, although we do not believe the implementation of the FCC mandate has materially affected us. We anticipate that number portability will increase competition for customers which could adversely affect our financial results by decreasing expected customer growth and expected revenue and by increasing the costs of adding new customers.

**We Have Experienced Net Losses Since Inception and We May Not Be Profitable in the Future**

Leap and its subsidiaries experienced net losses of \$28.0 million for the three months ended March 31, 2004, \$597.4 million for the year ended December 31, 2003, \$664.8 million for the year ended December 31, 2002, \$483.3 million for the year ended

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December 31, 2001, \$0.2 million for the year ended December 31, 2000, \$75.8 million for the transition period from September 1, 1999 to December 31, 1999, and \$164.6 million for the fiscal year ended August 31, 1999. We may not generate profits in the short term or at all. If we fail to achieve profitability after emerging from Chapter 11, that failure would have a negative effect on our financial condition and on the value of the common stock of a reorganized Leap.

### **We Face Increasing Competition, and Some Major Carriers Have Offered Service With Increasingly Large Bundles of Minutes of Use at Increasingly Low Prices, Which Could Have a Material Adverse Effect on Demand for the Cricket Service**

The telecommunications industry generally is very competitive and competition is increasing. Some competitors have announced rate plans substantially similar to the Cricket service plan in markets in which we offer wireless service. In addition, the competitive pressures of the wireless telecommunications market have caused other carriers to offer service plans with increasingly large bundles of minutes of use at increasingly low prices which are competing with the predictable and virtually unlimited Cricket calling plans. These competitive plans could adversely affect our ability to maintain our pricing, market penetration and customer retention. Our competitors have begun to price their services more aggressively and may attract more customers because of their stronger market presence and geographic reach. Potential customers may perceive the Cricket service to be less appealing than other wireless plans, which offer more features and options, including the ability to roam outside of the home service area. Many competitors have substantially greater financial and other resources than we have, and we may not be able to compete successfully.

We compete as a mobile alternative to landline service providers in the telecommunications industry. Wireline carriers have begun to aggressively advertise in the face of increasing competition from wireless carriers, cable operators and other competitors. We may not be successful in our efforts to persuade potential customers to adopt our wireless service in addition to, or in replacement of, their current landline service.

In addition, because of their size and bargaining power, our larger competitors may be able to purchase supplies at lower prices than we can. If consolidation in the industry creates even larger competitors, any purchasing advantages our competitors have may increase.

### **Our Primary Business Strategy May Not Succeed in the Long Term**

A major element of our business strategy is to offer consumers a service that allows them to make virtually unlimited calls within a local area and receive unlimited calls from any area for a flat monthly rate without entering into a long-term service contract. This strategy may not prove to be successful in the long term. From time to time, we also evaluate our service offerings and the demands of our target customers and may modify, change or adjust our service offerings or trial new service offerings as a result. We cannot assure you that these service offerings will be successful or prove to be profitable.

We recently launched several new calling plans and a plan that offers virtually unlimited long distance to more effectively compete with other telecommunications providers. These planned and new services are unproven. They may not attract or retain customers at a rate necessary to make them profitable and otherwise may not prove to be successful.

### **The Wireless Industry is Experiencing Rapid Technological Change, and We May Lose Customers if We Fail to Keep Up With These Changes**

The wireless communications industry is experiencing significant technological change, as evidenced by the ongoing improvements in the capacity and quality of digital technology, the development and commercial acceptance

of wireless data services, shorter development cycles for new products and enhancements and changes in end-user requirements and preferences. The cost of these changes may be prohibitive to us, and we may lose customers if we fail to keep up with these changes.

**We Had a Net Loss of Customers During the Year Ended December 31, 2003**

Although our total customers at March 31, 2004 was greater than our total customers at March 31, 2003, our total customers at December 31, 2003 were less than total customers at December 31, 2002. We believe the loss of customers occurred in large part because of our bankruptcy filing and decreased selling and marketing expenses in 2003 resulting from management's focus on cost reduction and cash conservation during the course of our bankruptcy. We also believe that our sales declined because of the economic climate in 2003, increased competition, and the increase in the percentage of the population that already subscribes to a wireless service which makes new sales more difficult. If we do not continue to successfully increase our total customers, we will

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be required to revise our planned operations substantially and our future results of operations will be materially less favorable than if we were able to increase our customer base.

### **If We Experience a High Rate of Customer Turnover, Our Ability to Become Profitable Will Decrease**

Customer turnover, referred to as churn, is an important business metric in the telecommunications industry because it can have significant financial effects. Because we do not require customers to sign long-term contracts, our service is available to a broader income base than many other wireless providers and, as a result, some of our customers may be more likely to terminate service for inability to pay than the average industry customer. In addition, our rate of customer turnover may be affected by other factors, including limited network coverage, reliability issues such as blocked or dropped calls, handset problems, inability to make calls while outside of the local calling area, customer care concerns, number portability and other competitive factors. Our strategies to address customer turnover may not be successful. A high rate of customer turnover would reduce revenues and increase the marketing costs required to attract the minimum number of replacement customers required to sustain our business plan, which, in turn, would have a material adverse effect on our business, financial condition and results of operations.

Our operating costs can also increase substantially as a result of credit card, subscription and dealer fraud. We have implemented a number of strategies and processes to detect and prevent efforts to defraud us, and we believe that our efforts have substantially reduced the types of fraud we have identified. However, if these strategies are not successful in detecting and controlling fraud in the future, it would have a material adverse impact on our financial condition and results of operations.

### **The Loss of Key Personnel and Difficulty Attracting and Retaining Qualified Personnel Could Harm Our Business**

We believe our success depends heavily on the contributions of our employees and on maintaining our experienced workforce. We do not, however, generally provide employment contracts to our employees and the uncertainties associated with our bankruptcy have caused many employees to consider or pursue alternative employment. Since we announced reorganization discussions and filed for Chapter 11, we have experienced higher than normal employee turnover, including turnover of individuals at the president, chief operating officer, senior vice president, vice president and other management levels. In addition, in connection with the change of control that will occur when we emerge from bankruptcy, we expect that a new CEO will be appointed in the near future to replace our existing CEO, Harvey P. White. The loss of key individuals, and particularly the cumulative effect of such losses, may have a material, adverse impact on our ability to manage and operate our business. We also may have difficulty attracting, developing, motivating and retaining experienced and innovative personnel as a result of our Chapter 11 filings, which could also adversely affect our business operations and financial condition.

### **Risks Associated With Wireless Handsets Could Pose Product Liability, Health and Safety Risks That Could Adversely Affect Our Business**

We do not manufacture handsets or other equipment sold by us and generally rely on our suppliers to provide us with safe equipment. Our suppliers are required by applicable law to manufacture their handsets to meet certain governmentally imposed safety criteria. However, even if the handsets we sell meet the regulatory safety criteria, we could be held liable with the equipment manufacturers and suppliers for products we sell if they are later found to have design or manufacturing defects. We generally have indemnification agreements with the manufacturers who supply us with handsets to protect us from direct losses associated with product liability, but we cannot guarantee that we will be fully protected against all losses associated with a product that is found to be defective.



Media reports have suggested that the use of wireless handsets may be linked to various health concerns, including cancer, and may interfere with various electronic medical devices, including hearing aids and pacemakers. Certain class action lawsuits have been filed in the industry claiming damages for alleged health problems arising from the use of wireless handsets. In addition, interest groups have requested that the FCC investigate claims that wireless technologies pose health concerns and cause interference with airbags, hearing aids and other medical devices. The media has also reported incidents of handset battery malfunction, including reports of batteries that have overheated. Malfunctions have caused at least one major handset manufacturer to recall certain batteries used in its handsets, including batteries in a handset sold by Cricket and other wireless providers.

Concerns over radio frequency emissions and defective products may discourage the use of wireless handsets, which could decrease demand for our services. In addition, if one or more Cricket customers were harmed by a defective product sold in connection with our services, our ability to add and maintain customers for Cricket service could be materially adversely affected by negative public reactions.

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There also are some safety risks associated with the use of wireless handsets while driving. Concerns over these safety risks and the effect of any legislation that has been and may be adopted in response to these risks could limit our ability to market and sell our wireless service.

### **We Rely Heavily on Third Parties to Provide Specialized Services; A Failure by Such Parties to Provide the Agreed Services Could Materially Adversely Affect Our Operations and Financial Condition**

We depend heavily on suppliers and contractors with specialized expertise in order for us to efficiently operate our business. For example, we rely on Lucent Technologies Inc., Nortel Networks Inc. and Ericsson Wireless Communications, Inc. to provide us with replacement parts for our networks, to help us maintain our telecommunications network software, and to update that software, including updates that allow us to comply with governmental regulatory mandates relating to matters like number portability and the Communications Assistance for Law Enforcement Act (CALEA). We also rely on specialized vendors to assist us in operating customer call centers and generating and distributing customers' bills. In addition, we rely on handset vendors to supply us with handsets for our customers, and on third-party retailers to sell our handsets to a majority of our new customers. In the past, our suppliers, contractors and third-party retailers have not always performed at the levels we expect or at the levels required by their contracts. If key suppliers, contractors or third-party retailers fail to comply with their contracts, fail to meet our performance expectations or refuse to supply us in the future, our business could be severely disrupted. Some vendors, including software vendors, are the exclusive sources of their products. Further, because of the time lags associated with transferring complex responsibilities from one vendor to another, the disruption to our business could materially affect our operations and financial condition even if alternative vendors were available to eventually replace any vendor that failed to provide the services we contracted to receive.

### **Regulation By Government Agencies May Increase Our Costs of Providing Service or Require Us to Change Our Services**

Our operations are subject to varying degrees of regulation by the FCC, the Federal Trade Commission, the Federal Aviation Administration, the Environmental Protection Agency, the Occupational Safety and Health Administration and state and local regulatory agencies and legislative bodies. Adverse decisions or regulations of these regulatory bodies could negatively impact our operations and costs of doing business. State regulatory agencies are increasingly focused on the quality of service and support that wireless carriers provide to their customers. Governmental regulations and orders could significantly increase our costs and affect our competitive position compared to other telecommunication providers. We are unable to predict the scope, pace or financial impact of regulations and other policy changes that could be adopted by the various governmental entities that oversee portions of our business.

### **We Will Likely Have to Raise Substantial Capital if We Wish to Launch Several New Cricket Markets in the Future, and Our New Secured Notes Will Contain Limitations on Incurring Indebtedness and Granting Liens That May Impede Our Ability to Do So**

We will likely have to raise substantial capital if we wish to launch Cricket service in several additional markets in the future. We previously financed the costs of launching new markets through secured financing provided by our major infrastructure equipment vendors. However, the commitments under our existing vendor credit facilities have been terminated, and our current infrastructure equipment vendors may not be willing to provide us with financing in the future to build out and launch new markets. Further, our bankruptcy may make it more difficult to raise capital in the future and any equipment financing provided to us may be more restrictive than the financing previously provided to us.

The indenture that will govern the \$350 million of new senior secured pay-in-kind notes that Cricket will issue when it emerges from bankruptcy will contain significant limitations on our ability to incur additional debt or to grant

additional liens on our assets. The indenture permits us to incur up to \$50 million of additional debt outstanding at any one time to procure equipment, inventory and telecommunications network assets. This additional debt may be secured, but only by the equipment, inventory or network assets financed with the proceeds of the debt. In addition, we must meet certain stringent financial ratios in order to incur additional unsecured indebtedness, subject to certain limited exceptions. As a result, before we can build out and launch new Cricket markets, we will likely be required to modify, refinance or repay the \$350 million of new senior secured pay-in-kind notes that will be issued when we emerge from bankruptcy, or raise additional capital through the issuance and sale of additional equity securities.

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**If Call Volume Under Our Cricket Flat Price Plans Exceeds Our Expectations, Our Costs of Providing Service Could Increase, Which Could Have a Material Adverse Effect On Our Competitive Position**

Cricket customers currently use their handsets approximately 1,500 minutes per month, and some markets are experiencing substantially higher call volumes. We design our networks to accommodate this expected high call volume. However, if future wireless use by Cricket customers exceeds the capacity of our networks, service quality may suffer. We may be forced to raise the price of Cricket service to reduce volume or otherwise limit the number of new customers, or incur substantial capital expenditures to improve network capacity.

We offer service plans that bundle certain features, long distance and virtually unlimited local service for a fixed monthly fee to more effectively compete with other telecommunications providers. If customers exceed expected usage, we could face capacity problems and our costs of providing the services could increase, making it less economical to continue providing long distance at current prices. If we are unable to cost-effectively provide our new products and services to customers, our competitive position and business prospects could be materially adversely affected.

**Future Declines in the Fair Value of Our Wireless Licenses Could Result in Additional Impairment Charges**

During the three months ended June 30, 2003, we recorded an impairment charge of \$171.1 million to reduce the carrying value of our wireless licenses to their estimated fair value. The fair values of our wireless licenses are based primarily on available market prices, including successful bid prices in FCC auctions and selling prices observed in wireless license transactions. The market values of wireless licenses have varied dramatically over the last several years, and may vary significantly in the future. In particular, valuation swings could occur if (a) future consolidation in the wireless industry allowed or required carriers to sell significant portions of their wireless spectrum holdings, or (b) a sudden large sale of spectrum by one or more wireless providers, such as NextWave Telecom, Inc., occurs. In addition, the price of wireless licenses could decline as a result of the FCC's pursuit of policies designed to increase the number of wireless licenses available in each of our markets. If the market value of wireless licenses were to decline significantly in the future, the value of our wireless licenses could be subject to further non-cash impairment losses in the future.

Even if the value of our wireless licenses does not decline, the carrying value of our licenses is likely to be reduced in the future when we emerge from bankruptcy and implement the fresh start provisions of SOP 90-7. Fresh start reporting requires a different standard for determining the carrying value of our wireless licenses than the approach required in connection with examining the possible impairment of our indefinite-lived intangible assets like wireless licenses.

**Our Bankruptcy Filings and the Highly Competitive Wireless Telecommunications Market Adversely Affect Our Ability to Predict Future Performance**

Our business plan and estimated future operating results are based on estimates of key operating metrics. Our Chapter 11 filings coupled with the highly competitive marketplace have adversely affected our ability to predict future customer growth and other key operating metrics.

**Declines in Our Operating Performance Could Ultimately Result in an Impairment of Our Long-Lived Assets**

We assess potential impairments to our long-lived assets, including property and equipment and other intangible assets, when there is evidence that events or changes in circumstances indicate that the carrying value of the assets may not be recoverable. Because our long-lived assets do not have identifiable cash flows that are largely independent of other asset groupings, we compare our total estimated undiscounted future cash flows, excluding interest costs, to

the carrying value of our long-lived and indefinite-lived assets in performing our impairment tests. Our estimated future operating results are based on estimates of key operating metrics. Therefore, if we do not achieve these metrics and, as a result, do not achieve our planned operating results, this may have a significant adverse effect on our estimated undiscounted future cash flows and may ultimately result in a non-cash impairment charge related to our long-lived assets. A significant impairment loss could have a material adverse effect on our operating income and the carrying value of our long-lived assets on our balance sheet.

Even if our future operating results and estimated cash flows do not require any future impairment of our long-lived assets, the carrying value of our long-lived assets are likely to be reduced in the future when we emerge from bankruptcy and implement the fresh start provisions of SOP 90-7. Fresh start reporting requires a different standard for determining the carrying value of our long-lived assets than the approach required in connection with examining the possible impairment of our long-lived assets.

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**Because our Consolidated Financial Statements Will Reflect Fresh Start Reporting Adjustments Made Upon Our Emergence from Bankruptcy, Financial Information Reflecting Our Future Results of Operations and Financial Condition Will Not Be Comparable to Prior Periods**

As a result of adopting fresh start reporting, the book values of our wireless licenses and our long-lived assets and the related depreciation and amortization expense, among other things, will change considerably from that reflected in our historical consolidated financial statements. Our future results will not be comparable to the historical consolidated statement of operations data included in this report. Once we emerge from bankruptcy, you will not be able to compare certain information reflecting our results of operations and financial condition to those for periods prior to our emergence from bankruptcy without making adjustments for fresh start reporting.

**We May Not Satisfy the Coverage Deadlines and Geographic Coverage Requirements Applicable to Our Wireless Licenses, Which May Result in the Revocation of Some of Our Wireless Licenses or the Imposition of Fines and/or Other Sanctions**

Our wireless licenses include provisions that require us to satisfy certain coverage requirements within five and/or ten years after the original license grant date. These initial requirements are met for most 10 MHz licenses when adequate service is offered to at least one-quarter of the population of the licensed area within five years, and for 30 MHz licenses when adequate service is offered to at least one third of the population within five years and two thirds of the population within ten years. Some of our wireless licenses, with an aggregate carrying value of approximately \$44.2 million at March 31, 2004, have initial coverage deadlines in 2004 that we had not yet met. We generally intend to either satisfy the minimum coverage requirements or sell or otherwise transfer the material wireless licenses for which we have not yet met the minimum coverage requirements before the deadline. Generally, however, we are not attempting to satisfy the coverage requirements or sell any of the wireless licenses that are to be transferred to the Leap Creditor Trust. Four of these wireless licenses, with an aggregate carrying value of approximately \$209,000, have initial coverage deadlines in 2004. Representatives of the Leap Creditor Trust have informed us that they are arranging for the sale of these licenses and they do not wish Leap to expend funds to meet the minimum coverage requirement. We estimate that it could cost up to \$5.4 million to meet the coverage requirements for our wireless licenses with initial coverage deadlines in 2004 that have not yet been met (excluding the licenses to be transferred to the Leap Creditor Trust). We cannot assure you that we will be able to satisfy the minimum coverage requirements or sell or transfer the wireless licenses before the deadline. Failure to comply with the FCC's coverage requirements could cause the revocation of some of our wireless licenses or the imposition of fines and/or other sanctions. No adjustments have been recorded in our condensed consolidated financial statements regarding the potential inability to satisfy the coverage requirements for the wireless licenses that may expire in the near future. Any subsequent expiration of these wireless licenses could have a material adverse effect on our condensed consolidated financial position and results of operations.

**Our Issuance of Shares to MCG Qualifies, and Implementation of Our Plan of Reorganization is Likely to Qualify, as an Ownership Change under Internal Revenue Code Section 382 and Limits Our Ability to Use Our Net Operating Loss and Capital Loss Carryforwards**

Our issuance of 21,020,431 shares of common stock to MCG in August 2002 caused an ownership change as defined under Internal Revenue Code Section 382. Accordingly, our ability to utilize our net operating loss and capital loss carryforwards is subject to an annual limitation. Under the Plan of Reorganization, there will be an additional ownership change in connection with our emergence from bankruptcy, which may further limit our ability to utilize our net operating loss and capital loss carryforwards.

The Plan of Reorganization contemplates a significant reduction of our outstanding indebtedness and, as a result, we expect to realize a significant amount of cancellation of indebtedness income. Although we should not be required

to recognize such cancellation of indebtedness income for tax purposes, we will be required to reduce our net operating loss and capital loss carryforwards by the amount of such excluded income. In addition, under certain circumstances, we may be required to reduce the tax bases of our assets by a portion of the excluded income. The Plan of Reorganization further contemplates the merger of certain subsidiaries and the transfer of the stock of certain Leap subsidiaries to Cricket, which are intended to be structured as tax-deferred transactions. Management believes that these mergers and transfers will not result in significant income tax to Leap and its subsidiaries; however, if any changes to the Plan of Reorganization or additional mergers and transfers cannot be structured in a tax-deferred manner, we may owe significant income taxes as a result.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

*Interest Rate Risk.* Our variable rate long-term debt ceased accruing interest as of the Petition Date as a result of the our Chapter 11 filings. Payments of principal and interest due under the variable rate long-term debt are generally stayed during the

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pendency of the Chapter 11 proceedings.

*Hedging Policy.* We have previously entered into interest rate cap agreements designed to fix or limit a portion of the interest cost to Cricket (and the Leap subsidiaries that guarantee the senior secured vendor credit facilities). However, these credit facilities ceased accruing interest on the Petition Date. These interest rate cap agreements expired in March 2004. Prior to their expiration, they were accounted for at fair value and had no carrying value. The interest rate cap agreements do not qualify for hedge accounting under SFAS No. 133, and Leap does not engage in any other hedging activities against foreign currency exchange rate or interest rate risks.

**Item 4. Controls and Procedures**

(a) Evaluation of Disclosure Controls and Procedures

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in the Company's Exchange Act reports is recorded, processed, summarized and reported within the time periods specified by the Securities and Exchange Commission and that such information is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow for timely decisions regarding required disclosure. Management has designed the Company's disclosure controls and procedures to provide a reasonable assurance of achieving the desired objectives. As required by SEC Rule 13a-15(b), the Company's management conducted an evaluation, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures as of March 31, 2004, the end of the period covered by this report. Based on that evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective at the reasonable assurance level as of March 31, 2004.

(b) Changes in Internal Controls

There were no changes in the Company's internal controls over financial reporting during the Company's fiscal quarter ended March 31, 2004 that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.



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**PART II**

**OTHER INFORMATION**

**Item 1. Legal Proceedings**

**Bankruptcy Proceedings**

On 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 in the United States Bankruptcy Court for the Southern District of California (jointly administered as Case Nos. 03-03470-A11 to 03-03535-A11). 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. On October 22, 2003, the Bankruptcy Court entered an order confirming the Plan of Reorganization. As a result of the Chapter 11 filings, attempts to collect, secure or enforce remedies with respect to most pre-petition claims against the debtors are subject to the automatic stay provisions of Section 362(a) of Chapter 11.

Consummation of the Plan of Reorganization is dependent upon satisfaction of a number of conditions prior to its effective date typical in reorganizations, as well as FCC approval for the change of control of our wireless licenses that will occur upon our emergence from bankruptcy. We cannot guarantee that the conditions to the effectiveness of the Plan of Reorganization will be met (or waived). Accordingly, we can provide no assurances that the Plan of Reorganization will be consummated and the reorganization completed.

On October 24, 2003, MCG filed a motion with the Bankruptcy Court seeking to stay the implementation of the Plan of Reorganization while MCG pursued an appeal of the Bankruptcy Court's confirmation order. On October 28, 2003, the Bankruptcy Court denied MCG's motion for a stay, permitting the debtors to proceed with the Plan of Reorganization. Previously, on August 1, 2003, Leap filed an action in the Bankruptcy Court against MCG and Michael C. Gelfand, MCG's sole stockholder, seeking to (a) avoid and recover from the defendants a preferential payment of \$1.5 million and (b) subordinate MCG's alleged general unsecured claim for \$39.8 million to the same priority as that of other common stockholders. On January 30, 2004, Leap, MCG, Michael Gelfand, the Leap Creditor Trust, the Official Unsecured Creditors' Committee of Leap and the informal committee of Cricket's senior secured vendor debtholders agreed to settle their various disputes. Under the settlement agreement, the parties have agreed to dismiss their respective claims and litigations and to grant each other mutual releases, in exchange for Cricket paying a portion of MCG's attorneys' fees and expenses incurred in connection with the Chapter 11 cases (subject to a maximum of \$750,000) and reorganized Leap issuing to MCG a five-year warrant to purchase up to one percent of the issued and outstanding common shares of reorganized Leap on the effective date of the Plan of Reorganization with an aggregate exercise price currently estimated to be approximately \$10 million (calculated as one percent of the difference between \$1.05 billion and the aggregate amount of outstanding debt owed by the Company to the FCC as reinstated upon its emergence from bankruptcy and after the payment of all past due amounts then owing to the FCC with respect to such debt). The Bankruptcy Court entered an order approving the settlement, and that order became effective on March 21, 2004. The settlement agreement may be terminated by Leap if a third party objects to the Leap's wireless license transfer applications filed with the FCC in connection with the Plan of Reorganization. As of March 31, 2004, no objections to Leap's transfer applications had been filed with the FCC. As of March 31, 2004, no adjustments have been made in our condensed consolidated financial statements related to the ultimate outcome of this matter.

American Wireless Group, LLC, or AWG, has also filed a claim for \$28 million against Leap in the Bankruptcy Court based on the same general claims made by the plaintiffs in the AWG Lawsuit described below. On October 6, 2003, Leap filed an action in the Bankruptcy Court against AWG and certain of its members seeking to subordinate

AWG's alleged general unsecured claims to the same priority as that of other common stockholders under section 510(b) of the Bankruptcy Code. AWG agreed to subordinate its claim and on March 8, 2004 the Bankruptcy Court entered its order approving the Stipulation and Consent Judgment subordinating AWG's claim.

For a more detailed description of our bankruptcy proceedings, see Note 2 to the condensed consolidated financial statements included in Part I-Item 1 of this report.

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### **Endesa Litigation**

From April 1999 to the date of sale on June 2, 2000, Leap owned 100% of Smartcom, S.A., a Chilean corporation that operates a nationwide wireless network in Chile. On June 2, 2000, Leap completed the sale of Smartcom to Endesa, S.A., a Spanish company. Leap has a \$35.0 million promissory note payable by Endesa as of June 2, 2001. That note is subject to a right of set-off to secure indemnification claims under the purchase agreement. Endesa has asserted claims of up to approximately \$49.0 million against Leap for breach of representations and warranties under the purchase agreement and has notified Leap that it is offsetting the claims against the entire unpaid balance of the note. The note matured on June 2, 2001 and Leap expects it to remain unpaid until the issues related to the claims are resolved. Proceedings relating to the resolution of these claims were initiated by Endesa in June 2001 and remain pending before the 19th Civil Court of Santiago in the Republic of Chile. Leap believes Endesa's claims are without merit, and is defending Endesa's lawsuit. Leap filed an action against Endesa in the Bankruptcy Court with respect to the promissory note, seeking to collect the amount due under the note. On March 11, 2004, the Bankruptcy Court rendered a decision to abstain from taking any further action in the matter before it. The Bankruptcy Court stayed that action and lifted the automatic stay so that the litigation could proceed in Chile. The order became effective March 21, 2004. However, the Bankruptcy Court's order allowed Endesa only to seek set-offs against the amount it owes under the promissory note and Endesa is precluded from seeking any affirmative relief against Leap. In accordance with the Plan of Reorganization, the note will be transferred to the Leap Creditor Trust on the effective date.

### **Securities Litigation**

Between December 5, 2002 and February 7, 2003, nine securities class action lawsuits were filed against Leap, and certain of its officers and directors, in the United States District Court for the Southern District of California on behalf of all persons who purchased or otherwise acquired Leap's common stock from February 11, 2002 through July 24, 2002, referred to herein as the Class Period. Those lawsuits were all virtually identical to one another. On March 14, 2003, the court entered plaintiffs' stipulation and order for the appointment of lead plaintiffs and approval of lead plaintiffs' selection of lead counsel and ordered the cases consolidated into a single action entitled *In re Leap Wireless Securities Litigation*, Case No. 02-CV-2388J (AJB). On May 23, 2003, the plaintiffs filed an amended complaint which named only Harvey White and Susan Swenson as defendants. The amended complaint alleges that the defendants were responsible for the dissemination of a series of material misrepresentations to the market during the Class Period, thereby artificially inflating the price of Leap's common stock in violation of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, and Rule 10b-5 promulgated thereunder. Plaintiffs allege that defendants concealed the deteriorated value of Leap's wireless licenses by relying upon a fraudulent impairment test of those assets, which resulted in a gross and material overstatement of the value of Leap's assets in its consolidated financial statements. The amended complaint also claims that misrepresentations were made regarding certain business metrics related to the operation of Leap's subsidiary, Cricket Communications. The complaint seeks an unspecified amount of damages, plus costs and expenses related to bringing the actions. No class has yet been certified in the lawsuit. On July 29, 2003, the defendants filed a motion to dismiss the amended complaint. The defendants' motion to dismiss states, among other matters, that the amended complaint fails to plead any facts which show that any representations made by Leap or the defendants were false or that any of the alleged misrepresentations caused a change in the value of Leap's shares. Plaintiffs filed an opposition to the motion to dismiss and the defendants have filed a reply. The Court has taken the matter under submission and will decide the motion based on the papers filed. Although Leap is not a defendant in the case, plaintiffs continue to pursue the individual defendants. The two named defendants have asserted claims for indemnity against the debtors, including Leap.

On December 31, 2002, several members of AWG filed a lawsuit against various officers and directors of Leap in the Circuit Court of the First Judicial District of Hinds County, Mississippi, referred to herein as the Whittington Lawsuit. Leap purchased certain FCC wireless licenses from AWG and paid for those licenses with shares of Leap stock. The complaint alleges that Leap failed to disclose to AWG material facts regarding a dispute between Leap and

MCG relating to MCG's claim that it was entitled to an increase in the purchase price for certain wireless licenses it sold to Leap. The dispute with MCG resulted in an award against Leap in an arbitration proceeding in 2002. Leap satisfied the award by issuing 21,020,431 of Leap shares to MCG. Plaintiffs claim that the result in the arbitration and subsequent issuance of shares to MCG, caused a decrease in the value of the shares transferred to AWG for the FCC licenses. Leap is not a defendant in the Whittington Lawsuit. Instead, plaintiffs contend that the named defendants are the controlling group that was responsible for Leap's alleged fraudulent failure to disclose the material facts regarding the MCG dispute and the risk that the shares held by the plaintiffs might be diluted if MCG was successful in the arbitration. On May 16, 2003, plaintiffs filed an amended complaint which set forth the same allegations against the defendants, but added several additional plaintiffs. On May 29, 2003, the defendants removed the Whittington Lawsuit from state court in Mississippi to the United States District Court for the Southern District of Mississippi in Jackson. Plaintiffs filed a motion to remand the case to state court. Defendants have filed a motion to dismiss the Whittington Lawsuit noting, among other matters, that plaintiffs failed to plead facts which show that they are entitled to relief, that Leap made adequate disclosure of the relevant facts regarding the MCG dispute, and that any failure to disclose such information did not cause any damage to the plaintiffs. The

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named defendants have asserted claims of indemnity against the debtors, including Leap.

In a related action, on June 6, 2003, AWG filed a lawsuit in the Circuit Court of the First Judicial District of Hinds County, Mississippi, referred to herein as the AWG Lawsuit, against the same individual defendants named in the Whittington Lawsuit. The complaint generally sets forth the same claims made by the plaintiffs in the Whittington Lawsuit. Leap is not a defendant in the AWG Lawsuit. On June 26, 2003, the defendants removed the AWG Lawsuit from state court in Mississippi to the United States District Court for the Southern District of Mississippi in Jackson. Plaintiffs filed a motion to remand the case to state court. Defendants have filed a motion to dismiss the AWG Lawsuit, making arguments similar to these made in their motion to dismiss the Whittington Lawsuit. The named defendants have asserted claims for indemnity against the debtors, including Leap.

A new judge was recently appointed in the Whittington and AWG Lawsuits. As a result, delays may occur before the pending motions are decided.

## **Zawalick Litigation**

On February 24, 2003, plaintiff Steven Zawalick filed a purported derivative action in the Supreme Court of the State of New York, Case No. 03600591, on behalf of Leap against Morgan Stanley & Co., Inc., Donaldson Lufkin Jenrette Securities Corporation, Bear Stearns & Co., Inc., ABN AMRO Incorporated and Credit Suisse First Boston Corp., each of whom were initial purchasers in the private placement of Leap's debt securities on February 23, 2000. Leap was also named as a nominal defendant in the lawsuit. The complaint alleges that the sales were disguised brokerage transactions and that the investment banking firms charged excessive brokerage fees in violation of New York General Obligations Law Section 5-531, which limits the fees payable to loan brokers. The complaint sought compensatory damages, costs and fees in connection with bringing suit, and other remedies. Leap believes the plaintiff lacked a right to bring the claim and that any action taken in the lawsuit after the April 13, 2003 commencement of the bankruptcy is in violation of the automatic stay of the bankruptcy code. On June 23, 2003, plaintiff served the complaint on Leap as a nominal defendant. In response, Leap filed with the court a notice of commencement of the bankruptcy and automatic stay of all proceedings against it. Plaintiff did not take any action to proceed with the lawsuit or to lift the stay. The New York court entered an order on November 25, 2003 that the Plaintiff's pursuit of the case be discontinued. Upon the effectiveness of the Plan of Reorganization, any rights Leap may have under this action will be transferred to the Leap Creditor Trust.

Leap is often involved in various claims arising in the course of business, seeking monetary damages and other relief. The amount of the liability, if any, from such claims cannot be determined with certainty. However, in the opinion of Leap's management, the ultimate liability for such claims will not have a material adverse effect on Leap's condensed consolidated financial position, results of operations or cash flows.

## **Item 2. Changes in Securities and Use of Proceeds**

None

## **Item 3. Defaults Upon Senior Securities**

As a result of Leap's Chapter 11 filing, Leap is currently in default under the indenture governing its senior notes and senior discount notes and the obligations under those notes have been accelerated. At March 31, 2004, Leap had \$224.6 million of principal outstanding under its 12.5% senior notes and approximately \$504.4 million in accreted value of principal and accrued interest outstanding under its 14.5% senior discount notes. The senior notes and senior

discount notes ceased accruing interest as of the Petition Date, and payments of principal and interest due under the notes have been stayed during the pendency of the Chapter 11 proceedings. The indebtedness under the senior notes and the senior discount notes will be cancelled on the effective date of the Plan of Reorganization.

In February 2000, Leap completed an offering of 225,000 senior units, each senior unit consisting of one 12.5% senior note due 2010 and one warrant to purchase Leap common stock, and 668,000 senior discount units, each senior discount unit consisting of one 14.5% senior discount note due 2010 and one warrant to purchase Leap common stock. The total gross proceeds from the sale of the senior units and senior discount units were \$225.0 million and \$325.1 million, respectively, of which \$164.4 million was allocated to the fair value of the warrants, estimated using the Black-Scholes option pricing model. The warrants issued in the units offering are exercisable for an aggregate of 2,829,854 shares of Leap common stock at an exercise price of \$96.80 per share. All of these warrants will be cancelled under the Plan of Reorganization.

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Leap has outstanding 225,000 senior notes and 668,000 senior discount notes. Each note has a principal amount at maturity of \$1,000. Except while Leap is in bankruptcy, interest on the senior notes was payable semi-annually, and would have begun accruing cash interest on April 15, 2005 with the first semi-annual interest payment due October 15, 2005. Each senior discount note had an initial accreted value of \$486.68 and a principal amount at maturity of \$1,000. Cricket Communications Holdings, Inc., Backwire.com Inc. and Telephone Entertainment Network, Inc. guarantee the notes. The terms and conditions of the notes are more fully described in the indenture for the notes, which is filed with the SEC as an exhibit to this Annual Report on Form 10-K.

Leap's wholly owned subsidiary, Cricket Communications, Inc., previously entered into senior secured vendor credit facilities with each of Lucent, Nortel and Ericsson Credit AB to finance Cricket's purchase of network infrastructure products and services from Lucent, Nortel and an affiliate of Ericsson Credit AB plus interest expense and other costs and origination and commitment fees related to the credit facilities. Cricket is currently in default under each of its senior secured vendor credit facilities because it has failed to pay principal and interest and has failed to comply with other covenants under those facilities, and as a result of the Chapter 11 proceedings, the indebtedness under these facilities has been accelerated. As of March 31, 2004, Cricket was in default under the senior secured vendor credit facilities by approximately \$1,618.3 million in accreted value of principal, interest and fees. The senior secured vendor credit facilities ceased accruing interest as of the Petition Date. Payments of principal, interest and fees due under the senior secured vendor credit facilities and payments of amounts owing under the purchase agreements generally are stayed during the pendency of the Chapter 11 proceedings. See Part I-Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources.

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

None.

**Item 5. Other Information**

None.

**Item 6. Exhibits and Reports on Form 8-K**

(a) *Index to Exhibits:*

<b>Exhibit Number</b>	<b>Description of Exhibit</b>
10.12.6*	Amendment No. 6 to the Amended and Restated System Equipment Purchase Agreement between Cricket Communications, Inc. and Lucent Technologies Inc., effective as of February 4, 2004. Portions of this Exhibit (indicated with an asterisks) have been omitted pursuant to a request for confidential treatment pursuant to Rule 14b-2 under the Securities Exchange Act of 1934.
31.1*	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2*	

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Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1\*\* Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2\*\* Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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\* Filed herewith.

\*\* These certifications are being furnished solely to accompany this quarterly report pursuant to 18 U.S.C. § 1350, and are not being filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and are not to be incorporated by reference into any filing of Leap Wireless International, Inc., whether made before or after the date hereof, regardless of any general incorporation language in such filing.

(b) *Reports on Form 8-K.*

Current Report on Form 8-K/A, dated July 30, 2003, filed with the SEC on May 7, 2004, Items 3 and 7 reported, relating to the updated version of the Fifth Amended Joint Plan of Reorganization dated as of July 30, 2003, as modified to reflect all technical amendments subsequently approved by the Bankruptcy Court.



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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Company has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

LEAP WIRELESS INTERNATIONAL, INC.

Date: May 17, 2004

By: /s/ HARVEY P. WHITE  
Harvey P. White  
Chief Executive Officer and Director  
(Principal Executive Officer)

Date: May 17, 2004

By: /s/ S. DOUGLAS HUTCHESON  
S. Douglas Hutcheson  
Chief Financial Officer  
(Principal Financial Officer)