NextWave Wireless Inc.
Form 10-Q
August 10, 2010

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended July 3, 2010

OR

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

For the transition period from to

Commission file number 000-51958

NEXTWAVE WIRELESS INC.
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	20-5361360 (IRS Employer Identification No.)
12264 El Camino Real, Suite 305, San Diego, California (Address of principal executive offices)	92130 (Zip Code)

(858) 480-3100
(Registrant’s telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes R No £

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of “accelerated filer and large accelerated filer” in Rule 12b-2 of the Exchange Act.

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

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

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13, or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes R No £

As of August 2, 2010, there were 22,396,411 shares of the Registrant's common stock outstanding.

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PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

NEXTWAVE WIRELESS INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except par value data)
(unaudited)

	July 3, 2010	January 2, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	$31,576	$15,056
Restricted cash and marketable securities	3,634	24,088
Wireless spectrum licenses held for sale	59,048	62,868
Prepaid expenses and other current assets	551	2,546
Current assets of discontinued operations	68,285	23,678
Total current assets	163,094	128,236
Wireless spectrum licenses, net – continuing operations	405,325	409,156
Property and equipment, net	3,821	213
Other assets, including assets measured at fair value of $0 and $1,227 at July 3, 2010 and January 2, 2010, respectively	5,126	6,959
Other noncurrent assets of discontinued operations	—	58,226
Total assets	$577,366	$602,790
LIABILITIES AND STOCKHOLDERS' DEFICIT		
Current liabilities:		
Accounts payable	$1,307	$1,229
Accrued expenses	7,891	8,196
Current portion of long-term obligations	62,134	86,154
Other current liabilities	136	10,283
Current liabilities of discontinued operations	28,117	30,371
Total current liabilities	99,585	136,233
Deferred income tax liabilities	88,867	88,958
Long-term obligations, net of current portion	729,282	641,950
Other liabilities	5,674	9,577
Long-term liabilities and deferred credits of discontinued operations	—	1,729
Commitments and contingencies		
Stockholders' deficit:		
Preferred stock, $0.001 par value; 25,000 shares authorized; 355 shares designated as Series A Senior Convertible Preferred Stock; no other shares issued or outstanding	—	—
Common stock, $0.007 par value; 57,143 shares authorized; 22,494 and 22,434 shares issued and outstanding at July 3, 2010 and January 2, 2010, respectively	157	157
Additional paid-in-capital	886,521	884,321
Accumulated other comprehensive income	17,823	14,437
Accumulated deficit	(1,265,052)	(1,190,520)
Stockholders' deficit attributed to NextWave	(360,551)	(291,605)
Noncontrolling interest in subsidiary	14,509	15,948
Total stockholders' deficit	(346,042)	(275,657)
Total liabilities and stockholders' deficit	$577,366	$602,790

The accompanying notes are an integral part of these condensed consolidated financial statements.

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NEXTWAVE WIRELESS INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share data)
(unaudited)

	Three Months Ended		Six Months Ended	
	July 3, 2010	June 27, 2009	July 3, 2010	June 27, 2009
Operating expenses:				
General and administrative	$8,023	$11,575	$13,859	$20,659
Sales and marketing	—	80	—	207
Asset impairment charges	—	83	—	9,562
Restructuring charges (credits)	22	(717)	15	2,038
Total operating expenses	8,045	11,021	13,874	32,466
Gain (loss) on sales of wireless spectrum licenses	(152)	668	12	671
Loss from operations	(8,197)	(10,353)	(13,862)	(31,795)
Other income (expense):				
Interest income	247	82	514	304
Interest expense	(54,175)	(39,123)	(98,263)	(75,863)
Gain on extinguishment of debt	—	—	37,988	—
Other income (expense), net	(1,151)	152	9,381	(1,349)
Total other income (expense), net	(55,079)	(38,889)	(50,380)	(76,908)
Loss from continuing operations before income taxes	(63,276)	(49,242)	(64,242)	(108,703)
Income tax benefit (provision)	—	1	—	(30)
Net loss from continuing operations	(63,276)	(49,241)	(64,242)	(108,733)
Loss from discontinued operations, net of gains (losses) on divestiture of discontinued operations of $(4,617), $(2), $(4,616) and $51, income tax provisions of $10, $76, $107 and $232, and net loss attributed to noncontrolling interest of $1,671, $0, $1,237 and $0, respectively	(7,906)	(6,246)	(10,290)	(28,933)
Net loss attributed to NextWave	$(71,182)	$(55,487)	$(74,532)	$(137,666)
Amounts attributed to NextWave common shares:				
Loss from continuing operations, net of tax	$(63,276)	$(49,241)	$(64,242)	$(108,733)
Loss from discontinued operations, net of tax	(7,906)	(6,246)	(10,290)	(28,933)
Net loss attributed to NextWave common shares	$(71,182)	$(55,487)	$(74,532)	$(137,666)
Net loss per share attributed to NextWave common shares – basic and diluted				
Continuing operations	$(2.60)	$(2.21)	$(2.65)	$(5.05)
Discontinued operations	(0.33)	(0.28)	(0.42)	(1.35)
Net loss	$(2.93)	$(2.49)	$(3.07)	$(6.40)
Weighted average shares used in per share calculation	24,279	22,288	24,256	21,503

The accompanying notes are an integral part of these condensed consolidated financial statements.

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NEXTWAVE WIRELESS INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

	Six Months Ended July 3, 2010	Six Months Ended June 27, 2009
OPERATING ACTIVITIES		
Net loss	$(75,769)	$(137,666)
Loss from discontinued operations, net of tax	(11,527)	(28,933)
Loss from continuing operations	(64,242)	(108,733)
Adjustments to reconcile loss from continuing operations to net cash used in operating activities of continuing operations:		
Amortization of intangible assets	3,838	3,838
Depreciation	160	116
Non-cash share-based compensation	611	1,218
Non-cash interest expense	97,981	70,867
Gain on extinguishment of debt	(37,988)	—
Asset impairment charges	—	9,563
Other non-cash adjustments	917	(501)
Changes in operating assets and liabilities:		
Prepaid expenses and other current assets	718	303
Other assets	(226)	(362)
Accounts payable and accrued liabilities	(3,980)	(4,573)
Other current liabilities	(8,162)	(516)
Net cash used in operating activities of continuing operations	(10,373)	(29,451)
INVESTING ACTIVITIES		
Proceeds from the sale of ARS securities	24,023	—
Payments received on notes receivable	7,100	—
Proceeds from the sale of wireless spectrum licenses	683	5,475
Purchase of property and equipment	(3,803)	—
Other, net	1,054	231
Net cash provided by investing activities of continuing operations	29,057	5,706
FINANCING ACTIVITIES		
Proceeds from long-term obligations	25,000	(6,731)
Payments on long-term obligations	(25,256)	(6,731)
Proceeds from the sale of common shares	141	—
Net cash used in financing activities of continuing operations	(115)	(6,731)
Cash provided (used) by discontinued operations:		
Net cash provided by (used in) operating activities of discontinued operations	3,330	(13,654)
Net cash provided by (used in) investing activities of discontinued operations	(394)	159
Net cash used in financing activities of discontinued operations	(7,100)	(39)
Net cash provided (used) by discontinued operations	(4,164)	(13,534)
Effect of foreign currency exchange rate changes on cash	(1,073)	270
Net increase (decrease) in cash and cash equivalents	13,332	(43,740)
Cash and cash equivalents, beginning of period	20,512	61,517
Cash and cash equivalents, end of period	33,844	17,777
Less cash and cash equivalents of discontinued operations, end of period	(2,268)	(9,908)
Cash and cash equivalents of continuing operations, end of period	$31,576	$7,869

NONCASH FINANCING ACTIVITIES		
Senior, Second and Third Lien Notes issued to noteholders in exchange for debt modification fees	$21,249	$—
Fair value of warrants issued in connection with the Asset Sale Condition of the Second Lien Notes	$—	$1,719

The accompanying notes are an integral part of these condensed consolidated financial statements.

NEXTWAVE WIRELESS INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation and Significant Accounting Policies

Financial Statement Preparation

The condensed consolidated financial statements of NextWave Wireless Inc. (together with its subsidiaries, “NextWave”, “we”, “our” or “us”) are unaudited. We have prepared the condensed consolidated financial statements in accordance with the rules and regulations of the United States Securities and Exchange Commission (“SEC”), and therefore, certain information and disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted. In the opinion of management, the accompanying condensed consolidated financial statements for the periods presented reflect all adjustments necessary to fairly state our financial position, results of operations and cash flows, including adjustments related to asset impairment write-offs and restructuring-related charges. These condensed consolidated financial statements should be read in conjunction with our audited financial statements for the year ended January 2, 2010, from which the balance sheet data was derived, included in our Annual Report on Form 10-K filed with the SEC on April 2, 2010.

Basis of Presentation and Liquidity

The accompanying consolidated financial statements have been prepared assuming that we will continue as a going concern. This basis of accounting contemplates the recovery of our assets and the satisfaction of our liabilities in the normal course of business. We generated net losses attributable to NextWave of $74.5 million and $137.7 million for the six months ended July 3, 2010 and June 27, 2009, respectively, and have an accumulated deficit of $1.3 billion at July 3, 2010. Our net loss from continuing operations of $64.2 million for the six months ended July 3, 2010 includes a $38.0 million noncash gain on extinguishment of debt resulting from the debt modification of our Third Lien Subordinated Secured Convertible Notes due 2011 (the “Third Lien Notes”) in March 2010, as described below, which was treated as an extinguishment of debt for accounting purposes. Without this gain, we would have reported a loss from continuing operations of $102.2 million for the six months ended July 3, 2010. We used cash from operating activities of our continuing operations of $10.4 million and $29.5 million during the six months ended July 3, 2010 and June 27, 2009, respectively. Our total unrestricted cash and cash equivalents held by continuing operations at July 3, 2010 totaled $31.6 million. We had net working capital of $63.5 million at July 3, 2010.

We have funded our operations, business combinations, strategic investments and wireless spectrum license acquisitions primarily with the $550.0 million in cash received in our initial capitalization in April 2005, the net proceeds of $295.0 million from our issuance of our Senior Secured Notes (the “Senior Notes”) in 2006 and 2010, the net proceeds of $351.1 million from our issuance of Series A Senior Convertible Preferred Stock (the “Series A Preferred Stock”) in March 2007, which, in October 2008, we exchanged for Third Lien Notes in the aggregate principal amount of $478.3 million, and the net proceeds of $101.0 million from our issuance of Senior Subordinated Secured Second Lien Notes (the “Second Lien Notes”) in October 2008 and July 2009. We did not receive any proceeds from the issuance of the Third Lien Notes.

In an effort to reduce our future working capital requirements and in order to comply with the terms of our Senior Notes, Second Lien Notes and Third Lien Notes, in the second half of 2008, our Board of Directors approved the implementation of a global restructuring initiative, pursuant to which we have divested, either through sale, dissolution or closure, our operating business segments. The actions completed as a result of our global restructuring initiative are described in more detail below under the heading “Discontinued Operations”.

Effective as of March 16, 2010, we entered into an Amendment and Limited Waiver (the “Amendment and Waiver”) to the agreements governing our Senior Notes, Second Lien Notes and Third Lien Notes. Pursuant to the Amendment and Waiver, the maturity date of our Senior Notes was extended from July 17, 2010 to July 17, 2011, with an additional extension to October 17, 2011 if certain conditions are met, including the pendency of asset sales that would yield net proceeds sufficient to repay all then-outstanding Senior Notes. In addition, the maturity date of our Second Lien Notes was extended from

December 31, 2010 to November 30, 2011. As a result of the Amendment and Waiver, the interest payable on our Senior Notes and Second Lien Notes was increased to a rate of 15% per annum and the interest payable on our Third Lien Notes was increased to a rate of 12% per annum initially, increasing 1% per annum on each of December 31, 2010, March 30, 2011, June 30, 2011 and September 30, 2011 to a maximum of 16%. After giving effect to the Amendment and Waiver, all Notes will receive only payment-in-kind interest for the full term of such Notes, unless we elect to pay cash interest, and the redemption premium on the Notes was eliminated. The Amendment and Waiver reduced the requirement to maintain a minimum cash balance from $5.0 million to $1.0 million and, after payment in full of certain designated Senior Notes with an aggregate principal amount of $56.5 million at July 3, 2010 and the Senior Incremental Notes (as defined below) with an aggregate principal amount of $25.5 million at July 3, 2010, permits us to retain up to $12.5 million of asset sale proceeds for general working capital purposes and permitted investments. As consideration for the Amendment and Waiver, we paid an amendment fee to each Holder through the issuance of additional Notes under the applicable Note Agreements in an amount equal to 2.5% of the outstanding principal and accrued and unpaid interest on such Holder's existing Notes.

As permitted by the Amendment and Waiver, in order to fund our working capital needs and permitted investments pending completion of asset sales, we issued $20.0 million and $5.0 million in additional Senior Notes (the "Senior Incremental Notes") to Avenue Capital Management II, L.P., acting on behalf of its managed investment funds signatory thereto ("Avenue"), and Solus Core Opportunities Master Fund Ltd and its affiliates and co-investors ("Solus"), respectively. As with the other Senior Notes, amounts outstanding under the Senior Incremental Notes bear interest at a rate of 15% per annum, payable in-kind unless we elect to pay cash, and are secured by a first lien on the same assets securing our Senior Notes, on a pari passu basis. No commitment fee or structuring fee was payable in connection with the issuance of the Senior Incremental Notes.

The Amendment and Waiver to our Third Lien Notes, which increased the interest rate payable on our Third Lien Notes, was determined to have been accomplished with debt instruments that are substantially different, in accordance with generally accepted accounting principles, resulting in an effective extinguishment of the existing Third Lien Notes and a new issue of Third Lien Notes as of the amendment date for accounting purposes. The new issue of Third Lien Notes was recorded at fair value using a discount rate of 40%, and that amount was used to determine the net debt extinguishment gain of $38.0 million recognized during the six months ended July 3, 2010, in other income in the accompanying consolidated statements of operations. The net gain of $38.0 million was determined as the difference between the remaining unamortized discount under the extinguished Third Lien Notes of $123.1 million and the new discount of $164.8 million, plus $9.6 million of embedded derivative liabilities that were eliminated at the date of the extinguishment, partially offset by $13.3 million in fee notes issued to the Third Lien noteholders. The new discount of $164.8 million is amortized using the effective interest rate method over the remaining term of the Third Lien Notes due December 2011 which will significantly increase our interest expense for financial reporting purposes.

In 2010, we have capital expenditure needs associated with certain build-out or substantial service requirements which apply to our licensed wireless spectrum, which generally must be satisfied as a condition of license renewal. The substantial service build-out deadline for our domestic Wireless Communication Services ("WCS") spectrum was July 21, 2010 under the Federal Communication Commission ("FCC") rules in existence at that time. However, the FCC adopted new rules on May 20, 2010, that, when effective, (anticipated to be September 1, 2010) purported to replace the July 21, 2010 substantial service requirements with new requirements that must be met 42 and 72 months after the date that new WCS technical and service rules become effective. We filed substantial service showings with the FCC on July 20, 2010 for all of our WCS licenses under the rules then in effect. While we believe we have made the capital expenditures required to complete the applicable WCS build-out requirements, we may be required to make additional capital expenditures to comply with the new rules if the FCC does not accept our substantial service showings under the rules in effect on July 20, 2010. The substantial service deadline for Educational Broadband Service and Broadband Radio Service ("EBS/BRS") spectrum is May 1, 2011; however, most of our EBS leases require us to complete most build out activities in 2010, in advance of the FCC's substantial service deadline. Failure to meet our service requirements could result in forfeiture of the applicable licenses.

We believe that the completion of our asset divestiture and cost reduction actions, our current cash and cash equivalents, our ability to pay payment-in-kind interest in lieu of cash interest to the holders of our secured notes, and access to $12.5 million of future asset sales proceeds as permitted by our secured note agreements will allow us to meet our estimated operational cash requirements at least through June 2011. Should we be unable to achieve the revenues and/or cash flows through June 2011 as contemplated in our current operating plan, or if we were to incur significant unanticipated expenditures in excess of proceeds available to us through asset sales, we will seek to identify additional capital resources including the use of our remaining $10.0 million of incremental Second Lien Notes debt basket, and will implement certain additional actions to reduce our working capital requirements including staff reductions.

Reverse Stock Split

Effective June 21, 2010 we amended our Amended and Restated Certificate of Incorporation to effect a 1-for-7 reverse stock split. The primary purpose of the reverse stock split was to raise the per share trading price of our common stock to seek to maintain the listing of our common stock on The NASDAQ Stock Market. At the effective time of the reverse stock split, every seven shares of our pre-split common stock, with a par value $0.001 per share, was automatically converted into one share of post-split common stock, with a par value $0.007 share. The number of authorized shares of our common stock was reduced accordingly by a ratio of 1-for-7 from 400 million to 57.1 million shares. Outstanding stock incentive awards and shares available for future grants were also adjusted to give effect to the reverse split. In settlement of fractional shares resulting from the reverse split, we made a cash payment based on the average closing sales price of our common stock for the ten trading days immediately preceding the effective time.

Delisting of Our Common Stock

On October 7, 2008, we received a Staff Deficiency Letter from NASDAQ notifying us that we were not in compliance with NASDAQ's Marketplace Rule 5450(a)(1) (the "Rule") because the closing bid price for our common stock had, for the preceding 30 consecutive business days, closed below the minimum $1.00 per share requirement for continued listing. In accordance with NASDAQ Marketplace Rule 5810(c)(3)(A), we were provided a period of 180 calendar days to regain compliance. On October 16, 2008, NASDAQ announced that they had suspended the enforcement of the Rule until January 19, 2009, and as a result, the period during which we had to regain compliance was extended to July 10, 2009. On July 15, 2009, NASDAQ announced that they had determined to continue the temporary suspension of the Rule until July 31, 2009, and as a result, the period during which we had to regain compliance was extended to January 21, 2010. On January 22, 2010, we received a Staff Determination letter from the Listing Qualifications Department of NASDAQ indicating that our common stock would be subject to delisting from The NASDAQ Global Market because of non-compliance with the Rule, unless we requested a hearing before a NASDAQ Listing Qualifications Panel (the "Panel") by the close of business on January 29, 2010. We requested a hearing on the matter and such hearing occurred on February 25, 2010. On March 26, 2010, the Panel granted our request for continued listing, subject to the conditions that on or before May 1, 2010, we must inform the Panel that we have filed a proxy statement for our annual meeting of stockholders including a vote on a reverse stock split in a ratio sufficient to meet the $1.00 per share requirement for continued listing and on or before July 21, 2010, we must have evidenced a closing bid price of $1.00 or more for a minimum of ten prior consecutive trading days. On July 21, 2010, the Panel notified us that our stock had not met this requirement and that our common stock would be delisted from the NASDAQ effective July 23, 2010. Pink OTC Markets, Inc. informed us that our stock was eligible to begin trading immediately on the OTCQB as of the open of trading on July 23, 2010 and the stock currently is trading on that market under the symbol WAVE.

Discontinued Operations and Segment Reporting

On July 30, 2010, we signed a definitive agreement for the sale of our remaining 65% stock ownership in our PacketVideo Corporation ("PacketVideo") subsidiary to NTT DOCOMO, Inc. ("DOCOMO") and continued to pursue wireless spectrum license sales, the net proceeds of which we will retain $12.5 million for general working capital purposes and permitted investments and the remainder of which will be used to reduce our outstanding indebtedness, thereby reducing interest accruals payable in future years. We are also actively pursuing the sale or wind-down of various remaining portions of our spectrum operations in South America and Europe.

We have classified the businesses comprising our Multimedia and Semiconductor segments as well as our WiMAX Telecom, Inquam and South American businesses, which were previously reported in our Strategic Initiatives segment, as discontinued operations for all periods presented.

Our continuing operations are comprised of our strategic initiatives segment, which manages our portfolio of licensed wireless spectrum assets. Since we now operate in only one business, we no longer provide segment reporting.

The carrying amounts of the assets and liabilities of our discontinued operations are as follows:

(in thousands)		July 3, 2010		January 2, 2010
Cash and cash equivalents	$	2,268	$	5,456
Restricted cash		451		804
Accounts receivable, net of allowance for doubtful accounts of $6 and $205		924		5,563
Accounts receivable – related party		2,243		—
Deferred contract costs		1,568		1,632
Inventory, prepaid expenses and other assets		5,429		10,223
Property and equipment, net		4,106		—
Goodwill		37,253		—
Other intangible assets, net		12,074		—
Other assets		1,969		—
Current assets of discontinued operations		68,285		23,678
Property and equipment, net		—		3,516
Goodwill		—		38,899
Other intangible assets, net		—		14,604
Other assets		—		1,207
Other noncurrent assets of discontinued operations		—		58,226
Wireless spectrum licenses included in wireless spectrum licenses held for sale		12,131		14,934
Total assets of discontinued operations	$	80,416	$	96,838
Accounts payable	$	1,730	$	2,630
Accrued expenses		5,912		5,999
Deferred revenue		4,392		5,186
Deferred revenue – related party		7,942		6,797
Long-term obligations and other current liabilities		3,149		4,205
Deferred income tax liabilities		4,992		4,529
Other liabilities		—		1,025
Current liabilities of discontinued operations		28,117		30,371
Deferred income tax liabilities		—		743
Other liabilities		—		986
Other liabilities		—		1,729
Total liabilities of discontinued operations	$	28,117	$	32,100

The results of operations of our discontinued operations are as follows:

(in thousands)	Three Months Ended July 3, 2010	Three Months Ended June 27, 2009	Six Months Ended July 3, 2010	Six Months Ended June 27, 2009
Revenues	$ 8,843	$ 13,934	$ 20,524	$ 32,082
Revenues – related party	2,268	—	9,337	—
Total revenues	11,111	13,934	29,861	32,082
Operating expenses:				
Cost of revenues	5,864	7,048	11,972	14,969
Cost of revenues – related party	227	—	530	—
Engineering, research and development	4,515	4,771	9,551	14,549
Sales and marketing	1,942	2,319	4,859	5,694
General and administrative	3,080	4,829	6,764	9,054
Asset impairment charges	297	1,500	2,013	11,369
Restructuring charges	97	290	958	4,941
Total operating expenses	16,022	20,757	36,647	60,576
Net gains (losses) on business divestitures	(4,617)	(2)	(4,616)	51
Loss from operations	(9,528)	(6,825)	(11,402)	(28,443)
Other income (expense), net	(39)	655	(18)	(258)
Loss before income taxes	(9,567)	(6,170)	(11,420)	(28,701)
Income tax benefit (provision)	(10)	(76)	(107)	(232)
Net loss from discontinued operations	(9,577)	(6,246)	(11,527)	(28,933)
Net loss attributed to noncontrolling interest in subsidiary	1,671	—	1,237	—
Net loss from discontinued operations attributed to NextWave	$ (7,906)	$ (6,246)	$ (10,290)	$ (28,933)

Principles of Consolidation

Our consolidated financial statements include the assets, liabilities and operating results of our wholly-owned subsidiaries as of July 3, 2010 and June 27, 2009, and for the three and six months then ended, respectively. Noncontrolling interest represents the noncontrolling shareholder’s proportionate share of the net equity in our consolidated subsidiary, PacketVideo. All significant intercompany accounts and transactions have been eliminated in consolidation.

Fiscal Year End

We operate on a 52-53 week fiscal year ending on the Saturday nearest to December 31 of the current calendar year or the following calendar year. Normally, each fiscal year consists of 52 weeks, but every five or six years the fiscal year consists of 53 weeks. Fiscal year 2010 is a 52-week year ending on January 1, 2011 and fiscal year 2009 is a 53-week year ending on January 2, 2010. The three and six month periods ending on July 3, 2010 and June 27, 2009 include 13 and 26 weeks, respectively.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. On an ongoing basis, we evaluate our estimates, including those related to revenue recognition, income taxes and the valuation of marketable securities, share-based awards, goodwill, wireless spectrum licenses, intangible assets and other long-lived assets. Actual results could differ from those estimates.

Revenues, Cost of Revenues and Deferred Contract Costs

Our discontinued operations have derived revenues from the following sources:

- contracts to provide multimedia software products for mobile and home electronic devices and related royalties through our PacketVideo subsidiary; and
- customer subscriptions for our WiMAX Telecom subsidiary.

For software arrangements, or in cases where the software is considered more than incidental and is essential to the functionality of the hardware or the infrastructure products, revenue is recognized pursuant to software revenue recognition and construction-type and production-type contracts accounting guidance.

For post launch hosting arrangements, revenue is recognized on a pro rata basis based on the term of the contract.

Our revenue arrangements can include multiple deliverables, software or technology license, non-recurring engineering services and post-contract customer support. For these arrangements, we consider the revenue recognition - multiple-element arrangements accounting guidance. Accordingly, we evaluate each deliverable in the arrangement to determine whether it represents a separate unit of accounting. If objective and reliable evidence of fair value exists ("vendor specific objective evidence") for all units of accounting in the arrangement, revenue is allocated to each unit of accounting or element based on those relative fair values. If vendor specific objective evidence of fair value exists for all undelivered elements, but not for delivered elements, the residual method would be used to allocate the arrangement consideration. If elements cannot be treated as separate units of accounting because vendor specific objective evidence of the undelivered elements does not exist, they are combined into a single unit of accounting and the associated revenue is deferred until all combined elements have been delivered or until there is only one remaining element to be delivered. To date, we have not been able to establish vendor specific objective evidence for any of the elements included in our revenue arrangements, as the software and hardware products or services have not yet been sold separately, nor has a standard price list been established. As a result, once the software or technology is delivered and the only undelivered element is services, the entire non-contingent contract value is recognized ratably over the remaining service period. Costs directly attributable to providing these services are also deferred and amortized over the remaining service period of the respective revenues.

Services sold separately are generally billed on a time and materials basis at agreed-upon billing rates, and revenue is recognized as the services are performed.

We earn royalty revenues on licensed embedded multimedia products sold by our licensees. Generally, royalties are paid by licensees on a contingent, per unit, or fixed fee usage basis. The licensees generally report and pay the royalty in the quarter subsequent to the period of delivery or usage. We recognize royalty revenues based on royalties reported by licensees. When royalty arrangements also provide for ongoing post-contract customer support that does not meet the criteria to be recognized upon delivery of the software, the royalty is recognized ratably from the date the royalty report is received through the stated remaining term of the post-contract customer support. In limited situations, we have determined that post-contract customer support revenue can be recognized upon delivery of the software because the obligation to provide post-contract customer support is for one year or less, the estimated cost of providing the post-contract customer support during the arrangement is insignificant and unspecified upgrades or enhancements offered for the particular post-contract customer support arrangement historically have been and are expected to continue to be minimal and infrequently provided. In these instances, we have accrued all the estimated costs of providing the services upfront, which to date have been insignificant.

If we receive non-refundable advanced payments from licensees that are allocable to future contracts periods or could be creditable against other obligations of the licensee to us, the recognition of the related revenue is deferred until such future periods or until such creditable obligations lapse.

In instances where we have noted extended payment terms, revenue is recognized in the period the payment becomes due. If an arrangement includes specified upgrade rights, revenue is deferred until the specified upgrade has been delivered.

We do not generally allow for product returns and we have no history of significant product returns. Accordingly, no allowance for returns has been provided.

The timing and amount of revenue recognition depends upon a variety of factors, including the specific terms of each arrangement and the nature of our deliverables and obligations. Determination of the appropriate amount of revenue recognized involves judgments and estimates that our management believes are reasonable.

Income Taxes

We recognize income tax benefits (expense) based on estimates of our consolidated taxable income (loss) taking into account the various legal entities through which, and jurisdictions in which, we operate. As such, income tax benefits (expense) may vary from the customary relationship between income tax benefit (expense) and income (loss) before taxes.

Recent Accounting Pronouncements

In October 2009, the FASB issued an Accounting Standards Update (“ASU”) for revenue recognition related to multiple-deliverable revenue arrangements. This ASU provides amendments to the existing criteria for separating consideration in multiple-deliverable arrangements. The amendments establish a selling price hierarchy for determining the selling price of a deliverable, eliminate the residual method of allocation of arrangement consideration to all deliverables and require the use of the relative selling price method in allocation of arrangement consideration to all deliverables, require the determination of the best estimate of a selling price in a consistent manner, and significantly expand the disclosures related to the multiple-deliverable revenue arrangements. The amendments are effective for our fiscal year 2011 with early adoption permitted. We are currently evaluating the impact of adopting these amendments on our consolidated financial statements.

In October 2009, the FASB issued an ASU for software revenue recognition. This standard removes tangible products from the scope of software revenue recognition guidance and also provides guidance on determining whether software deliverables in an arrangement that includes a tangible product, such as embedded software, are within the scope of the software revenue guidance. This amendment is effective for our fiscal year 2011 with early adoption permitted. We are currently evaluating the impact of adopting this amendment on our consolidated financial statements.

2. Wireless Spectrum Licenses

We continue to market for sale our wireless spectrum holdings. Any sale or transfer of the ownership of our wireless spectrum holdings is generally subject to regulatory approval. We are required to use the net proceeds from the sale of our wireless spectrum licenses to redeem our Senior Notes, Second Lien Notes and Third Lien Notes, subject to our right to retain up to $12.5 million of such proceeds after payment of certain Senior Notes for general working capital purposes and permitted investments.

During the three and six months ended July 3, 2010, we recognized net gains (losses) on sales of our spectrum licenses of $(0.2) million and $12,000, respectively, after deducting incremental costs of $0.5 million and $0.7 million, respectively. The net gains (losses) recognized during the three and six months ended July 3, 2010, were partially reduced by lease payments received by us, pending completion of the sale of certain of our owned WCS spectrum licenses in the United States to a third party, of $0.3 million and the forfeiture of a spectrum license sales deposit received by us of $0.3 million. The net loss recognized during the three months ended July 3, 2010, includes incremental costs incurred on wireless spectrum sales anticipated to close during the third quarter of 2010.

During the three and six months ended June 27, 2009, we completed sales of certain of our owned Advanced Wireless Services (“AWS”) spectrum licenses in the United States to third parties for net proceeds, after deducting direct and incremental selling costs, of $3.7 million and $5.5 million, and recognized net gains on the sales of $0.7 million and $0.7 million, respectively. The net proceeds from the sales were used to redeem a portion of the Senior Notes at a redemption price of 105% of the principal amount thereof plus accrued interest.

We anticipate that certain of our remaining wireless spectrum licenses will be sold within the next twelve months. Accordingly, at July 3, 2010, we classified wireless spectrum holdings with a carrying value of $59.0 million as assets held for sale, and, in accordance with accounting guidance for assets while held for sale, we are no longer amortizing these assets. As of July 3, 2010, the aggregate net carrying value of our remaining wireless spectrum license assets that are not considered held for sale was $405.3 million, which includes $79.1 million of asset value allocated as a result of related deferred tax liabilities determined in accordance with accounting guidance for acquired temporary differences in certain purchase transactions that are not accounted for as business combinations.

Through our continued efforts to sell our wireless spectrum licenses in Europe and Argentina during 2010, we determined that the carrying value of certain of these spectrum licenses exceeded their fair value based primarily on bids received and negotiations with third parties regarding the sale of these licenses, which led to our decision not to pursue build out obligations in Europe during this time period. Accordingly, during the six months ended July 3, 2010, we wrote-down the carrying value of our wireless spectrum licenses in Europe and Argentina to their estimated fair value and recognized asset impairment charges of $0.2 million and $0.3 million, respectively, all of which is reported in discontinued operations. Upon the sale and deconsolidation during the three months ended July 3, 2010, of our Slovakia based subsidiary, WiMax Telecom SRO, we reclassified $1.2 million of the asset impairment charge on our wireless spectrum licenses in Slovakia that was recognized during the first quarter of 2010 against the net losses on business divestitures.

During the six months ended June 27, 2009, we determined that the carrying value of our remaining domestic AWS spectrum licenses and our wireless spectrum licenses in Europe exceeded their fair value based primarily on bids received and negotiations with third parties regarding the sale of these licenses which occurred in April 2009. Accordingly, during the six months ended June 27, 2009, we wrote-down the carrying value of our domestic AWS spectrum licenses and our wireless spectrum licenses in Europe to their estimated fair value and recognized asset impairment charges of $16.2 million, of which $9.4 million is reported in continuing operations and $6.8 million is reported in discontinued operations.

3. Asset Impairment Charges

Long-Lived Assets

In connection with our ongoing discussions to sell our Nevada office building, we determined that indicators of impairment were present, and, accordingly, based on the accounting guidance for the impairment or disposal of long-lived assets, we performed an assessment to determine if the carrying value of our building was recoverable through estimated undiscounted future cash flows resulting from the use of the assets and their eventual disposition. During the three and six months ended July 3, 2010, we recognized additional asset impairment charges of $1.5 million, all of which is reported as asset impairment charges in discontinued operations.

In connection with our global restructuring initiative, we reviewed our long-lived assets for impairment and, during the six months ended June 27, 2009, determined that indicators of impairment were present for certain long-lived assets. Accordingly, we performed an assessment to determine if the carrying value of these long-lived assets was recoverable through estimated undiscounted future cash flows resulting from the use of the assets and their eventual disposition. As a result of this assessment, during the three and six months ended June 27, 2009, we recognized additional asset impairment charges of $1.6 million and $4.8 million, of which $1.5 million and $4.6 million is reported as asset impairment charges in discontinued operations and $0.1 million and $0.2 million is reported as asset impairment charges in continuing operations, respectively.

There are inherent estimates and assumptions underlying the projected cash flows utilized in the recoverability assessment and management's judgment is required in the application of this information to the determination of the recovery value of the assets. No assurance can be given that the underlying estimates and assumptions will materialize as anticipated.

4. Restructuring Charges

The following summarizes the restructuring activity for the six months ended July 3, 2010 and June 27, 2009 and the related restructuring liabilities:

(in thousands)	Balance at Beginning of Year	Charges to Expense	Cash Payments	Reversal of Deferred Charges	Balance at End of Period
For the Six Months Ended July 3, 2010					
Lease abandonment and facility closure costs	$ 1,750	$ 108	$ —	$ —	$ 1,858
	349	1,087	(1,163)	—	273

Other related costs, including contract termination costs, selling costs and legal fees					
Total	$ 2,099	$ 1,195	$ (1,163)	$ —	$ 2,131
Continuing operations(1)	$ 1,833	$ 237			$ 1,697
Discontinued operations	266	958			434
Total	$ 2,099	$ 1,195			$ 2,131
For the Six Months Ended June 27, 2009					
Employee termination costs	$ 237	$ 4,884	$ (5,085)	$ —	$ 36
Lease abandonment and facility closure costs	1,616	282	(1,173)	1,136	1,861
Other related costs, including contract termination costs, selling costs and legal fees	2,668	1,813	(2,286)	—	2,195
Total	$ 4,521	$ 6,979	$ (8,544)	$ 1,136	$ 4,092
Continuing operations(2)	$ 3,492	$ 2,038			$ 3,789
Discontinued operations	1,029	4,941			303
Total	$ 4,521	$ 6,979			$ 4,092

(1) Included in restructuring charges of continuing operations for the six months ended July 2, 2010 is $0.2 million of interest accretion expense on long-term obligations resulting from the renegotiation of one of our abandoned lease liabilities, which is reported in interest expense of continuing operations in the consolidated statement of operations.

(2) Included in the restructuring charges of continuing operations for the three and six months June 27, 2009 is a credit of $1.0 million and net charges of $0.4 million of lease abandonment and facility closure costs related to certain shared facilities. The credit during the three months ended June 27, 2009 resulted from a reduction in our lease obligation pursuant to a sublease termination agreement that was consummated in June 2009. Also included in the restructuring charges of continuing operations for the three and six months ended June 27, 2009 are costs related to the divestiture and closure of discontinued businesses totaling $0.2 million and $1.3 million, respectively.

5. Long-Term Obligations

Long-term obligations held by continuing operations consist of the following:

(dollars in thousands)	July 3, 2010	January 2, 2010
15% Senior Secured Notes due July 2011, net of unamortized discounts of $6,917 and $6,177 at July 3, 2010 and January 2, 2010, respectively, and stated interest rates of 15% and 14% for payment-in-kind interest at July 3, 2010 and January 2, 2010, respectively, and 9% for cash interest at January 2, 2010	$ 203,430	$ 162,076
15% Senior-Subordinated Secured Second Lien Notes due November 2011, net of unamortized discounts of $12,038 and $13,182 at July 3, 2010 and January 2, 2010, respectively, and stated interest rates of 15% and 14% at July 3, 2010 and January 2, 2010, respectively	143,012	127,573
12% Third Lien Subordinated Secured Convertible Notes due December 2011, net of unamortized discounts of $144,670 and $134,230 at July 3, 2010 and January 2, 2010, respectively and stated interest rates of 12% and 7.5% at July 3, 2010 and January 2, 2010, respectively	420,250	389,869
Wireless spectrum leases, net of unamortized discounts of $15,386 and $16,556 at July 3, 2010 and January 2, 2010, respectively; expiring from 2011 through 2036 with one to five renewal options ranging from 10 to 15 years each	23,093	25,768
Collateralized non-recourse bank loan with interest at 30-day LIBOR plus 0.25%; principal and interest due upon sale of auction rate securities; secured by auction rate securities	—	21,406
Other	1,631	1,412
Long-term obligations	791,416	728,104
Less current portion	(62,134)	(86,154)
Long-term portion	$ 729,282	$ 641,950

Effective as of March 16, 2010, we entered into the Amendment and Waiver (Note 1) to the agreements governing our Senior Notes, Second Lien Notes and Third Lien Notes. Pursuant to the Amendment and Waiver, the maturity date of our Senior Notes was extended from July 17, 2010 to July 17, 2011, with an additional extension to October 17, 2011 if certain conditions are met, including the pendency of asset sales that would yield net proceeds sufficient to repay all then-outstanding Senior Notes. In addition, the maturity date of our Second Lien Notes was extended from December 31, 2010 to November 30, 2011. As a result of the Amendment and Waiver, the interest payable on our Senior Notes and Second Lien Notes was increased to a rate of 15% per annum beginning March 16, 2010 and the interest payable on our Third Lien Notes was increased to a rate of 12% per annum beginning March 16, 2010, increasing 1% per annum on each of December 31, 2010, March 30, 2011, June 30, 2011 and September 30, 2011 to a maximum of 16%. After giving effect to the Amendment and Waiver, all Notes will receive only payment-in-kind interest for the full term of such Notes, unless we elect to pay cash interest, and the redemption premium on the Notes was eliminated. As a result of the Amendment and Waiver, we classified $59.0 million of the long term obligations as current obligations based on our estimated repayment obligation upon the sale of our Held For Sale assets as required by the Senior Notes, Second Lien Notes, and Third Lien Notes. The Amendment and Waiver reduced the requirement to maintain a minimum cash balance from $5.0 million to $1.0 million and, after payment in full of certain designated Senior Notes (the “Priority Notes”) with an aggregate principal amount of $56.5 million at July 3, 2010 and the Senior Incremental Notes (as defined below) with an aggregate principal amount of $25.5 million at July 3, 2010, permits us to retain up to $12.5 million of asset sale proceeds for general working capital purposes and permitted investments. The Amendment and Waiver also eliminates the redemption premium on all Notes. As consideration for the Amendment and Waiver, we paid an amendment fee to each Holder through the issuance of additional Notes (the “Fee Notes”) under the applicable Note Agreements in an amount equal to 2.5% of the outstanding principal and accrued and unpaid interest on such Holder’s existing Notes as of March 16, 2010. The Fee Notes were paid on March 16, 2010 through the issuance of $4.3 million in Senior Notes, $3.6 million in Second Lien Notes and $13.3 million in Third Lien Notes.

As permitted by the Amendment and Waiver, we issued $20.0 million and $5.0 million in additional Senior Notes (the “Senior Incremental Notes”) during the second quarter of 2010 to Avenue Capital Management II, L.P., acting on behalf of its managed investment funds signatory thereto, and Solus Core Opportunities Master Fund Ltd and its affiliates and co-investors, respectively. As with the other Senior Notes, amounts outstanding under the Senior Incremental Notes bear interest at a rate of 15% per annum, payable in-kind unless we elect to pay cash, and are be secured by a first lien on the same assets securing our Senior Notes, on a pari passu basis. No commitment fee or structuring fee was payable in connection with the issuance of the Senior Incremental Notes.

We determined that the Senior Note and Second Lien Note debt instruments prior to and after the March 16, 2010 Amendment and Waiver are not substantially different and, therefore, do not receive debt extinguishment accounting treatment in accordance with generally accepted accounting principles. Under modification accounting, new effective interest rates are determined as of the modification date based on the carrying amount of the original debt instrument and the revised cash flows. The Fee Notes and the fair value of any new embedded derivatives are considered to be associated with the modified debt instruments and, along with existing unamortized discounts, are amortized as an adjustment to interest expense over the remaining term of the modified debt instruments using the effective interest method.

The automatic extension of the maturity date of our Senior Notes from July 17, 2011 to October 17, 2011 if certain conditions are met, including the pendency of asset sales that would yield net proceeds sufficient to repay all then-outstanding Senior Notes, constitutes an embedded derivative. Accordingly, we have bifurcated the estimated fair value of the embedded derivative from the carrying value of the Senior Notes upon modification and recognized subsequent changes in the fair value of the embedded derivative against income. We measured the estimated fair value of the Senior Notes embedded derivative using a probability-weighted discounted cash flow model, which includes management assumptions of the probability of occurrence of certain conditions, including the pendency of asset sales that would yield net proceeds sufficient to repay all then-outstanding Senior Notes. The initial estimated fair value of the Senior Notes embedded derivative at March 16, 2010 of $0.2 million was recorded as a decrease in the carrying value of the Senior Notes and the estimated fair value of the embedded derivative of $0.1 million at July 3, 2010 is reported in other long-term liabilities in the accompanying consolidated balance sheets. The changes in the estimated fair value of the embedded derivative of $0.1 million and $(0.1) million during the three and six months ended July 3, 2010, were recognized as credits (charges) to other income (expense) in the accompanying consolidated statements of operations.

The requirements to redeem the Second Lien Notes upon an asset sale and a change in control constitute embedded derivatives. Accordingly, we have bifurcated the estimated fair value of each embedded derivative from the carrying value of the Second Lien Notes and recognized subsequent changes in the fair value of the embedded derivatives against income. We measured the estimated fair value of the Second Lien Notes embedded derivatives using a probability-weighted discounted cash flow model, which includes management assumptions of the probability of occurrence of a redemption of the Second Lien Notes upon an asset sale and a change in control. The estimated fair value of the Second Lien Notes embedded derivatives of $0.1 million and $9.9 million at July 3, 2010 and January 2, 2010, respectively, are reported in other long-term liabilities in the accompanying consolidated balance sheets. Changes in the estimated fair value of the embedded derivatives of $0.1 million and $9.8 million during the three and six months ended July 3, 2010, respectively, were recognized as credits to other income (expense) in the accompanying consolidated statements of operations. The reduction in the fair value of the embedded derivative liabilities and the $9.8 million credit to other income (expense) during the six months ended July 3, 2010 resulted primarily from the Amendment and Waiver which eliminated the redemption premiums required upon an asset sale or change in control.

The Amendment and Waiver to our Third Lien Notes, which increased the interest rate payable on our Third Lien Notes, was determined to have been accomplished with debt instruments that are substantially different, in accordance with generally accepted accounting principles, resulting in an effective extinguishment of the existing Third Lien Notes and a new issue of Third Lien Notes as of the modification date for accounting purposes. The new issue of Third Lien Notes was recorded at its estimated fair value using a discount rate of 40%, which represents the estimated incremental borrowing rate of our Third Lien Notes that was determined by a third party valuation group, and that amount was used to determine a net debt extinguishment gain of $38.0 million that was recognized during the six months ended July 3, 2010 in other income in the accompanying consolidated statements of operations. The net gain of $38.0 million was determined as the difference between the remaining unamortized discount under the extinguished Third Lien Notes of $123.1 million and the new discount of $164.8 million, plus $9.6 million of embedded derivative liabilities that were eliminated at the date of the extinguishment, partially offset by $13.3 million in fee notes issued to the Third Lien noteholders. The new discount of $164.8 million is amortized using the effective interest rate method over the remaining term of the Third Lien Notes due December 2011 which will significantly increase our interest expense for financial reporting purposes.

The requirements to redeem the Third Lien Notes upon an asset sale and a change in control constitute embedded derivatives. Accordingly, we have bifurcated the estimated fair value of each embedded derivative from the fair value of the Third Lien Notes upon the effective reissuance of the Third Lien Notes at March 16, 2010, and recognized subsequent changes in the fair value of the embedded derivatives against income. We measured the estimated fair value of the Third Lien Notes embedded derivatives using a probability-weighted discounted cash flow model, which includes management assumptions of the probability of occurrence of a redemption of the Third Lien Notes upon an asset sale and a change in control. The initial estimated fair value of the Third Lien Notes embedded derivatives of $3.7 million was recorded as a reduction in the carrying value of the Third Lien Notes and the estimated fair values of the embedded derivatives of $5.5 million at July 3, 2010, are reported in other long-term liabilities in the accompanying consolidated balance sheets. Changes in the estimated fair value of the embedded derivatives of $(1.7) million and $4.1 million during the three and six months ended July 3, 2010, respectively, were recognized as credits (charges) to other income (expense) in the accompanying consolidated statements of operations.

During the three months ended July 3, 2010, we exercised our auction rate securities rights and sold our auction rate securities to UBS for $25.0 million and paid in full our collateralized non-recourse bank loan that was secured by our auction rate securities.

6. Related Party Transactions

Debt-Related Transactions

As permitted by the March 16, 2010 Amendment and Waiver, we issued $25.0 million in Senior Incremental Notes during the three months ended July 3, 2010 to Avenue Capital Management II, L.P., acting on behalf of its managed investment funds signatory thereto, and Solus Core Opportunities Master Fund Ltd and its affiliates and co-investors. Avenue Capital Management II, L.P., is an affiliate of Avenue Capital. Robert Symington, a portfolio manager with Avenue Capital, is a member of our Board of Directors. As of July 3, 2010, Avenue Capital and its affiliates beneficially owned shares representing 28.5% of our issued and outstanding common stock, $116.8 million, or 56% of the aggregate principal amount of our Senior Notes, $120.7 million, or 78% of the aggregate principal amount of our Second Lien Notes and $159.1 million, or 28% of the aggregate principal amount of our Third Lien Notes. As of July 3, 2010, Solus beneficially owned shares representing 10.0% of our issued and outstanding common stock, $37.0 million, or 18% of the aggregate principal amount of our Senior Lien Notes, $34.3 million, or 22% of the aggregate principal amount of our Second Lien Notes and $65.2 million, or 12% of the aggregate principal amount of our Third Lien Notes. As with the other Senior Notes, amounts outstanding under the Senior Incremental Notes bear interest at a rate of 15% per annum, payable in-kind unless we elect to pay cash, and will be secured by a first lien on the same assets securing our Senior Notes, on a pari passu basis. No commitment fee or structuring fee is payable in connection with the issuance of the Senior Incremental Notes. During the three months ended July 3, 2010, we received cash of $20.0 million and $5.0 million and issued Senior Incremental Notes in the same principal amount to Avenue Capital and Solus, respectively.

As consideration for the Amendment and Waiver, we paid an amendment fee to each of Avenue, Solus, Douglas F. Manchester, a member of our Board of Directors and Navation, Inc. (“Navation”), an entity owned by Allen Salmasi, our Chairman, through the issuance of additional Notes under the applicable Note Agreements in an amount equal to 2.5% of the outstanding principal and accrued and unpaid interest on such holder’s existing Notes as of March 16, 2010. The Fee Notes were paid on March 16, 2010 by the issuance of Senior Notes, Second Lien Notes and Third Lien Notes to Avenue Capital, Solus, Mr. Manchester and Navation, and will accrue interest and become payable in accordance with the terms of the respective Note Agreements. Avenue Capital received $2.3 million in Senior Notes, $2.8 million in Second Lien Notes and $3.7 million in Third Lien Notes. Solus received $0.7 million in Senior Notes, $0.8 million in Second Lien Notes and $1.5 million in Third Lien Notes. Mr. Manchester and Navation each received $1.9 million in Third Lien Notes. The transactions contemplated by the Amendment and Waiver, including the issuance of the Senior Incremental Notes, were approved and recommended to our Board of Directors by an independent committee consisting of members of the Board of Directors who do not have any direct or indirect economic interest in the Notes.

Business Divestiture and Revenue Transactions

In June 2010, we sold the capital stock of our WiMAX Telecom Slovakia s.r.o (“WT SRO”) subsidiary to flyhigh Partners s. r. o. (“flyhigh”), a private limited liability company of which the controlling shareholder is the former managing director and statutory representative of WT SRO, for $0.1 million and recognized a $8.8 million net loss from business divestitures. Upon closing of the sale, we have no remaining obligations to provide financing to support the ongoing operations of WT SRO. Also, in connection with the sale, we entered into an additional consideration agreement with flyhigh that provides for payment to us upon the occurrence of specified trigger events, which includes the sale, lease or contribution or other transfer of all or part of the assets or capital stock of WT SRO, including a spectrum license to third parties, other than the sale or lease of spectrum assignments of less than 10% to the MHz-pop of WT SRO in the aggregate, or a sale or other transfer of WT SRO share capital to any third party or sale or other transfer of share capital above 34% in flyghigh to any third party.

In June 2010, we sold the capital stock of our two Chilean subsidiaries, Southam Chile SA and Socidad Televisora CBC Ltd, to VTR GlobalCom S.A. and VTR Ingenieria S.A., the holders of our notes payable secured by the Chilean spectrum, for net proceeds of $0.7 million, after deducting direct and incremental costs of $0.5 million, and the assumption of the notes payable aggregating $4.3 million. We recognized a net gain on business divestitures of $4.2 million due to the assumption of our notes payable.

DOCOMO, a customer of PacketVideo, hold a 35% ownership interest in our PacketVideo subsidiary. On July 30, 2010 we signed a stock purchase agreement to sell our remaining 65% ownership interest in PacketVideo to DOCOMO (see Note 12). PacketVideo sells a version of its multimedia player to DOCOMO for installation into DOCOMO handset models. PacketVideo recognized $2.3 million and $9.3 million in related party revenues and $0.2 million and $0.5 million in cost of revenues, during the three and six months ended July 3, 2010, respectively, from

DOCOMO in the consolidated statements of operations for our discontinued operations.

7. Comprehensive Loss

Comprehensive loss and comprehensive loss attributable to the noncontrolling interest in subsidiary and NextWave are as follows:

(in thousands)	Three Months Ended July 3, 2010	Three Months Ended June 27, 2009	Six Months Ended July 3, 2010	Six Months Ended June 27, 2009
Net loss	$ (72,853)	$ (55,487)	$ (75,769)	$ (137,666)
Foreign currency translation adjustment	2,714	4,772	2,421	

December 31, 2009:						
Tier 1 leverage:						
Company	$ 163,613	7.96%	$ 82,188	4.00%	$ 102,735	5.00%
Bank (FSB)	154,316	7.53	82,018	4.00	102,522	5.00
Tier 1 capital (to risk-weighted assets):						
Company	163,613	11.95	54,746	4.00	82,119	6.00
Bank (FSB)	154,316	11.33	54,475	4.00	81,712	6.00
Total risk-based capital (to risk-weighted assets):						
Company	180,766	13.21	109,492	8.00	136,865	10.00
Bank (FSB)	171,385	12.58	108,949	8.00	136,186	10.00

Dividend Restrictions

In the ordinary course of business, the Company is dependent upon dividends from Five Star Bank to provide funds for the payment of interest expense on the junior subordinated debentures, dividends to shareholders and to provide for other cash requirements. Banking regulations may limit the amount of dividends that may be paid. Approval by regulatory authorities is required if the effect of dividends declared would cause the regulatory capital of the Bank to fall below specified minimum levels. Approval is also required if dividends declared exceed the net profits for that year combined with the retained net profits for the preceding two years. The Bank is currently required to obtain approval from the NYS Banking Department for dividend payments.

In addition, pursuant to the terms of the Treasury s TARP Capital Purchase Program, the Company may not declare or pay any cash dividends on its common stock other than regular quarterly cash dividends of not more than $0.10 without the consent of the U.S. Treasury.

ITEM 3. Quantitative and Qualitative Disclosures About Market Risk

The principal objective of the Company s interest rate risk management is to evaluate the interest rate risk inherent in certain assets and liabilities, determine the appropriate level of risk to the Company given its business strategy, operating environment, capital and liquidity requirements and performance objectives, and manage the risk consistent with the guidelines approved by the Company s Board of Directors. The Company s management is responsible for reviewing with the Board its activities and strategies, the effect of those strategies on the net interest margin, the fair value of the portfolio and the effect that changes in interest rates will have on the portfolio and exposure limits. Management develops an Asset-Liability Policy that meets strategic objectives and regularly reviews the activities of the Bank.

The primary tool the Company uses to manage interest rate risk is a rate shock simulation to measure the rate sensitivity of the balance sheet. Rate shock simulation is a modeling technique used to estimate the impact of changes in rates on net interest income and economic value of equity. The Company measures net interest income at risk by estimating the changes in net interest income resulting from instantaneous and sustained parallel shifts in interest rates of different magnitudes over a period of twelve months. This simulation is based on management s assumption as to the effect of interest rate changes on assets and liabilities and assumes a parallel shift of the yield curve. It also includes certain assumptions about the future pricing of loans and deposits in response to changes in interest rates. Further, it assumes that delinquency rates would not change as a result of changes in interest rates, although there can be no assurance that this will be the case. While this simulation is a useful measure as to net interest income at risk due to a change in interest rates, it is not a forecast of the future results and is based on many assumptions that, if changed, could cause a different outcome.

In addition to the changes in interest rate scenarios listed above, the Company typically runs other scenarios to measure interest rate risk, which vary depending on the economic and interest rate environments.

The Company has experienced no significant changes in market risk due to changes in interest rates since the Company s Annual Report on Form 10-K for the year ended December 31, 2009, dated March 12, 2010, as filed with the Securities and Exchange Commission.

ITEM 4. Controls and Procedures

Evaluation of disclosure controls and procedures

As of June 30, 2010, the Company carried out an evaluation, under the supervision and with the participation of the Company s management, including 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 pursuant to Rule 13a-15(b), as adopted by the Securities and Exchange Commission (SEC) under the Securities Exchange Act of 1934 (Exchange Act). Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company s disclosure controls and procedures were effective as of the end of the period covered by this report. Disclosure controls and procedures are the controls and other procedures that are designed to ensure that information required to be disclosed in the reports that the Company files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in the reports that the Company files or submits under the Exchange Act is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Changes in internal control over financial reporting

There were no changes in the Company s internal control over financial reporting that occurred during the quarter ended June 30, 2010 that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

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PART II. OTHER INFORMATION

ITEM 1. Legal Proceedings

The Company has experienced no significant changes in its legal proceedings from the disclosure included in the Company s Annual Report on Form 10-K for the year ended December 31, 2009, dated March 12, 2010, as filed with the Securities and Exchange Commission.

ITEM 1A. Risk Factors

The Company has experienced no significant changes in its risk factors from the disclosure included in the Company s Annual Report on Form 10-K for the year ended December 31, 2009, dated March 12, 2010 as filed with the Securities and Exchange Commission.

ITEM 6. Exhibits

(a) The following is a list of all exhibits filed or incorporated by reference as part of this Report.

Exhibit Number	Description	Location
3.1	Amended and Restated Certificate of Incorporation of the Company	Incorporated by reference to Exhibit 3.1 of the Form 10-K for the year ended December 31, 2008, dated March 12, 2009
3.2	Amended and Restated Bylaws of the Company	Incorporated by reference to Exhibit 3.4 of the Form 10-K for the year ended December 31, 2008, dated March 12, 2009
4.1	Warrant to Purchase Common Stock, dated December 23, 2008 issued by the Registrant to the United States Department of the Treasury	Incorporated by reference to Exhibit 4.2 of the Form 8-K, dated December 19, 2008
10.1	1999 Management Stock Incentive Plan	Incorporated by reference to Exhibit 10.1 of the S-1 Registration Statement
10.2	Amendment Number One to the FII 1999 Management Stock Incentive Plan	Incorporated by reference to Exhibit 10.1 of the Form 8-K, dated July 28, 2006
10.3	Form of Non-Qualified Stock Option Agreement Pursuant to the FII 1999 Management Stock Incentive Plan	Incorporated by reference to Exhibit 10.2 of the Form 8-K, dated July 28, 2006
10.4	Form of Restricted Stock Award Agreement Pursuant to the FII 1999 Management Stock Incentive Plan	Incorporated by reference to Exhibit 10.3 of the Form 8-K, dated July 28, 2006
10.5	Form of Restricted Stock Award Agreement Pursuant to the FII 1999 Management Stock Incentive Plan	Incorporated by reference to Exhibit 10.1 of the Form 8-K, dated January 23, 2008
10.6	1999 Directors Stock Incentive Plan	Incorporated by reference to Exhibit 10.2 of the S-1 Registration Statement
10.7		

	Amendment to the 1999 Director Stock Incentive Plan	Incorporated by reference to Exhibit 10.7 of the Form 10-K for the year ended December 31, 2008, dated March 12, 2009
10.8	2009 Management Stock Incentive Plan	Incorporated by reference to Exhibit 10.8 of the Form 10-Q for the quarterly period ended June 30, 2009, dated August 5, 2009
10.9	2009 Directors Stock Incentive Plan	Incorporated by reference to Exhibit 10.9 of the Form 10-Q for the quarterly period ended June 30, 2009, dated August 5, 2009
10.10	Form of Restricted Stock Award Agreement Pursuant to the FII 2009 Management Stock Incentive Plan	Incorporated by reference to Exhibit 10.1 of the Form 8-K, dated January 19, 2010

Exhibit Number	Description	Location
10.11	Form of Restricted Stock Award Agreement Pursuant to the FII 2009 Management Stock Incentive Plan	Incorporated by reference to Exhibit 10.1 of the Form 8-K, dated March 1, 2010
10.12	Form of Restricted Stock Award Agreement Pursuant to the FII 2009 Management Stock Incentive Plan	Incorporated by reference to Exhibit 10.2 of the Form 8-K, dated March 1, 2010
10.13	Amended Stock Ownership Requirements, dated December 14, 2005	Incorporated by reference to Exhibit 10.19 of the Form 10-K for the year ended December 31, 2005, dated March 15, 2006
10.14	Executive Agreement with Peter G. Humphrey	Incorporated by reference to Exhibit 10.1 of the Form 8-K, dated June 30, 2005
10.15	Executive Agreement with James T. Rudgers	Incorporated by reference to Exhibit 10.2 of the Form 8-K, dated June 30, 2005
10.16	Executive Agreement with Ronald A. Miller	Incorporated by reference to Exhibit 10.3 of the Form 8-K, dated June 30, 2005
10.17	Executive Agreement with Martin K. Birmingham	Incorporated by reference to Exhibit 10.4 of the Form 8-K, dated June 30, 2005
10.18	Agreement with Peter G. Humphrey	Incorporated by reference to Exhibit 10.6 of the Form 8-K, dated June 30, 2005
10.19	Executive Agreement with John J. Witkowski	Incorporated by reference to Exhibit 10.7 of the Form 8-K, dated September 14, 2005
10.20	Executive Agreement with George D. Hagi	Incorporated by reference to Exhibit 10.7 of the Form 8-K, dated February 2, 2006
10.21	Voluntary Retirement Agreement with James T. Rudgers	Incorporated by reference to Exhibit 10.1 of the Form 8-K, dated September 24, 2008
10.22	Amendment to Voluntary Retirement Agreement with James T. Rudgers	Incorporated by reference to Exhibit 10.1 of the Form 8-K, dated July 1, 2009
10.23	Voluntary Retirement Agreement with Ronald A. Miller	Incorporated by reference to Exhibit 10.2 of the Form 8-K, dated September 24, 2008
10.24	Amendment to Voluntary Retirement Agreement with Ronald A. Miller	Incorporated by reference to Exhibit 10.1 of the Form 8-K, dated March 3, 2010
10.25		

	Letter Agreement, dated December 23, 2008, including the Securities Purchase Agreement-Standard Terms attached thereto, by and between the Company and the United States Department of the Treasury	Incorporated by reference to Exhibit 10.1 of the Form 8-K, dated December 19, 2008
11.1	Statement of Computation of Per Share Earnings	Incorporated by reference to Note 2 of the Registrant s unaudited consolidated financial statements under Item 1 filed herewith.
12	Ratio of Earnings to Fixed Charges and Preferred Dividends	Filed Herewith
31.1	Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 Principal Executive Officer	Filed Herewith
31.2	Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 Principal Financial Officer	Filed Herewith
32	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	Filed Herewith

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Signatures

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

FINANCIAL INSTITUTIONS, INC.

/s/ Peter G. Humphrey	, August 3, 2010
Peter G. Humphrey President and Chief Executive Officer (Principal Executive Officer)	
/s/ Karl F. Krebs	, August 3, 2010
Karl F. Krebs Executive Vice President and Chief Financial Officer (Principal Financial and Principal Accounting Officer)	

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