

# FINAL TRANSCRIPT

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## **LEAP - Q2 2006 Leap Wireless International Earnings Conference Call**

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**Doug Hutcheson**

*Leap Wireless - President, CEO*

**Dean Luvisa**

*Leap Wireless - Acting CFO*

**Al Moschner**

*Leap Wireless - EVP, CMO*

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## PRESENTATION

**Operator**

Good day, ladies and gentlemen. Welcome to the second-quarter 2006 Leap Wireless International earnings call. My name is Colby, and I will be your coordinator for today. (Operator Instructions). And as a reminder, this conference is being recorded for replay purposes. I would now like to turn the presentation over to your host for today's call, Mr. Jim Seines, Director of Investor Relations. Please proceed, sir.

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**Jim Seines** - Leap Wireless - Director, IR

Good afternoon and welcome to Leap's second-quarter 2006 conference call. This call is being recorded and will be available for playback in the US through close of business August 17 by calling 1-888-286-8010. Callers from outside the US will need to dial 1-617-801-6888. The pass code for both calls is 99436977. This conference call is also being webcast live and will be available for replay on the Investor Relations section of our website at [www.leapwireless.com](http://www.leapwireless.com) for the next 30 calendar days.

Joining me on the call today to discuss our second-quarter results are Doug Hutcheson, President and Chief Executive Officer; Al Moschner, Executive Vice President and Chief Marketing Officer; Glenn Umetsu, Executive Vice President and Chief Technical Officer; and Dean Luvisa, acting Chief Financial Officer. Following our prepared remarks, Colby will come back online with instructions on keying in for the question-and-answer portion of today's call.

During our call today, we will discuss some financial metrics, which do not conform to generally accepted accounting principles, or GAAP, in the US, such as cost per gross addition, or CPGA; cash cost per user, or CCU; adjusted operating income before depreciation and amortization, or OIBDA; and calculated contribution per user per month. Any non-GAAP financial measures presented by the Company during today's call should be considered in addition to but not a substitute for the information prepared in accordance with generally accepted accounting principles. For a GAAP reconciliation of the non-GAAP financial measures discussed today, please access the financial reports page of the Investor Relations section of Leap's website, [www.leapwireless.com](http://www.leapwireless.com).

Today's conference call was preceded by our earnings release for the second quarter of 2006. This release has been distributed on the news wires and is available on the Investor Relations section of our website. The information contained in today's call should be considered together with the information contained in our earnings press release.

Before we start, I would like to remind you that statements made today that are not historical in nature, including any statements about our expectations regarding future events and performance, are forward-looking statements inherently involving numerous risks and uncertainties. For example, projections of future performance and statements including such words as hope, expect, plan, intend, believe, think, anticipate and similar terms are forward-looking statements. Forward-looking statements made in today's conference call speak only to management's views as of the date of this conference call. The Company undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. Our actual results could differ materially from those stated or implied by such forward-looking statement due to the risks and uncertainties associated with our business. Factors that could cause actual results to differ from our forward-looking statements are detailed in the section entitled "Risk Factors" included in our Quarterly Report on Form 10-Q for the second quarter of 2006, which we expect to file shortly, and our Annual Report on Form 10-K for fiscal year ended December 31, 2005 and in our other publicly-filed reports.

The material discussed during our conference call today does not attempt to address the investment objectives or financial situations or needs of any person or entity. It is being provided for general informational purposes and should not be construed as a solicitation to buy or sell any securities or related financial instruments. Investors should seek financial advice regarding the appropriateness of investments in any securities. This communication is qualified in its entirety by reference to all information disclosed by Leap in its press releases and public filings with the Securities and Exchange Commission.

Finally, the financial and operating data presented today including customer information reflects the consolidated results of Leap; its subsidiaries and its non-controlled joint venture, Alaska Native Broadband 1, LLC, which we will refer to as ANB in this call for the periods indicated.

In July, we completed the sale of our Toledo and Sandusky operating markets to Cleveland Unlimited and the formation of our new Oregon joint venture, LCW Wireless. Our third-quarter results will reflect the consolidation of LCW into our financial statements as well as the gain from the sale of our Toledo/Sandusky assets. In addition, our third-quarter net customer addition

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results will be adjusted to eliminate the effect of transferring approximately 31,000 customers in the Toledo and Sandusky markets to Cleveland Unlimited. With that, I would now like to turn the call over to Doug.

**Doug Hutcheson** - *Leap Wireless - President, CEO*

Thank you for joining us this afternoon. Today, we are pleased to report on our continued success in implementing a vision for the Company's future that has touched all facets of the business, a vision that has strengthened our performance and established a solid foundation for continued future growth and expansion. We have worked to ensure that the wireless services we provide to our customers are more innovative, reliable and cost-effective than ever. At the same time, we have put ourselves in a position to expand by assembling and launching a portfolio of highly attractive new markets, devoting the resources to ensure that the rollout of these markets meet the standard we have set for our business.

Our efforts have been wide-ranging and systematic, from advancing our service offerings and evolving the customer experience to realigning our distribution and improving our ability to communicate the significant changes within our evolving product portfolio to our customers. We believe that the progress we are sharing with you today is a strong indication that we are headed in the right direction and doing so in a timely, effective and financially-disciplined manner. Our progress relies on solid execution and a tight focus on well-defined objectives supporting our strategy. I would like to take a moment to highlight a few of our major accomplishments since our last conference call.

Cricket service launched in Houston, Cincinnati, Louisville, Lexington, Austin, Bryan, Temple, and Killeen on schedule and at or below budget. Additionally, I'm pleased to report that the Company has overcome some of the initial impediments of our Houston launch. And the current customer growth in the market is now at or better than planned at this stage of the launch. We achieved a positive OIBDA contribution at the market level for El Paso and Las Cruces for the second quarter, its first full quarter of operation. Also, Colorado Springs was nearing OIBDA breakeven at the market level late in the quarter. We completed the swap of our Grand Rapids, Michigan license for a license covering Rochester, New York, allowing us to build out an Upstate New York cluster.

And the Company successfully completed an amendment to our senior secured credit facility, increasing the aggregate size of the facility to 1.1 billion and improving the business's ability to implement our strategy. We believe that the operational and financial results provided today serve to illustrate the progress we're making as we execute on our strategy. The Company had a second quarter that solidly exceeded management's financial expectations. We achieved second-quarter adjusted OIBDA of nearly 78 million, even after absorbing approximately \$16 million of negative OIBDA associated with our new market launch activities. In addition, our existing markets achieved an adjusted OIBDA margin of 42% based on service revenues as we delivered nearly twice the product of other carriers at approximately 20% less ARPU.

I'm again pleased with our calculated contribution per user, a measure of the subscriber economics that reflects the net effect of our operating metrics. CCPU improved by \$1.35 year-over-year to \$16.56. Our performance on this metric for the second quarter is another achievement for our business, even with the inclusion of \$1.54 in costs associated with the new market launches. These accomplishments were the product of the hard work and dedication of our employees in every market and across all of our business functions. Even with the challenges of launching new markets and implementing operational improvements, their diligence and commitment to quality performance resulted in another breakthrough quarter and I would like to thank them for their role in our success.

During today's call, Dean will provide a review of the Company's financial results for the quarter, followed by AI who will provide an update on our customer and operational progress and Glenn who will review our operating costs and build-out progress. I will wrap up the prepared portion of today's call and introduce a guest at the end of the call, Amin Khalifa, who will be joining our organization later in August as the Company's CFO and Executive Vice President. With that, I would now like to turn the call over to Dean.

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**Dean Luvisa - Leap Wireless - Acting CFO**

Leap delivered strong operating results in the second quarter, producing nearly \$268 million of total revenue and \$77.7 million of adjusted OIBDA, even while absorbing the negative OIBDA associated with launching more than 8 million new covered POPs. During the quarter, we successfully expanded our coverage by nearly one-third, continued to improve our OIBDA and revenues and made substantial progress in positioning our capital structure for continued growth.

Total revenues for the quarter increased by \$41 million or 18%, and service revenues increased \$41.1 million or 22% compared to the same quarter last year, reflecting our success in growing the business both in our existing markets and in new markets. This increase was primarily due to an 11% increase in average total customers and a continued increase in the overall penetration of our higher end rate plans. Equipment revenues remain virtually unchanged for the quarter compared to last year. A 40% increase in handset sales volume was offset by lower net revenue per handset, which resulted from bundling the first month of service with the initial handset price and eliminating activation fees for new customers who purchased equipment.

Total operating expenses for the quarter increased by \$33.1 million or 15% over the second quarter of 2005 but decreased by 6% as a percentage of service revenues. Cost of service, excluding stock-based compensation expense was 26% of service revenues for the quarter, approximately even with the second quarter of last year as incremental lease and other fixed network costs in the new markets were offset by scale economies gained from a higher number of subscribers and increasing average revenue per user. Cost of equipment increased \$9.3 million or 22% due to the higher handset sales volumes, partially offset by reductions in costs to support our handset replacement programs for existing customers and lower average cost per handset sold.

Selling and marketing expenses excluding stock-based compensation expense increased from 13% to 15% of service revenues, reflecting the cost of supporting our new markets. General and administrative expenses excluding stock-based compensation expense decreased to 18.5% of service revenues from 19.4% in the second quarter of last year.

Finally, depreciation and amortization expense for the second quarter was 23% of service revenues, a decrease from 25% in the second quarter of last year. Stock-based compensation expense was \$4.7 million for the second quarter of 2006 compared to 7.1 million for the prior year period. This decrease was due primarily to the issuance of deferred stock units in the second quarter of 2005 that resulted in an expense of \$6.9 million. Because of the adoption of FAS 123R in 2006, we expect to recognize between 10 million and \$15 million of additional stock-based compensation expense during the remainder of 2006.

During the quarter, we signed agreements to sell licenses for approximately \$12.9 million. As a result of these agreements, we recognized an impairment charge of \$3.2 million to reduce the book value of four of the licenses we agreed to sell to the negotiated sales price less selling costs. We currently expect to recognize a net gain on the sale of the other licenses when the transaction is closed. During the second quarter of 2006, we recorded no income tax expense compared to tax expense of \$1 million for the second quarter of 2005. Our net income was \$7.5 million for the quarter or \$0.12 per diluted share compared to \$1.1 million or \$0.02 per diluted share for the second quarter of 2005. We expect net income to decrease in the second half of the year, and we may incur a net loss for the year due primarily to the effects of our new market launches and expenses associated with financing activities. We expect the new markets to begin making significant contributions to the bottom line in 2007.

Turning to quarter-over-quarter performance, service revenues were up \$14.9 million or 7% from the first quarter, reflecting a higher average number of customers, the effect of moving to pay in advance billing in May and a larger percentage of customers subscribing to our higher end rate plans. Equipment revenues decreased by \$13.8 million or 27% in the second quarter compared to the first quarter, driven primarily by a 4% reduction in handsets sold and the elimination of activation fees for new customers purchasing equipment. Interest expense for the second quarter was \$8.4 million compared to 7.4 million for the first quarter due mainly to the higher level of debt at the end of the quarter and higher interest rates on our floating-rate debt. Cash interest paid of \$12 million was higher than interest expense due to the capitalization of interest associated with our new market builds.

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In June, we amended the terms of our senior secured credit agreement, increasing our term loan from \$593 million to \$900 million and increasing our undrawn revolving credit facility from \$110 million to 200 million. The new facility provided us with approximately 300 million of additional cash on the balance sheet, allowed acceleration of our data network improvements and increased our flexibility to finance the purchase and build-out of additional markets. As a result of the amendment, we wrote off \$5.6 million of deferred debt issuance costs that had been capitalized and were being amortized to interest expense over the term of the original facility.

Moving to the balance sheet, total unrestricted cash, cash equivalents and short-term investments as of June 30 were approximately \$610 million, an increase of 244 million from that reported for March 31 of this year. The increase in cash was primarily attributable to 294 million of net proceeds from the increase in our senior secured term loan and \$63.5 million of cash provided by operating activities, offset by capital expenditures of 126 million. Following the end of the quarter, we used a portion of our cash to fund a refundable bidding deposit of \$255 million to the FCC for Auction 66 and increased our investment in our new joint venture, Denali Spectrum, which allowed it to put down a \$50 million Auction 66 deposit. We expect but cannot guarantee that we will complete arrangements for a bridge loan for up to \$850 million to provide additional funds for Cricket and Denali's participation in Auction 66 and subsequent potential license build-out. We're sizing the bridge loan to provide appropriate funding for the auction outcome, whether or not we choose to move ahead in the near-term with the forward sale of common equity that we discussed on our prior quarterly conference call.

Lastly, we made progress in hiring additional accounting and tax personnel in the quarter including a new director in our tax department. While we continue to report material weaknesses in our disclosure controls and procedures related to income tax accounting and accounting staffing, we expect to resolve these material weaknesses by the end of the year. I would now like to turn the call over to AI to discuss marketing, product development and customer activity.

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**AI Moschner** - Leap Wireless - EVP, CMO

Good afternoon to all of you who have joined us today. As Doug and Dean have noted, we had another quarter of attractive results at as Leap and ANB successfully launched Cricket services in several new markets. We also introduced another important phase of our data and content strategy, which we believe will support additional future ARPU growth while providing a content platform as EV-DO is deployed.

During the second quarter, consolidated gross customer additions were approximately 253,000, representing a 32% increase over the gross additions during the same period last year. Total net customer additions for the second quarter were approximately 58,000 new customers. As we completed a quarter, that brought tremendous transition to our business. These customer results for the quarter demonstrate the Company's continued progress.

First, we modified our dealer compensation policies, improved our customer acquisition processes and enhanced the ability of our dealers to service our customers. Second, we moved to a pay in advance billing for new and returning customers, requiring new customers to pay for their monthly service at the beginning of each month of service. At the same time, we eliminated activation fees for new customers who purchased handsets. We anticipate that the changes will increase gross customer additions and improve customer retention over time. In addition to improving customer acquisition quality, these changes reduce the costs of existing customers to reactivate their accounts, which further enhance customer retention and net adds.

In the second quarter, these actions have reduced the number of low-quality gross additions in several of our existing markets associated with unauthorized distributors. By the end of the quarter, we had seen recovery in the volume of gross additions and believe these to be of a higher quality. We believe that moving to a pay in advance will improve cash flows for new customers and affect the allocation of revenues. Consequently, this change in allocation will cause an increase in the CPGA metric and a deferred increase in ARPU, as the increased service revenue is recognized during the customer's second month of service.

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Third, we saw the seasonal decrease in gross additions and increase in churn that is typical for the second quarter. We also believe some market segments were affected by higher fuel costs, which slowed some of the slow progress we had seen earlier in the year.

Fourth, the Company experienced another strong quarter of customer activity in most of its new markets. We're pleased with the results and continue to believe that they validate our direction and activities.

Lastly, while we're pleased with the results of the quarter and the trajectory of the business's performance, we believe it is worth mentioning that certain unforeseen disruptions impacted net customer additions during the quarter. These disruptions by a competitor, which have been widely reported in the trade press, interfered with our indirect dealer relationships during the launch of our Houston market. This interference reduced the number of Cricket dealers operating during the initial weeks of launch and as a consequence adversely impacted our expected customer additions during the quarter.

We believe we would have performed within our net add guidance for the quarter had it not been for these circumstances, which we feel clearly crossed over the line of acceptable business practice. We have taken steps to address this matter, and we have expanded our dealer distribution network in the market substantially to its planned size. Also, value speaks for itself, and customer acquisition rates have now increased to levels projected for this stage of the launch. Now that we are aware of these practices, we're taking steps to proactively deal with the potential of similar action in the future.

For existing markets, net customer additions were 5,500 with more than 52,000 net customers in new markets. Overall, we're pleased with this performance, noting that we have added approximately 140,000 new customers to our Cricket and Jump's mobile service in our existing markets since this time last year. As these results indicate, the addition of new markets has gone well, which we expect will continue. Markets launched earlier this year are already contributing positively to the bottom line as El Paso/Las Cruces market achieved positive OIBDA for the second quarter. We also believe Colorado Springs will reach this benchmark in the near future as it approached the breakeven point late in the second quarter.

Where we expect to see the typical seasonal slowing of net additions during the third quarter and a maturing growth rate in Fresno relative to last year when it launched, we expect positive customer growth in our existing markets and continued robust growth in our new markets. As a result, we expect to see total net customer additions of between 110,000 and 210,000 in the third quarter principally from new markets.

Churn for the second quarter was 3.6%, an improvement of 0.3% over the second quarter of 2005 and better than our guidance range of 3.9 to 4.1% as a result partially attributable to the migration to pay in advance billing and our Jump Mobile product. Reflecting the typical seasonal rhythm of the third quarter, we expect churn to be between 3.9 and 4.3% and better than the 4.4% churn rate in the third quarter one year ago.

While we expect to see a year-over-year improvement in customer retention, higher energy prices and related inflationary pressures continue to introduce an element of risk to the retention guidance provided in the third quarter. We will continue to take a series of steps that we believe will have attractive long-term benefits for our customers and shareholders and look forward to watching this picture develop in the coming quarters.

Turning to operational metrics, service revenues for the second quarter were up, pushing ARPU to a record \$42.97, an impressive \$3.73 increase from the second quarter of last year. For the third quarter, we expect continuing strength in ARPU due to continuing customer migration to our highest value rate plans, the effects of introducing a pay in advance and increasing contributions from vertical markets -- I'm sorry -- vertical products. However, the seasonal patterns and customer behavior and variability in the timing of cash payments may impact ARPU in any one quarter. Taking these considerations into account for the third quarter, we expect ARPU near the same levels as that reported for the second quarter.

Looking at our customer acquisition expenses, CPGA for the quarter was just under \$198, of which approximately \$18 is attributable to costs associated with new market launch activity. This amount was higher than in previous quarters due to the

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shift to pay in advance, launch spending for two of our largest new markets at the end of the quarter, lower than anticipated gross customer additions related to the launch in Houston and temporal reduction in gross additions associated with improvements in our acquisition process. As the rate and scope of the new market launch is slow in the third quarter, we expect CPGA associated with the initial pre- and post-launch sales and marketing spending to decrease, partially offset by a full quarter of pay in advance billing. We expect CPGA to be less than \$180 for the third quarter.

I would like to provide you with an update on two other important initiatives that support our expected future growth and profitability. On June 12, Cricket successfully introduced our WAP portal, providing customers with unlimited ability to send and receive email and access a wide variety of prepackaged online content for a \$5 monthly fee. This product was initially launched on the Motorola RAZR, and we have been overwhelmed by the strong positive response from customers with higher than planned penetration of the installed base of enabled handsets in the first 30 days. Since launch, we have begun selling other handset models that support WAP product and expect most of our new handsets sold going forward to be WAP portal capable. This quarter, we expect to announce our new WAP storefronts, enhancing our ability to sell content to our customers. We expect these data initiatives to increase ARPU over time and provide the infrastructure to support broadband content on our future EV-DO-enabled network.

Jump Mobile continues to evolve as an important product, attracting new customers and providing a bridge for current customers who occasionally are unable to pay for their service. We continue to add Jump Mobile distributors in existing and new markets and expect the penetration of Jump Mobile to be in the low to mid single digits as a percentage of customers by the end of 2006.

Overall, we're pleased with our progress and believe that the first half of the year has had a very interesting and positive result. We plan to continue strengthening our position in the marketplace, which can only be accomplished through the dedicated efforts of many people both inside and outside of the Company who work very hard to make all that we do so successful. I want to send a special thanks to our field employees, launch teams, and our distribution partners who stood with us in the launches and transitions we have managed successfully. I would now like to turn the call over to Glenn.

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**Glenn Umetsu** - *Leap Wireless - EVP, CTO*

In the second quarter of 2006, we continued to effectively manage costs while investing in the infrastructure required to support our anticipated growth in new and existing markets. Once again, the Company realized significant efficiencies in cash costs per user, delivering a second quarter CCU of \$19.18, even as we absorbed the cost of activities associated with new market development and the incorporation of value-added data services. Operating costs associated with the development of new markets added approximately \$1.04 to CCU. Or put another way, our existing markets achieved \$18.14 of CCU for the quarter.

Our better-than-expected performance in CCU was driven by several factors, including -- one, the cost of handset equipment unrelated to new customer acquisition has decreased as our new programs have been successful in reducing costs associated with supporting existing customers. Two, customer care call centers experienced lower call volumes, which lowered CCU. Three, we continued to increase the use of Voice over IP technology in our networks to deliver services at lower unit costs. This has enabled us to further lower our costs, while increasing the volume of value-added services associated with the increased penetration of our higher end rate plans.

We expect to see moderate, continued upward pressure on CCU as a result of pre-launch expenses. We're looking forward to additional launch activity during the remainder of this year, which will increase CCU costs for the second half of 2006, resulting from incremental costs like those associated with additional cell sites and switches. We believe that customers will continue to adopt new products like data services and roaming, unlimited long distance and text messaging. These services are expected to drive revenue and subscriber growth as well as the costs associated with increased usage. We anticipate however that the higher associated revenue streams will yield a growing positive contribution to adjusted OIBDA over time.

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Since our last earnings call, we and our partner, ANB, successfully launched Cricket service in Houston, Austin, Temple and Bryan, Texas; and Cincinnati, Louisville and Lexington in the Ohio Valley, adding a total of approximately 8 million covered POPs in new markets. We have now launched approximately 65% or 13 million of the 20 million new covered POPs forecast at the high end of our current 2006 plan.

Leaps and ANB are not only launching markets on schedule and on budget, we are launching quality networks with more than 80% of cell sites on air at launch, which represents very good coverage, particularly when factoring the technical attributes of a lightly-loaded CDMA network into the analysis. The Houston market launched in early June, has a busy hour dropped call rate of under 1% -- an example of high quality from the first day of service.

For the third quarter, we expect CCU to remain under \$22, reflecting higher costs primarily related to the increase in new market launch activity and continued customer migration to more data-driven service offerings. In addition to our expansion progress, we're continuing with our plans to upgrade our outsourced billing and activation system, which is nearing the end of its lifecycle. We have shifted the timing of the replacement to early 2007, continuing use of our current systems until the change is completed. This system evolution will provide leading-edge technology, speed and greater efficiencies to the management of vital customer databases.

For the second quarter, capital expenditures were approximately \$126 million, primarily consisting of new market build costs. Thanks to the rapid deployment performance of the market launch teams, we and our joint venture partners are seeking to launch most if not all of the planned 20 million POPs scheduled in new markets this year. Together with the potential launch of the Portland expansion of our Oregon cluster by LCW Wireless, we expect 17 million to 20 million new POPs to be covered by Cricket service by the end of 2006.

All of our new markets will be equipped with the latest EV-DO technology, and we're on the path toward building out this capability in substantially all of our existing markets. We hope to begin offering customers new features and services, enabled by EV-DO, by the end of 2006. We have completed test calls on both Nortel and Lucent platforms and have completed installation in three trial markets. By the end of 2006, we expect substantially all of our markets to be EV-DO capable.

We explained last quarter that our capital expenditure guidance for 2006 could change after we completed certain capital market activities and assessed the impact of pending spectrum purchases in the Carolinas along with the potential launch of some markets ahead of schedule. As a result of these events, we're now revising our capital spending forecast to between \$525 million and \$585 million for 2006, which reflects the acceleration of spending on our data network upgrade and the initial costs of building out new market clusters in the Carolinas and Upstate New York. This change is related only to accelerated market launches, accelerated EV-DO build-out and costs associated with additional new markets. To be clear, capital expenditures for our new market launches are coming in at or below budget. Our change in guidance reflects an acceleration of capital spending, not an increase in project costs. We're proud of the tremendous success of our new market launch teams and all others who took part in delivering continued cost reductions. Doug?

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**Doug Hutcheson** - Leap Wireless - President, CEO

It should be clear from our discussion today that the visions and strategies we have implemented are creating strong operational and financial performance. We have seen attractive customer growth occur during the first half of the year in our existing markets, and there is no doubt we are seeing attractive customer growth in our new markets as well. Second-quarter adjusted consolidated OIBDA of nearly 78 million was \$3.4 million higher than in the second quarter last year, even after including \$16 million of negative OIBDA associated with our new market, demonstrating the continuing growth potential of our business.

On our last earnings call, we said that the Company was considering its options regarding the SEC's auction of AWS spectrum, commonly referred to as Auction 66. The Company continues to develop plans to participate in the auction, which begins in a few days. We may participate directly or with a designated entity partner as we've done previously. We believe our thoughtful

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approach will demonstrate our commitment to creating value for our business and our shareholders. For regulatory and competitive reasons, we will not disclose any specifics about which markets we're considering, how much spectrum we're likely to purchase or the prices we're likely to pay. The Company expects the total amount of spectrum at purchases to be influenced by two important factors, the availability of targeted markets that meet our strategic criteria and the attractiveness of pricing for such markets. We expect the amount of spectrum we purchase in Auction 66 to increase with lower spectrum prices and to decrease with higher spectrum prices.

Further, the Company in its new joint venture, Denali Spectrum management have paid approximately \$300 million in auction deposits to the SEC. We believe that investors should not draw conclusions about our eventual auction purchases based on the amount of our bidding deposit.

Before we close, the Company provided updated guidance today for the third quarter and the remainder of 2006. The Company anticipates total adjusted OIBDA for the third quarter to be between 57 million and \$67 million, including 20 million to \$25 million of negative OIBDA associated with our new market activities. We expect the existing market and performance implied by this guidance to follow the same path we have seen in previous years as we begin to see spending to increase customer activity and other planned expenses to moderate sequential OIBDA performance. However, we expect to see continued strong year-over-year growth in financial performance of our existing markets for the third quarter. Additionally, we expect third quarter will approach the peak of reductions to OIBDA associated with the launches of our new markets.

For the full year 2006, the strong execution of our market launch teams and the resulting potential to launch remaining markets ahead of schedule could result in the occurrence of new market launch costs earlier than previously expected, which would typically cause the Company's near-term OIBDA performance to decline. However, the Company's guidance for full year adjusted OIBDA has been revised to be between 265 million and \$300 million, raising the low end of the guidance up from 240 million even after revising our newly-covered POP guidance to 17 million to 20 million. We expect continuing strong performance in our existing markets and attractive breakeven performance from our new markets in coming quarters, which allows us to improve our outlook for the full year.

In closing, we're pleased with our progress and the Company remains focused on executing our mission. Today, we're much stronger than a year ago, and our second-quarter results demonstrate the tremendous execution the business is delivering on a number of key fronts. Looking forward, I believe the Company has a bright and promising future. As always, I encourage investors to be pragmatic, as our business is seasonal and all of the actions we're pursuing will need adequate time to develop to their appropriate outcome.

For the past six quarters, Dean Luvisa has served as the Company's acting CFO and provided key leadership to the business. Dean's many significant accomplishments in this role include successfully leading several substantial capital market efforts, working tirelessly with the investor community and leading the financial planning for the expansion effort that is now well underway. On behalf of the Board and myself, I want to extend strong appreciation to Dean for his contributions and accomplishments in his acting role. In the future, Dean will continue to lead a variety of the Company's growth and planning -- growth planning and implementation activities, working directly with me as the Company considers its next steps.

Meanwhile, the Company has expanded significantly, and the scale of the financial operations have increased dramatically due to our success. We're pleased to introduce Amin Khalifa as CFO and Executive Vice President, who will be joining the Company late in the month of August. Amin joins us with nearly 30 years of financial experience including seven years in the role of a public company chief financial officer. He brings substantial experience from other industries that will help strengthen the Company's financial operations and our capabilities as we continue to drive our cost leadership and growth plans. Amin and Dean will work closely together to transition the financial responsibilities over the coming months. Amin, would you like to add anything?

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**Amin Khalifa** - Leap Wireless - Future CFO, EVP

I just like to say -- and I apologize that the connection is not too good; I'm all the way over here in Dublin, Ireland -- but I'm very excited about joining Leap. And it's a very exciting opportunity for me and the tremendous growth that the Company has exhibited and I hope I can lend a hand in its future growth. But, Doug and Dean and Al and Glenn and the entire team, I can't wait to join.

I guess a couple of the things that I hope to bring to the party and part of that is the experience that Doug spoke about, but I think I've been known over the years as someone who has forged strong alliances between the finance organization and the business and really worked on a lot of the systems and processes. And starting with my days at Pepsi on, I think has been one area that I have really been able to help on and certainly in companies going through a lot of growth; I hope they can use some of that. But again, glad to be here and thanks for the introduction, Doug.

**Doug Hutcheson** - Leap Wireless - President, CEO

Our success is the result of our customers' appreciation of the value we provide and their loyalty, which we would not have earned without the continuing commitment of our employees. I'm proud of our team's performance as they delivered at every level of the organization. They are the driving force behind our success, and their accomplishments are truly appreciated. To all of our employees and to Dean, Al and Glenn, I want to say thank you for a job well done. I will now turn the call over to Jim for the Q&A portion.

**Jim Seines** - Leap Wireless - Director, IR

Colby, if you'd like, would you please come back on line to review the instructions and open the call for Q&A?

## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions). Romeo Reyes, Jefferies & Company.

**Romeo Reyes** - Jefferies & Company - Analyst

Everyone, great job on the guidance here. I just wanted to touch base with you guys on the sort of a penetration curve that you have experienced now that you have had some markets that have been around for about a year or so. If you could give us a sense of the penetration curve that you've seen over 3, 6, 12 months out in your new expansion market, that would be very helpful.

And then secondly, with respect to the net add, it seems like you're going to have blowout net adds for Q3. Based on sort of surveying the market in things like your net adds probably are going to be like 10 to 20% better than the market was expecting here for the full year. Can you give a sense of whether you expect that to accelerate in the latter -- into the fourth quarter on this year that would be great obviously as churn starts to come down?

**Dean Luvisa** - Leap Wireless - Acting CFO

So first, let's talk penetration curves. What we have found is the new markets have a variety of different penetration curves, and so each one has its own independent characteristics. However, they are all performing at or around the range that we had expected or better than that. So we're seeing a lot of pretty good uptake on the new products. We're pretty pleased with what

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we've seen. I don't want to dwell on Houston. Even Houston as we've moved through and addressed the issues, we are feeling that we see real good promising results there -- suspect that that will continue.

I think the most telling part on how we're doing is we launched El Paso on January 31 in the first quarter. And as a result of the uptake that we've seen there, that market contributed positive OIBDA not just -- it didn't just breakeven but for the entire second quarter. So clearly, the service revenues that we're seeing out of these new markets are sufficient that we're seeing a nice attractive breakeven. Now, not all markets will break even in three or four months. I think that they will all follow their unique characteristics. So we're looking forward to that.

As far as net adds for the rest of the year, we are -- as far as the third quarter, which we gave guidance on, we're in the middle of seeing a lot of the benefits that we've been working on in our core markets and expect to see some interesting results as we continue to move through that. But most of the net add growth we're expecting to see really in the third quarter comes from the fact that we will have nearly -- we're in the process of nearly doubling the size of our business. We'll have about 60, 65% of that up and going during the third quarter.

And we see a lot of interest in our products and services. It's been real rewarding for the Company to see how the value proposition that we deliver and the way that we service the customer base that we do seems to be -- there's a lot of interest out there. And as we continued -- as Al's team has continued to so successfully drive on the product portfolio, we've really been able to drive a lot at the customer base and are pleased with the results that that has also generated on the revenue front.

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**Romeo Reyes** - *Jefferies & Company - Analyst*

Doug, if I may, a quick follow-up question maybe for Glenn. It seems like your cost structure -- it seems like the CCPU didn't go up as much as you had anticipated. Are you experiencing better-than-expected costs in these expansion markets? My sense was that back haul in Q1, costs were a lot lower than maybe you had anticipated 6 or 12 months ago.

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**Glenn Umetsu** - *Leap Wireless - EVP, CTO*

That's a good observation. As we said earlier, the customer care calling costs were lower thanks to a lot of the re-engineering that Al and his team were doing. The cost for the handset equipment for the existing customers stayed under control. And the network savings coupled with increasing customer base helped to keep CCU in a reasonable range. So really, the expectations of the higher costs in our new markets over the period of -- is high. A period of launch activity was keeping our conservative cost estimating I guess from expectations of seeing the overall cost decrease immediately and reaping the benefits of the increased scale too early.

So as we thought about it, the existing market CCU of \$18.14 compared with \$18.43 in the second quarter of '05 shows that we were making progress overall. However in the short run, the dollar and \$0.04 of incremental new market CCU was prevailing over the savings in those existing markets.

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**Doug Hutcheson** - *Leap Wireless - President, CEO*

In addition, you've heard us talk quite a bit during the call about how well the teams have done. I think the teams have brought in the new markets at a real high-quality level. We've launched the markets with real strong coverage. And they've met or beat the budget targets that we set out for them on the new market front. So, we are optimistic.

Clearly, as we increase the lower end annual guidance -- or increase the lower end of our annual guidance and at the same time from when we initially provided that guidance also increased the amount of total POPs we're talking about launching, we are

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seeing some real -- we're real pleased with what the team is doing on bringing the markets online. So that I think we're in a spot to continue to push ahead here for the rest of the year.

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**Romeo Reyes** - *Jefferies & Company - Analyst*

Great job.

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**Operator**

Phil Cusick, Bear Stearns.

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**Phil Cusick** - *Bear Stearns - Analyst*

I've got to say I'm really impressed with this ARPU, almost \$43 in ARPU is something that I a year ago never would have thought you guys could have gotten it, so this has been great. What I want to focus on a little more though is the core markets, and it seems like there were a lot of puts and takes in terms of credit and things like that. I wonder if you could go back through those a little bit and really help me think about how gross adds should be trending. Because it looks like gross adds are more or less flat year-to-year in the core markets. And yet, we've done a lot of getting store base out there. Is it the macro environment? Is it a little bit of topping out on penetration in these core markets or is there something I'm missing?

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**Doug Hutcheson** - *Leap Wireless - President, CEO*

Be careful on topping out. We're up 140,000 year-over-year, so we're certainly growing. The business has a seasonal rhythm. We talk about that all the time. I want to point out to everybody that we did go over our guidance for the first quarter on net adds in our core markets substantially. So, we're in the process of working through a number of different changes and improvements that we're seeing in the business.

But the second quarter, we did two or three things that we think are pretty substantially value creating. The first thing is is that we've continued to roll out what we call the improvements to our dealer network. So we enhanced our dealer compensation policies. I think that was a process of getting them a little bit more aligned with where we were at. We improved our acquisition processes. We had found that not all dealers delivered equal quality customers. We had certain dealers that were able to generate perhaps a lot of volume but they were short-lived customers.

And so what we did this quarter, which I think is a huge win for the business as we moved those good customers that those dealers would have typically gotten, we moved them into more traditional distribution and we made it more difficult for the shorter-lived customers to join the franchise. Then, we also enhanced the ability for our dealers to service our customers. We think that's a home run and that was included with the broad-based program we call Cricket Remix. Included in Cricket Remix were all of these changes as well as pay in advance. So we've got all of that done.

In addition, we have seen as we have on quarters now for the last probably eight, nine quarters, we see flex in certain volumes that seem to be transitions when we see a lot of movement on fuel prices. I think you've heard us talk about that on several different quarters. We saw it a little narrower. On the downside, we saw it a little bit narrower and a little bit focused, and we feel pretty confident that we will see a return back on all of that. So we are not feeling like we're seeing terminal penetration at all. We are running the business with our seasonal rhythms, and we are adjusting through and making changes when we believe they are appropriate that we think create longer-term shareholder value and pushing ourselves ahead.

So the last piece that is interesting and as AI pointed out, we need to give it a few quarters to let it settle in. We've mentioned we have three reasons for churn. We have the ability to pay, the handset and the electronic product and feature set. And what

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you saw in the quarter that we did roll out -- some of these new programs -- we were pleasantly surprised that our initial results in how the changes that we made affected churn. And while I don't think everybody should adjust everything down 0.4 point on churn -- I think we're a little early on -- we saw real interesting and positive trends that allowed us to get another tool to address specifically the customer's ability to pay.

When a customer reactivates with us, they previously had to pay their bill in arrears plus the first month of service. And now, they pay that first month of service under pay in advance. So what it's done is it allowed us to -- a customer drops off -- should they decide that they no longer want to be with us, they've already paid for that bill now. And when they come back on, they restart. So we think we're going to see a lot of long-term benefit. It really targets in. It's a program that really gives us a real strong tool to work on that particular form of churn. So, we don't think we're at terminal penetration. We think that we have interesting further growth in subs on a seasonal rhythm like we always see it, and we think we've done some things that should help us on the churn line.

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**Phil Cusick** - *Bear Stearns - Analyst*

That sounds good. We're looking forward to next week to see what happens in the auction.

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**Operator**

Chris Larsen, Credit Suisse.

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**Chris Larsen** - *Credit Suisse - Analyst*

Could you go over your auction strategy and which market -- just kidding.

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**Doug Hutcheson** - *Leap Wireless - President, CEO*

It's up on our website.

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**Chris Larsen** - *Credit Suisse - Analyst*

A clarification -- did you say that the Las Cruces/El Paso market is now EBITDA positive?

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**Doug Hutcheson** - *Leap Wireless - President, CEO*

For the entire quarter, it produced. So it didn't just breakeven. But if you total the three months at the market level -- if you total those three months together, the market actually provided a contribution in the second quarter for the entire quarter.

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**Chris Larsen** - *Credit Suisse - Analyst*

Now that is certainly a lot faster than you've seen in the past. I mean historically, I think you had targeted about 12 months to get to the breakeven level. Should we start thinking about that now for some of these other new markets that go on?

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**Doug Hutcheson** - Leap Wireless - President, CEO

I'd like to think about it but I encourage you not to. The team has done a really nice job on that, and I think that they -- I think they deserve a lot of credit. I think that it would be unrealistic to assume that markets are going to typically breakeven in four or five months. So I encourage everybody not to go there. But I think it does show that the teams are doing a good job. And I think it does show that we can get these markets broke even and producing money.

However, some of the markets are larger and more complex and have more things going on. I'm sure they're going to do fine. I think we believe we are headed in the right direction [on a minute], and we're looking forward to moving them along and we'll give you estimates as we see things moving through. I think that people should see that these markets can be turned into producers, which is the reason that we're going on. That's the one piece I encourage people to be thoughtful of is we can make these markets producers and contribute. That's what people should take away, and we'll do it as efficiency as we can.

**Chris Larsen** - Credit Suisse - Analyst

If I could switch maybe to the older core markets, you're at 6% penetration but there's obviously a big range of penetrations within there. Is there anything you can give us that you've learned that it seems to peak out after your number 2 or your number 5 or your number 10 -- well not 10 but I guess your number 5? Is there anything you can tell us on where we should think of ultimate penetration for the product?

**Doug Hutcheson** - Leap Wireless - President, CEO

We're pretty committed to trying to drive up that core market penetration. And one of the things that we pointed out is that we're up 140,000 year-over-year. We have this every year with the seasonal rhythm, and we get in the middle of the year and people aren't sure how -- what the growth profile looks like. I want to encourage people that we don't see that any different this year than the past five or six years. We feel well positioned for the end of the year. We think there is more growth coming. We do see increased penetration available in our core markets.

In the last call, one of the things that I talked about was by the end of this process that we are on which will end sometime in 2007 as the Raleigh -- as the North Carolina markets and the Rochester markets come on, we have affected about 60% of our footprint. We've affected it to bring more value at it; we're affecting it to build better distribution. We've affected it with better products. We are real early on in touching the footprint. We've moved out some with our sales. We've moved out some of the less ideal businesses with some of the activities that we've done over the last year. And then, we've gotten on building a better product for all of the remaining markets. I think that we have results that show when we build the market clusters that adjacent markets tend towards doing pretty well, which gives us an indication that we are headed the right direction.

So I would encourage we're not going to give a terminal penetration number. But I would encourage investors to give us a chance to continue to perform a few more years before we conclude we're at terminal.

**Operator**

Michael Nelson, Stanford Group.

**Michael Nelson** - Stanford Group - Analyst

Could you please provide some color on what you are seeing in terms of data revenue? Maybe what percent of ARPU is derived from data, what types of applications are driving data and what you're seeing to support a business case for EV-DO?

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**Doug Hutcheson** - Leap Wireless - President, CEO

Sure. It's been a program for us that just keeps getting. What we started out -- Al's team started out a year ago -- we started out a couple of years ago with adding things like text messaging. And then a year ago or so, we added in instant messaging and then picture messaging and grew and just kind of one little bit after another. We've kind of sequentially added those products in.

What we find is when you have a younger demographic like we do and you provide them with an attractive handset and you make the feature set that is attractive for them, guess what, they use it! Now we don't bring it to market like many other carriers do. We bundle. And so when you hear us throughout the call talk about our higher value rate plans or whether that's affecting the service revenue or that's affecting some of the uptake and you really look at what that rate plan is, what you see is that it has got an awful lot of value in it around data products and services.

I believe in the last year that the Company has actually opened up its competitive differentiation position, which is what we discussed as you look at how we've been able to do our product development efforts. This quarter, we soft launched -- that is a funny term. We haven't put our full marketing muscle behind it let's say would be another way to say it -- an unlimited WAP-based product. And so with relatively little marketing push, we have been pretty surprised at the uptake. Not only have we've seen uptake on the targeted handset but there were some handsets in the base that customers were not aware had the feature on it and they actually went out and found it had it and added it on themselves. So with very little effort, our customers have migrated on this \$5 unlimited WAP-based product.

So what is the message out of all of that? The message is thus far that each kind of company has stepped into this area. We've seen pretty attractive returns. And when you see us look at the pleasant returns that we've seen on the ARPU line, that's principally driven by the data initiatives. We think given our customer base and our cost structure and our ability to roll out interesting products that it's an area that we should continue to pursue. We've trialed EV-DO or quite a while. While we have three markets up in trial, we have actually had one market up now for a little bit better than a year. We are -- we see promising results on that. And as a result of that, we will continue to proceed.

One last part -- I know it's a long answer but -- at the end of the day, we look forward to also the cost benefits that go along with this. By staying with your networks and keeping them current, what we have also been able to do is keep our costs -- manage our costs -- it's allowed us to cost reduce the product and service offerings that we do as well. And when you are focused on a cost leadership effort like we are, you will frequently see that we can use technology to gain further benefit and that requires us to keep our networks current.

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**Operator**

Ric Prentiss, Raymond James.

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**Ric Prentiss** - Raymond James - Analyst

A couple of questions for you to follow up on the items you've been hitting today. You mentioned obviously that handset is one of the key items that help control churn. How important was having a RAZR out there and how much demand have you seen from that? Is that a DO RAZR that you're starting to see the marketplace with?

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**Doug Hutcheson** - Leap Wireless - President, CEO

Sure. The first piece is I was in a store in one of our markets. And the day we launched the RAZR and the store wasn't open yet and we had put the poster up on the wall, and the poster was up on the wall probably 30 seconds before the store was open. We had a young man who was with a parent who is -- it was their birthday who was in the door trying to buy a RAZR. That

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certainly has been interesting, and the RAZR in particular has been the best penetration of any premium handset that we've had thus far. So the interest on the RAZR or premium handset has actually been real high, real interesting. And we would continue to put premium handsets out there.

We have over the last several years substantially shifted mix of the handsets that we sell. It hasn't all shifted to the premium handset, but the type of handsets the business sells has moved substantially up the pricing structure. Several years ago, most of our volume was at the lowest end handset. And while what we do there is important for generating traffic, the volume has become much more spread.

The last piece is the RAZR is DO capable, and customers are paying -- our out the door price is approaching \$300 on it. So we have customers that are willing to buy the handset. And when we do bring up the networks, we will have a DO network to support features and services on it.

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**Ric Prentiss** - *Raymond James - Analyst*

Follow-up question -- what do you think (technical difficulty) the DO network on? Is there kind of a price per POP we should think of there?

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**Doug Hutcheson** - *Leap Wireless - President, CEO*

I'm sorry; you broke up. But let me repeat back the question to you and see if I got it right. You're trying to get an idea what you think the relative cost is for the DO network?

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**Ric Prentiss** - *Raymond James - Analyst*

(technical difficulty).

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**Doug Hutcheson** - *Leap Wireless - President, CEO*

Yes, we've never announced a per POP price, and we probably can't given our contractual relationships. But there is -- if you go back historically and I'm not trying to update guidance -- but there is some stuff in a year or two ago that we discussed that I think gives you a framework to understand that. And originally when we were first talking about launching some of these very early new markets, we gave a cost per POP that was about \$28 a covered POP. And at that point, we were looking at around 17 million covered POPs and it came out to a number of about \$475 million was what the cost of building out and launching these new markets are. I'm not giving that as current guidance. I'm just going back and giving you that historical piece.

We incorporated EV-DO into that 476 million across almost all of our markets as well as the build-out about a year ago. So at that point when we were discussing the idea that we were going to upgrade DO, what you can see is still most of the cost is still around building the new markets. We're not going to change that. But what you do see is that DO costs came. We've been able to drive that into the business at what I think is an efficient level. So we should have better than 40 million covered POPs hopefully by the end of the year with DO within that original guidance.

With that said, this year's guidance was revised to the 5.25 to 5.85, which includes a higher number of POPs and an acceleration of the launch of POPs, the beginning incorporation of some new markets. And then previously, we had not expected to be in a position to incur some of the DO expenses until next year. And now we're able to get on with that earlier, and we think that's the right thing to do given some of the performance that we are seeing out of the data services that we put in place thus far.

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**Ric Prentiss** - *Raymond James - Analyst*

(technical difficulty) looks like some nice movement there.

**Operator**

James Breen, Thomas Weisel.

**James Breen** - *Thomas Weisel - Analyst*

Just wanted one follow-up on the CapEx. You kind of talked about the increased guidance. I was wondering how much of the increase is shift versus new CapEx this year, meaning a shift from '07. And then secondly on the churn, is it something you think is sustainable to drop down this quarter going forward and kind of what has led that? Could you give a little more color there?

**Doug Hutcheson** - *Leap Wireless - President, CEO*

Sure. The only increase in CapEx -- and it's a relatively small piece -- is the very preliminary beginnings of building out some of the 3 to 6 million POPs that we talked about in our press release for next year, which is the Carolinas and Upstate New York. So most of this is just acceleration of CapEx that was initially going to be spent in '07 and getting the job done here in this year. So I think that there is a very little increase, mostly an acceleration.

For the second part as far as churn reduction, I think it's a little bit early for us to give much. As you can see from our third-quarter guidance a year ago, we were at 4.4%. And this year, we're looking at being between 3.9 and 4.3. Some of that improvement is that the new markets do a little bit better initially on churn. So you get a little bit of advantage there. But some of that is also because we are pleased with the churn performance that we are seeing. I think we would like to wait. We're basically 60, 70 days into pay in advance, and I think we tend towards -- wind up being a little bit more data driven before we would make much more of a forecast other than the initial results look positive.

**Operator**

Todd Rethemeier, Soleil Securities.

**Todd Rethemeier** - *Soleil Securities - Analyst*

Two questions for you. One, I know that you generally don't like to do this. But given with all of the CapEx numbers moving around, is there any chance you would give us a rough number for 2007 CapEx obviously excluding any new-new markets from the auction?

**Doug Hutcheson** - *Leap Wireless - President, CEO*

We're not in a position to release '07. However, historically and I would just remind you some of the stuff in historical piece is a maturing market typically has run on CapEx between 11 and 13% of service revenues. We would tend towards being after a market is one year or so old, I think we have seen that typically be the trend. We will give you '07 guidance, maybe not next call but perhaps we will take on your -- I think you are requesting that we start thinking about it. And we will take on that commitment and see if we can give a little bit more boundaries on things.

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**Todd Rethemeier** - *Soleil Securities - Analyst*

Second question then also -- now I know that you use cash basis of accounting. And so you don't actually have bad debt expense from an accounting perspective anyway. But from an economic perspective, I guess how much bad debt would you say you have? How much ARPU are you leaving on the table? And if churn stays this low, how much ARPU can we expect to increase?

**Doug Hutcheson** - *Leap Wireless - President, CEO*

The pay in advance process will virtually eliminate that. When you say ARPU on the table, I am going to try and find a different way to answer that question. On our old product offering, which was bill in advance and pay in arrears, you would have customers leave with an outstanding bill. Now, our variable costs -- our risk on that was very low. And so we had worked out a way that we obviously were able to generate the attractive performance that we did. If they came back and remember if a customer comes back within a year and it's in our 10-Q on what we consider a customer is they would come back as a reactivation, not as a gross addition. They would be required to pay that bill.

I won't get into the exact percentages. But sometimes, you would pick up those previous months; sometimes, you wouldn't. It's all gone in pay in advance. The punch line on all of this is they pay for the month of service before. It is simpler. If they leave, it's on the end of the month. They don't have the money to make their bill and they don't have it until 10, 12 days later, they come back on and they pay us for -- they didn't pay us for 10, 12 days and we pick it up. We think that will have a net positive impact, and we think that will take about a year for us to finish letting it work into the base.

**Todd Rethemeier** - *Soleil Securities - Analyst*

So are you converting over all Leap customers to that?

**Doug Hutcheson** - *Leap Wireless - President, CEO*

No, we grandfather any customer on their old rate plans. But what you do see is you get some migration because customers deactivate and reactivate, so you get a little bit -- it's more than just gross ads. You get a little bit more acceleration on that as you have customers reactivate. So we still have customers -- I don't know if there's many of you that have been around -- but we still have customers on Cricket Talk, which was launched in August 2002.

**Operator**

Simon Flannery, Morgan Stanley.

**Simon Flannery** - *Morgan Stanley - Analyst*

Could you give us a little bit on the demographics and some of the stats on the customer base? Update some of the things -- in particular, I'm interested in where your customers are coming from, to what extent they are coming from prepaid or new to wireless or coming from the big four carriers, and anything around percent that use this as their primary phone line and have no landline?

**Dean Luvisa** - *Leap Wireless - Acting CFO*

Sure. Boy, we will try and catch all of those. If I miss any of them, come back and ask me again. First off, about half our customers are new to the segment. That's down from what it used to be, meaning where also what I find as promising is the business can attract customers both new to the category and is able to attract customers that have chosen to think about the value we bring

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to the marketplace. So that's about half -- 50-50 -- about half new to the system. Whether they come to us from prepaid or other carriers, we haven't ever given any specific data on that. So I don't know I'm in a position to help you there.

But the most interesting piece is the landline displacement piece. 90% of our customers or approximately 90% use this as their primary phone and about 40-some% -- 42, 43% I believe use this as their only phone. When we asked that, that is a two level question to get that answer, meaning we try and search down. So about 40-some% of our customers no longer have a landline phone. So we see a lot of landline displacement. That does speak to the quality of our networks. We're pretty proud and we think that is essential to have landline displacement. You know, our networks run about a 1% drop call. So think about it. 1 in 100 calls drop; I really do think that speaks to the testament of the network quality that Glenn and his team have been able to drive. And that's why we have -- we think that's one of the reasons that we have the landline displacement that we do.

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**Simon Flannery** - Morgan Stanley - Analyst

Any change in the MOUs? Are they still running sort of 1,200 plus?

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**Doug Hutcheson** - Leap Wireless - President, CEO

They're absolutely 1,200 plus. They continue to run 1400, 1500 minutes a month. So we continue to see that it's been interesting to watch because it has -- the growth has moderated as we've increased the data services. So that's been kind of interesting to watch and we're pleased with that. We think that's a promising result.

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**Operator**

[Raj Patel], Farallon Capital.

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**Raj Patel** - Farallon Capital - Analyst

I wanted to ask you a question. You mentioned the \$28 of CapEx per POP, which was the original guidance back whatever it was 15 months ago or a year ago. You've talked about 16 million of EBITDA dilution in Q2 guidance of 20 to 25 for Q3 and that being the peak in EBITDA dilution. I think if I remember correctly, Q1 was 6 million.

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**Doug Hutcheson** - Leap Wireless - President, CEO

Yes.

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**Raj Patel** - Farallon Capital - Analyst

Back when the \$28 of CapEx was given, I think it was \$8 of EBITDA dilution. I don't know if you'd updated that. In my head, I kind of believe you said it might get as low as \$5 but wanted to see if you wanted to provide an update on that at all.

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**Doug Hutcheson** - Leap Wireless - President, CEO

We are sorry you're having a bad day. Hopefully, we're not adding to it. The first part was the -- what we said on the 20 million to 25 million was that we were approaching. So, I think we -- whether it's third quarter or maybe the quarter after that, I think we'll get a little bit further along before we will say it's behind us. But we will let you know as soon as we think we're there.

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The number that we mentioned on the \$28 at that point was \$5 a covered POP for the working capital impact. So, that was not only what would run through the P&L or run through the OIBDA line, but that was also some of the activity that you would see on the balance sheet on things like inventory and such, which have moved around some. You'll see as you look at our numbers; we don't have an update other than what we said, which is that we are on or ahead of budget at this point on those numbers.

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**Raj Patel** - *Farallon Capital - Analyst*

Working capital generally is a pretty small amount of this, isn't it?

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**Doug Hutcheson** - *Leap Wireless - President, CEO*

Yes, the larger part is through the P&L.

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**Raj Patel** - *Farallon Capital - Analyst*

One other question and maybe a follow-up with Jim on it. But the peer impact on Q2 ARPU, I know you said it started -- was it end of May or end of April?

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**Doug Hutcheson** - *Leap Wireless - President, CEO*

Beginning of May.

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**Raj Patel** - *Farallon Capital - Analyst*

Have you been able to quantify or can you quantify what benefit we got for ARPU from that?

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**Doug Hutcheson** - *Leap Wireless - President, CEO*

It was relatively small this last quarter. We were initial on it. Most of the increase that you saw in ARPU in the quarter was related to migration to our highest value rate plans, a little bit from pay in advance and then we really are seeing some nice beginning contributions from some of the other vertical products that we've talked about, such as the data products and some of the enhanced long distance offerings. So it's not -- the value of pay in advance probably needs a little bit more time to work its way in.

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**Operator**

David Barden, Banc of America Securities.

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**David Barden** - *Banc of America Securities - Analyst*

Just a couple of maybe questions. I guess number one is, just as we look at especially the third-quarter subscriber guide, it obviously embeds in it an option at the conference level that the issues facing you have truly been put in a box. And I know in the lawsuit you filed, you suggested that some of that might have been starting to offset (technical difficulty). Could you pinpoint what it is that is happening or has happened in the last several weeks that makes you feel comfortable that this was an isolated market incident?

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Second, just on the kind of the Southern market launches especially, could you talk about what the requirements if any for new subscribers are you proposing? I know you ask for ID when they come in. Are you now accepting kind of signatures for customers? And then last, if you could just give your cell site number, I would appreciate it.

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**Doug Hutcheson** - *Leap Wireless - President, CEO*

Glenn, you're going to have to come up with a cell site number or we will have to get back on that. The first one is as we said in the call, what occurred was a delay in the ability for the Company to get its indirect distribution in place. What we also have pointed out is that we have subsequently been able to get that distribution in place. So we -- and as a result of that, we now see the Houston market performing at the levels for this point in the launch that we had expected to see. So, I think that's the best possible point I can give you that I think the team just nailed it as we were able to work through -- are working through the issue and trying to get things moved ahead. So, that's Houston. As we said in the call, we have moved -- we're moving through the process.

On the new activation process, the Company has increased its flexibility as far as what you need to -- as far as what you need to activate and have added in something that is around ESN validation. It's an internal piece that has allowed us a little bit more flexibility on how we work with things. And then we always have the ability based on what we see to add other forms of customer qualification in as well. And we've maintained all of those. So we're working through that.

I'm reluctant to get into a lot of details because you know managing this process is what we do. And what all we do probably isn't something that the Company wants fully discussed because we regularly are -- we're trying to keep a robust environment so that we can be sure of what we're doing.

The last piece is the cell site count has appeared, and it's roughly 3700 cell sites as of the quarter end.

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**David Barden** - *Banc of America Securities - Analyst*

Congratulations.

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**Doug Hutcheson** - *Leap Wireless - President, CEO*

Thank you for joining us on our call today. As I hope you've heard, we're encouraged by the solid progress and results we continue to see. I hope that you leave our call today with a good understanding of how we are shaping our future as we execute on the opportunities for expansion and profitability that we see before us. On behalf of the employees, officers and director of Leap, we thank you for your interest and continued support. We look forward to talking to you again at our third-quarter conference call. If you have any further questions about our year-end results or need additional clarification, please feel free to contact Jim Seines, Director of Investor Relations at 858-882-6084. Thank you.

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**Operator**

Thank you for your participation in today's conference. This concludes the presentation. You may now disconnect. Good day.

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