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LEAP - Q1 2005 Leap Wireless International Earnings Conference Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Leap Wireless earnings for the first quarter 2005 conference call. (OPERATOR INSTRUCTIONS). As a reminder, this conference is being recorded for replay purposes. I would now like to hand the conference over to your host for today, Mr. Jim Seines, Director of Investor Relations. Please proceed, sir.

Jim Seines - *Leap Wireless International, Inc. - Director IR*

Good afternoon, and welcome to Leap's first quarter 2005 conference call. This call is being recorded and will be available for playback in the U.S. through June 21 by calling 1-888-286-8010. Callers from outside the U.S. will need to dial 1-617-801-6888. The pass code for both calls is 24349294.

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 for the next 30 calendar days.

Regarding Company events, we recently participated at the Lehman Brothers' Worldwide Wireline and Wireless Conference. A webcast of our presentation at this conference is available on the Investor Relations section of our website for those interested.

Additionally, we're planning an informational nontransaction roadshow during the week of June 27 that will concentrate on the Boston, New York and Baltimore areas. And we have confirmed our attendance at the Jefferies' Third Annual Communications and Media Conference in September, and the JP Morgan Small Cap Conference in Boston in November. We're planning other IR related events and expect to provide updates on some of these additional activities when appropriate.

Joining me in the call today to discuss the results of the first quarter 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 and Treasurer.

Following our prepared remarks, Amanda will come back online to remind you how to key in for the question and answer portion of the call.

During our call today we will discuss some financial metrics which do not conform to generally accepted accounting principles, or GAAP, in the U.S., such as cost per gross addition, CPGA; cash cost per user, CCU; adjusted EBITDA, 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 GAAP reconciliation of the non-GAAP measures discussed today, please access the Financial Information page of the Investor Relations section of Leap's website, www.leapwireless.com.

Today's conference call is preceded by our earnings release for the first quarter. 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 the words such 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 statements due to 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 first quarter of 2005, which we expect to file shortly, and in our annual report on 10-K for the fiscal year ended December 31, 2004.

The material discussed during our conference call today does not attempt to address the investment objectives, financial situation, or needs of any person or entity. It is being provided for general informational purposes, and should be not construed as a solicitation to buy or sell any securities or related financial instruments. Investors should seek financial advice regarding the appropriateness of investment 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.

With that I would now like to turn the call over to Doug.

Doug Hutcheson - *Leap Wireless International, Inc. - President, CEO*

Thank you for joining us as we provide an update on our business for the first quarter of 2005. As you'll see, the Company had a strong first quarter and continues to make good progress in building a bright future. During today's call we will cover our operational and financial performance for the first quarter, the Company's progress in preparing for the launch of its new markets, and review our business strategy and outlook for the full year.

Since our last call a few weeks back, the Company has completed the following key activities. We introduced our Travel Time product three additional markets, bringing the total to 10. We expect this new offering to be rolled out across all of our markets by the end of June or early July.

We launched text messaging between the U.S. and Mexico, and completed a roaming agreement with a Mexico-based carrier to better serve our expanded customers. The Company received approval for the transfer of the SEC licenses to Cricket for our Fresno market and our Auction #58 properties.

Lastly, with the expected filing shortly of our Form 10-Q for the first quarter, we will be currently on all of our public filings. The Company believes it continues to make -- it continues to make progress in the coming months on additional programs to improve our customer experience, support our product development efforts, and strengthen our distribution and payment locations. The Company continues to make substantial progress in our operational performance, which has led to record financial results for the quarter.

A few highlights from our first quarter results include, the addition of nearly 46,000 net new customers at less than 3.3% churn for the quarter; an increase in total revenues to 228 million, an improvement of over $21 million from the previous quarter, principally driven by the $13 million increase in service revenues; adjusted EBITDA for the first quarter of approximately 70 million, a nearly 38% adjusted EBITDA margin on service revenues.

Lastly, the Company announced net income of 12.6 million, or $0.21 per share. Nearly across the board the business set new standards of performance resulting in the Company's first full quarter with positive net income since emerging as a reorganized entity last August. We are pleased with our achievements and underlying strength as we continue to execute across a broad range of activities, each firmly grounded in a product and customer centered philosophy designed to support the long-term growth of our business.

In today's call we will discuss a number of areas that highlight the various elements of our results. It is important to understand our business provides service to our customer niche at approximately two-thirds the industry average ARPU per user; acquires customers at much lower cost of acquisition, while providing twice the number of minutes at substantially lower monthly cost than traditional carriers.

I am particularly pleased with one of our performance measures that sums the effect of all these factors, including churn. The Company's calculated contribution per user per month increased to nearly $16 during the first quarter. The business and our subscriber economics are clearly performing well.

While we continue to pursue numerous activities designed to further improve our operational performance, it is appropriate to point out that our business is seasonal with a traditionally strong first quarter. As such, we believe it is important to look at our results beyond a quarter over quarter timeframe due to our seasonality. In addition, as we develop and implement the new initiatives we are pursuing, it may take time in excess of one quarter for these activities to further build our business results.

On today's call, Dean will discuss our financial results. Al will discuss our customers, product and acquisition metric progress. And Glenn will discuss our monthly service cost and Auction #58 market launches. I will return at the end of the call to provide an update to our strategy and outlook.

Dean Luvisa - *Leap Wireless International, Inc. - acting CFO and Treasurer*

As Doug indicated, we had a strong quarter producing a record of $228 million of total revenue, and approximately $70 million of adjusted EBITDA. As a result, we generated net income of almost $13 million and earnings of $0.21 per share. Our adjusted consolidated EBITDA for the first quarter represents an increase of approximately $17 million, or nearly 32%, over the same period last year, and approximately $19 million, or 38%, over the fourth quarter of 2004. The increase was driven primarily by growth in service revenue, coupled with effective underlying cost control. Our adjusted EBITDA margin as a percentage of service revenue was 38% for the quarter.

Total revenue for the quarter was approximately $228 million, an increase of nearly $22 million, or approximately 10% above the total revenue reported for the first quarter of last year. This improvement is a result of a $17 million increase in service revenues from the higher number of total subscribers, and the increased penetration of our higher end rate plans, and a $4.5 million increase in equipment revenues from a higher volume of handset sales, and a shift in the handset mix to higher priced models.

Looking sequentially, our total revenue increased by almost $22 million, or 11%, above that reported for the fourth quarter of 2004. Service revenue rose by more than $13 million as a result of seasonal improvements in ARPU associated with lower churn rates, a reduction in mail in rebate activity, and continued good take rates of our high-end rate plans, combined with higher average customers relative to the prior period.

Equipment revenues increased by approximately $8.5 million compared to the fourth quarter of 2004, driven by a reduction in the level of handset incentives for new sales and for customer upgrades in the first quarter of 2005. Much of the improvement from the fourth quarter resulted from substantially lower rebate activity as we moved away from mail in rebates.

Dropping below the revenue line, total operating expenses for the first quarter, excluding depreciation and amortization, rose by approximately $5 million or the 3% compared to the first quarter of 2004, which was significantly less than the 10% year-over-year increase in revenues that I mentioned previously. The change was primarily due to increases in the cost of handset equipment of $5.4 million, and an increase in cost of service of $2.2 million, offset by a reduction -- reductions in general and administrative costs of $2.6 million.

Sequentially total operating cost, excluding depreciation and amortization, increased by $2.5 million or 2% compared to the fourth quarter of 2004, significantly less than the 11% sequential improvement in revenue. This change was primarily due to an increase in cost of service, offset by reductions in the cost of equipment sold. Cost of service increased by $2.2 million, or 5%, compared to the first quarter of last year, slightly less than the 6% increase in weighted average subscribers over this period.

Costs associated with the value-added products, including long-distance, text messaging and Brew applications increased by $1.6 million over the prior year. And back haul and interconnect costs increased by another $1.6 million, of which $800,000 resulted from non-recurring credits last year. These increases were partially offset by reductions in labor related and other network expenses.

Looking sequentially from the fourth quarter to the first, cost of service increased by just under $4 million. The prior quarter included adjustments for the full calendar year run rate of property tax and to back haul and interconnect expense, while the current quarter returned to normal levels. We also experienced an increase in the cost of long-distance text messaging and Brew of nearly $1 million resulting from higher levels of usage of these products by our customers.

Cost of equipment increased by approximately $5.4 million in the first quarter of 2005 compared to the first quarter of the previous year, due to a higher average cost per handset sold and an increase in the number of upgrades by existing customers. Cost of equipment in the first quarter decreased by $1.8 million relative to the fourth quarter of 2004 due to a lower number of total handsets sold.

G&A decreased by $2.6 million or 7% in the first quarter of 2005 compared to the first quarter of 2004. This decrease was primarily driven by a $3.4 million reduction in call center costs, offset by an increase in professional services of $1 million. The reduction in call center costs resulted from continued process reengineering to lower calls per subscriber and average handle time, and the implementation of new technology to further reduce the cost to provide customer service. Sequentially, G&A was essentially flat from the fourth quarter of 2004 to the first quarter of 2005.

Sales and marketing expenses for the first quarter of 2005 were essentially flat as well compared to the prior quarter and to the same quarter last year, even after absorbing costs of developing a new branding campaign and a significant number of new products and services that were launched during the second quarter. Depreciation and amortization expense for the first quarter of 2005 declined by approximately $27 million from the first quarter of 2004 to $48 million. This reduction resulted from the reassessment of the useful lives of property and equipment during the third quarter of 2004, and the increased costs for the amortization of other intangible assets reflected on our balance sheet as a result of fresh start reporting. Additional information regarding these changes in depreciation and amortization are described in more detail in our most recent annual report on Form 10-K.

Sequentially depreciation and amortization increased by just over $2 million from the fourth quarter of 2004 to the first quarter of 2005. This increase resulted from additional equipment purchased during these periods. Going forward we expect depreciation and amortization expense to increase as we invest to improve and upgrade our systems, and as we build out new markets. However, because we generally do not begin depreciating assets in new markets until the date the market begins commercial operations, we do not expect increases in depreciation expense to be directly proportional with an increase in capital expenditures. Details regarding the Company's PP&E can be found in a supplementary balance sheet information contained in our annual and quarterly SEC filings.

Interest expense for the quarter was $9.1 million, down from $11 million for the fourth quarter of 2004. The decrease resulted from the lower interest expense associated with our new $500 million term load, which was in place for most of the quarter. This quarter did not show the full benefit of the lower interest expense since the new facility closed on January 10, and the $359 million pick (ph) notes remained outstanding until the end of the call notice period on January 25.

The additional interest expense on the pick notes during this 15 days period was approximately $1.9 million. We expect the effective interest rate on our $500 million term loan for the second quarter of 2005 to be approximately 6.1%, including the impact of an interest rate swap we entered into in early April. The swap effectively fixes the interest rate on $250 million of our debt for two years at approximately 6.7% per annum.

The refinancing of our debt provided a tax benefit in the first quarter related to the payoff of $350 million pick notes. Excluding the effect of this transaction, our book rate would have been approximately 41.5% on pretaxed income. As mentioned on a previous call, we generally anticipate that we will recognize income tax expenses at the full statutory rate or higher for book purposes, but we expect to pay only minimal cash taxes in the near term due to our net operating loss carryforwards.

As a result of improved revenue and increased cost control, I'm very pleased to report that our Company generated net income for the first quarter of almost $13 million or $0.21 per share, compared to net loss of almost $28 million in the same period last year. On a sequential basis, net income increased by $19.3 million from a loss of approximately $6.6 million for the fourth quarter of 2004.

Moving to the balance sheet, unrestricted cash, cash equivalents and short-term investments were approximately $122 million as of March 31, 2005, a decrease of $133 million from the prior quarter. The decrease primary resulted from payments of $212 million related to the acquisition of licenses in Auction #58 for both Cricket and for ANB 1, and capital expenditures of $24.5 million. These outflows were offset by approximately $60 million in net proceeds from our new term loan, and cash provided by operations and other items.

As mentioned previously, we have used debt financing to increase our liquidity and provide the Company with additional flexibility, while maintaining our conservative leverage. As of March 31, 2005 our leverage as measured by debt as a multiple of adjusted consolidated EBITDA remains one of the lowest by industry standards.

In addition, we recently announced agreements to sell licenses and several of our smaller operating markets and cell towers, which together are expected to add approximately $118 million toward cash position, net of fees and expenses. We expect these transactions to close later this year.

During the first quarter we identified several material weaknesses in our internal controls over financial reporting, which we described in our most recent annual report on Form 10-K. We have taken a number of steps to address these weaknesses, including performing additional reconciliation procedures, and hiring additional highly qualified personnel in our accounting group, such as our new Controller and Chief Accounting Officer, Grant Burton, who started on May 17.

In another example of these efforts, the Company recently launched improved revenue and inventory processes, and is undertaking steps to introduce improved fixed asset tracking systems. Despite these weaknesses, we believe the Company's consolidated interim financial results reported in our first quarter earnings release, and those we expect to report in our Form 10-Q, fairly present the Company's results of operations and financial conditions.

I would now like to turn the call over to Al to discuss marketing, product development and customer activity.

Al Moschner - *Leap Wireless International, Inc. - EVP, CMO*

Good afternoon to all of you who have joined us today. Building on the Company's solid financial performance during the first quarter, customer growth was also strong as the business followed the expected seasonal trends in both topline customer growth and churn. Gross additions for the first quarter were approximately 201,000, essentially even with the 207,000 reported in the first quarter of 2004. Net customer additions were likewise strong, with nearly 46,000 new customers joining the Cricket service. Customer churn for the quarter was 3.3%, compared to 3.1% in the first quarter a year ago.

As described during our last conference call, the most significant customer -- or reason for customers deactivate from our service is the desire for additional features and functions in our core products. As we have made significant progress during the second quarter introducing new functionality into the marketplace, we anticipate it will take time to see the full effect in our retention performance.

Looking sequentially, both net additions and customer churn improved, while gross additions declined by approximately 9% during the first quarter of 2005 compared to the fourth quarter of 2004. We do not think this difference is indicative of any trends affecting long-term consumer demand of our Cricket service; rather we believe that the quarter over quarter difference in topline customer growth is largely reflective of the typical seasonal patterns we have seen in our business.

The first quarter is typically the strongest performing quarter in terms of customer retention and net additions. Traditionally, we have seen a moderation in net additions as churn in the second and third quarters increased, with churn peaking in the third quarter as customers become more mobile during the summer months.

Customer growth significantly improves in the fourth quarter, reflecting the positive impacts of the holiday selling season. There are of course a number of variables that affect these seasonal growth and retention trends, including promotional levels, new product introductions, competitive actions, and general economic conditions. We will continue to manage the balance of brand, product, customer service, and promotional investment to most efficiently support our growth objectives.

Our actions to support measured, value driven growth are apparent in the improved average revenue per user seen during the quarter. ARPU for the first quarter came in at $39.03, an improvement of $1.42 over that reported for the first quarter of 2004, and a sequential improvement of $1.22, after adjusting fourth quarter ARPU for the mail in rebate impacts we discussed during our last conference call. This improvement in ARPU reflects the continued deepening penetration of high-value rate plans within our customer base; the impact of our planned shift away from mail in rebates in favor of instant rebates; and the sequential improvement in customer churn we saw during the quarter.

As indicated during our last conference call, we anticipate seeing a general upward pressure on ARPU, as our customer retention issues and new products and service pricing take hold. Our strategy also includes the addition and use of new product features and functional improvements to our core service plans.

We expect ARPU growth to come from three sources, improved service plan mix to higher price plans; increased penetration of feature add-ons; and the introduction of new capabilities, our away from home calling option, Travel Time, for example. A significant majority of our customers are initiating their Cricket service with our highest price plans. And we are seeing good acceptance rates of our feature add-ons. We will provide additional discussion surrounding our new initiatives over time, as they become a larger portion of our business.

That said, it is important for investors to recognize that we expect to see quarter over quarter variations in this number, given the relationship between churn and ARPU that exists within our business. In addition, should the positive impacts on ARPU resulting from customer usage and mix of our new products and services continue, we expect to offset some of that improvement by considering initiatives that improve value, further stimulate growth, or encourage retention efforts. As examples, we are exploring reducing the level of service and late fees charged to our customers, and subsidizing the introductory use of new functional capabilities to accelerate customer awareness and adoption.

Our focus on value driven growth is also apparent in our cost per gross addition, or CPGA, which came in at $128, a decrease of $31 over the CPGA reported for the fourth quarter of 2004. As we indicated during our last conference call, we remain confident that the marketing programs we have put into place, which are based on the compelling value differentiation of services we provide, will allow us to deliver gross additions below the $150 level for the remainder of the year.

Our strategy is to continue tapping into growth opportunities we see for our business within the value conscious segments that have remained under served by traditional contract-based wireless services.

As discussed in our last call and in recent public announcements, we have delivered on our product development plan for the first to of 2005 as outlined for you late last year. Our new marketing campaign designed to refresh the Cricket brand, has been well-received. And we're making excellent progress in our customer service initiatives. These activities need time to work, however, and we caution investors not anticipate seeing their impact on our subscription numbers until later this year.

We remain confident that the broad scope of activities we're pursuing will strengthen Cricket's position within the marketplace over time. As previously discussed, we have clearly reenergized our product development, marketing, and customer service activities over the past two quarters. And we have a robust pipeline of new products and handset launches planned throughout the remainder of 2005.

We continue to make excellent progress in rolling out our Travel Time product to Cricket customers. In early June we implemented the second phase of our roll out with the launch of Travel Time in three additional markets, for a total of 10. And we are on track to complete the introduction of this service to all markets by the end of June or early July.

In addition, we are working to extend this product into Mexico, and recently signed a roaming agreement supporting the expansion of Travel Time. This is an important product enhancement that will strengthen our market position with our Mexican-American customers in the Southwest. As we continue to add to the list of roaming partners, we do not expect, however, to generate material reciprocal revenue from roaming. Although we have all the a few thousand customers activated with Travel Time to date, the Memorial Day holiday demonstrated the importance of this enhancement, as we saw a significant spike in minute usage, as our customers were now able to use their Cricket service outside their service area.

We're now moving forward with the planned distribution expansion of our pre-paid Jump by Cricket. We have chosen to make -- take a measured approach to this new service, as we gauge customer usage trends against our expectations. Thus far we are encouraged by what we have seen, as monthly minute use is about one-third that of our unlimited core products. And we have yet to see any measurable cannibalization of those products.

Jumps' ARPU is also exceeding expectations, as refill rates are higher than expected. We remain early in our roll out of Jump in our distribution. But we have seen that Jump is attractive to new customers, as well as an appealing option for customers who have previously discontinued service. As we move ahead with the next phase of this product's evolution, including a major expansion of Jump Only distribution, we're planning product enhancement and the introduction of new product packaging.

We launched our multimedia messaging service, or MMS, in April, which has been widely accepted. The number of messages per day have been on a continuous rise, and we saw steep increase in usage as we announced the intercarrier capability with Verizon Wireless. We're working with other major carriers to complete the intercarrier MMS capability over the next several months.

As we mentioned in our last call, we're in the process of selectively expanding our distribution channel, including the introduction of new, exclusive premier dealers that closely resemble the look and feel of our Company-owned stores, and will act as payment and service locations. To date, we have established six of these premier deal locations, and we're pleased with their results, expecting this number to approach 100 by year end.

As part of this continuing channel rationalization process, we expect to transition some of our lower touch indirect dealers to Jump Only distribution. Together with this expansion of our distribution channel, we are also expanding a number of alternative payment locations available to our customers. Since the beginning of 2005, we have increased the number of payment terminals by over 40%. During the second half of the year we intend to continue to expand this expansion, while introducing new alternative payment options, including a Cricket branded debit card that we expect to be an effective retention and customer loyalty product.

As we mentioned on our last call, an important part of reducing churn will be the continued improvement of customer satisfaction. We will work to identify ways of improving all aspects of our service, and customer access to our call centers and the Internet. We are in the process of analyzing our overall fee structure to insure we strike the right balance between convenience and cost.

As our customer satisfaction metrics improve in our stores and our call centers, we continue to raise the bar to promote positive progress in this important area of our business.

Finally, it is exciting again to be able to talk about the launch of a new market. As we prepare to lodge Fresno in the second half of 2005, we have the advantage of all the experience from previous launches; a portfolio of new products and services; new branding and merchandising materials; and the implementation of our new distribution and payment locations strategy. For further updates on the progress we're making toward launching new markets, and additional development from the network operations side of our business, I would like now to turn the call over to Glenn.

Glenn Umetsu - *Leap Wireless International, Inc. - EVP, CTO*

Before we take a look at the progress of our market expansion efforts, I would like to highlight our performance during the first quarter, as there were many notable improvements. For the first quarter, our total cash cost per user, or CCU, was $18.94 versus $20.08 for the first quarter of 2004. This 6% reduction resulted from exceptional cost control, with total CCU expenses remaining essentially flat year-over-year, while we experienced a scale increase of 6% in average customer service from the previous year.

On a sequential basis, CCU increased by $0.20 or 1.1% from the fourth quarter of 2004, while the network operations component of CCU increased sequentially by $0.54, due to onetime credits in the fourth quarter of 2004. This increase was partially offset by reductions in the handset related costs not associated with initial customer acquisition that we include in the calculation of this key metrics.

While we expect to see upward pressures on CCU due to increased customer demand for features and services like long-distance, Travel Time, picture messaging, and ring tones we have redoubled our efforts to look for cost savings in our core activities. As a result, we are improving our fixed asset tracking, continuing work on least costs long-distance routing, which would include utilizing Voice over IP as it is feasible, reducing the cost to support local number portability, improving our handling of customer care calls through our interactive voice call response systems, and routing multimedia messages directly to other carriers rather than passing the traffic through higher cost clearinghouses.

Also moving in the direction of cost control and to better support the growth of our new markets, over the next six to nine months we're looking into transitioning our current billing and activation platforms to a larger and more advanced system. We expect these improvements to enable us to maintain CCU below $20 for the remainder of 2005.

Moving onto our new market development activities. We have started construction on the switch and cell site locations in our new Fresno market, and are well on track to launch an expansion of our Central Valley footprint in the second half of the year. The addition of Fresno, an example of our clustering strategy, will provide continuous coverage between our existing markets at Modesto and Merced N. Merced to the north, and Visalia to the south. In addition to providing greater service to our existing and potential new customers, we expect to be able to take advantage of economies of scale within this expanded market cluster.

We're moving forward with the construction planning of our Auction #58 market. We are naming key personnel to leadership positions and assigning RF designers for those markets. Locations, lease and implementation costs for switch, cell site and store facilities are also being researched.

Under a management services agreement, we are also providing planning services to Alaska Native Broadband 1 License, with respect to the build out and launch of the licenses it expects to acquire in connection with Auction #58. We're currently developing plans for such build outs and expect to fund the build out and initial operation of the licenses that ANB 1 License expect to acquire. We believe that we're on schedule to launch most of these markets by the end of next year, which together are expected to cover 14 to 17 million covered POPs by the end of 2006.

Turning to capital, we finished the first quarter of 2005 with total capital expenditures of $24.5 million, in line with our expectations for the quarter. Our outlook for capital expenditures remains at $28 per covered POP for Auction #58 markets, plus $5 in additional cash requirements, which includes operating losses and working capital which meet our expectations of the total cash investment required through free cash flow breakeven in these new markets.

The estimate for our additional cash expenditures is based on our experience with previous launches, but it is premature to provide a breakdown between the cost expected to flow through the P&L or working capital.

We continue to work with infrastructure providers to obtain good pricing. And are on track to make our total capital expenditure guidance of 175 to $230 million for 2005. Now back to Doug for his closing remarks.

Doug Hutcheson - *Leap Wireless International, Inc. - President, CEO*

As you can see, our business continues to move ahead across a broad range of activities, and is generating strong results, as indicated by the 38% first quarter adjusted EBITDA margins on service revenues, and our first complete quarter of net income as a reorganized Company.

The last area I would like to cover today is the Company's strategy and outlook. I believe it is important to consider the power of our business strategy of high-value, low-cost leader in the wireless industries. Consider the following analogy's context. Even as the airline industry continues to face challenges and tough times, the low-cost carriers stand out as bright spots in this highly competitive.

They focus not just on existing air travel customers, but on new consumers of airline travel as well, just as we work to attract new under served demographics to wireless. The low-cost carriers have prompted customers to change from traveling by car to traveling by air, just as we moved over the 50% of our customers to use our services as a replacement to their land line service.

And now we expect to move into the pre-paid space with high-value competitive price products that meet the needs of our customers.

The low-cost carriers continue to make progress by keeping their costs lower than traditional airline carriers, even though they purchase and operate the same aircraft, buy the same fuel, and rent gate space at the same airports. Just as we must purchase and operate similar network equipment, buy electricity and other consumable services, and rent space on towers like traditional wireless carriers. Both of our business models focus on maintaining and improving our costs to allow us to market the services that our existing and new customers desire.

Lastly, through thoughtful management of their balance sheets and a focus on operating efficiencies, these low-cost carriers continue to expand their businesses, much as we expect to continue to do in ours. Our business model is fundamentally different than other wireless carriers. And it is based on a relentless commitment to ensuring the necessary steps are taken in a cost-effective manner to service our existing customers and acquire new customers over time.

We believe our strategy and the steps we're taking to improve our business will create value for our shareholders, and expand the opportunities for our employees in the future. Within this context, implementing our business strategy as the high-value, low-cost wireless service provider is based on the successful execution in four key areas across the Company.

First, is to increase our profitability by continuing to build our financial performance of our current markets by better serving our customers. In the coming quarters we expect to make continued progress in improving our customer experience, building on our brand awareness and product portfolio, and strengthening our distribution and payment locations. All in order to take advantage of our cost structure and efficiently deliver the value and services our customers need and want.

At the appropriate time in coming quarters we expect to provide some additional discussion on the results of our new product activity as they become a larger portion of our progress.

Second, we are advancing our plan to expand our scale through the cost-effective addition of new markets that our experience indicates are among the better suited markets for our products and services. We're nearing selection of our equipment vendor partners and appear to be on track to meet our cost expectations to build these new markets. We're focusing on effectively and efficiently managing our sales to free cash flow breakeven for these markets. We believe we have chosen these markets well, and that they represent an opportunity to create longer-term returns well in excess of our cost of capital.

At the appropriate times in the coming quarters we expect to begin discussing the results of our new market activity in order to provide investors with a clear picture of the progress we are making in both our core and our new markets.

Third, we firmly believe that one of the fundamental competitive advantages for our business is our cost structure, and we will continue to review programs aimed at defending and improving our cost position.

As we previously said, cost reduction is a journey, not an event. As the business looks ahead, we're introducing new initiatives aimed at building, improving and adapting our systems and processes, thus enabling us to not only be compliant with appropriate regulatory statutes, but also improve our future flexibility, and most importantly our efficiencies.

These programs take many forms that include taking steps such as further automating our revenue and inventory processes, replacing our billing systems, providing increased controls to manage our fixed assets, and working to achieve compliance with Sarbanes-Oxley Section 404 requirements. We expect within our guidance there is the necessary investment during the second half of the year to allow us to efficiently and effectively grow our business, while addressing the investment associated with these requirements. We believe a more robust operating environment will emerge from this effort, enabling our employees to be more efficient and productive.

Lastly, the Company believes that the continued focus on the capital markets is a significant priority. Our expansion strategy is expected to be principally, although not necessarily exclusively, financed through the Company's existing financial resources and future business capabilities. When you consider the Company's existing cash, proceeds from the anticipated asset sales we have discussed, the cash flow from our ongoing businesses and incorporate that with our guidance on the costs and timing of our new market build, it is apparent that the Company has acted prudently in determining the next steps that we will take in our growth by avoiding significant incremental funding requirements.

That said, the Company will continue to review its opportunities and may consider actions that will provide a balance in our liquidity and maintaining an appropriate capital structure.

Additionally, we look forward to concluding the final steps necessary for a listing on the NASDAQ National Market System. We will update the markets on our listing status as additional information becomes available in the coming weeks. Also, as Jim said at the beginning of the call, we expect to be active on the IR front, and are looking forward to discussing our business and our progress with investors over the next few months.

The Company outlined our outlook for 2005 today in conjunction with today's earnings release. We believe we are on track to meet our financial targets, representing another strong year of improvement in our performance. While we continue to expect to see increasing customer results later in the year, we have broadened our net customer addition guidance to account for potential timing differences as customers come to recognize the value of the programs that we have and we will introduce in the coming months. We remain confident that the growth initiatives that we have undertaken will build our results in an effective and efficient manner. And we look forward to the further financial growth of our business that the consolidated impact of this broad range of activities is expected to bring.

I want to finish by recognizing the outstanding efforts of all of our employees completing an outstanding quarter and achieving net income positive performance for the quarter. It has been a long and, certainly at times, challenging road to build the business to this point. Their collective and individual efforts have all contributed to this quarter's record performance, and are appreciated.

On behalf of the Company, I also appreciate your continued support and interest. I will now turn the call back over to Jim.

Jim Seines - *Leap Wireless International, Inc. - Director IR*

Amanda, would you please come back online to review the instructions and open the Q&A portion of today's call?

QUESTIONS AND ANSWERS

Operator

Absolutely, sir. (OPERATOR INSTRUCTIONS). Phil Cusick, Bear Stearns.

Phil Cusick - *Bear Stearns - Analyst*

The first thing I would like to ask is something I think are on a lot of people's minds. What has happened in the last month that has made you lower the range of net adds from 150 to 200, to 125 to 200,000 for the year?

Doug Hutcheson - *Leap Wireless International, Inc. - President, CEO*

What we are seeing is we're pleased with all the launches of the new products that we have rolled out. And we're pleased with what we see on the brand awareness. We are expecting when we look at the distribution -- where we are at that on that, that it is going to take a while to get the full seasonal benefit -- the full benefit of those products. We're confident that we're going to see them later in the year.

Phil Cusick - *Bear Stearns - Analyst*

So the last 30 days have been a little bit slower on those new products than you expected, or have they rolled out a little later?

Doug Hutcheson - *Leap Wireless International, Inc. - President, CEO*

What we are seeing is we think it is appropriate at this time to broaden our range, because we think we going to see a lot of the improvement from the new products later in the year.

Phil Cusick - *Bear Stearns - Analyst*

Just another quick one. When do you expect the FCC licenses to come in at this point?

Doug Hutcheson - *Leap Wireless International, Inc. - President, CEO*

The Auction #58 licenses have been paid for under the way the auction process was run. They will actually transfer here late this quarter, early next quarter. The transfer has been approved. The Fresno license is expected to also close ahead of the end of this month, or early next month. What has not been approved by the SEC at this point is the transfer of the licenses to the Alaska Native Broadband 1. And I don't know -- I don't have exact timing on when the SEC would approve those licenses. But those licenses have also been paid for as well under the terms of the Auction #58 auction.

Phil Cusick - *Bear Stearns - Analyst*

And if I could ask one more quick one. There was a mention of ARPU showing seasonality at one point in the call. I wonder if you -- do you expect the ARPU increase to be fairly steady, or should we look for some weakness in the summer? It has been a long time since we had a sort of steady ARPU to be looking at.

Doug Hutcheson - *Leap Wireless International, Inc. - President, CEO*

Our ARPU, like many of our metrics, is seasonal. As we flex our churn, which is what Al talked about during the conference call, we have generally favorable trends on where we see our ARPU at. But we think the right way to look at our ARPU is seasonal, so year-over-year, as compared to quarter over quarter. So we think you'll see continuing improvements in ARPU year-over-year as we continue to progress ahead. Whether each quarter is a sequential improvement, that we're not discussing specifically at this point.

Operator

Todd Rethemeier, SurTerre Research.

Todd Rethemeier - *SurTerre Research - Analyst*

I just wanted to follow up a little bit on the rebates you were offering in the fourth quarter. Have you gone back and looked at the customers you added in the fourth quarter on rebates and looked at the customer life, how long you have been able to retain them, and the spend and things like that?

Because I am just wondering, it seems like the rebates were really quite successful in adding a lot of customers in the fourth quarter. And then when you stopped them in the first you did see a slowdown in gross adds. I am just wondering if it might be a good idea to go back and look at starting rebates again?

Doug Hutcheson - *Leap Wireless International, Inc. - President, CEO*

First off, the key change that we did between the two quarters was we used less mail in rebates during the first quarter and more smaller instant rebates. So we were considering rebates during both time periods. So rebates we were using promotional tactics during both quarters.

The fourth quarter is traditionally strong on net adds, or on gross adds. So a lot of what Al covered was our traditional strong fourth quarter. The stronger net adds in the first quarter also has a large component of lower churn. And the business is and will continue to review our rebating policy. We do study, depending on how a customer comes into the business, their expected life. And we will continue to do all steps that are appropriate to stimulate growth.

Our big focus right now though is to generate awareness on five major new products that we put out into the marketplace, whether that is Cricket Flex or the picture messaging, the news service rate plans, Travel Time and Jump. We are pleased when we have seen the initial reception on those, but believe we need to do additional awareness and distribution to really get the full benefit from those.

Todd Rethemeier - *SurTerre Research - Analyst*

And one last quick question. Any progress on the CFO search?

Doug Hutcheson - *Leap Wireless International, Inc. - President, CEO*

First I want to recognize what a great job Dean has done. It is a pleasure to be current on all of our financial filings. And on behalf of the Company I want to express Dean's -- thank you for Dean's good efforts. And I do not have an update. We're continuing to review what our next steps will be.

Operator

Ethan Schwartz of CRT Capital Group.

Ethan Schwartz: A bunch of questions. First, I know you went over this, but could you go over again -- it just went by quickly -- the sequential increase in cost of service? And particularly the expenses that were tied to the new products? And is there any way to sort of correlate that to the take up rates?

Doug Hutcheson - *Leap Wireless International, Inc. - President, CEO*

I'm going to let Dean -- there was about $1.6 million that was related to text messaging, long-distance and Brew. That was the year-over-year. And I believe it was about 1 million quarter over quarter. So Dean is verifying those numbers.

The uptake on Brew, we have had -- let me take a couple of those pieces. The Brew subscribers we have had double-digit percentage handset penetration at this point. So we've got people that are actively purchasing the Brew available handsets. We have a double-digit percentage of those that purchase that that are beginning to use brew. What isn't clear, given that we're about three months into it, is where that is going, and how far we can expect that to continue to progress. We're continuing to drive that into the base. And we're also looking with some of the things that Al talked about in his section. It is stimulating the Brew usage by giving people the ability to sample some of these products and see what they are at to stimulate additional usage.

Dean Luvisa - *Leap Wireless International, Inc. - acting CFO and Treasurer*

On the cost of service, and your question was sequentially, correct?

Ethan Schwartz: Right.

Dean Luvisa - *Leap Wireless International, Inc. - acting CFO and Treasurer*

Sequentially there was about $1 million that was related to higher level of usage on the LD text messaging and brew, which left $3 million of -- primarily related to calendar run rate on property tax adjustments and back haul and interconnect expanse. They were related to issues in the fourth quarter that returned to normal levels in the first quarter.

Ethan Schwartz: That's good. And then you also -- I think you have touched on this -- the loss for gross additions on handsets was pretty low. Is it going to stay? I think it came in around $13 and change. Is it going to stay around that level or float up slightly -- Even compared to the uptick last year for the rebates anomaly?

Doug Hutcheson - *Leap Wireless International, Inc. - President, CEO*

If you do the straight math, the average typical number that you have seen for our equipment handsets subsidy over a multiple quarter time period has generally been around $30. We have some flex on that quarter over quarter. Most of that flex comes to flexes (ph) with the promotional practices. And we would expect during certain periods we would have more promotional activity than we did during the first quarter.

Ethan Schwartz: Does that $30 include the retention portion of the handset cost or --?

Doug Hutcheson - *Leap Wireless International, Inc. - President, CEO*

No, that flows through the CCU line. In Glenn's portion he talked that we -- it flows through total cost. But when we calculate our metrics second subsidies flow through though CCU line.

Ethan Schwartz: On the messaging product, are you seeing any change in the demographics of the type of subs you are getting? And particularly are you having any better traction with the youth market or additional traction with the youth market?

Doug Hutcheson - *Leap Wireless International, Inc. - President, CEO*

The youth market is our traditionally strongest demographic that we have seen. And we certainly see the youth being the most oriented to use the product and uptake. One of the things to keep in mind, as an example, is our text messaging, here we're roughly about the 10th largest carrier and the fifth-largest text messenger in the country on a volume basis. So we would expect -- and that took us probably about 20, 24 months to get through that entire process that is driving that penetration into our base. We are optimistic that based on the early trends that we see, and some of the initial intercarrier traffic, and the new intercarrier traffic that we are expecting to add, that we will see nice growth with that over the next few quarters as well.

Ethan Schwartz: Just as sort of a final, general question, and I think it is something you have probably been asked a bunch of times. On cash cost per user, what could you point to as far as marginal CCU? Not just average CCU, which obviously is as much lower than the other national wireless carriers, but marginal CCU that would serve as, let's say, a barrier to entry for a mainstream carrier that wants to enter your niche?

Doug Hutcheson - *Leap Wireless International, Inc. - President, CEO*

I have talked about this a few times. Our marginal CCU is less than half of our total CCU at this point. So what you really see from that is the cost of the next minute is quite low for us. I think we have good barriers from entry on that.

The other piece that is a barrier for entry is us continuing with these initiatives that we have talked -- getting the right product and customer experience and brand awareness back into the marketplace as well. We're pretty excited to let this stuff go to work. We think it will take us a little while now that it is in place to get worked through the marketplace, but we are optimistic that it will work well for us.

Operator

(OPERATOR INSTRUCTIONS). Andrew Tuttle, Jefferies.

Romeo Reyes - *Jefferies and Company - Analyst*

It is Romeo. Just a couple of questions. First, I guess on subscribers on sort of like a -- if you could give us a little bit of guidance on further sequence of the net adds over the next couple of quarters. I guess based on what Al said, you're going to have -- Q1 and Q4 are going to be the strongest. And then I guess the middle quarters are going to be a little bit softer per the seasonality and the uptick in churn. Can you give us a little bit more color on that, if you can.

Secondly, with respect to EBITDA and some of the expenses incurred with the launch of Fresno, can you give us a sense of how much of that 8 million or so that you have projected for Fresno in OpEx, how much of that would you expect would be incurred in 2005 versus 2006? And then I wasn't here on EBITDA. Can you give us a sense of whether or not EBITDA is going to drop sequentially versus Q1?

Doug Hutcheson - *Leap Wireless International, Inc. - President, CEO*

Sure. Let me see if I can take them one at a time. I think our business is seasonal. We are expecting it to remain seasonal. And as we roll out our new initiatives what we're hoping to do is impact that seasonality. So we would expect second and third quarters to be softer on net adds, as you discussed, and fourth quarter to be stronger.

And so we are working to continue to drive customer growth. But we are in a situation where we're going to see a lot of it later in the year. Is basically where we see the growth coming.

The next piece is on the Fresno piece. I think that you will see most of the operating income hit on Fresno this year. We are optimistic that we will be driving that market in the second half of the year, and be using the holiday season to move that market ahead. So I think that will give you a little bit of that idea -- idea on that.

And then the last piece is the Company's guidance for EBIT -- that is for the full year -- remains where it is. So clearly what we're guiding to is between Fresno and some of the systems improvements and the preparations that we see for the new market launches is towards the end of the year you're going to see investments in that growth that would impact our operating income. Romeo, what I committed to do and will continue to do is as that becomes an impact on our numbers, we will breakout the core markets versus the new market impact and provide visibility, so people can see how the business is developing.

Operator

Kevin Roe of Roe Equity Research.

Kevin Roe: Just following up on the lower net add guidance. You had stated that it is a change in your expectations for new products for the second half. Is there any change in the business sense your guidance last month, either gross adds, trends or churn trends that impacted that revised net add guidance?

Doug Hutcheson - *Leap Wireless International, Inc. - President, CEO*

I don't think there is a substantial change. But what has become clear is driving the new products into the base is going to take until the end of year. And I don't think we lowered, I think we broadened. Well, I guess we broadened our guidance for the year. I still think that there is a lot of upside as we drive these products through, but I think it was appropriate to broaden our guidance.

Kevin Roe: On Jump, since you announced your pricing, some of the competitors in that pre-paid space have changed their pricing. It is a very dynamic -- as you know, dynamic segment, and there have been some pricing step downs. Have you seen a need as you continue to roll that out for price adjustments? Or basically how long will this $0.10 Travel -- $0.10 per minute rate be appropriate?

Doug Hutcheson - *Leap Wireless International, Inc. - President, CEO*

First off, remember that is $0.10 a minute for the outgoing minutes only and --.

Kevin Roe: Right, and free incoming.

Doug Hutcheson - *Leap Wireless International, Inc. - President, CEO*

And free incoming minutes. And I don't think we have seen anybody move closely to that level of pricing.

Kevin Roe: Well, for instance, NET10 has got $0.10 a minute. They don't have the free incoming, but you can use the phone anywhere in the country. And that wasn't around when you introduced Jump.

Doug Hutcheson - *Leap Wireless International, Inc. - President, CEO*

Our big next step on Jump, as we have talked about at our last conference call, is that we have it in 800 distribution locations, and we're trying to triple that number. A lot of that move is to move it into Jump Only distribution, and to get it on the racks where the product is most competitive.

So the first step was to do a cautious initial launch -- a prudent launch to get familiar with how the product was working, and then to go ahead and expand the distribution on it. The other piece is Jump does have the ability to work all over the country. So please remember, although it is not a $0.10 a minute, the product does have a -- under the terms of our various roaming agreements, does have broad coverage.

Kevin Roe: And how many markets is Jump in now?

Glenn Umetsu - *Leap Wireless International, Inc. - EVP, CTO*

Jump is in all of our markets, with limited distribution in our current -- with our current stores and our partners.

Kevin Roe: And last question is on churn seasonality. We saw churn up year-over-year this previous quarter. In Q2, as you said, it is going to be up on a seasonal basis. Should it also be up on a year-over-year basis in your expectation?

Doug Hutcheson - *Leap Wireless International, Inc. - President, CEO*

I still -- I think while it is going to certainly be seasonal, and we haven't finished the quarter, so I don't know that we've got specifics on ready to announce on where second quarter churn is going to be. We think the products and the initiatives that we're taking are going to impact churn over the course of the year. So we feel good that we're taking the right steps. Product and functionality was the largest element of our churn, and we need to now move those products and services into the base.

Kevin Roe: Okay, thanks, Doug.

Doug Hutcheson - *Leap Wireless International, Inc. - President, CEO*

Thank you for joining us on our call today. As you can tell, we are encouraged by our solid results for the first quarter. On behalf of our employees and the officers and Directors of Leap, we thank you for your interest and continued support.

We look forward to talking to you again at our second quarter conference call in August. If you have any further questions about our results for the first quarter, or need additional clarification, please feel free to contact Jim Seines, Director of IR, at 858-882-6084.

I hope that you have come away from our call today with a good understanding of how we're shaping our future as we execute on opportunities for expanding our growth and profitability that we see before us. Thank you.

Operator

Ladies and gentlemen, thank you for your participation in today's conference. This does conclude your program. Have a wonderful day.
