

Virgin Mobile USA, Inc.  
Form 10-K  
March 09, 2009  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, D. C. 20549**  
**FORM 10-K**

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

For the Fiscal Year Ended: December 31, 2008

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 001-33735

**VIRGIN MOBILE USA, INC.**

(Exact name of Registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction of incorporation or organization)

**20-8826316**  
(I.R.S. Employer Identification Number)

**10 Independence Boulevard**

**Warren, NJ**  
(Address of Principal Executive Offices)

**07059**  
(Zip Code)

**Registrant's telephone number including area code: (908) 607-4000**

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

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| Title of Class                                                          | Name of Exchange on Which Listed |
|-------------------------------------------------------------------------|----------------------------------|
| Class A common stock, par value \$0.01 per share                        | New York Stock Exchange          |
| <b>Securities registered pursuant to Section 12(g) of the Act: NONE</b> |                                  |

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES ☐ NO ☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. YES ☐ NO ☒

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer ☐ Accelerated Filer ☒ Non-Accelerated Filer ☐ Smaller Reporting Company ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES ☐ NO ☒

As of June 30, 2008, the aggregate market value of the voting and non-voting common equity of the Company held by non-affiliates was \$81.7 million.

The number of shares of each of the registrant's classes of common stock outstanding as of February 28, 2009 was as follows:

|                                                  |            |
|--------------------------------------------------|------------|
| Class A common stock, par value \$0.01 per share | 65,009,079 |
| Class B common stock (privately held)            | 2          |
| Class C common stock (privately held)            | 115,062    |

### Documents Incorporated by Reference

Applicable portions of the Proxy Statement for the Annual Meeting of Stockholders of the Company to be held on May 20, 2009 are incorporated by reference into Part III of this Form 10-K.

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### **Introductory Note**

In this annual report on Form 10-K (the "annual report"), unless we state otherwise or the context otherwise requires, the terms (1) the "Company", "we", "us" and "our" refer to Virgin Mobile USA, Inc., a Delaware corporation, and its consolidated subsidiaries; (2) "Operating Partnership" refers to Virgin Mobile USA, L.P., a Delaware limited partnership through which we conduct our business; (3) "Helio" refers to Helio LLC, a Delaware limited liability company; (4) "SK Telecom" refers to SK Telecom Co., Ltd., a company organized under the laws of the Republic of Korea, and its affiliated entities; (5) "Sprint Nextel" refers to Sprint Nextel Corporation, a corporation organized under the laws of the state of Kansas, and its affiliated entities; (6) the "Virgin Group" refers to Virgin Group Holdings Limited, a British Virgin Islands company, and its affiliated entities; and (7) "EarthLink" refers to EarthLink, Inc., a Delaware corporation.

Certain of the titles and logos of our products referenced in this annual report are our intellectual property or used by us under license. Each trade name, trademark or servicemark of any other company appearing in this annual report is the property of its holder.

This annual report includes industry data and forecasts that we have prepared based, in part, upon industry data and forecasts obtained from industry publications and surveys and internal company surveys. Third-party industry publications and surveys and forecasts generally state that the information contained therein has been obtained from sources believed to be reliable. The statements regarding our market position in this annual report are based on information derived from market studies and research reports cited in this annual report.

Although some of the companies that compete in our markets are publicly held as of the date of this report, some are not. Accordingly, only limited public information is available with respect to our relative market strength or competitive position. Unless we state otherwise, our statements about our relative market strength and competitive position in this annual report are based on our management's belief, internal studies and our management's knowledge of industry trends.

In this annual report, unless we state otherwise, (1) references to "Nielsen Mobile" refer to Nielsen Mobile's Quarterly Prepaid Report for the quarter ended December 31, 2008, (2) references to "IDC" refer to International Data Corporation's QView for the quarter ended September 30, 2008, (3) references to "Current Analysis" refer to Current Analysis, Inc.'s report published in 2007, (4) references to the "Yankee Group" refer to the Yankee Group's Market Adoption Monitor and Forecast published in 2007, and (5) references to "Market Tools" refer to MarketTools ZoomPanel, an online panel of highly representative consumers.

The following annual report should be read in conjunction with our financial statements and related footnotes included in Item 8 of this document. Unless the context indicates otherwise, whenever we refer in this annual report to a particular fiscal year, we mean the fiscal year ending December 31 in that particular calendar year.

### **Forward-Looking Statements**

This annual report contains certain forward-looking statements and information relating to us that are based on the beliefs of our management as well as assumptions made by, and information currently available to, us. These statements include, but are not limited to, statements about our strategies, plans, objectives, expectations, intentions, expenditures, and assumptions and other statements contained in this annual report that are not historical facts. When used in this document, words such as "anticipate", "believe", "estimate", "expect", "intend", "plan" and "project" and similar expressions, as they relate to us are intended to identify forward-looking statements. These statements reflect our current views with respect to future events, are not guarantees of future performance and involve risks and uncertainties that are difficult to predict. Further, certain forward-looking statements are based upon assumptions as to future events that may not prove to be accurate.

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Many factors could cause our actual results, performance or achievements to be materially different from any future results, performance or achievements that may be expressed or implied by such forward-looking statements. These factors include, among other things:

changes to our business resulting from increased competition;

our ability to develop, introduce and market innovative products, services and applications;

our customer turnover rate, or churn ;

bulk handset purchase and trading schemes;

changes in general economic, business, political and regulatory conditions;

availability and cost of the nationwide Sprint PCS network and Sprint Nextel's costs associated with operating the network;

potential liability resulting from pending or future litigation, or from changes in the laws, regulations or policies;

the degree of legal protection afforded to our products;

changes in interest rates;

changes in the prices of mobile phones that we purchase from manufacturers;

changes in the composition or restructuring of us or our subsidiaries and the successful completion of acquisitions, divestitures and joint venture activities; and

the various other factors discussed in the Risk Factors section of this report.

Many of these factors are macroeconomic in nature and are beyond our control. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, our actual results, performance or achievements may vary materially from those described in this annual report as anticipated, believed, estimated, expected, intended, planned or projected. We neither intend nor assume any obligation to update these forward-looking statements, which speak only as of their dates.

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### PART I

#### **Item 1. Business.** **Overview**

We are a leading national provider of wireless communications services, offering prepaid services and, following the acquisition of Helio LLC, postpaid services targeted at the youth market. Our customers are attracted to our products and services because of our flexible terms, easy to understand and value-oriented pricing structures, stylish handsets offered at affordable prices and relevant mobile data and entertainment content. Our prepaid product and service offerings have no annual contract or credit check and we attract a wide range of customers, approximately half of whom are ages 35 and under. Our voice and data plans allow our customers to talk, use text messaging, picture messaging, email and instant messaging on a per usage basis or according to the terms of our monthly hybrid plans. Following the acquisition of Helio on August 22, 2008, we began to offer postpaid voice and data plans, some with two-year contracts, for both individuals and families.

We were founded as Virgin Mobile USA, LLC, a joint venture between Sprint Nextel and the Virgin Group, and launched our service nationally in July 2002. In October 2007, we completed our initial public offering (the "IPO") and a related reorganization. Following this reorganization, Virgin Mobile USA, LLC converted into a Delaware limited partnership, changed its name to Virgin Mobile USA, L.P. (the "Operating Partnership") and became the indirect, majority-owned subsidiary of Virgin Mobile USA, Inc., a holding company which holds partnership units in the Operating Partnership directly and indirectly through Bluebottle USA Investments L.P. ("Bluebottle Investments") and Bluebottle USA Holdings L.P. ("Bluebottle Holdings"). Virgin Mobile USA, Inc. also holds the outstanding limited liability company interests of VMU GP, LLC, the general partner of Bluebottle Investments. As an indirect owner of VMU GP, LLC, the sole general partner of the Operating Partnership, Virgin Mobile USA, Inc. operates and controls all of the business and affairs of the Operating Partnership. Sprint Nextel, EarthLink and Virgin Mobile USA, Inc. and its subsidiaries are the only partners of the Operating Partnership. Virgin Mobile USA, Inc. consolidates the financial results of the Operating Partnership, and the ownership interest of Sprint Nextel, EarthLink and SK Telecom in the Operating Partnership in the year ended December 31, 2008 is treated as a minority interest in our consolidated financial statements.

In August 2008 we acquired Helio, a provider of postpaid wireless products and services with a customer base of approximately 170 thousand. The Helio acquisition allowed us to offer high-value postpaid services and to acquire a unique and differentiated set of data applications that we expect to offer across our customer base. As of December 31, 2008, we served approximately 5.4 million customers (including Helio customers), an increase of 5.8% compared to the approximately 5.0 million customers we served as of December 31, 2007.

We market our products and services under the Virgin Mobile and the Helio by Virgin Mobile brands. We have exclusive rights to use the Virgin Mobile brand, which enjoys strong brand awareness, for mobile voice and data services through 2027 in the United States, Puerto Rico and the U.S. Virgin Islands through a trademark license agreement with the Virgin Group. We control our customers' experience and all customer touch points including brand image, web site, retail merchandising, service and product pricing, mobile content, marketing, distribution and customer care but as a mobile virtual network operator, or MVNO, we do not own or operate a physical network, which frees us from related capital expenditures. This allows us to focus our resources and compete effectively against the major national wireless providers in our target market. We primarily focus on wireless consumers who use 200 to 1,000 minutes per month. According to Market Tools, 70% of wireless consumers use fewer than 1,000 minutes per month. According to Nielsen Mobile, prepaid subscribers average 425 minutes of calling per month.

We provide our services using the nationwide Sprint PCS network. We purchase wireless network services at fixed rates pursuant to our agreement with Sprint Nextel, under which Sprint Nextel provides the Company with access to its wireless voice and data services operating on the nationwide Sprint PCS network (the "PCS Services Agreement"). As a result, we are able to manage our network costs while dedicating our resources to acquiring and servicing customers rather than to acquiring spectrum or building and maintaining a wireless network.

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We operate in the highly competitive and regulated wireless communications industry. The primary bases of competition in our industry are the prices, types and quality of products and services offered. As the wireless communications industry continues to grow and consolidate, we continually reassess our business strategies and their impact on our operations. Our strategies have included pricing our handsets competitively to grow and maintain our customer base. We expect these strategies to continue in the future. We continually monitor the impact of handset prices on the profile of our new customers, the behavior of our existing customers and our financial performance. We make adjustments to our pricing strategy accordingly, including lowering or raising handset prices as necessary. Many factors, including risk factors described in the Risk Factors section of this annual report, could adversely affect our results, performance and achievements.

The following diagram depicts our current organizational structure:

## **Business Model**

As a mobile virtual network operator, or MVNO, we dedicate the majority of our resources to acquiring and servicing customers rather than acquiring spectrum or building and maintaining a capital intensive wireless network. As a result, in the year ended December 31, 2008, we expended approximately 1.4% of our revenues on

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capital expenditures (mostly to support information technology and customer support infrastructure). Moreover, the simple, grab-and-go packaging of our handsets enables efficient distribution in third-party stores, saving us the expense of owning and operating our own retail stores.

### **Business Strategy**

The following are core components of our business strategy:

***Focus on Fast-growing Segments of U.S. Wireless Market.*** We believe there is substantial demand in the United States for our straightforward, value-oriented prepaid and postpaid wireless communication services. The Yankee Group projected that the number of users of wireless service in the under 35 year-old segment in the United States would increase by 16 million from 2006 to 2008, representing approximately 42% of the total growth in U.S. wireless customers over the same period. According to the Yankee Group, as of December 31, 2008, there were approximately 49.5 million prepaid wireless customers in the United States, with the U.S. prepaid and hybrid market representing 18.1% of total wireless customers. That number is expected to grow to approximately 62.1 million by the end 2011, or approximately 20.9% of all wireless customers in the United States. We plan to continue to focus upon the under 35 year-old segment and grow our market share by continuing to tailor our products, services and advertising message to this market, leveraging our brand through new and existing distribution channels and utilizing select youth-oriented media channels that specifically resonate with our target market.

***Continue Product and Service Innovation.*** We continually innovate and strive to adapt to our customers' needs. In February 2008, for example, we launched a suite of new service plans designed to broadly appeal to higher-usage, higher-revenue customers. Our monthly hybrid plans, which range from \$20 each month to \$79.99 each month, include anytime and night and weekend minutes without long-term contracts or commitments, effectively expanding the prepaid market to include some customers who previously might have selected a postpaid service. We intend to continue our efforts to address our market's evolving needs and to offer innovative and popular products and services ahead of our competitors.

***Enhance Our Brand Strength.*** We aim to maintain and strengthen a vibrant brand image that resonates with our customers and distinguishes us from other wireless communications providers. Our goal is to attract and retain customers through our youth-oriented marketing message and service offerings that are straightforward, flexible and a good value. For example, our marketing events in 2008 included the Virgin Mobile Festival, a two-day event that drew approximately 60 thousand fans to see major performing artists, increasing brand awareness for the brand and our products and services. We will continue to leverage our brand through innovative services, targeted marketing, advertising, product packaging, point-of-sale materials and our website.

***Leverage Our Scale and Infrastructure to Drive Profitable Growth.*** As of December 31, 2008, our customer base was approximately 5.4 million. We have built our infrastructure to support future growth in customers and usage while leveraging the advantages of our predominantly variable cost structure. As we continue to scale the business, we expect our growing customer base to translate into improved cost economies without the need for substantial capital investment.

### **Customer Acquisition**

Our customer acquisition approach is based on the acquisition cost and expected value of each customer. Our promotional offers are typically consumer driven, linking the purchase of our airtime with the purchase of our handsets and other products and services.

We have identified a number of customer acquisition principles that we believe are critical to our success, including:

Marketplace segmentation that allows us to connect effectively with the best prospects through targeted use of media and an array of marketing vehicles;

Compelling, focused marketing messages aimed at our best prospects;



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Simple value proposition and service that is easy to articulate, understand, evaluate, buy and use;

Good value and fair pricing;

Innovative and exciting design in our products, packaging and point-of-sale presentation;

Easy and efficient account activation and maintenance through our website and other self-service tools and customer service;

Friendly and efficient customer care resulting in high customer satisfaction; and

Extensive distribution network of approximately 150 thousand third-party retail stores that offer account replenishment, or Top-Up cards, including more than 40 thousand retail locations that also sell our handsets. Our retail partners include national chains such as Amazon.com, Best Buy, CVS, K-Mart, Meijer, RadioShack, Rite Aid, Sears, 7-11, Sprint Nextel Stores, Target Stores, Walgreens and Wal-Mart.

The prepaid wireless communications business in the United States is seasonal and is often disproportionately dependent on fourth quarter results. Our business has experienced a similar pattern and we expect this pattern to continue in the future. We rely heavily and concentrate our marketing efforts on key promotional periods, including Valentine's Day, Dads and Grads, Back to School, school graduation and the November/December holiday season.

## **Products and Services**

We offer a range of products and services that are designed to meet the lifestyles of our target market.

*Voice Services.* We offer high-quality wireless services using the nationwide Sprint PCS network. In addition to voice services, our services include additional calling features such as voicemail and caller identification at no extra cost, as well as directory assistance and international calling.

*Data Services.* Our target customers use mobile data services at rates higher than those of the average wireless customer. In 2008, non-voice services represented 19.2% of our revenue, compared to 16.4% of our revenue in 2007.

We develop content and have entered into relationships with third parties to procure and offer customized content, graphics, messaging, music and other services, including:

Messaging (text or short message services, or SMS); multimedia services, such as picture messaging, instant messaging, or IM and email). We have partnered with Yahoo and AOL to provide our customers with mobile email and instant messaging.

Music (ringtones, text tones, alerts, artist profiles and communities).

Web browsing and search.

Downloadable games, customized wallpaper, screensavers and pictures.

*Handsets.* We offer stylish handsets at affordable prices. We currently offer fifteen handset models under the Virgin Mobile USA and Helio brands. Our handsets are affordably priced, with prices currently ranging from \$9.99 to \$149.99. We currently purchase our handsets from

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Kyocera Wireless Corp., LG Electronics MobileComm U.S.A., Inc., Samsung Electronics America, Inc. and Personal Communications Devices LLC. We periodically negotiate to purchase handsets from other manufacturers. Although we attempt to maintain multiple vendors to the extent practicable, our handset inventory is currently acquired from only a few sources. We believe that our relationships with our suppliers are strong.

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Each of our prepaid handsets is distributed in a simple package that can be picked up by a customer with no sales assistance. Each handset package includes everything a customer needs to get started, including the handset, battery, charger, initial credit for usage, promotional items and information that welcomes new customers to our service. Activation typically takes less than ten minutes on our website or through our customer service group, Virgin Mobile At Your Service. Our handsets are intended only for use with our wireless services.

*Virgin Mobile Sugar Mama.* Our Sugar Mama program is a service enhancement and mobile media platform that allows our customers to earn up to 75 minutes in airtime per month by viewing advertisements from several business partners. In the past, our Sugar Mama business partners have included companies, brands and institutions such as American Legacy Foundation, Levi Strauss, Showtime Networks, the U.S. Navy, Sony Pictures, Sony Music Entertainment, Unilever and Microsoft's Xbox. Internet access is required to establish and manage a Sugar Mama account. Customers generally must view an advertisement, rate it and answer a survey to receive airtime awards. As of December 31, 2008, our Sugar Mama program had approximately 900 thousand registered customers.

*Content Related Quality Control.* We have implemented policies to ensure the safety of our content and to safeguard against objectionable material. Our customers are prohibited from using our services for any illegal purpose. They are further prohibited from publishing, copying or reproducing (1) objectionable content or content that is offensive to third parties; (2) content that may infringe upon the patent, trademark or other intellectual property of others; (3) content used for purposes of solicitation of other customers or any other commercial purpose; or (4) content that could be harmful to other customers, such as content containing electronic viruses or worms. We reserve the right to remove any content that we, in our sole discretion, deem to be objectionable and to suspend or terminate the services of those we find to be in violation of our policies.

### *Pricing and Payment*

Our wireless services are intended to be straightforward and easy to use. While our customers have the option of choosing fixed-term postpaid contracts, we do not require them to do so. We offer our products and services on a flat per-minute basis and on a monthly basis for specified quantities of minutes purchased in advance without requiring our customers to enter into long-term contracts or commitments in connection with fixed-term contracts.

*Minute-based plans.* We currently offer two plans under which our customers can pay by the minute. The first offers airtime costing \$0.20 per minute, with the ability for customers to purchase optional add-on packages of minutes, or Minute Packs, costing \$20, \$30 and \$50 per month for 30-day bundles of 200, 400 and 1,000 anytime minutes, respectively. If a customer purchases another Minute Pack within 30 days of the customer's last purchased Minute Pack, the customer may roll forward up to 5,000 unused Minute Pack minutes for an additional 30 days. The second offers airtime costing \$0.10 per minute for a \$6.99 monthly fee. Neither of our prepaid plans feature separate night and weekend rates.

*Monthly plans.* We currently offer several plans under which our customers can purchase airtime in advance on a monthly basis. These plans range from \$24.99 per month for 200 anytime minutes and 500 separate night and weekend minutes to \$79.99 per month for Totally Unlimited Calling.

*Postpaid plans.* We offer postpaid plans to customers under the Helio by Virgin Mobile brand name under which customers pay on a monthly basis for fixed terms up to two years. We currently offer three A La Carte postpaid plans ranging from \$40 for 500 daytime minutes to \$80 for unlimited minutes. We also offer three postpaid All-In plans ranging from \$65 for 500 daytime minutes, unlimited night and weekend minutes and unlimited domestic text, picture, video and instant messaging, in addition to other features, to \$99 for unlimited minutes and unlimited domestic text, picture, video and instant messaging, in addition to other features. We collect certain personal information from postpaid customers which we use for billing purposes, and require such customers to

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have and maintain satisfactory credit to receive and continue to receive our services. We reserve the right to suspend or terminate services to a customer if we determine at any time that payment for services may not be made when due.

***Messaging.*** We currently offer several plans under which our prepaid customers can pay for domestic messaging services either on a monthly basis or per-message basis. Customers may choose from one of the following basic monthly pricing plans for domestic email, text, picture and instant messaging: (1) \$5.00 per month for 200 messages; (2) \$10.00 per month for 1,000 messages; and (3) \$20.00 per month for an unlimited number of email, text, picture and instant messages. Customers using monthly plans which require a registered payment method may choose from one of the following basic monthly pricing plans for domestic email, text, picture and instant messaging: (1) \$5.00 per month for 1,000 messages; and (2) \$10.00 per month for an unlimited number of domestic email, text, picture and instant messages. Customers may also choose to pay by the message, at a rate of \$0.15 per domestic email, text and instant message and \$0.25 per picture message.

***International.*** We provide international voice service that allows our customers to make and receive calls to and from approximately 220 countries worldwide. Customers making international calls are charged an international per-minute rate for each country in addition to the standard airtime rate of the respective customer's applicable plan. In addition, we offer international text messaging services priced on a per message basis. International text messages are \$0.20 to send and \$0.10 to receive. Standard domestic rates apply to calls to Puerto Rico and the United States Virgin Islands.

***Feature Pricing.*** Additional features fall into three general categories: (1) ringtones and other mobile music content; and (2) downloads, including games and graphics; and (3) mobile web browsing. All additional features are priced individually or offered on a daily or monthly subscription basis.

***Top-Up Cards and Payment Methods.*** Our prepaid customers may use Top-Up cards available in increments of \$10, \$20, \$30, \$50, and \$90 to add money to their accounts. Our Top-Up cards are currently offered at approximately 150 thousand third-party retail locations throughout our coverage area. Customers may use Top-Up cards to add cash to their account balances for our prepaid minute based plans, recurring charges for certain of our monthly plans, text and picture messaging and mobile content. For those plans that do not require a registered payment method, customers may also elect to register a credit card, debit card or PayPal account to credit their accounts automatically on a monthly basis or when their accounts reach a specified minimum amount.

***Legacy Pricing Offers.*** In addition to the pricing plans for our products and services described above, approximately 0.9 million of our customers use wireless services under our previous pricing plans, including our prepaid and monthly hybrid plans that predated new offers launched in February 2008, and our other Minute2Minute and Day2Day plans. Customers using our Minute2Minute plan are charged \$0.25 per minute for each of the first 10 minutes of each day, and \$0.10 for every minute thereafter. Customers electing our Day2Day plan are charged \$0.35 per day and pay \$0.10 for each minute of use. These pricing plans are not available to new customers.

## **Sales and Distribution**

We use direct and third-party distribution channels to market our products.

***Direct Distribution Channels.*** Our direct distribution channels consist of our website and Virgin Mobile At Your Service, our toll-free customer care center. Customers may purchase airtime directly from us by using a credit card, debit card or PayPal account or Top-Up card purchased at a third-party retail store, either using their handsets or through our website or customer care center. Customers may also register a credit, debit card or PayPal account with us, which allows them to elect to automatically add minutes to their account (1) once every month on a specified date, (2) once every 90 days, or (3) when their balance falls below \$5 (or, for customers on certain minute-based plans that are no longer available, when their balance (i) falls below \$5 or (ii) 90 days from their last Top-Up, whichever comes first).

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These channels fulfill the needs of a wide range of customers and prospects by providing means of purchasing products and services, replenishment, or Top-Up, as well as account services. As a source of sales, these channels represented approximately 2.42% of our 2008 total new customer additions (through both retail and direct channels). Periodically, we use direct promotions to increase sales in these channels. We advertise these promotions primarily through our online website, through Internet advertisements on third-party websites and through search engine advertising, as well as email and SMS communications to customers to stimulate referrals.

Our website also serves as an effective resource for potential customers to consider our products and services and an efficient channel for potential customers to buy products and activate their accounts as well as for existing customers to manage and service their accounts (adding airtime, changing their service plans, upgrading handsets, browsing and buying mobile content). Our website has low incremental operating costs and no third-party retailer subsidies. As a result, our website assists in reducing our customer acquisition, retention and service costs and is our most cost efficient advertising venue.

*Third-Party Retail Distribution Channels.* Our distribution network includes over 40 thousand stores selling handsets and approximately 150 thousand third-party retail stores selling Top-Up cards in the United States, Puerto Rico and the U.S. Virgin Islands. We intend to continue to expand our distribution network of retail partners.

We rely on four third-party retail distribution channels for product placement within their stores to promote the sale of our handsets to grow our customer base. As of December 31, 2008, we had direct or indirect arrangements with approximately 15 national retailers and a number of regional retailers, including Amazon.com, Best Buy, CVS, K-Mart, Meijer, RadioShack, Rite Aid, Sears, 7-11, Sprint Nextel Stores, Target Stores, Walgreens and Wal-Mart. In the first half of 2008, we entered into three agreements to expand our retail presence, entering new agreements with American Wireless and Sears and expanding our relationship with Wal-Mart. Collectively, these arrangements expanded our retail footprint by approximately two thousand doors in 2008. In addition, we have distribution arrangements with the Internet retailer Amazon.com and with certain other retailers, including Best Buy, RadioShack, Target and Wal-Mart, to offer our products on their websites.

As of December 31, 2008, sales through our third-party retail distribution channels represented approximately 95% of our total sales revenue (consisting of aggregated revenues from sales of our handsets and revenue realized upon use of our Top-Up cards) with Wal-Mart accounting for more than 10% of our total sales revenue. As of December 31, 2008, we also distributed our products through five other distribution agents for independent dealers which collectively represented approximately 11% of the total retail locations offering our products. Under our distribution agreements with these agents, we distribute our handsets and Top-Up cards to approximately 4,700 independent, regional wireless telecommunications dealers and stores.

To manage our relationship with third-party retail distribution channels, we have a dedicated internal sales force of approximately 32 representatives, and we have retained firms to provide regional support services. Our sales force is supplemented by a cross-functional team for each retail account consisting of members of our retail channel implementation, information technology, supply chain, brand, finance and legal teams. We provide our sales representatives with in-depth product and sales training to allow them to explain our products and services simply and clearly. We also have programs to train indirect representatives and retailers sales representatives.

## **Marketing**

Our marketing and promotion activities distinguish and differentiate our brand through a focused and efficient use of communication vehicles based on measured impact. We also develop initiatives that enhance our brand position and differentiate us in the marketplace, such as the RE\*Generation, our charitable campaign, and by sponsoring special events like the annual Virgin Mobile Festival and our sponsorship of the 2009 Britney Spears Circus Tour entitled Virgin Mobile Presents The Circus Starring Britney Spears. Our marketing campaigns, which extend across a variety of traditional, nontraditional and in-store media, promote key

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components of our value proposition and create an engaging dialogue with our prospects and customers. These campaigns are designed to increase consumer awareness, brand affinity, consideration and sales of our products and services. Support points of our overall value proposition include:

Monthly Plans without Annual Contracts that include Totally Unlimited Minutes and Unlimited 7PM Nights and Weekends;

Prepaid Plans without Annual Contracts that offer simple flat-rate minutes or Minute Packs that allow customers to buy minutes and roll forward unused minutes;

Individual and family contract plans featuring a range of 3G handset options, including the Ocean and Ocean 2 handsets, which allow users easy and fast access to social networks and features like Google Maps, Garmin Mobile, MySpace and YouTube;

Unlimited Text and Messaging for as little as \$10 per month;

Comprehensive coverage on the nationwide Sprint PCS network;

No activation fees on prepaid plans;

The ability to adjust or change plans at any time;

Online account management and industry-leading customer service (according to Market Strategies, Inc., approximately 90% of our pre-paid customers are happy with their service and would recommend it to a friend); and

Free minutes earned by our pre-paid customers for watching advertisements on Sugar Mama or through Studio V, our mobile content marketplace where users can create and sell their own mobile content.

As a central component of our marketing approach, we create year-round promotional plans and campaigns with our retail partners (Wal-Mart, Target, RadioShack, Best Buy and others) and assist them in the development of in-newspaper circulars, point-of-sale displays, in-store signage and customized offers that drive channel sales. Key promotional periods include Valentine's Day, Dads and Grads, Back to School and the November/December holiday season.

Our scale allows us to create our own major marketing and branding events, including the Virgin Mobile Festival, an annual music event featuring major performing artists that drew approximately 60 thousand fans in 2008. Our involvement and our presenting sponsorship include sweepstakes rewards, global streaming rights, the ability to sell sponsorships to other brands, on-site brand marketing and product demonstrations at an overall destination for our customers across the country, a distinctive VIP environment to entertain our many retail and trade constituents, and brand placement on all on-site and promotional media related to the event. In 2008, the Virgin Mobile Festival was nominated as U.S. festival of the year by Pollstar, a trade publication covering the worldwide concert industry.

*Social Initiatives.* Our RE\*Generation charitable initiative is primarily dedicated to building awareness about and helping homeless youth. Our focus on this issue is based on extensive research and dialogue with our current and prospective customers regarding the causes about which they care most. The RE\*Generation includes donations and service support to outstanding not-for-profit companies (including Stand Up For Kids and Children's Health Fund), as well as a range of outreach efforts designed to give our customers, prospects, and employees the ability to get involved and help homeless young people through direct donations and the use of our products and services. For example, customers can donate funds from their account or clothing provided by American Eagle Outfitters directly via SMS text messaging. We donate a portion of our net profits from mobile data service downloads to help young people in need, either through direct contributions to our charitable partners,

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additional outreach efforts or by funding the cost of programs that support and raise awareness for young people in need. We believe that it is important to support causes that matter to our customers and that customers who get involved with this initiative are more engaged with our services and brand. According to PR Week and Barkley Public Relations 2007 Cause Survey, more than 70% of consumers have purchased a product because the company brand supports a cause they believe in.

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*Marketing Team.* Our marketing team includes the following groups: (1) Consumer Insight and Marketing, which is responsible for our target audience identification, go-to-market and demand-creation strategies, all aspects of our customer-facing marketing efforts, and execution of our advertising campaigns; (2) Brand Development and Partnerships, which identifies and develops partnership programs and implements our events and sponsorships, including the Virgin Mobile Festival, Virgin Mobile Presents The Circus Starring Britney Spears, mobile ad sales (including Sugar Mama) and The RE\*Generation; (3) Corporate Communications and Public Relations, which is responsible for developing public relations strategies and execution, press-generating events, and cultivation of relationships with traditional and social media; (4) Digital Marketing, Media Planning and Advocacy, which determines our most effective and efficient media mix and is responsible for our channel and media investments, website management, interactive marketing and online sales, and referral marketing; and (5) Brand and Operations, which is responsible for stewardship of the brand and includes an in-house creative services group.

## **Customer Care**

Our customer care organization, known as Virgin Mobile At Your Service, is at the core of the Virgin Mobile brand. Our interactive voice response system, or IVR, operates in English, Spanish and Korean and handles about 180 thousand customer communications each day. The IVR is used by customers to perform many basic service transactions and get answers to frequently asked questions. After a customer's initial selection they can always reach a live advisor if they choose. Our live advisors handle on average 70 thousand telephone calls each day from customers through fully-outsourced call centers in Utah, South Korea, Jamaica, Nicaragua and the Philippines, as well as home-based agents located across the United States. We respond to approximately 1,200 emails each day from customers through our fully outsourced offshore care centers in India and the Philippines. During the seasonal new customer peak activation periods we activated numerous fully-outsourced call centers throughout the world to accommodate the additional volume. Virgin Mobile At Your Service operates 15 hours a day on weekdays and 14 hours a day on weekends, 365 days a year.

We believe we are able to operate our customer care more efficiently than traditional wireless providers because our straightforward and easy to use product and services are designed for low customer maintenance. Approximately 88% of Top-Up transactions in 2008 were completed without the assistance of a customer care representative. As a result, we believe we require significantly fewer customer service representatives per customer than our competitors.

We outsource our call centers under agreements with ICT Group, Inc., Sitel Operating Corp., West Telemarketing Corp., Results Global Services, Teleperformance, and email-based support under an agreement with Patni Computer Systems Inc.

The success of our efforts in customer service is supported by the recognition we have received from third parties and our customers:

Pre-paid customer satisfaction ratings consistently exceed 90%, according to Market Strategies, Inc.

Approximately 90% of our customers would recommend Virgin Mobile to a friend (75% have done so), according to Market Strategies, Inc.

J.D. Power and Associates 2007 Award for Highest Wireless Prepaid Customer Satisfaction; recognized for exceeding industry standards in every surveyed customer service category (Aug. 23, 2007).

Forrester Research's top ranking among National wireless carriers (November 2007 survey of nearly five thousand consumers) with the only excellent rating for ease of use. Virgin Mobile also was ranked highest by consumers for its usefulness and enjoyable customer experience.

J.D. Power and Associates 2006 Award for Highest Wireless Prepaid Customer Satisfaction (Aug. 24, 2006).



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PC Magazine 2008, 2007 and 2006 Reader Choice for Satisfaction with Prepaid Service Providers.

J.D. Power Call Center Customer Satisfaction Excellence Award; recognized for providing an outstanding experience in our call centers nationwide (as compared to all communications providers) 2004.

### **Customer Base Management and Retention**

We actively use customer lifecycle management initiatives to improve customer retention. Within 30 days of activation, all of our customers are scored for their propensity to churn using a statistical model measuring over fifty factors. Using this model, we are able to estimate the churn of our current customers and identify customers with the highest churn propensity. We can then focus lifecycle management spending on higher value, high-risk customers.

We have numerous systemic and outbound call systems in place to ensure that customers are constantly reminded of their balances, to Top-Up or of special offers for high-value customers. We also continuously deploy new lifecycle initiatives. We leverage all available channels to communicate and reinforce the value proposition of our highly competitive voice and data services offerings and deploy churn intervention programs at key lifecycle points utilizing direct marketing techniques. Our key churn reduction initiatives build upon proven successful programs and include: customer education, use of airtime incentives, discounts for replacement of lost, stolen and broken handsets, the recognition of high-value customers and win-back efforts focused on lapsed customers.

Our offerings and brand, combined with our high quality customer care and lifecycle management initiatives, allow us to maintain churn at levels below traditional prepaid levels. Our average monthly rate of customer turnover, or churn for the year ended December 31, 2008 was approximately 5.2%, compared to 4.9% in the year ended December 31, 2007.

### **Network**

Through the nationwide Sprint PCS network, we offer digital wireless services in all 50 states, Puerto Rico and the U.S. Virgin Islands. The nationwide Sprint PCS network offers digital wireless services using wireless code division multiple access, or CDMA, technology. Sprint Nextel's third-party PCS affiliates provide additional PCS service provider network coverage in certain regional U.S. markets on CDMA wireless networks built and operated by such third-party PCS affiliates, in most instances using spectrum licensed to, and controlled by Sprint Nextel and its third-party PCS affiliates.

### **Information Technology**

On July 3, 2008, we signed an outsourcing agreement with IBM, to which we refer in this annual report as the IBM Agreement. We believe that by outsourcing the development and maintenance of our information technology to IBM, we will enhance our technological capabilities and be able to improve our product portfolio for new and existing customers. Our agreement with IBM requires IBM to provide information technology services to us through May 15, 2013. We have the right, but not the obligation, to extend the agreement with IBM for one additional year, to May 15, 2014, if certain conditions are met. In certain circumstances, we may increase or decrease the level of baseline services provided by IBM, along with related payments.

As part of the IBM Agreement, we transitioned our information technology, infrastructure and applications development to IBM's service environment, and 46 of our employees transferred to IBM. We expect to complete the transition of our information technology, infrastructure and applications development to the IBM service environment in the first half of 2009. Prior to July 2008, we developed, procured, licensed, owned or maintained the IT systems required to operate our business.

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Either party can terminate the IBM Agreement early under certain circumstances, but if we terminate the IBM Agreement solely for our convenience, we would be required to pay certain termination fees and wind-down charges. The minimum termination fee that we would be obligated to pay at the beginning of 2009 is approximately \$13.0 million, which decreases over the life of the IBM Agreement. Wind-down charges are defined as non-cancelable lease payments, lease termination fees, certain salaries, benefits, relocation costs, severance costs relating to IBM employees that were formerly our employees, and certain other costs. Wind-down costs cannot be reasonably estimated at this time but could be material to our financial position if we elect to terminate the IBM Agreement.

Our critical IT systems fall into the following categories:

*Voice Processing and Rating Platform.* Our prepaid service enables both our customers and us to manage in real-time customers' accounts by automating the processes of activating new customer accounts, tracking customers' service usage, maintaining credit balances and managing communication sessions.

*Data Rating and Processing Platform.* Our data rating and processing platform enables us to debit money from customers' accounts continuously as services are being purchased and to direct customers to our customer service portal when a low balance threshold is triggered.

*Middleware.* Our customer information management solution automates the end-to-end provisioning, billing and customer care processes.

*Customer Relationship Management System.* As the interface for customer care and customer account management, our customer relationship management system (CRM) enables us to (1) manage our customer account features and lifecycle, (2) store customer and account data, (3) monitor the status of customer accounts, (4) generate messages alerting customers of their account status, and (5) add starter airtime to newly activated customer accounts.

*Value-Added Service Platforms.* We deliver our services through the following value-added service platforms: (1) text messaging, (2) website, (3) WAP portal, (4) content delivery systems, and (5) Interactive Voice Response, or IVR, system. These platforms combine our proprietary technology with technologies provided by IBM and other third-party suppliers.

*Retail Channels.* We manage our retail relationships and channels through the following integrated systems:

*Point of Sale.* Integration between retailer point-of-sale and our systems provides us with the real time ability to unlock handsets and Top-Up cards, minimizing risk of theft and fraud.

*Distribution.* Integration between our systems and distribution center systems allows real time inventory tracking, ordering, reporting and reconciliation to retailers.

*Banking.* Integration between our systems and credit card processing systems enables replenishment, or Top-Up, and other purchase via credit or debit accounts and provides fraud controls and reporting.

*Security and Controls.* Together with IBM, we have implemented a comprehensive information security program utilizing technical, physical and administrative safeguards to protect against reasonably anticipated risks and to ensure compliance with any applicable statutory and regulatory obligations addressing information security protection. We utilize both internal and certified third-party resources to review and monitor adherence to industry and internally established security standards.

## **Supply and Logistics**

*Purchasing.* We rely on outside vendors to produce handsets, accessories, user guides, Top-Up cards, point-of-sale material and product packaging. We provide all content and artwork for packaging and marketing materials. Our purchasing decisions rely on demand forecasts, which we base on communications with retailers, current and target inventory levels and anticipated marketing initiatives.

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*Logistics and warehousing.* We rely on Brightpoint, Inc. ( Brightpoint ), a third-party logistics provider, for warehousing and logistical inventory support. Handset and other inventory providers ship items to Brightpoint, which receives them as a bailee and performs quality assurance activities according to our guidelines. Brightpoint maintains a modern warehouse facility in Plainfield, Indiana and facilitates the distribution of our merchandise and materials to retailers based on our direction.

*Distribution.* Generally, we negotiate and place orders for all handsets, kit accessories, kitting material, Top-Up cards, and point of sale material. Accessories offered via the web and some other miscellaneous items are ordered directly by Brightpoint. Retailers submit their own electronic orders, which we release based on product availability, retail credit status and necessary lead times. Brightpoint packages all items according to our and our retailers' requirements and arranges and monitors all shipments. Once Brightpoint ships orders, we invoice retailers either directly or through an electronic data interface maintained by Brightpoint. We handle all collection functions internally.

*Reverse Logistics.* Brightpoint assists us in processing product returns and customer repair requests. Brightpoint receives all returned products and assesses them according to criteria we provide for product condition and account credits. In some instances, Brightpoint may reprogram handsets or ship them to the handset vendor or to repair facilities.

## **Competition**

The wireless communications industry is extremely competitive and, from a customer entry perspective, increasingly saturated. Wireless communications providers are increasingly competing to provide both voice and non-voice services to this saturated market. We believe that our primary competition in the U.S. wireless communications market comes from national and regional wireless communications providers, including AT&T, Verizon Wireless, T-Mobile, Sprint Nextel, Metro PCS and Cricket. We also face competition from resellers or MVNOs such as TracFone Wireless. The intensity of the competition in the wireless communications industry may affect our performance and results. Non-voice services, including data transmission, text messaging, e-mail and Internet access, are also now available from personal communications service providers and enhanced specialized mobile radio carriers. In many cases, non-voice services are offered in conjunction with or as adjuncts to voice services.

In the future, we may also face competition from entities providing similar services using different technologies, including Wi-Fi, Worldwide Interoperability for Microwave Access, or WiMax, and Voice over Internet Protocol, or VoIP. In addition, other potential competitors have announced plans (or suggested that they intend) to enter the mobile services marketplace. As wireless service becomes a viable alternative to traditional landline phone service, we increasingly compete directly with traditional landline telephone companies for customers and they have begun to advertise aggressively in the face of increasing competition from wireless communications providers, cable operators and other competitors. Cable operators are providing telecommunications services to the home, and some of these carriers are providing local and long distance voice services using VoIP. In particular circumstances, these carriers may be able to avoid payment of access charges to local exchange carriers for the use of their networks on long distance calls. Cost savings for these carriers could result in lower prices to customers and increased competition for wireless services. Some of our competitors offer these other services together with their wireless communications service, which may make their services more attractive to customers. In the future, we may also face competition from mobile satellite service, or MSS, providers, as well as from resellers of these services. The Federal Communications Commission ( FCC ) has granted to some MSS providers, and may grant others, the flexibility to deploy an ancillary terrestrial component to their satellite services. This added flexibility may enhance MSS providers' ability to offer more competitive mobile services. We may also face competition from wireless companies offering femtocells, which are relatively small wireless communications stations potentially suitable for installation in private residences and small businesses to route calls made on a mobile phone over the Internet.

There has also been an increasing trend toward consolidation of wireless communications providers through joint ventures, reorganizations and acquisitions, such as our own acquisition of Helio. These consolidated carriers

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may have substantially larger service areas, more capacity and greater financial resources and bargaining power than we do. As consolidation creates even larger competitors, the advantages held by our competitors may increase.

The wireless communications industry is experiencing significant technological changes, as evidenced by the increasing pace of improvements in the capacity and quality of digital technology, shorter cycles for new products and enhancements and changes in consumer preferences and expectations. Accordingly, we expect competition in the wireless communications industry to be dynamic and intense as a result of the actions of competitors and the development of new technologies, products and services. We compete for customers based on numerous factors, including wireless system coverage and quality, service value proposition (minutes and features relative to price), local market presence, digital voice and features, customer service, distribution strength and brand name recognition. Some competitors also market other services, such as landline local exchange, Internet access services and femtocells, with their wireless service offerings. Competition has caused, and we anticipate will continue to cause, the decline of market prices for two-way wireless products and services. Wireless carriers have begun to offer calling plans with unlimited voice and data services for a flat monthly rate. The introduction of these plans will further pressure prices for mobile wireless services. Our ability to compete successfully will depend, in part, on our ability to distinguish our service from competitors through marketing and through our ability to anticipate and respond to other competitive factors affecting the industry, including new services that may be introduced, changes in consumer preferences, demographic trends, economic conditions, and competitors' discount pricing and bundling strategies, all of which could adversely affect our operating margins, market penetration and customer retention. Many of the wireless communications providers in our markets have substantially greater financial resources than we do, and they may be able to offer prospective customers discounts or equipment subsidies that are substantially greater than those we are able to offer. While we believe that our various plans and our cost structure provide us with the means to react effectively to price competition, we cannot predict the effect that the market forces or the conduct of other operators in the industry will have on our business.

The following table summarizes our major competitors:

| <b>Category</b>                       | <b>Service Provider</b>                                                                   |
|---------------------------------------|-------------------------------------------------------------------------------------------|
| Pure Prepaid                          | Boost Mobile (a product of Sprint Nextel), T-Mobile To Go, AT&T Go Phone, Verizon INpulse |
| Family plans of major providers       | Verizon, AT&T, T-Mobile, Sprint Nextel                                                    |
| Hybrid offerings from major providers | AT&T GoPhone (Pick Your Plan), Verizon Easy Pay                                           |
| Unlimited hybrid offerings            | Cricket, Metro PCS                                                                        |
| MVNOs                                 | TracFone Wireless                                                                         |

The FCC is pursuing policies designed to increase the number of wireless licenses available. For example, the FCC has adopted rules that allow PCS and other wireless licenses to be partitioned, disaggregated and leased. The FCC also continues to allocate and auction additional spectrum that can be used for wireless services. It is possible that new companies, such as cable television, direct broadcast satellite operators, or Internet search engine providers will purchase or lease licenses and begin offering wireless services. In addition, because the FCC has recently permitted the offering of broadband services over power lines, it is possible that utility companies will begin competing against us.

While the U.S. wireless communications market is very competitive, we believe that there are significant obstacles that keep most of the larger providers from directly competing with our service offering. In general, these carriers' umbrella brands have failed to resonate with the youth market, and their strategies are focused on broad markets that include corporate and older customers and postpaid offerings. These providers may risk cannibalizing their existing customer base if they sought to compete more directly with us. In addition, the complexity of existing wireless offerings typically requires significant sales assistance that we believe is neither

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appealing to the youth market nor cost effective. We believe that there are also significant barriers to entry for companies attempting to enter the market with business models similar to ours due to the significant upfront investment to fund operating losses for several years prior to profitability.

We believe that we are strategically positioned to compete with other communications technologies that now exist. Continuing technological advances in telecommunications and FCC policies that encourage the development of new spectrum-based technologies make it difficult, however, to predict the extent of future competition.

## **Regulation**

The FCC has statutory jurisdiction and regulatory authority over the licensing, operation, and offering of wireless services. As an MVNO, many of the FCC's regulations do not apply to us because we do not hold wireless radio licenses or operate network facilities. Our operations, however, are subject to certain FCC regulations since we are considered: (1) a telecommunications carrier, (2) a commercial mobile radio services (CMRS) provider, and (3) a common carrier under the FCC's regulations and the Communications Act of 1934, as amended. As noted below, we are also regulated, to varying degrees, by state and local governments. In addition to others, we are currently subject to the following regulatory programs:

*Universal Service Fund (USF).* The FCC and many state public utility commissions (PUCs) have established USF programs to ensure that affordable telecommunications services are widely available. Funds from these programs are used to reimburse communications carriers that provide subsidized communications to lower-income customers or individuals living in rural areas. All telecommunications carriers must contribute to these funds. The FCC has undertaken a rulemaking proceeding for the comprehensive reform of the manner in which it assesses carrier USF contributions, the methods by which carriers may recover their costs from customers and the system through which USF funds will be distributed among and between states, carriers and services. As part of this proceeding, the FCC has proposed to transition to a connections-based or numbers-based approach for USF contributions. Under such a system, we would be required to contribute a per-connection or per-number flat fee for each connection or number that we serve, which may significantly increase our USF payments and cause us to increase our rates. In its proceeding, the FCC proposed to exclude prepaid wireless carriers from any per-connection or per-number fee, requiring these carriers instead to remit USF payments based on the amount of interstate and international minutes used by customers. No final decision has been made by the FCC in its proceeding. We are unable to predict the effect that any revised regulations adopted in the aforementioned proceeding would have on the expected amount of our USF payments, which could affect our costs of doing business and have a material effect on our business operations and financial results.

We currently remit approximately 11% of our interstate voice revenues to the federal USF program. We have contributed in excess of \$86 million to the USF since our launch in 2002 and, in December 2007, applied for a waiver of certain requirements to become eligible to receive funds to support services to low-income customers. Another wireless reseller already has received a waiver of these requirements from the FCC and currently offers subsidized services to lower-income customers, and other carriers may do so in the future, which may affect our ability to acquire customers for these subsidized services.

*Enhanced 911.* The FCC's enhanced 911 (E911) regulations require CMRS providers to enable emergency services personnel to locate wireless customers according to specified accuracy guidelines. Pursuant to these regulations, the FCC requires us to incorporate E911 features and capabilities into a specified percentage of our handsets. We may not be able to provide E911 services throughout our service area because our ability to offer these services is dependent on Sprint Nextel's deployment of facilities necessary to deliver E911 calls to emergency services personnel. Sprint Nextel's construction of these facilities is occurring on a market-by-market basis as local emergency service agencies become equipped to handle E911 calls.

The FCC has adopted regulations requiring greater accuracy in establishing the location of a wireless subscriber placing an E911 call. Any additional E911 regulations adopted by the FCC may require us to expend additional capital and resources, which may affect our business operations and financial results.

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Many state and local governments have imposed flat, per-customer monthly fees on wireless providers to support implementation of E911 services in their area. We remit these fees in states where we are statutorily required to do so. In the future, other states may extend these requirements to us, or increase the fees that we already remit, which could affect our costs of doing business and have a material effect on our business operations and financial results.

*Customer Privacy and Promotional Activities.* We are subject to various federal and state laws governing the privacy of customers' personal information, including FCC regulations governing customer proprietary network information (CPNI). The FCC has aggressively enforced its CPNI regulations and imposed substantial fines on wireless carriers that have not complied with these regulations. In 2007, the FCC adopted new CPNI regulations and proposed additional regulations on carriers' use and handling of customer records and data. Certain aspects of the FCC's CPNI regulations restrict our ability to use such information for promotional purposes. Material rule changes to the FCC's regulations may impose additional costs on us or require us to make material changes to our business or marketing practices, which may affect our business and financial results.

Additional federal and state laws also limit our ability to contact customers by telemarketing or email to advertise our services. For instance, using its authority under the Telephone Consumer Protection Act of 1991, the FCC has implemented a national do-not-call list to prohibit entities from making telemarketing calls to any customer, absent a relevant exemption, who has included their number on the list. The Federal Trade Commission operates its own national do-not-call list, as do many states. Significant changes to these laws may impact our ability to attract and retain customers.

*Telecommunications Relay Services.* Under federal law, CMRS providers must take steps to enable hearing impaired and other disabled persons to have reasonable access to wireless services. Under these regulations, we currently pay an annual assessment of 0.01012 percent of our interstate voice revenue to the FCC to support relay services for the disabled.

*Hearing-Aid Compatibility.* The FCC requires CMRS providers to offer customers a specified number of digital wireless handsets that are compatible with hearing aids. These regulations require us to incorporate certain hardware and software into our handsets to ensure that our handsets do not interfere with a customer's hearing aid. The incorporation of these features and capabilities into our handsets may increase their cost, which may reduce the demand for our handsets and services.

*State Regulations.* While the Communications Act generally preempts state or local regulation of the market entry or rates charged by wireless carriers, we are subject to a number of PUC regulations that govern the terms and conditions of our offerings, including billing practices, customer disputes and other consumer protection matters.

In addition to the foregoing regulations to which we are subject directly, the nationwide Sprint PCS network operations are subject to regulation by the FCC, as well as state and local governments. Changes to FCC, state or local regulations could affect the wireless coverage Sprint Nextel is able to provide to us. Moreover, changes to any regulations to which we are subject directly or indirectly could create uncertainty in the marketplace that could reduce demand for our services, increase the cost of doing business as a result of costs of litigation or increased service delivery cost or could in some other manner have a material adverse effect on our business, financial condition or results of operations. Any new legislation or regulation, or the application of laws or regulations from jurisdictions whose laws do not currently apply to our business, could have an adverse effect on our business.

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### **Environmental Matters**

We are subject to various federal, state and local environmental protection and health and safety laws and regulations, and we incur costs to comply with those laws. We lease real property, and some environmental laws hold current or previous operators of businesses and real property liable for contamination on that property, even if they did not know of and were not responsible for the contamination. Environmental laws may also impose liability on any person who disposes of hazardous substances, regardless of whether the disposal site is owned or operated by such person. Although we do not currently anticipate that the costs of complying with environmental laws will materially adversely affect us, we cannot ensure that we will not incur material costs or liabilities in the future due to the discovery of new facts or conditions, the occurrence of new releases of hazardous materials or a change in environmental laws.

### **Employees**

As of December 31, 2008, we employed 420 employees. We consider our relationship with our employees to be good. None of our employees are represented by unions. However, union organizing activities may increase and we cannot predict what level of success the unions may have in organizing our employees. See Risk Factors Risks Related to Our Business. The ability to hire and retain qualified personnel and the potential impact of unionization and organizing activities could adversely affect our costs and results of operations.

### **Intellectual Property**

We rely on copyright, patent, trademark and trade secret laws of the United States, as well as non-disclosure agreements, to protect our rights in our intellectual property, or IP.

We offer wireless services in the United States under the Virgin Mobile brand pursuant to an exclusive license from Virgin Enterprises Limited that permits our use of certain federally registered marks, including the trademarks VIRGIN and VIRGIN MOBILE. See Risk Factors Risks Related to Our Business We are dependent on our license agreement with the Virgin Group to use the Virgin Mobile brand and Certain Relationships and Related Transactions Virgin Trademark License Agreement. In addition to these licensed marks, we own 45 registered trademarks (eleven of which were acquired from Helio). These include registrations for trademarks and service marks relating to several service offerings and marketing phrases, such as SUGAR MAMA and OYSTR. The United States Patent and Trademark Office has issued Notices of Allowance or permitted registration for eight additional trademark applications (eight of which were acquired from Helio), has approved publication in the Official Gazette for one additional trademark application and is reviewing an additional seven trademark applications (four of which were acquired from Helio). In addition, we own 106 registered foreign trademarks in 22 countries and ten Community Trademarks, all of which were acquired from Helio. We cannot guarantee that any of our other pending applications will be approved. Moreover, even if the applications are approved, third parties may seek to oppose or otherwise challenge these registrations or our use of these marks.

We have filed several patent applications relating to systems and methods that allow customers of our services to ascertain and replenish their account balances, and we have obtained one patent issued by the Patent and Trademark Office. Although our business is not substantially dependent upon the issuance of patents, we believe that the systems and methods they describe accord us advantages over our competitors. Our competitors may attempt to design around our issued patent or patent applications to avoid infringement liability or copy or otherwise obtain and use our proprietary product and manufacturing process designs and other intellectual property.

### **Company Website and Availability of SEC Filings**

Our Internet website is [www.virginmobileusa.com](http://www.virginmobileusa.com). The content of our website is not deemed to be incorporated by reference into this report nor should it be deemed to have been filed with the Securities and Exchange Commission ( SEC ). We make available free of charge on our website or provide a link on our

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website to our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K, and any amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended (the Exchange Act). Also, recent Section 16 filings with the SEC made by us or any of our executive officers or directors with respect to our Common Stock are made available free of charge through our website. The periodic reports and amendments and the Section 16 filings are made available through our website as soon as reasonably practicable after such report or amendment is electronically filed with the SEC. To access these filings, go to our website, then click on our Investor Relations heading.

### **Item 1A. Risk Factors. Risks Related to Our Business**

*We have a short operating history which may not be indicative of our future performance and, if our revenue and earnings growth are not sustainable, we may not be able to generate the earnings necessary to fund our operations, continue to grow our business or repay our debt obligations.*

We launched our service nationally in July 2002 and had no revenues before that time. Consequently, we have a limited operating and financial history upon which to evaluate our business model, financial performance and ability to succeed in the future. You should consider our prospects in light of the risks we may encounter, including risks and expenses faced by new companies competing in rapidly evolving and highly competitive markets. We cannot be certain that our MVNO business model or any specific products or services will be profitable or competitive in the long-term against larger, facilities-based wireless providers or other MVNOs. We also cannot predict whether our MVNO model will allow us to offer the wireless services that customers may demand in the future. We have experienced, and may continue to experience, significant fluctuations in our revenues and cash flows. If we are unable to achieve sufficient revenues and earnings from operations, our financial results will be adversely affected and we will not have sufficient cash to fund our current operations, sustain the continued growth of our business, satisfy our debt covenants or repay our debt obligations. Failure to satisfy our debt covenants (as has occurred in the past) or make any required payments could result in defaults under our credit agreements. We have experienced, and may continue to experience, operating losses. In the event that we do become profitable, we can provide no assurances that such profitability can or will be sustained in the future.

*Competition in the wireless industry could adversely affect our revenues and profitability.*

The wireless communications market is extremely competitive, and competition for customers is increasing. We compete with (1) facilities-based wireless communications providers and their prepaid affiliates or brands, including Sprint Nextel and its Boost product; and (2) other MVNOs. We also may face competition from providers of an emerging technology known as WiMax, which is capable of supporting wireless transmissions suitable for future mobility applications, devices offering Voice over Internet Protocol, or VoIP, telecommunication services in conjunction with WiFi technology and femtocells, which route mobile calls over the Internet. We do not have any agreements in place that would give us access to these emerging technologies.

Most of our competitors have substantially greater financial, technical, personnel and marketing resources and a larger market share than we do, and we may not be able to compete successfully against them or other wireless communications providers. Due to their size and bargaining power, our larger competitors obtain discounts for facilities, equipment, handsets, content, and services, potentially placing us at a competitive disadvantage. As consolidation in the industry creates even larger competitors, our competitors' purchasing advantages may increase further, hampering our efforts to attract and retain customers. Certain of our competitors may also use their ownership of local wireline telecommunications facilities to introduce service features and calling plans, such as free wireless-to-landline calls, that we are unable to offer at similar cost. Their larger wireless customer bases may make discounted or free in-network calling (that we do not offer currently) more attractive than any similar service that we may offer. This may adversely affect our ability to compete against these competitors in the longer term.



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Other prospective entrants in the wireless communications industry, such as cable operators, now offer bundled local, long distance, high-speed data, and television and video services. The ability of these providers to bundle telecommunications, Internet, and video with wireless services, as well as their financial strength and economies of scale, may enable them to offer wireless services at prices that are lower than the prices at which we can offer comparable services. If we cannot compete effectively with these service providers, our revenues, profits, cash flows and growth may be adversely affected.

The prepaid wireless marketplace has become increasingly competitive, with a number of new entrants providing service. Several of these providers have marketed their services to the youth-oriented customer demographics that we target. Our operating performance and financial results may be adversely affected if we are unable to successfully differentiate our services from those of such competitors.

***We may face competitive pressure to reduce prices for our products and services, which may adversely affect our profitability and other financial results.***

As competition in the U.S. wireless communications industry has increased, providers have lowered prices or increased the number of minutes available under monthly service plans to attract or retain customers. To remain competitive with existing and future competitors, we may be compelled to offer greater subsidies for our handsets, reduce the prices for our services or increase the available minutes that we offer under our prepaid monthly hybrid service plans. Any subsidies or price reductions that we offer in order to remain competitive may reduce our margins and revenues, and may adversely affect our profitability and cash flows. In addition, when existing customers replace their handsets with new handsets, we incur losses related to the subsidy on the new handset without acquiring a new customer. Lower handset prices may also make our services more accessible to new, lower-value customers with less disposable income available to spend on our services. In addition, as handset prices decline and handsets become more disposable, customers without long-term contracts may change their wireless providers more frequently, thereby increasing our churn and resulting in higher acquisition costs to replace those customers. A shift to lower value or less loyal customers could have an adverse impact on our results of operations and cash flows. Those who receive inexpensive handsets as gifts and are not interested in using our service may fail to return them. As a result, we could lose our investment in these customers and handsets.

***Failure to develop future service offerings may limit our ability to compete effectively and grow our business.***

An important part of our business strategy is the development and introduction of new voice and data services. The success of our new service offerings will depend, in part, on our ability to anticipate and respond to varied and rapidly changing customer needs. In order to remain competitive in the U.S. wireless industry, we will need to introduce and commercialize these new services to our market on a timely basis. Our future service offerings may rely on new and unproven technology that may demand substantial capital outlays and utilize significant spectrum capacity. Our services currently depend on the nationwide Sprint PCS network, and we cannot guarantee that Sprint Nextel will make the necessary capital outlays or have sufficient spectrum capacity to deploy new services on that network.

To ensure that our services remain attractive to customers and competitive with those offered by other wireless communications providers, we may be required to modify, change, or adjust our service offerings or introduce new service offerings. For instance, we have launched several monthly hybrid calling plans to compete more effectively with other wireless communications providers. We cannot be certain that our monthly hybrid plans, or future service offerings, will be as profitable or successful as we have envisioned. A substantial portion of our recent gross additions have been under these monthly hybrid plans. We cannot guarantee that the adoption and growth of these monthly hybrid plans will continue or that we will be able to offer services under these monthly hybrid plans in a profitable manner.

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***Higher than expected customer turnover could result in increased costs and decreased revenues, which would have an adverse effect on our profitability.***

Many prepaid wireless service providers, including us, have historically experienced a high rate of customer turnover, or churn. A major element of our business strategy is offering customers wireless services without requiring long-term service contracts. In contrast, postpaid services providers generally require customers to enter into long-term service contracts that impose substantial early termination penalties. Although we offer long-term service contracts, we do not require them, nor do we impose termination penalties on our customers who pay by the minute or use monthly hybrid plans, who account for a substantial majority of our business. Accordingly, our customers can terminate service with us easily and transition to another carrier. We target higher-value customers with others likely to choose to participate in retention programs, which has the effect of reengaging some of these customers and lowering churn. The additional cost of such retention programs, however, results in lower average revenue per user. Although not every company in the wireless communication industry measures churn the same way that we do, we believe that we have a higher churn than those of our competitors which only offer postpaid services. Our churn for the year ended December 31, 2008 was approximately 5.2%. While we expect a certain level of customer turnover, if actual churn levels were to exceed our current forecasts, it could reduce our revenues, cause our operating margins to diminish, and adversely effect profitability. In addition, our marketing costs to attract the replacement customers required to sustain our business plan could increase, further reducing our profits. Our churn may be affected by several factors, including the following:

network coverage and connection quality;

handset and network reliability issues, such as dropped and blocked calls;

handset pricing and selection;

the ability to roam on wireless networks of other carriers;

pricing and affordability of our services;

pricing of competitive services relative to ours; and

customer care performance.

As an MVNO, we do not control network access, network reliability or connection quality. Furthermore, our customers do not have the ability to roam on other wireless networks in areas where the nationwide Sprint PCS network, or those parts of that network provided by Sprint Nextel's third-party PCS affiliates, are not available. These and other factors, which are outside our control, may lead to increased churn.

Additionally, the regulations promulgated by the FCC require wireless providers, including us, to provide wireless number portability to their customers. Under these regulations, wireless providers must transfer, or port, the number of a departing customer to the customer's new wireless carrier. These regulations could lead to increased churn as wireless customers have the ability to retain their wireless telephone numbers despite changing wireless providers.

***We may lose customers if we fail to keep up with rapid technological change occurring in the wireless industry.***

The wireless communications industry is experiencing significant technological change, including ongoing improvements in the capacity and quality of digital technology, the development and commercial acceptance of wireless broadband data services, shorter development cycles for new products and enhancements, and changes in consumer requirements and preferences. These changes may cause uncertainty about future demand for our wireless services and may affect the prices that we will be able to charge for these services. Rapid changes in technology, moreover, may lead to the development of wireless communications services or alternative services that consumers prefer over our services. Our

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operational performance and financial results may be adversely affected if we are unable to deploy future technologies or services on a timely basis or at an acceptable cost.

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In addition, our ability to subsidize handsets is limited because we do not require long-term contracts that may produce a more stable revenue stream. As a result, we do not offer the most expensive or technologically advanced handsets available to the market because the retail price of such handsets would be less attractive to our customers than the handsets we offer without greater subsidies.

***If we encounter problems with our third-party customer service and technical support providers our business will be harmed.***

We outsource a substantial portion of our customer service activities to domestic and international third-party service providers, including service providers in Utah, India, Jamaica, Nicaragua, the Philippines and South Korea. We rely heavily on third-party customer service representatives working on our behalf and we expect to continue to rely heavily on third parties in the future. This strategy provides us with lower operating costs and greater flexibility, but also presents risks to our business, including the following:

Customers may react negatively to providing information to and receiving support from overseas organizations.

We may not be able to impact the quality of support that we provide as directly as we would be able to do in directly administered call centers.

International outsourcing has received considerable negative attention in the media and the U.S. Congress may pass legislation that would impact how we operate and impact customer perceptions of our service. For example, Congress has discussed restricting the flow of personal information to overseas providers and requiring representatives in foreign jurisdictions to affirmatively identify themselves by name and location.

We rely on a global communications infrastructure that may be interrupted in a number of ways. For example, overseas calls may be disrupted if the underwater cables on which they depend are cut or otherwise disabled.

In recent years, India and the Philippines have experienced political instability and changing policies that may affect our operations. In addition, for a number of years India and Pakistan have been in conflict and an active state of war between the two countries could disrupt our services.

***We may consider entering into outsourcing agreements related to certain business operations. Any difficulties experienced in any such arrangements could result in additional expense, loss of customers and revenue, interruption of our services or a delay in the roll-out of new services.***

We have agreements with third parties to provide customer service and related support to our customers and have outsourced many aspects of our customer care and information technology to third parties. In the future, we may also consider entering into outsourcing agreements for the development and maintenance of additional systems necessary for the operation of our business. To the extent that we rely on third parties to perform certain of our operations or interface with our customers, we run the risk that these third parties will be unable to perform to our requirements. If this comes to pass, we would have to pursue alternative strategies to provide these services, which could result in delays, interruptions, additional expenses and loss of customers.

***Our business is seasonal, and we depend on fourth quarter customer additions; our results of operations for future periods will be affected negatively if we fail to deliver strong customer growth in the fourth quarter of any year.***

The prepaid wireless communications business in the United States has traditionally been seasonal and is often disproportionately dependent on fourth quarter results. Our business has experienced a similar pattern and we expect this pattern to continue in the future. If our fourth quarter customer additions fail to meet our expectations, it could adversely affect our results of operations and cash flows.

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***Bulk handset purchase and trading schemes may curtail our ability to offer handsets at subsidized retail prices and thus limit our ability to acquire new customers or result in significant additional costs.***

We acquire new customers in part by offering handsets for sale at significantly subsidized retail prices resulting in a loss to us on handset sales. In recent years, several third parties have purchased our less expensive handsets, reprogrammed them, and resold the handsets in bulk for use on other wireless communications providers' networks. As a result of such bulk purchase and trading schemes, we do not realize wireless services revenue in connection with such handsets, which in the past has resulted in substantial losses to us. In addition, bulk purchases deplete inventory of retail stores available for sale to legitimate customers. We estimate that in 2005, 2006 and 2007, approximately 228 thousand, 322 thousand and 76 thousand of our handsets were bought and resold in bulk, which resulted in a loss of approximately \$25.4 million, \$30.4 million and \$5.2 million, respectively, consisting primarily of loss subsidies and promotional expenses. We do not believe that we incurred material losses stemming from bulk purchasing in 2008. We believe that such bulk purchase and trading schemes constitute breaches of the contractual terms of purchase of our handsets and the use of our services and that many activities of bulk handset traders infringe on our trademark rights, constitute illegal interference with our business, and constitute civil conspiracy, unjust enrichment and unfair competition. While we have aggressively pursued claims against such bulk purchasers, we cannot predict whether our efforts will continue to be effective. We may be forced to raise our handset prices to deter future bulk purchase and trading activities, which may affect our ability to attract new customers. The continued bulk purchase and trading of our handsets may adversely affect our revenues, profitability and cash flows.

***We have a significant amount of debt and are subject to restrictive debt covenants which could have important consequences related to the success of our business.***

As of December 31, 2008, we had \$267.2 million in total debt, including \$197.2 outstanding under our senior secured credit facility (to which we refer as our Senior Credit Agreement) and \$70 million under our subordinated secured revolving credit facility (to which we refer as our Revolving Credit Facility). Since December 31, 2008, we have drawn an additional \$20 million from our Revolving Credit Facility, leaving us with \$287.2 million in total debt. We have used debt to finance a significant portion of our operations. The level of our indebtedness could have important consequences, including:

making it more difficult for us to satisfy our obligations under our debt instruments;

limiting cash flow available for general corporate purposes, including capital expenditures and acquisitions, because a substantial portion of our cash flow from operations must be dedicated to servicing our debt;

limiting our ability to obtain additional debt financing in the future for working capital, capital expenditures or acquisitions;

limiting our flexibility to react to competitive and other changes in our industry and economic conditions generally; and

exposing us to risks inherent in interest rate fluctuations because all of our borrowings are at variable rates of interest.

Our Senior Credit Agreement and our subordinated secured revolving credit facility contain a number of restrictive covenants and require us to maintain specified financial ratios and satisfy certain covenants. In 2005, we failed to satisfy a net service revenue covenant in our prior revolving credit facility, which resulted in a default under that facility and required us to negotiate with our lenders to amend and restate that facility in July 2006. As a result of the default, we had no access to the revolving credit facility provided under our 2005 senior credit facilities, which resulted in a liquidity shortfall in 2006. As a result of the liquidity shortfall, we were unable to make timely payments to Sprint Nextel on amounts owed under the PCS Services Agreement, requiring us to negotiate with Sprint Nextel in order to receive additional time to make such payments and to pay interest on such late payments. In connection with the amendment and restatement of our 2005 senior credit facilities and

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our liquidity shortfall, Sprint Nextel and the Virgin Group provided us with \$100 million under the Revolving Credit Facility, which replaced another \$100 million revolving credit facility that had been previously provided by the third-party lenders under our 2005 senior credit facilities. We used approximately \$45 million of the proceeds from our initial public offering to repay indebtedness owed to Sprint Nextel under the terms of our Revolving Credit Facility. Following such repayment, Sprint Nextel ceased to be a lender under our Revolving Credit Facility and the Virgin Group's commitment under the facility was increased to \$75 million. Accordingly, the maximum borrowing amount under our Revolving Credit Facility was reduced from \$100 million to \$75 million following the initial public offering. In connection with the acquisition of Helio, we entered into amendments to our Senior Credit Agreement and revolving credit facility. The amendment to our Senior Credit Agreement (1) required that the \$50 million of proceeds from the issuance of the Series A Convertible Preferred Stock ( Series A Preferred Stock ) be used to pay down a portion of the outstanding loan balance under our Senior Credit Agreement, (2) increased the interest rate applicable to outstanding balances under our Senior Credit Agreement by 100 basis points, to 5.5% per year, and (3) tightened the leverage ratio covenant by 0.25 times. The amendment to our Revolving Credit Facility increased the Virgin Group's lending commitment thereunder from \$75 million to \$100 million and added SK Telecom as a new lender with a lending commitment of \$35 million.

We cannot assure you that our business will generate sufficient cash flow from operations or that future borrowings will be available to us on acceptable terms or in an amount sufficient to enable us to pay interest or principal on our debt or to fund our other liquidity needs. In addition, our limited tangible assets may further limit our ability to obtain loans or access the debt capital markets. Failure to satisfy our debt covenants or make any required payments could result in defaults under our credit agreements. Our Senior Credit Agreement has a maturity date of December 14, 2010. If we are unable to refinance our debt, it may have a material adverse effect on our business and financial condition.

We may incur significant additional indebtedness from time to time. If we incur additional indebtedness, the related risks we could face would be magnified.

***Our products and services are sold primarily through third-party retail distribution partners, and the success of our business will depend in part on maintaining our relationships with these partners.***

Wireless products and services traditionally have been sold primarily in dedicated wireless retail stores, many branded with the name of the wireless communications provider. We have not operated, and do not plan to operate, branded stores dedicated to our wireless products and services. Instead, we sell our products and services through retail partners, third-party distribution channels and through our website and our customer care center.

Our four largest distribution partners account for a substantial majority of our sales. The success of our business depends in part on maintaining our relationships with these and other distribution partners and the terms of our distribution agreements with these partners. Our distribution agreements with retail partners generally have short terms and do not impose minimum purchase obligations on our distribution partners. We, on the other hand, have long-term supply contracts with manufacturers of our handsets that include significant purchasing commitments.

Accordingly, there is no assurance that our distribution partners will continue to distribute our products or distribute sufficient quantities to match our purchase obligations with our suppliers. If our distribution agreements expire or are terminated or if our distribution partners cease to distribute our products and services, we may not be able to establish alternative distribution channels for our products and services.

***As an MVNO, we are dependent on Sprint Nextel for our wireless network and any disruptions to such network may adversely affect our business and financial results.***

*We are dependent on Sprint Nextel's physical network.* As an MVNO, we do not own spectrum or own or operate a physical network. Sprint Nextel is our exclusive wireless network provider. To be successful, we will need to continue to provide our customers with reliable service over the nationwide Sprint PCS network. We

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rely on Sprint Nextel and its third-party PCS affiliates to maintain their wireless facilities and government authorizations and to comply with government policies and regulations. If Sprint Nextel or its third-party PCS affiliates fail to do so, we may incur substantial losses. Delays or failure to add network capacity, or increased costs of adding capacity or operating the network, could limit our ability to increase our customer base, limit our ability to increase our revenues, or cause a deterioration of our operating margin. Some of the risks related to the nationwide Sprint PCS network and infrastructure include: physical damage to access lines, breaches of security, power surges or outages, software defects and disruptions beyond Sprint Nextel's control, such as natural disasters and acts of terrorism, among others. The PCS Services Agreement with Sprint Nextel does not contain any contractual indemnification provisions relating to network outages or other disruptions. Any impact on the nationwide Sprint PCS network will have an adverse impact on our business and may adversely affect our financial condition, results of operations and cash flows.

*We are dependent on technology used by Sprint Nextel.* Wireless communications technology is evolving rapidly. A significant change in current wireless network technologies or the emergence of alternative technologies could reduce significantly our ability to offer a full range of data services, as compared to our competitors. If Sprint Nextel fails to keep up with these changes, we may lose customers or may not be able to attract new customers. In addition, our PCS Services Agreement with Sprint Nextel presently covers only our access to the nationwide Sprint PCS network using CDMA technology and may limit our ability to access other networks or services offered by Sprint Nextel now or in the future, such as the WiMax network offered through Clearwire, a joint venture between Sprint Nextel and other entities. If Sprint Nextel migrates a significant number of customers to a successor network other than the Clearwire network and ceases activation of new customers on the nationwide Sprint PCS network, or a significant number of Sprint Nextel's activation of new voice and data customers are on a successor network, we will begin negotiations with Sprint Nextel regarding a possible arrangement to provide us with access to that successor network. If at any time Sprint Nextel offers terms and conditions for the use of the successor network that are substantially similar to those under the PCS Services Agreement, we must accept the offer. If after a specified negotiation period, we cannot reach an agreement with Sprint Nextel, or Sprint Nextel has not offered terms for the successor network that are substantially similar to those under the PCS Services Agreement, then we must elect to either (1) use the successor network exclusively at the same level of functionality as the nationwide PCS network at rates fixed at those applicable to us for the services on the CDMA network under the PCS Services Agreement or (2) terminate the agreement and continue to use the CDMA network for a period of approximately two years pursuant to the terms and conditions of the PCS Services Agreement, subject to a cap on rates at those applicable to us as of the beginning of the negotiation period. If we elect to terminate the agreement under (2) above, our exclusivity obligations cease and we may negotiate with other network providers to obtain mobile services during this period and thereafter. We may not be able to negotiate new terms with Sprint Nextel or negotiate for competitive terms with a third-party provider of those services. In all cases, Sprint Nextel reserves the right to discontinue providing services over the CDMA network after expiration of a two-year migration period and we will bear the costs (if any) of migrating end users to a new network if necessary. The PCS Services Agreement does not give us the right to use the WiMax network operated by Clearwire, and we may be unable to deploy 4G services.

*If the PCS Services Agreement is terminated, we may be unable to obtain the wireless services necessary to operate our business.* Our PCS Services Agreement with Sprint Nextel expires in 2027. Sprint Nextel, however, may terminate the PCS Services Agreement prior to the expiration of its term due to various reasons specified in the PCS Services Agreement, including:

breach of the agreement by us;

acquisition of control of us by a specified competitor of Sprint Nextel; or

a specified competitor of the Virgin Group acquires control of us and Virgin Group terminates the Virgin trademark license agreement.

In case of either the expiration or termination of the Sprint PCS Services Agreement, we may be unable to reach a further agreement with Sprint Nextel and its third-party PCS affiliates or with an alternate wireless

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communications provider to obtain the wireless services necessary to operate our business. In addition, transition to an alternative provider is limited to a provider with a CDMA network as our handsets are not capable of operating on all networks. Such a transition could be time-consuming and costly and we could lose a substantial number of customers during the transition period.

*Our dependence on Sprint Nextel is not limited to our use of the nationwide Sprint PCS network. We rely on Sprint Nextel and its third-party PCS affiliates for other critical operational matters, including:*

continued expansion and improvement by Sprint Nextel of the nationwide Sprint PCS network and its third-party PCS affiliates networks, which is expected to require additional investment;

deployment of upgrades and maintenance of the nationwide Sprint PCS network by Sprint Nextel and its third-party PCS affiliates;

maintenance by Sprint Nextel of its relationships with its third-party PCS affiliates;

maintenance by Sprint Nextel and its third-party PCS affiliates of FCC authorizations in good standing;

integration of new services into the nationwide Sprint PCS network;

certification of new handsets for use on the nationwide Sprint PCS network;

compliance with FCC, state E911 and other regulatory requirements;

obtaining telephone numbers;

maintenance of interconnection agreements; and

compliance with applicable laws and regulations including the Communications Assistance for Law Enforcement Act of 1994, or CALEA, network technical requirements.

*We compete with Sprint Nextel's products.* We compete with several of Sprint Nextel's products, including its postpaid products and its prepaid Boost product. In addition, Sprint Nextel may from time to time create products or acquire interests in business that directly or indirectly compete with us. As a result, Sprint Nextel's interests may be different from, or adverse to, ours.

***Sprint Nextel's failure to obtain the proper licenses and governmental approvals from regulatory authorities would cause us to be unable to successfully operate our business.***

The FCC licenses currently held by Sprint Nextel and its third-party PCS affiliates to provide PCS services are subject to renewal and revocation. There is no guarantee that Sprint Nextel's or its third-party PCS affiliates' PCS licenses will be renewed. The FCC requires all PCS licensees to meet certain requirements, including so-called "build-out" requirements, to retain their licenses. Sprint Nextel's or its third-party PCS affiliates' failure to comply with certain FCC requirements in a given license area could result in the revocation of Sprint Nextel's or such third-party PCS affiliates' PCS license for that geographic area.

***We are dependent on our license agreement with the Virgin Group to use the Virgin Mobile brand.***



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We are party to a trademark license agreement with the Virgin Group, to which we refer as the Virgin Trademark License Agreement, pursuant to which we have exclusive rights to use the Virgin Mobile brand for wireless products and services in the United States, Puerto Rico and the U.S. Virgin Islands through 2027. The Virgin Group may terminate the Trademark License Agreement prior to the expiration of its term due to various reasons specified in the agreement, including:

breach of the agreement by us;

acquisition of control of us by certain competitors of the Virgin Group; or

a specified competitor of Sprint Nextel acquires control of us and Sprint Nextel terminates the Sprint PCS Services Agreement.

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Further, we are subject to certain requirements regarding customer service, including levels of overall customer satisfaction. Failure to satisfy these levels may result in termination of the Trademark License Agreement by the Virgin Group.

In case of either the expiration or termination of the Virgin Trademark License Agreement, we may be unable to reach a further acceptable agreement with the Virgin Group. Our inability to use the Virgin Mobile brand would have a material adverse effect on our operations.

***We may be limited in our ability to grow our business and customer base unless we can continue to obtain network capacity at favorable rates and meet the growing demands on our business systems and processes.***

To further expand our MVNO business, we must continue to obtain wireless network capacity at favorable rates and terms, provide adequate customer service and acquire and market a sufficient quantity and mix of handsets and related accessories. Our operating performance and ability to attract new customers may be adversely affected if we are unable to meet the increasing demands for our services in a timely and efficient manner, while adequately addressing the growing demands on our customer service, billing, and other back-office functions. Any change in our ability, or the ability of third parties with whom we contract, to provide these services also could adversely affect our operations and financial performance.

***Our operations and growth could be adversely affected if our wireless data services do not perform satisfactorily.***

We provide text, instant and picture messaging, email, ringtones, streaming music, games, and other wireless data services marketed under the VirginXL and Helio by Virgin Mobile brand names. These non-voice mobile data services represent a significant portion of our revenues. Our future results may be adversely affected if these services are not utilized by a sufficient number of our customers or fail to produce sufficient levels of customer satisfaction and revenues. These services and features may not counter increasing competition and pricing pressure in the wireless voice market or markedly differentiate us from our competitors. We also may not realize our goals successfully if we fail to develop and deploy new wireless data applications for our customers, offer wireless data services profitably, or achieve a satisfactory level of customer acceptance and utilization of our wireless data services.

***Our service offerings may not be successful in the long term.***

Our postpaid and prepaid services may not prove to be successful or profitable in the long term. In addition, a majority of the customers that purchase our prepaid services are lower-income, lower-usage customers. Our long-term success is dependent upon our sustained ability to generate sufficient revenue from our customers based on their use of our services and respond to churn by adding new customers. If we are unable to sustain or increase the revenue that we generate from our existing customers or obtain new customers to replace churned customers, our operational performance and financial results may be adversely affected.

***We rely on third parties for equipment and services that are integral to our business.***

We have entered into agreements with third-party contractors, including Kyocera Wireless Corp., LG Electronics MobileComm U.S.A., Inc., Samsung Electronics America, Inc., Personal Communications Devices LLC and UTStarcom Personal Communications LLC, to provide equipment and services required for our operation, in addition to content development, product distribution, supply chain, handset sourcing, customer care and billing and payment processing. Some of these agreements contain termination provisions that allow for these agreements to be cancelled upon short or no notice. If these contracts are terminated and we are unable to renew them or negotiate agreements for replacement services with other providers at comparable rates, our business will suffer. Our handset inventory is currently acquired from only a few sources. In addition, our ability to control the efficiency, timeliness and quality of the services provided by our third-party contractors is limited.

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***We may be affected by ongoing litigation between QUALCOMM and Broadcom.***

QUALCOMM Incorporated, which licenses CDMA technology to handset manufacturers, is engaged in a patent dispute with Broadcom Corporation. If the parties are unable to resolve their dispute, QUALCOMM is unable to provide non-infringing technological solutions, or our handset providers are unable to obtain licenses to use the CDMA technology at issue, we may be unable to launch certain advanced handset models.

***Our future success will depend in part on our ability to protect our intellectual property rights, and our inability to enforce these rights could cause us to lose sales and any competitive advantage we have.***

Our success depends to a significant degree upon our ability to protect and preserve the proprietary aspects of our products and services and other intellectual property. We rely on the patent, trademark, copyright and trade secret laws of the United States and other countries, as well as nondisclosure agreements, to protect our intellectual property rights. However, we may be unable to prevent third parties from using our technology without our authorization, breaching any nondisclosure agreements with us, or independently developing technology that is similar to ours, particularly in those countries where the laws do not protect our proprietary rights as fully as in the United States. The use of our intellectual property or similar intellectual property by others could reduce or eliminate any competitive advantage we have developed, cause us to lose sales or otherwise harm our business. If it becomes necessary for us to resort to litigation to protect these rights, any proceedings could be burdensome and costly and we may not prevail.

***We depend upon our senior management and our business may be adversely affected if we cannot retain them.***

Our success depends upon the retention of our experienced senior management with specialized industry and technical knowledge. We might not be able to find qualified replacements for the members of our senior management team if their services were no longer available to us; accordingly, the loss of critical members of our senior management team could have a material adverse effect on our ability to effectively pursue our business. We have key person life insurance for Daniel H. Schulman, our chief executive officer, but do not have such insurance for other members of our senior management team.

***Difficulty hiring and retaining qualified personnel, costs associated with any workforce reductions and the potential impact of unionization and organizing activities could have an adverse effect on our costs and results of operations.***

The success of our business depends in large part upon our ability to attract and retain highly skilled, knowledgeable and qualified managerial, professional, technical, sales and customer support personnel. If we are unable to recruit and retain qualified employees our results of operations could be adversely affected. In addition, in order to remain competitive we could decide to further reduce our workforce to better align our cost structure with our economics or to otherwise reduce operating costs or improve efficiencies, which could lead to a decline in employee morale, reduced productivity and increased attrition. Furthermore, we may incur substantial costs relating to severance or similar payments in the event of a workforce reduction.

In addition, union organizing activities may occur, and the adverse impact of unionization and organizing activities on our costs and operating results could be substantial.

***We may consider mergers, acquisitions, strategic investments or other similar investments, which may subject us to integration and other risks.***

Subject to our existing and future contractual obligations, we may from time to time consider mergers, acquisitions, strategic investments or other similar transactions to obtain increased market share or access to new technologies and services. Risks we may encounter include: (1) negotiation of potential acquisitions could cause us to incur significant costs; (2) potential acquisitions may not contribute to our business strategy, or we may pay

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more than the real value of the assets or company being acquired; (3) such acquired assets or operations may not result in sales or profits that justify the investments made in such acquisitions; (4) we may have difficulty assimilating the acquired technologies or products into our products and services; (5) our relationship with current and new employees, customers and distributors could be impaired; (6) our due diligence process may fail to identify technical or legal problems, such as issues with the acquired company's product quality, product structure or relationships with vendors; (7) we may face contingencies related to product liability, intellectual property, financial disclosures, legal claims and accounting practices or internal controls; (8) potential acquisitions may result in litigation from terminated employees or third parties; (9) potential acquisitions may divert our management's attention from our existing operations; and (10) we may be unable to obtain the timely authorizations from governmental authorities to the extent required to complete such potential acquisitions pursuant to competition, antitrust or other laws. These factors could have a material adverse effect on our businesses, results of operations, financial condition or cash flows, particularly in the case of the acquisition of a larger company or a high number of acquisitions. To the extent that we issue additional equity in connection with future acquisitions, existing stockholders may be diluted and earnings per share may decrease. In addition, certain transactions may result in payments to Sprint Nextel and the Virgin Group under their respective tax receivable agreements.

***Our internal controls over financial reporting may not continue to be effective and our independent registered public accounting firm may not be able to certify as to their effectiveness, which could have a significant and adverse effect on our business and reputation.***

We regularly evaluate our internal controls over financial reporting in order to allow management to report on, and our independent registered public accounting firm to attest to, our internal controls over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act of 2002, as amended, and rules and regulations of the SEC thereunder, to which we refer as Section 404. The process of documenting and testing our internal control procedures in order to satisfy the requirements of Section 404 requires annual management assessments of the effectiveness of our internal controls over financial reporting and a report by our independent registered public accounting firm addressing effectiveness of internal controls over financial reporting.

If we fail to maintain the adequacy of our internal controls, as such standards are modified, supplemented or amended from time to time, we may not be able to ensure that we can conclude on an ongoing basis that we have effective internal controls over financial reporting in accordance with Section 404. If this happens, our independent registered public accounting firm will not be able to certify as to the effectiveness of our internal control over financial reporting and we may be subject to sanctions, stock exchange delisting or investigation by regulatory authorities, such as the SEC. As a result, there could be a negative reaction in the financial markets due to a loss of confidence in the reliability of our financial statements. This could harm our reputation and cause us to lose existing customers or fail to gain new customers and otherwise negatively affect our financial condition, results of operations and cash flows. In addition, we may be required to incur costs in improving our internal control system and the hiring of additional personnel.

***If we are unable to effectively manage our inventory held on consignment by our retailers, it could adversely affect our results of operations.***

A significant portion of our inventory is held on consignment by certain of our retail partners. In these consignment locations, we do not have physical possession of the consigned inventory. We therefore have to rely on certain information provided by our retail partners, in addition to periodic inspections, to determine inventory balances on hand at such consignment locations.

Our retail partners who hold inventory on a consignment basis are required to use commercially reasonable procedures to safeguard such goods in their possession and maintain property insurance in negotiated amounts adequate to cover the value of the consigned inventory in their possession. If we are unable to properly monitor, control and manage our inventory or unable to recover in the event of loss or damage to such inventory, we may incur unexpected costs associated with writing off lost or damaged inventory.

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Our consignment agreements include certain rights of our retail partners to return unsold consignment inventory. In certain instances, while we may not be contractually obligated to accept returned consignment inventory, we may determine that it is in our best interest to accept returns in order to maintain good relations with our retail partners. If we are unable to find an alternative channel for distribution of such returned consignment inventory, such returns would increase our expenses and result in lost revenues.

During the years ended December 31, 2008 and 2007, we recorded charges of \$1.2 million and \$3.2 million, respectively, related to consignment inventory. These charges were the result of identified book-to-physical inventory differences related to consigned inventory. If we are unable to effectively manage appropriate consigned inventory levels, we may suffer inventory losses that will reduce our operating income levels. There can be no assurance that any efforts to strengthen our monitoring and management of consigned inventory will be adequate to meaningfully reduce the risk of inventory loss.

### ***Pending civil litigation could have a material adverse effect on us.***

We and certain of our former and current executive officers and directors, as well as our principal shareholders, are defendants in several federal securities class action lawsuits. See Item 3, Legal Proceedings for a more detailed description of these proceedings. These actions remain in preliminary stages and it is not yet possible to determine their ultimate outcome. The plaintiffs in the class action lawsuits seek substantial damages. The legal and other costs associated with the defense of all of these actions, the amount of time required to be spent by management and the Board of Directors on these matters and the ultimate outcome of the litigation may have a material adverse effect on our business, financial condition and results of operations.

### ***Our postpaid business exposes us to increased credit risk.***

In 2008, following our acquisition of Helio, we began to offer postpaid wireless services for the first time. We require our postpaid customers to have satisfactory credit to receive our services, and the success of our postpaid offerings depends on our ability to manage our credit risk while attracting new customers with profitable usage patterns. We have less experience in postpaid than in prepaid wireless services, and there can be no assurance that we will be able to manage our credit risk or generate sufficient revenue to cover our postpaid-related expenses, including losses arising from our customers' failure to make payments when due. Our failure to manage our credit risks may materially adversely affect our profitability and ability to grow.

We evaluate potential postpaid customers and manage their accounts using techniques that are designed to set terms and limits for the credit risk we accept. The techniques we use may not accurately predict future defaults due to, among other things, inaccurate assumptions or models. While we continually seek to improve our assumptions and models, we may make modifications that unintentionally cause them to be less predictive or incorrectly interpret the data produced by these models in setting our credit policies. Our ability to manage credit risk may also be adversely affected by legal or regulatory changes, competitors' actions, consumer behavior, and inadequate collections staffing or techniques.

### ***Recent developments in the U.S. and global financial markets may materially affect our business and financial condition.***

Recent developments in the U.S. and global financial markets have illustrated that the current environment is one of extraordinary and unprecedented uncertainty and instability for many companies. A number of significant transactions and events have occurred with respect to participants in the financial services and insurance industries, including the failure or forced sale of several banks and other institutions and broad scale market intervention by governments in the U.S. and abroad. Global financial markets continue to experience substantial disruptions and liquidity shortages.

The current economic environment has made it difficult for businesses and consumers to obtain credit, which could cause our suppliers, distributors and postpaid customers to have problems meeting their contractual obligations with us. If our suppliers are unable to fulfill our orders or meet their contractual obligations with us, we may not have the services or handsets available to meet the needs of our current and future subscribers, which could cause us to lose current and potential subscribers to other carriers. In addition, if our distributors are unable

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to stay in business, we could lose distribution points, which could negatively affect our business and results of operations. Finally, if our postpaid customers are unable to pay their bills or potential subscribers feel they are unable to take on additional financial obligations, it could negatively affect our results of operations.

The existing market dislocation and the continuation of the global economic downturn could adversely affect consumer spending, the availability of credit to us or to businesses generally and further contribute to an overall weakening of the U.S. and global economies and, consequently, materially and adversely affect our business, financial condition and results of operations.

*The value of our equity securities could continue to be volatile.*

Our Class A common stock has experienced substantial price decline. In addition, the stock market has experienced price and volume fluctuations that have affected the market price of many companies in a manner unrelated to the operating performance of these companies. The overall market and the price characteristics of our common stock may continue to fluctuate greatly. The trading price of our Class A common stock may be significantly affected by various factors, including:

Our results of operations;

Announcements by us or by our competitors of significant events, including acquisitions;

Threatened or pending litigation;

Changes in investors' and analysts' perceptions of our industry, business or any of our competitors' businesses;

Investors' and analysts' assessments of reports prepared or conclusions reached by third parties;

Changes in legislation;

Broader market fluctuations;

General economic or political conditions;

Material internal control weaknesses;

Failure to timely file periodic reports; and

Delisting by the New York Stock Exchange.

Additionally, volatility or a lack of positive performance in our stock price may adversely affect our ability to retain or attract key employees. Many of these key employees are granted stock options and restricted stock, the value of which is dependent on our stock price.

*If we do not meet the New York Stock Exchange listing requirements, our common stock may be delisted.*

## Edgar Filing: Virgin Mobile USA, Inc. - Form 10-K

Our Class A common stock is listed on the New York Stock Exchange, or NYSE, and is subject to various NYSE listing requirements. In November 2008, we received written notice from the NYSE relating to the continued listing standards set forth in Sections 8.02.01B and 8.02.01C of the NYSE Listed Company Manual. Section 8.02.01B requires that the Company's average market capitalization over a consecutive 30 trading-day period equal or exceed \$100 million. As of the end of business on November 11, 2008, the date of the NYSE's review of the current financial condition of the Company, the Company's average market capitalization over the same period was \$89.8 million. In evaluating the Company's average market capitalization, the NYSE took into account 78.4 million Company common shares and their substantial equivalents, including limited partnership interests in our Operating Partnership. Section 8.02.01C requires that a company's listed security average closing price of a security equal or exceed \$1.00 per share over a consecutive 30 trading-day period. Under the NYSE's applicable rules and regulations regarding listed security average closing price, the Company's Class A common stock must, within six months from the Company's receipt of notice pursuant to the listing standards set forth in Section 8.02.01C, maintain an average 30-day trading period closing price equal to or exceeding \$1.00 per share.

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On December 23, 2008, the Company provided, on a confidential basis, the NYSE with a business plan demonstrating its ability to comply with the NYSE's continued listing standards. On January 15, 2009, the NYSE notified the Company that it has accepted the business plan; as a result, the Company has until May 2009 to comply with the share price standard of at least \$1.00 per share and until May 2010 to comply with the market capitalization standard of at least \$100 million, based on the value of Company common shares and their substantial equivalents, including limited partnership interests in our Operating Partnership. The Company will be subject to periodic review by the NYSE during this period.

If we fail to perform according to our business plan or otherwise fail to meet the NYSE listing requirements, the NYSE may suspend trading in our common stock or delist our common stock from the NYSE. Delisting from the NYSE would make trading our Class A common stock more difficult for our investors, leading to declines in share price. Delisting of our Class A common stock may also make it more difficult to raise additional capital.

As of February 28, 2009, our 30 trading day average market capitalization was approximately \$74.2 million and our 30 trading day average stock price was \$0.93.

## **Risks Related to Our Industry**

***Government regulations and taxation could increase our costs, limit our growth, and adversely affect our operations and financial results.***

The licensing, operation and provision of wireless telecommunications systems and services are regulated by the Federal Communications Commission, or FCC, and, depending on the jurisdiction, state and local regulatory agencies. These regulatory authorities have established certain taxes and fees on the providers of wireless services. Although we remit all applicable federal and state regulatory fees, we currently do not recover these regulatory fees or our compliance costs directly from those of our customers who select flat-rate plans. We may decide to pass these costs to all of our customers in the future, however, which may negatively affect our ability to attract and retain customers. Federal, state, and local taxation of our services also significantly increases our cost of doing business and affects our profitability.

The FCC and many states have established universal service fund (USF) programs to ensure that affordable, quality telecommunications services are available to all U.S. residents. Under the FCC's current regulations, carriers, including us, must contribute to the federal USF program a variable percentage of interstate end-user telecommunications revenues. The FCC, however, has indicated that it may transition to a connections-based or numbers-based approach for USF contributions in the near future. Under such a system, carriers would contribute a per-customer flat fee for each connection or number that the carrier serves. While no final decision has been made by the FCC on transitioning to a connections-based or numbers-based USF contribution methodology, any such transition may require us to increase our rates, adversely affecting our profitability and hindering our ability to attract and retain customers. Generally, any connections-based or numbers-based regime that imposes a flat rate for all wireless users, without adjustment for or exception of lower usage customers, would be regressive and may adversely affect our customers, who on average have lower usage levels and lower incomes than those of postpaid services.

The FCC also has adopted rules requiring wireless providers to implement enhanced 911 (E-911) calling capabilities in two phases, the second of which requires carriers to provide automatic customer location information with a specified accuracy. Many state and local governments have imposed flat per-customer fees on wireless providers to support local implementation of this service. Although we remit all applicable E-911 fees, we do not currently recoup E-911 fees directly from those of our customers who select flat-rate plans. Any increase in these fees may affect our operations and require us to raise our service rates, which may affect our ability to attract and retain customers. In the future, we also may seek to recover these fees from all of our customers, which may affect our ability to attract and retain customers. Moreover, any connections-based or numbers-based regime that imposes a flat rate for all wireless users, without adjustment for or exception of lower usage customers, would adversely affect our customers, who on average have lower usage levels and lower incomes than those of postpaid services.



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While Section 332 of the Communications Act of 1934, as amended, generally preempts state and local regulation of wireless services, states have begun to regulate the practices of wireless providers by applying traditional consumer protection requirements to wireless services. The trend toward increasing the amount and applicability of these requirements greatly affects our ability to offer nationwide services. If a significant number of states were to extend consumer protection requirements to wireless services, it would alter significantly our business practices and impose additional costs on us. If we fail to comply with any of these government regulations, we may be subject to monetary sanctions, which could have a material adverse effect on our business.

### ***Circumvention of security systems on our handsets may adversely affect our operational performance and financial results.***

Software installed on handsets sold by many wireless providers, including us, prevents a customer from using a handset sold by one wireless provider on another wireless provider's system. A federal regulation issued by the U.S. Copyright Office in 2007 provides that circumvention of such software, when circumvention is accomplished for the sole purpose of lawfully connecting to a wireless telephone communication network, is exempt from the Digital Millennium Copyright Act's prohibition against circumvention of technological measures that control access to copyrighted works. The U.S. Copyright Office is currently considering whether to extend this exemption for another three-year period.

Like most wireless providers, we subsidize handsets with the expectation that the customer will use the handset on our wireless service and generate sufficient revenue to defray our upfront subsidy. Since we do not impose annual service contracts or early termination penalties, customers may terminate service with us at any time and transition to a new provider. Our financial results could be adversely affected if a significant number of our customers were encouraged by the regulation described above to transition to a new wireless communications provider before we were able to recoup our upfront handset subsidy.

In addition, while this regulation does not prevent us from relying on other legal theories, it has eliminated one claim that otherwise might have been brought against bulk purchasers of our handsets and may impair our ability to deter future bulk purchase and trading activities.

### ***Concern about alleged health risks relating to radio frequency emissions from wireless handsets may harm our prospects.***

There have been suggestions that radio frequency emissions from wireless handsets may be linked to health concerns, including increased incidences of cancer. Although medical reviews have concluded that evidence does not support a finding of adverse health effects as a result of wireless handset use, some studies have suggested that radio frequency emissions may cause certain adverse biological effects. Research on these and other health concerns is ongoing and may demonstrate a link between radio frequency emissions and health concerns.

We and other wireless communications providers may be subject to litigation relating to these and other health concerns, including claims that handsets interfere with various electronic medical devices, such as hearing aids and pacemakers. Concerns over radio frequency emissions may also discourage the use of wireless handsets, which could have a material adverse effect on our business.

### ***We and others in our industry are subject to allegations of intellectual property infringement which, if resolved against us, could reduce our revenues, cause us to lose customers or increase our costs.***

Wireless communications providers have been the subject of third-party allegations of intellectual property rights infringement, and we cannot be certain that our products do not and will not infringe the intellectual property rights of others. In some instances, these third-party allegations have progressed to lawsuits alleging infringement of patent and other rights. We have been and may again be a target of lawsuits alleging that our

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service offerings infringe third parties' intellectual property rights. Any such allegations, whether or not meritorious, could result in costly litigation and divert the efforts of our legal staff and other personnel. While we will seek appropriate assurances and indemnification from vendors, if it is ultimately determined that a third-party has enforceable intellectual property rights with respect to our services, it may adversely affect our results of operations or prevent us from offering our services. If we are found liable for infringement, we may be required to enter into licensing agreements (if available on acceptable terms or at all) or pay damages and cease making or selling certain products. In addition, we may need to redesign some of our service offerings to avoid future infringement liability.

### **Risks Related to Our Organizational Structure**

***Our only material assets are the units of our Operating Partnership, and we are accordingly dependent upon distributions from the Operating Partnership to pay our expenses, taxes and dividends (if and when declared by our Board of Directors).***

Virgin Mobile USA, Inc. is a holding company and has no material assets other than its direct and indirect ownership of partnership units in the Operating Partnership. Virgin Mobile USA, Inc. has no independent means of generating revenue. To the extent that Virgin Mobile USA, Inc. needs funds, and the Operating Partnership is restricted from making such distributions under applicable law or regulation or under any present or future debt covenants, or is otherwise unable to provide such funds, it will materially adversely affect our business, liquidity, financial condition and results of operation.

***Our corporate structure may result in conflicts of interest between our stockholders and the holders of our Operating Partnership units.***

Our corporate structure is similar to that of an umbrella partnership real estate investment trust, or UPREIT, which means that we hold our assets and conduct substantially all of our operations through an operating limited partnership, and may in the future issue limited partnership units to third parties. Persons holding operating partnership units have the right to vote on certain amendments to the partnership agreement of the Operating Partnership, as well as on certain other matters. Persons holding these voting rights may exercise them in a manner that conflicts with the interests of our stockholders. Circumstances may arise in the future when the interests of limited partners in our Operating Partnership conflict with the interests of our stockholders. As we control the general partner of the Operating Partnership, we have fiduciary duties to the limited partners of the Operating Partnership that may conflict with fiduciary duties our officers and directors owe to our stockholders. These conflicts may result in decisions that are not in the best interests of stockholders.

In addition, our amended and restated certificate of incorporation provides that none of SK Telecom, Sprint Nextel nor the Virgin Group (each as defined therein a Founding Stockholder), nor their respective affiliates, has any duty to refrain from (1) engaging, directly or indirectly, in a corporate opportunity in the same or similar lines of business in which we now engage or propose to engage; or (2) doing business with any of our clients, customers or vendors. In the event that any of our Founding Stockholders acquires knowledge of a potential transaction or other business opportunity which may be a corporate opportunity for itself or its affiliates and for us or our affiliates, then our Founding Stockholders have no duty to communicate or offer such transaction or business opportunity to us and may take any such opportunity for themselves or offer it to another person or entity. None of our Founding Stockholders, nor any of their respective officers, directors or employees, shall be liable to us or to any of our stockholders (or any affiliates thereof) for breach of any fiduciary or other duty by engaging in any such activity, and we waive and renounce any claim based on such activity. This provision applies even if the business opportunity is one that we might reasonably be deemed to have pursued or had the ability or desire to pursue if granted the opportunity to do so. Our second amended and restated certificate of incorporation provides that any amendment or repeal of the provisions related to corporate opportunities described above requires the affirmative vote of 80% of the holders of the then-outstanding shares of our common stock.

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***We are required to pay Sprint Nextel for the tax benefits relating to any additional tax depreciation or amortization deductions we may claim as a result of the tax basis step-up we received in connection with our purchase from Sprint Nextel of units in the Operating Partnership concurrently with our initial public offering and subsequent exchanges by Sprint Nextel of its units in the Operating Partnership for shares of our common stock and related transactions with Sprint Nextel.***

*The amounts of the tax benefits we expect to receive and the amounts we will be required to pay may vary. Concurrently with our initial public offering, Sprint Nextel sold a portion of its interest in Virgin Mobile USA, LLC to us in consideration of approximately \$136.0 million (which was paid from the net proceeds to us from the offering). In addition, from time to time, Sprint Nextel may exchange its partnership units in the Operating Partnership for shares of our Class A common stock. Such exchanges may result in increases in the tax bases of the assets of the Operating Partnership that would be allocated to Virgin Mobile USA, Inc. Any increase in tax basis that is attributable to an amortizable asset may reduce the amount of tax that we would otherwise be required to pay in the future. The amount of the benefit realized by us will vary depending on the amount, character and timing of our taxable income and there can be no assurances that any such benefit will be utilizable in whole or in part.*

Concurrently with our initial public offering, we entered into a tax receivable agreement with Sprint Nextel that provided for the payment by us to Sprint Nextel of the amount of the actual cash savings, if any, in U.S. federal, state and local income tax that we actually realize as a result of these increases in tax basis. For purposes of the tax receivable agreement, cash savings in income tax generally will be computed by comparing our income tax liability (assuming no contribution of net operating losses by the Virgin Group) to the amount of such taxes that we would have been required to pay if (1) there had been no increase to the tax basis of the assets of the Operating Partnership as a result of the initial sale and future exchanges, (2) we had not entered into the tax receivable agreement and (3) the Virgin Group had not contributed any net operating losses. This amount will be adjusted under the terms of the tax receivable agreement to the extent that the aggregate hypothetical value of benefits contributed by both the Virgin Group and Sprint Nextel exceeds our actual cash tax savings from such benefits. The term of the tax receivable agreement commenced upon consummation of our initial public offering and will continue until all such tax benefits have been utilized or expired, including the tax benefits derived from future exchanges.

*It is expected that payments to Sprint Nextel will be substantial.* While the actual amount and timing of payments under the tax receivable agreement will depend upon a number of factors, including the timing of the exchanges, the amount and timing of taxable income we generate in the future, our use of net operating loss carryovers, the portion of our payments under the tax receivable agreement constituting imputed interest and increases in the tax basis of our assets resulting in payments to Sprint Nextel, we expect that the payments that may be made to Sprint Nextel will be substantial. Assuming no material changes in the relevant tax law and that we earn significant taxable income to realize the full tax benefit of the increased amortization of our assets, we expect that future payments to Sprint Nextel, in respect of the initial purchase of interests of Virgin Mobile USA, LLC concurrently with our initial public offering, to aggregate approximately \$120.7 million. Future payments to Sprint Nextel in respect of subsequent exchanges would be in addition to this amount and are expected to be substantial. In addition, we will depend on distributions from the Operating Partnership to fund our payment obligations under the tax receivable agreement. Under the terms of the limited partnership agreement of the Operating Partnership, all distributions to fund such obligations are made to the partners pro rata in accordance with their respective percentage ownership interests in the Operating Partnership. Accordingly, every time we cause the Operating Partnership to make a distribution to us in order to fund our payment obligations to Sprint Nextel under the tax receivable agreement, the Operating Partnership will be required to make a corresponding distribution to its other limited partners. The payments under the tax receivable agreement are not conditioned upon Sprint Nextel's continued ownership of us. We may need to incur debt to finance payments under the tax receivable agreement to the extent our cash resources are insufficient to meet our obligations under the tax receivable agreement as a result of timing discrepancies or otherwise.

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In addition, although we are not aware of any issue that would cause the Internal Revenue Service, or IRS, to challenge the tax basis increases or other benefits arising under the tax receivable agreement, Sprint Nextel will not reimburse us for any payments previously made if such basis increases or other benefits are subsequently disallowed, although the amount of any tax savings subsequently disallowed will reduce any future payment otherwise owed to Sprint Nextel. As a result, in such circumstances we could make payments to Sprint Nextel under the tax receivable agreement in excess of our actual cash tax savings.

*The timing of our payments to Sprint Nextel could be accelerated in certain circumstances and could exceed our actual cash savings.* If we undergo a change in control and do not elect to terminate the tax receivable agreement as discussed below, cash savings in income tax will be computed as described above, but with the additional assumption that we have sufficient income in each subsequent year to claim all of the tax benefits attributable to the increase to the tax basis of the assets of the Operating Partnership and to utilize any loss carryovers attributable to such increase in basis. If we or our direct or indirect subsidiary transfers any asset to a corporation with which we do not file a consolidated tax return, we will be treated as having sold that asset in a taxable transaction for purposes of determining the cash savings in income tax under the tax receivable agreement. In addition, prior to agreeing to engage in any business combination, sale or purchase of assets, or reorganization outside the ordinary course of its business which would not constitute a change of control for purposes of the tax receivable agreement and which could adversely affect the expected value of the benefits payable to Sprint Nextel under the tax receivable agreement, we will be required to obtain the consent of Sprint Nextel, which consent may be conditioned upon our agreement to make a make-whole payment to Sprint Nextel to compensate Sprint Nextel for such reduction in benefits. Although not assured, we expect that the consideration that we will remit to Sprint Nextel will not exceed the tax liability that we otherwise would have been required to pay absent the contribution by Sprint Nextel of tax attributes as a result of the reorganization transactions and subsequent exchanges. However, such payments could be substantial and could exceed our actual cash tax savings under the tax receivable agreement.

The tax receivable agreement provides that in the event that we breach any of our material obligations under the tax receivable agreement, whether as a result of our failure to make any payment when due (subject to a specified cure period), failure to honor any other material obligation under the tax receivable agreement or by operation of law as a result of the rejection of the tax receivable agreement in a case commenced under the Bankruptcy Code or otherwise, then all our payment and other obligations under the tax receivable agreement will be accelerated and will become due and payable. Such payments could be substantial and could exceed our actual cash tax savings under the tax receivable agreement. Additionally, we have the right to terminate the tax receivable agreement with respect to previous exchanges (or, in certain circumstances, including if we undergo a change of control, with respect to all previous and future exchanges). If we terminate the tax receivable agreement, our payment and other obligations under the tax receivable agreement will be accelerated and will become due and payable. Although not assured, we expect that the consideration that we will remit to Sprint Nextel will not exceed the tax liability that we otherwise would have been required to pay absent the contribution by Sprint Nextel of tax attributes as a result of the reorganization transactions and subsequent exchanges. However, such payments could be substantial and could exceed our actual cash tax savings under the tax receivable agreement.

***We are required to pay the Virgin Group for the tax benefits relating to certain tax attributes contributed by the Virgin Group to us in connection with the reorganization transactions we undertook concurrently with our initial public offering.***

*The amounts of the tax benefits we expect to receive and the amounts we will be required to pay may vary.* In connection with the reorganization transactions we undertook concurrently with our initial public offering, the Virgin Group contributed to Virgin Mobile USA, Inc. its interest in Bluebottle Investments, which resulted in our receiving approximately \$314.3 million of net operating losses accumulated by Bluebottle Investments. If utilized by us, these net operating losses will reduce the amount of tax that we would otherwise be required to pay in the future. The amount of benefit realized by us may vary depending on the amount, character and timing

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of our taxable income and there can be no assurances that any such benefit will be utilizable in whole or in part. In addition, Section 382 of the Internal Revenue Code of 1986, as amended, imposes an annual limit on the ability of a corporation that undergoes an ownership change to use its net operating losses to reduce its tax liability. We believe an ownership change of Bluebottle Investments occurred as a result of our offering that imposed a limitation on the use of such net operating losses under Section 382.

Concurrently with our initial public offering, we entered into a tax receivable agreement with the Virgin Group that provided for the payment by us to the Virgin Group of the amount of the actual cash savings, if any, in U.S. federal, state and local income tax that we actually realize as a result of the use of these net operating losses. For purposes of the tax receivable agreement, cash savings in income tax generally will be computed by comparing our income tax liability (assuming no step-up in the basis of the assets attributable to exchanges by Sprint Nextel) to the amount of such taxes that we would have been required to pay had such net operating losses not been available to us and assuming no step-up in the basis of the assets attributable to exchanges by Sprint Nextel. This amount will be adjusted under the terms of the tax receivable agreement to the extent that the aggregate hypothetical value of benefits contributed by both the Virgin Group and Sprint Nextel exceed our actual cash tax savings from such benefits. The term of the tax receivable agreement commenced upon consummation of our initial public offering and will continue until all such tax benefits have been utilized or expired.

*It is expected that payments made to the Virgin Group will be substantial.* While payments made under the tax receivable agreement will depend upon a number of factors, the amount and timing of taxable income we generate in the future, our use of additional amortization deductions attributable to our acquisition of units in the Operating Partnership from Sprint Nextel and the portion of our payments under the tax receivable agreement constituting imputed interest, we expect that the payments that may be made to the Virgin Group will be substantial. Assuming no material changes in the relevant tax law and that we earn significant taxable income to realize the full tax benefit of the net operating losses contributed by the Virgin Group, we expect future payments to the Virgin Group to aggregate \$128.9 million. In addition, we depend on distributions from the Operating Partnership to fund our cash payment obligations, if any, under the tax receivable agreement. Under the terms of the limited partnership agreement of the Operating Partnership, all distributions to fund such obligations are made to the partners pro rata in accordance with their respective percentage ownership interests in the Operating Partnership. Accordingly, every time we cause the Operating Partnership to make a distribution to us in order to fund our cash payment obligations to the Virgin Group under the tax receivable agreement, the Operating Partnership will be required to make a corresponding distribution to its other limited partners. The payments under the tax receivable agreement are not conditioned upon the Virgin Group's or its affiliates' continued ownership of us.

In addition, although we are not aware of any issue that would cause the IRS to challenge any benefits arising under the tax receivable agreement, the Virgin Group will not reimburse us for any payments previously made if such benefits were subsequently disallowed, although the amount of any tax savings subsequently disallowed will reduce any future payment otherwise owed to the Virgin Group. As a result, in such circumstances we could make payments to the Virgin Group under the tax receivable agreement in excess of our actual cash tax savings.

*The timing of our payments to the Virgin Group could be accelerated in certain circumstances and our payments could exceed our actual cash savings.* If we undergo a change in control and do not elect to terminate the tax receivable agreement as discussed below, cash savings in income tax will be computed as described above, but with the additional assumption that we have sufficient income in each subsequent year to utilize all of the remaining net operating losses, subject to any applicable limitations on the use of such net operating losses. If we or our direct or indirect subsidiary transfers any asset to a corporation with which we do not file a consolidated tax return, we will be treated as having sold that asset in a taxable transaction for purposes of determining the cash savings in income tax under the tax receivable agreement. In addition, prior to agreeing to engage in any business combination, sale or purchase of assets, or reorganization outside the ordinary course of

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its business which would not constitute a change of control for purposes of the tax receivable agreement and which could adversely affect the expected value of the benefits payable to the Virgin Group under the tax receivable agreement, we will be required to obtain the consent of the Virgin Group, which consent may be conditioned upon our agreement to make a make-whole payment to the Virgin Group to compensate the Virgin Group for such reduction in benefits. Although not assured, we expect that the consideration that we will remit to the Virgin Group will not exceed the tax liability that we otherwise would have been required to pay absent the contribution by the Virgin Group of tax attributes as a result of the reorganization transactions and subsequent exchanges. However, such payments could be substantial and could exceed our actual cash tax savings under the tax receivable agreement.

The tax receivable agreement provides that in the event that we breach any of our material obligations under the tax receivable agreement, whether as a result of our failure to make any payment when due (subject to a specified cure period), failure to honor any other material obligation under the tax receivable agreement or by operation of law as a result of the rejection of the tax receivable agreement in a case commenced under the Bankruptcy Code or otherwise, then all our payment and other obligations under the tax receivable agreement will be accelerated and will become due and payable. Such payments could be substantial and could exceed our actual cash tax savings under the tax receivable agreement. Additionally, we have the right to terminate the tax receivable agreement, in which case our payment and other obligations under the tax receivable agreement will be accelerated and will become due and payable. Although not assured, we expect that the consideration that we will remit to the Virgin Group will not exceed the tax liability that we otherwise would have been required to pay absent the contribution by the Virgin Group of tax attributes as a result of the reorganization transactions and subsequent exchanges. However, such payments could be substantial and could exceed our actual cash tax savings under the tax receivable agreement.

### ***Anti-takeover provisions in our charter documents and Delaware law could delay or prevent a change in control.***

Provisions contained in our amended and restated certificate of incorporation and by-laws may delay or prevent a merger or acquisition that a stockholder may consider favorable by permitting our Board of Directors to issue one or more series of preferred stock, requiring advance notice for stockholder proposals and nominations, placing limitations, with the exceptions of SK Telecom, Sprint Nextel and the Virgin Group, on convening stockholder meetings and not permitting written consents of stockholders. In addition, we are subject to provisions of the Delaware General Corporation Law that restrict certain business combinations with interested stockholders other than SK Telecom, Sprint Nextel and the Virgin Group. These provisions may also discourage acquisition proposals or delay or prevent a change in control, which could harm our stock price.

### ***Because SK Telecom, Sprint Nextel and the Virgin Group collectively control us, the influence of our public stockholders over significant corporate actions will be limited, and conflicts of interest between SK Telecom, Sprint Nextel and the Virgin Group and us or other investors could arise in the future.***

As of March 1, 2009, SK Telecom, Sprint Nextel and the Virgin Group, our Founding Stockholders as defined in our amended and restated certificate of incorporation, beneficially owned interests together representing approximately 61.7% of our voting power. As a result, the Founding Stockholders may together exercise control or significant influence over our decisions to enter into any material corporate transaction and will likely have the ability to prevent any transaction that requires the approval of stockholders regardless of whether or not our other stockholders or debtholders believe that any such transactions are in our own best interests. In addition, the Founding Stockholders have rights with respect to certain actions involving our company. For example, the Founding Stockholders could cause us to make, or prevent us from making, acquisitions that increase our indebtedness or sell revenue-generating assets. We compete with several of Sprint Nextel's products, including its postpaid products and its prepaid Boost product. In addition, the Founding Stockholders may from time to time acquire and hold interests in businesses that compete directly or indirectly with us. The Founding Stockholders also may pursue acquisition or licensing opportunities that may be

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complementary to our business, and as a result, those acquisition opportunities may not be available to us. So long as the Founding Stockholders continue to own a significant amount of our equity, even if such amount represents less than 50% of our voting power, or the rights under the stockholders' agreement continue, they will continue to be able to influence significantly or effectively control our decisions.

*We are deemed a controlled company within the meaning of the New York Stock Exchange rules and, as a result, are exempt from certain corporate governance requirements.*

So long as SK Telecom, Sprint Nextel and the Virgin Group together own a majority of our shares, we will be a controlled company within the meaning of corporate governance standards of NYSE. Under those standards, a company of which more than 50% of the voting power is held by another company or group is a controlled company and need not comply with certain requirements, including (1) the requirement that a majority of the Board of Directors consist of independent directors, (2) the requirement that there be a nominating and corporate governance committee composed entirely of independent directors with a written charter addressing the committee's purpose and responsibilities, (3) the requirement that there be a compensation committee composed entirely of independent directors with a written charter addressing the committee's purpose and responsibilities and (4) the requirement of an annual performance evaluation of the nominating/corporate governance and compensation committees. We intend to utilize each of these exemptions as long as we are eligible to do so. As a result, we do not have a majority of independent directors on our Board of Directors, do not have a nominating and corporate governance committee and our compensation committee does not consist entirely of independent directors. If we are no longer eligible to rely on the controlled company exception, we intend to comply with all applicable corporate governance requirements, but we will be able to rely on phase-in periods for certain of these requirements in accordance with NYSE rules. Accordingly, our stockholders may not have the same protections afforded to stockholders of companies that are subject to all NYSE corporate governance requirements.

### **Item 1B. Unresolved Staff Comments.**

None.

### **Item 2. Properties**

We maintain our corporate headquarters in a leased space in Warren, New Jersey. We lease additional space in Los Angeles, Pasadena and in New York City and, until March 2009, Walnut Creek, California. All of our properties are leased. We believe that our facilities are suitable for their purposes and that additional facilities can be secured for our anticipated needs.

### **Item 3. Legal Proceedings.**

We are subject to legal proceedings and claims arising in the normal course of business. We assess potential liability by analyzing litigation and regulatory matters using available information. We develop views on estimated losses in consultation with outside counsel handling our defense in these matters, which involves an analysis of potential results, assuming a combination of litigation and settlement strategies. We accrue a liability for the matters discussed below if it is probable that a loss contingency exists and the amount of the loss can be reasonably estimated. Should developments in any of these matters cause a change in our determination as to an unfavorable outcome and result in the need to recognize a material accrual, or should any of these matters result in a final adverse judgment or be settled for significant amounts, it could have a material adverse effect on our results of operations, cash flows and financial position in the period or periods in which such change in determination, judgment or settlement occurs.

#### *Intellectual Property Litigation*

*Antor Media Corp. v. Nokia, Inc., et al.* On May 16, 2005, we were named as one of twelve defendants sued in the United States District Court for the Eastern District of Texas for alleged infringement of U.S. Patent No.

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5,734,961, which pertains to a system for transmitting information from a central server to a customer over a network. The plaintiff seeks monetary damages of an amount equal to no less than a reasonable royalty, enhanced damages, attorney fees and a permanent injunction. Nine defendants have since settled. We filed an answer denying infringement and all other claims and have asserted patent invalidity and inequitable conduct as defenses. We have filed counterclaims seeking declaratory judgments of patent invalidity, unenforceability, and non-infringement. The Court stayed the action pending an ongoing reexamination of the relevant patent in the United States Patent and Trademark Office. On August 19, 2008, the Patent and Trademark Office finally rejected all claims in regard to the patent at issue. Antor Media Corp. is seeking to amend the patent claims.

*Minerva Indus., Inc. v. Motorola, Inc. et al.* On June 6, 2007, Minerva Indus., Inc. ( Minerva ) filed this action against Virgin Mobile USA, LLC, Helio LLC and 41 other defendants in the United States District Court for the Eastern District of Texas for alleged infringement of U.S. Patent No. 6,681,120, which relates to a mobile entertainment and communication device. The plaintiff seeks monetary damages of an amount equal to no less than a reasonable royalty, trebled for willful infringement, attorney fees and a permanent injunction. The defendants entered into a joint defense agreement and filed a joint answer to Minerva's complaint on January 7, 2008. A new patent was issued to Minerva on the same day. Minerva filed a new action alleging infringement of the new patent. Discovery is underway. A claim construction hearing has been scheduled for January 6, 2010, with a trial scheduled to begin on June 7, 2010.

*Electronic Data Systems Corp. v. Online Wireless, Inc. et al.* On February 4, 2008, Electronic Data Systems ( EDS ) filed suit against us and five other providers of prepaid wireless services. The lawsuit alleges that the defendants have infringed on two EDS patents, each of which sets forth a system and method that allows a consumer to use a personal computer or ATM machine to purchase prepaid telephone services electronically using funds debited from a designated financial account. EDS seeks an injunction, damages, and costs. The defendants have entered into a joint defense agreement. Discovery is set to commence in September 2009. A claim construction hearing has been scheduled for March 9, 2011, and trial has been scheduled to begin on August 1, 2011. We are seeking indemnification from several sources.

*Intellect Wireless, Inc. v. T-Mobile USA, Inc., et al.* On February 28, 2008, Intellect Wireless, Inc. filed a complaint against us, Helio, Inc. and two other defendants in the United States District Court for the Northern District of Illinois for alleged infringement, contributory infringement, or induced infringement of United States Patent Nos. 7,257,210, 7,305,076, and 7,266,186. The plaintiff alleges that we directly or indirectly infringed the patents by offering wireless plans, packages, and services that include Caller ID, picture messaging, and multimedia messaging services, which it asserts are covered under the subject patents. The plaintiff requests damages equal to no less than a reasonable royalty, attorneys' fees, and a permanent injunction. We have entered into a joint defense agreement with the other defendants in the matter and are seeking indemnification from several sources. Discovery is underway and fact discovery cutoff is set for August 31, 2009.

*MetroPCS Wireless, Inc. v. Virgin Mobile USA, L.P.* On September 19, 2008 MetroPCS Wireless, Inc. ( MetroPCS ) filed a declaratory judgment action in the United States District Court for the Northern District of Texas relating to a program pursuant to which MetroPCS reprograms, or reflashes, non-MetroPCS handsets for use on the MetroPCS wireless network. In a letter dated July 2, 2008 and subsequent correspondence, we demanded that MetroPCS cease and desist from reflashing our handsets. The complaint seeks a judgment declaring, should MetroPCS reflash any of our handsets: (1) that we have no valid Lanham Act trademark infringement claim; (2) that we have no trademark dilution claim; (3) that an exemption to the Digital Millennium Copyright Act preempts contractual terms between us and our customers that prohibit handset reflashing; and (4) that MetroPCS has not tortiously interfered with our contractual relations or prospective business relations. On October 30, 2008, we filed an answer and counterclaims against MetroPCS. The parties engaged in mediation on January 22, 2009, without reaching agreement. On February 3, 2009, MetroPCS filed a motion for partial summary judgment. On February 23, 2009, we filed an opposition to MetroPCS's motion and cross-moved for partial summary judgment.



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*Technology Patents LLC v. Deutsche Telekom, A.G. et al.* On November 9, 2007, Technology Patents LLC ( "Technology Patents" ) filed suit against Helio and other defendants, alleging infringement of two patents that detail a method of delivering text messages internationally using the Internet as a packet-switched network to reach a broadcast mobile network in the destination country. Technology Patents seeks a permanent injunction enjoining the defendants' international text or SMS messaging operations and capabilities in the United States, including an order requiring Helio and other carriers to disable international text messaging in the United States. Technology Patents also seeks damages for past infringement equal to at least a reasonable royalty plus interest and costs. The defendants moved to dismiss the complaint. On August 29, 2008, the Court issued an order denying the motion to dismiss. Discovery is underway and is scheduled to conclude in August 2009, with a claims construction hearing scheduled for December 15, 2009.

### *Trade Secret Litigation*

*BrandPort, Inc. v. Virgin Mobile USA, LLC.* In June 2006, BrandPort, Inc. ( "BrandPort" ) sued us in the Chancery Division of New Jersey Superior Court, Somerset County. BrandPort alleged that, in developing our Sugar Mama program, the Company misappropriated trade secrets and confidential information and breached a nondisclosure agreement. BrandPort seeks compensatory damages for the Company's alleged use of its trade secrets and confidential information. BrandPort lost motions for both a temporary restraining order and a preliminary injunction in 2006. Following discovery, we filed a motion for summary judgment, which was granted in its entirety on July 14, 2008, dismissing all of BrandPort's claims. BrandPort has appealed the decision.

### *Class Action Litigation*

*Belloni et al v. Verizon Communications et al.* We are one of twelve telecommunications carriers named as defendants in a class action lawsuit brought on behalf of a purported class of long distance telephone customers. The amended class action complaint filed in October 2006 in the United States District Court for the Southern District of New York alleges that the defendants unlawfully collected and remitted money to the Internal Revenue Service in the guise of an excise tax that the plaintiffs assert was inapplicable to the services provided. On January 16, 2007, the Judicial Panel on Multidistrict Litigation conditionally transferred the action to the United States District Court for the District of Columbia for coordinated or consolidated pretrial proceedings with related actions. Plaintiffs seek compensatory, statutory and punitive damages in an amount not specified. Plaintiffs generally claim that defendants are liable for the full amount collected from customers and remitted to the government, and damages flowing from the alleged failure to file with the FCC and communicate to the public the non-applicability of the Communications Excise Tax. Plaintiffs also seek attorneys' fees and costs. Subject to consolidation, this action has been stayed.

*Ballas v. Virgin Mobile USA, LLC, Virgin Mobile USA, Inc. and Virgin Media, Inc.* We have been named as a defendant in a putative class action lawsuit commenced on May 21, 2007 in the Supreme Court of the State of New York, Nassau County, brought on behalf of a purported class of individuals who purchased Virgin Mobile-brand handsets within the State of New York. The complaint named us, Virgin Mobile USA, LLC, and Virgin Media, Inc. (which was subsequently dismissed voluntarily from the lawsuit) as defendants. The complaint alleges that defendants failed to disclose, on both their websites and on the retail packaging of Virgin Mobile-brand handsets, the replenishment or Top-Up requirements (the periodic minimum payments required to keep an account active) and the consequences of failing to adhere to them, and further alleges that the retail packaging implies that no such requirements exist. The plaintiff asserts two causes of action, one for breach of contract and one for deceptive acts and practices and misleading advertising under New York General Business Law §§ 349 and 350. The Court granted our motion to dismiss for failure to state a cause of action. On July 7, 2008, the plaintiff initiated an appeal. Following briefing, the appellate court is expected to schedule a hearing on the appeal. Briefing is complete, and oral argument was heard on February 2, 2009.

*Nevels v. AT&T Mobility LLC et al.* We are one of seven defendants named in a class action lawsuit filed on May 14, 2008 in the United States District Court for the Southern District of Mississippi. Plaintiffs seek

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compensatory damages, restitution, attorneys' fees, and other costs under the Communications Act of 1934 based on their allegations that the defendants improperly (1) prohibit customers from disabling text messaging services and (2) charge customers for receipt of unsolicited text messages. On August 29, 2008, we filed a motion to dismiss the complaint. Plaintiffs failed to respond to the motion, and on September 25, 2008, we submitted a Proposed Order to the Court dismissing the complaint.

*Lockyear v. Virgin Mobile USA, Inc. and Virgin Mobile USA, L.P.* On July 10, 2008, two plaintiffs initiated a purported class action lawsuit against us in California state court alleging (1) breach of contract, (2) violations of the California Consumer Legal Remedies Act, (3) violation of California's Unfair Competition Law, (4) unauthorized telephone charges in violation of California's Public Utilities Code, (5) violation of California's Computer Crime Law, (6) unjust enrichment, and (7) trespass to chattels. The allegations relate to allegedly improper billing by us for allegedly unwanted services provided by third party content providers. Plaintiffs seek compensatory and punitive damages, attorneys' fees, costs, and injunctive and declaratory relief. We are investigating the allegations and seeking indemnification from several sources. We will defend itself vigorously against the lawsuit. On December 16, 2008, we filed a demurrer. Oral argument was heard on February 20, 2009, and the demurrer was overruled.

*Conrad v. Virgin Mobile USA, Inc. and Flycell, Inc.* On July 29, 2008, a plaintiff initiated a purported class action lawsuit against us and another defendant in Illinois state court, alleging breach of contract and violations of the Illinois Consumer Fraud and Deceptive Business Practices Act. The allegations, which are nearly identical to those raised in the *Lockyear* matter filed in California state court, allege improper billing for unwanted services provided by third party content providers. Plaintiff seeks actual, consequential, and compensatory damages, as well as injunctive, statutory and/or declaratory relief. We are investigating the allegations and seeking indemnification from several sources. We will defend vigorously against the lawsuit. On December 16, 2008, we moved to dismiss the complaint. The matter was referred to a magistrate judge and, on January 27, 2009, a status conference was held. The motion to dismiss was denied without prejudice pending limited discovery, after which we may seek leave to renew the motion to dismiss.

*Botts v. Virgin Mobile USA, Inc. and Virgin Mobile USA, L.P.* On July 22, 2008, a plaintiff initiated a purported class action lawsuit against us in Florida State Court alleging breach of contract. The allegations, which are nearly identical to those raised in the *Lockyear* matter filed in California state court, relate to allegedly improper billing for allegedly unwanted services provided by third party content providers. Plaintiff seeks actual, consequential, and compensatory damages, as well as injunctive statutory and/or declaratory relief. We are investigating the allegations and seeking indemnification from several sources. We will defend vigorously against the lawsuit. On December 16, 2008, we moved to dismiss the complaint. As of this filing, no briefing schedule on the motion has been set.

*Shivers v. Virgin Mobile USA, Inc., M-Qube, Inc. and Flycell, Inc.* On August 29, 2008, a plaintiff initiated a purported class action lawsuit against us and other defendants in California state court alleging (1) breach of contract, (2) violations of the California Consumer Legal Remedies Act, (3) violation of California's Unfair Competition Law, (4) violation of California's Public Utility Code, (5) unjust enrichment, and (6) tortious interference with a contract. The allegations, which are nearly identical to those raised in the *Lockyear* matter also pending in California state court, allege improper billing for alleged unwanted services provided by third-party content providers. Plaintiffs seek actual, consequential and compensatory damages, as well as injunctive, statutory and/or declaratory relief. We are investigating the allegations and seeking indemnification from several sources. We will defend vigorously against the lawsuit. On December 16, 2008 we filed a demurrer. Oral argument was heard on March 3, 2009. The demurrer has been taken under submission.

### *E911 Litigation*

*Commonwealth of Kentucky v. Virgin Mobile USA, LP.* On October 14, 2008, the Commonwealth of Kentucky filed a complaint in state court seeking to recover e911 charges that it alleges were owed through July 2006. We filed an answer and counterclaims on January 15, 2009. The Commonwealth answered the counterclaims on February 2, 2009, and has served discovery requests.

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*TracFone Wireless, Inc. and Virgin Mobile USA, L.P. v. Commission on State Emergency Communications.* On June 20, 2008, following administrative proceedings, the Texas Commission on State Emergency Communications adopted, with minor modifications, a decision by an administrative law judge holding that state e911 fees apply to prepaid wireless carriers under Texas law. On July 10, 2008, we jointly filed with another prepaid carrier a petition for rehearing, which the Commission rejected. On August 21, 2008, we filed a joint Petition for Judicial Review in Texas state court. A briefing schedule has not yet been set.

*Virgin Mobile USA, LLC v. Arizona Department of Revenue.* We pursued an informal review process with the Arizona Department of Revenue to resolve the issue of whether e911 fees were owed under Arizona law. We were unsuccessful in advancing our position through the informal review process. We are now pursuing formal review with the Office of Administrative Hearings. A hearing was held February 17, 2009. A decision will issue following post-hearing briefing.

### *Securities Litigation*

Plaintiffs filed two class-action federal lawsuits, one in the District of New Jersey and the other in the Southern District of New York, against us, certain of the Company's officers and directors, and other defendants. The suits alleged that the prospectus and registration statement filed pursuant to the Company's IPO contained materially false and misleading statements in violation of the Securities Act of 1933, as amended (the Securities Act), and additionally alleged that at the time of the IPO we were aware, but did not disclose, that results for the third quarter of 2007 indicated widening losses and slowing customer growth trends. On January 7, 2008, we filed a motion to consolidate all cases in the United States District Court for the Southern District of New York for pre-trial purposes. On April 7, 2008, the United States Judicial Panel on Multidistrict Litigation granted the motion and consolidated the cases in the District of New Jersey. On March 17, 2008, the district court judge in the New Jersey matter appointed the New Jersey plaintiffs as lead plaintiffs for the litigation. Plaintiffs filed a consolidated amended complaint on May 16, 2008. On July 15, 2008, we filed a motion to dismiss the amended complaint. Plaintiffs filed an opposition brief on October 6, 2008 and we filed a reply brief on November 5, 2008. On March 9, 2009, the court issued a ruling from the bench denying our motion to dismiss the case.

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

No items were submitted to a vote of security holders during the quarter ended December 31, 2008.

On February 23, 2009, the Company held a Special Meeting of Stockholders, at which Stockholders of the Company were asked to approve:

1. An amendment to the Company's Amended and Restated Certificate of Incorporation to (i) increase the number of authorized shares of Class B common stock from one share to two shares and (ii) add SK Telecom as a Founding Stockholder solely for purposes of Article XI (which addresses certain rights and obligations of the Founding Stockholders of the Company) therein;
2. The issuance of shares of Class A common stock upon conversion of the shares of Series A Preferred Stock issued to the Virgin Group and SK Telecom, and the granting of voting rights to the Virgin Group and SK Telecom with respect to the Series A Preferred Stock; and
3. An amendment to the Company's 2007 Omnibus Incentive Compensation Plan (the Omnibus Plan) to increase the number of shares of Class A common stock designated for issuance thereunder from 7,726,384 shares (including shares previously granted under the Omnibus Plan or its predecessor plans or subject to outstanding awards thereunder) to 12,726,384 shares.

The Stockholders approved each of the foregoing items.

**Table of Contents****PART II****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.**

Shares of our Class A common stock are traded on the NYSE under the listing symbol VM. Trading of our Class A common shares commenced in October 2007 in connection with our initial public offering. Prior to that, there was no public market for our common stock. All of the shares of Class B common stock and Class C common stock are held by Sprint Nextel and the Virgin Group, respectively, and there is currently no public market for these shares.

As of February 28, 2009, we had 65,009,079 shares of Class A common stock outstanding, par value \$0.01 per share, held by approximately 5,700 beneficial owners.

The following table provides, for the period indicated, the range of high and low sale prices per share on the NYSE for our Class A common stock:

| <b>Quarter</b>                                          | <b>High</b> | <b>Low</b> |
|---------------------------------------------------------|-------------|------------|
| Quarter ended December 31, 2007 (from October 10, 2007) | \$ 15.69    | \$ 6.45    |
| Quarter ended March 31, 2008                            | \$ 9.42     | \$ 1.90    |
| Quarter ended June 30, 2008                             | \$ 5.18     | \$ 2.03    |
| Quarter ended September 30, 2008                        | \$ 3.65     | \$ 2.20    |
| Quarter ended December 31, 2008                         | \$ 2.82     | \$ 0.60    |

We have never declared or paid a cash dividend on our common stock and we do not anticipate paying any cash dividends on our common stock in the foreseeable future. Any future determination to pay dividends will be at the discretion of our Board of Directors and will be dependent upon then-existing conditions, including our financial condition and results of operations, contractual restrictions, business prospects and other factors that our Board of Directors considers relevant. Our ability to pay dividends is also restricted by the terms of our respective credit agreements.

**Equity Compensation Plan Information**

The following table provides information as of December 31, 2008 with respect to shares of our Class A common stock issuable under our equity compensation plans.

**Equity Compensation Plan Information**

| <b>Plan category</b>                                       | <b>Number of securities to be issued upon exercise of outstanding options, warrants and rights<br/>(a)</b> | <b>Weighted-average exercise price of outstanding options, warrants and rights<br/>(b)</b> | <b>Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))<br/>(c)**</b> |
|------------------------------------------------------------|------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Equity compensation plans approved by security holders     | 6,288,172*                                                                                                 | \$ 10.72                                                                                   | 376,521                                                                                                                                                      |
| Equity compensation plans not approved by security holders |                                                                                                            |                                                                                            |                                                                                                                                                              |
| <b>Total</b>                                               | <b>6,288,172</b>                                                                                           | <b>\$ 10.72</b>                                                                            | <b>376,521</b>                                                                                                                                               |

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- \* This total excluded 427,650 outstanding Restricted Stock Awards.
  
- \*\* On February 23, 2009, a special meeting of our stockholders was held at which our stockholders approved the amendment of our 2007 Omnibus Incentive Compensation Plan to increase the number of shares of common stock designated for issuance thereunder from 7,726,384 shares (including shares previously granted under the 2007 Omnibus Incentive Compensation Plan or its predecessor plans or subject to outstanding awards thereunder) to 12,726,834 shares, of which 11,374,255 have been granted as of February 28, 2009.

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### **Recent Sales of Unregistered Securities**

On August 22, 2008, we issued 25 thousand shares of Series A Preferred Stock to each of the Virgin Group and SK Telecom for an aggregate investment amount of \$50 million. The issuance of Preferred Stock was not registered under the Securities Act because it was offered and sold in a transaction exempt from registration under Section 4(2) of the Securities Act. On February 23, 2009, a special meeting of our stockholders was held at which our stockholders approved the grant of certain conversion rights to holders of Series A Preferred Stock. As a result of such approval, commencing February 2010, each share of Series A Preferred Stock may be converted into 117.64706 shares of our Class A common stock, reflecting an effective conversion price of \$8.50 per share of Class A common stock, until the fourth anniversary of the original issue date (August 22, 2012) or will be automatically converted into 117.64706 shares of our Class A common stock if the price of our Class A common stock exceeds the conversion price of the Series A Preferred Stock. Assuming no further increase to the number of Class A common shares and assuming full conversion of all outstanding Operating Partnership units into Class A common stock, if all of the Series A Preferred Stock were converted as of December 31, 2008, we would then have had 85,869,649 shares of Class A common stock outstanding (including dividends accrued over the full four-year period), and the Class A common stock issued upon conversion of the Series A Preferred Stock would have represented approximately 8.5% of the outstanding shares after giving effect to the conversion. On a pro forma combined basis, the diluted net income per common share for the year ended December 31, 2008 would have been \$0.13. The Series A Preferred Stock earns dividends at a rate of 6.0% per year, payable semi-annually in kind.

Immediately after the receipt of the investment proceeds in the aggregate amount of \$50 million from the Virgin Group and SK Telecom, we contributed such proceeds to the Operating Partnership through an indirect contribution to Bluebottle Investments and Bluebottle Holdings. The Operating Partnership used such proceeds to pay down outstanding indebtedness under our Senior Credit Agreement, in the amount of \$50 million.

### **Purchases of Equity Securities by the Issuer and Affiliated Purchasers for the period October 1, 2008 through December 31, 2008**

None.

### **Item 6. Selected Financial Data.**

The following table sets forth our selected historical financial and other data as of the dates and for the periods indicated. Virgin Mobile USA, Inc. is a holding company formed in 2007 in connection with our initial public offering, or IPO, which occurred on October 16, 2007. We accounted for our reorganization transactions, for periods prior to our IPO, using a carryover basis, similar to a pooling-of-interest as the reorganization transactions were premised on a non-substantive exchange in order to facilitate the IPO. This is consistent with Financial Accounting Standards Board Technical Bulletin 85-5, *Issues Relating to Accounting for Business Combinations, including Costs of Closing Duplicate Facilities of an Acquirer; Stock Transactions between Companies under Common Control; Down-Stream Mergers, Identical Common Shares for a Pooling of Interests; and Pooling of Interests by Mutual and Cooperative Enterprises*. Under this method of accounting, we treated the companies as if they had always been combined for accounting and financial reporting purposes and, therefore, the consolidated financial statements for the years ended and as of December 31, 2006, 2005, and 2004 are presented on the same basis as that for the years ended and as of December 31, 2008 and 2007. The financial information for the years ended December 31, 2008, 2007 and 2006 and as of December 31, 2008 and 2007 has been derived from our audited consolidated financial statements included elsewhere in this report. The financial information as of December 31, 2006, has been derived from our audited financial statements not included in this report and the financial information for the years ended and as of December 31, 2005 and 2004 has been derived from our accounting records.

Effective December 31, 2008, we elected to change the method of accounting for regulatory fees and tax surcharges, primarily Universal Service Fund, or USF contributions from a net basis to a gross basis in the

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statement of operations. As originally reported, we accounted for USF contributions on a net basis such that the USF remittance to the government agencies was recorded as cost of service and the surcharge for USF collected from customers was recorded as a reduction of cost of service. We changed our accounting policy to account for USF contributions on a gross basis such that the surcharge for USF collected from customers is recorded in net service revenue and remittances to government agencies are recorded in cost of service. This change in accounting policy, which was applied retroactively, increased both net service revenue and cost of service by \$13.3 million, \$12.5 million, \$2.9 million, and \$0.3 million during the years ended December 31, 2008, 2007, 2006, and 2005, respectively. We did not collect any USF from our customers during the year ended December 31, 2004. This change in accounting policy does not change previously reported operating income (loss) or net income (loss).

We use several financial performance metrics, presented below under Other Data (unaudited) including Adjusted EBITDA, Average Revenue Per User, or ARPU, Cash Cost Per User, or CCPU, Cost Per Gross Addition, or CPGA, Adjusted EBITDA margin, Free Cash Flow and Unlevered Free Cash Flow which are not calculated in accordance with Generally Accepted Accounting Principles, or GAAP. A non-GAAP financial metric is defined as a numerical measure of a company's financial performance that (1) excludes amounts, or is subject to adjustments that have the effect of excluding amounts, that are included in the comparable measure calculated and presented in accordance with GAAP in the statement of operations or statement of cash flows or (2) includes amounts, or is subject to adjustments that have the effect of including amounts, that are excluded from the comparable measure so calculated and presented. We believe that the non-GAAP financial metrics that we use are helpful in understanding our operating performance from period to period, and although not every company in the wireless communication industry defines these metrics in precisely the same way, we believe that these metrics as we use them facilitate comparisons with other wireless communication companies. These metrics should not be considered substitutes for any performance metric determined in accordance with GAAP.

The selected historical financial and other data presented below is not indicative of our results for any future periods. You should read the information in the table below in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations, and our historical audited financial statements and the accompanying notes included elsewhere in this report.

**Table of Contents****Virgin Mobile USA, Inc.****Selected Historical Consolidated Financial and Other Data**

(in thousands, except per share amounts and other data unless otherwise indicated)

|                                                                                  | Year Ended December 31, |              |              |              |              |
|----------------------------------------------------------------------------------|-------------------------|--------------|--------------|--------------|--------------|
|                                                                                  | 2008                    | 2007         | 2006         | 2005         | 2004         |
| <b>Statement of Operations Data:</b>                                             |                         |              |              |              |              |
| Operating revenue:                                                               |                         |              |              |              |              |
| Net service revenue                                                              | \$ 1,235,870            | \$ 1,239,533 | \$ 1,022,927 | \$ 884,116   | \$ 567,006   |
| Net equipment and other revenue                                                  | 87,623                  | 85,890       | 90,524       | 106,116      | 123,632      |
| Total operating revenue                                                          | 1,323,493               | 1,325,423    | 1,113,451    | 990,232      | 690,638      |
| Operating expenses:                                                              |                         |              |              |              |              |
| Cost of service (exclusive of depreciation and amortization)                     | 367,104                 | 362,043      | 302,002      | 309,621      | 229,283      |
| Cost of equipment                                                                | 426,249                 | 425,263      | 378,981      | 361,655      | 364,042      |
| Selling, general and administrative (exclusive of depreciation and amortization) | 433,051                 | 446,708      | 401,964      | 346,723      | 253,419      |
| Restructuring                                                                    | 8,972                   |              |              |              |              |
| (Gain) loss from litigation                                                      |                         |              | (15,384)     | 29,981       |              |
| Depreciation and amortization                                                    | 40,128                  | 33,608       | 28,381       | 19,413       | 12,891       |
| Total operating expense                                                          | 1,275,504               | 1,267,622    | 1,095,944    | 1,067,393    | 859,635      |
| Operating income (loss)                                                          | 47,989                  | 57,801       | 17,507       | (77,161)     | (168,997)    |
| Interest expense                                                                 | 33,710                  | 54,988       | 53,822       | 24,594       | 7,567        |
| Interest income                                                                  | (3,001)                 | (1,597)      | (1,642)      | (687)        | (1)          |
| Interest expense net                                                             | 30,709                  | 53,391       | 52,180       | 25,281       | 7,568        |
| Other expense (income)                                                           | 5,686                   | (129)        | 2,268        | 6,223        | (329)        |
| Income (loss) before income taxes and minority interest                          | 11,594                  | 4,539        | (36,941)     | (108,665)    | (176,236)    |
| Income taxes                                                                     | 1,285                   | 321          |              |              |              |
| Income before minority interest                                                  | 10,309                  | 4,218        | (36,941)     | (108,665)    | (176,236)    |
| Minority interest                                                                | 2,364                   |              |              |              |              |
| Net income (loss)                                                                | 7,945                   | 4,218        | (36,941)     | (108,665)    | (176,236)    |
| Preferred stock dividends                                                        | 1,083                   |              |              |              |              |
| Net income (loss) available to common stockholders                               | \$ 6,862                | \$ 4,218     | \$ (36,941)  | \$ (108,665) | \$ (176,236) |
| Earnings (loss) per weighted average common share basic                          | \$ 0.13                 | \$ 0.13      | \$ (1.45)    | \$ (4.49)    | \$ (7.36)    |
| Earnings (loss) per weighted average common share diluted                        | \$ 0.13                 | \$ 0.08      | \$ (1.45)    | \$ (4.49)    | \$ (7.36)    |
| <b>Balance Sheet Data (at period end):</b>                                       |                         |              |              |              |              |
| Cash and cash equivalents                                                        | \$ 12,030               | \$ 19        | \$ 8         | \$ 18,579    | \$ 33        |
| Total assets                                                                     | 367,068                 | 282,039      | 276,947      | 221,232      | 165,394      |
| Total debt                                                                       | 267,174                 | 323,751      | 553,298      | 497,527      | 98,965       |
| Preferred Stock                                                                  | 50,000                  |              |              |              |              |
| Stockholders' deficit                                                            | (355,630)               | (415,199)    | (644,479)    | (622,003)    | (194,532)    |



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## Statement of Cash Flow Data:

Net cash provided by (used in):

|                      |           |           |             |            |             |
|----------------------|-----------|-----------|-------------|------------|-------------|
| Operating activities | \$ 44,493 | \$ 39,649 | \$ (38,874) | \$ (1,721) | \$ (40,528) |
| Investing activities | (15,615)  | (28,443)  | (34,453)    | (33,607)   | (26,288)    |
| Financing activities | (16,867)  | (11,195)  | 54,756      | 53,874     | 66,812      |
| Capital expenditure  | (18,773)  | (28,443)  | (34,453)    | (33,607)   | (26,288)    |

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|                                             | Year Ended December 31, |           |             |             |              |
|---------------------------------------------|-------------------------|-----------|-------------|-------------|--------------|
|                                             | 2008                    | 2007      | 2006        | 2005        | 2004         |
| <b>Other Data: (unaudited)</b>              |                         |           |             |             |              |
| Gross additions (a)                         | 3,305,857               | 3,384,460 | 3,013,781   | 2,666,194   | 2,328,830    |
| Churn (b)                                   | 5.2%                    | 4.9%      | 4.8%        | 4.3%        | 3.9%         |
| Net additions (c)                           | 119,237                 | 511,796   | 729,313     | 993,625     | 1,422,855    |
| End-of-period customers (d)                 | 5,380,310               | 5,085,886 | 4,574,090   | 3,844,777   | 2,851,152    |
| Adjusted EBITDA (in thousands) (e)          | \$ 101,127              | \$ 99,694 | \$ 47,884   | \$ (48,275) | \$ (133,567) |
| Adjusted EBITDA margin (e)                  | 8.2%                    | 8.0%      | 4.7%        | (5.5)%      | (23.6)%      |
| ARPU (f)                                    | \$ 20.30                | \$ 21.24  | \$ 21.54    | \$ 22.54    | \$ 24.24     |
| CCPU (g)                                    | \$ 12.74                | \$ 13.05  | \$ 13.21    | \$ 14.95    | \$ 16.85     |
| CPGA (h)                                    | \$ 108.68               | \$ 111.66 | \$ 120.55   | \$ 118.62   | \$ 131.58    |
| Free Cash Flow (in thousands) (i)           | \$ 25,720               | \$ 11,206 | \$ (73,327) | \$ (35,328) | \$ (66,816)  |
| Unlevered Free Cash Flow (in thousands) (i) | \$ 57,776               | \$ 62,657 | \$ (20,999) | \$ (10,858) | \$ (63,124)  |

- (a) Gross additions represents the number of new customers who activated an account during a period or, in the case of postpaid, the number of new or existing customers who entered into a new long-term contract (rather than an extension of an existing contract), unadjusted for churn during the same period. In measuring gross additions, we begin with account activations and exclude returns, customers who have reactivated and fraudulent activations. Returns include remorse returns for the postpaid business, within 30 days of activation, and retailer returns for the prepaid business, with the timing dependent on the retailer's policy. These adjustments are applied in order to arrive at a more meaningful measure of our customer growth.
- (b) Churn is used to measure customer turnover on an average monthly basis. Churn is calculated as the ratio of the net number of customers who disconnect from our service during the period being measured to the weighted average number of customers during that period, divided by the number of months during the period being measured. The net number of customers who disconnect from our service is calculated as the total number of customers who disconnect less the adjustments noted under gross additions above. These adjustments are applied in order to arrive at a more meaningful measure of churn. The weighted average number of customers is the sum of the average number of customers for each day during the period being measured divided by the number of days in the period. For the prepaid business, churn includes those pay-by-the-minute customers who we automatically disconnect from our service when they have not replenished, or Topped-Up, their accounts for 150 days, as well as those monthly customers who we automatically disconnect when they have not paid their monthly recurring charge for 150 days (except for such monthly customers who are engaged in a retention program or who replenish their account for less than the amount of their monthly recurring charge and, according to the terms of our monthly plans, may continue to use our services on a pay-by-the-minute basis), and such customers who voluntarily disconnect from our service prior to reaching 150 days since replenishing their account or paying their monthly recurring charge. We utilize 150 days in our calculation because it represents the last date upon which a customer who replenishes his or her account is still permitted to retain the same phone number. We also have a service preserver option which allows customers to extend the 150-day period to one year by replenishing their account using an annual top-up. In this case, we will automatically disconnect their service if an additional top-up is not made within 415 days of the qualifying annual top-up. For the postpaid business, churn includes those customers who either disconnect from our service voluntarily or whose service we disconnect for nonpayment. These calculations are consistent with the terms and conditions of our service offering. We believe churn is a useful metric to track changes in customer retention over time and to help evaluate how changes in our business and services offerings affect customer retention. In addition, churn is also useful for comparing our customer turnover to that of other wireless communications providers.
- (c) Net customer additions represents the number of new customers who activated an account during a period or, in the case of postpaid, the number of new or existing customers who entered into a new long-term contract (rather than an extension of an existing contract), adjusted for churn during the same period.
- (d) End-of-period customers are the total number of customers at the end of a given period.
- (e) Adjusted EBITDA is calculated as net income (loss) plus interest expense (net), income tax expense, tax receivable agreements expense, depreciation and amortization (including the amortization of intangibles associated with our acquisition of Helio), write-offs of property

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and equipment, non-cash compensation expense, minority interest, equity issued to a member, debt extinguishment costs and expenses of Bluebottle Investments prior to the completion of the IPO. Beginning in the second quarter of 2008, we updated our definition of Adjusted

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EBITDA to exclude minority interest and write-offs of property and equipment. Although these are all necessary elements of our cost structure, they are customary adjustments in the calculation of supplemental metrics. We believe Adjusted EBITDA is a useful tool in evaluating performance because it eliminates items which do not relate to our core operating performance and provides an indicator which our management uses to evaluate our business. Specifically, our management uses Adjusted EBITDA in their calculation of compensation targets, preparation of budgets and evaluations of performance.

We believe that analysts and investors use Adjusted EBITDA as a supplemental measure to evaluate our company's overall operating performance and that this metric facilitates comparisons with other wireless communications companies. However, Adjusted EBITDA has material limitations as an analytical tool and should not be considered in isolation, as an alternative to net income, operating income or any other measures derived in accordance with GAAP, or as a substitute for analysis of our results as reported under GAAP. The items we eliminate in calculating Adjusted EBITDA are significant to our business: (1) interest expense is a necessary element of our costs and ability to generate revenue because we incur interest expense related to any outstanding indebtedness, (2) to the extent that we incur income tax, it represents a necessary element of our costs and our ability to generate revenue because ongoing revenue generation is expected to result in future income tax expense, (3) depreciation and amortization are necessary elements of our costs, (4) write-offs of property and equipment eliminate non-productive assets from our balance sheet, reconciling it to our earnings, (5) tax receivable agreements expenses are the costs related to our tax receivable agreements, as they are reimbursements to the Virgin Group, for the utilization of net operating loss carryforwards we received as part of the IPO, and to Sprint Nextel, for the increase in tax basis that will be allocated to us, (6) non-cash compensation expense is expected to be a recurring component of our costs and we may be able to incur lower cash compensation costs to the extent that we grant non-cash compensation, (7) minority interest is the income related to the minority owners of Virgin Mobile USA, L.P. and, therefore, not available to our common stockholders, (8) expense resulting from equity issued to a member represents an actual cost relating to a prior contractual obligation, and (9) expenses associated with Bluebottle Investments prior to the IPO. Furthermore, any measure that eliminates components of our capital structure and the carrying costs associated with the property and equipment on our balance sheet has material limitations as a performance measure. Because Adjusted EBITDA is not calculated in the same manner by all companies, it may not be comparable to other similarly titled measures used by other companies.

Adjusted EBITDA margin is used to measure our Adjusted EBITDA performance relative to our net service revenue so that we can gauge the performance of Adjusted EBITDA normalized for the changing scale of our business. Adjusted EBITDA margin is calculated by dividing Adjusted EBITDA by our net service revenue.

| (in thousands, except Adjusted EBITDA margin)             | Year Ended December 31, |                  |                     |                    |                     |
|-----------------------------------------------------------|-------------------------|------------------|---------------------|--------------------|---------------------|
|                                                           | 2008                    | 2007             | 2006<br>(Unaudited) | 2005               | 2004                |
| Net income (loss)                                         | \$ 7,945                | \$ 4,218         | \$ (36,941)         | \$ (108,665)       | \$ (176,236)        |
| Plus:                                                     |                         |                  |                     |                    |                     |
| Depreciation and amortization                             | 40,128                  | 33,608           | 28,381              | 19,413             | 12,891              |
| Interest expense net                                      | 30,709                  | 53,391           | 52,180              | 25,281             | 7,568               |
| Income tax expense                                        | 1,285                   | 321              |                     |                    |                     |
| Tax receivable agreements expense                         | 5,616                   |                  |                     |                    |                     |
| Non-cash compensation expense                             | 12,409                  | 7,423            | 2,563               | 1,475              | 5                   |
| Write-offs of property and equipment                      | 671                     | 450              |                     |                    |                     |
| Bluebottle USA Investments L.P. expenses prior to the IPO |                         | 283              | 232                 | 5,527              | 217                 |
| Equity issued to a member                                 |                         |                  |                     | 7,623              | 21,988              |
| Debt extinguishment costs                                 |                         |                  | 1,469               | 1,071              |                     |
| Minority interest                                         | 2,364                   |                  |                     |                    |                     |
| <b>Adjusted EBITDA</b>                                    | <b>\$ 101,127</b>       | <b>\$ 99,694</b> | <b>\$ 47,884</b>    | <b>\$ (48,275)</b> | <b>\$ (133,567)</b> |
| Net service revenue                                       | \$ 1,235,870            | \$ 1,239,533     | \$ 1,022,927        | \$ 884,116         | \$ 567,006          |
| <b>Adjusted EBITDA Margin</b>                             | <b>8.2%</b>             | <b>8.0%</b>      | <b>4.7%</b>         | <b>(5.5)%</b>      | <b>(23.6)%</b>      |



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- (f) Average revenue per user, or ARPU, is used to measure and track the average revenue generated by our customers on a monthly basis. ARPU is calculated as net service revenue for the period divided by the weighted average number of customers for the period being measured, further divided by the number of months in the period being measured. The weighted average number of customers is the sum of the average customers for each day during that period being measured divided by the number of days in that period. ARPU helps us to evaluate customer performance based on customer revenue and to forecast our future service revenues. As discussed above, net service revenue and ARPU now include the surcharge for USF collected from customers, formerly recorded as a reduction in cost of service.

| (in thousands, except number of months and ARPU) | 2008            | Year Ended December 31, |                     |                 | 2004            |
|--------------------------------------------------|-----------------|-------------------------|---------------------|-----------------|-----------------|
|                                                  |                 | 2007                    | 2006<br>(Unaudited) | 2005            |                 |
| Net service revenue                              | \$ 1,235,870    | \$ 1,239,533            | \$ 1,022,927        | \$ 884,116      | \$ 567,006      |
| Divided by weighted average number of customers  | 5,073           | 4,864                   | 3,957               | 3,268           | 1,949           |
| Divided by number of months in the period        | 12              | 12                      | 12                  | 12              | 12              |
| <b>ARPU</b>                                      | <b>\$ 20.30</b> | <b>\$ 21.24</b>         | <b>\$ 21.54</b>     | <b>\$ 22.54</b> | <b>\$ 24.24</b> |

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- (g) Cash cost per user, or CCPU, is used to measure and track our costs to provide support for our services to our existing customers on an average monthly basis. The costs included in this calculation are our (1) cost of service (exclusive of depreciation and amortization), excluding cost of service associated with initial customer acquisition, (2) general and administrative expenses, excluding Bluebottle Investments general and administrative expenses prior to the IPO, non-cash compensation expenses and write-offs of property and equipment, (3) restructuring expenses, (4) net loss on equipment sold to existing customers, (5) cooperative advertising in support of existing customers and (6) other expense (income), excluding tax receivable agreements expenses, debt extinguishment costs and Bluebottle Investments. These costs are divided by our weighted average number of customers for the period being measured, further divided by the number of months in the period being measured. As discussed above, CCPU now includes USF taxes on a gross basis, with the surcharge collected from customers now reflected in ARPU. CCPU helps us to assess our ongoing business operations on a per customer basis, and evaluate how changes in our business operations affect the support costs per customer. Given its use throughout the industry, CCPU also serves as a standard by which we compare our performance against that of other wireless communications companies.

| (in thousands, except number of months and CCPU)                                                                                     | Year Ended December 31, |                   |                     |                   |                   |
|--------------------------------------------------------------------------------------------------------------------------------------|-------------------------|-------------------|---------------------|-------------------|-------------------|
|                                                                                                                                      | 2008                    | 2007              | 2006<br>(Unaudited) | 2005              | 2004              |
| Cost of service (exclusive of depreciation and amortization)                                                                         | \$ 367,104              | \$ 362,043        | \$ 302,002          | \$ 309,621        | \$ 229,283        |
| Less: Cost of service associated with initial customer acquisition                                                                   | (2,148)                 | (2,261)           | (1,968)             | (3,750)           | (7,367)           |
| Add: General and administrative expenses (excluding Bluebottle USA Investments L.P. expenses prior to the IPO) (1)                   | 336,316                 | 338,548           | 288,414             | 254,989           | 161,269           |
| Add: Restructuring expense                                                                                                           | 8,972                   |                   |                     |                   |                   |
| Less: Non-cash compensation expense                                                                                                  | (12,409)                | (7,423)           | (2,563)             | (1,475)           | (5)               |
| Less: Write-offs of property and equipment                                                                                           | (671)                   | (155)             |                     |                   |                   |
| Add: Net loss on equipment sold to existing customers                                                                                | 77,656                  | 69,026            | 38,042              | 22,291            | 11,259            |
| Add: Cooperative advertising in support of existing customers                                                                        | 549                     | 2,348             | 2,362               | 4,620             |                   |
| Add: Other expense (income), net of tax receivable agreements expense, Bluebottle USA Investments L.P. and debt extinguishment costs | 70                      | (135)             | 799                 | (122)             | (305)             |
| <b>Total CCPU costs</b>                                                                                                              | <b>\$ 775,439</b>       | <b>\$ 761,991</b> | <b>\$ 627,088</b>   | <b>\$ 586,174</b> | <b>\$ 394,134</b> |
| Divided by weighted average number of customers                                                                                      | 5,073                   | 4,864             | 3,957               | 3,268             | 1,949             |
| Divided by number of months in the period                                                                                            | 12                      | 12                | 12                  | 12                | 12                |
| <b>CCPU</b>                                                                                                                          | <b>\$ 12.74</b>         | <b>\$ 13.05</b>   | <b>\$ 13.21</b>     | <b>\$ 14.95</b>   | <b>\$ 16.85</b>   |

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- (1) Bluebottle USA Investments L.P. general and administrative expenses were: \$0, \$277, \$232, \$253, and \$241 for the years ended December 31, 2008, 2007, 2006, 2005 and 2004, respectively.

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- (h) Cost per gross addition, or CPGA, is used to measure the cost of acquiring a new customer. The costs included in this calculation are our (1) selling expenses less cooperative advertising in support of existing customers, (2) net loss on equipment sales (cost of equipment less net equipment revenue), excluding the net loss on equipment sold to existing customers, write-offs of property and equipment and equity issued to a member, and (3) cost of service associated with initial customer acquisition. These costs are divided by gross additions for the period being measured. CPGA helps us to assess the efficiency of our customer acquisition methods and evaluate our sales and distribution strategies. CPGA also allows us to compare our average acquisition costs to those of other wireless communications providers.

| (in thousands, except CPGA)                                       | Year Ended December 31, |                   |                     |                   |                   |
|-------------------------------------------------------------------|-------------------------|-------------------|---------------------|-------------------|-------------------|
|                                                                   | 2008                    | 2007              | 2006<br>(Unaudited) | 2005              | 2004              |
| Selling expenses                                                  | \$ 96,735               | \$ 107,883        | \$ 113,318          | \$ 91,481         | \$ 91,909         |
| Add: Cost of equipment                                            | 426,249                 | 425,263           | 378,981             | 361,655           | 364,042           |
| Less: Net equipment and other revenue                             | (87,623)                | (85,890)          | (90,524)            | (106,116)         | (123,632)         |
| Less: Net loss on equipment sold to existing customers            | (77,656)                | (69,026)          | (38,042)            | (22,291)          | (11,259)          |
| Less: Write-offs of property and equipment                        |                         | (295)             |                     |                   |                   |
| Less: Equity issued to a member                                   |                         |                   |                     | (7,623)           | (21,988)          |
| Less: Cooperative advertising in support of existing customers    | (549)                   | (2,348)           | (2,362)             | (4,620)           |                   |
| Add: Cost of service associated with initial customer acquisition | 2,148                   | 2,261             | 1,968               | 3,750             | 7,367             |
| <b>Total CPGA costs</b>                                           | <b>\$ 359,304</b>       | <b>\$ 377,848</b> | <b>\$ 363,339</b>   | <b>\$ 316,236</b> | <b>\$ 306,439</b> |
| Divided by gross additions                                        | 3,306                   | 3,384             | 3,014               | 2,666             | 2,329             |
| <b>CPGA</b>                                                       | <b>\$ 108.68</b>        | <b>\$ 111.66</b>  | <b>\$ 120.55</b>    | <b>\$ 118.62</b>  | <b>\$ 131.58</b>  |

- (i) Free Cash Flow is a non-GAAP financial measure that is calculated as net cash provided by operating activities less capital expenditures. Free Cash Flow is an indicator of cash generated by our business after operating expenses, capital expenditures and interest expense. Unlevered Free Cash Flow is a non-GAAP financial measure that is calculated as net cash provided by operating activities excluding cash paid for interest, less capital expenditures. Unlevered Free Cash Flow is an indicator of cash generated by our business after operating expenses and capital expenditures and before interest payments. We believe these measures help to (1) evaluate our ability to satisfy our debt and meet other mandatory payment obligations, (2) measure our ability to pursue growth opportunities, and (3) determine the amount of potential cash which may potentially be available to stockholders in the form of stock repurchase and/or dividends subject to the terms and conditions of our Senior Credit Agreement, if we choose to make such dividend payments. Given that our business is not capital intensive, we believe these measures to be of particular relevance and utility. We also use Free Cash Flow and Unlevered Free Cash Flow internally for a variety of purposes, including managing our projected cash needs.

| (in thousands)                                      | Year Ended December 31, |                  |                     |                    |                    |
|-----------------------------------------------------|-------------------------|------------------|---------------------|--------------------|--------------------|
|                                                     | 2008                    | 2007             | 2006<br>(Unaudited) | 2005               | 2004               |
| Net cash provided by (used in) operating activities | \$ 44,493               | \$ 39,649        | \$ (38,874)         | \$ (1,721)         | \$ (40,528)        |
| Less:                                               |                         |                  |                     |                    |                    |
| Capital expenditures                                | (18,773)                | (28,443)         | (34,453)            | (33,607)           | (26,288)           |
| <b>Free Cash Flow</b>                               | <b>25,720</b>           | <b>11,206</b>    | <b>(73,327)</b>     | <b>(35,328)</b>    | <b>(66,816)</b>    |
| Add:                                                |                         |                  |                     |                    |                    |
| Cash paid for interest                              | 32,056                  | 51,451           | 52,328              | 24,470             | 3,692              |
| <b>Unlevered Free Cash Flow</b>                     | <b>\$ 57,776</b>        | <b>\$ 62,657</b> | <b>\$ (20,999)</b>  | <b>\$ (10,858)</b> | <b>\$ (63,124)</b> |



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

*The following discussion should be read in conjunction with our financial statements and related footnotes included elsewhere in this annual report. This discussion contains forward-looking statements that are subject to known and unknown risks and uncertainties. Actual results and the timing of events may differ significantly from those expressed or implied in such forward-looking statements due to a number of factors, including those included in Item 1A. Risk Factors.*

### **Company Overview**

We are a leading national provider of wireless communications services, offering prepaid services and, following the acquisition of Helio, postpaid services targeted at the youth market. Our customers are attracted to our products and services because of our flexible terms, easy to understand and value-oriented pricing structures, stylish handsets offered at affordable prices and relevant mobile data and entertainment content. Our prepaid product and service offerings have no annual contract or credit check and we attract a wide range of customers, approximately half of whom are ages 35 and under. Our voice and data plans allow our customers to talk, use text messaging, picture messaging, email and instant messaging on a per usage basis or according to the terms of our monthly hybrid plans. Following the acquisition of Helio on August 22, 2008, we began to offer postpaid voice and data plans, some with two-year contracts, for both individuals and families.

Founded as a joint venture between Sprint Nextel and the Virgin Group, we launched our service nationally in July 2002. As of December 31, 2008, we served 5.38 million customers, a 5.8% increase over the 5.09 million customers we served as of December 31, 2007. We achieved our second consecutive year of profitability with net income of \$7.9 million in 2008 compared to net income of \$4.2 million in 2007 and a net loss of \$36.9 million in 2006. On August 22, 2008, we acquired Helio, a provider of postpaid wireless products and services, with a customer base of approximately 170 thousand. The acquisition of Helio allowed us to offer high-value postpaid services and to acquire a unique and differentiated set of data applications that we expect to offer across our customer base. In addition, in connection with the acquisition of Helio, we: (1) revised the terms of our PCS Services Agreement with Sprint Nextel, which we currently expect will reduce our effective per-minute network cost in 2009; (2) received additional investments of \$25 million from each of the Virgin Group and SK Telecom, in exchange for our issuance of Series A Convertible Preferred Stock, or the Series A Preferred Stock; (3) used the \$50 million of proceeds from the issuance of our Series A Preferred Stock to repay a portion of the borrowings outstanding under our senior secured credit facility, or Senior Credit Agreement; (4) increased the borrowing availability under our subordinated secured revolving credit facility, or Revolving Credit Facility, from \$75 million to \$135 million, through additional commitments of \$25 million by the Virgin Group and \$35 million by SK Telecom; and (5) added SK Telecom as a strategic stockholder entitled to two seats on our Board of Directors.

Our products and services are marketed under the Virgin Mobile brand and for a short transition period, the Helio brand, using the nationwide Sprint PCS network. We have exclusive rights to use the Virgin Mobile brand, which enjoys strong brand awareness, for mobile voice and data services, through 2027 in the United States, Puerto Rico and U.S. Virgin Islands through a trademark license agreement with the Virgin Group. We control our customers' experience and all customer touch points, including brand image, web site, retail merchandising, service and product pricing, mobile content options, marketing, distribution and customer care, but as a mobile virtual network operator, or MVNO, we do not own or operate a physical network, which frees us from related capital expenditures. This allows us to focus our resources and compete effectively against the major national wireless providers in our target market. We focus primarily on wireless consumers who use 200 to 1,000 minutes per month. According to Market Tools, 70% of wireless consumers use fewer than 1,000 minutes per month. According to Nielsen Mobile, prepaid subscribers average 425 minutes of calling per month.

We operate in the highly competitive and regulated wireless communications industry. The primary bases of competition in our industry are the prices, types and quality of products and services offered. As the wireless communications industry continues to grow and consolidate, we continually reassess our business strategies and their impact on our operations. Our strategies have included pricing our handsets and service offers competitively.

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to grow and maintain our customer base. We expect these strategies to continue in the future. We continually monitor the impact of handset prices and service offers on the profile of our new customers, the behavior of our existing customers and our financial performance. We will make adjustments to our pricing strategy accordingly, including potentially lowering or raising handset prices and updating our service offers. Many factors, including risk factors described in the Risk Factors section of this annual report, could adversely affect our performance and results.

We primarily rely on four third-party retail channels for distribution and product placement within their stores to promote the sale of our handsets to grow our customer base. In the first half of 2008, we entered into three agreements to expand our retail presence. We entered new agreements with American Wireless and Sears and expanded our relationship with Wal-Mart by both increasing the number of doors in which our products are sold by approximately 20% and by increasing our shelf space at all Wal-Mart locations where our products are sold. Collectively, these arrangements expanded our retail footprint by approximately 2,000 doors during 2008. There is no assurance that our distribution partners will continue to distribute our products and the loss of any of our retail distribution partners could result in lower gross additions, account replenishments, or Top-Ups, and increased churn and therefore adversely affect our results of operations and cash flows.

We earn revenues primarily from the sale of wireless voice and mobile data services, along with the sale of handsets through third party retail locations, our website and our call center, Virgin Mobile At Your Service. Our services are available through a variety of different pricing plans, including flat rate and monthly plans that offer the benefits of long-term contract-based wireless plans with the flexibility of pay-as-you-go services. Following the acquisition of Helio on August 22, 2008, we began to offer postpaid voice and data plans, with two-year contracts, for both individuals and families. During the first half of 2008, we rolled out new pricing plans which were designed to improve the competitiveness and value of our offers to our customers. These new plans provide our customers the ability to purchase, in a variety of ways and on a flexible basis, packages of minutes, or minute packs, in denominations ranging from \$20 to \$50. They also include, subject to certain restrictions, a roll-forward feature for previously purchased minutes. On July 1, 2008, we further revised our calling plans by unveiling our Totally Unlimited nationwide calling plan for \$79.99 per month. We believe that the flexibility and competitive price points on these plans will help us retain customers and stimulate growth. Further, we believe the value and flexibility of our products and services are increasingly attractive to budget-conscious consumers during challenging economic times. Our monthly plans have grown to 48% of gross additions in the fourth quarter of 2008, compared to 28% in the fourth quarter of 2007, and we expect these new monthly plans to contribute an increasing portion of our revenue going forward. We continue to assess the various competitive offers and pricing actions in the marketplace and will continue to monitor the offers and pricing actions our competitors take to assure that our offers remain competitive. If we are unsuccessful in responding to competing offers, our results and performance, including end-of-period customers, may be adversely affected.

From time to time, we evaluate strategic opportunities, including mergers and acquisitions, partnerships and co-marketing opportunities, to improve our products and services, accelerate growth and increase stockholder value. Prior to our acquisition of Helio, we had grown our business organically, but, subject to existing and future contractual obligations, we may continue to consider mergers, acquisitions and strategic investments from time to time that enable us to achieve greater scale, cost or technology advantages.

The United States economy is in a recession and capital markets are currently undergoing a period of unprecedented volatility. While we believe that the challenging economic environment makes the value and flexibility of our plans more attractive to consumers, our management believes that if the economic environment continues to be unfavorable in comparison to the prior years in which we have operated and negatively affects consumer spending, our handset sales, usage and results of operations may be adversely affected. In such circumstances, we and our competitors might be compelled to offer our products and services at lower prices, which may have a negative impact on operating income. Reduced revenues as a result of decreased consumer spending would also reduce our working capital for planned retail distribution improvements, otherwise hinder our ability to improve our stock performance and might necessitate cost saving measures.

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On November 13, 2008, we received written notice from the NYSE notifying us that we were not in compliance with certain of the listing criteria. We are below the applicable standards because the average market capitalization of our Class A common stock and substantial equivalents, over a period of 30 trading days, is less than \$100 million. On November 19, 2008, we received a second written notice from the NYSE notifying us that we were not in compliance with the stock price listing criteria because the average price of one share of our Class A common stock, over 30 trading days, was less than \$1.00. In December 2008, we filed our business plan with the NYSE and in January 2009, the NYSE notified us that it had accepted our plan of compliance and we have until May 2009 to comply with the share price standard and until May 2010 to comply with the market capitalization standard. We are subject to periodic review by the NYSE during this period.

### ***PCS Services Agreement with Sprint Nextel***

We purchase wireless network services at a fixed price from Sprint Nextel under an agreement which runs through 2027. During 2008, we entered into six amendments to the PCS Services Agreement with Sprint Nextel and one amendment during 2009. On March 12, 2008, we entered into the Second Amendment to the PCS Services Agreement with Sprint Nextel to provide that, among other things, we would not be subject to any true-up process and the related payment obligations with respect to the fiscal year ended December 31, 2007.

On May 12, 2008, we entered into the Third Amendment to the PCS Services Agreement with Sprint Nextel to provide that we would pay Sprint Nextel at least \$298 million for wireless network services, including voice, messaging and data traffic, according to a monthly payment schedule during the year ending December 31, 2008, and would receive off-peak rates for a two-hour period each weekday until (pursuant to the Fifth Amendment to the PCS Services Agreement, as described below) the closing of the acquisition of Helio. This amendment was contingent upon us obtaining approval from the Virgin Group to increase the lending commitment under the Revolving Credit Facility from \$75 million to \$100 million by June 30, 2008.

On June 27, 2008, in connection with the agreement to acquire Helio we entered into the Fourth and Fifth Amendments to the PCS Services Agreement with Sprint Nextel. The Fourth Amendment to the PCS Services Agreement eliminated the requirement for us to secure an increase in the Virgin Group's lending commitment under the Revolving Credit Facility from \$75 million to \$100 million, which had been a requirement to the continued effectiveness of the Third Amendment to the PCS Services Agreement. The Fifth Amendment to the PCS Services Agreement, which became effective upon the closing of the acquisition of Helio and superseded the Third Amendment to the PCS Services Agreement, eliminated the annual true-up process and related payment obligations, and obligated us to pay Sprint Nextel a minimum of \$320 million, \$370 million and \$420 million during the years ending December 31, 2008, 2009 and 2010, respectively, for wireless network services, including voice, messaging and data traffic. Under the Fifth Amendment there will be no minimum annual commitment for 2011 and beyond with pricing in 2011 based on the pricing schedule for 2010. Additionally, effective July 1, 2008, Sprint Nextel is providing us with a \$2.50 network usage credit for each gross addition through December 31, 2009, up to a maximum of \$10 million. We are eligible to receive this credit provided that no undisputed amounts invoiced to us under the PCS Services Agreement are past due.

On December 22, 2008, we entered into the Sixth and Seventh Amendments to the PCS Services Agreement with Sprint Nextel. Under the terms of the Sixth Amendment, our required minimum payment for the year ended December 31, 2008 decreased from \$320 million to \$318 million. In addition, Sprint Nextel provided us with an additional network usage credit of \$2.00 for each gross addition between October 1, 2008 and December 31, 2008, which will be in addition to the \$2.50 network usage credit described above and not subject to the \$10 million limit discussed above. During the year ended December 31, 2008, we recorded a credit of \$7.1 million in cost of service for both network usage credits. There were no network usage credits recorded during the years ended December 31, 2007 and 2006. Under the Seventh Amendment, beginning in 2009 we are no longer subject to minimum annual payments and pay fixed rates for voice, messaging and data traffic that are lower than rates applicable in 2008. We may benefit from additional discounts to these rates in 2010, with the degree of discount based upon the total payments under the PCS Services Agreement for 2009. We expect to negotiate with Sprint Nextel for rates and other terms applicable to 2011 and beyond, but if we fail to reach an agreement, 2010 rates will apply.

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On February 25, 2009, we entered into the Eighth Amendment to the PCS Services Agreement with Sprint Nextel. Under the terms of the Eighth Amendment, our required minimum payment for the year ended December 31, 2008 decreased from \$318 million to \$317.2 million.

### ***Initial Public Offering***

We are a Delaware corporation formed as a holding company for the purpose of facilitating an initial public offering, or IPO, of Class A common stock, which was completed on October 16, 2007. Prior to the completion of the IPO, Virgin Mobile USA, Inc. and its subsidiaries completed reorganization transactions, or the Reorganization, pursuant to which Virgin Mobile USA, LLC, the principal operating entity for our business, converted into a Delaware limited partnership, changed its name to Virgin Mobile USA, L.P., or the Operating Partnership, and became a majority-owned subsidiary of Virgin Mobile USA, Inc., the holding company for the public's common equity interests in our business.

On October 16, 2007, we completed our IPO and we, along with the selling stockholders sold 27,500,000 shares of our Class A common stock. We received net proceeds of \$352.7 million after deducting underwriting commissions and discounts of \$23.7 million and estimated offering expenses of \$7.4 million. We used \$136.0 million of the IPO proceeds to pay Sprint Nextel for a portion of Sprint Nextel's limited liability company interests in Virgin Mobile USA, LLC that we purchased in connection with the Reorganization and the IPO. The remaining net proceeds of \$216.7 million were used to (1) repay \$150.0 million of outstanding borrowings and \$0.8 million of accrued interest under our Senior Credit Agreement, and (2) repay \$45.0 million of indebtedness and \$0.6 million of accrued interest owed to Sprint Nextel under the Revolving Credit Facility. Subsequent to the IPO, the remaining net proceeds of approximately \$20 million were used for general corporate purposes.

We accounted for the Reorganization, for periods prior to the Reorganization and IPO using a carryover basis, similar to a pooling-of-interest as the Reorganization was premised on a non-substantive exchange in order to facilitate the IPO, resulting in the retention of historical based accounting. This is consistent with Financial Accounting Standards Board Technical Bulletin 85-5, *Issues Relating to Accounting for Business Combinations, including Costs of Closing Duplicate Facilities of an Acquirer; Stock Transactions between Companies under Common Control; Down-Stream Mergers, Identical Common Shares for a Pooling of Interests; and Pooling of Interests by Mutual and Cooperative Enterprises*. Under this method of accounting, we treat the companies as if they had always been combined for accounting and financial reporting purposes and, therefore, the consolidated financial statements for the year ended December 31, 2006 are presented on the same basis as that for the years ended December 31, 2008 and 2007.

### ***Acquisition of Helio LLC***

On August 22, 2008, we acquired Helio, a provider of wireless products and services, at which time Helio became a wholly owned subsidiary of the Operating Partnership. We expect the acquisition of Helio to facilitate our entry into postpaid offerings and allow us to take advantage of Helio's proprietary technology and advanced mobile content applications.

Under the terms of the agreement to acquire Helio, we acquired Helio from SK Telecom, EarthLink, Inc., or EarthLink, and Helio, Inc. in exchange for 12,806,632 limited partnership units in the Operating Partnership and 193,368 shares our Class A common stock, together equivalent to 13 million shares of our Class A common stock. Each of the newly issued Virgin Mobile USA, L.P. partnership units is convertible into shares of our Class A common stock on a one-for-one basis, at any time, at the option of the holder. The purchase price, based on the average closing price of our Class A common stock two trading days before and ending two trading days after the date of the announcement, was \$41.7 million, including \$4.1 million direct costs of the acquisition. The issuance of ownership units by the Operating Partnership reduced our ownership interest in the Operating Partnership from 81.6% to 68.3%. We recorded a \$37.1 million gain on the issuance of the common units by the Operating Partnership and reflected the gain in additional paid-in-capital in accordance with Staff Accounting Bulletin No. 51, *Accounting for Sales of Stock of a Subsidiary*.

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On December 2, 2008, SK Telecom exchanged its limited partnership units in the Operating Partnership for shares of our Class A common stock. On February 23, 2009, our stockholders approved the resolution to increase the number of authorized Class B common stock from one share to two shares. EarthLink was then issued a share of Class B common stock entitling EarthLink to a number of votes per share on all matters submitted to a vote of stockholders that is equal to the total number of shares of Class A common stock for which the partnership units that EarthLink holds in the Operating Partnership are exchangeable.

In connection with the acquisition of Helio, the Company recorded a reserve for the restructuring of the Helio business. As part of the preliminary purchase price allocation related to the acquisition of Helio, \$9.6 million was recorded for closures of sales offices, kiosks, and stores and one-time benefits for certain employees of Helio who were terminated. Adjustments to the allocation of the purchase price of Helio were recorded for \$1.7 million for costs associated with store and office closures and \$0.6 million for one-time termination benefits for additional former Helio employees terminated as part of the integration of Helio into the Company's business. The adjustment of the restructuring liability related to store and office closures was primarily the result of revisions to the assumption for sublease income on certain leased properties. During 2008, the Company incurred \$0.6 million of restructuring expense related to one-time employee termination benefits for those employees assisting in the integration of Helio into the Company's business. The estimated future expense to complete the restructuring actions is approximately \$0.1 million, which is expected to be incurred in 2009. Cash payments related to the Helio restructuring activities were \$7.8 million in 2008 and are expected to be approximately \$4.1 million and \$0.6 million in 2009 and 2010, respectively.

On August 22, 2008, in connection with the acquisition of Helio, we issued 50,000 shares of Series A Preferred Stock with 25,000 shares issued to the Virgin Group and 25,000 shares issued to SK Telecom. The Series A Preferred Stock was issued at the stated value of \$1,000 per share, with proceeds to us of approximately \$50 million. The Series A Preferred Stock carries a cumulative 6% annual dividend payable semi-annually, which will be paid with additional shares of Series A Preferred Stock at the stated value of \$1,000 per share. On February 23, 2009, our stockholders approved the conversion feature and voting rights of the Series A Preferred Stock. Accordingly, each share of the Series A Preferred Stock will be mandatorily convertible into 117.64706 shares of our Class A common stock at the earlier of (1) August 22, 2012 and (2) such time as the market price of our Class A Common Stock exceeds \$8.50 per share. The Series A Preferred Stock will also be convertible at the option of the holder 18 months after the date of issuance, on or after February 22, 2010. Additionally, each share of the Series A Preferred Stock carries a voting right which equates to the number of shares of Class A common stock into which such share of Series A Preferred Stock would be convertible in case of mandatory conversion.

In connection with the acquisition of Helio, we entered into a Second Amendment to the Senior Credit Agreement and a Second Amendment to the Revolving Credit Facility. The Second Amendment to the Senior Credit Agreement (1) required that the \$50 million of proceeds from the issuance of the Series A Preferred Stock be used to pay down a portion of the outstanding loan balance under the Senior Credit Agreement, (2) increased the interest rate applicable to outstanding balances by 100 basis points per year, and (3) tightened the leverage ratio covenant by 0.25 times (for the quarter ending December 31, 2008, the required leverage ratio decreased from 3.00:1.00 to 2.75:1.00). The Second Amendment to the Revolving Credit Facility increased the Virgin Group's lending commitment from \$75 million to \$100 million and added SK Telecom as a new lender with a lending commitment of \$35 million.

### ***IBM Outsourcing Agreement***

On July 3, 2008, we signed an outsourcing agreement with IBM. We believe that by outsourcing the development and maintenance of our information technology to IBM, we will enhance our technological capabilities and be able to improve our product portfolio for new and existing customers. Our agreement with IBM requires IBM to provide information technology services to us through May 15, 2013. We have the right, but not the obligation, to extend the agreement with IBM for one additional year, or to May 15, 2014, if certain conditions are met.

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As part of the IBM Agreement, we transitioned our information technology, infrastructure and applications development to IBM's service environment and 46 of our employees transferred to IBM. In connection with the outsourcing, 140 employees were terminated during 2008, and 18 employees are expected to be terminated during 2009. In addition, we expect to close our facility in Walnut Creek, CA during the first half of 2009. Employees being terminated are required to remain with us through a specified transition period in order to be eligible to receive any one-time termination benefits. The outsourcing resulted in restructuring charges for one-time termination benefits, including severance, completion bonuses, retention bonuses, and the associated benefits and payroll taxes, contract termination fees, fixed asset related charges for disposals, and other charges. During the year ended December 31, 2008, we recorded \$7.7 million of restructuring expenses, primarily related to employee charges. We estimate we will incur additional restructuring expenses of approximately \$2.6 million during the year ended December 31, 2009.

Cash payments related to the IBM restructuring activities were \$3.7 million in 2008 and are expected to be approximately \$5.8 million in 2009 and \$0.4 million in 2010. We expect to complete the transition of our information technology, infrastructure and applications development to the IBM service environment in the first half of 2009. Beginning in 2009, we anticipate average annual savings of approximately \$12 million over the term of the IBM Agreement.

In accordance with the IBM Agreement, we prepaid \$9.8 million in service charges to IBM during the period July 2008 through December 2008 and are required to prepay an additional \$0.3 million in service charges to IBM prior to March 31, 2009. The prepayments required during 2008 were paid from funds generated from operations which we expect will also be the source of funding for the \$0.3 million of remaining prepayments. The prepayments have been, and will be, applied to charges for IBM services to us over the five-year term. The IBM Agreement calls for IBM to provide a baseline level of service according to an agreed-upon pricing schedule. See *Contractual Obligations, Commitments and Contingencies* for a discussion of expected cash payments under the IBM Agreement.

### ***Reduction in Force***

In November 2008, we eliminated 29 positions in order to reduce operating costs in response to the deteriorating economic environment. Restructuring expense in the amount of \$0.7 million was recorded during the year ended December 31, 2008 for one-time termination benefits including severance payments, salary continuation, retention bonuses, associated payroll taxes and benefits. An additional \$0.2 million of expense is expected to be recognized during the first half of 2009 related to one-time termination benefits when termination dates extend into 2009. Cash payments related to the reduction in force were \$0.2 million in 2008 and are expected to be approximately \$0.7 million during the first half of 2009.

### **Critical Accounting Policies and Estimates**

Our consolidated financial statements are prepared in accordance with generally accepted accounting principles in the United States. Preparation of these consolidated financial statements requires us to make judgments, estimates and assumptions which affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements as well as the reported revenue and expenses during the reporting periods. These estimates and judgments are subject to an inherent degree of uncertainty. We believe that the estimates and judgments upon which we rely are reasonable based upon information available to us at the time that these estimates and judgments are made. We continually evaluate our judgments, estimates and assumptions. To the extent there are material differences between these estimates and actual results, our consolidated financial statements will be affected.

We believe the following to be our more significant critical accounting policies and estimates used in the preparation of our consolidated financial statements.

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### *Revenue Recognition and Allowance for Doubtful Accounts*

Operating revenues consist of service revenues and revenue generated from the sale of equipment (handsets and accessories). Operating revenues are recognized in accordance with the provisions of Staff Accounting Bulletin No. 104, *Revenue Recognition* and Emerging Issues Task Force, or EITF, Issue No. 00-21, *Revenue Arrangements with Multiple Deliverables*, or EITF 00-21. We recognize revenue when (1) persuasive evidence of an arrangement exists, (2) delivery has occurred, (3) the seller's price to the buyer is fixed or determinable and (4) collectibility is reasonably assured. Determination regarding the fixed nature of the fee charged for products delivered and their collectibility are based on our management's judgments.

*Service revenues* are generated from the sale of voice and mobile data services. As our customers pay for these services in advance, we record these funds as deferred revenue. We recognize revenue as our customers use available services, or when the pay-as-you-go balances in their accounts expire, net of any credits or adjustments. We also derive revenue for monthly subscription charges and other services charged at fixed amounts. We recognize these fees ratably over the service period, net of credits and adjustments for service discounts, billing disputes or fraud or unauthorized usage.

When we activate a new postpaid customer, we frequently sell that customer a handset and the first month of service in a bundled transaction. Under the provisions of EITF 00-21, the sale of a handset along with a month of wireless service and an activation fee constitutes a multiple element arrangement. We divide this arrangement into separate units of accounting, and allocate the consideration between the handset and the wireless service using the residual method of accounting. Consideration received for the wireless service is recognized at fair value as service revenue when earned, and any remaining consideration received is recognized as equipment revenue when the handset is delivered and accepted by the customer.

*Equipment revenues* are recognized at the time that the title to individual handsets, along with any risk for damage or loss, passes to the customer. In the context of handset revenue recognition, customer means either (1) a non-consignment retailer, where the title passes to the retailer upon delivery to that retailer or (2) an end-user who purchases the handset from either a consignment retailer, where the title does not pass upon shipment but at the time of sale to the end-user, or through our website or call center, where title passes upon shipment.

For all handsets sold, our customers have the right to return handsets within a specified time or before a certain amount of use, whichever occurs first. We record estimates for returns at the time of recognizing the revenue. Our assessment of the estimated handset returns is based primarily on historical return rates. If our customers' actual returns are not consistent with our estimates of their returns, our revenues may be different than initially recorded.

In addition, we offer price protection arrangements, whereby we reimburse retailers for any losses that they may incur whenever we permanently or temporarily reduce the price of our handsets. We record such reimbursements as a reduction to handset revenue at the time that the related revenue is recognized. Our assessment of price protection is based on our estimates of the quantity of handsets the retailer has purchased and has on hand at the time of the price reduction as well as on our management's plans for handset pricing. If actual retailer handset inventory on hand is not consistent with our estimates, our revenues may be different than initially recorded.

We establish an allowance for doubtful accounts receivable sufficient to cover probable and reasonably estimable losses. Our estimate of the allowance for doubtful accounts considers a number of factors, including collection experience, aging of the accounts receivable portfolios, the credit quality of our customer base, estimated proceeds from future bad debt sales, and other qualitative considerations, including macro-economic factors. The accounting estimates related to recognition of revenue require us to make assumptions about future billing adjustments for disputes with customers, unauthorized usage, and future returns. The allowance amounts recorded represent our best estimate of future outcomes; to the extent that our actual experience differs

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significantly from historical trends, the required allowance amounts could differ from our estimate. Any resulting adjustments would change the net accounts receivable reported on our balance sheet, and bad debt expense, in the case of estimates related to doubtful accounts, reported in our results of operations in future periods.

### *Inventory*

Our inventory consists primarily of new and refurbished handsets, including inventory on consignment. New handsets are stated at the lower of cost or replacement value. We determine cost on a First in, First out, or FIFO basis. Typically, we sell our handsets for less than their book value since we provide a handset subsidy to our customers. Handset costs are expensed at the time of sale. The cost for refurbished handsets is valued at the lower of fair market value or repair cost. We make provisions to reduce any excess, obsolete or slow moving inventory to net realizable value, which represents replacement value. The total inventory reserves for obsolete and unmarketable inventory were not significant at December 31, 2008 and 2007. If actual market conditions are less favorable than those projected, additional inventory write-downs may be required.

### *Property and equipment, and internal use software*

Property and equipment and internal use software are recorded at cost. Depreciation and amortization are applied using the straight-line method over the estimated useful lives of the assets once the assets are placed in service. We estimate the useful economic lives of our assets to be:

|                           |                                      |
|---------------------------|--------------------------------------|
| Furniture and fixtures    | 3-7 years                            |
| Leasehold improvements    | shorter of the lease term or 3 years |
| Computer equipment        | 3 years                              |
| IT network/infrastructure | 3-5 years                            |
| Computer software         | 1-3 years                            |

We periodically review the estimated useful economic lives of our property and equipment and internal use software. If conditions indicate these assets may not be useful for as long as, or may be useful longer than originally anticipated, we will make adjustments to those estimates. Our property and equipment and internal use software are tested for recoverability whenever events or changes in circumstances indicate that their carrying value may not be recoverable. Impairment can arise from obsolescence of these assets as well as a change in expected cash flows. Such impairment tests are based on comparison of estimated undiscounted cash flows to the recorded value of the asset group. If impairment is indicated, the value of the asset group will be written down to its fair value. For software projects that are under development, we periodically assess the probability of deployment into the business to determine if an impairment charge is required.

### *Stock-based Compensation*

We account for stock-based compensation in accordance SFAS No. 123 (revised 2004) *Share Based Payment*. Under the fair value recognition provisions of this statement, share-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense over the requisite service period, which is generally the vesting period. We use the Black-Scholes pricing model to estimate the fair value of our stock options as of the grant date. Fair value models require management to make assumptions such as expected volatility of our stock and expected term. We also estimate the amount of share-based awards that will be forfeited. If actual forfeiture rates differ significantly from our estimate, stock-based compensation expense and our results of operations could be materially impacted. Following the completion of our IPO, we use the price of our common stock at the date of grant to determine the fair value of restricted stock unit and restricted stock awards granted. During 2007, we began issuing restricted stock and restricted stock units in conjunction with our other equity instruments. As of December 31, 2008, we had unrecognized compensation costs related to non-vested awards of approximately \$17.1 million, which is expected to be recognized over a weighted-average period of 1.9 years, and will be adjusted for subsequent changes in estimated forfeitures.



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### *Goodwill Impairment Testing*

Goodwill represents the excess of acquisition purchase price over the fair value of the net tangible assets and identifiable intangible assets acquired in a business combination. Goodwill is not amortized, but is subject to an annual impairment test, as of August 1, or more frequently if events and circumstances indicate that the carrying amount may not be fully recoverable using the guidance and criteria described in Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets*, or SFAS 142.

Because of the decrease in our market capitalization during the fourth quarter of 2008, we completed a goodwill impairment test as of December 31, 2008 using the two-step process detailed in SFAS 142. The first step of the impairment test compares the fair value of the reporting unit with its carrying amount, including goodwill, in order to determine whether or not the second step, which compares the implied fair value of the reporting unit's goodwill with the carrying amount of that goodwill, is required to be performed. Goodwill is tested for impairment at the consolidated level since we operate as a single reporting unit as defined in SFAS 142. We used our total market capitalization including all potentially convertible securities plus a control premium to determine the fair value of the reporting unit. The control premium represents the amount in excess of the trading value of our common stock that an acquiring entity would be willing to pay for a controlling interest in the Company. The carrying amount of the reporting unit in the impairment test equaled our stockholders' deficit of \$(355.6) million at December 31, 2008. The reporting unit's carrying value was below zero, therefore, the fair value exceeded the carrying value and no impairment loss was recorded during 2008. Since we found no indication of impairment, we did not proceed with the second step of the impairment analysis as specified by SFAS 142. A 10 percent change in the market price of our common stock used in the measurement of our market capitalization would not have impacted the outcome of the impairment test.

### *Intangible Asset Impairment Testing*

At December 31, 2008, we had identified intangible assets arising from our acquisition of Helio in August 2008 that are being amortized over their estimated lives. In accordance with Financial Accounting Standards Board Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, or SFAS 144, we perform a two-step test for asset, or asset group, recoverability whenever events and circumstances indicate that its carrying amount may not be recoverable. The first step compares the undiscounted cash flows of the asset or asset group to its carrying value. If the comparison indicates that the carrying value of the asset or asset group exceeds the undiscounted cash flows, an impairment loss is recorded which is measured by comparing the fair value of each asset or asset group to its carrying value.

We considered the decrease in our market capitalization during the fourth quarter of 2008 to be an indicator of possible impairment of the identifiable intangible assets. For purposes of recognition and measurement of an impairment loss, a long-lived asset or assets shall be grouped with other assets and liabilities at the lowest level for which identifiable cash flows are largely independent of the cash flows of other assets and liabilities. In accordance with SFAS 144 we performed the impairment test at the consolidated company level, as this is the lowest level for which identifiable cash flows are largely independent of the cash flows of other assets and liabilities. We have compared the undiscounted future cash flows estimated to be generated by the asset group with the net book value of the asset group at December 31, 2008 and noted no impairment. If estimates or their related assumptions used to forecast cash flows change in the future, it could result in lower estimated future cash flows that may not support the current carrying value of these assets, which could require us to record impairment charges for these assets that could materially impact our financial condition or operating performance. A 10 percent decrease in the revenue assumed in the forecast of undiscounted cash flows would not have impacted the outcome of the impairment test.

### *Tax Asset Valuation Allowance*

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for future tax consequences attributable to differences between the financial statement carrying

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amounts of existing assets and liabilities and their respective tax bases, as well as operating losses and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Valuation allowances are established when necessary in order to reduce deferred tax assets to the amounts expected to be recovered.

Bluebottle Investments, which has elected to be treated as a corporation for federal and state income tax purposes, has net operating loss carryforwards resulting from the accumulated losses incurred by Virgin Mobile USA, LLC since inception. In connection with the Reorganization, the Virgin Group contributed to us its interest in Bluebottle Investments, which resulted in us receiving the net operating losses carryforwards. We expect that these net operating losses will reduce the amount of cash tax that we would otherwise be required to pay in the future, but we will be required to compensate the Virgin Group for the tax benefit resulting from these net operating losses pursuant to the terms of our tax receivable agreement with the Virgin Group. Our ability to utilize the net operating loss carryforwards in future years may be limited in some circumstances. A full valuation allowance has been recorded against our deferred tax assets since their future realizability is uncertain since historically we have not generated net income.

### **Change in Accounting Principle**

Effective October 1, 2008, we elected to change the method of accounting for regulatory fees and tax surcharges, primarily Universal Service Fund, or USF contributions from a net basis to a gross basis in the statement of operations. As originally reported, we accounted for USF contributions on a net basis such that the USF remittance to the government agencies was recorded as cost of service and the surcharge for USF collected from customers was recorded as a reduction of cost of service. We changed our accounting policy to account for USF contributions on a gross basis such that the surcharge for USF collected from customers is recorded in net service revenue and remittances to government agencies are recorded in cost of service. This change in accounting policy, which was applied retrospectively, increased both net service revenue and cost of service by \$13.3 million, \$12.5 million, and \$2.9 million for the years ended December 31, 2008, 2007 and 2006, respectively. This change in accounting policy does not change previously reported operating income (loss) or net income (loss).

We concluded that the gross basis of revenue reporting is preferable because USF is the responsibility of the Company, is not levied on the end customer and does not vary depending on the amounts ultimately collected from the end customers. Additionally, we believe it to be the prevailing wireless telecommunications industry practice and it will make our financial data more comparable to that of our competitors. See Note 3 to our consolidated financial statements.

**Table of Contents****Results of Operations***Key Performance Metrics*

Our management utilizes the following key performance metrics used in the wireless communications industry to manage and assess our financial performance. These metrics include gross additions, churn, net customer additions, end-of-period customers, Adjusted EBITDA, Adjusted EBITDA margin, Average Revenue Per User, or ARPU, Cash Cost Per User, or CCPU, Cost Per Gross Addition, or CPGA, Free Cash Flow and Unlevered Free Cash Flow (for information on Free Cash Flow and Unlevered Free Cash Flow see Liquidity and Capital Resources). Trends in key performance metrics such as ARPU, CCPU, and CPGA will depend upon the scale of our business as well as the dynamics in the marketplace and our success in implementing our strategies. The following table provides a summary of these key performance metrics for the periods indicated and the trends in each of these metrics are discussed below:

|                                             | 2008       | Year Ended December 31,<br>2007<br>(Unaudited) | 2006        |
|---------------------------------------------|------------|------------------------------------------------|-------------|
| Gross additions                             | 3,305,857  | 3,384,460                                      | 3,013,781   |
| Churn                                       | 5.2%       | 4.9%                                           | 4.8%        |
| Net customer additions                      | 119,237    | 511,796                                        | 729,313     |
| End-of-period customers                     | 5,380,310  | 5,085,886                                      | 4,574,090   |
| Adjusted EBITDA (in thousands)              | \$ 101,127 | \$ 99,694                                      | \$ 47,884   |
| Adjusted EBITDA margin                      | 8.2%       | 8.0%                                           | 4.7%        |
| ARPU                                        | \$ 20.30   | \$ 21.24                                       | \$ 21.54    |
| CCPU                                        | \$ 12.74   | \$ 13.05                                       | \$ 13.21    |
| CPGA                                        | \$ 108.68  | \$ 111.66                                      | \$ 120.55   |
| Free Cash Flow (in thousands) (1)           | \$ 25,720  | \$ 11,206                                      | \$ (73,327) |
| Unlevered Free Cash Flow (in thousands) (1) | \$ 57,776  | \$ 62,657                                      | \$ (20,999) |

(1) See Liquidity and Capital resources for discussion of results.

*Gross additions* represents the number of new customers who activated an account during a period or, in the case of postpaid, the number of new or existing customers who entered into a new long-term contract (rather than an extension of an existing contract), unadjusted for churn during the same period. In measuring gross additions, we begin with account activations and exclude returns, customers who have reactivated and fraudulent activations. Returns include remorse returns for the postpaid business, within 30 days of activation, and retailer returns for the prepaid business, with the timing dependent on the retailer's policy. These adjustments are applied in order to arrive at a more meaningful measure of our customer growth. For the years ended December 31, 2008, 2007 and 2006, gross additions were 3.3 million, 3.4 million and 3.0 million, respectively. The slight decline we experienced this year primarily reflected the economic recession and its impact on consumer behavior, as well as some impact from expanding competitive pressure in key markets. This was partially mitigated by the favorable impact of the new offers we launched this year as well as the strategic expansion of our retail distribution and handset lineup. We continue to focus on consumer preferences and on developing competitive product and service offerings that differentiate us in the marketplace. In particular, we believe that the flexibility and competitive pricing on our restructured and expanded suite of offers, the recent introduction of our *Totally Unlimited* voice offer and our entry into the postpaid market will help us retain customers, stimulate growth and, we believe, maintain healthy revenue and cost metrics. Also, we have been attracting higher-value customers with improved handsets such as the Wild Card and Slash, which have been bringing in significantly higher than average data usage. The integration of Helio is enabling us to offer more advanced data services. By leveraging owned assets, intellectual property, and existing content partnerships, we have been able to extend services to current devices such as the Shuttle and to even more devices beginning in 2009. This, along with our expanded suite of offers, should make a positive impact on our position in the marketplace. The specific level of our gross additions in the future will depend, in part, on the level of competitive activity and customer movement in the marketplace, along with the availability of attractive new offers and handset technology. Gross additions will also continue to be impacted by the seasonality of our business and the state of the economy.

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*Churn* is used to measure customer turnover on an average monthly basis. Churn is calculated as the ratio of the net number of customers who disconnect from our service during the period being measured to the weighted average number of customers during that period, divided by the number of months during the period being measured. The net number of customers who disconnect from our service is calculated as the total number of customers who disconnect less the adjustments noted under gross additions above. These adjustments are applied in order to arrive at a more meaningful measure of churn. The weighted average number of customers is the sum of the average number of customers for each day during the period being measured divided by the number of days in the period. For the prepaid business, churn includes those pay-by-the-minute customers who we automatically disconnect from our service when they have not replenished, or Topped-Up, their accounts for 150 days, as well as those monthly customers who we automatically disconnect when they have not paid their monthly recurring charge for 150 days (except for such monthly customers who are engaged in a retention program or who replenish their account for less than the amount of their monthly recurring charge and, according to the terms of our monthly plans, may continue to use our services on a pay-by-the-minute basis), and such customers who voluntarily disconnect from our service prior to reaching 150 days since replenishing their account or paying their monthly recurring charge. We utilize 150 days in our calculation because it represents the last date upon which a customer who replenishes his or her account is still permitted to retain the same phone number. We also have a service preserver option which allows customers to extend the 150-day period to one year by replenishing their account using an annual top-up. In this case, we will automatically disconnect their service if an additional top-up is not made within 415 days of the qualifying annual top-up. For the postpaid business, churn includes those customers who either disconnect from our service voluntarily or whose service we disconnect for nonpayment. These calculations are consistent with the terms and conditions of our service offering. We believe churn is a useful metric to track changes in customer retention over time and to help evaluate how changes in our business and services offerings affect customer retention. In addition, churn is also useful for comparing our customer turnover to that of other wireless communications providers. For the years ended December 31, 2008, 2007 and 2006, our churn was 5.2%, 4.9% and 4.8%, respectively. Note that our churn for the current year includes the impact of postpaid churn from our recent acquisition of Helio which, given the number of customers and the short time period covered, did not have a significant impact on our overall churn results. Note, also, that our churn for 2007 reflected some incremental losses associated with changes across our bucket offers, including the cap on unlimited usage for our \$44.99 offer and higher pricing on over-the-limit usage. The increase in our churn as compared to last year is due in large part to economic challenges faced by our customers and continuing weakness in the overall economy. Despite increasing weakness in economic conditions, for the most recent three month period, our churn was slightly improved as compared to prior periods, due to effective retention programs. As with gross additions, the trends in our churn will continue to reflect competitive activity in the marketplace and the availability of attractive new offers and handsets. In particular, as noted above, we believe that the flexibility and competitive price points on the restructured and expanded suite of offers we introduced this year, and our move into the postpaid market with an expanded set of handsets, will help us retain customers. Also, we believe our customer behavior will continue to be affected by the seasonality of our business and by the state of the economy. In addition to continually improving our offers and handsets, our ongoing lifecycle management programs, which target and incent specific customer segments deemed valuable to our business, will help to mitigate both economic and competitive pressure in the future.

*Net customer additions and end-of-period customers* are used to measure the growth of our business, to forecast our future financial performance and to gauge the marketplace acceptance of our offerings. Net customer additions represents the number of new customers who activated an account during a period or, in the case of postpaid, the number of new or existing customers who entered into a new long-term contract (rather than an extension of an existing contract), adjusted for churn during the same period. End-of-period customers are the total number of customers at the end of a given period. For the years ended December 31, 2008, 2007 and 2006, we experienced net customer additions of 119 thousand, 512 thousand and 729 thousand, respectively. The decline in our net customer additions reflects the economic downturn and increased competitive pressure as discussed above. As of December 31, 2008, we had approximately 5.4 million customers, including 151 thousand postpaid customers. This represents an increase of 5.8%, as compared to December 31, 2007, with 3.0% of that growth attributable to our acquisition of Helio. At the end of 2007, we had approximately 5.1 million customers

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which represented a growth of 11.2% as compared to December 2006. Net customer additions reflect a percentage share of new users in the marketplace as well as a percentage of customers who have switched to us from our competitors net of our competitive losses, or churn. We believe that a challenging economic environment may make the value and flexibility of our products and services more attractive to consumers as they evaluate their spending going forward. This could have a positive impact on our net additions.

*Non-GAAP performance metrics.* We use several financial performance metrics, including Adjusted EBITDA, Adjusted EBITDA margin, ARPU, CCPU, CPGA, Free Cash Flow and Unlevered Free Cash Flow, which are not calculated in accordance with Generally Accepted Accounting Principles, or GAAP. A non-GAAP financial metric is defined as a numerical measure of a company's financial performance that (1) excludes amounts, or is subject to adjustments that have the effect of excluding amounts, that are included in the comparable measure calculated and presented in accordance with GAAP or (2) includes amounts, or is subject to adjustments that have the effect of including amounts, that are excluded from the comparable measure so calculated and presented. We believe that the non-GAAP financial metrics that we use are helpful in understanding our operating performance from period to period, and although not every company in the wireless communications industry defines these metrics in precisely the same way, we believe that these metrics as we use them facilitate comparisons with other wireless communications providers. These metrics should not be considered substitutes for any performance metric determined in accordance with GAAP.

*Adjusted EBITDA* is calculated as net income (loss) plus interest expense (net), income tax expense, tax receivable agreements expense, depreciation and amortization (including the amortization of intangibles associated with our acquisition of Helio), write-offs of property and equipment, non-cash compensation expense, minority interest, equity issued to a member, debt extinguishment costs and expenses of Bluebottle Investments prior to the completion of the IPO. Beginning in the second quarter of 2008, we updated our definition of Adjusted EBITDA to exclude minority interest and write-offs of property and equipment. Although these are all necessary elements of our cost structure, they are customary adjustments in the calculation of supplemental metrics. We believe Adjusted EBITDA is a useful tool in evaluating performance because it eliminates items which do not relate to our core operating performance and provides an indicator which our management uses to evaluate our business. Specifically, our management uses Adjusted EBITDA in their calculation of compensation targets, preparation of budgets and evaluations of performance.

We believe that analysts and investors use Adjusted EBITDA as a supplemental measure to evaluate our company's overall operating performance and that this metric facilitates comparisons with other wireless communications companies. However, Adjusted EBITDA has material limitations as an analytical tool and should not be considered in isolation, as an alternative to net income, operating income or any other measures derived in accordance with GAAP, or as a substitute for analysis of our results as reported under GAAP. The items we eliminate in calculating Adjusted EBITDA are significant to our business: (1) interest expense is a necessary element of our costs and ability to generate revenue because we incur interest expense related to any outstanding indebtedness, (2) to the extent that we incur income tax, it represents a necessary element of our costs and our ability to generate revenue because ongoing revenue generation is expected to result in future income tax expense, (3) depreciation and amortization are necessary elements of our costs, (4) write-offs of property and equipment eliminate non-productive assets from our balance sheet, reconciling it to our earnings, (5) tax receivable agreements expenses are the costs related to our tax receivable agreements, as they are reimbursements to the Virgin Group, for the utilization of net operating loss carryforwards we received as part of the IPO, and to Sprint Nextel, for the increase in tax basis that will be allocated to us, (6) non-cash compensation expense is expected to be a recurring component of our costs and we may be able to incur lower cash compensation costs to the extent that we grant non-cash compensation, (7) minority interest is the income related to the minority owners of the Operating Partnership and, therefore, not available to our common stockholders, (8) expense resulting from equity issued to a member represents an actual cost relating to a prior contractual obligation, and (9) expenses associated with Bluebottle Investments prior to the IPO. Furthermore, any measure that eliminates components of our capital structure and the carrying costs associated with the property and equipment on our balance sheet has material limitations as a performance measure. Because Adjusted EBITDA is not calculated in the same manner by all companies, it may not be comparable to other similarly titled measures used by other companies.

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For the years ended December 31, 2008, 2007 and 2006, Adjusted EBITDA was \$101.1 million, \$99.7 million and \$47.9 million, respectively. Our year-over-year Adjusted EBITDA performance reflects pressure from the economic recession and a decline/mix shift in customer usage, which we were able to mitigate through a continued focus on operating efficiencies, including a reduction in our Sprint Nextel network rates. In addition, our Adjusted EBITDA for the current year reflects a \$10.3 million FET refund, less the impact of additional contributions to state E911 funds, estimated at \$5.6 million, \$8.6 million in restructuring charges primarily associated with our IBM outsourcing agreement and approximately \$5.5 million in transition expenses associated with our acquisition of Helio and our IBM contract. Our Adjusted EBITDA for 2007 reflected FET refunds of \$10.1 million and E911 tax refunds and favorable settlements with taxing jurisdictions of \$4.3 million. As we may experience some continued pressure on revenue resulting from lower usage and lower pricing, we have considered, and will continue to consider, appropriate measures to align our costs with the revenue that is being generated, including reducing our administrative costs or potentially raising our handset prices in order to reduce our subsidy.

*Adjusted EBITDA margin* is used to measure our Adjusted EBITDA performance relative to our net service revenue so that we can gauge the performance of Adjusted EBITDA normalized for the changing scale of our business. Adjusted EBITDA margin is calculated by dividing Adjusted EBITDA by our net service revenue. For the years ended December 31, 2008, 2007 and 2006, our Adjusted EBITDA margin was 8.2%, 8.0% and 4.7%, respectively. Our year-over-year Adjusted EBITDA margin performance reflects continued operating efficiencies, including a reduction in Sprint Nextel network rates, partially offset by the decline/mix shift in customer usage. Also, our Adjusted EBITDA margin performance reflects the additional factors impacting our Adjusted EBITDA, discussed above.

The following table illustrates the calculation of Adjusted EBITDA and Adjusted EBITDA margin and reconciles Adjusted EBITDA to net income (loss) which we consider to be the most directly comparable GAAP financial measure.

| (in thousands, except Adjusted EBITDA margin)             | Year Ended December 31, |                     |                  |
|-----------------------------------------------------------|-------------------------|---------------------|------------------|
|                                                           | 2008                    | 2007<br>(Unaudited) | 2006             |
| Net income (loss)                                         | \$ 7,945                | \$ 4,218            | \$ (36,941)      |
| Plus:                                                     |                         |                     |                  |
| Depreciation and amortization                             | 40,128                  | 33,608              | 28,381           |
| Interest expense net                                      | 30,709                  | 53,391              | 52,180           |
| Income tax expense                                        | 1,285                   | 321                 |                  |
| Tax receivable agreements expense                         | 5,616                   |                     |                  |
| Non-cash compensation expense                             | 12,409                  | 7,423               | 2,563            |
| Write-offs of property and equipment                      | 671                     | 450                 |                  |
| Bluebottle USA Investments L.P. expenses prior to the IPO |                         | 283                 | 232              |
| Debt extinguishment costs                                 |                         |                     | 1,469            |
| Minority interest                                         | 2,364                   |                     |                  |
| <b>Adjusted EBITDA</b>                                    | <b>\$ 101,127</b>       | <b>\$ 99,694</b>    | <b>\$ 47,884</b> |
| Net service revenue                                       | \$ 1,235,870            | \$ 1,239,533        | \$ 1,022,927     |
| <b>Adjusted EBITDA Margin</b>                             | <b>8.2%</b>             | <b>8.0%</b>         | <b>4.7%</b>      |

*ARPU* is used to measure and track the average revenue generated by our customers on a monthly basis. ARPU is calculated as net service revenue for the period divided by the weighted average number of customers for the period being measured, further divided by the number of months in the period being measured. The weighted average number of customers is the sum of the average customers for each day during that period being measured divided by the number of days in that period. ARPU helps us to evaluate customer performance based on customer revenue and to forecast our future service revenues. For the years ended December 31, 2008, 2007

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and 2006, ARPU was \$20.30, \$21.24 and \$21.54, respectively. As discussed above, net service revenue and ARPU now include the surcharge for USF collected from customers, formerly recorded as a reduction in cost of service. The impact on ARPU was \$0.22, \$0.21 and \$0.06 for 2008, 2007 and 2006, respectively, with the much smaller impact in 2006 due to the fact that this revenue is collected from customers on our monthly plans which mostly ramped up in 2006. The 4.4% and 1.4% year over year decline in ARPU, respectively, reflects a decline in average voice usage for our prepaid customers, driven, in part, by the recession, the migration of high-usage, traditional pay-as-you-go, customers to the lower-priced bucket offers and a trend towards substitution of lower priced text messaging for voice services. The decline also reflects the impact, as noted above, of the E911 tax refund and favorable settlements with taxing jurisdictions last year, and the impact of contributing to additional state E911 funds this year. These factors were partially offset by higher penetration and usage for our mobile data services, the latter stimulated by new offerings and new handsets, and the positive impact of our new, higher-usage, postpaid customers. We may experience some downward pressure on ARPU as prices decline and as the economic downturn may continue to cause some customers to reduce their usage or substitute lower priced text messaging for voice due to decreased disposable income; however, such pressure may be largely offset by a continued shift to higher value customers, including expansion into the postpaid market, and by increased penetration of new services. For example, we have seen an increase in data usage from our customers who purchased the Wild Card and Slash handsets, and customers on our new offers, including our new Totally Unlimited voice offer, are currently generating significantly higher ARPUs than average.

The following table illustrates the calculation of ARPU and reconciles ARPU to net service revenue which we consider to be the most directly comparable GAAP financial measure.

| (in thousands, except number of months and ARPU) | Year Ended December 31, |                     |                 |
|--------------------------------------------------|-------------------------|---------------------|-----------------|
|                                                  | 2008                    | 2007<br>(Unaudited) | 2006            |
| Net service revenue                              | \$ 1,235,870            | \$ 1,239,533        | \$ 1,022,927    |
| Divided by weighted average number of customers  | 5,073                   | 4,864               | 3,957           |
| Divided by number of months in the period        | 12                      | 12                  | 12              |
| <b>ARPU</b>                                      | <b>\$ 20.30</b>         | <b>\$ 21.24</b>     | <b>\$ 21.54</b> |

CCPU is used to measure and track our costs to provide support for our services to our existing customers on an average monthly basis. The costs included in this calculation are our (1) cost of service (exclusive of depreciation and amortization), excluding cost of service associated with initial customer acquisition, (2) general and administrative expenses, excluding Bluebottle Investments general and administrative expenses prior to the IPO, non-cash compensation expenses and write-offs of property and equipment, (3) restructuring expenses, (4) net loss on equipment sold to existing customers, (5) cooperative advertising in support of existing customers and (6) other expense (income), excluding tax receivable agreements expenses, debt extinguishment costs and Bluebottle Investments. These costs are divided by our weighted average number of customers for the period being measured, further divided by the number of months in the period being measured. CCPU helps us to assess our ongoing business operations on a per customer basis, and evaluate how changes in our business operations affect the support costs per customer. Given its use throughout the industry, CCPU also serves as a standard by which we compare our performance against that of other wireless communications companies. For the years ended December 31, 2008, 2007 and 2006, our CCPU was \$12.74, \$13.05 and \$13.21, respectively. As discussed above, CCPU now includes USF taxes on a gross basis, with the surcharge collected from customers now reflected in ARPU. The impact on CCPU was the same as the impact on ARPU. The improvement in CCPU over this period was a result of lower average customer voice usage, decreasing costs on the per-minute rate charged to us by Sprint Nextel, the allocation of fixed costs over a growing customer base and a decline in our care center expenses reflecting significantly lower cost per minute rates as a result of the move to offshore service, as well as lower call volumes. These factors were partially offset by net additions to our hybrid plan customers and the impact of our postpaid customers, both of which have a higher CCPU as a result of their higher usage profiles, as well as the impact of the restructuring charge and transition expenses recorded this year. Our net loss on

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equipment sold to existing customers for replacement handsets increased 12.5% in 2008, as compared to last year, reflecting an increase in the number of replacement handsets and a shift to higher-end handsets. We anticipate that there may be some pressure on CCPU in the future, as the economy improves, due to potentially increasing customer usage and purchases of subsidized replacement handsets; however, efficiencies driven by the increasing scale of our business are expected to help offset that pressure. In addition, we will consider appropriate cost reductions and pricing actions necessary to maintain a balanced relationship between ARPU and CCPU. As noted above, on December 22, 2008, we entered into the Sixth and Seventh Amendments to the PCS Services Agreement with Sprint Nextel. Under the Seventh Amendment, beginning in 2009 we will no longer be subject to minimum annual payments and will pay fixed rates for voice, messaging and data traffic that are lower than rates applicable in 2008. This will help us to offset any upward pressure on CCPU.

The following table illustrates the calculation of CCPU and reconciles total costs used in the CCPU calculation to cost of service, which we consider to be the most directly comparable GAAP financial measure.

| (in thousands, except number of months and CCPU)                                                                                     | Year Ended December 31, |                     |                   |
|--------------------------------------------------------------------------------------------------------------------------------------|-------------------------|---------------------|-------------------|
|                                                                                                                                      | 2008                    | 2007<br>(Unaudited) | 2006              |
| Cost of service (exclusive of depreciation and amortization)                                                                         | \$ 367,104              | \$ 362,043          | \$ 302,002        |
| Less: Cost of service associated with initial customer                                                                               | (2,148)                 | (2,261)             | (1,968)           |
| Add: General and administrative expenses (excluding Bluebottle USA Investments L.P. expenses prior to the IPO) (1)                   | 336,316                 | 338,548             | 288,414           |
| Add: Restructuring expense                                                                                                           | 8,972                   |                     |                   |
| Less: Non-cash compensation expense                                                                                                  | (12,409)                | (7,423)             | (2,563)           |
| Less: Write-offs of property and equipment                                                                                           | (671)                   | (155)               |                   |
| Add: Net loss on equipment sold to existing customers                                                                                | 77,656                  | 69,026              | 38,042            |
| Add: Cooperative advertising in support of existing customers                                                                        | 549                     | 2,348               | 2,362             |
| Add: Other expense (income), net of tax receivable agreements expense, Bluebottle USA Investments L.P. and debt extinguishment costs | 70                      | (135)               | 799               |
| <b>Total CCPU costs</b>                                                                                                              | <b>\$ 775,439</b>       | <b>\$ 761,991</b>   | <b>\$ 627,088</b> |
| Divided by weighted average number of customers                                                                                      | 5,073                   | 4,864               | 3,957             |
| Divided by number of months in the period                                                                                            | 12                      | 12                  | 12                |
| <b>CCPU</b>                                                                                                                          | <b>\$ 12.74</b>         | <b>\$ 13.05</b>     | <b>\$ 13.21</b>   |

(1) Bluebottle USA Investments L.P. general and administrative expenses were: \$0, \$277 and \$232 for the years ended December 31, 2008, 2007 and 2006, respectively.

CPGA is used to measure the cost of acquiring a new customer. The costs included in this calculation are our (1) selling expenses less cooperative advertising in support of existing customers, (2) net loss on equipment sales (cost of equipment less net equipment revenue), excluding the net loss on equipment sold to existing customers, write-offs of property and equipment and equity issued to a member, and (3) cost of service associated with initial customer acquisition. These costs are divided by gross additions for the period being measured. CPGA helps us to assess the efficiency of our customer acquisition methods and evaluate our sales and distribution strategies. CPGA also allows us to compare our average acquisition costs to those of other wireless communications providers. For the years ended December 31, 2008, 2007 and 2006, our CPGA was \$108.68, \$111.66 and \$120.55, respectively. The decline in CPGA across this period reflects, for 2007, the increase in gross additions and, for both periods, a decline in advertising and media spending. These factors were partially offset by the increased handset subsidies this year to promote our new offers, including higher retail commissions due to the popularity of our high-end Wild Card handset. While these handsets have a slightly higher CPGA, they generate higher data usage. In addition, our CPGA for this year reflects the higher CPGA associated with our new postpaid business. The variable component of CPGA (the component which varies directly with the number of customers we acquire and which includes costs such as our handset subsidy) will



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continue to vary based on our mix of handsets and our marketing efforts to acquire new customers. Overall CPGA performance, including costs which are less variable in nature, such as marketing costs, which are allocated across our gross additions, will also continue to vary based on our level of gross additions.

The following table illustrates the calculation of CPGA and reconciles the total costs used in the CPGA calculation to selling expense, which we consider to be the most directly comparable GAAP financial measure.

| (in thousands, except CPGA)                                       | Year Ended December 31, |                     |                   |
|-------------------------------------------------------------------|-------------------------|---------------------|-------------------|
|                                                                   | 2008                    | 2007<br>(Unaudited) | 2006              |
| Selling expenses                                                  | \$ 96,735               | \$ 107,883          | \$ 113,318        |
| Add: Cost of equipment                                            | 426,249                 | 425,263             | 378,981           |
| Less: Net equipment and other revenue                             | (87,623)                | (85,890)            | (90,524)          |
| Less: Net loss on equipment sold to existing customers            | (77,656)                | (69,026)            | (38,042)          |
| Less: Write-offs of property and equipment                        |                         | (295)               |                   |
| Add: Cooperative advertising in support of existing customers     | (549)                   | (2,348)             | (2,362)           |
| Add: Cost of service associated with initial customer acquisition | 2,148                   | 2,261               | 1,968             |
| <b>Total CPGA costs</b>                                           | <b>\$ 359,304</b>       | <b>\$ 377,848</b>   | <b>\$ 363,339</b> |
| Divided by gross additions                                        | 3,306                   | 3,384               | 3,014             |
| <b>CPGA</b>                                                       | <b>\$ 108.68</b>        | <b>\$ 111.66</b>    | <b>\$ 120.55</b>  |

**Historical Results of Operations*****Out-of-Period Adjustments***

In conjunction with the preparation of our financial statements for the six months ended June 30, 2007, we identified errors in our financial statements in the amount of \$0.5 million, \$(0.3) million, \$(0.3) million and \$3.8 million to our net income (loss) for the years ended December 31, 2006, 2005 and 2004 and for the three months ended March 31, 2007, respectively. These errors, which were determined to constitute material weaknesses in our internal control over financial reporting, were primarily the result of system interface failures for certain recovery fees, airtime taxes and regulatory charges and accrued revenues, overstated our net service revenue and overstated our cost of service, except for the three month period ended March 31, 2007, which understated our net service revenue and overstated our cost of service. We corrected these errors through a restatement of our results for the three months ended March 31, 2007 in the amount of \$3.8 million and an out-of-period net adjustment amounting to \$(0.1) million (comprised of the cumulative effect of the prior years' errors in the amount of \$0.5 million, \$(0.3) million and \$(0.3) million for the years ended December 31, 2006, 2005 and 2004, respectively) included elsewhere in this report. We did not restate our financial statements for any period ended on or prior to December 31, 2006, as we do not believe that these errors were material to any interim or annual prior periods. The impact of the out-of-period adjustments in 2007 was not material to our financial statements for the three months ended March 31, 2007. We restated our previously reported interim results for the three months ended March 31, 2007 when we filed our quarterly report on Form 10-Q for the period ending March 31, 2008.

In September 2007, in order to remediate these material weaknesses, we (1) commenced an external assessment of our revenue flows and control points, (2) instituted additional monitoring controls in our periodic reconciliations of the affected accounts, and (3) made corrections to those interfaces responsible for the errors. The external assessment was completed in the fourth quarter of 2007. As a result of the assessment, we launched a dedicated team who instituted automated controls to monitor data flows between key systems, providing management with more timely information in the event discrepancies should occur, and correcting the system interfaces. These controls, which are ongoing, are intended to ensure that correction of potentially material errors will take place prior to results being reported. Management has tested these new controls and found no material weaknesses.

**Table of Contents***Comparison of results of operations for the year ended December 31, 2008 to the year ended December 31, 2007*

| (\$ in thousands)                                                                | Year Ended December 31, |                  | Change          |                |
|----------------------------------------------------------------------------------|-------------------------|------------------|-----------------|----------------|
|                                                                                  | 2008                    | 2007             | \$              | %              |
| <b>Operating revenue:</b>                                                        |                         |                  |                 |                |
| Net service revenue                                                              | \$ 1,235,870            | \$ 1,239,533     | \$ (3,663)      | (0.3)%         |
| Net equipment and other revenue                                                  | 87,623                  | 85,890           | 1,733           | 2.0%           |
| <b>Total operating revenue</b>                                                   | <b>1,323,493</b>        | <b>1,325,423</b> | <b>(1,930)</b>  | <b>(0.1)%</b>  |
| <b>Operating expenses</b>                                                        |                         |                  |                 |                |
| Cost of service (exclusive of depreciation and amortization)                     | 367,104                 | 362,043          | 5,061           | 1.4%           |
| Cost of equipment                                                                | 426,249                 | 425,263          | 986             | 0.2%           |
| Selling, general and administrative (exclusive of depreciation and amortization) | 433,051                 | 446,708          | (13,657)        | (3.1)%         |
| Restructuring expense                                                            | 8,972                   |                  | 8,972           | N/M            |
| Depreciation and amortization                                                    | 40,128                  | 33,608           | 6,520           | 19.4%          |
| <b>Total operating expenses</b>                                                  | <b>1,275,504</b>        | <b>1,267,622</b> | <b>7,882</b>    | <b>0.6%</b>    |
| <b>Operating income</b>                                                          | <b>47,989</b>           | <b>57,801</b>    | <b>(9,812)</b>  | <b>(17.0)%</b> |
| <b>Other expense (income)</b>                                                    |                         |                  |                 |                |
| Interest expense                                                                 | 33,710                  | 54,988           | (21,278)        | (38.7)%        |
| Interest income                                                                  | (3,001)                 | (1,597)          | (1,404)         | (87.9)%        |
| Interest expense net                                                             | 30,709                  | 53,391           | (22,682)        | (42.5)%        |
| Other expense (income)                                                           | 5,686                   | (129)            | 5,815           | N/M            |
| <b>Total other expense</b>                                                       | <b>36,395</b>           | <b>53,262</b>    | <b>(16,867)</b> | <b>(31.7)%</b> |
| <b>Income before income tax expense</b>                                          | <b>11,594</b>           | <b>4,539</b>     | <b>7,055</b>    | <b>155.4%</b>  |
| Income tax expense                                                               | 1,285                   | 321              | 964             | 300.3%         |
| <b>Income before minority interest</b>                                           | <b>10,309</b>           | <b>4,218</b>     | <b>6,091</b>    | <b>144.4%</b>  |
| Minority interest                                                                | 2,364                   |                  | 2,364           | N/M            |
| <b>Net income</b>                                                                | <b>\$ 7,945</b>         | <b>\$ 4,218</b>  | <b>\$ 3,727</b> | <b>88.4%</b>   |

*Operating Revenue*

*Total operating revenue* for the year ended December 31, 2008 was \$1,323.5 million, a decrease of \$1.9 million, or 0.1%, as compared to 2007, reflecting a decline in net service revenue of 0.3%, partially offset by an increase in net equipment and other revenue of 2.0%.

*Net service revenue* consists primarily of voice and mobile data services, reduced primarily by sales and E911 taxes. E911 taxes are typically assessed by state and local regulatory authorities on a flat rate basis, with most states basing it on the number of active customers. Net service revenue also includes non-refundable customer account balances, reflected as revenue after a customer has deactivated service and expired Top-Up cards. As noted above, net service revenue also includes the surcharge for USF collected from our customers, formerly recorded as a reduction in cost of service. The impact was \$13.3 million and \$12.5 million for 2008 and 2007, respectively. Net service revenue for the year ended December 31, 2008 was \$1,235.9 million, a decrease of \$3.7 million, or 0.3%, as compared to 2007. This decrease reflects the impact of lower average voice usage and migration of high-usage, traditional pay-as-you-go, customers to the lower-priced monthly offers, as well as the \$4.3 million of E911 tax refunds and favorable settlements with taxing jurisdictions in 2007 and the \$5.6 million of additional contributions to state E911 funds in 2008, each as discussed above. These factors were partially offset by the 5.8% growth in our customer base, driven by net additions to our higher-value hybrid base,



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and the addition of Helio's postpaid customers, along with a greater penetration of data services, including the growing substitution of lower-priced text messaging for voice services.

*Net equipment and other revenue* consists primarily of handset sales reduced by an allowance for returns, promotional handset price reductions and price protection estimates, and is also reduced for costs such as cooperative advertising, a fund provided by us and typically calculated as a percentage of sales that a retailer must use to promote our products, and commissions, for which we do not receive an identifiable and separable benefit. Net equipment revenue for the year ended December 31, 2008 was \$87.6 million, an increase of \$1.7 million, or 2.0%, as compared to 2007. This increase primarily reflects an increase in volume, including the impact of our postpaid handset sales, a mix shift to higher-end handsets and the inclusion of early termination fees associated with the postpaid business. These factors were partially offset by an increase in promotional spending, recorded as a reduction of net equipment revenue, and some decline in average prices.

### *Operating Expenses*

*Cost of service* includes network service costs, airtime taxes (including Federal and State Universal Service Funds, State PUC taxes and other miscellaneous taxes and fees), production costs for Top-Up cards, mobile data service fees and entertainment content license fees. As discussed above, cost of service includes Federal and State USF taxes on a gross cost basis, with the amount collected from customers now reflected in net service revenue. Cost of service for the year ended December 31, 2008 was \$367.1 million, an increase of \$5.1 million, or 1.4%, compared to 2007. This increase reflects the impact on network utilization of our customer growth, including the addition of our postpaid customers, and the growth in our data services and messaging bundles, partially offset by a reduction in Sprint Nextel network rates and lower voice usage.

*Cost of equipment* includes the cost of purchasing and packaging handsets sold to our customers. Cost of equipment is reduced for market development funds received from our handset vendors, which are recorded as contra equipment cost. Cost of equipment for the year ended December 31, 2008 was \$426.2 million, an increase of \$1.0 million, or 0.2%, compared to 2007. This increase reflects a net \$45.0 million reduction in cost in 2007 as a result of a change to consignment for certain retailers, an increase in volume, including the impact of our postpaid business, and the impact of a mix shift to higher-end handsets such as the Wild Card. These factors were largely offset by lower average purchase prices driven by lower warranty replacement costs, and an increase in market development funds received from our handset vendors.

*Selling, general and administrative expenses* for the year ended December 31, 2008 were \$433.1 million, a decrease of \$13.7 million, or 3.1%, compared to 2007. This decrease resulted primarily from a \$11.8 million decline in advertising and media spending, an \$18.6 million decrease in IT expenses, reflecting the benefit of our IBM outsourcing contract, an \$8.2 million decrease in commissions amortized for sales of Top-Up cards, and a \$4.3 million decrease in our care center expenses reflecting, in part, our move to offshore service. These were partially offset primarily by a \$18.4 million increase in our administrative support expenses, including expenses associated with being a public company, expenses associated with our postpaid business and an increase in royalty expense, the \$5.5 million in transition expenses associated with our acquisition of Helio and our IBM contract, and a \$4.4 million increase in our sales distribution expenses, again, including expenses associated with our postpaid business.

*Restructuring expenses* for the year ended December 31, 2008 were \$9.0 million. This includes \$7.7 million of expense associated with our IBM outsourcing agreement, \$0.4 million of which is fixed asset-related, \$0.6 million of expense associated with our acquisition of Helio, both primarily employee charges, and \$0.7 million of expense associated with our fourth quarter workforce reduction.

*Depreciation and amortization expense* for the year ended December 31, 2008 was \$40.1 million, an increase \$6.5 million, or 19.4%, as compared to 2007. The increase primarily reflects an incremental \$7.2 million of depreciation and amortization associated with Helio, including approximately \$3.4 million for the amortization of intangible assets.

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*Interest expense net* for the year ended December 31, 2008 was \$30.7 million, a decrease of \$22.7 million, or 42.5%, as compared to 2007, with the decline reflecting lower interest rates and lower average debt, as well as an increase in interest income related to FET refunds.

*Other expense (income)* for the year ended December 31, 2008 was \$5.7 million, compared to \$(0.1) million for the prior year, with the increase primarily reflecting our tax receivable agreements expense.

### *Comparison of results of operations for the year ended December 31, 2007 to the year ended December 31, 2006*

| (\$ in thousands)                                                                | Year Ended December 31, |                  | Change         |              |
|----------------------------------------------------------------------------------|-------------------------|------------------|----------------|--------------|
|                                                                                  | 2007                    | 2006             | \$             | %            |
| <b>Operating revenue:</b>                                                        |                         |                  |                |              |
| Net service revenue                                                              | \$ 1,239,533            | \$ 1,022,927     | \$ 216,606     | 21.2%        |
| Net equipment and other revenue                                                  | 85,890                  | 90,524           | (4,634)        | (5.1)%       |
| <b>Total operating revenue</b>                                                   | <b>1,325,423</b>        | <b>1,113,451</b> | <b>211,972</b> | <b>19.0%</b> |
| <b>Operating expenses</b>                                                        |                         |                  |                |              |
| Cost of service (exclusive of depreciation and amortization)                     | 362,043                 | 302,002          | 60,041         | 19.9%        |
| Cost of equipment                                                                | 425,263                 | 378,981          | 46,282         | 12.2%        |
| Selling, general and administrative (exclusive of depreciation and amortization) |                         |                  |                |              |