NEXTEL PARTNERS INC
Form 10-Q
August 09, 2004

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2004

OR

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

For the transition period from to .
Commission file number: 000-29633

NEXTEL PARTNERS, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware	**91-1930918**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

4500 Carillon Point
Kirkland, Washington 98033
(425) 576-3600
(Address of principal executive offices, zip code and registrant's telephone number, including area code)

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 ý No o.

Indicate by check mark whether the registrant is an accelerated filer (as defined in the Exchange Act Rule 12b-2). Yes ý No o.

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

Outstanding Title of Class	**Number of Shares on August 2, 2004**

Class A Common Stock	184,711,591 shares
Class B Common Stock	79,056,228 shares

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Item I FINANCIAL INFORMATION

Item I Financial Statements

NEXTEL PARTNERS, INC. AND SUBSIDIARIES
Consolidated Condensed Balance Sheets
(dollars in thousands)
(unaudited)

	June 30, 2004	December 31, 2003
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 138,180	$ 122,620
Short-term investments	84,212	146,191
Accounts receivable, net of allowance $16,077 and $14,873, respectively	171,072	150,219
Subscriber equipment inventory	34,922	24,007
Other current assets	19,191	19,006
Total current assets	447,577	462,043
PROPERTY, PLANT AND EQUIPMENT, at cost	1,440,390	1,380,866
Less accumulated depreciation and amortization	(428,846)	(355,770)
Property, plant and equipment, net	1,011,544	1,025,096
OTHER NON-CURRENT ASSETS:		
FCC licenses, net of accumulated amortization of $8,744	374,064	371,898
Debt issuance costs and other, net of accumulated amortization of $4,706 and $12,165, respectively	21,708	30,273
Total non-current assets	395,772	402,171
TOTAL ASSETS	$ 1,854,893	$ 1,889,310
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$ 84,446	$ 76,654
Accrued expenses and other current liabilities	91,143	98,878
Due to Nextel WIP	11,479	9,893
Total current liabilities	187,068	185,425
LONG-TERM OBLIGATIONS:		
Long-term debt	1,633,794	1,653,539
Deferred income taxes	37,552	45,387
Other long-term liabilities	15,801	18,255
Total long-term obligations	1,687,147	1,717,181
TOTAL LIABILITIES	1,874,215	1,902,606

	June 30, 2004	December 31, 2003
COMMITMENTS AND CONTINGENCIES (See Notes)		
STOCKHOLDERS' EQUITY (DEFICIT):		
Common stock, Class A, par value $.001 per share, 184,629,733 and 183,186,434 shares, respectively, issued and outstanding, and paid-in capital	1,023,647	1,015,376
Common stock, Class B, par value $.001 per share convertible, 79,056,228 shares issued and outstanding, and paid-in capital	163,312	163,312
Accumulated deficit	(1,205,374)	(1,190,643)
Deferred compensation	(907)	(1,341)
Total stockholders' equity (deficit)	(19,322)	(13,296)
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)	$ 1,854,893	$ 1,889,310

See accompanying notes to the consolidated condensed financial statements.

NEXTEL PARTNERS, INC. AND SUBSIDIARIES
Consolidated Condensed Statements of Operations
(dollars in thousands, except per share amounts)
(unaudited)

	For the three months ended June 30,		For the six months ended June 30,	
	2004	2003	2004	2003
REVENUES:				
Service revenues (earned from Nextel WIP $36,790, $26,917, $70,577 and $49,866, respectively)	$ 312,232	$ 226,507	$ 599,494	$ 427,049
Equipment revenues	20,167	7,762	39,036	15,029
Total revenues	332,399	234,269	638,530	442,078
OPERATING EXPENSES:				
Cost of service revenues (excludes depreciation of $29,581, $26,769, $59,277 and $53,176, respectively) (incurred from Nextel WIP $28,710, $23,971, $55,034 and $43,813, respectively)	86,960	77,492	170,291	149,073
Cost of equipment revenues	38,276	23,333	73,582	44,935
Selling, general and administrative (incurred from Nextel WIP $5,626, $2,973, $10,576 and $6,385, respectively)	117,808	98,734	231,230	187,369
Stock based compensation (primarily selling, general and administrative related)	337	218	554	481
Depreciation and amortization	36,630	33,488	73,199	65,994
Total operating expenses	280,011	233,265	548,856	447,852
INCOME (LOSS) FROM OPERATIONS	52,388	1,004	89,674	(5,774)
Interest expense, net	(27,296)	(39,104)	(58,248)	(79,397)
Interest income	302	481	979	1,282
Loss on early retirement of debt	(53,413)	(68,082)	(54,971)	(68,127)
LOSS BEFORE DEFERRED INCOME TAX BENEFIT (PROVISION)	(28,019)	(105,701)	(22,566)	(152,016)
Deferred income tax benefit (provision)	8,634	(3,216)	7,835	(6,090)
NET LOSS	(19,385)	(108,917)	(14,731)	(158,106)
Mandatorily redeemable preferred stock dividends		(1,092)		(2,141)
NET LOSS ATTRIBUTABLE TO COMMON STOCKHOLDERS	$ (19,385)	$ (110,009)	$ (14,731)	$ (160,247)
NET LOSS PER SHARE ATTRIBUTABLE TO COMMON STOCKHOLDERS:				
Basic and Diluted	$ (0.07)	$ (0.44)	$ (0.06)	$ (0.64)

	For the three months ended June 30,		For the six months ended June 30,	
Weighted average number of shares outstanding:				
Basic and Diluted	263,051,820	250,959,915	262,725,205	250,718,365

See accompanying notes to the consolidated condensed financial statements.

NEXTEL PARTNERS, INC. AND SUBSIDIARIES
Consolidated Condensed Statements of Cash Flows
(in thousands)
(unaudited)

	For the six months ended June 30,	
	2004	**2003**
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$ (14,731)	$ (158,106)
Adjustments to reconcile net loss to net cash from operating activities		
Deferred income tax provision	(7,835)	6,090
Depreciation and amortization	73,199	65,994
Amortization of debt issuance costs	2,105	2,331
Interest accretion for senior discount notes	20	26,802
Bond discount amortization	468	616
Loss on retirement of debt	54,971	68,127
Fair value adjustments of derivative instruments	(2,106)	(1,406)
Stock based compensation	554	481
Other	(291)	313
Changes in current assets and liabilities:		
Accounts receivable, net	(20,853)	(4,540)
Subscriber equipment inventory	(10,915)	593
Other current and long-term assets	(47)	(3,497)
Accounts payable, accrued expenses and other current liabilities	3,997	(15,570)
Operating advances due from Nextel WIP	2,310	(8,887)
Net cash from operating activities	80,846	(20,659)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures	(64,318)	(84,824)
FCC licenses	(2,500)	(13,607)
Proceeds from sale and maturities of short-term investments, net	61,979	(7,888)
Net cash from investing activities	(4,839)	(106,319)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from borrowings	724,565	625,000
Stock options exercised	6,638	246
Proceeds from stock issued for employee stock purchase plan	1,150	847
Proceeds from sale lease-back transactions	779	6,250
Debt repayments	(788,909)	(486,497)
Capital lease payments	(1,569)	(1,114)
Debt and equity issuance costs	(3,101)	(12,848)
Net cash from financing activities	(60,447)	131,884
NET INCREASE IN CASH AND CASH EQUIVALENTS	15,560	4,906
CASH AND CASH EQUIVALENTS, beginning of period	122,620	67,522

	For the six months ended June 30,	
CASH AND CASH EQUIVALENTS, end of period	$ 138,180	$ 72,428
SUPPLEMENTAL DISCLOSURE OF NON-CASH TRANSACTIONS		
Cash paid for income taxes	$	$
Capitalized interest on accretion of senior discount notes	$	$ 373
Accretion of mandatorily redeemable preferred stock dividends	$	$ 2,141
Retirement of long-term debt with common stock	$	$ 6,973
Cash paid for interest, net of capitalized amount	$ 70,051	$ 51,359

See accompanying notes to the consolidated condensed financial statements.

NEXTEL PARTNERS, INC. AND SUBSIDIARIES
Notes to Consolidated Condensed Financial Statements
June 30, 2004
(unaudited)

1. BASIS OF PRESENTATION

Our interim consolidated condensed financial statements for the three- and six-month periods ended June 30, 2004 and 2003 have been prepared without audit, pursuant to the rules and regulations of the Securities and Exchange Commission("SEC") for interim financial reporting. Certain information and footnote disclosures normally included in the annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations for interim financial statements. These consolidated condensed financial statements should be read in conjunction with the audited consolidated financial statements and notes contained in our annual report on Form 10-K for the year ended December 31, 2003 and quarterly filings on Form 10-Q filed with the SEC.

The financial information included herein reflects all adjustments (consisting only of normal recurring adjustments and accruals) which are, in the opinion of management, necessary for the fair presentation of the results of the interim periods. The results of operations for the three- and six-month periods ended June 30, 2004 are not necessarily indicative of the results to be expected for the full year ending December 31, 2004.

2. OPERATIONS

Description of Business

Nextel Partners provides a wide array of digital wireless communications services throughout the United States, primarily to business users, utilizing frequencies licensed by the Federal Communications Commission ("FCC"). Our operations are primarily conducted by Nextel Partners Operating Corp. ("OPCO"), a wholly owned subsidiary. Substantially all of our assets, liabilities, operating losses and cash flows are within OPCO and our other wholly owned subsidiaries.

Our digital network ("Nextel Digital Wireless Network") has been developed with advanced mobile communication systems employing digital technology developed by Motorola, Inc. ("Motorola") (such technology is referred to as the "integrated Digital Enhanced Network" or "iDEN") with a multi-site configuration permitting frequency reuse. Our principal business objective is to offer high-capacity, high-quality, advanced communication services in our territories throughout the United States targeted towards mid-sized and rural markets. Various operating agreements entered into by our subsidiaries and Nextel WIP Corp. ("Nextel WIP"), an indirect wholly owned subsidiary of Nextel Communications, Inc. ("Nextel"), govern the support services to be provided to us by Nextel WIP (see Note 7).

3. SIGNIFICANT ACCOUNTING POLICIES

Concentration of Risk

We believe that the geographic and industry diversity of our customer base minimizes the risk of incurring material losses due to concentration of credit risk.

We are a party to certain equipment purchase agreements with Motorola (see Note 7). For the foreseeable future we expect that we will need to rely on Motorola for the manufacture of a substantial portion of the infrastructure equipment necessary to construct and make operational our portion of the Nextel Digital Wireless Network as well as for the provision of digital mobile telephone handsets and accessories.

As previously discussed, we are reliant on Nextel WIP for the provision of certain services. For the foreseeable future, we will need to rely on Nextel WIP for the provision of these services, as we will not have the infrastructure to support those services.

In addition, if Nextel encounters financial or operating difficulties relating to its portion of the Nextel Digital Wireless Network, or experiences a significant decline in customer acceptance of services and products, our business may be adversely affected, including the quality of our services, the ability of our customers to roam within the entire network and our ability to attract and retain customers.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ materially from those estimates.

Principles of Consolidation

The consolidated condensed financial statements include our accounts and those of our wholly owned subsidiaries. All significant intercompany transactions and balances have been eliminated in consolidation.

Net Income (Loss) per Share

In accordance with Statement of Financial Accounting Standards ("SFAS") No. 128, "*Computation of Earnings Per Share*," basic earnings per share is computed by dividing income (loss) attributable to common stockholders by the weighted average number of shares of common stock outstanding during the period. Diluted earnings per share adjusts basic earnings per common share for the effects of potentially dilutive common shares. Potentially dilutive common shares primarily include the dilutive effects of shares issuable under our stock option plan and outstanding unvested restricted stock using the treasury stock method and the dilutive effects of shares issuable upon the conversion of our convertible senior notes using the if-converted method. As presented, basic and diluted loss per share are equal since common equivalent shares are excluded from the calculation of diluted earnings per share as their effects are antidilutive due to our net losses.

At June 30, 2004 approximately 32.9 million shares issuable upon the assumed conversion of our $1^1/_2$% convertible senior notes could potentially dilute earnings per share in the future but were excluded from the calculation of diluted earnings per common share due to their antidilutive effects. Additionally, at June 30, 2004 and 2003, approximately 170,000 and 180,000 shares of restricted stock, respectively, and 22.9 million and 19.2 million stock options outstanding, respectively, were excluded from the calculation of common equivalent shares, as their effects are antidilutive.

The following schedule is our net loss per share calculation for the three and six months ended June 30, 2004 and 2003:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2004	2003	2004	2003
	(in thousands, except share and per share amounts)			
Loss attributable to common stockholders (numerator for basic and diluted)	$ (19,385)	$ (110,009)	$ (14,731)	$ (160,247)
Gross weighted average common shares outstanding (denominator for basic and diluted)	263,221,820	251,139,915	262,895,205	250,898,365
Less:				
Weighted average shares subject to repurchase	(170,000)	(180,000)	(170,000)	(180,000)
Shares used in computation	263,051,820	250,959,915	262,725,205	250,718,365
Basic and diluted net loss per share	$ (0.07)	$ (0.44)	$ (0.06)	$ (0.64)

Cash and Cash Equivalents

Cash equivalents include time deposits and highly liquid investments with remaining maturities of three months or less at the time of purchase.

Short-Term Investments

Marketable debt securities with original purchase maturities greater than three months are classified as short-term investments. Short-term investments at June 30, 2004 and December 31, 2003 consisted of U.S. Treasury securities, mortgage-backed securities, auction rate securities and commercial paper. We classify our debt securities as trading because the securities are bought and held principally for the purpose of selling them in the near term. Trading securities are recorded at fair value. Unrealized holding gains and losses on trading securities are included in earnings.

Sale-Leaseback Transactions

We periodically enter into transactions whereby we transfer specified switching equipment and telecommunication towers and related assets to third parties, and subsequently lease all or a portion of these assets from these parties. During the three months ended June 30, 2004 and 2003 we received cash proceeds of approximately $390,000 and $5.4 million, respectively, and for the six months ended June 30, 2004 and 2003 we received cash proceed of approximately $779,000 and $6.3 million, respectively, for assets sold to third parties. No gain was recognized on these transactions.

FCC Licenses

FCC operating licenses are recorded at historical cost. Our FCC licenses and the requirements to maintain the licenses are similar to other licenses granted by the FCC, including Personal Communications Services ("PCS") and cellular licenses, in that they are subject to renewal after the initial 10-year term. Historically, the renewal process associated with these FCC licenses has been perfunctory. The accounting for these licenses has historically not been constrained by the renewal and operational requirements.

On January 1, 2002 we implemented SFAS No. 142, "*Goodwill and Other Intangible Assets*." SFAS No. 142 requires the use of a non-amortization approach to account for purchased goodwill and certain

intangibles. Under a non-amortization approach, goodwill and certain intangibles are not amortized into results of operations, but instead are reviewed at least annually for impairment, and written down as a charge to results of operations only in the periods in which the recorded value of goodwill and certain intangibles exceeds fair value. We have determined that FCC licenses have indefinite lives; therefore, as of January 1, 2002, we no longer amortize the cost of these licenses. We performed an annual asset impairment analyses on our FCC licenses and to date we have determined there has been no impairment related to our FCC licenses. For our impairment analysis, we used the aggregate of all our FCC licenses, which constitutes the footprint of our portion of the Nextel Digital Wireless Network, as the unit of accounting for our FCC licenses based on the guidance in Emerging Issues Task Force ("EITF") Issue No. 02-7, "*Unit of Accounting for Testing Impairment of Indefinite-Lived Intangible Assets*."

As a result of adopting SFAS No. 142, we record a non-cash income tax provision in accordance with the annual effective tax rate methodology for interim tax reporting. Because we ceased amortizing licenses for financial statement purposes on January 1, 2002, we can no longer estimate the amount, if any, of deferred tax liabilities related to our FCC licenses which will reverse during the net operating loss carry forward period. Accordingly, we increase the valuation allowance as the deferred tax liabilities related to FCC licenses increase. During the three and six months ended June 30, 2004, we recorded a deferred income tax benefit of $8.6 million and $7.8 million, respectively, relating to our FCC licenses. During the same periods ended June 30, 2003, we recorded a deferred income tax provision of $3.2 million and $6.1 million, respectively, relating primarily to our FCC licenses.

Interest Rate Risk Management

We use derivative financial instruments consisting of interest rate swap and interest rate protection agreements in the management of our interest rate exposures. In April 1999 and 2000, we entered into interest rate swap agreements for $60 million and $50 million, respectively, to partially hedge interest rate exposure with respect to our term B and C loans. In April 2004 we terminated the $60 million interest rate swap agreement in accordance with its original terms and paid approximately $639,000 for the final settlement. We did not record any realized gain or loss with this termination since this swap did not qualify for cash flow hedge accounting and we recognized changes in its fair value up to the termination date as part of our interest expense.

The term B and C loans were replaced in connection with the refinancing of our credit facility in May 2004; however, we maintained the existing $50 million rate swap agreement. The interest rate swap agreement has the effect of converting certain of our variable rate obligations to fixed or other variable rate obligations. Prior to the adoption of SFAS No. 133 (as described below), amounts paid or received under the interest rate swap agreement were accrued as interest rates changed and recognized over the life of the swap agreement as an adjustment to interest expense. On January 1, 2001, we adopted SFAS No. 133, "*Accounting for Derivative Instruments and Hedging Activities,*" as amended by SFAS No. 138. These statements establish accounting and reporting standards requiring that every derivative instrument (including certain derivative instruments embedded in other contracts) be recorded on the balance sheet as either an asset or liability measured at fair value. These statements require that changes in the derivative's fair value be recognized currently in earnings unless specific hedge accounting criteria are met. If hedge accounting criteria are met, the changes in a derivative's fair value (for a cash flow hedge) are deferred in stockholders' equity as a component of comprehensive income. These deferred gains and losses are recognized as income in the period in which the hedge item and hedging instrument are settled. The ineffective portions of hedge returns are recognized as earnings. In accordance with SFAS No. 133, our existing swap agreement has been designated as an ineffective cash flow hedge.

The interest rate swap agreement is included in other long-term liabilities on the balance sheet. The following discloses the fair value of the swap agreements recorded as of June 30, 2004:

	(in thousands)
Fair value of liability as of December 31, 2003	$ 5,195
Change in fair value interest rate changes	(2,106)
Settlement of $60 million swap agreement terminated	(639)
Fair value of liability as of June 30, 2004	$ 2,450

For the three months ended June 30, 2004 and 2003, we recorded non-cash, non-operating gains of $972,000 and $797,000, respectively, and for the six months ended June 30, 2004 and 2003 we recorded non-cash, non-operating gains of $2.1 million and $1.4 million, respectively, related to the change in market value of the interest rate swap agreements in interest expense.

We will not use financial instruments for trading or other speculative purposes, nor will we be a party to any leveraged derivative instrument. The use of derivative financial instruments is monitored through regular communication with senior management. We will be exposed to credit loss in the event of nonperformance by the counter parties. This credit risk is minimized by dealing with a group of major financial institutions with whom we have other financial relationships. We do not anticipate nonperformance by these counter parties. We are also subject to market risk should interest rates change.

Revenue Recognition

Service revenues primarily include fixed monthly access charges for the digital cellular service, Nextel Direct Connect, and other wireless services and variable charges for airtime usage in excess of plan minutes. We recognize revenue for access charges and other services charged at fixed amounts plus excess airtime usage ratably over the service period, net of customer discounts and adjustments, over the period earned.

For regulatory fees billed to customers such as the Universal Service Fund ("USF") we net those billings against payments to the USF. Total billings to customers during the three months ended June 30, 2004 and 2003 were $3.3 million and $1.4 million, respectively, and for the six months ended June 30, 2004 and 2003 were $6.3 million and $2.7 million, respectively.

For the three- and six-month periods ended June 30, 2003, we recognized revenue for phone equipment on a straight-line basis over the expected customer relationship, starting when the customer takes title. As required by Staff Accounting Bulletin, or SAB, No. 101 "*Revenue Recognition in Financial Statements*," our activation fees and phone equipment revenues were deferred and recognized over three years. The decision to defer these revenues was based on the conclusion that while the service contract and the phone equipment revenues are a multiple element arrangement, the elements of the arrangement should not be accounted for separately. The key factor in our conclusion was that our wireless service was essential to the functionality of the phone, due to the fact that our phones, which have a "push to talk" feature, could only be used on our digital network. Concurrently, the related costs for the phone equipment were deferred solely to the extent of deferred revenues. The direct and incremental equipment costs in excess of revenues generated from phone equipment sales were expensed. Subsequent to the initial deferral, the amortization of deferred revenues was equal to the amortization of the deferred costs, resulting in no change to net loss. For the three months ended June 30, 2004 and 2003, we recognized $6.3 million and $7.8 million, respectively, and $13.0 million and $15.0 million for the six months ended June 30, 2004 and 2003, respectively, of activation fees and phone equipment revenues and equipment costs that had been previously deferred.

In November 2002, the EITF issued a final consensus on Issue No. 00-21, "*Accounting for Revenue Arrangements with Multiple Deliverables.*" Issue No. 00-21 provides guidance on how and when to recognize revenues on arrangements requiring delivery of more than one product or service. We adopted EITF Issue No. 00-21 on July 1, 2003 and elected to apply the provisions prospectively to our existing customer arrangements, as described below.

Under EITF Issue No. 00-21, we are no longer required to consider whether a customer is able to realize utility from the phone in the absence of the undelivered service. Given that we meet the criteria stipulated in EITF Issue No. 00-21, we account for the sale of a phone as a unit of accounting separate from the subsequent service to the customer. Accordingly, we recognize revenue from phone equipment sales and the related cost of phone equipment revenues when title to the phone equipment passes to the customer for all arrangements entered into beginning in the third quarter of 2003. This has resulted in the classification of amounts received for the sale of the phone equipment, including any activation fees charged to the customer, as equipment revenues at the time of the sale. In December 2003, the SEC staff issued SAB No. 104, "*Revenue Recognition in Financial Statements,*" which updated SAB No. 101 to reflect the impact of the issuance of EITF No. 00-21.

For arrangements entered into prior to July 1, 2003, we continue to amortize the revenues and costs previously deferred as was required by SAB No. 101. The table below shows the recognition of service revenues, equipment revenues and cost of equipment revenues (handset costs) on a pro forma basis adjusted to exclude the impact of SAB No. 101 and as if EITF No. 00-21 had been historically recorded for all customer arrangements.

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2004	2003	2004	2003
	(in thousands, except per share amounts)			
Service revenues	$ 311,247	$ 227,081	$ 597,470	$ 428,245
Equipment revenues	$ 14,882	$ 11,040	$ 28,056	$ 22,101
Cost of equipment revenues	$ 32,006	$ 27,185	$ 60,578	$ 53,203
Pro forma income (loss) attributable to common stockholders	$			