

NEXTEL PARTNERS INC  
Form 10-Q  
November 09, 2004

# UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

## FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2004

OR

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

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

Commission file number: 000-29633

## NEXTEL PARTNERS, INC.

(Exact Name of Registrant as Specified in Its Charter)

**Delaware**  
(State or Other Jurisdiction of  
Incorporation or Organization)

**91-1930918**  
(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  No .

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

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

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| <b>Outstanding Title of Class</b> | <b>Number of Shares on November 1, 2004</b> |
|-----------------------------------|---|
| Class A Common Stock              | 180,364,933 shares                          |
| Class B Common Stock              | 84,632,604 shares                           |

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 FORM 10-Q  
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**PART I FINANCIAL INFORMATION****Item 1. Financial Statements****NEXTEL PARTNERS, INC. AND SUBSIDIARIES****Consolidated Condensed Balance Sheets****(dollars in thousands)****(unaudited)**

|  | <b>September 30,<br/>2004</b> | <b>December 31,<br/>2003</b> |
|--|-------------------------------|------------------------------|
| <b>ASSETS</b>  |                               |                              |
| <b>CURRENT ASSETS:</b>   |                               |                              |
| Cash and cash equivalents  | \$ 121,945                    | \$ 122,620                   |
| Short-term investments   | 115,342                       | 146,191                      |
| Accounts receivable, net of allowance \$16,835 and \$14,873, respectively  | 183,843                       | 150,219                      |
| Subscriber equipment inventory   | 41,490                        | 24,007                       |
| Other current assets   | 24,613                        | 19,006                       |
| Total current assets   | 487,233                       | 462,043                      |
| <b>PROPERTY, PLANT AND EQUIPMENT, at cost</b>  | <b>1,479,095</b>              | <b>1,380,866</b>             |
| Less accumulated depreciation and amortization   | (466,048 )                    | (355,770 )                   |
| Property, plant and equipment, net   | 1,013,047                     | 1,025,096                    |
| <b>OTHER NON-CURRENT ASSETS:</b>   |                               |                              |
| FCC licenses, net of accumulated amortization of \$8,744   | 375,208                       | 371,898                      |
| Debt issuance costs and other, net of accumulated amortization of \$5,579 and \$12,165, respectively   | 21,065                        | 30,273                       |
| Total non-current assets   | 396,273                       | 402,171                      |
| <b>TOTAL ASSETS</b>  | <b>\$ 1,896,553</b>           | <b>\$ 1,889,310</b>          |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY (DEFICIT)</b>   |                               |                              |
| <b>CURRENT LIABILITIES:</b>  |                               |                              |
| Accounts payable   | \$ 72,650                     | \$ 76,654                    |
| Accrued expenses and other current liabilities   | 102,118                       | 98,878                       |
| Due to Nextel WIP  | 6,488                         | 9,893                        |
| Total current liabilities  | 181,256                       | 185,425                      |
| <b>LONG-TERM OBLIGATIONS:</b>  |                               |                              |
| Long-term debt   | 1,633,162                     | 1,653,539                    |
| Deferred income taxes  | 45,814                        | 45,387                       |
| Other long-term liabilities  | 15,331                        | 18,255                       |
| Total long-term obligations  | 1,694,307                     | 1,717,181                    |
| <b>TOTAL LIABILITIES</b>   | <b>1,875,563</b>              | <b>1,902,606</b>             |
| <b>COMMITMENTS AND CONTINGENCIES (See Notes)</b>   |                               |                              |
| <b>STOCKHOLDERS EQUITY (DEFICIT):</b>  |                               |                              |
| Common stock, Class A, par value \$.001 per share, 180,060,600 and 183,186,434 shares, respectively, issued and outstanding, and paid-in capital | 1,018,810                     | 1,015,376                    |
| Common stock, Class B, par value \$.001 per share convertible, 84,632,604 and 79,056,228 shares issued and outstanding, and paid-in capital      | 172,697                       | 163,312                      |
| Accumulated deficit  | (1,169,853 )                  | (1,190,643 )                 |
| Deferred compensation  | (664 )                        | (1,341 )                     |
| Total stockholders equity (deficit)  | 20,990                        | (13,296 )                    |
| <b>TOTAL LIABILITIES AND STOCKHOLDERS EQUITY (DEFICIT)</b>   | <b>\$ 1,896,553</b>           | <b>\$ 1,889,310</b>          |

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 |                     | For the nine months ended |                      |
|--|----------------------------|---------------------|---------------------------|----------------------|
|  | September 30,<br>2004      | 2003                | September 30,<br>2004     | 2003                 |
| <b>REVENUES:</b>   |                            |                     |                           |                      |
| Service revenues (earned from Nextel WIP \$42,738, \$32,622, \$113,315 and \$82,488, respectively)   | \$ 337,152                 | \$ 260,650          | \$ 936,646                | \$ 687,699           |
| Equipment revenues   | 20,390                     | 20,264              | 59,426                    | 35,293               |
| Total revenues   | 357,542                    | 280,914             | 996,072                   | 722,992              |
| <b>OPERATING EXPENSES:</b>   |                            |                     |                           |                      |
| Cost of service revenues (excludes depreciation of \$30,337, \$27,134, \$89,614 and \$80,310, respectively) (incurred from Nextel WIP \$31,258, \$26,348, \$86,292 and \$70,161, respectively) | 92,606                     | 83,258              | 262,897                   | 232,331              |
| Cost of equipment revenues   | 34,248                     | 37,076              | 107,830                   | 82,011               |
| Selling, general and administrative (incurred from Nextel WIP \$3,932, \$3,538, \$14,507 and \$9,923, respectively)  | 127,160                    | 104,808             | 358,390                   | 292,177              |
| Stock based compensation (primarily selling, general and administrative related)   | (22 )                      | 259                 | 532                       | 740                  |
| Depreciation and amortization  | 37,311                     | 33,527              | 110,510                   | 99,521               |
| Total operating expenses   | 291,303                    | 258,928             | 840,159                   | 706,780              |
| <b>INCOME FROM OPERATIONS</b>  | <b>66,239</b>              | <b>21,986</b>       | <b>155,913</b>            | <b>16,212</b>        |
| Interest expense, net  | (23,460 )                  | (37,438 )           | (81,708 )                 | (116,835 )           |
| Interest income  | 823                        | 648                 | 1,802                     | 1,930                |
| Loss on early retirement of debt   |                            | (6,290 )            | (54,971 )                 | (74,417 )            |
| <b>INCOME (LOSS) BEFORE DEFERRED INCOME TAX PROVISION</b>  | <b>43,602</b>              | <b>(21,094 )</b>    | <b>21,036</b>             | <b>(173,110 )</b>    |
| Deferred income tax provision  | (8,081 )                   | (885 )              | (246 )                    | (6,975 )             |
| <b>NET INCOME (LOSS)</b>   | <b>35,521</b>              | <b>(21,979 )</b>    | <b>20,790</b>             | <b>(180,085 )</b>    |
| Mandatorily redeemable preferred stock dividends   |                            |                     |                           | (2,141 )             |
| <b>NET INCOME (LOSS) ATTRIBUTABLE TO COMMON STOCKHOLDERS</b>   | <b>\$ 35,521</b>           | <b>\$ (21,979 )</b> | <b>\$ 20,790</b>          | <b>\$ (182,226 )</b> |
| <b>NET INCOME (LOSS) PER SHARE ATTRIBUTABLE TO COMMON STOCKHOLDERS:</b>  |                            |                     |                           |                      |
| Basic  | \$ 0.13                    | \$ (0.09 )          | \$ 0.08                   | \$ (0.73 )           |
| Diluted  | \$ 0.12                    | \$ (0.09 )          | \$ 0.08                   | \$ (0.73 )           |
| Weighted average number of shares outstanding:   |                            |                     |                           |                      |
| Basic  | 263,945,444                | 251,284,864         | 263,134,769               | 250,909,273          |
| Diluted  | 304,833,454                | 251,284,864         | 269,973,801               | 250,909,273          |

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 nine months ended |               |
|--|---------------------------|---------------|
|  | September 30,<br>2004     | 2003          |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>                                     |                           |               |
| Net income (loss)  | \$ 20,790                 | \$ (180,085 ) |
| Adjustments to reconcile net income (loss) to net cash from operating activities |                           |               |
| Deferred income tax provision  | 246                       | 6,975         |
| Depreciation and amortization  | 110,510                   | 99,521        |
| Amortization of debt issuance costs  | 3,009                     | 3,717         |
| Interest accretion for senior discount notes                                     | 20                        | 27,013        |
| Interest accretion for mandatorily redeemable preferred stock series B           |                           | 1,138         |
| Bond discount amortization   | 720                       | 928           |
| Loss on retirement of debt   | 54,971                    | 74,417        |
| Fair value adjustments of derivative instruments                                 | (2,760 )                  | (2,689 )      |
| Stock based compensation   | 532                       | 740           |
| Other  | (449 )                    | 1,144         |
| Changes in current assets and liabilities:                                       |                           |               |
| Accounts receivable, net   | (33,624 )                 | (12,096 )     |
| Subscriber equipment inventory   | (17,483 )                 | 149           |
| Other current and long-term assets   | (5,523 )                  | (2,085 )      |
| Accounts payable, accrued expenses and other current liabilities                 | 3,450                     | 9,104         |
| Operating advances due from Nextel WIP   | (2,691 )                  | 1,561         |
| Net cash from operating activities   | 131,718                   | 29,452        |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>                                     |                           |               |
| Capital expenditures   | (103,372 )                | (147,066 )    |
| FCC licenses   | (3,650 )                  | (14,369 )     |
| Proceeds from sale and maturities of short-term investments, net                 | 30,849                    | (16,803 )     |
| Net cash from investing activities   | (76,173 )                 | (178,238 )    |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>                                     |                           |               |
| Proceeds from borrowings   | 724,565                   | 750,000       |
| Stock options exercised  | 10,774                    | 1,314         |
| Proceeds from stock issued for employee stock purchase plan                      | 1,827                     | 1,362         |
| Proceeds from sale lease-back transactions                                       | 1,211                     | 6,392         |
| Debt repayments  | (788,909 )                | (540,704 )    |
| Capital lease payments   | (2,380 )                  | (1,858 )      |
| Debt and equity issuance costs   | (3,308 )                  | (17,017 )     |
| Net cash from financing activities   | (56,220 )                 | 199,489       |
| <b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>                                 | (675 )                    | 50,703        |
| <b>CASH AND CASH EQUIVALENTS, beginning of period</b>                            | 122,620                   | 67,522        |
| <b>CASH AND CASH EQUIVALENTS, end of period</b>                                  | \$ 121,945                | \$ 118,225    |
| <b>SUPPLEMENTAL DISCLOSURE OF NON-CASH TRANSACTIONS</b>                          |                           |               |
| Cash paid for income taxes   | \$                        | \$            |
| Capitalized interest on accretion of senior discount notes                       | \$                        | \$ 378        |
| 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                                | \$ 94,762                 | \$ 93,676     |

See accompanying notes to the consolidated condensed financial statements.

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

**1. BASIS OF PRESENTATION**

Our interim consolidated condensed financial statements for the three- and nine-month periods ended September 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 nine-month periods ended September 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. 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 adjust 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. For the three and nine months ended September 30, 2003, 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.

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The following schedule is our net income (loss) per share calculation for the three and nine months ended September 30, 2004 and 2003:

|  | Three Months Ended<br>September 30,<br>2004        |              | Nine Months Ended<br>September 30,<br>2004 |               |
|--|--|--------------|--|---------------|
|  | 2003   |              | 2003                                       |               |
|  | (in thousands, except share and per share amounts) |              |  |               |
| Income (loss) attributable to common stockholders (numerator for basic)            | \$ 35,521  | \$ (21,979 ) | \$ 20,790                                  | \$ (182,226 ) |
| Effect of dilutive securities:   |  |              |  |               |
| Convertible Senior Notes   | \$ 1,125   |              |  |               |
| Adjusted Income (loss) attributable to common stockholders (numerator for diluted) | \$ 36,646  | \$ (21,979 ) | \$ 20,790                                  | \$ (182,226 ) |
| Gross weighted average common shares outstanding                                   | 264,056,776  | 251,435,407  | 263,236,913                                | 251,079,346   |
| Less: Weighted average shares subject to repurchase                                | (111,332 )   | (150,543 )   | (102,144 )                                 | (170,073 )    |
| Weighted average common shares outstanding basic (denominator for basic)           | 263,945,444  | 251,284,864  | 263,134,769                                | 250,909,273   |
| Effect of dilutive securities:   |  |              |  |               |
| Convertible Senior Notes   | 32,872,584   |              |  |               |
| Stock options  | 7,944,490  |              | 6,769,395                                  |               |
| Restricted stock (unvested)  | 70,936   |              | 69,637                                     |               |
| Weighted average common shares outstanding diluted (denominator for diluted)       | 304,833,454  | 251,284,864  | 269,973,801                                | 250,909,273   |
| Net income (loss) per share, basic   | \$ 0.13  | \$ (0.09 )   | \$ 0.08                                    | \$ (0.73 )    |
| Net income (loss) per share, diluted   | \$ 0.12  | \$ (0.09 )   | \$ 0.08                                    | \$ (0.73 )    |

For the nine months ended September 30, 2004, approximately 32.9 million shares issuable upon the assumed conversion of our 1½% convertible senior notes that could potentially dilute earnings per share in the future were excluded from the calculation of diluted earnings per common share due to their antidilutive effects. Additionally, for the three and nine months ended September 30, 2004 approximately 3.1 million options were excluded from the calculation of diluted earnings per common share as their exercise prices exceed the average market price of our class A common stock.

For the three months ended September 30, 2003, approximately 32.9 million shares issuable upon the assumed conversion of our 1½% senior convertible notes that could potentially dilute earnings per share in the future were excluded from the calculation of diluted earnings per common share due to their antidilutive effects. Additionally, for the three months ended September 30, 2003 approximately 170,000 shares of restricted stock and 18.8 million stock options outstanding were excluded from the calculation of common equivalent shares, as their effects were antidilutive.

*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 September 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 September 30, 2004 and 2003 we received cash proceeds of approximately \$432,000 and \$142,000, respectively, and for the nine months ended September 30, 2004 and 2003 we received cash proceeds of approximately \$1.2 million and \$6.4 million, respectively, for assets sold to third parties. No gain was initially 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 nine months ended September 30, 2004, we recorded a deferred income tax provision of \$8.1 million and \$246,000, respectively, relating to our FCC licenses. During the same periods ended September 30, 2003, we recorded a deferred income tax provision of \$885,000 and \$7.0 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 September 30, 2004:

|  | (in thousands) |
|--|----------------|
| Fair value of liability as of December 31, 2003      | \$ 5,195       |
| Change in fair value - interest rate changes         | (2,760 )       |
| Settlement of \$60 million swap agreement terminated | (639 )         |
| Fair value of liability as of September 30, 2004     | \$ 1,796       |

For the three months ended September 30, 2004 and 2003, we recorded non-cash, non-operating gains of \$654,000 and \$1.3 million, respectively, and for the nine months ended September 30, 2004 and 2003, we recorded non-cash, non-operating gains of \$2.8 million and \$2.7 million, respectively, related to the change in market value of the interest rate swap agreements in interest expense.

In September 2004 we entered into a series of interest rate swap agreements, which will have the effect of converting certain of our variable interest rate \$700 million term C loan obligations to fixed interest rates. The total amount to be hedged will be \$150 million. The commencement date for the swap transactions is December 1, 2004 and the expiration date is August 31, 2006. We believe these interest rate swap agreements qualify for cash flow accounting since the critical terms of the instruments match at inception and are expected to on an ongoing basis, therefore it is assumed the instruments will offset and be perfectly effective.

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 September 30, 2004 and 2003 were \$3.4 million and \$1.6 million, respectively, and for the nine months ended September 30, 2004 and 2003 were \$9.7 million and \$4.4 million, respectively.

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.

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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. For the three months ended September 30, 2004 and 2003, we recognized \$5.8 million and \$7.6 million, respectively, and \$18.8 million and \$22.6 million for the nine months ended September 30, 2004 and 2003, respectively, of activation fees and phone equipment revenues and equipment costs that had been previously deferred. 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<br>Ended September 30, |              | For the Nine Months<br>Ended September 30, |               |
|--|---|--------------|--|---------------|
|  | 2004  | 2003         | 2004                                       | 2003          |
|  | (in thousands, except per share amounts)    |              |  |               |
| Service revenues   | \$ 336,239                                  | \$ 259,527   | \$ 933,709                                 | \$ 687,772    |
| Equipment revenues   | \$ 15,512                                   | \$ 13,805    | \$ 43,568                                  | \$ 35,906     |
| Cost of equipment revenues   | \$ 28,457                                   | \$ 29,494    | \$ 89,035                                  | \$ 82,697     |
| Income (loss) attributable to common stockholders                    | \$ 35,521                                   | \$ (21,979 ) | \$ 20,790                                  | \$ (182,226 ) |
| Income (loss) per share attributable to common stockholders, basic   | \$ 0.13                                     | \$ (0.09 )   | \$ 0.08                                    | \$ (0.73 )    |
| Income (loss) per share attributable to common stockholders, diluted | \$ 0.12                                     | \$ (0.09 )   | \$ 0.08                                    | \$ (0.73 )    |

### *Reclassifications*

Certain amounts in prior years' financial statements have been reclassified to conform to the current year presentation.

### *Long-Lived Assets*

Our long-lived assets consist principally of property, plant and equipment. It is our policy to assess impairment of long-lived assets pursuant to SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. This includes determining if certain triggering events have occurred, including significant decreases in the market value of certain assets, significant changes in the manner in which an asset is used, significant changes in the legal climate or business climate that could affect the value of an asset, or current period or continuing operating or cash flow losses or projections that demonstrate continuing losses associated with certain assets used for the purpose of producing revenue that might be an indicator of impairment. When we perform the SFAS 144 impairment tests, we identify the appropriate asset group to be our network system, which includes the grouping of all our assets required to operate our portion of the Nextel Digital Mobile Network and provide service to our customers. We based this conclusion of asset grouping on the revenue dependency, operating interdependency and shared costs to operate our network. Thus far, none of the above triggering events has resulted in any impairment charges.

### *Stock-Based Compensation*

In December 2002, the FASB issued SFAS No. 148, *Accounting for Stock Based Compensation Transition and Disclosure*. This statement amends SFAS No. 123, *Accounting for Stock-Based Compensation*, to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. We continue to apply the intrinsic value method for stock-based compensation to employees prescribed by Accounting Principles Board Opinion ( APB ) No. 25, *Accounting for Stock Issued to Employees*. We have provided below the disclosures required by SFAS No. 148.

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As required by SFAS No. 148, had compensation cost been determined based upon the fair value of the awards granted during the three and nine months ended September 30, 2004 and 2003, our net income (loss) and basic and diluted income (loss) per share would have adjusted to the pro forma amounts indicated below:

|   | For the Three Months<br>Ended September 30, |              | For the Nine Months<br>Ended September 30, |               |
|---|---|--------------|--|---------------|
|   | 2004  | 2003         | 2004                                       | 2003          |
|   | (in thousands, except per share amounts)    |              |  |               |
| Net income (loss), as reported  | \$ 35,521                                   | \$ (21,979 ) | \$ 20,790                                  | \$ (182,226 ) |
| Add: stock-based employee compensation expense (income) included in reported net loss                           | (22 )                                       | 259          | 532  | 740           |
| Deduct: total stock-based employee compensation expense determined under fair-value-based method for all awards | (6,212 )                                    | (5,996 )     | (19,016 )                                  | (19,439 )     |
| As adjusted, net income (loss)  | \$ 29,287                                   | \$ (27,716 ) | \$ 2,306                                   | \$ (200,925 ) |
| Basic income (loss) per share attributable to common stockholders   |   |              |  |               |
| As reported   | \$ 0.13                                     | \$ (0.09 )   | \$ 0.08                                    | \$ (0.73 )    |
| As adjusted   | \$ 0.11                                     | \$ (0.11 )   | \$ 0.01                                    | \$ (0.80 )    |
| Diluted income (loss) per share attributable to common stockholders   |   |              |  |               |
| As reported   | \$ 0.12                                     | \$ (0.09 )   | \$ 0.08                                    | \$ (0.73 )    |
| As adjusted   | \$ 0.10                                     | \$ (0.11 )   | \$ 0.01                                    | \$ (0.80 )    |
| Weighted average fair value per share of options granted  | \$ 7.76                                     | \$ 6.32      | \$ 8.38                                    | \$ 4.82       |

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model as prescribed by SFAS No. 148 using the following assumptions:

|                                 | 2004        | 2003        |
|---------------------------------|-------------|-------------|
| Expected stock price volatility | 53% - 71%   | 74% - 85%   |
| Risk-free interest rate         | 3.1% - 3.4% | 3.6% - 3.8% |
| Expected life in years          | 5 years     | 5 years     |
| Expected dividend yield         | 0.00%       | 0.00%       |

The Black-Scholes option-pricing model requires the input of subjective assumptions and does not necessarily provide a reliable measure of fair value.

*Recently Issued Accounting Pronouncements*

In December 2003, the FASB issued FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities* ( FIN 46R ), which addresses how a business enterprise should evaluate whether it has a controlling financial interest in an entity through means other than voting rights and accordingly should consolidate the entity. FIN 46R replaces FASB Interpretation No. 46, *Consolidation of Variable Interest Entities*, which was issued in January 2003. We adopted FIN 46R effective January 1, 2004 without any impact to our financial statements.

## 4. PROPERTY AND EQUIPMENT

|  | As of<br>September 30,<br>2004<br>(in thousands) | December 31,<br>2003 |
|--|--|----------------------|
| Building and improvements                      | \$ 9,828   | \$ 8,523             |
| Equipment                                      | 1,314,763  | 1,223,279            |
| Furniture, fixtures and software               | 119,831  | 105,544              |
| Less accumulated depreciation and amortization | (466,048 )                                       | (355,770 )           |
| Subtotal                                       | 978,374  | 981,576              |
| Construction in progress                       | 34,673   | 43,520               |
| Total property and equipment                   | \$ 1,013,047                                     | \$ 1,025,096         |

## 5. NON-CURRENT PORTION OF LONG-TERM DEBT

|   | As of<br>September 30,<br>2004<br>(in thousands) | December 31,<br>2003 |
|---|--|----------------------|
| 12½% Senior Discount Notes due 2009, net discount of \$7.2 million and \$7.9 million, respectively  | \$ 139,047                                       | \$ 138,344           |
| 14% Senior Discount Notes due 2009  |  | 1,773                |
| 11% Senior Notes due 2010, interest payable semiannually in cash and in arrears   | 1,157  | 367,450              |
| 1½% Convertible Senior Notes due 2008, interest payable semi-annually in cash and in arrears  | 300,000  | 300,000              |
| 8⅛% Senior Notes due 2011, net of \$0.4 million and \$0 discount, respectively, interest payable semi-annually in cash and in arrears   | 474,582  | 450,000              |
| Bank Credit Facility tranche C loan and term B and C loans, respectively; interest, at our option, calculated on Administrative Agent's alternate base rate or reserve adjusted LIBOR | 700,000  | 375,000              |
| Capital leases  | 18,376   | 20,972               |
| Total non-current portion of long-term debt   | \$ 1,633,162                                     | \$ 1,653,539         |

## 12½% Senior Discount Notes Due 2009

On December 4, 2001 we issued in a private placement \$225.0 million of 12½% senior discount notes due 2009. These notes were issued at a discount to their aggregate principal amount at maturity and generated aggregate gross proceeds to us of approximately \$210.4 million. We subsequently exchanged all of these 12½% senior discount notes due 2009 for registered notes having the same financial terms and covenants as the privately placed notes. Interest accrues for these notes at the rate of 12½% per annum, payable semi-annually in cash in arrears on May 15 and November 15 of each year, which commenced on May 15, 2002. During August 2003, we repurchased for cash \$11.1 million (principal amount at maturity) of our 12½% senior discount notes due 2009 in open-market purchases. On December 31, 2003 we completed the redemption of \$67.7 million (principal amount at maturity) of the notes outstanding with net proceeds from our public offering in November 2003.

The 12½% senior discount notes due 2009 represent our senior unsecured obligations and rank equally in right of payment to our entire existing and future senior unsecured indebtedness and senior in right of payment to all of our existing and future subordinated indebtedness. The 12½% senior discount notes due 2009 are effectively subordinated to (i) all of our secured obligations, including borrowings under the bank credit facility, to the extent of assets securing such obligations and (ii) all indebtedness,



including borrowings under the bank credit facility and trade payables, of OPCO. As of September 30, 2004, we were in compliance with applicable covenants.

*14% Senior Discount Notes Due 2009*

On March 15, 2004, we redeemed for cash the remainder of our outstanding 14% senior discount notes due 2009, representing approximately \$1.8 million aggregate principal amount at maturity, for a total redemption price of approximately \$1.9 million. As a result of this transaction the notes have been paid in full.

*11% Senior Notes Due 2010*

On March 10, 2000, we issued \$200.0 million of 11% senior notes due 2010, and on July 27, 2000, we issued an additional \$200.0 million of 11% senior notes due 2010, each in a private placement. We subsequently exchanged all of the March 2000 and July 2000 notes for registered notes having the same financial terms and covenants as the privately placed notes. Interest accrues for these notes at the rate of 11% per annum, payable semi-annually in cash in arrears on March 15 and September 15 of each year, which commenced on September 15, 2000.

In November 2002 we exchanged \$10.0 million (principal amount at maturity) of the notes for shares of our Class A common stock. During August 2003 and March 2004, we repurchased for cash \$22.6 million and \$10.5 million (principal amounts at maturity), respectively, of our 11% senior notes due 2010 in open-market purchases for \$24.1 million and \$11.8 million, respectively, including accrued interest.

On April 28, 2004, we commenced a tender offer and consent solicitations relating to all of our outstanding 11% senior notes due 2010. The tender offer expired May 25, 2004 and we received the consents necessary to amend the indentures governing the 11% senior notes due 2010 to eliminate substantially all restrictive covenants and certain event of default provisions. As of September 30, 2004 we had purchased approximately \$355.8 million (principal amount at maturity) of our 11% senior notes due 2010 for \$406.6 million including accrued interest, resulting in a loss of approximately \$43.8 million for the premium paid for retiring the debt early. The tender offer was funded through a combination of proceeds from a private placement of \$25 million aggregate principal amount of 8<sup>1</sup>/<sub>8</sub>% senior notes due 2011, refinancing our wholly owned subsidiary's existing \$375.0 million tranche B term loan with a new \$700.0 million tranche C term loan and available cash.

The 11% senior notes due 2010 represent our senior unsecured obligations, and rank equally in right of payment to our entire existing and future senior unsecured indebtedness and senior in right of payment to all of our existing and future subordinated indebtedness. The 11% senior notes due 2010 are effectively subordinated to (i) all of our secured obligations, including borrowings under the bank credit facility, to the extent of assets securing such obligations and (ii) all indebtedness, including borrowings under the bank credit facility and trade payables, of OPCO. As of September 30, 2004, with respect to \$1.2 million (principal amount at maturity) of 11% senior notes due 2010 that remain outstanding, we were in compliance with applicable covenants.

*1<sup>1</sup>/<sub>2</sub>% Convertible Senior Notes Due 2008*

In May and June 2003, we issued an aggregate principal amount of \$175.0 million of 1<sup>1</sup>/<sub>2</sub>% convertible senior notes due 2008 in private placements. At the option of the holders, these 1<sup>1</sup>/<sub>2</sub>% convertible senior notes due 2008 are convertible into shares of our Class A common stock at a conversion rate of 131.9087 shares per \$1,000 principal amount of notes, which represents a conversion price of \$7.58 per share, subject to adjustment. Interest accrues for these notes at the rate of 1<sup>1</sup>/<sub>2</sub>% per annum, payable semi-annually in cash in arrears on May 15 and November 15 of each year, which commenced on November 15, 2003. We subsequently filed a registration statement with the SEC to register the resale of the 1<sup>1</sup>/<sub>2</sub>% convertible

senior notes due 2008 and the shares of our Class A common stock into which the 1½% convertible senior notes due 2008 are convertible.

In addition, in August 2003 we closed a private placement of \$125.0 million of 1½% convertible senior notes due 2008. At the option of the holders, these 1½% convertible senior notes due 2008 are convertible into shares of our Class A common stock at a conversion rate of 78.3085 shares per \$1,000 principal amount of notes, which represents a conversion price of \$12.77 per share, subject to adjustment. Interest accrues for these notes at the rate of 1½% per annum, payable semi-annually in cash in arrears on May 15 and November 15 of each year, which commenced on November 15, 2003. We subsequently filed a registration statement with the SEC to register the resale of the 1½% convertible senior notes due 2008 and the shares of our Class A common stock into which the 1½% convertible senior notes due 2008 are convertible.

The 1½% convertible senior notes due 2008 represent our senior unsecured obligations, and rank equally in right of payment to our entire existing and future senior unsecured indebtedness and senior in right of payment to all of our existing and future subordinated indebtedness. The 1½% convertible senior notes due 2008 are effectively subordinated to (i) all of our secured obligations, including borrowings under the bank credit facility, to the extent of assets securing such obligations and (ii) all indebtedness, including borrowings under the bank credit facility and trade payables, of OPCO.

#### 8⅛% Senior Notes Due 2011

On June 23, 2003, we issued \$450.0 million of 8⅛% senior notes due 2011 in a private placement. We subsequently exchanged all of the 8⅛% senior notes due 2011 for registered notes having the same financial terms and covenants as the privately placed notes. Interest accrues for these notes at the rate of 8⅛% per annum, payable semi-annually in cash in arrears, on January 1 and July 1 of each year, which commenced on January 1, 2004.

On May 19, 2004, we issued an additional \$25 million of 8⅛% senior notes due 2011 under a separate indenture in a private placement for proceeds of \$24.6 million. We subsequently exchanged all of the 8⅛% senior notes due 2011 for registered notes having the same financial terms and covenants as the privately placed notes. Interest accrues at the rate of 8⅛% per annum, payable semi-annually in cash in arrears on January 1 and July 1 of each year, which commenced on July 1, 2004.

The 8⅛% senior notes due 2011 represent our senior unsecured obligations and rank equally in right of payment to our entire existing and future senior unsecured indebtedness and senior in right of payment to all of our existing and future subordinated indebtedness. The 8⅛% senior notes due 2011 are effectively subordinated to (i) all of our secured obligations, including borrowings under the bank credit facility, to the extent of assets securing such obligations and (ii) all indebtedness including borrowings under the bank credit facility and trade payables, of OPCO. As of September 30, 2004, we were in compliance with applicable covenants.

#### *Bank Credit Facility*

On May 19, 2004, OPCO refinanced its existing \$475.0 million credit facility with a syndicate of banks and other financial institutions led by J.P. Morgan Securities Inc. and Morgan Stanley Senior Funding, Inc. as joint lead arrangers and book runners, Morgan Stanley Senior Funding, Inc. as syndication agent, and JPMorgan Chase Bank as administrative agent. The new credit facility includes a \$700.0 million tranche C term loan, a \$100.0 million revolving credit facility and an option to request an additional \$200.0 million of incremental term loans. Such incremental term loans shall not exceed \$200.0 million or have a final maturity date earlier than the maturity date for the tranche C term loan. The tranche C term loan matures on May 31, 2011. The revolving credit facility will terminate on the last business day in May falling on or

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nearest to May 31, 2011. The incremental term loans, if any, shall mature on the date specified on the date the respective loan is made, provided that such maturity date shall not be earlier than the maturity date for the tranche C term loan. As of September 30, 2004, \$700.0 million of the tranche C term loan was outstanding and no amounts were outstanding under either the \$100.0 million revolving credit facility or the incremental term loans. The proceeds from the tranche C term loan were used to repay borrowings under our previous tranche B senior secured credit facility as well as fund a portion of the tender offer for our 11% senior notes due 2010.

The tranche C term loan bears interest, at our option, at the administrative agent's alternate base rate or reserve-adjusted LIBOR plus, in each case, applicable margins. The initial applicable margin for the tranche C term loan is 2.50% over LIBOR and 1.50% over the base rate. For the revolving credit facility, the initial applicable margin is 3.00% over LIBOR and 2.00% over the base rate and thereafter will be determined on the basis of the ratio of total debt to annualized EBITDA and will range between 1.50% and 3.00% over LIBOR and between 0.50% and 2.00% over the base rate. As of September 30, 2004, the interest rate on the tranche C term loan was 4.3125%.

Borrowings under the term loans are secured by, among other things, a first priority pledge of all assets of OPCO and all assets of the subsidiaries of OPCO and a pledge of their respective capital stock. The credit facility contains financial and other covenants customary for the wireless industry, including limitations on our ability to incur additional debt or create liens on assets. The credit facility also contains covenants requiring that we maintain certain defined financial ratios. As of September 30, 2004, we were in compliance with all covenants associated with this credit facility.

### *Mandatorily Redeemable Preferred Stock*

In May 2003, the FASB issued SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*. This statement establishes standards for how an issuer classifies and measures in its statement of financial position certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within the scope of the statement as a liability (or an asset in some circumstances) because that financial instrument embodies an obligation of the issuer. This statement was effective for all freestanding financial instruments entered into or modified after May 31, 2003; otherwise it was effective at the beginning of the first interim period beginning after June 15, 2003. We identified that our Series B mandatorily redeemable preferred stock was within the scope of this statement and reclassified it to long-term debt and began recording the Series B mandatorily redeemable preferred stock dividends as interest expense beginning July 1, 2003.

In November 2003, we redeemed all of the 13,110,000 shares of our outstanding Series B mandatorily redeemable preferred stock held by Nextel WIP for an aggregate redemption price of \$38.9 million. Following the redemption, we no longer have any shares of preferred stock outstanding.

The following schedule shows the pro forma impact of SFAS No. 150 had it been effective in prior periods.

|  | <b>For the Three Months</b> |              | <b>For the Nine Months</b> |               |
|--|-----------------------------|--------------|----------------------------|---------------|
|  | <b>Ended September 30,</b>  |              | <b>Ended September 30,</b> |               |
|  | <b>2004</b>                 | <b>2003</b>  | <b>2004</b>                | <b>2003</b>   |
|  | <b>(in thousands)</b>       |              |                            |               |
| Net income (loss), as reported   | \$ 35,521                   | \$ (21,979 ) | \$ 20,790                  | \$ (180,085 ) |
| Less: mandatorily redeemable preferred stock dividend classified as interest expense |                             |              |                            | (2,141 )      |
| Net income (loss), adjusted for SFAS No. 150   | \$ 35,521                   | \$ (21,979 ) | \$ 20,790                  | \$ (182,226 ) |

## 6. COMMITMENTS AND CONTINGENCIES

### *Legal Proceedings*

On December 5, 2001, a purported class action lawsuit was filed against us, two of our executive officers and four of the underwriters involved in our initial public offering. It was filed on behalf of all persons who acquired our common stock between February 22, 2000 and December 6, 2000 and initially named as defendants us, John Chapple, our President, Chief Executive Officer and Chairman of the Board, John D. Thompson, our Chief Financial Officer and Treasurer until August 2003, and the underwriters involved in our initial public offering. Mr. Chapple and Mr. Thompson have been dismissed from the lawsuit without prejudice. The complaint seeks recessionary and/or compensatory damages. We dispute the allegations of the complaint that suggest any wrongdoing on our part or by our officers. However, the plaintiffs and the issuing company defendants, including us, have reached a settlement of the issues in the lawsuit. The proposed settlement, which is not material to us, is subject to a number of contingencies, including negotiation of a settlement agreement and its approval by the Court. In June 2004, an agreement of settlement was submitted to the Court for preliminary approval. We are unable to determine whether or when a settlement will occur or be finalized.

On June 8, 2001, a purported class action lawsuit was filed against Nextel Partners, Inc. as well as several other wireless carriers and manufacturers of wireless telephones. The complaint alleges that the defendants, among other things, manufactured and distributed wireless telephones that cause adverse health effects. The plaintiffs seek compensatory damages, reimbursement for certain costs including reasonable legal fees, punitive damages and injunctive relief. The defendants timely removed the case to Federal court and this case and related cases were consolidated in the United States District Court for the District of Maryland. On March 5, 2003, the court granted the defendants' consolidated motion to dismiss the plaintiffs' claims. The plaintiffs have appealed to the United States Court of Appeals for the Fourth Circuit. The appeal is fully briefed. We dispute the allegations of the complaint, will vigorously defend against the action, and intend to seek indemnification from the manufacturers of the wireless telephones if necessary.

On April 1, 2003, a purported class action lawsuit was filed in the 93<sup>rd</sup> District Court of Hidalgo County, Texas against us, Nextel and Nextel West Corp. The lawsuit is captioned Rolando Prado v. Nextel Communications, *et al*, Civil Action No. C-695-03-B. On May 2, 2003, a purported class action lawsuit was filed in the Circuit Court of Shelby County for the Thirtieth Judicial District at Memphis, Tennessee against us, Nextel and Nextel West Corp. The lawsuit is captioned Steve Strange v. Nextel Communications, *et al*, Civil Action No. 01-002520-03. On May 3, 2003, a purported class action lawsuit was filed in the Circuit Court of the Second Judicial Circuit in and for Leon County, Florida against Nextel Partners Operating Corp. d/b/a Nextel Partners and Nextel South Corp. d/b/a Nextel Communications. The lawsuit is captioned Christopher Freeman and Susan and Joseph Martelli v. Nextel South Corp., *et al*, Civil Action No. 03-CA1065. On July 9, 2003, a purported class action lawsuit was filed in Los Angeles Superior Court, California against us, Nextel, Nextel West, Inc., Nextel of California, Inc. and Nextel Operations, Inc. The lawsuit is captioned Nick's Auto Sales, Inc. v. Nextel West, Inc., *et al*, Civil Action No. BC298695. On August 7, 2003, a purported class action lawsuit was filed in the Circuit Court of Jefferson County, Alabama against us and Nextel. The lawsuit is captioned Andrea Lewis and Trish Zruna v. Nextel Communications, Inc., *et al*, Civil Action No. CV-03-907. On October 3, 2003, an amended complaint for a purported class action lawsuit was filed in the United States District Court for the Western District of Missouri. The amended complaint named us and Nextel Communications, Inc. as defendants; Nextel Partners was substituted for the previous defendant, Nextel West Corp. The lawsuit is captioned Joseph Blando v. Nextel West Corp., *et al*, Civil Action No. 02-0921 (the Blando Case). All of these complaints allege that we, in conjunction with the other defendants, misrepresented certain cost-recovery line-item fees as government taxes. Plaintiffs seek to enjoin such practices and seek a refund of monies paid by the class based on the alleged misrepresentations. Plaintiffs also seek attorneys' fees, costs and, in

some cases, punitive damages. We believe the allegations are groundless. On October 9, 2003, Judge Gaitan in the United States District Court for the Western District of Missouri in the Blando Case entered an order granting preliminary approval of a nationwide class action settlement that encompasses most of the claims involved in these cases. Notice of the settlement was provided to the identified class, and on January 29, 2004, the court conducted a final approval hearing and, on April 20, 2004, approved the settlement. On May 27, 2004, various objectors and class members appealed Judge Gaitan's order granting final approval of the settlement to the United States Court of Appeals for the Eighth Circuit. Distribution of settlement benefits is stayed until the appellate court issues a final order resolving the appeal. In conjunction with the settlement, we recorded an estimated liability during the third quarter of 2003, which did not materially impact our financial results.

We are subject to other claims and legal actions that may arise in the ordinary course of business. We do not believe that any of these other pending claims or legal actions or the items discussed above will have a material effect on our business, financial position or results of operations.

## 7. RELATED PARTY TRANSACTIONS

### *Nextel Operating Agreements*

We, our operating subsidiary and Nextel WIP, which held approximately 32.0% of our outstanding common stock as of September 30, 2004 and with which one of our directors is affiliated, entered into a joint venture agreement dated January 29, 1999. The joint venture agreement, along with the other operating agreements, defines the relationships, rights and obligations between the parties and governs the build-out and operation of our portion of the Nextel Digital Wireless Network and the transfer of licenses from Nextel WIP to us. Our roaming agreement with Nextel WIP provides that each party pays the other company's monthly roaming fees in an amount based on the actual system minutes used by our respective customers when they are roaming on the other party's network. For the three months ended September 30, 2004 and 2003, we earned approximately \$42.7 million and \$32.6 million, respectively, and for the nine months ended September 30, 2004 and 2003, we earned approximately \$113.3 million and \$82.5 million, respectively, from Nextel customers roaming on our system, which is included in our service revenues.

During the three months ended September 30, 2004 and 2003, we incurred charges from Nextel WIP totaling \$31.3 million and \$26.3 million, respectively, and for the nine months ended September 30, 2004 and 2003, we incurred charges from Nextel WIP of \$86.3 million and \$70.2 million, respectively, for services such as specified telecommunications switching services, charges for our customers roaming on Nextel's system and other support costs. The costs for these services are recorded in cost of service revenues.

During 2003 and 2004, Nextel continued to provide certain services to us for which we paid a fee based on their cost. These services are limited to Nextel telemarketing and customer care, fulfillment, activations, and billing for the national accounts. We also paid Nextel a royalty fee and a 2004 sponsorship fee for NASCAR. For the three months ended September 30, 2004 and 2003, we were charged approximately \$2.6 million and \$2.5 million, respectively, and \$10.8 million and \$6.6 million for the nine months ended the same periods, respectively, for these services and fees. Nextel WIP also provides us access to certain back office and information systems platforms on an ongoing basis. For the three months ended September 30, 2004 and 2003, we were charged approximately \$1.3 million and \$1.1 million, respectively, and \$3.7 million and \$3.4 million for the nine months ended September 30, 2004 and 2003, respectively, for these services. The costs for all of these services and fees are included in selling, general and administrative expenses.

In the event of a termination of the joint venture agreement, Nextel WIP could, under certain circumstances, purchase or be required to purchase all of our outstanding common stock. In such event, Nextel WIP, at its option, would be entitled to pay the purchase price therefor in cash or in shares of

Nextel common stock. The circumstances that could trigger these rights and obligations include, without limitation, termination of our operating agreements with Nextel WIP, a change of control of Nextel or a failure by us to make certain required changes to our business.

#### *Business Relationship*

In the ordinary course of business, we lease tower space from American Tower Corporation. One of our directors is a stockholder and former president, chief executive officer and chairman of the board of directors of American Tower Corporation. During the three months ended September 30, 2004 and 2003, we paid American Tower Corporation for these tower leases \$3.0 million and \$2.7 million, respectively, and \$7.9 million for each of the nine-month periods ended September 30, 2004 and 2003.

## **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

Some statements and information contained in this Management's Discussion and Analysis of Financial Condition and Results of Operations are not historical facts but are forward-looking statements. For a discussion of these forward-looking statements and of important factors that could cause results to differ materially from the forward-looking statements, see Forward-Looking Statements and Risk Factors below.

Please read the following discussion together with our 2003 annual report on Form 10-K along with Selected Consolidated Financial Data, the consolidated condensed financial statements and the related notes included elsewhere in this report.

### **Overview**

We provide fully integrated, wireless digital communications services using the Nextel® brand name in mid-sized and rural markets throughout the United States. We offer four distinct wireless services in a single wireless handset. These services include Nationwide Direct Connect<sup>SM</sup>, cellular voice, short messaging and cellular Internet access, which provides users with wireless access to the Internet and an organization's internal databases as well as other applications, including e-mail. We hold licenses for wireless frequencies in markets where over 53 million people, or Pops, live and work. We have constructed and operate a digital mobile network compatible with the digital mobile network constructed and operated by Nextel in targeted portions of these markets, including 13 of the top 100 metropolitan statistical areas and 56 of the top 200 metropolitan statistical areas in the United States ranked by population. Our combined Nextel Digital Wireless Network constitutes one of the largest fully integrated digital wireless communications systems in the United States, currently covering 297 of the top 300 metropolitan statistical areas in the United States.

We offer a package of wireless voice and data services under the Nextel brand name targeted primarily to business users. We currently offer the following four services, which are fully integrated and accessible through a single wireless handset:

- digital cellular, including advanced calling features such as speakerphone, conference calling, voicemail, call forwarding and additional line service;
- Direct Connect service, the digital walkie-talkie service that allows customers to instantly connect with business associates, family and friends without placing a phone call;
- short messaging, the service that utilizes the Internet to keep customers connected to clients, colleagues and family with text, numeric and two-way messaging; and

- Nextel Online® services, which provide customers with Internet-ready handsets access to the World Wide Web and web-based applications such as e-mail, address books, calendars and advanced Java enabled business applications.

As of September 30, 2004, we had approximately 1,507,500 digital subscribers. Our network provides coverage to approximately 39 million Pops in 31 different states, which include markets in Alabama, Arkansas, Florida, Georgia, Hawaii, Idaho, Illinois, Indiana, Iowa, Kentucky, Louisiana, Maryland, Minnesota, Mississippi, Missouri, Nebraska, New York, North Dakota, Ohio, Oklahoma, Pennsylvania, South Carolina, South Dakota, Tennessee, Texas, Virginia, Vermont, West Virginia and Wisconsin. We also hold licenses in Kansas and Wyoming but currently do not have any cell sites operational in these states.

During the third quarter of 2004 we continued to focus on our key financial and operating performance metrics, including growth in subscribers and service revenues, adjusted EBITDA, net cash from operating activities, churn and lifetime revenue per subscriber ( LRS ).

Accomplishments during the third quarter of 2004, which we believe are important indicators of our overall performance and financial well-being, include:

- Growing our subscriber base approximately 32% in a twelve-month period by adding approximately 362,800 net new customers to end the third quarter of 2004 at 1,507,500 subscribers as compared to 1,144,700 as of September 30, 2003.
- Growing our service revenues approximately 29% from \$260.7 million for the prior year's third quarter to \$337.2 million for third quarter 2004.
- Increasing Adjusted EBITDA 86% from \$55.8 million for the three months ended September 30, 2003 to \$103.5 million for the three months ended September 30, 2004.
- Lowering our customer churn rate to 1.4% for the three-month period ended September 30, 2004 compared to 1.5% for the same period ended September 30, 2003.
- Remaining one of the industry leaders in LRS with an LRS of \$4,857 for the third quarter of 2004 compared to \$4,667 for the third quarter of 2003.
- Generating \$50.9 million net cash from operating activities during the third quarter of 2004 compared to \$50.1 million during the third quarter of 2003.

Please see Selected Consolidated Financial Data Additional Reconciliations of Non-GAAP Financial Measures (Unaudited) for more information regarding our use of Adjusted EBITDA and LRS as non-GAAP financial measures. Our operations are primarily conducted by OPCO. Substantially all of our assets, liabilities, operating losses and cash flows are within OPCO and our other wholly owned subsidiaries.

During the three months ended September 30, 2004, we also accomplished the following:

- Completed our 30,000 square foot Customer Care Center expansion in Panama City Beach, Florida.
- Launched a camera phone, the i860, with multimedia messaging capabilities.
- Introduced two new handset models, the i315 and i325, with off-network walkie-talkie capabilities designed for industrial, government and public safety users.

## SELECTED CONSOLIDATED FINANCIAL DATA

We have summarized below our historical consolidated condensed financial data as of September 30, 2004 and December 31, 2003 and for the three and nine months ended September 30, 2004 and 2003, which are derived from our records.

|  | Three Months Ended<br>September 30 |                     | Nine Months Ended<br>September 30 |                      |
|--|------------------------------------|---------------------|-----------------------------------|----------------------|
|  | 2004                               | 2003                | 2004                              | 2003                 |
| <b>(in thousands, except per share amounts)<br/>(unaudited)</b>  |                                    |                     |                                   |                      |
| <b>Consolidated Statements of Operations Data:</b>   |                                    |                     |                                   |                      |
| Operating revenues:  |                                    |                     |                                   |                      |
| Service revenues(1)  | \$ 337,152                         | \$ 260,650          | \$ 936,646                        | \$ 687,699           |
| Equipment revenues(1)  | 20,390                             | 20,264              | 59,426                            | 35,293               |
| <b>Total revenues</b>  | <b>357,542</b>                     | <b>280,914</b>      | <b>996,072</b>                    | <b>722,992</b>       |
| Operating expenses:  |                                    |                     |                                   |                      |
| Cost of service revenues (excludes depreciation of \$30,337,<br>\$27,134, \$89,614 and \$80,310, respectively) | 92,606                             | 83,258              | 262,897                           | 232,331              |
| Cost of equipment revenues(1)  | 34,248                             | 37,076              | 107,830                           | 82,011               |
| Selling, general and administrative  | 127,160                            | 104,808             | 358,390                           | 292,177              |
| Stock-based compensation (primarily selling, general and<br>administrative related)                            | (22 )                              | 259                 | 532                               | 740                  |
| Depreciation and amortization  | 37,311                             | 33,527              | 110,510                           | 99,521               |
| Total operating expenses   | 291,303                            | 258,928             | 840,159                           | 706,780              |
| <b>Income from operations</b>  | <b>66,239</b>                      | <b>21,986</b>       | <b>155,913</b>                    | <b>16,212</b>        |
| Other income (expense):  |                                    |                     |                                   |                      |
| Interest expense, net(2)   | (23,460 )                          | (37,438 )           | (81,708 )                         | (116,835 )           |
| Interest income  | 823                                | 648                 | 1,802                             | 1,930                |
| Loss on early extinguishment of debt   |                                    | (6,290 )            | (54,971 )                         | (74,417 )            |
| <b>Income (Loss) before deferred income tax provision</b>  | <b>43,602</b>                      | <b>(21,094 )</b>    | <b>21,036</b>                     | <b>(173,110 )</b>    |
| Deferred income tax provision  | (8,081 )                           | (885 )              | (246 )                            | (6,975 )             |
| <b>Net Income (Loss)</b>   | <b>35,521</b>                      | <b>(21,979 )</b>    | <b>20,790</b>                     | <b>(180,085 )</b>    |
| Mandatorily redeemable preferred stock dividends(2)  |                                    |                     |                                   | (2,141 )             |
| <b>Net Income (Loss) attributable to common stockholders</b>   | <b>\$ 35,521</b>                   | <b>\$ (21,979 )</b> | <b>\$ 20,790</b>                  | <b>\$ (182,226 )</b> |
| <b>Net Income (Loss) per share attributable to common<br/>stockholders</b>                                     |                                    |                     |                                   |                      |
| Basic  | \$ 0.13                            | \$ (0.09 )          | \$ 0.08                           | \$ (0.73 )           |
| Diluted  | \$ 0.12                            | \$ (0.09 )          | \$ 0.08                           | \$ (0.73 )           |
| Weighted average number of shares outstanding  |                                    |                     |                                   |                      |
| Basic  | 263,945                            | 251,285             | 263,135                           | 250,909              |
| Diluted  | 304,833                            | 251,285             | 269,974                           | 250,909              |

|   | As of<br>September 30,<br>2004<br>(in thousands)<br>(unaudited) | As of<br>December 31,<br>2003 |
|---|---|-------------------------------|
| <b>Consolidated Balance Sheet Data:</b>               |   |                               |
| Cash and cash equivalents, and short-term investments | \$ 237,287  | \$ 268,811                    |
| Property, plant and equipment, net                    | 1,013,047   | 1,025,096                     |
| FCC operating licenses, net                           | 375,208   | 371,898                       |
| Total assets  | \$ 1,896,553  | \$ 1,889,310                  |
| Current liabilities                                   | 181,256   | 185,425                       |
| Long-term debt  | 1,633,162   | 1,653,539                     |
| Total stockholders' equity (deficit)                  | 20,990  | (13,296 )                     |
| Total liabilities and stockholders' equity (deficit)  | \$ 1,896,553  | \$ 1,889,310                  |

|   | As of<br>September 30,<br>2004 | As of<br>September 30,<br>2003 |
|---|--------------------------------|--------------------------------|
| <b>Other Data:</b>                      |                                |                                |
| Covered Pops (end of period) (millions) | 39                             | 38                             |
| Subscribers (end of period)             | 1,507,500                      | 1,144,700                      |

|                                       | Three Months Ended<br>September 30<br>2004 |              | Nine Months Ended<br>September 30<br>2004 |               |
|---------------------------------------|--|--------------|---|---------------|
|                                       | 2004                                       | 2003         | 2004                                      | 2003          |
|                                       | (in thousands)<br>(unaudited)              |              |   |               |
| <b>Other Data:</b>                    |  |              |   |               |
| <i>Statements of Cash Flows Data:</i> |  |              |   |               |
| Net cash from operating activities    | \$ 50,872                                  | \$ 50,111    | \$ 131,718                                | \$ 29,452     |
| Net cash from investing activities    | \$ (71,334 )                               | \$ (71,919 ) | \$ (76,173 )                              | \$ (178,238 ) |
| Net cash from financing activities    | \$ 4,227                                   | \$ 67,605    | \$ (56,220 )                              | \$ 199,489    |
| Adjusted EBITDA(3)                    | \$ 103,529                                 | \$ 55,772    | \$ 266,956                                | \$ 116,473    |
| Net capital expenditures(4)           | \$ 38,390                                  | \$ 40,546    | \$ 97,411                                 | \$ 129,212    |

(1) Effective July 1, 2003, we adopted Emerging Issues Task Force ( EITF ) Issue No. 00-21, Accounting for Revenue Arrangements with Multiple Deliverables, and elected to apply the provisions prospectively to our existing customer arrangements. See Management's Discussion and Analysis of Financial Condition and Results of Operations for a more detailed description of the impact of our adoption of this policy.

(2) In May 2003, the Financial Accounting Standards Board, or FASB, issued SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity. This statement establishes standards for how an issuer classifies and measures in its statement of financial position certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within the scope of the statement as a liability (or an asset in some circumstances) because that financial instrument embodies an obligation of the issuer. This statement was effective for all freestanding financial instruments entered into or modified after May 31, 2003; otherwise it was effective at the beginning of the first interim period beginning after June 15, 2003. We identified that our Series B mandatorily redeemable preferred stock was within the scope of this statement and reclassified it to long-term debt and began recording the Series B mandatorily redeemable preferred stock dividends as interest expense beginning July 1,



2003. We redeemed all of our outstanding Series B mandatorily redeemable preferred stock on November 21, 2003 and currently have no other preferred stock outstanding.

(3) The term EBITDA refers to a financial measure that is defined as earnings (loss) before interest, taxes, depreciation and amortization; we use the term Adjusted EBITDA to reflect that our financial measure also excludes cumulative effect of change in accounting principle, loss from disposal of assets, gain (loss) from early extinguishment of debt and stock-based compensation. Adjusted EBITDA is commonly used to analyze companies on the basis of leverage and liquidity. However, Adjusted EBITDA is not a measure determined under generally accepted accounting principles, or GAAP, in the United States of America and may not be comparable to similarly titled measures reported by other companies. Adjusted EBITDA should not be construed as a substitute for operating income or as a better measure of liquidity than cash flow from operating activities, which are determined in accordance with GAAP. We have presented Adjusted EBITDA to provide additional information with respect to our ability to meet future debt service, capital expenditure and working capital requirements. The following schedule reconciles Adjusted EBITDA to net cash from operating activities reported on our Consolidated Statements of Cash Flows, which we believe is the most directly comparable GAAP measure:

|   | Three Months Ended<br>September 30<br>2004 |           | Nine Months Ended<br>September 30<br>2004 |            |
|---|--|-----------|---|------------|
|   | 2003                                       | 2003      | 2003                                      | 2003       |
|   | (in thousands)                             |           |   |            |
| Net cash from operating activities (as reported on Consolidated Condensed Statements of Cash Flows) | \$ 50,872                                  | \$ 50,111 | \$ 131,718                                | \$ 29,452  |
| Adjustments to reconcile to Adjusted EBITDA:  |  |           |   |            |
| Cash paid interest expense, net of capitalized amount   | 24,711                                     | 42,317    | 94,762                                    | 93,676     |
| Interest income   | (823 )                                     | (648 )    | (1,802 )                                  | (1,930 )   |
| Change in working capital and other   | 28,769                                     | (36,008 ) | 42,278                                    | (4,725 )   |
| Adjusted EBITDA   | \$ 103,529                                 | \$ 55,772 | \$ 266,956                                | \$ 116,473 |

(4) Net capital expenditures exclude capitalized interest and are offset by net proceeds from the sale and leaseback transactions of telecommunication towers and related assets to third parties accounted for as operating leases. Net capital expenditures as defined are not a measure determined under GAAP in the United States of America and may not be comparable to similarly titled measures reported by other companies. Net capital expenditures should not be construed as a substitute for capital expenditures reported on the Consolidated Condensed Statements of Cash Flows, which is determined in accordance with GAAP. We report net capital expenditures in this manner because we believe it reflects the net cash used by us for capital expenditures and to satisfy the reporting requirements for our debt covenants. The following schedule reconciles net capital expenditures to capital expenditures reported on our Consolidated Condensed Statements of Cash Flows, which we believe is the most directly comparable GAAP measure:

|   | Three Months Ended<br>September 30 |           | Nine Months Ended<br>September 30 |            |
|---|------------------------------------|-----------|-----------------------------------|------------|
|   | 2004                               | 2003      | 2004                              | 2003       |
|   | (in thousands)                     |           |                                   |            |
| Capital expenditures (as reported on Consolidated Condensed Statements of Cash Flows)       | \$ 39,054                          | \$ 62,242 | \$ 103,372                        | \$ 147,066 |
| Less: cash paid portion of capitalized interest   | (318 )                             | (352 )    | (824 )                            | (1,028 )   |
| Less: cash proceeds from sale and lease-back transactions accounted for as operating leases | (432 )                             | (142 )    | (1,211 )                          | (6,392 )   |
| Change in capital expenditures accrued or unpaid  | 86                                 | (21,202 ) | (3,926 )                          | (10,434 )  |
| Net capital expenditures  | \$ 38,390                          | \$ 40,546 | \$ 97,411                         | \$ 129,212 |

#### Additional Reconciliations of Non-GAAP Financial Measures (Unaudited)

The information presented in this report includes financial information prepared in accordance with GAAP, as well as other financial measures that may be considered non-GAAP financial measures. Generally, a non-GAAP financial measure is a numerical measure of a company's performance, financial position or cash flows that either excludes or includes amounts that are not normally excluded or included in the most directly comparable measure calculated and presented in accordance with GAAP. As described more fully below, management believes these non-GAAP measures provide meaningful additional information about our performance and our ability to service our long-term debt and other fixed obligations and to fund our continued growth. The non-GAAP financial measures should be considered in addition to, but not as a substitute for, the information prepared in accordance with GAAP.

**ARPU Average Revenue Per Unit**

ARPU is an industry term that measures service revenues per month from our subscribers divided by the average number of subscribers in commercial service. ARPU itself is not a measurement under GAAP in the United States and may not be similar to ARPU measures of other companies; however, ARPU uses GAAP measures as the basis for calculation. We believe that ARPU provides useful information concerning the appeal of our rate plans and service offerings and our performance in attracting high value customers. The following schedule reflects the ARPU calculation and reconciliation of service revenues reported on the Consolidated Condensed Statements of Operations to service revenues used for the ARPU calculation:

|   | Three Months Ended<br>September 30 |            | Nine Months Ended<br>September 30 |            |
|---|------------------------------------|------------|-----------------------------------|------------|
|   | 2004                               | 2003       | 2004                              | 2003       |
| <b>ARPU (without roaming revenues)</b>                          |                                    |            |                                   |            |
| Service revenues  | \$ 337,152                         | \$ 260,650 | \$ 936,646                        | \$ 687,699 |
| Adjust: activation fees deferred and recognized for SAB No. 101 | (913 )                             | (1,123 )   | (2,937 )                          | 73         |
| Add: activation fees reclassified for EITF No. 00-21(1)         | 3,054                              | 2,100      | 8,190                             | 2,100      |
| Less: roaming and other revenues                                | (43,327 )                          | (32,622 )  | (114,993 )                        | (82,488 )  |
| Service revenue for ARPU  | \$ 295,966                         | \$ 229,005 | \$ 826,906                        | \$ 607,384 |
| Average units (subscribers)                                     | 1,458                              | 1,096      | 1,364                             | 1,007      |
| ARPU  | \$ 68                              | \$ 70      | \$ 67                             | \$ 67      |

|   | Three Months Ended<br>September 30 |            | Nine Months Ended<br>September 30 |            |
|---|------------------------------------|------------|-----------------------------------|------------|
|   | 2004                               | 2003       | 2004                              | 2003       |
| <b>ARPU (including roaming revenues)</b>                        |                                    |            |                                   |            |
| Service revenues  | \$ 337,152                         | \$ 260,650 | \$ 936,646                        | \$ 687,699 |
| Adjust: activation fees deferred and recognized for SAB No. 101 | (913 )                             | (1,123 )   | (2,937 )                          | 73         |
| Add: activation fees reclassified for EITF No. 00-21(1)         | 3,054                              | 2,100      | 8,190                             | 2,100      |
| Less: other revenues  | (588 )                             |            | (1,678 )                          |            |
| Service revenue for ARPU  | \$ 338,705                         | \$ 261,627 | \$ 940,221                        | \$ 689,872 |
| Average units (subscribers)                                     | 1,458                              | 1,096      | 1,364                             | 1,007      |
| ARPU  | \$ 77                              | \$ 80      | \$ 77                             | \$ 76      |



(1) On July 1, 2003, we adopted EITF Issue No. 00-21, Accounting for Revenue Arrangements with Multiple Deliverables, and elected to apply the provisions prospectively to our existing customer arrangements. Subsequent to that date, each month we recognize the activation fees, phone equipment revenues and equipment costs that had been previously deferred in accordance with Staff Accounting Bulletin, or SAB, No. 101. Under the provisions of SAB No. 101, Revenue Recognition in Financial Statements, we accounted for the sale of our phone equipment and the subsequent service to the customer as a single unit of accounting due to the fact that our wireless service is essential to the functionality of our phones. Accordingly, we recognized revenues from the phone equipment sales and an equal amount of the cost of phone equipment revenues over the expected

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customer relationship period when title to the phone passed to the customer. 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 revenues 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. 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.

**LRS Lifetime Revenue Per Subscriber**

LRS is an industry term calculated by dividing ARPU (see above) by the subscriber churn rate. The subscriber churn rate is an indicator of subscriber retention and represents the monthly percentage of the subscriber base that disconnects from service. Subscriber churn is calculated by dividing the number of handsets disconnected from commercial service during the period by the average number of handsets in commercial service during the period. LRS itself is not a measurement determined under GAAP in the United States of America and may not be similar to LRS measures of other companies; however, LRS uses GAAP measures as the basis for calculation. We believe that LRS is an indicator of the expected lifetime revenue of our average subscriber, assuming that churn and ARPU remain constant as indicated. We also believe that this measure, like ARPU, provides useful information concerning the appeal of our rate plans and service offering and our performance in attracting and retaining high value customers. The following schedule reflects the LRS calculation:

|                                       | Three Months Ended |   |          |   |
|---------------------------------------|--------------------|---|----------|---|
|                                       | September 30       |   | 2003     |   |
|                                       | 2004               |   | 2003     |   |
| ARPU                                  | \$ 68              |   | \$ 70    |   |
| Divided by: churn                     | 1.4                | % | 1.5      | % |
| Lifetime revenue per subscriber (LRS) | \$ 4,857           |   | \$ 4,667 |   |

**RESULTS OF OPERATIONS****Three Months Ended September 30, 2004 Compared to Three Months Ended September 30, 2003***Revenues*

Total revenues increased 27% to \$357.5 million for the three months ended September 30, 2004 as compared to \$280.9 million generated in the same period in 2003. This growth in revenues was due mostly to the increase in our subscriber base. We expect our revenues to continue to increase as we add more subscribers and continue to introduce new products. Although we anticipate continued growth in our revenues in 2004, we have launched all of our markets and we therefore do not expect to continue to experience revenue growth rates of the same magnitude as we have experienced in the past when we were launching new markets on a continuous basis.

For the third quarter of 2004, our ARPU was \$68 (or \$77, including roaming revenues from Nextel), which was a decline of \$2 compared to the third quarter of 2003 due mostly to growth in our government and corporate accounts, which typically have a lower ARPU, offset by an increase for our Nationwide Direct Connect service, which initially launched during third quarter 2003.

We expect to continue to achieve ARPU levels above the industry average and anticipate our ARPU to be in the mid to high \$60s for the remainder of 2004. The following table illustrates service and equipment revenues as a percentage of total revenues for the three months ended September 30, 2004 and 2003 and our ARPU for those periods.

|                              | <b>For the Three<br/>Months Ended<br/>September 30,<br/>2004</b> | <b>% of<br/>Consolidated<br/>Revenues</b> | <b>For the Three<br/>Months Ended<br/>September 30,<br/>2003</b> | <b>% of<br/>Consolidated<br/>Revenues</b> |
|------------------------------|--|---|--|---|
| Service and roaming revenues | \$ 337,152   | 94 %                                      | \$ 260,650   | 93 %                                      |
| Equipment revenues           | 20,390   | 6 %                                       | 20,264   | 7 %                                       |
| Total revenues               | \$ 357,542   | 100 %                                     | \$ 280,914   | 100 %                                     |
| ARPU(1)                      | \$ 68  |   | \$ 70  |   |

(1) See Selected Consolidated Financial Data Additional Reconciliations of Non-GAAP Financial Measures (Unaudited) for more information regarding our use of ARPU as a non-GAAP financial measure.

Our primary sources of revenues are service revenues and equipment revenues. Service revenues increased 29% to \$337.2 million for the three-month period ended September 30, 2004 as compared to \$260.7 million for the same period in 2003. Our service revenues consist of charges to our customers for airtime usage and monthly network access fees from providing integrated wireless services within our territory, specifically digital cellular services, Direct Connect services, text messaging and Nextel Online services. Service revenues also include roaming revenues from Nextel subscribers using our portion of the Nextel Digital Wireless Network. Roaming revenues for the third quarter of 2004 accounted for approximately 13% of our service revenues and is slightly higher compared to third quarter 2003 at 12%. Although we continue to see growth in roaming revenues due to an increase in coverage and on-air cell sites, we expect roaming revenues as a percentage of our service revenues to remain flat or decline due to the anticipated revenue growth that we expect to achieve from our own customer base.

We adopted EITF Issue No. 00-21, *Accounting for Revenue Arrangements with Multiple Deliverables*, 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 revenues 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 results 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. 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 (as amended by SAB 104 in December 2003). For a more detailed discussion of this accounting policy, please see [Critical Accounting Policies Revenue Recognition](#).

The following table shows the reconciliation of the reported service revenues, equipment revenues and cost of equipment revenues to the adjusted amounts that exclude the effects of the adoption of EITF No. 00-21 and SAB No. 101. We believe the adjusted amounts best represent the actual service revenues and the actual subsidy on equipment costs when equipment revenues are netted with cost of equipment revenues that we use to measure our operating performance.

|  | <b>Three Months Ended</b> |                   |
|--|---------------------------|-------------------|
|  | <b>September 30,</b>      | <b>2003</b>       |
|  | <b>2004</b>               |                   |
|  | <b>(in thousands)</b>     |                   |
| <b>Revenues:</b>   |                           |                   |
| Service revenues as reported   | \$ 337,152                | \$ 260,650        |
| Previously deferred activation fees recognized (SAB No. 101)                   | (913 )                    | (1,123 )          |
| Activation fees to equipment revenues (EITF No. 00-21)                         | 3,054                     | 2,100             |
| <i>Total service revenues without SAB No. 101 and EITF No. 00-21</i>           | <i>\$ 339,293</i>         | <i>\$ 261,627</i> |
| Equipment revenues as reported:  | \$ 20,390                 | \$ 20,264         |
| Previously deferred equipment revenues recognized (SAB No. 101)                | (4,878 )                  | (6,459 )          |
| Activation fees from service revenues (EITF No. 00-21)                         | (3,054 )                  | (2,100 )          |
| <i>Total equipment revenues without SAB No. 101 and EITF No. 00-21</i>         | <i>\$ 12,458</i>          | <i>\$ 11,705</i>  |
| Cost of equipment revenues as reported:  | \$ 34,248                 | \$ 37,076         |
| Previously deferred cost of equipment revenues recognized (SAB No. 101)        | (5,791 )                  | (7,582 )          |
| <i>Total cost of equipment revenues without SAB No. 101 and EITF No. 00-21</i> | <i>\$ 28,457</i>          | <i>\$ 29,494</i>  |

Equipment revenues reported for the third quarter of 2004 were \$20.4 million as compared to \$20.3 million reported for the same period in 2003, representing a slight increase of 1%. Of the \$126,000 increase from 2003 to 2004, \$954,000 is for additional activation fees recorded as equipment revenues based on EITF No. 00-21 plus \$753,000 due to an increase in number of gross additional subscribers, offset by recognizing \$1.6 million less equipment revenues previously deferred in accordance with SAB No. 101. Our equipment revenues consist of revenues received for wireless telephones and accessories purchased by our subscribers.

#### *Cost of Service Revenues*

Cost of service revenues consists primarily of network operating costs, which include site rental fees for cell sites and switches, utilities, maintenance and interconnect and other wireline transport charges. Cost of service revenues also includes the amounts we must pay Nextel WIP when our customers roam onto Nextel's portion of the Nextel Digital Wireless Network. These expenses depend mainly on the number of operating cell sites, total minutes of use and the mix of minutes of use between interconnect and Direct Connect. The use of Direct Connect is more efficient than interconnect and, accordingly, less costly for us to provide.

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For the three months ended September 30, 2004, our cost of service revenues was \$92.6 million as compared to \$83.3 million for the same period in 2003, representing an increase of \$9.3 million, or 11%. The increase in costs was partially the result of bringing on-air approximately 325 additional cell sites since September 30, 2003. Furthermore, our number of customers as of September 30, 2004 grew 32% since September 30, 2003, and we experienced an increase in airtime usage by our customers, both of which resulted in higher network operating costs. Compared to third quarter 2003, the average monthly minutes of use per subscriber increased by 7%, to 758 average monthly minutes of use per subscriber from 711 average monthly minutes of use per subscriber for the same period in 2003. Our roaming fees paid to Nextel also increased as our growing subscriber base roamed on Nextel's compatible network.

We expect cost of service revenues to increase as we place more cell sites in service and the usage of minutes increases as our customer base grows. However, we expect our cost of service revenues as a percentage of service revenues and cost per average minute of use to decrease as economies of scale continue to be realized. From the third quarter of 2003 to the same period in 2004, our cost of service revenues as a percentage of service revenues declined from 32% to 27%.

### *Cost of Equipment Revenues*

Cost of equipment revenues includes the cost of the subscriber wireless telephones and accessories sold by us. Our cost of equipment revenues for the three-month period ended September 30, 2004 was \$34.2 million as compared to \$37.1 million for the same period in 2003, or a decline of \$2.9 million, or 8%. The decrease in costs relates mostly to recognizing \$1.8 million less equipment costs that were previously deferred in accordance with SAB No. 101 and \$1.1 million from volume purchase discounts applied to offset the cost of phones.

Due to the "push to talk" functionality of our handsets, the cost of our equipment tends to be higher than that of our competitors. As part of our business plan, we often offer our equipment at a discount or as part of a promotion as an incentive to our customers to commit to contracts for our higher priced service plans and to compete with the lower priced competitor handsets. The table below shows that the gross subsidy (without the effects of SAB No. 101 and EITF No. 00-21) between equipment revenues and cost of equipment revenues was a loss of \$16.0 million for the three months ended September 30, 2004 as compared to a loss of \$17.8 million for the same period in 2003. We expect to continue to employ these discounts and promotions in an effort to grow our subscriber base. Therefore, for the foreseeable future, we expect that cost of equipment revenues will continue to exceed our equipment revenues.

|                                   | <b>For the Three Months<br/>Ended September 30,</b> |              |
|-----------------------------------|---|--------------|
|                                   | <b>2004</b>   | <b>2003</b>  |
|                                   | <b>(in thousands)</b>                               |              |
| Equipment revenues billed         | \$ 12,458   | \$ 11,705    |
| Cost of equipment revenues billed | (28,457 )   | (29,494 )    |
| Total gross subsidy for equipment | \$ (15,999 )  | \$ (17,789 ) |

### *Selling, General and Administrative Expenses*

Selling, general and administrative expenses consist of sales and marketing expenses, expenses related to customer care services and general and administrative costs. For the three months ended September 30, 2004, selling, general and administrative expenses were \$127.2 million compared to \$104.8 million for the same period in 2003, representing an increase of \$22.4 million, or 21%.

Sales and marketing expenses for the three months ended September 30, 2004 were \$52.8 million, an increase of \$7.7 million, or 17%, from third quarter 2003 due to the following:

- \$1.9 million increase in advertising and media expenses as a result of general marketing campaigns along with sponsorship of NASCAR in conjunction with Nextel;
- \$600,000 in facility and lease costs for the 25 new company-owned stores put in operation since September 30, 2003, for a total of 56 retail stores at September 30, 2004. We expect to have approximately 70 company-owned stores by year-end, which will result in additional start-up and operating costs for fourth quarter 2004; and
- \$5.2 million increase in commissions, commission bonuses and residuals paid to account representatives and the indirect sales channel.

General and administrative costs include costs associated with customer care center operations and service and repair for customer phones along with corporate personnel including billing, collections, legal, finance, human resources and information technology. For the three months ended September 30, 2004, general and administrative costs were \$74.4 million, an increase of \$14.7 million, or 25%, compared to the same period in 2003 due to the following:

- \$3.5 million increase due to hiring additional staff and operating expenses to support our growing customer base and related customer care activities in Las Vegas, Nevada and Panama City Beach, Florida;
- \$10.6 million increase in expenses for service and repair, billing, collection and customer retention expenses to support a larger and growing customer base, offset by a \$5.6 million decrease in bad debt due to improved collection activity; and
- \$6.2 million increase in support of our information systems, facilities and corporate expenses.

As we continue to grow our customer base and expand our operations, we expect our sales and marketing expenses and general and administrative costs to continue to increase, but at a slower rate than our customer growth due to efficiencies we anticipate being able to implement.

#### *Stock-Based Compensation Expense*

For the three-month period ended September 30, 2004 we recorded a non-cash stock-based compensation credit of \$22,000 due to forfeitures and for 2003 we recorded non-cash, stock-based compensation expense associated with our grants of restricted stock and employee stock options of approximately \$259,000. Subject to our mandatory adoption of any future accounting pronouncements, we expect stock-based compensation expense to continue to decrease as the options and restricted stock continue to vest.

#### *Depreciation and Amortization Expense*

For the third quarter ended September 30, 2004, our depreciation and amortization expense was \$37.3 million compared to \$33.5 million for the same period in 2003, representing an increase of 11%. The \$3.8 million increase in depreciation expense was due to adding approximately 325 cell sites since September 30, 2003. We also acquired furniture and equipment for our offices and 25 new company-owned stores. We expect depreciation to continue to increase due to additional cell sites we plan to place in service along with furniture and equipment for new company-owned stores and the expansion of our existing customer call center in Panama City Beach, Florida which became operational during third quarter 2004.

*Interest Expense and Interest Income*

Interest expense, net of capitalized interest, declined \$13.9 million, or 37%, from \$37.4 million for the three-month period ended September 30, 2003 to \$23.5 million for the three-month period ended September 30, 2004. This decline was due mostly to our repurchase for cash of our 14% senior discount notes due 2009, 12<sup>1</sup>/<sub>2</sub>% senior discount notes due 2009 and 11% senior notes due 2010 during that period. In addition, for our interest rate swap agreements we recorded a non-cash fair market value gain of approximately \$654,000 for the third quarter of 2004 compared to approximately \$1.3 million non-cash fair market value gain for the same period in 2003.

For the three months ended September 30, 2004, interest income was \$823,000 compared to \$648,000 for 2003. The increase is due mostly to improved rates of return.

*Deferred Income Tax Provision*

Because we ceased amortizing licenses for financial statement purposes on January 1, 2002 in accordance with SFAS 142, 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 adjust the valuation allowance as the deferred tax liabilities related to FCC licenses increase. During the three months ended September 30, 2004, we recorded a deferred income tax provision of \$8.1 million compared to a provision of \$885,000 for the three months ended September 30, 2003 relating to our FCC licenses. Our interim period tax provision (or benefit) is calculated as the estimated annual effective tax rate applied to the year-to-date income less amounts reported for previous interim periods. The increase in tax expense over the prior year is a result of the fact that we incurred losses in the second quarter, but we expect income for the year whereas we had losses in all four quarters last year.

*Net Income (Loss) Attributable to Common Stockholders*

For the three months ended September 30, 2004, we had a net income attributable to common stockholders of approximately \$35.5 million compared to a net loss attributable to common stockholders of \$22.0 million for the same period in 2003, representing an improvement of \$57.5 million. With our continuing progress in increasing revenues as well as scaling our cost structure, we expect to generate net income for the fourth quarter of 2004.

**Nine Months Ended September 30, 2004 Compared to Nine Months Ended September 30, 2003**

*Revenues*

Total revenues increased 38% to \$996.1 million for the nine months ended September 30, 2004 compared to \$723.0 million generated in the same period in 2003. This growth was due to increased revenues from existing markets in addition to launching new markets in Augusta, Georgia during May 2003 and Burlington, Vermont during June 2003. For the nine months ended September 30, 2004 our ARPU was \$67, which was the same for the nine months ended September 30, 2003.

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The following table sets forth our revenues and ARPU for these periods:

|                              | <b>For the Nine<br/>Months Ended<br/>September 30,<br/>2004</b> | <b>% of<br/>Consolidated<br/>Revenues</b> | <b>For the Nine<br/>Months Ended<br/>September 30,<br/>2003</b> | <b>% of<br/>Consolidated<br/>Revenues</b> |
|------------------------------|---|---|---|---|
| Service and roaming revenues | \$ 936,646  | 94 %                                      | \$ 687,699  | 95 %                                      |
| Equipment revenues           | 59,426  | 6 %                                       | 35,293  | 5 %                                       |
| Total revenues               | \$ 996,072  | 100 %                                     | \$ 722,992  | 100 %                                     |
| ARPU(1)                      | \$ 67   |   | \$ 67   |   |



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(1) See Selected Consolidated Financial Data Additional Reconciliations of Non-GAAP Financial Measures (Unaudited) for more information regarding our use of ARPU as a non-GAAP financial measure.

Service revenues increased 36% to \$936.6 million for the nine months ended September 30, 2004 compared to \$687.7 million for the nine months ended September 30, 2003. Roaming revenues for the nine months ended September 30, 2004 accounted for approximately 12% of our service revenues, which was consistent for the same period in 2003.

Because we adopted EITF No. 00-21 prospectively beginning on July 1, 2003, all previously deferred activation fees, handset revenues and related costs for the handsets deferred in accordance with SAB No. 101 will continue to be amortized over their remaining customer relationships. For a discussion of this accounting policy, please see Critical Accounting Policies Revenue Recognition.

The following table shows the reconciliation from the reported service revenues, equipment revenues and cost of equipment revenues to the adjusted amounts that exclude the adoption of EITF No. 00-21 and SAB No. 101. We believe the adjusted amounts best represent our actual service revenues and the actual subsidy on equipment costs when equipment revenues are netted with cost of equipment revenues.

|  | <b>Nine Months Ended<br/>September 30,<br/>2004</b> |   | <b>2003</b>       |
|--|---|---|-------------------|
|  | <b>(in thousands)</b>                               |   |                   |
| <b>Revenues:</b>   |   |   |                   |
| Service revenues as reported   | \$ 936,646  |   | \$ 687,699        |
| Activation fees deferred (SAB No. 101)   |   |   | 3,319             |
| Previously deferred activation fees recognized (SAB No. 101)                   | (2,937  | ) | (3,246            |
| Activation fees to equipment revenues (EITF No. 00-21)                         | 8,190   |   | 2,100             |
| <i>Total service revenues without SAB No. 101 and EITF No. 00-21</i>           | <i>\$ 941,899</i>                                   |   | <i>\$ 689,872</i> |
| Equipment revenues as reported:  | \$ 59,426   |   | \$ 35,293         |
| Equipment revenues deferred (SAB No. 101)                                      |   |   | 19,947            |
| Previously deferred equipment revenues recognized (SAB No. 101)                | (15,858   | ) | (19,334           |
| Activation fees from service revenues (EITF No. 00-21)                         | (8,190  | ) | (2,100            |
| <i>Total equipment revenues without SAB No. 101 and EITF No. 00-21</i>         | <i>\$ 35,378</i>                                    |   | <i>\$ 33,806</i>  |
| Cost of equipment revenues as reported:  | \$ 107,830  |   | \$ 82,011         |
| Cost of equipment revenues deferred (SAB No. 101)                              |   |   | 23,266            |
| Previously deferred cost of equipment revenues recognized (SAB No. 101)        | (18,795   | ) | (22,580           |
| <i>Total cost of equipment revenues without SAB No. 101 and EITF No. 00-21</i> | <i>\$ 89,035</i>                                    |   | <i>\$ 82,697</i>  |

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Equipment revenues for the nine months ended September 30, 2004 were \$59.4 million compared to \$35.3 million for the same period in 2003, representing an increase of \$24.1 million, or 68%. Of the increase, \$16.4 million relates to the adoption of EITF No. 00-21 and recognizing equipment revenues previously deferred in accordance with SAB No. 101, in addition to \$6.1 million of activation fees reported in equipment revenues. The remaining \$1.6 million increase is due to growth in the number of subscribers during the period.

### *Cost of Service Revenues*

For the nine months ended September 30, 2004, our cost of service revenues was \$262.9 million compared to \$232.3 million for the same period in 2003, representing an increase of \$30.6 million, or 13%. The increase in costs was primarily the result of bringing on-air approximately 325 additional cell sites since September 30, 2003, as well as an increase in airtime usage from 667 average monthly minutes of use per subscriber for the nine months ended September 30, 2003 to 739 average monthly minutes of use per subscriber for the nine months ended September 30, 2004. Increased airtime usage resulted from the 32% growth in the number of customers from September 30, 2003 along with the 11% increase in average minutes of use per subscriber per month since that time.

### *Cost of Equipment Revenues*

Our cost of equipment revenues for the nine months ended September 30, 2004 was \$107.8 million compared to \$82.0 million for the same period in 2003. Of the \$25.8 million increase in costs, \$19.5 million was related to the adoption of EITF No. 00-21 and recognizing cost of equipment revenues previously deferred in accordance with SAB No. 101. The remaining \$6.3 million increase in costs was due to the growth in number of subscribers.

Due to the push to talk functionality of our handsets, the cost of our equipment tends to be higher than that of our competitors. As part of our business plan, we often offer our equipment at a discount or as part of a promotion as an incentive to our customers to commit to contracts for our higher priced service plans and to compete with the lower priced competitor handsets. Therefore, we believe these amounts best represent the economics and actual cash subsidy on equipment costs. As a result, the table below shows that the gross subsidy (without the effects of SAB No. 101 and EITF No. 00-21) between equipment revenues and cost of equipment revenues was a loss of \$53.7 million for the nine months ended September 30, 2004, compared to a loss of \$48.9 million for the same period in 2003. We expect to continue to employ these discounts and promotions in an effort to grow our subscriber base. Therefore, for the foreseeable future, we expect that cost of equipment revenues will continue to exceed our equipment revenues.

|                                   | <b>For the Nine Months<br/>Ended September 30,</b> |              |
|-----------------------------------|--|--------------|
|                                   | <b>2004</b>  | <b>2003</b>  |
|                                   | <b>(in thousands)</b>                              |              |
| Equipment revenues billed         | \$ 35,378  | \$ 33,806    |
| Cost of equipment revenues billed | (89,035 )  | (82,697 )    |
| Total gross subsidy for equipment | \$ (53,657 )                                       | \$ (48,891 ) |

*Selling, General and Administrative Expenses*

For the nine months ended September 30, 2004, selling, general and administrative expenses were \$358.4 million compared to \$292.2 million for 2003, representing an increase of \$66.2 million, or 23%. The increase was due to implementing sales and marketing activities to grow our customer base and operating costs for additional company-owned stores, along with billing, collections, customer retention, customer care and service and repair costs to support a larger and growing customer base.

*Stock-Based Compensation Expense*

For the nine months ended September 30, 2004 and 2003, we recorded stock-based compensation expense associated with our grants of restricted stock and employee stock options of approximately \$532,000 and \$740,000, respectively.

*Depreciation and Amortization Expense*

For the nine months ended September 30, 2004, our depreciation and amortization expense was \$110.5 million compared to \$99.5 million for the same period in 2003, representing an increase of 11%. The \$11.0 million increase related primarily to depreciating the wireless network assets for the 325 additional cell sites placed in service since September 30, 2003, along with furniture and equipment purchased to set up new company-owned stores.

*Interest Expense and Interest Income*

Interest expense, net of capitalized interest, declined from \$116.8 million for the nine months ended September 30, 2003 to \$81.7 million for the nine months ended September 30, 2004, representing a decrease of 30%. This reduction was due mostly to our repurchase for cash of our 14% senior discount notes due 2009, 12½% senior notes due 2009 and 11% senior notes due 2010 during that period. In addition, for our interest rate swap agreements we recorded a non-cash fair market value gain of approximately \$2.8 million for the nine months ended September 30, 2004 compared to approximately \$2.7 million non-cash fair market value gain for the same period in 2003.

For the nine months ended September 30, 2004, interest income was \$1.8 million compared to \$1.9 million for the same period in 2003, representing a decrease of \$100,000, or 5%. This decrease was due to a decline in interest rates on our short-term investments.

*Loss on Early Retirement of Debt*

For the nine months ended September 30, 2004, we recorded a \$55.0 million loss on early retirement of debt related to our repurchase for cash of the remaining \$1.8 million (principal amount at maturity) of our 14% senior discount notes due 2009 and \$366.3 million of our 11% senior notes due 2010. Of the \$55.0 million loss, \$45.2 million represents a premium paid to repurchase our 11% senior notes due 2010 for cash and \$9.8 million relates to the write-off of the deferred financing costs for the 14% senior discount notes due 2009, the 11% senior notes due 2010 and the tranche B term loan of the credit facility that was refinanced on May 19, 2004. For the nine months ended September 30, 2003, we recorded a \$74.4 million loss on early retirement of debt related to our repurchase for cash of our 14% senior discount notes, 11% senior notes and 12½% senior notes, along with exchanging \$8.0 million of our 14% senior discount notes for equity.

*Deferred Income Tax Provision*

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. This charge is required because we

have significant deferred tax liabilities related to FCC licenses with a lower tax than book basis as a result of accelerated and continued amortization of FCC licenses for tax purposes. Historically, we did not need a valuation allowance for the portion of our net operating loss equal to the amount of license amortization expected to occur during the carry forward period of our net operating loss. 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 increased the valuation allowance upon the adoption of SFAS No. 142 to \$12.3 million and continue to adjust the valuation allowance as the deferred tax liabilities related to FCC licenses increase. During the nine months ended September 30, 2004, we recorded a deferred income tax provision of \$246,000 and for the same period in 2003 we recorded a \$7.0 million deferred income tax provision relating to our FCC licenses. The reduction in income tax expense relates to the fact that we believe a greater portion of our annual net income (loss) will be recognized in the fourth quarter of 2004 as opposed to 2003.

*Net Loss*

For the nine months ended September 30, 2004, we had net income attributable to common stockholders of approximately \$20.8 million compared to a net loss of \$182.2 million for 2003, representing a \$203.0 million, or 111%, improvement. The \$20.8 million net income included a \$55.0 million loss for early retirement of certain debt.

**Liquidity and Capital Resources**

As of September 30, 2004, our cash and cash equivalents and short-term investments balance was approximately \$237.3 million, a decrease of \$31.5 million compared to the balance of \$268.8 million as of December 31, 2003 and a decrease of \$25.2 million compared to the balance of \$262.5 million as of September 30, 2003. In addition, we had access to an undrawn line of credit of \$100.0 million for a total liquidity position of \$337.3 million as of September 30, 2004. The \$31.5 million decrease in our liquidity position from December 31, 2003 was in part a result of our redemption for cash of approximately \$1.8 million (principal amount at maturity) of our remaining 14% senior discount notes due 2009 and using approximately \$60.0 million of available cash to fund the tender offer of our 11% senior notes due 2010, offset by positive cash from operating activities.

*Statement of Cash Flows Discussion*

|                                    | <b>For the Nine Months Ended September 30,</b> |               |                  |                 |
|------------------------------------|--|---------------|------------------|-----------------|
|                                    | <b>2004</b>                                    | <b>2003</b>   | <b>\$ Change</b> | <b>% Change</b> |
|                                    | <b>(dollars in thousands)</b>                  |               |                  |                 |
| Net cash from operating activities | \$ 131,718                                     | \$ 29,452     | \$ 102,266       | 347 %           |
| Net cash from investing activities | \$ (76,173 )                                   | \$ (178,238 ) | \$ 102,065       | 57 %            |
| Net cash from financing activities | \$ (56,220 )                                   | \$ 199,489    | \$ (255,709 )    | -128 %          |

For the nine months ended September 30, 2004, we provided \$131.7 million in cash from operating activities, compared to providing \$29.5 million in cash for the same period in 2003. The \$102.3 million increase in funds from operating activities was due to the following:

- a \$154.8 million increase in cash generated from operating activities, excluding changes in current assets and liabilities; offset by
- a \$21.5 million increase in our accounts receivable balance from customers due to the growth in number of subscribers;

- a \$21.1 million increase in our on-hand subscriber equipment inventory and other current assets; and
- a \$9.9 million decrease in accounts payable and other current liabilities and operating advances to Nextel WIP due to the timing of payments.

Net cash from investing activities for the nine months ended September 30, 2004 was \$76.2 million compared to \$178.2 million for the same period in 2003. The \$102.1 million increase in net cash from investing activities was primarily due to:

- a \$43.7 million decrease in capital expenditures;
- a \$10.7 million decrease in FCC licenses acquired; and
- a \$47.7 million increase in net cash proceeds from the sale and maturities of short-term investments.

Net cash from financing activities for the nine months ended September 30, 2004 totaled \$56.2 million, which was a decline of \$255.7 million compared to \$199.5 million provided in the same period in 2003. The \$255.7 million net decrease in cash from financing activities was due to:

- a \$248.2 million decrease in cash which was used to redeem the remainder of our outstanding 14% senior discount notes due 2009 and repurchase for cash in open-market purchases and for the tender offer our 11% senior notes due 2010;
- a \$522,000 increase in capital lease payments;
- a \$5.2 million decline in proceeds from sale-leaseback transactions; and
- a \$25.4 million decline in proceeds from refinancing the credit facility and issuing \$25.0 million of 8 $\frac{1}{8}$ % senior notes due 2011; offset by
- a \$13.7 million decline in debt and equity issuance costs; and
- a \$9.9 million increase in proceeds from stock options exercised and the cash proceeds from employee purchases of stock.

#### *Capital Needs and Funding Sources*

Our primary liquidity needs arise from the capital requirements necessary to expand and enhance coverage in our existing markets that are part of the Nextel Digital Wireless Network. Other liquidity needs include the future acquisition of additional frequencies, the installation of new or additional switch equipment, the introduction of new technology and services, and debt service requirements related to our long-term debt and capital leases. Without limiting the foregoing, we expect capital expenditures to include, among other things, the purchase of switches, base radios, transmission towers and antennae, radio frequency engineering, cell site construction, and information technology software and equipment.

Based on our ten-year operating and capital plan, we believe that our existing cash and cash equivalents and short-term investments and access to our line of credit, as necessary, will provide sufficient funds for the foreseeable future to finance our capital needs and working capital requirements as well as provide the necessary funds to acquire any additional FCC licenses.

To the extent we are not able to continue to generate positive cash from operating activities, we will be required to use more of our available liquidity to fund operations or we would require additional financing. We may be unable to raise additional capital on acceptable terms, if at all. Furthermore, our ability to generate positive cash from operating activities is dependent upon the amount of revenue we receive from customers, operating expenses required to provide our service, the cost of acquiring and retaining customers and our ability to continue to grow our customer base.



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Additionally, to the extent we decide to expand our digital wireless network or deploy next generation technologies, we may require additional financing to fund these projects. In the event that additional financing is necessary, such financing may not be available to us on satisfactory terms, if at all, for a number of reasons, including, without limitation, restrictions in our debt instruments on our ability to raise additional funds, conditions in the economy generally and in the wireless communications industry specifically, and other factors that may be beyond our control. To the extent that additional capital is raised through the sale of equity or securities convertible into equity, the issuance of such securities could result in dilution of our stockholders.

The following table provides details regarding our contractual obligations subsequent to September 30, 2004:

### Payments due by Period (in thousands)

| Contractual Obligations       | 2004<br>(3 months) | 2005      | 2006      | 2007      | 2008       | Thereafter   | Total        |
|-------------------------------|--------------------|-----------|-----------|-----------|------------|--------------|--------------|
| Long-term debt                | \$                 | \$        | \$        | \$ 5,250  | \$ 307,000 | \$ 1,310,157 | \$ 1,622,407 |
| Capital lease obligations     | 829                | 3,499     | 3,817     | 4,163     | 4,540      | 4,952        | \$ 21,800    |
| Operating leases              | 21,313             | 75,401    | 55,394    | 41,570    | 30,187     | 57,623       | \$ 281,488   |
| Purchase obligations(1)       | 2,075              | 1,150     |           |           |            |              | 3,225        |
| Total contractual obligations | \$ 24,217          | \$ 80,050 | \$ 59,211 | \$ 50,983 | \$ 341,727 | \$ 1,372,732 | \$ 1,928,920 |

(1) Included in the Purchase obligations caption above are minimum amounts due under our most significant agreements for telecommunication services required for back-office support. Amounts actually paid under some of these agreements may be higher due to variable components of these agreements. In addition to the amounts reflected in the table, we expect to pay significant amounts to Motorola for infrastructure, handsets and related services in future years. Potential amounts payable to Motorola are not shown above due to the uncertainty surrounding the timing and extent of these payments. See notes to the consolidated condensed financial statements appearing elsewhere in this Quarterly Report on Form 10-Q and notes to the consolidated financial statements in our 2003 Annual Report on Form 10-K for the year ended December 31, 2003.

### Sources of Funding

To date, third-party financing activities have provided the majority of our funding. Listed below are the sources of funding, including our refinancing activities:

- proceeds from cash equity contributions and commitments of \$202.8 million in January and September of 1999;
- the offering of 14% senior discount notes due 2009 for initial proceeds of \$406.4 million in January 1999, less \$191.2 million for the partial redemption of these notes in April 2000, \$86.1 million (principal amount at maturity) repurchased for cash in May and June 2003, \$375.8 million (principal amount at maturity) as of June 30, 2003 repurchased pursuant to a tender offer commenced in June 2003, \$16.5 million (principal amount at maturity) and \$4.8 million (principal amount at maturity) repurchased for cash in July 2003 and December 2003, respectively, and \$1.8 million (principal amount at maturity) redeemed in March 2004;
- term loans incurred in the aggregate principal amount of \$375.0 million in January and September 1999 and January 2002, which we refinanced in May 2004 and increased to \$700.0 million;

- the contribution by Nextel WIP of FCC licenses valued at \$178.3 million, in exchange for Class B common stock and Series B preferred stock in January and September 1999 and September 2000, less redemption of all the Series B preferred stock for \$38.9 million in November 2003;
- the contribution by Motorola of a \$22.0 million credit to use against our purchases of Motorola-manufactured infrastructure equipment in exchange for Class A common stock, all of which had been used by December 31, 1999;
- net proceeds from the sale of Class A common stock in our initial public offering of \$510.8 million in February 2000;
- the offering of 11% senior notes due 2010 for \$200.0 million in March 2000 and an additional \$200.0 million in 11% senior notes due 2010 in July 2000, less \$22.6 million (principal amount at maturity) repurchased for cash in August 2003, \$10.5 million (principal amount at maturity) repurchased for cash in March 2004 and \$355.8 million (principal amount at maturity) repurchased for cash through a tender offer that expired in May 2004;
- the offering of 12½% senior discount notes due 2009 for \$210.4 million in December 2001, less \$11.1 million (principal amount at maturity) repurchased for cash in August 2003 and the redemption of \$67.7 million (principal amount at maturity) in December 2003;
- net proceeds totaling \$28.0 million from the sale of switches in Kentucky and Florida in July and October 2002;
- cancellation of existing indebtedness in November and December 2002 and January and February 2003 in the aggregate amount of \$45.0 million (principal amount at maturity) in exchange for the issuance of shares of our Class A common stock;
- the offering of 1½% convertible senior notes due 2008 for \$150.0 million in May 2003 and an additional \$25.0 million in June 2003 pursuant to the exercise of an over-allotment option held by the initial purchasers of the notes;
- the offering of 8⅛% senior notes due 2011 for \$450.0 million in June 2003 and an additional \$25.0 million in May 2004 for proceeds of \$24.6 million;
- the offering of 1½% convertible senior notes due 2008 for \$125.0 million in August 2003; and
- net proceeds of \$104.5 million from our sale of Class A common stock in November 2003.

Our funding sources from debt are described below in more detail:

On May 19, 2004, OPCO refinanced its existing \$475.0 million credit facility with a syndicate of banks and other financial institutions led by J.P. Morgan Securities Inc. and Morgan Stanley Senior Funding, Inc. as joint lead arrangers and book runners, Morgan Stanley Senior Funding, Inc. as syndication agent, and JPMorgan Chase Bank as administrative agent. The new credit facility includes a \$700.0 million tranche C term loan, a \$100.0 million revolving credit facility and an option to request an additional \$200.0 million of incremental term loans. Such incremental term loans shall not exceed \$200.0 million or have a final maturity date earlier than the maturity date for the tranche C term loan. The tranche C term loan matures on the date falling on or nearest to May 31, 2011. The revolving credit facility will terminate on the last business day in May falling on or nearest to May 31, 2011. The incremental term loans, if any, shall mature on the date specified on the date the respective loan is made, provided that such maturity date shall not be earlier than the maturity date for the tranche C term loan. As of September 30, 2004, \$700.0 million of the tranche C term loan was outstanding and no amounts were outstanding under either the \$100.0 million revolving credit facility or the incremental term loans. Borrowings under the new secured credit facility



were used to repay borrowings under our previous \$475.0 million tranche B senior secured credit facility as well as fund a portion of the tender offer for our 11% senior notes due 2010.

The tranche C term loan bears interest, at our option, at the administrative agent's alternate base rate or reserve-adjusted LIBOR plus, in each case, applicable margins. The initial applicable margin for the tranche C term loan is 2.50% over LIBOR and 1.50% over the base rate. For the revolving credit facility, the initial applicable margin is 3.00% over LIBOR and 2.00% over the base rate and thereafter will be determined on the basis of the ratio of total debt to annualized EBITDA and will range between 1.50% and 3.00% over LIBOR and between 0.50% and 2.00% over the base rate. As of September 30, 2004, the interest rate on the tranche C term loan was 4.3125%.

Borrowings under the term loans are secured by, among other things, a first priority pledge of all assets of OPCO and all assets of the subsidiaries of OPCO and a pledge of their respective capital stock. The credit facility contains financial and other covenants customary for the wireless industry, including limitations on our ability to incur additional debt or create liens on assets. The credit facility also contains covenants requiring that we maintain certain defined financial ratios. As of September 30, 2004, we were in compliance with all covenants associated with this credit facility.

Our 14% senior discount notes due 2009 were issued in January 1999. The notes were issued at a discount to their aggregate principal amount at maturity and generated aggregate gross proceeds to us of approximately \$406.4 million. In July 1999 we exchanged these notes for registered notes having the same financial terms and covenants as the notes issued in January 1999. Cash interest began accruing on the notes on February 1, 2004. On April 18, 2000, we redeemed 35% of the accreted value of these outstanding notes for approximately \$191.2 million with proceeds from our initial public offering. The redemption payment of \$191.2 million included \$167.7 million of these outstanding notes (principal amount at maturity) plus a 14% premium of approximately \$23.5 million. In November and December 2002 we exchanged approximately \$27.0 million (principal amount at maturity) of the notes for shares of our Class A common stock and again in January and February 2003 exchanged an additional \$8.0 million (principal amount at maturity) of the notes for shares of our Class A common stock. From May 13, 2003 through June 4, 2003, we repurchased for cash approximately \$86.1 million (principal amount at maturity) of the notes outstanding for \$87.9 million. On June 11, 2003 we commenced a tender offer that expired July 11, 2003 to repurchase all of the remaining notes outstanding, which through June 30, 2003 we purchased approximately \$375.8 million (principal amount at maturity) of the 14% senior discount notes due 2009 for \$398.1 million. From July 1, 2003 through July 11, 2003, we repurchased for cash an additional \$16.5 million (principal amount at maturity) of the 14% senior discount notes due 2009 for \$17.5 million. On December 1, 2003 we repurchased for cash approximately \$4.8 million (principal amount at maturity) of the notes outstanding for \$5.1 million. During March 2004, we redeemed the remaining \$1.8 million (principal amount at maturity) of our outstanding 14% senior discount notes due 2009.

On March 10, 2000, we issued \$200.0 million of 11% senior notes due 2010, and on July 27, 2000, we issued an additional \$200.0 million of 11% senior notes due 2010, each in a private placement. We subsequently exchanged all of the March 2000 and July 2000 notes for registered notes having the same financial terms and covenants as the privately placed notes. Interest accrues for these notes at the rate of 11% per annum, payable semi-annually in cash in arrears on March 15 and September 15 of each year, which commenced on September 15, 2000. In November 2002 we exchanged \$10.0 million (principal amount at maturity) of the notes for shares of our Class A common stock. During August 2003 and March 2004, we repurchased for cash \$22.6 million and \$10.5 million (principal amounts at maturity), respectively, of our 11% senior notes due 2010 in open-market purchases. On April 28, 2004, we commenced a tender offer and consent solicitations relating to all of our outstanding 11% senior notes due 2010. In connection with the tender offer, which expired on May 25, 2004, we purchased approximately \$355.8 million (principal amount at maturity) of the 11% senior notes due 2010 for approximately

\$406.6 million including accrued interest. As of September 30, 2004, there was approximately \$1.2 million (principal amount at maturity) of outstanding 11% senior notes due 2010.

On December 4, 2001 we issued in a private placement \$225.0 million of 12½% senior discount notes due 2009. These notes were issued at a discount to their aggregate principal amount at maturity and generated aggregate gross proceeds to us of approximately \$210.4 million. We subsequently exchanged all of these 12½% senior discount notes due 2009 for registered notes having the same financial terms and covenants as the privately placed notes. Interest accrues for these notes at the rate of 12½% per annum, payable semi-annually in cash in arrears on May 15 and November 15 of each year, which commenced on May 15, 2002. During August 2003, we repurchased for cash \$11.1 million (principal amount at maturity) of our 12½% senior discount notes due 2009 in open-market purchases. On December 31, 2003 we completed the redemption of \$67.7 million (principal amount at maturity) of the notes outstanding with net proceeds from our public offering in November 2003.

On May 13, 2003, we closed a private placement of \$150.0 million of 1½% convertible senior notes due 2008. On June 11, 2003, we closed a private placement of an additional \$25.0 million of these notes pursuant to the exercise of an over-allotment option held by the initial purchasers of these notes, increasing the total proceeds to \$175.0 million. At the option of the holders, the notes are convertible into shares of our Class A common stock at an initial conversion rate of 131.9087 shares per \$1,000 principal amount of notes, which represents a conversion price of \$7.58 per share, subject to adjustment. Interest accrues for these notes at the rate of 1½% per annum, payable semi-annually in cash in arrears on May 15 and November 15 of each year, which commenced on November 15, 2003. We subsequently filed a registration statement with the SEC to register the resale of the 1½% convertible senior notes due 2008 and the shares of our Class A common stock into which the 1½% convertible senior notes due 2008 are convertible.

On June 23, 2003, we issued \$450.0 million of 8⅛% senior notes due 2011 in a private placement. We subsequently exchanged all of the 8⅛% senior notes due 2011 for registered notes having the same financial terms and covenants as the privately placed notes. Interest accrues for these notes at the rate of 8⅛% per annum, payable semi-annually in cash in arrears, on January 1 and July 1 of each year, which commenced on January 1, 2004. The proceeds from this offering were used primarily to fund the purchase of the 14% senior discount notes due 2009 in our June 2003 tender offer.

On August 6, 2003, we closed a private placement of \$125.0 million of 1½% convertible senior notes due 2008. At the option of the holders, the notes are convertible into shares of our Class A common stock at an initial conversion rate of 78.3085 shares per \$1,000 principal amount of notes, which represents a conversion price of \$12.77 per share, subject to adjustment. Interest accrues for these notes at the rate of 1½% per annum, payable semi-annually in cash in arrears on May 15 and November 15 of each year, which commenced on November 15, 2003. We subsequently filed a registration statement with the SEC to register the resale of the 1½% convertible senior notes due 2008 and the shares of our Class A common stock into which the 1½% convertible senior notes due 2008 are convertible.

On May 19, 2004, we issued an additional \$25.0 million of 8⅛% senior notes due 2011 under a separate indenture in a private placement. We subsequently exchanged all of these 8⅛% senior notes for registered notes having the same financial terms and covenants as the privately placed notes. Interest accrues for these notes at the rate of 8⅛% per annum, payable semi-annually in cash in arrears on January 1 and July 1 of each year, which commenced on July 1, 2004. The proceeds were used to fund a portion of the purchase of the 11% senior notes due 2010 in our tender offer.

As discussed in more detail in Risk Factors, if we fail to satisfy the financial covenants and other requirements contained in our credit facility and the indentures governing our outstanding notes, our debts



could become immediately payable at a time when we are unable to pay them, which could adversely affect our liquidity and financial condition.

In the future, we may opportunistically engage in additional debt-for-equity exchanges or repurchase additional outstanding notes for cash if the financial terms are sufficiently attractive.

### **Critical Accounting Policies**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires estimates and assumptions that affect the reported amounts of assets and liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities in the consolidated financial statements and accompanying notes included elsewhere in this Quarterly Report on Form 10-Q. The SEC has defined a company's most critical accounting policies as the ones that are most important to the portrayal of the company's financial condition and results of operations, and which require the company to make its most difficult and subjective judgments, often as a result of the need to make estimates of matters that are inherently uncertain. Based on this definition, we have identified the critical accounting policies and judgments addressed below. We also have other key accounting policies, which involve the use of estimates, judgments and assumptions. For additional information see the notes to the consolidated financial statements included elsewhere in this Quarterly Report on Form 10-Q. Although we believe that our estimates and assumptions are reasonable, they are based upon information presently available. Actual results may differ significantly from these estimates under different assumptions or conditions.

#### *Revenue Recognition*

We recognize service revenues for access charges and other services charged at fixed amounts ratably over the service period, net of credits and adjustments for service discounts. These discounts typically relate to promotional service campaigns in which customers will receive a monthly discount on their service plan for a limited period depending on the features of the rate plan. Additionally, for situations where customers may have a billing dispute, coverage dispute or service issue, we may grant a one-time credit or adjustment to the customer's bill. We recognize excess usage and long distance revenue at contractual rates per minute as minutes are used. To account for the service revenues, including adjustments and discounts, that are unbilled at month-end, we make an estimate of unbilled service revenues from the end of the billed service period to the end of the month. This estimate, which is subjective, is based on a number of factors, including: the increase in net subscribers, number of business days from the billed service period to the end of the month and the average revenue per subscriber, after taking partial billing periods into consideration. This estimate is accrued monthly and reversed the following month when the actual service period is billed again. The actual service revenues could be greater or lower than the amounts estimated due to rate plans in effect and the minutes of use differing from the factors used for the estimate. Historically, our differences between the estimated and actual service revenues have not been material.

Equipment revenues include the sale of phone and accessory equipment. We recognize revenues for phone and accessory equipment when title passes to the customer, which is upon shipping the item to the customer.

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.

Prior to the adoption of EITF No.00-21, we followed the guidance of SAB No. 101, *Revenue Recognition in Financial Statements*, and accounted for the sale of our phone equipment and the subsequent service to the customer as a single unit of accounting as our wireless service is essential to the functionality of our phones. Accordingly, we recognized revenues from the phone equipment sales and an equal amount of the cost of phone equipment revenues over the expected customer relationship period when title to the phone passed to the customer. 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 revenues 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 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. 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. 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.

#### *Accounts Receivable*

Accounts receivable are recorded at the invoiced amount and include late payment fee charges for unpaid balances. The allowance for doubtful accounts is our best estimate of the amount of probable credit losses that will occur in our existing accounts receivable balance. We review our allowance for doubtful accounts monthly. We determine the allowance based on the age of the balances and our experience of collecting on certain account types such as corporate, small business, government or other various classifications. Account balances are charged off against the allowance after all means of collection have been exhausted internally and the potential for recovery is considered remote or delegated to a third-party collection agency. Changes to our allowance may be required if we have to alter our write-off patterns due to the financial condition of our customers or if we adjust our credit standards for new customers. Historically, we have not had to make material adjustments.

#### *Capitalization and Depreciation of Fixed Assets*

Our business is inherently capital intensive due to the build out and continual expansion of our digital network. Thus, we record our system (digital network) and non-system fixed assets, including improvements that extend useful lives, at cost, while maintenance and repairs are charged to operations as incurred. Depreciation and amortization are computed using the straight-line method with estimated useful lives of up to 31 years for cell site shelters, three to ten years for digital mobile network equipment, and three to seven years for furniture and fixtures. Leasehold improvements are amortized over the shorter of the respective lives of the leases or the useful lives of the improvements. As we continue to track the utilization of our system and non-system fixed assets, we may find that the actual economic lives may be different than our estimated useful lives, thus resulting in different carrying values of our fixed assets or property, plant and equipment. This could also result in a change of our depreciation expense in future periods. To date, we have not changed the estimated useful lives that we employ, but we will continue to conduct periodic evaluations to confirm that they are appropriate, taking into consideration such factors as changes in our technology and the industry.

Construction in progress includes costs of labor (internal and external), materials, transmission and related equipment, engineering, site design, interest and other costs relating to the construction and development of our digital mobile network. Assets under construction are not depreciated until placed into

service. In capitalizing costs related to the construction of our digital network, we include costs that are required to activate the network.

#### *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 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 for impairment, at least annually, 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 initial and annual asset impairment analyses on our FCC licenses in accordance with SFAS No. 142 and to date we have determined there has been no impairment as the fair values of the licenses were greater than their carrying values. For our impairment analysis, we use the aggregate of all of 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 EITF Issue No. 02-7, *Unit of Accounting for Testing Impairment Indefinite-Lived Intangible Assets*, to estimate the fair value of our licenses using a discounted cash flow model. The estimates that we use in the cash flow model were based on our long-range cash flow projections, discounted at our corporate weighted average cost of capital. The use of different estimates or assumptions within our discounted cash flow model when determining the fair value of our licensing cost may result in different values for our licensing costs and any related impairment charge.

As a result of the adopting SFAS No. 142, we now record a non-cash income tax provision based on 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 with a corresponding deferred tax provision as the deferred tax liabilities related to FCC license amortization increase. During the three- and nine-month periods ended September 30, 2004, we recorded a tax provision of \$8.1 million and \$246,000, respectively, primarily related to our FCC licenses.

#### *Impairment of Long-Lived Assets*

Our long-lived assets consist principally of property, plant and equipment. It is our policy to assess impairment of long-lived assets pursuant to SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. This includes determining if certain triggering events have occurred, including significant decreases in the market value of certain assets, significant changes in the manner in which an asset is used, significant changes in the legal climate or business climate that could affect the value of an asset, or current period or continuing operating or cash flow losses or projections that demonstrate continuing losses associated with certain assets used for the purpose of producing revenue that might be an indicator of impairment. When we perform the SFAS No. 144 impairment tests, we identify the appropriate asset group to be our network system, which includes the grouping of all of our assets required to operate our portion of the Nextel Digital Wireless Network and provide service to our customers. We based this conclusion of asset grouping on the revenue dependency, operating interdependency and shared

costs to operate our network. Thus far, none of the above triggering events has resulted in any impairment charges.

### **Recently Issued Accounting Pronouncements**

In December 2003, the FASB issued FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities* ( FIN 46R ), which addresses how a business enterprise should evaluate whether it has a controlling financial interest in an entity through means other than voting rights and accordingly should consolidate the entity. FIN 46R replaces FASB Interpretation No. 46, *Consolidation of Variable Interest Entities*, which was issued in January 2003. We adopted FIN 46R effective January 1, 2004 without any impact to our financial statements.

### **Related Party Transactions**

#### *Nextel Operating Agreements*

We, along with our operating subsidiary, entered into a joint venture agreement dated January 29, 1999 with Nextel WIP, which held approximately 32.0% of our outstanding common stock as of September 30, 2004 and with which one of our directors is affiliated. The joint venture agreement, along with other operating agreements between Nextel WIP and us, defines the relationships, rights and obligations between the parties and governs the build-out and operation of our portion of the Nextel Digital Wireless Network and the transfer of licenses from Nextel WIP to us. Our roaming agreement with Nextel WIP provides that each party pays the other company's monthly roaming fees in an amount based on the actual system minutes used by our respective customers when they are roaming on the other party's network. For the three months ended September 30, 2004 and 2003, we earned approximately \$42.7 million and \$32.6 million, respectively, and for the nine months ended September 30, 2004 and 2003, we earned approximately \$113.3 million and \$82.5 million, respectively, from Nextel customers roaming on our system, which is included in our service revenues.

During the three months ended September 30, 2004 and 2003, we incurred charges from Nextel WIP totaling \$31.3 million and \$26.3 million, respectively, and for the nine months ended September 30, 2004 and 2003, we incurred charges from Nextel WIP for \$86.3 million and \$70.2 million, respectively, for services such as specified telecommunications switching services, charges for our customers roaming on Nextel's system and other support costs. The costs for these services are recorded in cost of service revenues.

During 2003 and 2004 Nextel continued to provide certain services to us for which we paid a fee based on their cost. These services are limited to Nextel telemarketing and customer care, fulfillment, activations and billing for the national accounts. We also paid Nextel a royalty fee and a 2004 sponsorship fee for NASCAR. For the three months ended September 30, 2004 and 2003, we were charged approximately \$2.6 million and \$2.5 million, respectively, and \$10.8 million and \$6.6 million for the nine months ended the same periods, respectively, for these services and fees. Nextel WIP also provides us access to certain back office and information systems platforms on an ongoing basis. For the three months ended September 30, 2004 and 2003, we were charged approximately \$1.3 million and \$1.1 million, respectively, and \$3.7 million and \$3.4 million for the nine months ended September 30, 2004 and 2003, respectively, for these services. The costs for all of these services and fees are included in selling, general and administrative expenses.

In the event of a termination of the joint venture agreement, Nextel WIP could, under certain circumstances, purchase or be required to purchase all of our outstanding common stock. In such event, Nextel WIP, at its option, would be entitled to pay the purchase price therefor in cash or in shares of Nextel common stock. The circumstances that could trigger these rights and obligations include, without

limitation, termination of our operating agreements with Nextel WIP, a change of control of Nextel or a failure by us to make certain required changes to our business.

*Business Relationship*

In the ordinary course of business, we lease tower space from American Tower Corporation. One of our directors is a stockholder and former president, chief executive officer and chairman of the board of directors of American Tower Corporation. During the three months ended September 30, 2004 and 2003, we paid American Tower Corporation for these tower leases \$3.0 million and \$2.7 million, respectively, and \$7.9 million for each of the nine-month periods ended September 30, 2004 and 2003.

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## RISK FACTORS

*The following risk factors and other information included in this Quarterly Report on Form 10-Q should be carefully considered. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known to us or that we currently deem immaterial also may impair our business operations. If any of the following risks occur, our business, operating results and financial condition could be seriously harmed.*

### **Our highly leveraged capital structure and other factors could limit both our ability to obtain additional financing and our growth opportunities and could adversely affect our business in several other ways.**

The total non-current portion of our outstanding debt including capital lease obligations was approximately \$1.6 billion as of September 30, 2004 and greatly exceeds the level of our revenues and stockholders' equity. As of September 30, 2004, the non-current portion of total long-term debt outstanding included \$700.0 million outstanding under our credit facility, \$1.2 million of outstanding 11% senior notes due 2010, \$139.0 million at their accreted value of outstanding 12½% senior discount notes due 2009, \$300.0 million of outstanding 1½% convertible senior notes due 2008, \$474.6 million of outstanding 8⅞% senior notes due 2011, and \$18.4 million of capital lease obligations. In aggregate, this indebtedness represented approximately 99% of our total book capitalization at that date.

Our large amount of outstanding indebtedness, and the fact that we may need to incur additional debt in the future, could significantly impact our business for the following reasons:

- it limits our ability to obtain additional financing, if needed, to implement any enhancement of our portion of the Nextel Digital Wireless Network, including any enhanced iDEN services, to expand wireless voice capacity, enhanced data services or potential next-generation mobile wireless services, to cover our cash flow deficit or for working capital, other capital expenditures, debt service requirements or other purposes;
- it will require us to dedicate a substantial portion of our operating cash flow to fund interest expense on our credit facility and other indebtedness, reducing funds available for our operations or other purposes;
- it makes us vulnerable to interest rate fluctuations because our credit facility term loan bears interest at variable rates; and
- it limits our ability to compete with competitors who are not as highly leveraged, especially those who may be able to price their service packages at levels below those which we can or are willing to match.

Our ability to make payments on our indebtedness and to fund planned capital expenditures will depend on our ability to generate cash in the future. This, to a certain extent, is subject to general economic, financial, competitive, legislative, regulatory and other factors that are beyond our control. Based on our current level of operations and anticipated cost savings and operating improvements, we believe our cash flow from operations, available cash and available borrowings under our credit facility will be adequate for the foreseeable future to meet our estimated capital requirements to build out and maintain our portion of the Nextel Digital Wireless Network using the current 800 MHz iDEN system.

We cannot be sure, however, that our business will generate sufficient cash flow from operations, that currently anticipated cost savings and operating improvements will be realized on schedule or that future borrowings will be available to us under our credit facility in an amount sufficient to enable us to pay our indebtedness and our obligations under our credit facility or our existing senior discount notes, convertible senior notes and senior notes, or to fund our other liquidity needs. In addition, if our indebtedness cannot

be repaid at maturity or refinanced, we will not be able to meet our obligations under our debt agreements, which could result in the cessation of our business.

If we default on our debt or if we are liquidated, the value of our assets may not be sufficient to satisfy our obligations. We have a significant amount of intangible assets, such as licenses granted by the FCC. The value of these licenses will depend significantly upon the success of our business and the growth of the specialized mobile radio, or SMR, and wireless communications industries in general.

General conditions in the wireless communications industry or specific competitors' results, including potential decreases in new subscriber additions, declining ARPU or increased customer dissatisfaction, may adversely affect the market price of our notes and Class A common stock and, as a result, could impair our ability to raise additional capital through the sale of our equity or debt securities. In addition, the fundraising efforts of Nextel or any of its affiliates may also adversely affect our ability to raise additional funds.

**We have a history of operating losses, may incur operating losses in the future and may not be able to generate the earnings necessary to fund our operations, sustain the continued growth of our business or repay our debt obligations.**

We did not commence commercial operations until January 29, 1999, and the portion of the Nextel Digital Wireless Network we began operating on that date only had a few months of operating history. Since then, we have had a history of operating losses, and, as of September 30, 2004, we had an accumulated deficit of approximately \$1.2 billion. We may incur operating losses in the future. We cannot assure you that we will sustain profitability in the future. If we fail to achieve significant and sustained growth in our revenues and earnings from operations, we will not have sufficient cash to fund our current operations, sustain the continued growth of our business or repay our debt obligations. In addition, the slowdown in the U.S. economy generally has added economic and consumer uncertainty that could adversely affect our revenue growth. Our failure to fund our operations or continued growth would have an adverse impact on our financial condition, and our failure to make any required payments would result in defaults under all of our debt agreements, which could result in the cessation of our business.

**If Nextel experiences financial or operational difficulties, our business may be adversely affected.**

Our business plan depends, in part, on Nextel continuing to build and sustain customer support of its brand and the Motorola iDEN technology. If Nextel encounters financial problems or operating difficulties relating to its portion of the Nextel Digital Wireless Network or experiences a significant decline in customer acceptance of its products or the Motorola iDEN technology, our affiliation with and dependence on Nextel may adversely affect our business, 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. Additional information regarding Nextel, its domestic digital mobile network business and the risks associated with that business can be found in Nextel's Annual Report on Form 10-K for the year ended December 31, 2003, as well as Nextel's other filings made under the Securities Act of 1933, as amended (the Securities Act), and the Securities Exchange Act of 1934, as amended (the Exchange Act) (SEC file number 0-19656).

**Under certain circumstances, Nextel WIP has the ability to purchase, and a majority of our Class A stockholders can cause Nextel WIP to purchase, all of our outstanding Class A common stock.**

Under our restated certificate of incorporation and our operating agreements, in certain circumstances and subject to certain limitations, Nextel WIP has the ability to purchase, or to cause and fund redemption by us of, all of the outstanding shares of our Class A common stock. In addition, under the provisions of our restated certificate of incorporation, upon the occurrence of certain events, the

holders of a majority of our outstanding Class A common stock can require Nextel WIP to purchase, or cause and fund a redemption by us of, all of the outstanding shares of our Class A common stock. The circumstances that could trigger Nextel WIP's purchase right include the occurrence of January 29, 2008 (subject to certain postponements by our board of directors); failure by us to implement certain required changes to our business; failure by Nextel WIP to fund certain changes to our digital transmission technology; or termination of our operating agreements with Nextel WIP as a result of our breach. The circumstances that could trigger our stockholders' put right include a change of control of Nextel; failure by us to implement certain required changes to our business; or termination of our operating agreements with Nextel WIP as a result of a breach by Nextel WIP.

**Our existing debt agreements contain restrictive and financial covenants that limit our operating flexibility.**

The indentures governing our existing senior discount notes, convertible senior notes and senior notes and the credit facility of OPCO, contain covenants that, among other things, restrict our ability to take specific actions even if we believe them to be in our best interest. These include restrictions on our ability to:

- incur additional debt;
- pay dividends or distributions on, or redeem or repurchase, capital stock;
- create liens on assets;
- make investments, loans or advances;
- issue or sell capital stock of certain of our subsidiaries;
- enter into transactions with affiliates;
- enter into a merger, consolidation or sale of assets; or
- engage in any business other than telecommunications.

In addition, our credit facility imposes financial covenants that require our principal subsidiary to comply with specified financial ratios and tests, including minimum interest coverage ratios, maximum leverage ratios and minimum fixed charge coverage ratios. We cannot assure you that we will be able to meet these requirements or satisfy these covenants in the future, and if we fail to do so, our debts could become immediately payable at a time when we are unable to pay them, which would adversely affect our ability to carry out our business plan and would have a negative impact on our financial condition.

**Implementation of mandated wireless local number portability could negatively impact our business.**

The FCC mandated that wireless carriers provide for local number portability ( LNP ) by November 24, 2003 in the top 100 metropolitan statistical areas ( MSAs ) in the United States. In addition, wireless carriers in areas outside of the top 100 MSAs must port a telephone number on request within six months, or by May 24, 2004, whichever is later. LNP allows subscribers to keep their wireless phone number when switching to a different service provider. We implemented LNP in our markets that are within the top 100 MSAs in the United States that were required to be completed by November 24, 2003 and implemented LNP in our remaining markets by the May 24, 2004 deadline. We anticipate number portability could increase churn, which is likely to increase our costs. A high rate of churn would adversely affect our results of operations because of loss of revenue and the cost of adding new subscribers, which generally includes a commission expense and/or significant handset discounts. A high rate of churn is a significant factor in income and profitability for participants in the wireless industry. We may be required to subsidize product upgrades and /or reduce pricing to match competitors' initiatives and retain

customers, which could adversely impact our revenues and profitability. Since the launch, the wireless industry has continued to work to improve its ability to support number portability. If consumer dissatisfaction results, it could adversely impact industry growth.

**Our future performance will depend on our and Nextel's ability to succeed in the highly competitive wireless communications industry.**

Our ability to compete effectively with established and prospective wireless communications service providers depends on many factors, including the following:

- If the wireless communications technology that we and Nextel use does not continue to perform in a manner that meets customer expectations, we will be unable to attract and retain customers. Customer acceptance of the services we offer is and will continue to be affected by technology-based differences and by the operational performance and reliability of system transmissions on the Nextel Digital Wireless Network. If we are unable to address and satisfactorily resolve performance or other transmission quality issues as they arise, including transmission quality issues on Nextel's portion of the Nextel Digital Wireless Network, we may have difficulty attracting and retaining customers, which would adversely affect our revenues.
- As personal communication services and cellular operators, such as Verizon Wireless, Sprint PCS and ALLTEL, begin to offer two-way radio dispatch services, our historical competitive advantage of being uniquely able to combine that service with our mobile telephone service may be impaired. Further, some of our competitors have attempted to compete with Direct Connect by offering unlimited mobile-to-mobile calling plan features and reduced rate calling plan features for designated groups. If these calling plan modifications are perceived by our existing and potential customers as viable substitutes for our differentiated services, our business may be adversely affected.
- Because the Nextel Digital Wireless Network does not currently provide roaming or similar coverage on a nationwide basis that is as extensive as is available through most cellular and personal communication services providers, we may not be able to compete effectively against those providers.
- In addition, some of our competitors provide their customers with handsets with both digital and analog capability, which expands their coverage, while we have only digital capability. We cannot be sure that we, either alone or together with Nextel, will be able to achieve comparable system coverage or that a sufficient number of customers or potential customers will be willing to accept system coverage limitations as a trade-off for our multi-function wireless communications package.
- Neither we nor Nextel has the extensive direct and indirect channels of products and services distribution that are available to some of our competitors. The lack of these distribution channels could adversely affect our operating results. Although we have recently expanded our distribution channels to include retail locations, we cannot assure you that these distribution channels will be successful. Moreover, many of our competitors have established extensive networks of retail locations, including locations dedicated solely to their products, and multiple distribution channels and, therefore, have access to more potential customers than we do.
- Because of their greater resources and potentially greater leverage with multiple suppliers, some of our competitors may be able to offer handsets and services to customers at prices that are below the prices that we can offer for comparable handsets and services. If we cannot, as a result, compete effectively based on the price of our product and service offerings, our revenues and growth may be adversely affected.

- The wireless telecommunications industry is experiencing significant technological change. Our digital technology could become obsolete or it may not be a suitable platform for the implementation of new and emerging technologies and service offerings. We rely on digital technology that is not compatible with, and that competes with, other forms of digital and non-digital voice communication technology.
- Competition among these differing technologies could result in the following: segment the user markets, which could reduce demand for specific technologies, including our technology; reduce the resources devoted by third-party suppliers, including Motorola, which supplies all of our current digital technology, to developing or improving the technology for our systems; and otherwise adversely affect market acceptance of our services.
- We offer our subscribers access to digital two-way mobile data and Internet connectivity under the brand name Nextel Online. We cannot be sure that these services will continue to perform satisfactorily, be utilized by a sufficient number of our subscribers or produce sufficient levels of customer satisfaction or revenues. Because we have less spectrum than some of our competitors, and because we have elected to defer the implementation of next-generation services, any digital two-way mobile data and Internet connectivity services that we may offer could be significantly limited compared to those services offered by other wireless communications providers with larger spectrum positions. The success of these new services will be jeopardized if: we are unable to offer these new services profitably; these new service offerings adversely impact the performance or reliability of the Nextel Digital Wireless Network; we, Nextel or third-party developers fail to develop new applications for our customers; or we otherwise do not achieve a satisfactory level of customer acceptance and utilization of these services.
- We expect that as the number of wireless communications providers in our market areas increases, including providers of both digital and analog services, our competitors' prices in these markets will decrease. We may encounter further market pressures to reduce our digital wireless network service offering prices; restructure our digital wireless network service offering packages to offer more value; or respond to particular short-term, market-specific situations, for example, special introductory pricing or packages that may be offered by new providers launching their services in a particular market. A reduction in our pricing would likely have an adverse effect on our revenues and operating results.
- Because of the numerous features we offer and the fact that Motorola is our sole source of handsets (with the exception of the Blackberry 7510, which is available only from RIM), our mobile handsets are, and are likely to remain, significantly more expensive than mobile analog telephones and are, and are likely to remain, somewhat more expensive than digital cellular or personal communication services telephones that do not incorporate a comparable multi-function capability. The higher cost of our equipment may make it more difficult or less profitable to attract customers who do not place a high value on our multi-service offering. This may reduce our growth opportunities or profitability.
- The acquisition of AT&T Wireless by Cingular Wireless, which closed in October 2004, created the largest wireless phone provider in the United States, with significantly more resources and a larger customer base than us or any other competing company. This concentration of resources in the marketplace could result in increased cost efficiency for Cingular, allowing it to obtain more favorable terms from its suppliers, which could enable Cingular to discount its handsets or services to customers.

**Any failure to effectively integrate our portion of the Nextel Digital Wireless Network with Nextel's portion effectively would have an adverse effect on our results of operations.**

Pursuant to our operating agreements with Nextel WIP, Nextel WIP provides us with important services and assistance, including a license to use the Nextel brand name and the sharing of switches that direct calls to their destinations. Any interruption in the provision of these services could delay or prevent the continued integration of our portion of the Nextel Digital Wireless Network with Nextel's portion, which is essential to the overall success of our business.

Moreover, our business plan depends on our ability to implement integrated customer service, network management and billing systems with Nextel's systems to allow our respective portions of the Nextel Digital Wireless Network to operate together and to provide our and Nextel's customers with seamless service. Integration requires that numerous and diverse computer hardware and software systems work together. Any failure to integrate these systems effectively may have an adverse effect on our results of operations.

**Difficulties in operating our portion of the Nextel Digital Wireless Network could increase the costs of operating the network, which would adversely affect our ability to generate revenues.**

The continued operation of our portion of the Nextel Digital Wireless Network involves a high degree of risk. Before we are able to build additional cell sites in our markets to expand coverage, fill in gaps in coverage or increase capacity, we will need to:

- select and acquire appropriate sites for our transmission equipment, or cell sites;
- purchase and install low-power transmitters, receivers and control equipment, or base radio equipment;
- build out the physical infrastructure;
- obtain interconnection services from local telephone service carriers on a timely basis; and
- test the cell site.

Our ability to perform these necessary steps successfully may be hindered by, among other things, any failure to:

- lease or obtain rights to sites for the location of our base radio equipment;
- obtain necessary zoning and other local approvals with respect to the placement, construction and modification of our facilities;
- acquire additional necessary radio frequencies from third parties or exchange radio frequency licenses with Nextel WIP;
- commence and complete the construction of sites for our equipment in a timely and satisfactory manner; or
- obtain necessary approvals, licenses or permits from federal, state or local agencies, including land use regulatory approvals and approvals from the Federal Aviation Administration and Federal Communications Commission with respect to the transmission towers that we will be using.

Before fully implementing our portion of the Nextel Digital Wireless Network in a new market area or expanding coverage in an existing market area, we must complete systems design work, find appropriate sites and construct necessary transmission structures, receive regulatory approvals, free up frequency channels now devoted to non-digital transmissions and begin systems optimization. These processes may take weeks or months to complete and may be hindered or delayed by many factors, including



unavailability of antenna sites at optimal locations, land use and zoning controversies and limitations of available frequencies. In addition, we may experience cost overruns and delays not within our control caused by acts of governmental entities, design changes, material and equipment shortages, delays in delivery and catastrophic occurrences. Any failure to construct our portion of the Nextel Digital Wireless Network on a timely basis may adversely affect our ability to provide the quality of services in our markets consistent with our current business plan, and any significant delays could have a material adverse effect on our business.

**If we do not offer services that Nextel WIP requires us to offer or we fail to meet performance standards, we risk termination of our agreements with Nextel WIP, which would eliminate our ability to carry out our current business plan and strategy.**

Our operating agreements with Nextel WIP require us to construct and operate our portion of the Nextel Digital Wireless Network in accordance with specific standards and to offer certain services by Nextel and its domestic subsidiaries. Our failure to satisfy these obligations could constitute a default under the operating agreements that would give Nextel WIP the right to terminate these agreements and would terminate our right to use the Nextel brand. The non-renewal or termination of the Nextel WIP operating agreements would eliminate our ability to carry out our current business plan and strategy and adversely affect our financial condition, and could also trigger Nextel's right to purchase all of our outstanding Class A common stock, as described above.

**We may be required to implement material changes to our business operations to the extent these changes are adopted by Nextel, which may not be beneficial to our business.**

If Nextel adopts material changes to its operations, our operating agreements with Nextel WIP give it the right to require us to make similar changes to our operations. The failure to implement required changes could, under certain circumstances, trigger the ability of Nextel WIP to terminate the operating agreements, which could result in the adverse effects described above. Even if the required change is beneficial to Nextel, the effect on our business may vary due to differences in markets and customers. We cannot assure you that such changes would not adversely affect our business plan.

**The transmission technology used by us and Nextel is different from that used by most other wireless carriers, and, as a result, we might not be able to keep pace with industry standards if more widely used technologies advance.**

The Nextel Digital Wireless Network uses scattered, non-contiguous radio spectrum near the frequencies used by cellular carriers. Because of their fragmented character, these frequencies traditionally were only usable for two-way radio calls, such as those used to dispatch taxis and delivery vehicles. Nextel became able to use these frequencies to provide a wireless telephone service competitive with cellular carriers only when Motorola developed a proprietary technology it calls iDEN. We, Nextel and Southern LINC are currently the only major U.S. wireless service providers utilizing iDEN technology on a nationwide basis, and iDEN phones are not currently designed to roam onto other domestic wireless networks.

Our operating agreements with Nextel WIP require us to use the iDEN technology in our system and prevent us from adopting any new communications technologies that may perform better or may be available at a lower cost without Nextel WIP's consent.

Future technological advancements may enable other wireless technologies to equal or exceed our current levels of service and render iDEN technology obsolete. If Motorola is unable to upgrade or improve iDEN technology or develop other technology to meet future advances in competing technologies on a timely basis, or at an acceptable cost, because of the restrictive provisions in our operating agreements with Nextel WIP, we will be less able to compete effectively and could lose customers to our competitors, all of which would have an adverse effect on our business and financial condition.

**We are dependent on Motorola for telecommunications equipment necessary for the operation of our business, and any failure of Motorola to perform would adversely affect our operating results.**

Motorola is currently our sole-source supplier of transmitters used in our network and wireless telephone equipment used by our customers (with the exception of the Blackberry 7510, which is available only from RIM), and we rely, and expect to continue to rely, on Motorola to manufacture a substantial portion of the equipment necessary to construct our share of the Nextel Digital Wireless Network. We expect that for the next few years, Motorola will be the only manufacturer of wireless telephones that are compatible with the Nextel Digital Wireless Network. If Motorola becomes unable to deliver such equipment, or refuses to do so on reasonable terms, then we may not be able to service our existing subscribers or add new subscribers and our business would be adversely affected. Motorola and its affiliates engage in wireless communications businesses and may in the future engage in additional businesses that do or may compete with some or all of the services we offer. Motorola has recently announced plans for the proposed spin-off of its semiconductor unit and has made a number of changes in its senior management team. If these or other factors affecting our relationship with Motorola were to result in a significant adverse change in Motorola's ability or willingness to provide handsets and related equipment and software applications, or to develop new technologies or features for us, or in Motorola's ability or willingness to do so on a timely, cost-effective basis, we may not be able to adequately service our existing subscribers or add new subscribers and may not be able to offer competitive services. We cannot assure you that any potential conflict of interest between us and Motorola will not adversely affect our ability to obtain equipment in the future.

In addition, the failure by Motorola to deliver necessary technology improvements and enhancements and system infrastructure and subscriber equipment on a timely, cost-effective basis would have an adverse effect on our growth and operations. For instance, we rely on Motorola to provide us with technology improvements designed to expand our wireless voice capacity and improve our services, such as the 6:1 voice coder software upgrade, and the handset-based A-GPS location technology solution necessary for us to comply with the FCC's E911 requirements. The failure by Motorola to deliver these improvements and

solutions, or its inability to do so within our anticipated timeframe, could impose significant additional costs on us.

We generally have been able to obtain adequate quantities of base radios and other system infrastructure equipment from Motorola, and adequate volumes and mix of wireless telephones and related accessories from Motorola, to meet subscriber and system loading rates, but we cannot be sure that equipment quantities will be sufficient in the future. Additionally, in the event of shortages of that equipment, our agreements with Nextel WIP provide that available supplies of this equipment would be allocated proportionately between Nextel and us.

**Costs and other aspects of a future deployment of advanced digital technology could adversely affect our operations and growth.**

Based on our current outlook and the current outlook of Nextel, we anticipate eventually deploying advanced digital technology that will allow high capacity wireless voice and high-speed data transmission, and potentially other advanced digital services. The technology that we would deploy to provide these types of broadband wireless services is sometimes referred to as next-generation technologies. We and Nextel are focusing activities on maximizing our ability to offer next-generation capabilities while continuing to fully utilize our iDEN digital wireless network. Significant capital expenditures may be required in implementing this next-generation technology, and we cannot assure you that we will have the financial resources necessary to fund these expenditures or, if we do implement this technology, that it would provide the advantages that we would expect. Moreover, it may be necessary to acquire additional frequencies to implement next-generation technologies, and we cannot be sure that we will be able to obtain such spectrum on reasonable terms, if at all. The actual amount of the funds required to finance and implement this technology may significantly exceed our current estimate. Further, any future implementation could require additional unforeseen capital expenditures in the event of unforeseen delays, cost overruns, unanticipated expenses, regulatory changes, engineering design changes, equipment unavailability and technological or other complications. In addition, there are several types of next-generation technologies that may not be fully compatible with each other or with other currently deployed digital technologies. If the type of technology that we either choose to deploy or are required to deploy to maintain compatibility with the technology chosen by Nextel does not gain widespread acceptance or perform as expected, or if our competitors develop next-generation technology that is more effective or economical than ours, our business would be adversely affected.

**We may not be able to obtain additional spectrum, which may adversely impact our ability to implement our business plan.**

We may seek to acquire additional spectrum, including through participation as a bidder, or member of a bidding group, in government-sponsored auctions of spectrum. We may not be able to accomplish any spectrum acquisition or the necessary additional capital for that purpose may not be available on acceptable terms, or at all. If sufficient additional capital is not available, to the extent we are able to complete any spectrum acquisition, the amount of funding available to us for our existing businesses would be reduced. Even if we are able to acquire additional spectrum, we may still require additional capital to finance the pursuit of any new business opportunities associated with our acquisition of additional spectrum, including those associated with the potential provision of any new next-generation wireless services. This additional capital may not be available on reasonable terms, or at all.

**Our network may not have sufficient capacity to support our anticipated subscriber growth.**

Our business plan depends on assuring that our portion of the Nextel Digital Wireless Network has adequate capacity to accommodate anticipated new subscribers and the related increase in usage of our network. This plan relies on:

- our ability to economically expand the capacity and coverage of our network;
- the ability to obtain additional spectrum when and where required;
- the availability of wireless handsets of the appropriate model and type to meet the demands and preferences of our customers; and
- the ability to obtain and construct additional cell sites and obtain other infrastructure equipment.

We cannot assure you that we will not experience unanticipated difficulties in obtaining these items, which could adversely affect our ability to build our portion of the network.

**Potential systems limitations on adding subscribers may adversely affect our growth and performance.**

Our success in generating revenues by attracting and retaining large numbers of subscribers to our portion of the Nextel Digital Wireless Network is critical to our business plan. In order to do so, we must maintain effective procedures for customer activation, customer service, billing and other support services. Even if our system is technically functional, we may encounter other factors that could adversely affect our ability to successfully add customers to our portion of the Nextel Digital Wireless Network, including:

- inadequate or inefficient systems or business processes and related support functions, especially related to customer service and accounts receivable collection; and
- an inappropriately long length of time between a customer's order and activation of service for that customer, especially because the current activation time for our new customers is longer than that of some of our competitors.

Customer reliance on our customer service functions may increase as we add new customers. Our inability to timely and efficiently meet the demands for these services could decrease or postpone subscriber growth, or delay or otherwise impede billing and collection of amounts owed, which would adversely affect our revenues.

**If an event constituting a change of control or fundamental change occurs under our indentures, we may be required to redeem or repurchase all of our outstanding notes even if our credit facility prohibits such redemption or repurchase or we lack the resources to make such redemption or repurchase.**

Upon the occurrence of a defined change of control or fundamental change under the indentures governing our existing senior discount notes, convertible senior notes and senior notes, other than a change of control involving certain of our existing stockholders, we could be required to redeem or repurchase our existing senior discount notes, convertible senior notes and senior notes. However, our credit facility prohibits us, except under certain circumstances, from redeeming or repurchasing any of our outstanding notes before their stated maturity. In the event we become subject to a change of control at a time when we are prohibited from redeeming or repurchasing our outstanding notes our failure to redeem or repurchase such notes would constitute an event of default under the respective indentures, which would in turn result in a default under our credit facility. Any default under our indentures or credit facility would result in an acceleration of such indebtedness, which would harm our financial condition and adversely impact our ability to implement our business plan and could result in the cessation of our business. Moreover, even if we obtained consent under our credit facility, we cannot be sure that we would

have sufficient resources to redeem or repurchase our outstanding notes and still have sufficient funds available to successfully pursue our business plan.

**We are dependent on our current key personnel, and our success depends upon our continued ability to attract, train and retain additional qualified personnel.**

The loss of one or more key employees could impair our ability to successfully operate our portion of the Nextel Digital Wireless Network. We believe that our future success will also depend on our continued ability to attract and retain highly qualified technical, sales and management personnel.

**Concerns that the use of wireless telephones may pose health and safety risks may discourage the use of our wireless telephones.**

Studies and reports have suggested that, and additional studies are currently being undertaken to determine whether, radio frequency emissions from enhanced specialized mobile radio, or ESMR, cellular and personal communications service, or PCS, wireless telephones may be linked with health risks, including cancer, and may interfere with various electronic medical devices, including hearing aids and pacemakers. The actual or perceived risk of wireless telephones could adversely affect us through a reduced subscriber growth rate, a reduction in subscribers, reduced network usage per subscriber or reduced financing available to the mobile communications industry generally.

Litigation by individuals alleging injury from health effects associated with radio frequency emissions from wireless telephones has been brought against us and other mobile wireless carriers and manufacturers. In addition, purported class action litigation has been filed seeking to require all wireless telephones to include an earpiece that would enable use of the telephones without holding them against the user's head. While it is not possible to predict the outcome of this litigation, circumstances surrounding it could increase the cost of our wireless telephones as well as increase other costs of doing business.

Due to safety concerns, some state and local legislatures have passed or are considering legislation restricting the use of wireless telephones while driving automobiles. Federal legislation has been proposed that would affect funding available to states that do not adopt similar legislation. The passage of this type of legislation could decrease demand for our services, which could have a material adverse effect on our results of operations.

**Regulatory authorities exercise considerable power over our operations, which could be exercised against our interests and impose additional unanticipated costs.**

The FCC and state telecommunications authorities regulate our business to a substantial degree. The regulation of the wireless telecommunications industry is subject to constant change by legislation and by new rules and regulations of the FCC. We cannot predict the effect that any legislation or FCC rulemaking may have on our future operations. We must comply with all applicable regulations to conduct our business. Modifications of our business plans or operations to comply with changing regulations or actions taken by regulatory authorities might increase our costs of providing service and adversely affect our financial condition. In addition, we anticipate FCC regulation or Congressional legislation that creates additional spectrum allocations that may also have the effect of adding new entrants into the mobile telecommunications market.

If we fail to comply with the terms of our licenses or applicable regulations, we could lose one or more licenses or face penalties and fines. For example, we could lose a license if we fail to construct or operate facilities as required by the license. If we lose licenses, that loss could have a material adverse effect on our business and financial condition.

**We may not be able to meet a December 31, 2005 FCC deadline with respect to A-GPS handset subscriber penetration, in which event the FCC could impose fines or take other regulatory action that could have an adverse effect on our business.**

On August 2, 2004, we filed our required Phase I and Phase II E911 Quarterly Report with the FCC which sets forth our compliance with the FCC's mandates regarding the sale of A-GPS capable handsets. A-GPS capable handsets are used to locate customers placing emergency 911-telephone calls. The FCC currently requires that by December 31, 2005, 95% of our subscriber base must use A-GPS capable handsets. In our last quarterly FCC report, we notified the FCC that we do not project that we can meet the FCC's December 31, 2005 benchmark of 95% A-GPS handset penetration. If we are not able to achieve this benchmark or obtain a waiver or postponement of this benchmark, the FCC could impose fines or take other regulatory action that could have an adverse effect on our business.

In addition, we may incur significant additional costs in order to satisfy the Phase II E911 requirement because our compliance requires that the non-A-GPS capable handsets in our subscriber base be replaced with A-GPS capable handsets. The amount of the costs we would incur is highly dependent on both the number of new subscribers added to our network who purchase an A-GPS capable handset, and the number of existing subscribers who upgrade from non-A-GPS capable handsets to A-GPS capable handsets. If our rate of churn remains low, unless substantial numbers of subscribers upgrade their handsets, we may have to incur significant costs to get a sufficient number of A-GPS capable handsets into our network.

**Nextel WIP has contractual approval rights that allow it to exert significant influence over our operations, and it can acquire additional shares of our stock.**

Pursuant to our amended and restated shareholders' agreement and operating agreements, the approval of the director designated by Nextel WIP, and/or of Nextel WIP itself, is required in order for us to:

- make a material change in our technology;
- modify our business objectives in any way that is inconsistent with our objectives under our material agreements, including our operating agreements with Nextel WIP;
- dispose of all or substantially all of our assets;
- make a material change in or broaden the scope of our business beyond our current business objectives; or
- enter into any agreement the terms of which would be materially altered in the event that Nextel WIP either exercises or declines to exercise its rights to acquire additional shares of our stock under the terms of the amended and restated shareholders' agreement or our restated certificate of incorporation.

These approval rights relate to significant transactions, and decisions by the Nextel WIP-designated director could conflict with those of our other directors, including our independent directors.

In addition, the amended and restated shareholders' agreement does not prohibit Nextel WIP or any of our other stockholders or any of their respective affiliates from purchasing shares of our Class A common stock in the open market. Any such purchases would increase the voting power and influence of the purchasing stockholder and could result in a change of control of us. Shares of Class A common stock are immediately and automatically convertible into an equal number of shares of Class B common stock upon the acquisition of such shares of Class A common stock by Nextel, by any of its majority-owned subsidiaries, or by any person or group that controls Nextel. We recently amended our restated certificate of incorporation in response to a request from Nextel WIP to increase the number of shares of Class B

common stock that is authorized for issuance thereunder. We are also aware that, in connection with our public equity offering in November 2003, Nextel indicated an interest in purchasing shares of Class A common stock from existing stockholders through a private placement or through open-market purchases. Additionally, if we experience a change of control, Nextel WIP could purchase all of our licenses for \$1.00, provided that it enters into a royalty-free agreement with us to allow us to use the licenses in our territory for as long as our operating agreements with Nextel WIP remain in effect. Such an agreement would be subject to approval by the FCC.

**Significant stockholders represented on our board of directors can exert significant influence over us and may have interests that conflict with those of our other stockholders.**

As of September 30, 2004, our officers, directors and greater than 5% stockholders together controlled approximately 40% of our outstanding common stock. As a result, these stockholders, if they act together, will be able to greatly affect the management and affairs of our company and matters requiring stockholder approval, including the election of directors and approval of significant corporate transactions. This concentration of ownership may have the effect of delaying or preventing a change in control of our company.

In addition, under our amended and restated shareholders' agreement, Nextel WIP and Madison Dearborn Partners each have the right to designate a member to our board of directors. We cannot be certain that any conflicts that arise between our interests and those of these stockholders will always be resolved in our favor. Moreover, as described above, Nextel WIP has certain approval rights that allow it to exert significant influence over our operations.

Madison Dearborn Partners and Eagle River each own significant amounts of our capital stock, and Madison Dearborn Partners currently has a representative on our board of directors. Each of these entities or their affiliates has significant investments in other telecommunications businesses, some of which may compete with us currently or in the future. We do not have a non-competition agreement with any of our stockholders, and thus their or their affiliates' current and future investments could create conflicts of interest with us.

**Anti-takeover provisions could prevent or delay a change of control that stockholders may favor.**

Provisions of our charter documents, amended and restated shareholders' agreement, operating agreements and Delaware law may discourage, delay or prevent a merger or other change of control of our company that stockholders may consider favorable. We have authorized the issuance of blank check preferred stock and have imposed certain restrictions on the calling of special meetings of stockholders. If we experience a change of control, Nextel WIP could purchase all of our licenses for \$1.00, provided that it enters into a royalty-free agreement with us to allow us to use the frequencies in our territory for as long as our operating agreements remain in effect. Such an agreement would be subject to approval by the FCC. Moreover, a change of control could trigger an event of default under our credit facility and the indentures governing our senior discount notes, convertible senior notes and senior notes. These provisions could have the effect of delaying, deferring or preventing a change of control in our company, discourage bids for our Class A common stock at a premium over the market price, lower the market price of our Class A common stock, or impede the ability of the holders of our Class A common stock to change our management.

**Regulations to which we are subject may affect the ability of some of our investors to have an equity interest in us. Additionally, our restated certificate of incorporation contains provisions that allow us to redeem shares of our securities in order to maintain compliance with applicable federal and state telecommunications laws and regulations.**

Our business is subject to regulation by the FCC and state regulatory commissions or similar state regulatory agencies in the states in which we operate. This regulation may prevent some investors from owning our securities, even if that ownership may be favorable to us. The FCC and some states have statutes or regulations that would require an investor who acquires a specified percentage of our securities or the securities of one of our subsidiaries to obtain approval from the FCC or the applicable state commission to own those securities. Moreover, our restated certificate of incorporation allows us to redeem shares of our stock from any stockholder in order to maintain compliance with applicable federal and state telecommunications laws and regulations.

#### **FORWARD-LOOKING STATEMENTS**

This report contains forward-looking statements. They can be identified by the use of forward-looking words such as believes, expects, plans, may, will, would, could, should or anticipates or other comparable words, or by discussions of strategy, plans or goals that involve risks and uncertainties that could cause actual results to differ materially from those currently anticipated. You are cautioned that any forward-looking statements are not guarantees of future performance and involve risks and uncertainties, including those set forth above under Risk Factors and as described from time to time in our reports filed with the Securities and Exchange Commission, including this Quarterly Report on Form 10-Q and our Annual Report on Form 10-K. Forward-looking statements include, but are not limited to, statements with respect to the following:

- our business plan, its advantages and our strategy for implementing our plan;
- the success of efforts to improve, and satisfactorily address any issues relating to, our network performance;
- the characteristics of the geographic areas and occupational markets that we are targeting in our portion of the Nextel Digital Wireless Network;
- the implementation and performance of the technology, including higher speed data infrastructure and software designed to significantly increase the speed of our network, being deployed or to be deployed in our various markets, including the expected 6:1 voice coder software upgrade being developed by Motorola and technologies to be implemented in connection with the completed launch of Nationwide Direct Connect capability;
- our ability to attract and retain customers;
- our anticipated capital expenditures, funding requirements and contractual obligations, including our ability to access sufficient debt or equity capital to meet operating and financing needs;
- the availability of adequate quantities of system infrastructure and subscriber equipment and components to meet our service deployment, marketing plans and customer demand;
- no significant adverse change in Motorola's ability or willingness to provide handsets and related equipment and software applications or to develop new technologies or features for us, or in our relationship with it, as a result of the proposed spin-off of its semiconductor unit, recent changes in its senior management team or otherwise;
- the ability to achieve and maintain market penetration and average subscriber revenue levels;

- our ability to successfully scale, in some circumstances in conjunction with third parties under our outsourcing arrangements, our billing, collection, customer care and similar back-office operations to keep pace with customer growth, increased system usage rates and growth in levels of accounts receivables being generated by our customers;
- the development and availability of new handsets with expanded applications and features, including those that operate using the 6:1 voice coder, and market acceptance of such handsets and service offerings;
- the availability and cost of acquiring additional spectrum;
- the quality and price of similar or comparable wireless communications services offered or to be offered by our competitors, including providers of PCS and cellular services including, for example, two-way walkie-talkie services first introduced by several of our competitors in 2003;
- future legislation or regulatory actions relating to specialized mobile radio services, other wireless communications services or telecommunications services generally;
- delivery and successful implementation of any new technologies deployed in connection with any future enhanced iDEN or next generation or other advanced services we may offer; and
- the costs of compliance with regulatory mandates, particularly the requirement to deploy location-based 911 capabilities and wireless number portability.

### Item 3. Quantitative and Qualitative Disclosures About Market Risk

We are subject to market risks arising from changes in interest rates. Our primary interest rate risk results from changes in LIBOR or the prime rate, which are used to determine the interest rate applicable to the term loan of OPCO under our credit facility. Our potential loss over one year that would result from a hypothetical, instantaneous and unfavorable change of 100 basis points in the interest rate of all our variable rate obligations would be approximately \$6.5 million.

On January 1, 2001, we adopted SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* ( SFAS 133 ), 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. The statements require that changes in the derivative's fair value be recognized currently in earnings unless specific hedge accounting criteria are met. In April 1999 and 2000, we entered into interest rate swap agreements for \$60.0 million and \$50.0 million, respectively, to partially manage interest rate exposure with respect to our previous \$375.0 million term B loan. 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. In May 2004, we refinanced our term B and term C loans and replaced them with a \$700.0 million tranche C credit facility, but maintained our existing \$50 million rate swap agreement. Interest rate swaps have the effect of converting the applicable variable rate obligations to fixed or other variable rate obligations. To date, we have elected not to designate our interest rate swaps as hedges under SFAS 133. The interest rate swap agreements are included in other long-term liabilities on the balance sheet. For the three months ended September 30, 2004, we recorded a non-cash, fair market value gain of approximately \$654,000 related to the market value of interest rate swap agreements, which has been reflected in interest expense.

The following discloses the fair value of the swap agreements recorded as of September 30, 2004:

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|  | (in thousands) |
|--|----------------|
| Fair value of liability as of December 31, 2003      | \$ 5,195       |
| Change in fair value interest rate changes           | (2,760 )       |
| Settlement of \$60 million swap agreement terminated | (639 )         |
| Fair value of liability as of September 30, 2004     | \$ 1,796       |

We have 11% senior notes due 2010, 12½% senior discount notes due 2009, 8⅛% senior notes due 2011 and 1½% convertible senior notes due 2008 outstanding. While fluctuations in interest rates may affect the fair value of these notes, causing the notes to trade above or below par, interest expense will not be affected due to the fixed interest rate of these notes.

A summary of our long-term debt obligations, including scheduled principal repayments and weighted average interest rates, as of September 30, 2004 follows:

|                                      | 2004   | 2005   | 2006   | 2007     | 2008       | Thereafter | Total      | Fair Value   |
|--------------------------------------|--------|--------|--------|----------|------------|------------|------------|--------------|
| <b>Long-term debt obligations:</b>   |        |        |        |          |            |            |            |              |
| Fixed-rate debt                      |        |        |        |          | \$ 300,000 | \$ 622,407 | \$ 922,407 | \$ 1,244,228 |
| Average interest rate                | 6.70 % | 6.70 % | 6.70 % | 6.70 %   | 6.90 %     | 8.60 %     | 7.20 %     | %            |
| Variable-rate debt(1)                |        |        |        | \$ 5,250 | \$ 7,000   | \$ 687,750 | \$ 700,000 | \$ 700,000   |
| Average interest rate (LIBOR + 2.5%) |        |        |        |          |            |            |            |              |

(1) As of September 30, 2004 variable rate debt consists of our bank credit facility. The bank credit facility includes a \$700.0 million tranche C term loan, a \$100.0 million revolving credit facility and an option to request an additional \$200.0 million of incremental term loans. The tranche C term loan bears interest, at our option, at the administrative agent's alternate base rate or reserve-adjusted LIBOR plus, in each case, applicable margins. The initial applicable margin for the tranche C term loan is 2.50% over LIBOR and 1.50% over the base rate and thereafter will be determined on the basis of the ratio of total debt to annualized EBITDA and will range between 1.50% and 3.00% over LIBOR and between 0.50% and 2.00% over the base rate. For the revolving credit facility, the initial applicable margin is 3.00% over LIBOR and 2.00% over the base rate and thereafter will be determined on the basis of the ratio of total debt to annualized EBITDA and will range between 1.50% and 3.00% over LIBOR and between 0.50% and 2.00% over the base rate. As of September 30, 2004, the interest rate on the tranche C term loan was 4.3125%.

Aggregate notional amounts associated with interest rate swaps in place as of September 30, 2004 are as follows:

| Interest rate swaps:                   | 2004      | 2005      | 2006 | 2007 | 2008 | Thereafter | Total      | Fair Value |
|--|-----------|-----------|------|------|------|------------|------------|------------|
| Notional amount(1)                     | \$ 50,000 | \$ 50,000 | \$   | \$   | \$   | \$         | \$ 100,000 | \$ 1,796   |
| Weighted-average fixed rate payable(2) | 6.70      | 6.70 %    | %    |      |      |            |            |            |

(1) Includes notional amounts of \$50.0 million that will expire in April 2005.

(2) Represents the weighted average fixed rate based on the contract notional amount as a percentage of total notional amounts in a given year.

In September 2004 we entered into a series of interest rate swap agreements, which will have the effect of converting certain of our variable interest rate \$700 million term C loan obligations to fixed interest rates. The total amount to be hedged will be \$150 million. The commencement date for the swap transactions is December 1, 2004 and the expiration date is August 31, 2006. We believe these interest rate swap agreements qualify for cash flow accounting since the critical terms of the instruments match at

inception and are expected to on an ongoing basis, therefore it is assumed the instruments will offset and be perfectly effective.

We do not intend to use financial instruments for trading or other speculative purposes, nor do we intend to 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.

#### **Item 4. Controls and Procedures**

We carried out an evaluation required by the Securities Exchange Act of 1934, under the supervision and with the participation of our senior management, including our principal executive officer and principal financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this report. Based on this evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, are effective in timely alerting them to material information required to be included in our periodic SEC reports.

There has been no change in our internal control over financial reporting during our third fiscal quarter of 2004 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**PART II OTHER INFORMATION**

**Item 1. Legal Proceedings**

On December 5, 2001, a purported class action lawsuit was filed in the United States District Court for the Southern District of New York against us, two of our executive officers and four of the underwriters involved in our initial public offering. The lawsuit is captioned *Keifer v. Nextel Partners, Inc., et al*, No. 01 CV 10945. It was filed on behalf of all persons who acquired our common stock between February 22, 2000 and December 6, 2000 and initially named as defendants us, John Chapple, our President, Chief Executive Officer and Chairman of the Board, John D. Thompson, our Chief Financial Officer and Treasurer until August 2003, and the following underwriters of our initial public offering: Goldman Sachs & Co., Credit Suisse First Boston Corporation (predecessor of Credit Suisse First Boston LLC), Morgan Stanley & Co. Incorporated and Merrill Lynch Pierce Fenner & Smith Incorporated. Mr. Chapple and Mr. Thompson have been dismissed from the lawsuit without prejudice. The complaint alleges that the defendants violated the Securities Act and the Exchange Act by issuing a registration statement and offering circular that were false and misleading in that they failed to disclose that: (i) the defendant underwriters allegedly had solicited and received excessive and undisclosed commissions from certain investors who purchased our common stock issued in connection with our initial public offering; and (ii) the defendant underwriters allegedly allocated shares of our common stock issued in connection with our initial public offering to investors who allegedly agreed to purchase additional shares of our common stock at pre-arranged prices. The complaint seeks rescissory and/or compensatory damages. We dispute the allegations of the complaint that suggest any wrongdoing on our part or by our officers. However, the plaintiffs and the issuing company defendants, including us, have reached a settlement of the issues in the lawsuit. The proposed settlement, which is not material to us, is subject to a number of contingencies, including negotiation of a settlement agreement and its approval by the Court. In June 2004, an agreement of settlement was submitted to the Court for preliminary approval. We are unable to determine whether or when a settlement will occur or be finalized.

On June 8, 2001, a purported class action lawsuit was filed in the State Court of Fulton County, State of Georgia by Reidy Gimpelson against us and several other wireless carriers and manufacturers of wireless telephones. The lawsuit is captioned *Riedy Gimpelson vs. Nokia, Inc., et al*, Civil Action No. 2001-CV-3893. The complaint alleges that the defendants, among other things, manufactured and distributed wireless telephones that cause adverse health effects. The plaintiffs seek compensatory damages, reimbursement for certain costs including reasonable legal fees, punitive damages and injunctive relief. The defendants timely removed the case to Federal court and this case and related cases were consolidated in the United States District Court for the District of Maryland. On March 5, 2003, the court granted the defendants' consolidated motion to dismiss the plaintiffs' claims. The plaintiffs have appealed to the United States Court of Appeals for the Fourth Circuit. The appeal is fully briefed. We dispute the allegations of the complaint, will vigorously defend against the action, and intend to seek indemnification from the manufacturers of the wireless telephones if necessary.

On April 1, 2003, a purported class action lawsuit was filed in the 93<sup>rd</sup> District Court of Hidalgo County, Texas against us, Nextel and Nextel West Corp. The lawsuit is captioned *Rolando Prado v. Nextel Communications, et al*, Civil Action No. C-695-03-B. On May 2, 2003, a purported class action lawsuit was filed in the Circuit Court of Shelby County for the Thirtieth Judicial District at Memphis, Tennessee against us, Nextel and Nextel West Corp. The lawsuit is captioned *Steve Strange v. Nextel Communications, et al*, Civil Action No. 01-002520-03. On May 3, 2003, a purported class action lawsuit was filed in the Circuit Court of the Second Judicial Circuit in and for Leon County, Florida against Nextel Partners Operating Corp. d/b/a Nextel Partners and Nextel South Corp. d/b/a Nextel Communications. The lawsuit is captioned *Christopher Freeman and Susan and Joseph Martelli v. Nextel South Corp., et al*, Civil Action No. 03-CA1065. On July 9, 2003, a purported class action lawsuit was filed in Los Angeles Superior Court, California against us, Nextel, Nextel West, Inc., Nextel of California, Inc. and Nextel

Operations, Inc. The lawsuit is captioned *Nick's Auto Sales, Inc. v. Nextel West, Inc., et al*, Civil Action No. BC298695. On August 7, 2003, a purported class action lawsuit was filed in the Circuit Court of Jefferson County, Alabama against us and Nextel. The lawsuit is captioned *Andrea Lewis and Trish Zruna v. Nextel Communications, Inc., et al*, Civil Action No. CV-03-907. On October 3, 2003, an amended complaint for a purported class action lawsuit was filed in the United States District Court for the Western District of Missouri. The amended complaint named us and Nextel Communications, Inc. as defendants; Nextel Partners was substituted for the previous defendant, Nextel West Corp. The lawsuit is captioned *Joseph Blando v. Nextel West Corp., et al*, Civil Action No. 02-0921 (the Blando Case). All of these complaints allege that we, in conjunction with the other defendants, misrepresented certain cost-recovery line-item fees as government taxes. Plaintiffs seek to enjoin such practices and seek a refund of monies paid by the class based on the alleged misrepresentations. Plaintiffs also seek attorneys' fees, costs and, in some cases, punitive damages. We believe the allegations are groundless. On October 9, 2003, Judge Gaitan in the United States District Court for the Western District of Missouri in the Blando Case entered an order granting preliminary approval of a nationwide class action settlement that encompasses most of the claims involved in these cases. Notice of the settlement was provided to the identified class, and on January 29, 2004, the court conducted a final approval hearing and, on April 20, 2004, approved the settlement. On May 27, 2004, various objectors and class members appealed Judge Gaitan's order granting final approval of the settlement to the United States Court of Appeals for the Eighth Circuit. Distribution of settlement benefits is stayed until the appellate court issues a final order resolving the appeal. In conjunction with the settlement, we recorded an estimated liability during the third quarter of 2003, which did not materially impact our financial results.

We are subject to other claims and legal actions that may arise in the ordinary course of business. We do not believe that any of these other pending claims or legal actions or the items discussed above will have a material effect on our business, financial position or results of operations.

#### Item 5. Other Information.

On September 20, 2004, we (through OPCO) entered into a Subscriber Units and Services Supply Agreement (the Supply Agreement) with Motorola. Motorola currently holds shares of our class A common stock, and 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.

Pursuant to the terms of the Supply Agreement, we have agreed on a non-exclusive basis to purchase and Motorola has agreed to sell to us handsets for use on the Nextel Digital Wireless Network as well as certain related support services. The Supply Agreement also provides for our purchase of certain subscriber accessories related to the handsets. The initial term of the Supply Agreement is effective from January 1, 2004 through December 31, 2004 and will continue in effect beyond this initial term until terminated by either party upon 30 days' prior written notice to the other. The Supply Agreement may also be terminated in the event of a breach by either party that continues for a period of 30 days after the breaching party has received notice or immediately upon the bankruptcy or liquidation of any party, upon any assignment in violation of the terms of the agreement upon a failure to make any payment when due or upon a change in a party's ownership.

The Supply Agreement provides for certain promotional programs, including a co-operative advertising program, a volume rebate incentive program, discounts for the initial launch of certain handsets and certain volume-based price reductions. Motorola also has the right, for certain proposed products or features, to offer us the option to pre-pay for the specific product or feature on special terms and conditions.

This Item 5 contains a summary of the terms and conditions of the Supply Agreement. This summary is qualified in its entirety by reference to the full and complete text of the Supply Agreement and its associated attachments and appendices, copies of which have been filed as an exhibit to this report. We are seeking confidential treatment of certain portions of the Supply Agreement in order to protect disclosure of our proprietary and confidential information to potential competitors and others.

**Item 6. Exhibits**

- (a) List of Exhibits.
- 3.1 Restated Certificate of Incorporation (incorporated by reference to Exhibit 3.1.1 to Registration Statement on Form S-1 declared effective February 22, 2000 (File No. 333-95473)).
- 3.1(a) Certificate of Amendment to the Restated Certificate of Incorporation of Nextel Partners, Inc. (incorporated by reference to Exhibit 3.1 (a) to Quarterly Report on Form 10-Q filed August 9, 2004)
- 3.2 Amended and Restated Bylaws, effective of June 3, 2004 (incorporated by reference to Exhibit 3.2 to Quarterly Report on Form 10-Q filed August 9, 2004)
- 10.80 Subscriber Units and Services Supply Agreement between Motorola, Inc. and Nextel Partners Operating Corp. dated September 20, 2004
- 31.1 Certification of John Chapple, Chairman and Chief Executive Officer of Nextel Partners, Inc. pursuant to Exchange Act Rule 13a-14(a) under the Securities Exchange Act of 1934
- 31.2 Certification of Barry Rowan, Chief Financial Officer of Nextel Partners, Inc. pursuant to Exchange Act Rule 13a-14(a) under the Securities Exchange Act of 1934
- 32.1 Certification of John Chapple, Chairman and Chief Executive Officer of Nextel Partners, Inc., pursuant to 18 U.S.C. Section 1350.
- 32.2 Certification of Barry Rowan, Chief Financial Officer of Nextel Partners, Inc., pursuant to 18 U.S.C. Section 1350.

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Confidential Treatment Requested.

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: November 9, 2004

NEXTEL PARTNERS, INC.

(Registrant)

By: /s/ BARRY ROWAN

Barry Rowan

*Vice President, Chief Financial Officer*

*(Principal Financial Officer)*

By: /s/ LINDA ALLEN

Linda Allen

*Chief Accounting Officer*

*(Principal Accounting Officer)*