Virgin Mobile USA, Inc.
Form 10-Q
November 12, 2008
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended September 30, 2008

or

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from ______ to ______

Commission File Number: 001-33735

Virgin Mobile USA, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**20-8826316**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
10 Independence Boulevard, Warren, New Jersey	**07059**
(Address of principal executive offices)	**(Zip Code)**

(908) 607-4000

(Registrant s telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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. x Yes ¨ No

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

Large accelerated filer ¨	Accelerated filer ¨	Non-accelerated filer x (Do not check if a smaller reporting company)	Smaller reporting company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). ¨ Yes þ No

The number of shares of each of the registrant s classes of common stock outstanding as of October 31, 2008 was as follows:

Class A common stock, par value $0.01 per share	53,707,076
Class B common stock, par value $0.01 per share	1
Class C common stock, par value $0.01 per share	115,062

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Virgin Mobile USA, Inc.

Form 10-Q

For the quarterly period ended September 30, 2008

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Virgin Mobile USA, Inc.

Condensed Consolidated Balance Sheets

(In thousands, except share amounts)

(Unaudited)

	September 30, 2008	December 31, 2007
Assets		
Current assets:		
Cash and cash equivalents	$ 6,495	$ 19
Accounts receivable, less allowances of $1,584 at September 30, 2008 and $610 at December 31, 2007	58,140	57,956
Due from related parties	220	321
Other receivables	22,573	14,613
Inventories	153,054	137,364
Prepaid expenses and other current assets	33,571	19,722
Total current assets	274,053	229,995
Property and equipment	177,634	154,162
Accumulated depreciation and amortization	(124,691)	(108,249)
Property and equipment - net	52,943	45,913
Acquired intangible assets	52,703	
Goodwill	8,448	
Other assets	7,842	6,131
Total assets	$ 395,989	$ 282,039
Liabilities, Minority Interest, Preferred Stock and Stockholders deficit		
Current liabilities:		
Accounts payable	$ 97,943	$ 111,753
Due to related parties	81,780	56,486
Book cash overdraft		2,045
Accrued expenses and other current liabilities	118,370	73,142
Deferred revenue	129,835	128,125
Current portion of long-term debt	26,395	32,669
Total current liabilities	454,323	404,220
Non-current liabilities:		
Long-term debt	177,378	244,037
Related party debt	55,000	45,000
Due to related parties	6,380	
Other liabilities	2,000	3,981
Total non-current liabilities	240,758	293,018
Commitments and contingencies (See Note 12)		
Minority interest in consolidated subsidiaries	6,390	
	50,000	

Series A convertible preferred stock, par value $0.01 and stated value $1,000 per share - 50,000 shares authorized, and 50,000 shares issued and outstanding at September 30, 2008, and 0 shares issued and outstanding at December 31, 2007		
Stockholders deficit:		
Common stock:		
Class A common stock, par value $0.01 per share - 200,000,000 shares authorized, and 53,421,107 shares issued and outstanding, net of 37,560 treasury shares at September 30, 2008, and 53,136,839 shares issued and outstanding, net of 13,231 treasury shares at December 31, 2007	534	532
Class C common stock, par value $0.01 per share - 999,999 shares authorized, and 115,062 shares issued and outstanding at September 30, 2008 and December 31, 2007	1	1
Class B common stock, par value $0.01 per share - 1 share authorized, issued and outstanding at September 30, 2008 and December 31, 2007		
Additional paid-in-capital	386,932	340,382
Accumulated deficit	(742,498)	(754,860)
Accumulated other comprehensive loss	(451)	(1,254)
Total stockholders deficit	(355,482)	(415,199)
Total liabilities, minority interest, preferred stock and stockholders deficit	$ 395,989	$ 282,039

The accompanying notes are an integral part of the financial statements.

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Virgin Mobile USA, Inc.

Condensed Consolidated Statements of Operations and Comprehensive Income

(In thousands, except per share amounts)

(Unaudited)

	Three months ended September 30, 2008	Three months ended September 30, 2007	Nine months ended September 30, 2008	Nine months ended September 30, 2007
Operating revenue				
Net service revenue	$ 305,031	$ 301,414	$ 900,159	$ 933,464
Net equipment revenue	18,154	18,090	67,221	52,942
Total operating revenue	323,185	319,504	967,380	986,406
Operating expenses				
Cost of service (exclusive of depreciation and amortization)	84,543	89,352	250,442	273,331
Cost of equipment	102,997	99,133	307,770	292,157
Selling, general and administrative (exclusive of depreciation and amortization)	104,510	115,529	323,927	335,132
Restructuring expense	6,511		6,511	
Depreciation and amortization	10,538	8,619	28,060	25,350
Total operating expenses	309,099	312,633	916,710	925,970
Operating income	14,086	6,871	50,670	60,436
Other expense (income)				
Interest expense	8,591	15,171	25,933	43,180
Interest income	(1,686)	(839)	(1,756)	(1,400)
Interest expense - net	6,905	14,332	24,177	41,780
Other (income) expense	(1,737)	(80)	6,453	(275)
Total other expense - net	5,168	14,252	30,630	41,505
Income (loss) before income tax expense and minority interest	8,918	(7,381)	20,040	18,931
Income tax expense	421		1,288	
Income (loss) before minority interest	8,497	(7,381)	18,752	18,931
Minority interest	4,430		6,390	
Net income (loss)	4,067	(7,381)	12,362	18,931
Preferred stock dividends	333		333	
Net income (loss) available to common stockholders	$ 3,734	$ (7,381)	$ 12,029	$ 18,931
Net income (loss)	$ 4,067	$ (7,381)	$ 12,362	$ 18,931
Other comprehensive income (loss):				
Unrealized income (loss) on interest rate swap	1,337	(1,848)	803	(1,700)
Total comprehensive income (loss)	$ 5,404	$ (9,229)	$ 13,165	$ 17,231

Basic and diluted earnings (loss) per share information:								
Earnings (loss) per common share - basic	$	0.07	$	(0.29)	$	0.23	$	0.73
Earnings (loss) per common share - diluted	$	0.07	$	(0.29)	$	0.23	$	0.37
Weighted average common shares outstanding - basic		52,987		25,828		52,844		25,810
Weighted average common shares outstanding - diluted		65,046		25,828		52,943		50,652

The accompanying notes are an integral part of the financial statements.

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Virgin Mobile USA, Inc.

Condensed Consolidated Statements of Cash Flows

(In thousands)

(Unaudited)

	Nine months ended September 30, 2008	Nine months ended September 30, 2007
Operating activities		
Net income	$ 12,362	$ 18,931
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	28,060	25,350
Amortization of deferred financing costs	1,278	1,474
Non-cash charges for stock-based compensation	9,207	3,580
Non-cash cost of royalties and services	333	408
Write-offs of fixed assets	671	
Minority interest	6,390	
Changes in assets and liabilities, net of assets acquired and liabilities assumed:		
Accounts receivable	17,963	17,236
Due from related parties	101	11,995
Other receivables	(7,940)	(852)
Inventories	(8,065)	(42,949)
Prepaid expenses and other assets	(9,657)	(3,258)
Accounts payable	(20,954)	11,945
Due to related parties	22,213	9,359
Deferred revenue	(4,808)	(3,579)
Accrued expenses and other liabilities	(6,356)	(22,853)
Net cash provided by operating activities	40,798	26,787
Investing activities		
Cash acquired, net of acquisition costs	3,516	
Capital expenditures	(12,570)	(19,144)
Net cash used in investing activities	(9,054)	(19,144)
Financing activities		
Net change in book cash overdraft	(2,045)	(12,156)
Repayment of long-term debt	(72,933)	(27,750)
Proceeds from issuance of Preferred Stock	50,000	
Net change in related party debt		32,000
Other	(290)	263
Net cash used in financing activities	(25,268)	(7,643)
Net increase in cash and cash equivalents	6,476	
Cash and cash equivalents at beginning of year	19	8
Cash and cash equivalents at end of period	$ 6,495	$ 8

The accompanying notes are an integral part of the financial statements.

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Virgin Mobile USA, Inc.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

1. Overview and Basis of Presentation

Overview

Virgin Mobile USA, Inc., a Delaware corporation, was formed and capitalized in April 2007 as a holding company for the purposes of facilitating an initial public offering (the IPO) of Class A common stock, which was completed on October 16, 2007. In connection with the IPO, Virgin Mobile USA, Inc. and its subsidiaries (the Company) completed reorganization transactions (the Reorganization), in which Virgin Mobile USA, LLC, the principal operating entity for the Company s business, converted into a Delaware limited partnership, changed its name to Virgin Mobile USA, L.P., and became an indirect, majority-owned subsidiary of Virgin Mobile USA, Inc., the holding company for the public s common equity interests in the business.

The Company is a mobile virtual network operator, commonly referred to as an MVNO, offering prepaid, or pay-as-you-go, and, following the acquisition of Helio LLC (Helio), postpaid wireless communications services, including voice, data, and entertainment content, without owning a wireless network. The Company uses the Virgin Mobile name and logo under license from Virgin Enterprises Ltd. (together with its affiliated entities, the Virgin Group). The Company offers its services over the nationwide Sprint PCS network under the terms of the PCS Services Agreement between the Company and an affiliate of Sprint Nextel Corporation (together with its affiliated entities, Sprint Nextel) The Company conducts its business within one industry and one geographic segment.

On August 22, 2008, the Company completed its acquisition of Helio, at which time Helio became a wholly-owned subsidiary of Virgin Mobile USA, L.P. The financial results of Helio are included in the Company s financial results beginning on August 22, 2008, the closing date of the acquisition (see Note 4).

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and with Article 10 of Regulation S-X of the Securities and Exchange Commission for interim financial reporting. Accordingly, they do not include annual disclosures necessary for a presentation of the Company s financial position, results of operations and cash flows in conformity with accounting principles generally accepted in the United States of America. In the opinion of management, the interim financial information provided herein reflects all adjustments (consisting of normal and recurring adjustments, except for the out-of-period adjustment described below) necessary for a fair presentation of the Company s financial position, results of operations and cash flows for the interim periods presented on a basis consistent with the Company s historical audited financial statements and accompanying notes for the year ended December 31, 2007. The financial statements provided herein should be read in conjunction with the financial statements and accompanying notes included in the Company s annual report on Form 10-K for the year ended December 31, 2007. During the three and nine months ended September 30, 2008, the Company recorded a reduction to Selling, general and administrative expense of approximately $1 million and $0.6 million, respectively, for an out-of-period adjustment which management believes is immaterial to the previously issued financial statements for all periods affected, as well as the estimated results of operations for the year ending December 31, 2008.

Liquidity

The Company has incurred substantial cumulative net losses and negative cash flows from operations since inception, and has a stockholders deficit of $355.5 million, negative working capital of $180.3 million and non-current debt of $232.4 million as of September 30, 2008. The Company makes significant initial cash outlays to acquire new customers in the form of handset and other subsidies. Additionally, the Company has been incurring increasing costs to maintain current customers through the sale of replacement handsets at a loss to the Company. Management expects these costs to be funded primarily through service revenue generated from the Company s existing customer base and borrowings under its subordinated secured revolving credit facility (the Revolving Credit Facility). Although it is difficult for the Company to predict future liquidity requirements with certainty, based on the Company s expected cash flows from operations and available funds from its Revolving Credit Facility, management believes that the Company has the ability to finance its projected operating, investing and financing requirements of existing operations and planned customer growth through at least September 30, 2009. In addition, the Company s ability to make scheduled principal and interest payments, or to refinance indebtedness and

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Virgin Mobile USA, Inc.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

to satisfy other obligations, including obligations under the PCS Services Agreement with Sprint Nextel, as well as the Company s ability to meet long-term liquidity needs, will depend upon future operating performance, as well as general economic, financial, competitive, legislative, regulatory, business and other factors beyond the Company s control. If the Company materially underachieves its operating plan and the availability under the Revolving Credit Facility, and cash flow from operations become insufficient to allow the Company to meet its obligations, the Company is committed to taking certain alternative actions that could include reducing inventory purchases, reducing planned capital expenditures, extending the payment for certain liabilities within contractual terms with vendors, curtailing marketing costs and reducing other variable costs. In addition, management may also seek additional increases in its borrowing capacity under the Revolving Credit Facility, seek to raise additional funds, through public or private debt, equity financing to support operations, or to restructure debt repayment obligations. Additional funds, however, may not be available to the Company on commercially reasonable terms when required, or at all, and any additional capital raised through the sale of equity or equity-linked securities, if possible, could result in dilution to existing stockholders. There is no assurance management will be successful in achieving its operating plan or would be able to implement alternative actions or obtain additional borrowing capacity on acceptable terms.

The Company s third party senior secured credit facility (Senior Credit Agreement) and Revolving Credit Facility require compliance with covenants, including a consolidated leverage ratio and fixed charge ratio which will become more restrictive in the fourth quarter. Based on projected operating results and financial position, the Company expects to remain in compliance with the required covenants through at least September 30, 2009. If the Company does not meet these covenants, its borrowing availability under the Revolving Credit Facility could be eliminated and outstanding borrowings under the Senior Credit Agreement and the Revolving Credit Facility could become due.

In connection with the acquisition of Helio, each of the Virgin Group and SK Telecom USA Holdings, Inc. (SK Telecom) invested $25 million in the Company in exchange for the issuance by the Company of 25,000 shares of Series A Preferred Stock (the Preferred Stock) to each of the Virgin Group and SK Telecom. The $50 million of proceeds received by the Company was used to pay down a portion of the outstanding principal under the Senior Credit Agreement. (See Notes 5 and 6).

The Company s Class A common stock is listed on the New York Stock Exchange (NYSE) and subject to various NYSE listing requirements. These requirements include, among other things, that the Company maintain an average closing price of at least $1.00 per share and an average market capitalization above $100 million over thirty consecutive trading days. In October 2008, the Company s closing price was below $1.00 per share on several occasions and market capitalization (including the value of the Company s Virgin Mobile USA, L.P. interests) was below $100 million. If the Company fails to maintain compliance with the NYSE listing requirements, the NYSE may initiate suspension and delisting procedures.

2. Summary of Significant Accounting Policies

Goodwill and Intangible Assets

Goodwill is the excess of the purchase price over the fair value of identifiable net assets acquired in business combinations accounted for as purchases. Goodwill is tested for impairment, based on fair value at the reporting unit level during each year, or more frequently if events and circumstances indicate that goodwill may be impaired. Intangible assets with finite lives are amortized over their estimated useful lives and tested for impairment when events and circumstances indicate that its carrying amount may not be recoverable. The Company does not have any indefinite lived intangible assets other than goodwill.

Minority Interest

The Company has accounted for the Reorganization, for periods prior to the completion of the IPO, using a carryover basis, similar to a pooling-of-interest, as the reorganization transactions were premised on a non-substantive exchange in order to facilitate the IPO, resulting in the retention of historical based accounting. This is consistent with Financial Accounting Standards Board Technical Bulletin 85-5, *Issues Relating to Accounting for Business Combinations, including Costs of Closing Duplicate Facilities of an Acquirer; Stock Transactions between*

Companies under Common Control;

Virgin Mobile USA, Inc.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Down-Stream Mergers, Identical Common Shares for a Pooling of Interests; and Pooling of Interests by Mutual and Cooperative Enterprises. Under this method of accounting, the companies are treated as if they had always been combined for accounting and financial reporting purposes and, therefore, the condensed consolidated financial statements for the three and nine months ended September 30, 2007 are presented on the same basis as those for the three and nine months ended September 30, 2008. The weighted average shares outstanding for the three and nine months ended September 30, 2007 are based on the number of member units in Virgin Mobile USA, LLC retroactively adjusted for the conversion into Class A common stock of the Company. The Company began recording minority interest during the three months ended June 30, 2008 when the Company had cumulative earnings since the date of the Reorganization. The Company presents minority interest in a manner consistent with Emerging Issues Task Force Issue No. 94-2, *Treatment of Minority Interests in Certain Real Estate Investment Trusts*.

Gain on Issuance of Partnership Units By Subsidiary

The Company recognizes any gains or losses related to the issuance of partnership units by a consolidated subsidiary as adjustments to stockholders deficit. The Company acquired Helio from SK Telecom, EarthLink, Inc. (EarthLink) and Helio, Inc. in exchange for limited partnership units in Virgin Mobile USA, L.P. and shares of the Company s Class A common stock. The issuance of common units by Virgin Mobile USA, L.P. reduced the Company s ownership interest in Virgin Mobile USA, L.P. from 81.6% before the issuance of ownership units to 68.3% after the issuance. The Company recorded a $37.1 million gain on the issuance of the common units by Virgin Mobile USA, L.P. and reflected it in additional paid in capital in accordance with Staff Accounting Bulletin No. 51, *Accounting for Sales of Stock of a Subsidiary.*

Recently Issued and Newly Adopted Accounting Pronouncements

In March 2008, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 161, *Disclosures About Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133* (SFAS 161). SFAS 161 enhances the disclosure requirements for an entity s derivative instruments and hedging activities. It is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. Since SFAS 161 requires additional disclosures concerning derivatives and hedging activities, the adoption of SFAS 161 will not affect the financial condition, results of operations or cash flows of the Company.

In December 2007, the FASB issued SFAS No. 141 (R), *Business Combinations* (SFAS 141R). SFAS 141(R) requires the acquiring entity in a business combination to recognize all (and only) assets acquired and liabilities assumed in the transaction; establishes the acquisition date fair value as the measurement objective for all assets acquired and liabilities assumed; and requires the acquirer to disclose to investors and other users all of the information they need to evaluate and understand the nature and financial effect of the business combination. SFAS 141(R) is effective for fiscal years beginning on or after December 15, 2008. The Company will adopt SFAS 141R on January 1, 2009 and is evaluating the impact the adoption may have on its financial condition, results of operations or cash flows.

In December 2007, the FASB issued SFAS No. 160*, Noncontrolling Interests in Consolidated Financial Statements* (SFAS 160). SFAS 160 clarifies that a noncontrolling interest, sometimes called a minority interest, in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity, but separate from stockholders equity, in the consolidated financial statements. Currently, companies report noncontrolling interests as a liability or in the mezzanine section between liabilities and equity. Accordingly, prior to the adoption of SFAS 160 on January 1, 2009, the Company will continue to reflect noncontrolling interest in the mezzanine section between liabilities and equity. Following the adoption of SFAS 160, the Company will reflect noncontrolling interest as equity. SFAS 160 will also change the way a noncontrolling interest is presented in the consolidated statement of operations, by requiring that consolidated net income include amounts attributable to both the parent and the noncontrolling interest. SFAS 160 also requires disclosure on the face of the statement of operations of those amounts of consolidated net income attributable to both parent and noncontrolling interest. Prior to the adoption of SFAS 160, noncontrolling interest will continue to be reported as a deduction in arriving at consolidated net income. The implementation of SFAS 160 will change the presentation of noncontrolling interest in the Company s balance sheet and statement of operations, but is not expected to have a material impact on the Company s consolidated financial position or results of operations.

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In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115* (SFAS 159). SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. SFAS 159 does not affect any existing accounting literature that requires certain assets and liabilities to be carried at fair value. The adoption of SFAS 159 on January 1, 2008 did not have a material impact on the financial condition, results of operations or cash flows of the Company.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. SFAS 157 also applies under other accounting pronouncements that require or permit fair value measurements, but does not require any new fair value measurements. The FASB issued FASB Staff Position No. 157-2, *Partial Deferral of the Effective Date of Statement 157,* which deferred the effective date of SFAS 157 for all nonfinancial assets and liabilities to fiscal years beginning after November 15, 2008.

SFAS 157 establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a reporting entity s own assumptions about the assumptions that market participants would use in pricing an asset or liability.

Assets and liabilities measured at fair value on a recurring basis consist of a liability for an interest rate swap. The fair value was derived based on market prices of securities with similar characteristics (level 2) and was $(0.5) million as of September 30, 2008. The Company is evaluating the impact the adoption of SFAS 157 for nonfinancial assets and liabilities will have on its financial condition, results of operations or cash flows of the Company.

3. Inventories

Inventories consist of the following (in thousands):

	September 30, 2008	December 31, 2007
Handsets and accessories	$ 80,172	$ 72,094
Refurbished handsets	3,504	3,590
Handset inventory on consignment	69,378	61,680
	$ 153,054	$ 137,364

4. Acquisition of Helio LLC

On August 22, 2008, the Company completed its acquisition of Helio, at which time Helio became a wholly-owned subsidiary of Virgin Mobile USA, L.P. The acquisition of Helio is expected to facilitate the Company s entry into postpaid offerings and allow the Company to take advantage of Helio s proprietary technology. The financial results of Helio are included in the Company s financial results beginning on August 22, 2008, the closing date of the acquisition.

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Notes to Condensed Consolidated Financial Statements

(Unaudited)

The Company acquired Helio from SK Telecom, EarthLink and Helio, Inc. in exchange for 12,806,632 limited partnership units in Virgin Mobile USA, L.P. and 193,368 shares of the Company s Class A common stock, together equivalent to 13 million shares of the Company s Class A common stock. The newly issued Virgin Mobile USA, L.P. partnership units are convertible into shares of the Company s Class A common stock on a one-for-one basis at any time. The purchase price, based on the average closing price of the Company s Class A common stock two trading days before and ending two trading days after the date of the announcement, of $2.90 per share, was $41.3 million, including direct costs of the acquisition of $3.7 million. Subject to approval by the stockholders of the Company, each of SK Telecom and EarthLink will be issued one share of Class B common stock. Each of these shares will entitle its recipient to a number of votes on all matters submitted to a vote of stockholders that is equal to the total number of shares of Class A common stock for which the partnership units that its owner holds in Virgin Mobile USA, L.P. are exchangeable.

The acquisition of Helio was accounted for under SFAS No. 141, *Business Combinations.* The preliminary allocation of the purchase price, including acquisition costs, to Helio s tangible and intangible assets acquired and liabilities assumed was based on their estimated fair values. Included in the liabilities assumed are reserves for the restructuring of the Helio business (see Note 8). This allocation is preliminary related to the fair value of inventory, property and equipment, purchase commitments, restructuring liabilities and intangible assets, and further adjustments may be included in the final allocation of the purchase price. The excess of the purchase price over the tangible and identifiable intangible assets acquired and liabilities assumed has been allocated to goodwill, which is not deductible for tax purposes. The purchase price has been allocated as follows (in thousands):

Cash and cash equivalents	$ 7,217
Accounts and other receivables	18,166
Inventory	7,626
Prepaid expenses and other current assets	1,112
Property and Equipment	22,603
Other assets	6,403
Acquired intangible assets	53,290
Goodwill	8,448
Accounts payable and due to related parties	(16,113)
Accrued expenses and other current liabilities	(50,405)
Deferred Revenue	(6,519)
Related party debt	(10,000)
Due to related parties	(492)
Total preliminary purchase price allocation	$ 41,336

In performing the preliminary purchase price allocation, the Company considered, among other factors, its intention for future use of acquired assets, analyses of historical performance and estimates of future performance of Helio s product and service offerings. The fair values of identifiable intangible assets associated with the acquisition of Helio were calculated using the income approach. The preliminary valuation for these identifiable intangible assets and their respective weighted average amortization period, is as follows (dollars in thousands):

	Fair Value	**Weighted average amortization period (in years)**
Customers Relationships	$ 32,870	5.9
Acquired technology	20,420	6.3

	$ 53,290	6.1

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Virgin Mobile USA, Inc.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Intangible asset amortization was $0.6 million for the three and nine months ended September 30, 2008 and is included in depreciation and amortization. Amortization expenses are estimated based on expected annual cash flows and amount to $2.3 million for the remainder of 2008 and $9.4 million, $11.9 million, $10.5 million, $8.9 million, and $5.1 million for each of the next five years.

The pro forma summary information provided below is for illustrative purposes only, and is not necessarily indicative of the consolidated results of operations for future periods or that actually would have been realized had the Company acquired Helio at the beginning of the periods presented. The following pro forma summary information assumes the Company acquired Helio at the beginning of each of the periods presented and includes the impact of certain adjustments such as amortization of intangible assets and changes in interest expense (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2008	2007	2008	2007
Operating revenue	$ 350,584	$ 371,188	$ 1,101,589	$ 1,101,634
Net loss	(12,671)	(98,225)	(101,817)	(213,831)
Basic and diluted loss per share	(0.24)	(3.77)	(1.92)	(8.22)

5. Preferred Stock

On August 22, 2008, in connection with the Helio acquisition, the Company issued 50,000 shares of Preferred Stock, with 25,000 shares issued to the Virgin Group and 25,000 shares issued to SK Telecom. The Preferred Stock was issued at the stated value of $1,000 per share, with proceeds to the Company of approximately $50 million. The proceeds were used to repay a portion of the outstanding balance under the Senior Credit Agreement. The liquidation value of the Preferred Stock is $1,000 per share, which, if paid, will be drawn from those assets of the Company available to its stockholders. The Preferred Stock carries a cumulative 6% annual dividend payable semi-annually, which will be paid with additional shares of Preferred Stock at the stated value of $1,000 per share.

Subject to the approval by the stockholders of the Company, each share of the Preferred Stock will be mandatorily convertible into 117.64706 shares of the Company s Class A common stock, at the earlier of (i) August 22, 2012 and (ii) such time as the market price of the Company s Class A Common Stock exceeds $8.50 per share. Subject to approval by the stockholders of the Company, the Preferred Stock will also be convertible at the option of the holder on or after February 22, 2010, 18 months after the date of issuance. Should the Company fail to obtain stockholder approval of the conversion feature, the Preferred Stock will be mandatorily redeemed on August 22, 2012 at a cash redemption price equal to the stated value of $1,000 per share.

6. Debt

Third Party Credit Agreement

On June 27, 2008, the Company entered into the Second Amendment to the Senior Credit Agreement. The amendment (i) required that the $50 million proceeds from the issuance of the Preferred Stock be used to pay down a portion of the outstanding loan balance, (ii) increased the interest rate applicable to outstanding balances by 100 basis points per year, and (iii) decreased the leverage ratio covenant for each quarter by 0.25 times (for the quarter ending December 31, 2008, the required leverage ratio decreases from 3.00:1.00 to 2.75:1.00). The obligations under the Senior Credit Agreement continue to be collateralized by a security interest in substantially all of the Company s tangible and intangible assets.

The Senior Credit Agreement contains customary representations and warranties, as well as affirmative and negative covenants, including restrictions and limits on the Company s ability to dispose of assets, incur additional indebtedness, issue guarantees, pay dividends, make capital distributions, create liens on assets, make investments, engage in mergers or consolidations, and engage in certain transactions with affiliates. The Company was in compliance with the covenants as of September 30, 2008.

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The Company may be required, under certain circumstances, to make mandatory prepayments upon the receipt of cash proceeds from the issuance of debt, equity and asset sales, as well as the generation of excess cash flows, as defined in the Senior Credit Agreement. Under the terms of the Senior Credit Agreement, there are no penalties for either mandatory or voluntary prepayments. During the nine months ended September 30, 2008, the Company made principal payments of $72.9 million under the Senior Credit Agreement, including a $50.0 million mandatory repayment using the proceeds from the issuance of the Preferred Stock. The Senior Credit Agreement is payable in installments, with a balloon payment of $151.0 million due on December 14, 2010. As of September 30, 2008, the scheduled principal payments by year were as follows (in thousands):

Amended Credit Agreement Maturities	
2008	$ 6,599
2009	26,395
2010	170,779
	$ 203,773

The Senior Credit Agreement bears interest at a Eurodollar rate equal to three-month LIBOR plus an applicable margin of 5.50% or 5.95%, or an alternate base rate plus an applicable margin of 4.50% or 4.95%, in each case, depending on the Company s leverage. As of September 30, 2008, the Company had $203.8 million outstanding under the Senior Credit Agreement, and the annualized interest rate applicable to the outstanding balance was 9.3%.

Related Party Subordinated Credit Agreement

Concurrent with the amendment to the Senior Credit Agreement, the Company entered into the Second Amendment to the Revolving Credit Facility. The Second Amendment to the Revolving Credit Facility increased the Virgin Group s lending commitment from $75 million to $100 million and added SK Telecom as a new lender with a lending commitment of $35 million.

A 1% quarterly tolling charge is applied to the outstanding borrowings under the Revolving Credit Facility with the Virgin Group, but this charge is not applied to any borrowings from SK Telecom or any borrowings from the Virgin Group in excess of $75 million. In addition, the Company is required to pay a commitment fee to the Virgin Group currently equal to 1% per year on the average unused portion of the Revolving Credit Facility, but neither the $25 million increase in the Virgin Group s lending commitment nor the unused portion of the Revolving Credit Facility with SK Telecom is subject to the commitment fee.

Amounts outstanding under the Revolving Credit Facility bear interest at three-month LIBOR plus an applicable margin of 4.50% or 4.95%, depending on the Company s leverage, or 12% if the three-month LIBOR rate cannot be ascertained. On September 30, 2008, the Company had $55.0 million outstanding under the Revolving Credit Facility, and the weighted average interest rate applicable to the outstanding balances was 7.7%. In October 2008, the Company borrowed an additional $20.0 million under the Revolving Credit Facility, bringing the total amount outstanding under the Revolving Credit Facility to $75.0 million.

The Second Amendment to the Revolving Credit Facility contains customary representations and warranties and affirmative and negative covenants which are substantially similar to those contained in the Senior Credit Agreement. The Company was in compliance with the covenants as of September 30, 2008.

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7. Stock-Based Compensation

Stock Options

The following table summarizes the Company s stock option award activity during the nine months ended September 30, 2008:

	Shares under Option	Weighted Average per Share Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value (000 s)
Outstanding at December 31, 2007	4,144,982	$ 14.07		
Granted	31,892	8.71		
Exercised				
Forfeited	(546,201)	15.56		
Expired	(109,047)	17.14		
Outstanding at September 30, 2008	3,521,626	$ 13.69	3.60	$
Vested or expected to vest at September 30, 2008	3,404,402	$ 13.63	4.38	$
Exercisable at September 30, 2008	2,453,139	$ 12.88	3.06	$

The weighted-average per share grant date fair value of options granted during the nine months ended September 30, 2008 and 2007 was $5.29 and $6.58, respectively. The total fair value of stock options vested during the nine months ended September 30, 2008 and 2007 was $9.2 million and $5.1 million, respectively. As of September 30, 2008, there was a total of $5.3 million of unrecognized compensation expense, net of estimated forfeitures, related to nonvested stock options, which is expected to be recognized over a weighted-average period of 2.3 years.

Restricted Stock and Restricted Stock Units

The following table summarizes the Company s restricted stock and restricted stock unit award activity during the nine months ended September 30, 2008:

	Nonvested Restricted Stock Units		Nonvested Restricted Stock	
	Number of Awards	Weighted Average Grant Date Fair Value	Number of Awards	Weighted Average Exercise Price Per Unit
Outstanding at December 31, 2007	810,981	$ 14.84	495,075	$ 27.22
Granted	1,117,018	3.34		
Vested	(203,613)	15.00	(38,294)	27.83
Forfeited	(158,126)	15.00	(24,329)	27.83

Outstanding at September 30, 2008	1,566,260	$	8.26	432,452	$	27.13

As of September 30, 2008, the total unrecognized compensation expense, net of estimated forfeitures, for nonvested restricted stock units and restricted stock was $6.6 million and $6.3 million, respectively, which is expected to be recognized over a weighted-average period of 2.2 years and 1.7 years, respectively.

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Performance-Based Restricted Stock Units

The following table summarizes the Company s performance-based restricted stock unit award activity during the nine months ended September 30, 2008:

	Nonvested Performance-Based Restricted Stock Units	
	Number of Awards	Weighted Average Grant Date Fair Value
Outstanding at December 31, 2007		$
Granted	860,000	2.46
Outstanding at September 30, 2008	860,000	$ 2.46

As of September 30, 2008, the total unrecognized compensation expense, net of estimated forfeitures, for nonvested performance-based restricted stock units was $1.7 million, which is expected to be recognized over a weighted-average period of 2.5 years.

8. Restructuring

Outsourcing Agreement

On July 3, 2008, the Company signed an outsourcing agreement with IBM (the IBM Agreement). Management of the Company believes that outsourcing much of its information technology needs to IBM will enhance its technological capabilities and help to improve its product portfolio for new and existing customers and, beginning in 2009, reduce the Company s ongoing information technology costs. The IBM Agreement requires IBM to provide information technology services to the Company through May 15, 2013. The Company has the right, but not the obligation, to extend the IBM Agreement for one additional year, or to May 15, 2014, if certain conditions are met. The transition of the Company s information technology, infrastructure and applications development to the IBM service environment is expected to be completed by March 31, 2009.

In connection with the outsourcing, 46 of the Company s employees transferred to IBM on June 30, 2008, 85 employees were terminated during the three months ended September 30, 2008 and approximately 30 employees will be terminated during the three months ended December 31, 2008. In addition, the Company expects to close its facility in Walnut Creek, CA during the first quarter of 2009. The outsourcing is expected to result in restructuring charges for one-time termination benefits, including severance, completion bonuses, retention bonuses, and the associated benefits and payroll taxes, contract termination fees, fixed asset related charges for disposals, and accelerated depreciation and amortization for assets that IBM will not be using, and other charges during the second half of 2008 and the year ending December 31, 2009. Employees being terminated are required to remain with the Company through a specified transition period in order to be eligible to receive any one-time termination benefits. Estimated restructuring charges by year and in total are shown below (in thousands):

	2008	2009	2010	Total

Employee related	$ 7,380	$ 651	$ 57	$ 8,088
Fixed asset related	565	89		654
Contract terminations		1,956		1,956
Other	25			25
Total	$ 7,970	$ 2,696	$ 57	$ 10,723

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During the three months ended September 30, 2008, the Company incurred the following restructuring charges (in thousands):

Employee related	$ 5,822
Fixed asset related	387
Other	7
Total	$ 6,216

During the three and nine months ended September 30, 2008, the Company paid $74 thousand of restructuring expenses, and the remaining liability of $6.0 million was included in Accrued expenses and other current liabilities.

Restructuring Related to the Acquisition of Helio

In connection with the acquisition of Helio, the Company recorded a reserve for the restructuring of the Helio business, which is included as part of Accrued expenses and other current liabilities. As part of the acquisition, $9.5 million was recorded for closure of sales offices, kiosks, and stores and one-time benefits for certain employees of Helio who were terminated. During the three months ended September 30, 2008, the Company incurred $295 thousand related to one-time employee termination benefits for those employees assisting in the integration of Helio into the Company s business. The estimated charges for the remainder of 2008 are approximately $0.6 million and $0.3 million for the year ended December 31, 2009.

The following table summarizes the changes to the restructuring reserve for the periods presented (in thousands):

	Employee related	Store and office closures	Total
Balance at August 22, 2008			