

NEXTEL PARTNERS INC
Form 10-Q
August 14, 2002

Table of Contents

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 June 30, 2002

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

Outstanding Title of Class	Number of Shares on August 1, 2002
Class A Common Stock	166,136,028 shares
Class B Common Stock	79,056,228 shares

TABLE OF CONTENTS

PART I FINANCIAL INFORMATION

Item 1. Financial Statements

Consolidated Balance Sheets

Consolidated Statements of Operations

Consolidated Statement of Changes in Stockholders' Equity

Consolidated Statements of Cash Flows

Notes to Consolidated Financial Statements (Unaudited)

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

Item 3. Quantitative and Qualitative Disclosures About Market Risk

PART II OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 6. Exhibits and Reports on Form 8-K

SIGNATURES

EXHIBIT 10.18(B)

EXHIBIT 10.19.(B)

Table of Contents**NEXTEL PARTNERS, INC.****INDEX**

	<u>Page No.</u>
PART I	
FINANCIAL INFORMATION	
Item 1. Financial Statements (Unaudited)	
Consolidated Balance Sheets As of June 30, 2002 and December 31, 2001	3
Consolidated Statements of Operations Three and six months ended June 30, 2002 and 2001	4
Consolidated Statement of Changes in Stockholders' Equity Six months ended June 30, 2002	5
Consolidated Statements of Cash Flows Six months ended June 30, 2002 and 2001	6
Notes to Consolidated Financial Statements	7
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	13
Item 3. Quantitative and Qualitative Disclosures about Market Risk	37
PART II	
OTHER INFORMATION	
Item 1. Legal Proceedings	39
Item 4. Submission of Matters to a Vote of Security Holders	39
Item 6. Exhibits and Reports on Form 8-K	40

Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Financial Statements**

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

	June 30, 2002	December 31, 2001
	<u>(unaudited)</u>	
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 112,259	\$ 304,359
Short-term investments	220,494	252,926
Accounts receivable, net of allowance \$7,761 and \$4,068, respectively	109,885	85,129
Subscriber equipment inventory	8,295	7,115
Receivable from officer	2,200	
Other current assets	15,013	9,540
	<u>468,146</u>	<u>659,069</u>
Total current assets		
PROPERTY, PLANT AND EQUIPMENT, at cost	1,109,033	968,268
Less accumulated depreciation	(167,846)	(122,334)
	<u>941,187</u>	<u>845,934</u>
Property, plant and equipment, net		
OTHER NON-CURRENT ASSETS:		
FCC operating licenses, net of accumulated amortization of \$8,744 and \$8,744, respectively	318,171	283,728
Debt issuance costs, net of accumulated amortization of \$11,280 and \$9,061, respectively, and other assets	30,144	30,790
Receivable from officer		2,200
	<u>348,315</u>	<u>316,718</u>
Total non-current assets		
TOTAL ASSETS	\$ 1,757,648	\$ 1,821,721
	<u> </u>	<u> </u>
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES		
Accounts payable	\$ 67,718	\$ 71,009
Accrued expenses	56,574	54,016
Due to Nextel	4,131	2,947
	<u>128,423</u>	<u>127,972</u>
Total current liabilities		
LONG-TERM OBLIGATIONS		
12.5% Senior notes due 2009	210,996	210,492
14% Senior discount notes due 2009	419,722	392,337
11% Senior notes due 2010	400,000	400,000
Credit facility term B, C and D	375,000	325,000

Edgar Filing: NEXTEL PARTNERS INC - Form 10-Q

Deferred Income Taxes	14,058	
Other long-term liabilities	16,538	15,395
	<u> </u>	<u> </u>
Total long-term obligations	1,436,314	1,343,224
	<u> </u>	<u> </u>
Total liabilities	1,564,737	1,471,196
	<u> </u>	<u> </u>
COMMITMENTS AND CONTINGENCIES (See Notes)		
REDEEMABLE PREFERRED STOCK, Series B redeemable 2010, par value \$.001 per share, 12% cumulative annual dividend; 13,110,000 shares issued and outstanding	32,920	31,021
	<u> </u>	<u> </u>
STOCKHOLDERS EQUITY		
Common stock, Class A, par value \$.001 per share, 166,076,376 and 165,562,642 shares, respectively, issued and outstanding, and paid-in capital	868,873	865,807
Common stock, Class B, par value \$.001 per share convertible, 79,056,228 shares issued and outstanding, and paid-in capital	163,312	163,312
Accumulated deficit	(863,638)	(697,010)
Deferred compensation	(8,556)	(12,605)
	<u> </u>	<u> </u>
Total stockholders equity	159,991	319,504
	<u> </u>	<u> </u>
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	\$ 1,757,648	\$ 1,821,721
	<u> </u>	<u> </u>

The accompanying notes are an integral part of these condensed consolidated financial statements.

Table of Contents

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

	For the three months ended June 30,		For the six months ended June 30,	
	2002	2001	2002	2001
REVENUES:				
Service revenues (Received from Nextel WIP \$19,997, \$14,490, \$35,349 and \$24,052, respectively.)	\$ 153,418	\$ 82,912	\$ 281,082	\$ 145,995
Equipment revenues	7,668	3,021	13,155	5,484
Total revenues	<u>161,086</u>	<u>85,933</u>	<u>294,237</u>	<u>151,479</u>
OPERATING EXPENSES:				
Cost of service revenues (Paid to Nextel WIP \$21,160, \$14,486, \$36,953 and \$24,185, respectively.)	66,350	46,668	127,779	80,037
Cost of equipment revenues	23,637	12,885	43,170	24,516
Selling, general and administrative (exclusive of stock based compensation expense shown below) (Paid to Nextel WIP \$1,111, \$1,324, \$2,437 and \$2,175, respectively.)	76,846	49,453	146,916	92,854
Stock based compensation	2,865	7,931	5,756	15,617
Depreciation and amortization	23,532	19,825	45,647	34,186
Total operating expenses	<u>193,230</u>	<u>136,762</u>	<u>369,268</u>	<u>247,210</u>
LOSS FROM OPERATIONS	(32,144)	(50,829)	(75,031)	(95,731)
Interest expense, net	(42,158)	(29,272)	(80,157)	(61,453)
Interest income	2,084	9,132	4,517	22,628
LOSS BEFORE DEFERRED INCOME TAX PROVISION	(72,218)	(70,969)	(150,671)	(134,556)
Deferred income tax provision	(1,779)		(14,058)	
LOSS BEFORE CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE	(73,997)	(70,969)	(164,729)	(134,556)
Cumulative effect of change in accounting principle, net of \$0 income tax				(1,787)
NET LOSS	(73,997)	(70,969)	(164,729)	(136,343)
Mandatorily redeemable preferred stock dividends	(970)	(860)	(1,899)	(1,685)
LOSS ATTRIBUTABLE TO COMMON STOCKHOLDERS	<u>\$ (74,967)</u>	<u>\$ (71,829)</u>	<u>\$ (166,628)</u>	<u>\$ (138,028)</u>
LOSS PER SHARE ATTRIBUTABLE TO COMMON STOCKHOLDERS, BASIC AND DILUTED:				

Edgar Filing: NEXTEL PARTNERS INC - Form 10-Q

Loss before cumulative effect of change in accounting principle	\$ (0.31)	\$ (0.30)	\$ (0.68)	\$ (0.56)
Cumulative effect of change in accounting principle			\$	\$ (0.01)
	\$ (0.31)	\$ (0.30)	\$ (0.68)	\$ (0.57)
Weighted average number of shares outstanding	244,374,968	242,437,611	244,244,960	242,372,745

The accompanying notes are an integral part of these condensed consolidated financial statements.

Table of Contents

NEXTEL PARTNERS, INC. AND SUBSIDIARIES
Consolidated Statement of Changes in Stockholders Equity
(dollars in thousands)
(unaudited)
For the Six Months Ended June 30, 2002

	Class A Common Stock and Paid-In Capital		Class B Common Stock and Paid-In Capital		Accumulated Deficit	Deferred Compensation	Totals
	Shares	Amount	Shares	Amount			
BALANCE							
December 31, 2001	165,562,642	\$ 865,807	79,056,228	\$ 163,312	\$(697,010)	\$(12,605)	\$ 319,504
Series B redeemable preferred stock dividend					(1,899)		(1,899)
Net loss					(164,729)		(164,729)
Issuance of stock options		3,313				(3,313)	
Equity Issuance Costs		(5)					(5)
Deferred compensation options forfeited		(1,606)				1,606	
Vesting of deferred compensation						5,756	5,756
Stock options exercised	253,889	435					435
Stock issued for employee stock purchase plan	259,845	929					929
BALANCE							
June 30, 2002	166,076,376	\$ 868,873	79,056,228	\$ 163,312	\$(863,638)	\$ (8,556)	\$ 159,991

The accompanying notes are an integral part of these condensed consolidated financial statements.

Table of Contents

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

	For the Six Months Ended June 30,	
	2002	2001
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	\$ (164,729)	\$(136,343)
Adjustments to reconcile net loss to net cash used in operating activities		
Cumulative effect of change in accounting principle		1,787
Deferred income tax provision	14,058	
Depreciation and amortization	45,647	34,186
Amortization of debt issuance costs	2,219	1,809
Interest accretion for senior discount notes	26,773	21,244
Bond discount amortization	504	
Fair value adjustments of derivative instruments	595	2,083
Stock based compensation	5,756	15,617
Allowance for doubtful accounts	13,115	1,332
Gain on deferred sale-leaseback	(198)	(298)
Change in current assets and liabilities:		
Accounts receivable	(37,871)	(22,290)
Subscriber equipment inventory	(1,180)	(1,747)
Other current assets	(5,570)	6,237
Accounts payable, accrued expenses and other liabilities	5,908	4,613
Operating advances due to/(from) Nextel WIP	1,184	1,342
	(93,789)	(70,428)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures	(142,650)	(230,432)
Change in capital expenditure-related accruals	(5,404)	19,345
Proceeds from sale of assets	1,848	5,473
FCC licenses	(34,416)	(22,898)
Proceeds from sale of short-term investments	32,432	141,709
	(148,190)	(86,803)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from borrowings	50,000	
Stock options exercised	435	466
Proceeds from stock issued for employee stock purchase plan	929	702
Proceeds from equity contributions		67
Equity costs	(5)	
Debt issuance costs	(1,480)	(564)
	49,879	671
NET DECREASE IN CASH AND CASH EQUIVALENTS	(192,100)	(156,560)
CASH AND CASH EQUIVALENTS, beginning of period	304,359	493,552
CASH AND CASH EQUIVALENTS, end of period	\$ 112,259	\$ 336,992

	_____	_____
SUPPLEMENTAL DISCLOSURE OF NON-CASH TRANSACTIONS		
Cash paid for taxes	\$ _____	\$ _____
Capitalized interest on accretion of senior discount notes	\$ 612	\$ 2,675
Accretion of redeemable preferred stock dividends	\$ 1,899	\$ 1,685
CASH PAID FOR INTEREST, net of capitalized amount	\$ 48,105	\$ 36,123

The accompanying notes are an integral part of these condensed consolidated financial statements.

Table of Contents

**NEXTEL PARTNERS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (Unaudited)**

1. BASIS OF PRESENTATION

Our interim consolidated financial statements for the three-month and six-month periods ended June 30, 2002 have been prepared without audit, pursuant to the rules and regulations of the Securities and Exchange Commission for interim financial reporting. Certain information and footnote disclosures normally included in the annual financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations for interim financial statements. These condensed consolidated 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, 2001 filed with the Securities and Exchange Commission.

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-month and six-month periods ended June 30, 2002 are not necessarily indicative of the results to be expected for the full year ending December 31, 2002.

2. OPERATIONS

Description of Business

We provide 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 Corporation (OPCO), our wholly owned subsidiary. Substantially all of our assets, liabilities, operating losses and cash flows are within OPCO and our wholly owned subsidiaries.

Our digital network (Nextel digital mobile network) has been developed with advanced mobile communication systems employing digital technology with a multi-site configuration permitting frequency reuse utilizing digital technology developed by Motorola, Inc. (Motorola). We refer to such technology as the integrated Digital Enhanced Network or iDEN. 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 tertiary 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) (see Note 7), provide for support services to be provided by Nextel WIP, as required.

3. SIGNIFICANT ACCOUNTING POLICIES

Concentration of Risk

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

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

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 from those estimates.

Table of Contents

Principles of Consolidation

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

Net 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 loss attributable to common stockholders by the weighted average number of shares of common stock outstanding during the period. Diluted earnings per share is computed by dividing loss attributable to common stockholders by the weighted average number of common and dilutive common equivalent shares outstanding during the period. Common equivalent shares consist of shares of common stock issuable upon the conversion of the convertible preferred stock (using the if-converted method) and shares issuable upon the exercise of stock options and warrants (using the treasury stock method). As presented, basic and diluted loss per share are equal since common equivalent shares are excluded from the calculation of diluted earnings per share as their effects are antidilutive due to our net losses. We have not had any issuances or grants for nominal consideration as defined under Staff Accounting Bulletin 98. For the three and six months ended June 30, 2002 and 2001, approximately 545,000 and 1.9 million shares of restricted stock, respectively, and 14.7 million and 8.2 million stock options, respectively, were excluded from the calculation of common equivalent shares, as their effects are antidilutive.

Sale-Leaseback Transactions

On October 13, 1999, we signed a Letter of Agreement by and among Nextel and some of its subsidiaries and Spectrasite Holdings, Inc. (Spectrasite) and some of its subsidiaries to transfer specified telecommunication towers and related assets to Spectrasite for cash. Subsequently, we leased space on the telecommunication towers from Spectrasite pursuant to a master lease agreement. For the three months ended June 30, 2002 and 2001 we received cash proceeds of approximately \$785,000 and \$2.5 million, respectively, and for the six months ended June 30, 2002 and 2001 we received cash proceeds of approximately \$1.8 million and \$5.5 million, respectively, for the assets sold to Spectrasite and other such companies. These sale-leaseback transactions are accounted for as real estate lease agreements and normal sales-leasebacks. Any gain recognized on the sale of assets is deferred and amortized in cost of service revenues over the life of the lease. For the three months ended both June 30, 2002 and 2001, we amortized approximately \$168,000, and for the six months ended June 30, 2002 and 2001, we amortized approximately \$198,000 and \$298,000, respectively, related to the net gain on sales of these assets.

FCC Licenses and Adoption of SFAS 142

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 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 asset impairment analysis on our FCC licenses in accordance with SFAS No. 142 and determined no impairment related to our FCC licenses.

In connection with the adoption of SFAS 142, we recorded a non-cash income tax provision of \$12.3 million at the end of the first quarter of 2002 to increase the valuation allowance related to our net operating loss. This charge is required because we have significant deferred tax liabilities related to FCC licenses with a lower tax 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 carryforward period of our net operating loss. Since 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 carryforward period. Accordingly, we increased the valuation allowance upon the adoption of SFAS 142 and continue to increase the valuation allowance as the deferred tax liabilities increase. During the three months ended June 30, 2002, we recorded an additional \$1.8 million income tax provision to increase the valuation allowance.

The following table presents the pro forma financial results for the three and six months ended June 30, 2001 had SFAS 142 been effective January 1, 2001 and, accordingly, had our FCC licenses not been amortized:

Table of Contents

	Three Months Ended June 30, 2001	Six Months Ended June 30, 2001
Loss before cumulative effect of change in accounting principle (in thousands)		
As reported	\$(70,969)	\$(134,556)
FCC license amortization	1,284	2,400
Pro forma	\$(69,685)	\$(132,156)
Loss per share attributable to common stockholders before cumulative effect of change in accounting principle		
As reported	\$ (0.29)	\$ (0.56)
Pro forma	\$ (0.29)	\$ (0.55)

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.

In March 2002, we entered into agreements to purchase additional 800 MHz SMR frequencies covering portions of the Rio Grande area of Texas, subject to FCC approval and other standard closing conditions, for aggregate consideration of approximately \$32.6 million. During the second quarter of 2002, we completed the transaction.

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 an interest rate swap agreement for \$60 million and \$50 million, respectively, to partially hedge interest rate exposure with respect to our \$325 million term B and C loans. This 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 133, amounts paid or received under the interest rate swap agreement were accrued as interest rates change and recognized over the life of the swap agreement as an adjustment to interest expense. As of December 31, 2000, the fair value of the swap agreements were not recognized in the consolidated financial statements, since the swap agreements met the criteria for hedge accounting prior to adoption of SFAS 133.

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. 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 133, our interest rate swap agreements have been designated as ineffective cash flow hedges. The hedges are included in other long-term liabilities on the balance sheet. For the three months ended June 30, 2002 and 2001, we recorded a charge of \$2.0 million and income of \$343,000, respectively, related to the change in fair value of the interest rate swap agreements which has been reflected in interest expense, and for the six months ended June 30, 2002 and 2001, we recorded a charge of \$595,000 and \$2.1 million, respectively, to interest expense.

We do not use financial instruments for trading or other speculative purposes, nor are we 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 counterparties. This credit risk is minimized by dealing with a group of major financial institutions with which we have other financial relationships. We do not anticipate nonperformance by these counterparties.

Revenue Recognition

Table of Contents

Revenue net of customer discounts and rebates is recognized for airtime and other services over the period earned. In conjunction with our implementation of Staff Accounting Bulletin 101 (SAB 101), Revenue Recognition in Financial Statements, our activation fees and phone revenues are deferred and recognized over three years, the expected life of the customer relationship. The decision to defer these revenues is based on the conclusion that the service contract and the phone revenue are multiple element arrangements or earnings processes that should not be separated. In other words, the service contract is essential to the functionality of the phone. Concurrently, the related costs for the phone equipment are deferred solely to the extent of deferred revenues. The direct and incremental phone costs in excess of revenues generated from phone sales are expensed immediately as the amounts exceed our minimum contractual revenue. Subsequent to the initial deferral, the amortization of deferred revenue is equal to the amortization of the deferred costs, resulting in no net change to loss from operations or net loss. For the three and six months ended June 30, 2002, we recognized \$200,000 and \$446,000, respectively, and \$285,000 and \$570,000 for the three and six months ended June 30, 2001, respectively, of equipment revenues that were initially deferred on January 1, 2000.

Reclassifications

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

Recently Issued Accounting Pronouncements

In June 2001, the Financial Accounting Standards Board (FASB) issued SFAS No. 143, Accounting for Asset Retirement Obligations (effective for us on January 1, 2003). This Statement addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. We are in the process of evaluating the financial statement impact of the adoption of SFAS No. 143.

In July 2002, the FASB issued SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities, which is effective for exit or disposal activities that are initiated after December 31, 2002. This statement addresses financial accounting and reporting for costs associated with exit or disposal activities. It nullifies Emerging Issues Task Force (EITF) Issue No. 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring). The principal difference between Statement 146 and Issue 94-3 relates to the recognition of a liability for a cost associated with an exit or disposal activity. Statement 146 requires that a liability be recognized for those costs only when the liability is incurred, that is, when it meets the definition of a liability in the FASB's conceptual framework. In contrast, under Issue 94-3, a company recognized a liability for an exit cost when it committed to an exit plan. Statement 146 also establishes fair value as the objective for initial measurement of liabilities related to exit or disposal activities. We are in the process of evaluating the financial statement impact of the adoption of SFAS No. 146.

4. PROPERTY, PLANT AND EQUIPMENT

	June 30, 2002	December 31, 2001
	(in thousands)	
Building and improvements	\$ 6,492	\$ 3,983
Equipment	926,317	807,730
Furniture and Fixtures	43,978	34,571
Construction in progress	132,246	121,984
	<hr/>	<hr/>
Total property and equipment	\$ 1,109,033	\$ 968,268
	<hr/>	<hr/>

5. LONG-TERM DEBT

	June 30, 2002	December 31, 2001
	(in thousands)	
12.5% Senior Notes due November 15, 2009, net of \$14.0 million and \$14.5 million discount at June 30, 2002 and December 31, 2001, respectively	\$ 210,996	\$ 210,492

Table of Contents

	June 30, 2002	December 31, 2001
	(in thousands)	
14% Senior Redeemable Discount Notes due 2009, net of unamortized discount of \$100.3 million at June 30, 2002 and \$127.7 million at December 31, 2001	419,722	392,337
11% Senior Notes due 2010, interest payable semiannually in cash and in arrears	400,000	400,000
Bank Credit Facility – Term B Loan, interest at Company’s option, calculated on Administrative Agent’s alternate base rate or reserve adjusted London Interbank Offered Rate (LIBOR)	175,000	175,000
Bank Credit Facility – Term C and Term D Loans, interest at Company’s option, calculated on Administrative Agent’s alternate base rate or reserve adjusted LIBOR	200,000	150,000
	<u>\$ 1,405,718</u>	<u>\$ 1,327,829</u>
Total long-term debt	<u>\$ 1,405,718</u>	<u>\$ 1,327,829</u>

Our Notes contain certain covenants that limit, among other things, our ability to: (i) pay dividends, redeem capital stock or make certain other restricted payments or investments, (ii) incur additional indebtedness or issue preferred equity interests, (iii) merge, consolidate or sell all or substantially all of our assets, (iv) create liens on assets and (v) enter into certain transactions with affiliates or related persons. As of June 30, 2002, we were in compliance with all of our required covenants.

Our Term Loans contain financial covenants requiring us to maintain (i) certain defined ratios of senior debt and total debt to EBITDA (net loss before interest expense, interest income, depreciation, amortization and deferred compensation expense) as adjusted, (ii) a minimum interest coverage ratio, (iii) a minimum fixed charge coverage ratio, (iv) a maximum leverage ratio and (v) minimum service revenues, subscriber units and covered population equivalents. As of June 30, 2002, we were in compliance with all of our required covenants.

6. COMMITMENTS AND CONTINGENCIES*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 names as defendants us, John Chapple, our President, Chief Executive Officer and Chairman of the Board, John D. Thompson, our Chief Financial Officer and Treasurer, Goldman Sachs & Co., Credit Suisse First Boston Corporation, Morgan Stanley & Co. Incorporated and Merrill Lynch Pierce Fenner & Smith Incorporated. The complaint alleges that the defendants violated the Securities Act of 1933 and the Securities Exchange Act of 1934 by issuing a registration statement and prospectus 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 rescissionary and/or compensatory damages. We dispute the allegations of the complaint that suggest any wrongdoing on our part or by our officers, and we intend to defend the action vigorously and will pursue all appropriate remedies available to us and our officers.

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 pending claims or legal actions will have a material effect on our financial position or results of operations.

7. RELATED PARTY TRANSACTIONS*Motorola Purchase Agreements*

Pursuant to the equipment purchase agreements between us and Motorola, who currently holds approximately 5.3% of our outstanding common stock, Motorola provided the iDEN infrastructure and subscriber handset equipment to us throughout our markets (such equipment

Edgar Filing: NEXTEL PARTNERS INC - Form 10-Q

purchase agreements, are referred to herein as the Equipment Purchase Agreements). We expect to continue to rely on Motorola for the manufacture of a substantial portion of the equipment necessary to construct our portion of the Nextel digital mobile network and handset equipment for the foreseeable future. The Equipment Purchase Agreements govern our rights and obligations regarding purchases of system infrastructure equipment manufactured by Motorola and others.

Table of Contents

For the three months ended June 30, 2002 and 2001, we purchased approximately \$54.3 million and \$58.4 million, respectively, and \$85.1 million and \$94.4 million for the six months ended June 30, 2002 and 2001, respectively, of infrastructure and other equipment, handsets, warranties and services from Motorola.

The Joint Venture Agreements

We, OPCO and Nextel WIP, who currently holds approximately 32.3% of our outstanding common stock and with whom two of our directors are affiliated, entered into a joint venture agreement (the "Joint Venture Agreement") dated January 29, 1999. The Joint Venture Agreement defines the relationships, rights and obligations between the parties. We are all also parties to a roaming agreement that provides that each party pays the other party's monthly roaming fees in an amount based on the actual system minutes generated by the respective subscribers of each home service provider operating as authorized roamers in the remote service provider's territory. For the three months ended June 30, 2002 and 2001 we earned approximately \$20.0 million and \$14.5 million, respectively, and for the six months ended June 30, 2002 and 2001 we earned approximately \$35.3 million and \$24.1 million, respectively, from Nextel customers roaming on our system, which is included in our service revenues.

During the three months ended June 30, 2002 and 2001, recorded as part of cost of service revenues, we paid Nextel WIP \$21.2 million and \$14.5 million, respectively, and for the six months ended June 30, 2002 and 2001, we paid Nextel WIP \$37.0 million and \$24.2 million, respectively, for services such as specified telecommunications switching services, charges for our customers roaming on Nextel's system and other support costs.

During 2002 we continue to receive transition services from Nextel. These services are limited to Nextel telemarketing and customer care, fulfillment, activations and billing for the national accounts. During the three months ended June 30, 2002 and 2001, we were charged approximately \$736,000 and \$979,000, respectively, and during the six months ended June 30, 2002 and 2001, we were charged approximately \$1.7 million and \$1.6 million, respectively, for these services. Nextel WIP also provides us access to certain back office and information systems platforms on an ongoing basis. We pay to Nextel a fee, based on Nextel's cost, for these services. For the three months ended June 30, 2002 and 2001, we were charged approximately \$375,000 and \$345,000, respectively, and for the six months ended June 30, 2002 and 2001, we were charged approximately \$698,000 and \$623,000, respectively, for these services. Both the transition and back office information services are included in our selling, general and administrative expenses.

Business Relationship

In the ordinary course of business, we have engaged the services of and leased tower space from a company whose stockholder, president, chief executive officer and chairman of the board of directors is one of our directors. For the three and six months ended June 30, 2002, we paid this company \$2.3 million and \$5.0 million, respectively, and \$4.2 million and \$6.0 million for the three and six months ended June 30, 2001, respectively, for these services and tower leases.

Related Party Ownership

The following chart reflects ownership by major related-party stockholders as of June 30, 2002.

Major Stockholder	Class of Stock	Voting %	Equity %
Nextel WIP	Common-Class B	32.25%	30.42%
DLJ Merchant Banking Partners II, LP and affiliates (DLJ Merchant Banking)	Common-Class A	11.64%	10.98%
Madison Dearborn Capital Partners II, LP	Common-Class A	11.10%	10.47%
Eagle River Investments, LLC	Common-Class A	7.95%	7.50%
Motorola, Inc.	Common-Class A	5.33%	5.03%

Table of Contents**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 the Selected Consolidated Financial Data, the consolidated financial statements and the related notes included elsewhere in this report.

Overview

We provide digital wireless communications services in mid-sized and tertiary markets throughout the United States. We hold licenses for wireless frequencies in 58 markets where over 51 million people, or Pops, live and work. We have the right to operate in 15 of the top 100 metropolitan statistical areas in the United States ranked by population and 55 of the top 200 metropolitan statistical areas. As of June 30, 2002, we had commercial operations in markets with total Pops of approximately 51 million and the ability to offer service to, or cover, approximately 36 million Pops. These operational markets are in Alabama, Arkansas, Florida, Georgia, Hawaii, Idaho, Illinois, Indiana, Iowa, Kentucky, Louisiana, Minnesota, Mississippi, Nebraska, New York, North Dakota, Pennsylvania, Tennessee, Texas, Virginia, West Virginia and Wisconsin.

As of June 30, 2002, we had approximately 691,600 digital subscribers. Our subscriber base grew 93% compared to June 30, 2001, when we had an ending subscriber count of approximately 358,900.

The Nextel Wireless Web data service we offer provides Internet-ready telephones with wireless Internet services, including web-based applications and content. As of June 30, 2002, we had approximately 189,000 data subscribers. Average revenue per unit, or ARPU, is an industry term that measures total service revenues per month from our subscribers divided by the average number of digital subscriber units in commercial service for that month. Revenue from data subscribers represents less than \$1.00 of our incremental ARPU and we do not anticipate that revenue from data subscribers will have a significant effect on ARPU in the foreseeable future.

Selected Consolidated Financial Data

We have summarized below our historical consolidated financial data as of and for the three and six months ended June 30, 2002 and 2001. The historical operating data presented below for the same periods are derived from our records.

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2002	2001	2002	2001
	(dollars in thousands)		(dollars in thousands)	
Consolidated Statements of Operations Data:				
Operating revenues:				
Service revenues	\$ 153,418	\$ 82,912	\$ 281,082	\$ 145,995
Equipment revenues	7,668	3,021	13,155	5,484
Total revenues	161,086	85,933	294,237	151,479
Operating expenses:				
Cost of service revenues	66,350	46,668	127,779	80,037
Cost of equipment revenues	23,637	12,885	43,170	24,516
Selling, general and administrative	76,846	49,453	146,916	92,854
Stock-based compensation	2,865	7,931	5,756	15,617

Edgar Filing: NEXTEL PARTNERS INC - Form 10-Q

Depreciation and amortization	23,532	19,825	45,647	34,186
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total operating expenses	193,230	136,762	369,268	247,210
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Operating loss	(32,144)	(50,829)	(75,031)	(95,731)

Edgar Filing: NEXTEL PARTNERS INC - Form 10-Q

Current liabilities	128,423	127,972
Long-term debt	1,405,718	1,327,829
Series B redeemable preferred stock	32,920	31,021
Total stockholders' equity	159,991	319,504
Total liabilities and stockholders' equity	<u>\$1,757,648</u>	<u>\$1,821,721</u>
Other Data:		
Covered Pops (end of period) (millions)	36	29
Subscribers (end of period)	691,600	358,900

Table of Contents

	Six Months Ended June 30,	
	2002	2001
	(dollars in thousands)	
Other Data:		
Cash flows from operating activities	\$ (93,789)	\$ (70,428)
Cash flows from investing activities	\$ (148,190)	\$ (86,803)
Cash flows from financing activities	\$ 49,879	\$ 671
	<u> </u>	<u> </u>
Net decrease in cash and cash equivalents	\$ (192,100)	\$ (156,560)
Cash and cash equivalents, beginning of period	\$ 304,359	\$ 493,552
	<u> </u>	<u> </u>
Cash and cash equivalents, end of period	\$ 112,259	\$ 336,992
	<u> </u>	<u> </u>

(1) Short-term investments include marketable securities and corporate commercial paper with original purchase maturities greater than three months.

(2) EBITDA represents net loss before interest expense, interest income, depreciation, amortization, stock-based compensation expense and loss from disposal of assets. EBITDA is commonly used to analyze companies on the basis of operating performance, leverage and liquidity. While EBITDA should not be construed as a substitute for operating income or loss as a measure of performance or as a better measure of liquidity than cash flow from operating activities, which are determined in accordance with generally accepted accounting principles, we have presented EBITDA to provide additional

information with respect to our ability to meet future debt service, capital expenditure and working capital requirements.

EBITDA is not a measure of financial performance determined under generally accepted accounting principles. Also, EBITDA as calculated above may not be comparable to similarly titled measures reported by other companies.(3) Capital expenditures are exclusive of capitalized interest but include accrued or financed capital. Capital expenditures are required to purchase network equipment, such as switching and radio transmission equipment. Capital expenditures also include purchases of other equipment used for administrative purposes, such as office equipment, computers and telephone systems. These amounts exclude \$628,000 and \$1.7 million of capitalized interest for the three months ended June, 30, 2002 and 2001, respectively, and \$1.1 million and \$3.0 million of capitalized interest for the six months ended June 30, 2002 and 2001, respectively, and are offset by net proceeds from the

transfer of telecommunication towers and related assets of \$785,000 and \$2.5 million for the three months ended June 30, 2002 and 2001, respectively, and \$1.8 million and \$5.5 million for the six months ended June 30, 2002 and 2001, respectively (see Note 3 of the Notes to the Financial Statements).

RESULTS OF OPERATIONS

Three Months Ended June 30, 2002 Compared to Three Months Ended June 30, 2001

Revenues

Our primary sources of revenues are service revenues and equipment revenues. Service revenues increased 85% to \$153.4 million for the three months ended June 30, 2002 as compared to \$82.9 million recognized during the three months ended June 30, 2001. Our service revenues consist of charges for airtime usage and monthly network access fees from providing integrated wireless services within our territory, particularly mobile telephone and two-way radio dispatch services. Service revenues also include roaming revenues from Nextel subscribers using our portion of the Nextel digital mobile network. Roaming revenues for the three months ended June 30, 2002 accounted for approximately 13.0% of our service revenues, as compared to 17.4% for the same period in 2001. 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 continue to decline due to the anticipated revenue growth that we expect from our increasing customer base.

In addition, although we anticipate continued growth in our service revenues during 2002, we have launched all of our markets, other than Burlington, Vermont, and, we therefore do not expect to experience in future years revenue growth rates of the same magnitude as we have experienced in the past.

The following table shows the impact of our accounting policy whereby we defer activation fees and equipment revenue and related costs over a three year period for the three months ended June 30, 2002 and 2001.

Table of Contents

	For the Three Months Ended	
	June 30, 2002	June 30, 2001
(in thousands)		
Revenues:		
Service revenues billed or accrued	\$ 154,436	\$ 83,394
Activation fees deferred	(1,664)	(707)
Previously deferred activation fees recognized	646	225
Total service revenues reported	\$ 153,418	\$ 82,912
Equipment revenues billed	\$ 10,262	\$ 5,788
Equipment revenues deferred	(7,163)	(5,282)
Previously deferred equipment revenues recognized	4,569	2,515
Total equipment revenues reported	\$ 7,668	\$ 3,021
Operating expenses:		
Cost of equipment revenues	\$ 27,249	\$ 16,134
Cost of equipment revenues deferred	(8,827)	(5,989)
Previously deferred cost of equipment revenues recognized	5,215	2,740
Total cost of equipment revenues reported	\$ 23,637	\$ 12,885

Equipment revenues reported for the three months ended June 30, 2002 were \$7.7 million as compared to \$3.0 million reported for the same period in 2001, representing an increase of \$4.7 million, or 157%, due to an increase in our subscriber base. Our equipment revenues consist of revenues received for wireless telephones and accessories purchased by our subscribers. Certain of our digital equipment sales are made through independent distributors under agreements allowing rights of return on merchandise unsold by the distributors.

Total revenues increased 88% to \$161.1 million for the three months ended June 30, 2002 as compared to \$85.9 million generated in the same period in 2001. This growth in revenues was due to launching new markets during 2001 along with increased revenues from existing markets of approximately \$57.4 million, an increase of 83% over the same period in 2001.

For the three months ended June 30, 2002, our ARPU was \$69, which declined \$2 as compared to the three months ended June 30, 2001. We attribute the decrease in ARPU to the maturity of our markets and an increase in competitive pricing plans, offset by an increase in the minutes used by our customers and additional usage of features such as voice mail, short message services and, to a lesser extent, Nextel Wireless Web services and Nextel Worldwide roaming products. While we expect to continue to achieve ARPU levels above the industry average, we anticipate our ARPU to be approximately \$68 for the third quarter of 2002. The following table sets forth our revenues and ARPU:

Revenues
(Dollar amounts in thousands, except for ARPU)

	For the Three Months Ended June 30, 2002	% of Consolidated Revenues	For the Three Months Ended June 30, 2001	% of Consolidated Revenues
Service and roaming revenues	\$ 153,418	95%	\$ 82,912	96%
Equipment revenues	7,668	5%	3,021	4%
Total revenues	\$ 161,086	100%	\$ 85,933	100%

Edgar Filing: NEXTEL PARTNERS INC - Form 10-Q

ARPU⁽¹⁾

\$ 69

\$ 71

(1) ARPU was not adjusted for the deferral of activation fees and phone revenues and does not include roaming revenues generated by Nextel customers that use our portion of the Nextel digital mobile network.

Cost of Service Revenues

Table of Contents

Cost of service revenues consists primarily of network operating costs which involve 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 mobile 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 Nextel Direct Connect services. The use of Nextel Direct Connect is more efficient than interconnect and, accordingly, relatively less costly to provide.

For the three months ended June 30, 2002, our cost of service revenues was \$66.4 million as compared to \$46.7 million for the same period in 2001, representing an increase of 42%. The increase in costs was primarily the result of bringing on-air approximately 1,008 additional cell sites since June 30, 2001, as well as an increase in airtime usage. Increased airtime usage resulted from the growth in the number of customers from 2001 along with the increased minutes of use per customer. As is typical, due to seasonality of the second quarter, we saw a significant increase in minutes of use per average subscriber, which was 609 minutes per average subscriber per month for the second quarter 2002. This is an increase of approximately 9.5% as compared to the second quarter 2001, with 556 minutes of use per average subscriber per month. 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.

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 reported for the three months ended June 30, 2002 was \$23.6 million as compared to \$12.9 million for the same period in 2001. The increase in costs was related mostly to the growth in number of subscribers. As part of our business plan, we often offer our equipment at a discount or as part of a promotion. As a result, the difference between equipment revenues and cost of equipment revenues was a loss of \$16.0 million for the three months ended June 30, 2002, as compared to a loss of \$9.9 million for the same period in 2001. We expect to continue to employ these discounts and promotions in an effort to grow our number of subscribers. Therefore, for the foreseeable future, we expect that cost of equipment revenues will continue to exceed our equipment revenues.

Selling, General and Administrative Expenses

Selling, general and administrative expenses consist of sales and marketing expenses, customer care services and general and administrative costs. For the three months ended June 30, 2002, selling, general and administrative expenses were \$76.8 million as compared to \$49.5 million for the same period in 2001, representing an increase of 55%.

Sales and marketing expenses increased as a result of:

- increased sales and marketing activities to launch markets and grow our customer base;
- our hiring of additional sales and marketing employees to accommodate the growth in new and existing markets; and
- higher expenses related to a greater proportion of sales received from indirect distribution channels.

General and administrative costs relate to corporate personnel including tax, legal, planning, human resources, information technology, treasury, accounting and our customer care center operations. Our general and administrative costs increased as a result of our:

- hiring employees for our functional departments and offices to support the growth of the new and existing markets;
- increasing staffing and operating our customer care and fulfillment service center in Las Vegas, Nevada and Panama City Beach, Florida to support the growing customer base;
- hiring employees to maintain and support systems; and
- conversion to a new billing system.

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 in the foreseeable future. However, we expect our acquisition cost per customer to decrease as we continue to increase the amount of sales from our lower cost distribution channels, decrease equipment subsidies and work on increasing the productivity of our direct sales representatives.

Table of Contents*Stock-Based Compensation Expense*

For the three months ended June 30, 2002 and 2001, we recorded stock-based compensation expense associated with our grants of restricted stock and employee stock options granted of \$2.9 million and \$7.9 million, respectively. This is a non-cash expense. We expect stock based compensation expense to decrease as the options continue to vest.

Depreciation and Amortization Expense

For the three months ended June 30, 2002, our depreciation and amortization expense was \$23.5 million as compared to \$19.8 million for the same period in 2001, representing an increase of 19%. The \$3.7 million increase related primarily to depreciating the wireless network assets for the 1,008 additional cell sites placed in service from June 30, 2001, along with the costs related to furniture and equipment purchased to set up new offices. We expect depreciation to continue to increase due to the additional cell sites we plan to place in service. Additionally, in accordance with SFAS No. 142, Goodwill and Other Intangible Assets, we have determined that our FCC licenses have an indefinite life, and, as such, have discontinued amortization on our FCC licenses as of January 1, 2002.

Interest Expense and Interest Income

Interest expense, net of capitalized interest, increased from \$29.3 million for the three months ended June 30, 2001 to \$42.2 million for the three months ended June 30, 2002, representing an increase of 44%. The increase was due to interest on the 12.5% senior notes for \$225 million that we issued in December 2001 as well as the additional \$50 million term loan we closed in February 2002. Additionally, for the three months ended June 30, 2002, approximately \$2.0 million related to the charge for the fair market value adjustments of our interest rate swaps.

For the three months ended June 30, 2002, interest income was \$2.1 million, as compared to \$9.1 million for 2001, representing a decrease of 77%. This decrease was due to a decline in interest rates on our short-term investments and a reduction in our cash balance because of additional spending related to the network build-out.

Net Loss

For the three months ended June 30, 2002, we had a loss attributable to common stockholders of approximately \$75.0 million as compared to a loss of \$71.8 million for the same period in 2001, representing an increase of 4%. The \$75.0 million loss includes a non-cash, non-operating charge of \$1.8 million included as income tax expense to increase the valuation allowance related to our net operating losses in connection with the required adoption of SFAS 142. Expenses increased in all categories as we launched new markets, added subscriber usage to the network, hired staff for functional departments and offices, and increased marketing and sales activities for the existing and newly launched markets.

Six Months Ended June 30, 2002 Compared to Six Months Ended June 30, 2001*Revenues*

Service revenues increased 93% to \$281.1 million for the six months ended June 30, 2002 as compared to \$146.0 million recognized during the six months ended June 30, 2001. Roaming revenues for the six months ended June 30, 2002 accounted for approximately 12.5% of our service revenues, as compared to 16.4% for the same period in 2001.

The following table shows the impact of our accounting policy whereby we defer activation fees and equipment revenue and related costs over a three-year period for the six months ended June, 2002 and 2001.

	For the Six Months Ended	
	June 30, 2002	June 30, 2001
	(in thousands)	
Revenues:		
Service revenues billed or accrued	\$ 283,000	\$ 146,828
Activation fees deferred	(3,069)	(1,228)

Table of Contents

	For the Six Months Ended	
	June 30, 2002	June 30, 2001
	(in thousands)	
Previously deferred activation fees recognized	1,151	395
Total service revenues reported	\$ 281,082	\$ 145,995
Equipment revenues billed	\$ 19,367	\$ 10,318
Equipment revenues deferred	(14,700)	(9,455)
Previously deferred equipment revenues recognized	8,488	4,621
Total equipment revenues reported	\$ 13,155	\$ 5,484
Operating expenses:		
Cost of equipment revenues	\$ 51,300	\$ 30,183
Cost of equipment revenues deferred	(17,769)	(10,683)
Previously deferred cost of equipment revenues recognized	9,639	5,016
Total cost of equipment revenues reported	\$ 43,170	\$ 24,516

Equipment revenues reported for the six months ended June 30, 2002 were \$13.2 million as compared to \$5.5 million reported for the same period in 2001, representing an increase of \$7.7 million, or 140%, due to an increase in our subscriber base.

Total revenues increased 94% to \$294.2 million for the six months ended June 30, 2002 as compared to \$151.5 million generated in the same period in 2001. This growth in revenues was due to launching new markets during 2001 along with increased revenues from existing markets of approximately \$110.7 million, an increase of 90% over the same period in 2001.

For the six months ended June 30, 2002 our ARPU was \$68, which is a \$3 decline compared to the six months ended June 30, 2001. We attribute the decrease in ARPU to the maturity of our markets and an increase in competitive pricing plans, offset by an increase in the minutes used by our customers and additional usage of features such as voice mail, short message services and, to a lesser extent, Nextel Wireless Web services and Nextel Worldwide roaming products. The following table sets forth our revenues and ARPU:

Revenues
(Dollar amounts in thousands, except for ARPU)

	For the Six Months Ended June 30, 2002	% of Consolidated Revenues	For the Six Months Ended June 30, 2001	% of Consolidated Revenues
Service and roaming revenues	\$ 281,082	96%	\$ 145,995	96%
Equipment revenues	13,155	4%	5,484	4%
Total revenues	\$ 294,237	100%	\$ 151,479	100%
ARPU ⁽¹⁾	\$ 68		\$ 71	

(1)

Edgar Filing: NEXTEL PARTNERS INC - Form 10-Q

ARPU was not adjusted for the deferral of activation fees and phone revenues and does not include roaming revenues generated by Nextel customers that use our portion of the Nextel digital mobile network.

Cost of Service Revenues

For the six months ended June 30, 2002, our cost of service revenues was \$127.8 million as compared to \$80.0 million for the same period in 2001, representing an increase of 60%. The increase in costs was primarily the result of bringing on-air approximately 1,008 additional cell sites since June 30, 2001, as well as an increase in airtime usage from 524 minutes of use per average subscriber per month for the six months ended June 30, 2001 to 574 minutes of use per average subscriber per month for the six months ended June 30, 2002. Increased airtime usage resulted from the 93% growth in the number of customers from 2001 along with the 9.5% increase in minutes of use per average subscriber per month.

Cost of Equipment Revenues

Our cost of equipment revenues for the six months ended June 30, 2002 was \$43.2 million as compared to \$24.5 million for the same period in 2001. The increase in costs was related mostly to the growth in number of subscribers. As part of our business plan, we often offer our equipment at a discount or as part of a promotion. As a result, the difference between equipment revenues and cost

Table of Contents

of equipment revenues was a loss of \$30.0 million for the six months ended June 30, 2002, as compared to a loss of \$19.0 million for the same period in 2001. We expect to continue to employ these discounts and promotions in an effort to grow our number of subscribers.

Selling, General and Administrative Expenses

For the six months ended June 30, 2002, selling, general and administrative expenses were \$146.9 million as compared to \$92.9 million for 2001, representing an increase of 58%.

Stock-Based Compensation Expense

For the six months ended June 30, 2002 and 2001, we recorded stock-based compensation expense associated with our grants of restricted stock and employee stock options granted of \$5.8 million and \$15.6 million, respectively.

Depreciation and Amortization Expense

For the six months ended June 30, 2002, our depreciation and amortization expense was \$45.6 million as compared to \$34.2 million for the same period in 2001, representing an increase of 33%. The \$11.4 million increase related primarily to depreciating the wireless network assets for the 1,008 additional cell sites placed in service from June 30, 2001, along with the costs related to furniture and equipment purchased to set up new offices. Additionally, in accordance with SFAS No. 142, Goodwill and Other Intangible Assets, we have determined that our FCC licenses have an indefinite life, and, as such, have discontinued amortization on our FCC licenses as of January 1, 2002.

Interest Expense and Interest Income

Interest expense, net of capitalized interest, increased from \$61.5 million for the six months ended June 30, 2001 to \$80.2 million for the six months ended June 30, 2002, representing an increase of 30%. The increase was due to interest on the 12.5% senior notes for \$225 million that we issued in December 2001 as well as the additional \$50 million term loan we closed in February 2002. Additionally, for the six months ended June 30, 2002, approximately \$595,000 of our interest expense related to the non-cash charge for the fair market value adjustments of our interest rate swaps.

For the six months ended June 30, 2002, interest income was \$4.5 million, as compared to \$22.6 million for 2001, representing a decrease of 80%. This decrease was due to a decline in interest rates on our short-term investments and a reduction in our cash balance because of additional spending related to the network build-out.

Net Loss

For the six months ended June 30, 2002, we had a loss attributable to common stockholders of approximately \$166.6 million as compared to a loss of \$138.0 million for 2001, representing an increase of 21%. The \$166.6 million loss includes a non-cash charge of \$14.1 million as income tax expense to increase the valuation allowance related to our net operating losses in connection with the required adoption of SFAS 142. The \$138.0 million loss for 2001 includes a charge of approximately \$1.8 million relating to the implementation of SFAS 133. Expenses increased in all categories as we launched new markets, added subscriber usage to the network, hired staff for functional departments and offices, and increased marketing and sales activities for the existing and newly launched markets.

Liquidity and Capital Resources

Our primary liquidity needs arise from the capital requirements necessary to complete the build-out of our portion of the Nextel digital mobile network and expand or enhance coverage in our existing markets, including the future acquisitions of additional frequencies, installing new switches and the introduction of new services. 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; and cell site construction.

For the six months ended June 30, 2002, we used \$93.8 million in cash for operating activities, as compared to \$70.4 million for the same period in 2001. The increased use of funds for operating activities in 2002 was primarily due to hiring employees, setting

Table of Contents

up functional departments and offices, network operating costs for additional sites placed in service, increased marketing and sales activities along with purchasing an inventory of telephones and accessories and an increase in receivables due to additional customers.

Net cash used in investing activities during the six months ended June 30, 2002 was \$148.2 million, an increase of \$61.4 million as compared to the same period in 2001. The increase in cash used in investing activities for 2002 was due primarily to a decrease in proceeds from the sale of short-term investments, as well as an increase in expenditures related to FCC licenses. During the first six months of 2002, we invested \$142.7 million in capital expenditures, excluding \$585,000 of non-cash capitalized interest, spent primarily to build out the Nextel digital mobile network in Vermont and expand coverage on the Nextel digital mobile network in our existing markets. In addition, we completed construction of our switch in Iowa and continued work on our switch in Florida, which is expected to come on-line during the second half of 2002. The additional switch in Florida is expected to eventually result in an expense savings by reducing our switch-sharing costs. We also invested \$34.4 million, excluding \$27,000 of non-cash capitalized interest, in FCC licenses during the six months ended June 30, 2002. We continue to anticipate our total capital spending will be approximately \$315 million for 2002.

As of June 30, 2002, our cash and cash equivalents and short-term investments balance was approximately \$332.8 million, which includes the net proceeds of approximately \$205.4 million from the issuance of our 12.5% senior discount notes in December 2001, compared to \$557.3 million as of December 31, 2001. In February 2002, we also amended our credit facility to obtain an additional \$50 million of senior bank debt. In addition, we have access to an undrawn line of credit of \$100 million. While we believe we have sufficient funds to continue the build-out of our portion of the Nextel digital mobile network to cover approximately 36 million Pops using the current 800 MHz iDEN system; acquire additional frequencies; install additional switches; and provide us with the working capital necessary to cover our debt service requirements and operating losses through 2003 (after which time we anticipate achieving positive free cash flow for the full fiscal year), we cannot assure you that additional funding will not be necessary. Additionally, to the extent we decide to expand our digital mobile network or implement a 3G technology, we would 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, market conditions and other factors that may be beyond our control.

The following table provides details regarding our contractual cash obligations subsequent to June 30, 2002:

Payments due by Period
(in thousands)

Contractual Obligations	Total	2002	2003	2004	2005	2006	Thereafter
Long-term Debt	\$ 1,520,000	\$	\$ 1,688	\$ 3,750	\$ 3,750	\$ 3,750	\$ 1,507,062
Redeemable Preferred Stock	\$ 82,107	\$	\$	\$	\$	\$	\$ 82,107
Operating Leases	\$ 260,380	\$30,819	\$59,928	\$56,399	\$43,614	\$23,766	\$ 45,854
Total Contractual Obligations	\$1,862,487	\$30,819	\$61,616	\$60,149	\$47,364	\$27,516	\$1,635,023

Sources of Funding

To date, third-party financing activities have provided all of our funding. As of June 30, 2002 these financings totaled approximately \$2.1 billion and included:

proceeds from cash equity contributions of \$202.8 million;

the offering of 14% senior discount notes for \$406.4 million, less \$191.2 million for the partial redemption of these notes in April 2000;

term loans incurred by our operating subsidiary in the aggregate principal amount of \$375.0 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;

Table of Contents

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;

the offering of 11% senior notes for \$200 million in March 2000;

the offering of an additional \$200 million in 11% senior notes in July 2000; and

the offering of 12.5% senior discount notes for \$210.4 million in December 2001.

Nextel Partners Operating Corp., one of our wholly owned subsidiaries, entered into a credit facility in January 1999 with a syndicate of banks and other financial institutions led by Donaldson, Lufkin & Jenrette Securities Corporation, as arranger, DLJ Capital Funding, as syndication agent, and Bank of Montreal, as administrative agent. This credit facility was amended and restated in September 1999 and further amended on March 10, 2000, January 25, 2001 and January 21, 2002. On February 5, 2002, we closed the transaction to amend our existing \$150 million credit facility to provide for an additional \$50 million term D loan. Currently, the credit facility, as amended, includes a \$175 million term B loan, a \$150 million term C loan, a \$50 million term D loan and a \$100 million reducing revolving credit facility. The credit facility may not exceed \$475 million. The \$175 million term B loan matures on January 29, 2008, and the \$150 million term C and \$50 million term D loans mature on July 29, 2008. The revolving credit facility will terminate on January 29, 2007. As of June 30, 2002, \$375 million of term loans were outstanding and no amounts were outstanding under the \$100 million revolving credit facility.

The term B, C and D loans all bear interest, at our option, at the administrative agent's alternate base rate or reserve-adjusted London Interbank Offering Rate (LIBOR) plus, in each case, applicable margins. The applicable margin for the term B loan is 4.75% over LIBOR and 3.75% over the base rate of the higher of 0.5% per annum above the latest federal funds rate or the prime rate. The applicable margin for the term C and D loans is 4.25% over LIBOR and 3.25% over the base rate. For the revolving credit facility, the initial applicable margin is 4.25% over LIBOR and 3.25% over the base rate until consolidated EBITDA is positive, at which time the applicable margin will be initially 4.0% over LIBOR and 3.0% 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 2.25% and 3.75% over LIBOR and between 1.25% and 2.75% over the base rate. As of June 30, 2002, the interest rates on the \$175 million term B loan, the \$150 term C loan and the \$50 million term D loan were 6.61%, 6.14% and 6.17%, respectively.

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.

Equipment and Operating Agreements

Currently, our agreements with Nextel WIP allow us access to Nextel's switches and switching facilities. Nextel WIP has agreed to cooperate with us to establish a switch facility for our network and to deploy switches in our territory in a manner which best meets the following criteria:

integration of our cell sites into Nextel's national switching infrastructure;

shared coverage of Nextel Direct Connect service to communities of interest;

minimized costs to us and to Nextel; and

maximized quality of service to our customers and to Nextel customers.

These criteria provide for a flexible construction schedule of switches to serve our territory, depending on the existing switches in Nextel's territory and the amount of customer traffic handled by any one switch. We have the option of installing our own switching facilities within our territory. However, our deployment of any switching facility requires coordination with Nextel WIP and may require Nextel WIP's approval. Our agreements with Nextel WIP require us to implement and install appropriate switch elements as the number of our subscribers and cell site levels increases. For example, we will need to install a mobile switching office for every 120,000 subscriber units or a base site controller for every 50 operational cell sites. We believe that we have sufficient funds for these installations under our current business plans. We now have four switches in operation with the most recent switch in Iowa placed in

Table of Contents

operation during the first quarter of 2002. We are currently working on another switch in Florida with an expected operational date during the second half of 2002.

Additionally, during first quarter of 2002 we opened our second customer support facility in Panama City Beach, Florida. We occupied this facility in January and started to answer customer calls during February.

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. 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 Note 3 Significant Accounting Policies in Item 1 of Part I, Financial Statements (Unaudited) of this Form 10-Q, and Note 2 Operations and Significant Accounting Policies in Item 8 of Part II, Financial Statements and Supplementary Data, of our Annual Report on Form 10-K for the year ended December 31, 2001. 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 revenue for airtime and other services over the service period, net of credits and adjustments for service discounts. We also recognize revenues for sale of accessory equipment when title passes, which is upon shipping the accessory to the customer. Certain of our telephone and accessory equipment sales are also made through independent distributors under agreements allowing rights of return on merchandise unsold by the distributors.

In conjunction with the implementation of SAB 101, our activation fees and phone revenues are deferred and recognized over three years, the expected life of the customer relationship. The decision to defer these revenues is based on the conclusion that the service contract and the phone revenue are multiple element arrangements or earnings processes that should not be separated. In other words, the service contract is essential to the functionality of the phone. Concurrently, the related costs for the phone equipment are deferred to the extent of deferred revenues, resulting in no change to EBITDA or net loss. The direct and incremental phone costs in excess of revenues generated from phone sales are expensed immediately as the amounts exceed our minimum contractual revenue.

Capitalization and Depreciation of Fixed Assets

We are inherently capital intensive with the build out of the 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 based on 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.

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 the digital network, we include costs that are required to get the mobile network ready for commencement or capable of generating billable revenues.

FCC Licenses

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 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 asset impairment analysis on our FCC licenses in accordance with SFAS No. 142 and determined there was no impairment related to our FCC licenses.

Table of Contents

In connection with the adoption of SFAS 142, we recorded a non-cash income tax provision of \$12.3 million to increase the valuation allowance related to our net operating loss. This charge is required because we have significant deferred tax liabilities related to FCC licenses with a lower tax 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. Since 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.

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. In March 2002, we entered into agreements to purchase additional 800 MHz SMR frequencies covering portions of the Rio Grande area of Texas, subject to FCC approval and other standard closing conditions, for aggregate consideration of approximately \$32.6 million. During the second quarter of 2002, we completed the transaction.

Impairment of Long-Lived Assets

Our long-lived assets consist principally of property, plant and equipment and FCC licenses. It is our policy to assess impairment of long-lived assets pursuant with SFAS 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. This includes determining if certain factors 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. Thus far, we believe none of these factors have occurred.

Recently Issued Accounting Pronouncements

In June 2001, the Financial Accounting Standards Board issued SFAS No. 143, *Accounting for Asset Retirement Obligations* (effective for us on January 1, 2003). This Statement addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. We are in the process of evaluating the financial statement impact of the adoption of SFAS No. 143.

In July 2002, the FASB issued SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*, which is effective for exit or disposal activities that are initiated after December 31, 2002. This statement addresses financial accounting and reporting for costs associated with exit or disposal activities. It nullifies EITF Issue No. 94-3, *Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)*. The principal difference between Statement 146 and Issue 94-3 relates to the recognition of a liability for a cost associated with an exit or disposal activity. Statement 146 requires that a liability be recognized for those costs only when the liability is incurred, that is, when it meets the definition of a liability in the FASB's conceptual framework. In contrast, under Issue 94-3, a company recognized a liability for an exit cost when it committed to an exit plan. Statement 146 also establishes fair value as the objective for initial measurement of liabilities related to exit or disposal activities. We are in the process of evaluating the financial statement impact of the adoption of SFAS No. 146.

Related Party Transactions

Motorola Purchase Agreements

Pursuant to the equipment purchase agreements between us and Motorola, who currently holds approximately 5.3% of our outstanding common stock, Motorola provides the iDEN infrastructure and subscriber handset equipment to us throughout our markets. We expect to continue to rely on Motorola for the manufacture of a substantial portion of the equipment necessary to construct our portion of the Nextel digital mobile network and handset equipment for the foreseeable future. The equipment purchase agreements govern our rights and obligations regarding purchases of system infrastructure equipment manufactured by Motorola and others.

Table of Contents

For the three months ended June 30, 2002 and 2001, we purchased approximately \$66.0 million, \$58.4 million, respectively, and \$85.1 million and \$94.4 million for the six months ended June 30, 2002 and 2001, respectively, of infrastructure and other equipment, handsets, warranties and services from Motorola.

Nextel Operating Agreements

We, our operating subsidiary and Nextel WIP, who currently holds approximately 32.3% of our outstanding common stock and with whom two of our directors are 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 mobile 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 June 30, 2002 and 2001 we earned approximately \$20.0 million and \$14.5 million, respectively, and for the six months ended June 30, 2002 and 2001 we earned approximately \$35.3 million and \$24.1 million, respectively, from Nextel customers roaming on our system, which is included in our service revenues.

During the three months ended June 30, 2002 and 2001, recorded as part of cost of service revenues, we paid Nextel WIP \$21.2 million and \$14.5 million, respectively, and for the six months ended June 30, 2002 and 2001, we paid Nextel WIP \$37.0 million and \$24.2 million, respectively, for services such as specified telecommunications switching services, charges for our customers roaming on Nextel's system and other support costs.

During 2002 the transition services that were still required from Nextel were limited to Nextel telemarketing and customer care, fulfillment, activations and billing for the national accounts. During the three months ended June 30, 2002 and 2001, we were charged approximately \$736,000 and \$979,000, respectively, and during the six months ended June 30, 2002 and 2001, we were charged approximately \$1.7 million and \$1.6 million, respectively, for these services. Nextel WIP also provided us access to certain back office and information systems platforms on an ongoing basis. We pay to Nextel a fee, based on Nextel's cost, for these services. For the three months ended June 30, 2002 and 2001, we were charged approximately \$375,000 and \$345,000, respectively, and for the six months ended June 30, 2002 and 2001, we were charged approximately \$698,000 and \$623,000, respectively. Both the transition and back office information services are included in selling, general and administrative expenses.

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

Business Relationship

In the ordinary course of business, we have engaged the services of and leased tower space from American Tower Corporation, of which Mr. Dodge, one of our directors, is a stockholder, president, chief executive officer and chairman of the board of directors. During the three and six months ended June 30, 2002 we paid American Tower Corporation \$2.3 million, and \$5.0 million, respectively, and for the three and six months ended June 30, 2001, we paid \$4.2 million and \$6.0 million, respectively, for these services and tower leases.

DLJ Merchant Banking Relationship

Donaldson, Lukfin & Jenrette Securities Corporation and Credit Suisse First Boston have served as initial purchasers of our senior notes and senior discount notes and received customary discounts and commissions in connection with each such offering. Donaldson, Lukfin & Jenrette Securities Corporation also acted as our financial advisor and as arranger, and DLJ Capital Funding, Inc., an affiliate of Donaldson, Lufkin & Jenrette Securities Corporation, acted as syndication agent, under our credit facility, and received customary fees and reimbursements in connection therewith. DLJ Merchant Banking and certain related parties, all of which are affiliates of Donaldson, Lufkin & Jenrette Securities Corporation, currently own approximately 11.6% of our outstanding common stock through their affiliate, Credit Suisse First Boston, and are represented on our Board of Directors. Donaldson, Lufkin & Jenrette Securities Corporation was a co-lead manager of the initial public offering of our Class A Common Stock, and we may from time to time enter into other investment banking relationships with it or one of our affiliates. The aggregate amount of all fees paid to the Credit Suisse and the DLJ Entities in connection with the capitalization transactions from inception through June 30, 2002 is approximately \$29.9 million.

Recent Developments

Table of Contents

On July 24, 2002, we announced the addition of two new members to our board of directors. As a part of their board participation, these new members will also serve on our audit committee.

On July 31, 2002, we entered into a participation agreement with GE Capital Corporation for a sale-leaseback of certain switch equipment that will result in aggregate net proceeds to us of approximately \$28 million. The first closing of this transaction was held on July 31, 2002 and resulted in a payment to us of \$13.8 million. We anticipate the second and final closing to be held in October 2002.

Table of Contents

RISK FACTORS

The following risk factors and other information included in this Quarterly Report 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, financial condition, operating results and cash flows could be materially adversely affected.

We have a history of operating losses, expect to continue to incur substantial 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 mobile network we acquired on that date only had a few months of operating history. Since then, we have had a history of operating losses, and, as of June 30, 2002, we had an accumulated deficit of approximately \$863.6 million. We expect to continue to incur substantial operating losses and to generate negative cash flow from operating activities at least through 2003. We cannot assure you that we will become profitable or 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 their brand and the Motorola iDEN technology. If Nextel encounters financial problems or operating difficulties relating to their portion of the Nextel digital mobile network or experiences a significant decline in customer acceptance of their 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, their domestic digital mobile network business and the risks associated with that business can be found in Nextel's 10-K Annual Report on Form 10-K for the year ended December 31, 2001, as well as Nextel's other filings made under the Securities Act of 1933 and the Securities Exchange Act of 1934 (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 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.

Any failure to integrate our portion of the Nextel digital mobile network with Nextel's portion effectively or on schedule 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 successful integration of our portion of the Nextel digital mobile 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 mobile network to operate together, and 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 or on schedule may have an adverse effect on our results of operations.

Table of Contents

Difficulties in constructing and operating our portion of the Nextel digital mobile network could increase the estimated costs and delay the continued expansion of the network, which would adversely affect our ability to generate revenue.

The continued operation of our portion of the Nextel digital mobile network involves a high degree of risk. Before we are able to build additional cell sites in our markets to expand coverage, fill in holes in coverage or to 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; and
- obtain necessary approvals, licenses and permits from federal, state and local agencies, including land use regulatory approvals and approval 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 mobile 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 mobile network on a timely basis may 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 mobile network to specific standards, and to offer certain services by Nextel and its domestic subsidiaries. Our failure to satisfy these obligations could constitute a material 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.

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 their 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 their operating agreements with us. Even if the required change is beneficial to Nextel, the effect on

Table of Contents

our business may differ 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 mobile 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 technology that may perform better or are 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.

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, and we rely, and expect to continue to rely, on Motorola to manufacture a substantial portion of the equipment necessary to construct our portion of the Nextel digital mobile network. We expect that for the next few years, Motorola, and competing manufacturers who are licensed by Motorola, will be the only manufacturers of wireless telephones that are compatible with the Nextel digital mobile 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 their 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. 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. 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 third-generation or 3G. We and Nextel are focusing activities on maximizing our ability to offer 3G capabilities while continuing to fully utilize our iDEN digital mobile network. Significant capital expenditures would be required in implementing this third-generation technology, and there can be no guarantee 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 third-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 third-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 third-generation technology that is more effective or economical than ours, our business may be adversely affected.

Table of Contents

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 spectrum, we may still require additional capital to finance the pursuit of any new business opportunities associated with our acquisitions of additional spectrum, including those associated with the potential provision of any new third-generation or 3G wireless services. This additional capital may not be available.

We cannot be sure that any future spectrum auctions will occur or, if so, occur on their currently announced schedules. For example, the Federal Communications Commission already has postponed on several occasions the first auction of the reallocated 700 MHz spectrum now being used by broadcast television stations, and that auction is currently scheduled for August 27, 2002. We also cannot be sure:

in which auctions we will participate, alone or as a member of a bidding group;

whether we or any bidding group in which we are a participant will be a successful bidder and will be awarded spectrum licenses in any auction; and

what amounts would be required to be bid to prevail in any auction.

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 mobile 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 mobile network, we may have difficulty attracting and retaining customers, which would adversely affect our revenues.

Because the Nextel digital mobile network does not provide roaming 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 have the extensive direct and indirect channels of distribution for the Nextel digital mobile network products and services that are available to some of our competitors. The lack of these distribution channels could adversely affect our operating results. 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, some of our competitors may be able to offer services to customers at prices that are below the prices that we can offer for comparable services. If we cannot, as a result, compete effectively based on the price of our 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. 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 can: segment the user markets, which could reduce demand for specific technologies, including our technology;

Table of Contents

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 adversely affect market acceptance of our services.

In 2000, we began to offer our subscribers access to digital two-way mobile data and Internet connectivity under the brand name Nextel Wireless Web. 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 revenue. Because we have less spectrum than some of our competitors, and because we have elected to defer the implementation of third generation or 3G 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 mobile 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.

If either personal communication services or cellular operators provide two-way radio dispatch or comparable capabilities in the future, our competitive advantage may be impaired. Further, some of our competitors have attempted to compete with the Nextel Direct Connect service by offering unlimited mobile-to-mobile calling plan features and reduced rate calling plan features for designated small 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.

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 mobile network service offering prices; restructure our digital mobile 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, 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 unique multi-service offering. This may reduce our growth opportunities or profitability.

Recent agreements between competitors in some of our markets to share network construction efforts will reportedly reduce their costs and increase their coverage area. These agreements, along with future agreements, may increase market pressure for us to reduce our prices and expand our coverage areas.

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

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

the ability to obtain additional spectrum when and where required;

the availability of wireless telephones 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 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.

We have potential systems limitations on adding customers, which may adversely affect our growth and performance.

Table of Contents

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

inadequate or inefficient systems, business process and related support functions especially as 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.

Our highly leveraged capital structure and other factors could limit our ability to obtain additional financing and our growth opportunities.

The level of our outstanding debt greatly exceeds the level of our revenues and stockholders' equity. As of June 30, 2002, we had approximately \$1.4 billion of total long-term debt outstanding, including \$375 million outstanding under our credit facility, \$419.7 million of 14% senior discount notes outstanding at their accreted value, \$400 million of 11% senior notes outstanding and \$211.0 million of 12.5% senior discount notes outstanding at their accreted value. This indebtedness represented approximately 88% of our total book capitalization at that date. As of June 30, 2002, we also had \$32.9 million of mandatorily redeemable preferred stock outstanding, including accrued dividends.

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 continue the build-out of or implement any enhancement of our portion of the Nextel digital mobile network including any enhanced iDEN services to expand wireless voice capacity, enhanced data services or potential third generation or 3G 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 build-out, 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 to meet our estimated capital requirements to build out our portion of the Nextel digital mobile network using the current 800 MHz iDEN system until we become free cash flow positive, which we anticipate will not occur before 2004.

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, our obligations under our credit facility or our existing senior discount 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.

General conditions in the wireless communications industry or specific competitors' results, including potential slowing of new subscriber additions, declining ARPU or increased customer dissatisfaction, may adversely affect the market price of our Class A

Table of Contents

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.

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

Our credit facility and the indentures governing our existing senior notes and senior discount notes 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 which require our principal subsidiary to comply with specified financial ratios and tests, including minimum interest coverage ratios, maximum leverage ratios, minimum service revenues, minimum subscriber units and covered Pops, minimum EBITDA requirements 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 could adversely affect our ability to carry out our business plan and would have a negative impact on our financial condition.

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

Upon the occurrence of a defined change of control under the indentures governing our existing senior discount notes and senior notes, other than a change of control involving certain of our existing stockholders, we could be required to redeem our existing senior discount notes and senior notes. However, our credit facility prohibits us, except under certain circumstances, from redeeming 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 our outstanding notes our failure to redeem 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 could 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 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 build out and operate our portion of the Nextel digital mobile 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. We believe that there is and will continue to be intense competition for qualified personnel in the wireless communications industry. We may not be successful in retaining our key personnel or in attracting and retaining other 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.

Table of Contents

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 portable 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.

Litigation by individuals alleging injury from health effects associated with radio frequency emissions from mobile phones 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 wireless 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. The passage of this type of legislation could decrease demand for our services.

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. New rules and regulations may be adopted pursuant to the Communications Act of 1934, as amended. While the Telecommunications Act of 1996 provided for significant deregulation of the U.S. telecommunications industry, certain FCC rules regulating it remain subject to judicial review and additional FCC rulemaking. As a result, we cannot predict the effect that this or other legislation or any 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.

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 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 their rights to acquire additional shares of our stock under the terms of the amended 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 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. 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

Table of Contents

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 June 30, 2002, our officers, directors and greater than 5% stockholders together controlled approximately 72.0% of our outstanding common stock. As a result, these stockholders, if they act together, will be able to control the management and affairs of our company and all 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 shareholders' agreement, Nextel WIP, Madison Dearborn Partners and Eagle River each have the right to designate a member to our eight-member board of directors. We cannot be certain that any conflicts that arise between the interests of our company 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.

DLJ Merchant Banking, Madison Dearborn Partners and Eagle River each own significant amounts of our capital stock and each 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 noncompetition agreement with any of our stockholders, and thus their or their affiliates' current and future investments could create conflicts of interest.

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

Provisions of our charter documents, amended shareholders' agreement, operating agreements and Delaware law may discourage, delay or prevent a merger or other change of control 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 provisions in our credit facility and the indentures governing our senior discount 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.

Our Series B preferred stock has a liquidation preference to our common stock, can be redeemed by us at any time and must be redeemed for cash in February 2010.

Upon a liquidation of our company, holders of our Series B preferred stock would be entitled to receive, prior to receipt of any funds by the holders of our common stock, an aggregate liquidation preference equal to \$21.9 million, plus dividends accrued on such amount from the date of issuance up to the liquidation date equal to 12% per annum of the aggregate liquidation preference, compounded quarterly. As of June 30, 2002, we had \$32.9 million of Series B preferred stock outstanding, including accrued dividends. In addition, we can redeem all of our Series B preferred stock at any time upon payment of the accreted liquidation preference, subject to the covenants in our debt instruments. Pursuant to our restated certificate of incorporation, we must redeem all of our Series B preferred stock in February 2010, and we cannot guarantee that we will have sufficient cash from operations at that time to make such redemption. In the event that we default on our redemption obligations, the accreted liquidation preference will continue to accrue until we fulfill our redemption obligations in full.

Table of Contents

Our stock price has been and is likely to continue to be volatile.

The market price of our Class A common stock has been volatile in the past and is likely to continue to be volatile and could be subject to wide fluctuations in response to factors such as the following, some of which are beyond our control:

quarterly variations in our or Nextel's operating results;

variations in our or Nextel's operating results from the expectations of securities analysts and investors;

changes in expectations as to our or Nextel's future financial performance, including financial estimates by securities analysts and investors;

changes in laws and regulations affecting the telecommunications industry;

announcements of significant claims or proceedings against us;

changes in market valuations of Nextel or other telecommunications companies;

announcements of technological innovations or new services by us, Nextel or our competitors;

announcements by us, Nextel or our competitors of significant contracts, acquisitions, strategic partnerships, joint ventures or capital commitments;

negative publicity regarding the telecommunications industry as a result of recent announcements regarding certain accounting issues, corporate governance matters and financial difficulties at other telecommunications companies;

additions or departures of key personnel;

future sales of our Class A common stock; and

volume fluctuations.

Table of Contents

FORWARD-LOOKING STATEMENTS

Our forward-looking statements are subject to a variety of factors that could cause actual results to differ materially from current beliefs.

Some statements and information contained in this Quarterly Report are not historical facts, but are forward-looking statements. They can be identified by the use of forward-looking words such as believes, expects, plans, may, will, would, could, should, estimates or a 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. We warn you that these forward-looking statements are only predictions, subject to risks and uncertainties. Actual events or results can differ materially from those expressed or implied as a result of a variety of factors, including those set forth above under Risk Factors. Such forward-looking statements include, but are not limited to, statements with respect to the following:

our plan for meeting our scheduled build-out for commercial launch of markets within our portion of the Nextel digital mobile network;

our business plan, its advantages and our strategy for implementing our plan;

general economic conditions in the geographic areas and occupational markets that we are targeting in our portion of the Nextel digital mobile network;

our expectation regarding the continued successful performance and market acceptance of the technology we use;

our ability to attract and retain sufficient customers;

our anticipated capital expenditures and funding requirements, 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;

the ability to achieve and maintain market penetration and average subscriber revenue levels sufficient to provide financial viability;

our ability to timely and successfully accomplish required scale-up of 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 receivable;

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;

future legislation or regulatory actions relating to specialized mobile radio services, other wireless communications services or telecommunications services generally;

other risks and uncertainties described from time to time in our reports filed with the SEC;

our ability to implement new digital technology, sometimes referred to as 3G or third-generation technology, which could facilitate high-speed, high-volume wireless voice and data transmission and other advanced digital services; and

Nextel's planned enhancement of Direct Connect called traveling Direct Connect, which would allow two or more subscribers traveling outside of their Direct Connect calling area to a different market area to use Direct Connect in that market.

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 loans of our subsidiary under our credit

Table of Contents

facility. 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 \$375 million term loans. Interest rate swaps have the effect of converting the applicable variable rate obligations to fixed or other variable rate obligations. 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 \$2.7 million.

On January 1, 2001, we adopted SFAS No. 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. 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 133, these swap agreements have been designated as ineffective cash flow hedges. The interest rate swap agreements are included in other long-term liabilities on the balance sheet. For the three and six months ended June 30, 2002 we recorded a non-cash, non-operating charge of \$2.0 million and \$595,000, respectively, related to the market value of the interest rate swap agreements which has been reflected in interest expense, and for the three and six months ended June 30, 2001, we recorded a non-cash, non-operating income of \$343,000 and a charge of \$2.1 million, respectively, to interest expense.

The following discloses the fair value of the swap agreements recorded during 2002:

	(in thousands)
Fair value as of January 1, 2002	\$6,968
Change in fair value - loss on interest rate change	\$ 595
	<hr/>
Fair value of liabilities as of June 30, 2002	\$7,563
	<hr/>

In January 1999, we issued our 14% senior discount notes, and in March 2000 and July 2000, we issued our 11% senior notes. In addition, on December 4, 2001 we issued 12.5% senior notes in a private placement. While fluctuations in interest rates may affect the fair value of these notes, interest expense will not be affected due to the fixed interest rate of these notes.

We do not use and 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 counterparties. This credit risk is minimized by dealing with a group of major financial institutions with which we have other financial relationships. We do not anticipate nonperformance by these counterparties.

Table of Contents**PART II OTHER INFORMATION****Item 1. Legal Proceedings**

See our Quarterly Report on Form 10-Q for the period ended March 31, 2002 for a description of pending legal proceedings.

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

On May 14, 2002, we held our 2002 annual meeting of stockholders in Bellevue, Washington. Only holders of record of our class A common stock and class B common stock on the record date of March 29, 2002 were entitled to vote at the annual meeting. Each holder of record class A common stock and class B common stock at the close of business on the record date was entitled to one vote per share on each matter voted upon by the stockholders at the annual meeting. There was no opposition to the nominees of the Board of Directors and all such nominees were elected to serve as our directors. Set forth below is information regarding the shares voted in the election of our directors.

Name	Votes	
	For	Withheld
John Chapple	212,361,733	14,078,489
Steven Dodge	213,216,400	13,223,822
Timothy Donahue	212,366,318	14,073,904
Andrew Rush	213,071,128	13,369,094
Andrew Sinwell	213,071,128	13,369,094
Dennis Weibling	213,638,433	12,801,789

Additionally, an amendment of our 1999 non qualified stock option plan to increase by 12,000,000 the number of shares of Class A common stock reserved for issuance under the plan and to extend the period during which options could be granted under the plan to January 1, 2008 was approved, and received the following votes:

	Votes
For	199,533,641
Against	20,080,625
Abstain	50,639
Broker Non-Votes	6,775,317

Item 6. Exhibits and Reports on Form 8-K

(a) List of Exhibits.

Exhibit Number	Exhibit Description
10.18(b)	Third Amended and Restated 1999 Nonqualified Stock Option Plan.
10.19(b)	Form of Restricted Stock Purchase Agreement to be executed between the Company and each of its outside directors who are issued restricted stock.

(b) Reports on Form 8-K:

Edgar Filing: NEXTEL PARTNERS INC - Form 10-Q

1. Current report on Form 8-K dated and filed May 21, 2002 with the Securities and Exchange Commission reporting changes in registrant's certifying accountant.
2. Current report on Form 8-K dated and filed May 28, 2002 with the Securities and

Table of Contents

- Exchange Commission reporting changes in registrant s certifying accountant Amendment 1.
3. Current report on Form 8-K/A dated May 28, 2002 and filed May 29, 2002 with the Securities and Exchange Commission reporting changes in registrant s certifying accountant Amendment 2.
 4. Current report on Form 8-K/A dated and filed June 6, 2002 with the Securities and Exchange Commission reporting changes in registrant s certifying accountant Amendment 3.

Table of Contents

SIGNATURES

Pursuant to the requirements 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.

NEXTEL PARTNERS, INC. (Registrant)

Date: August 14, 2002

By: /s/ JOHN D. THOMPSON

John D. Thompson
Chief Financial Officer and Treasurer
(Principal Financial and Accounting Officer)

Table of Contents

CERTIFICATION

Pursuant to 18 U.S.C. § 1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, I, John Chapple, President, Chief Executive Officer and Chairman of the Board, certify that:

1. I have read this quarterly report on Form 10-Q of Nextel Partners, Inc.;
2. To my knowledge, this report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
3. To my knowledge, the information in this report fairly presents, in all material respects, the financial condition and results of operations as of June 30, 2002.

Date:
August 14, 2002

/s/ John Chapple

John Chapple
President, Chief Executive Officer
and Chairman of the Board

Table of Contents

CERTIFICATION

Pursuant to 18 U.S.C. § 1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, I, John D. Thompson, Vice President, Chief Financial Officer and Treasurer, certify that:

1. I have read this quarterly report on Form 10-Q of Nextel Partners, Inc.;
2. To my knowledge, this report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
3. To my knowledge, the information in this report fairly presents, in all material respects, the financial condition and results of operations as of June 30, 2002.

Date:
August 14, 2002

/s/ John D. Thompson

John D. Thompson
Vice President, Chief Financial
Officer and Treasurer