Virgin Mobile USA, Inc.
Form 10-Q
August 14, 2008
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

or

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

Commission File Number: 001-33735

Virgin Mobile USA, Inc.

(Exact name of registrant as specified in its charter)

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

(908) 607-4000

(Registrant s telephone number, including area code)

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

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

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

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

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

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

Class A common stock, par value $0.01 per share	53,233,237
Class B common stock, par value $0.01 per share	1
Class C common stock, par value $0.01 per share	115,062

Table of Contents

Virgin Mobile USA, Inc.

Form 10-Q

For the quarterly period ended June 30, 2008

Table of Contents

Table of Contents

Virgin Mobile USA, Inc.

Condensed Consolidated Balance Sheets

(In thousands, except share amounts)

(Unaudited)

	June 30, 2008	December 31, 2007
Assets		
Current assets:		
Cash and cash equivalents	$ 5,559	$ 19
Accounts receivable, less allowances of $711 at June 30, 2008 and $610 at December 31, 2007	45,843	57,956
Due from related parties	2,225	321
Other receivables	6,858	14,613
Inventories	128,740	137,364
Prepaid expenses and other current assets	23,376	19,722
Total current assets	212,601	229,995
Property and equipment	163,296	154,162
Accumulated depreciation and amortization	(125,771)	(108,249)
Property and equipment, net	37,525	45,913
Other assets	5,033	6,131
Total assets	$ 255,159	$ 282,039
Liabilities, Minority interest and Stockholders deficit		
Current liabilities:		
Accounts payable	$ 85,760	$ 111,753
Due to related parties	66,283	56,486
Book cash overdraft		2,045
Accrued expenses	66,542	73,142
Deferred revenue	125,093	128,125
Current portion of long-term debt	32,669	32,669
Total current liabilities	376,347	404,220
Non-current liabilities:		
Long-term debt	227,703	244,037
Related party debt	40,000	45,000
Due to related parties	8,116	
Other liabilities	2,000	3,981
Total non-current liabilities	277,819	293,018
Commitments and contingencies (See Note 7)		
Minority interest in consolidated subsidiaries	1,960	
Stockholders deficit:		
Common stock:		
	532	532

Class A common stock, par value $0.01 per share - 200,000,000 shares authorized and 53,134,233 shares issued and outstanding, net of 30,837 treasury shares at June 30, 2008 and 53,136,839 shares issued and outstanding, net of 13,231 treasury shares at December 31, 2007		
Class C common stock, par value $0.01 per share - 999,999 shares authorized and 115,062 shares issued and outstanding at June 30, 2008 and December 31, 2007	1	1
Class B common stock, par value $0.01 per share - 1 share authorized, issued and outstanding at June 30, 2008 and December 31, 2007		
Additional paid-in-capital	346,853	340,382
Accumulated deficit	(746,565)	(754,860)
Accumulated other comprehensive loss	(1,788)	(1,254)
Total stockholders deficit	(400,967)	(415,199)
Total liabilities, minority interest and stockholders deficit	$ 255,159	$ 282,039

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

Table of Contents

Virgin Mobile USA, Inc.

Condensed Consolidated Statements of Operations and Comprehensive Income

(In thousands, except per share amounts)

(Unaudited)

	Three months ended June 30, 2008	Three months ended June 30, 2007	Six months ended June 30, 2008	Six months ended June 30, 2007
Operating revenue				
Net service revenue	$ 291,364	$ 309,713	$ 595,128	$ 632,050
Net equipment revenue	26,040	17,875	49,067	34,852
Total operating revenue	317,404	327,588	644,195	666,902
Operating expenses				
Cost of service (exclusive of depreciation and amortization)	82,407	90,001	165,899	183,979
Cost of equipment	99,755	98,376	204,773	193,024
Selling, general and administrative (exclusive of depreciation and amortization)	106,417	109,555	219,417	219,603
Depreciation and amortization	8,844	8,650	17,522	16,731
Total operating expenses	297,423	306,582	607,611	613,337
Operating income	19,981	21,006	36,584	53,565
Other expense (income)				
Interest expense - net	7,933	13,859	17,272	27,448
Other expense (income)	6,110	7	8,190	(195)
Total other expense	14,043	13,866	25,462	27,253
Income before income tax expense and minority interest	5,938	7,140	11,122	26,312
Income tax expense	432		867	
Income before minority interest	5,506	7,140	10,255	26,312
Minority interest	1,960		1,960	
Net income	3,546	7,140	8,295	26,312
Other comprehensive income (loss):				
Unrealized income (loss) on interest rate swap	1,729	811	(534)	148
Total comprehensive income	$ 5,275	$ 7,951	$ 7,761	$ 26,460
Basic and diluted earnings per share information:				
Earnings per common share - basic	$ 0.07	$ 0.28	$ 0.16	$ 1.02
Earnings per common share - diluted	$ 0.07	$ 0.14	$ 0.16	$ 0.53
Weighted average common shares outstanding - basic	52,787	25,803	52,772	25,800
Weighted average common shares outstanding - diluted	52,787	50,024	52,841	50,057

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

4

Table of Contents

Virgin Mobile USA, Inc.

Condensed Consolidated Statements of Cash Flows

(In thousands)

(Unaudited)

	Six months ended June 30, 2008	2007
Operating activities		
Net income	$ 8,295	$ 26,312
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	17,522	16,731
Amortization of deferred financing costs	588	987
Non-cash charges for stock-based compensation	6,761	2,190
Non-cash cost of royalties and services		408
Write-offs of fixed assets	230	
Minority interest	1,960	
Changes in assets and liabilities:		
Accounts receivable	12,113	11,684
Due from related parties	(1,904)	4,013
Other receivables	7,755	9,773
Inventories	8,624	(7,306)
Prepaid expenses and other assets	(3,144)	(1,870)
Accounts payable	(25,993)	677
Due to related parties	17,913	(3,778)
Deferred revenue	(3,032)	3,127
Accrued expenses and other liabilities	(9,115)	(38,404)
Net cash provided by operating activities	38,573	24,544
Investing activities		
Capital expenditures	(9,364)	(12,691)
Net cash used in investing activities	(9,364)	(12,691)
Financing activities		
Net change in book cash overdraft	(2,045)	(15,603)
Repayment of long-term debt	(16,334)	(18,500)
Net change in related party debt	(5,000)	22,000
Other	(290)	250
Net cash used in financing activities	(23,669)	(11,853)
Net increase in cash and cash equivalents	5,540	
Cash and cash equivalents at beginning of year	19	8
Cash and cash equivalents at end of period	$ 5,559	$ 8

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

5

Table of Contents

Virgin Mobile USA, Inc.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

1. Overview and Basis of Presentation

Overview

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

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

Proposed Acquisition of Helio LLC

On June 27, 2008, the Company entered into an agreement (the Helio Agreement) to acquire Helio LLC (Helio), a provider of wireless products and services. The acquisition of Helio will facilitate the Company s entry into the postpaid market and allow the Company to take advantage of Helio s proprietary technology. Helio will become a wholly owned subsidiary of Virgin Mobile USA, L.P.

Under the terms of the Helio Agreement, the Company will acquire Helio from SK Telecom USA Holdings, Inc. (SK Telecom), EarthLink, Inc. and Helio, Inc. in exchange for limited partnership units in Virgin Mobile USA, L.P. and Class A common stock of the Company, together equivalent to 13 million shares of the Company s Class A common stock. Each of the newly issued Virgin Mobile USA, L.P. partnership units will be convertible into shares of the Company s Class A common stock on a one-for-one basis. The estimated purchase price based on the closing price of the Company s class A common stock two trading days before and ending two trading days after the date of the announcement, will be approximately $38 million plus costs of the acquisition. The transaction is expected to close by the end of the third quarter of 2008, subject to regulatory approval and other customary closing conditions.

The Company is currently party to two credit agreements: a third party senior secured credit facility (the Senior Credit Agreement) and a subordinated secured revolving credit facility with the Virgin Group (the Revolving Credit Facility). Under the terms of the Helio Agreement, each of the Virgin Group and SK Telecom or one of its respective affiliates will invest $25 million in the Company in exchange for the issuance by the Company of 25,000 shares of newly issued convertible preferred stock (the Preferred Stock). The $50 million proceeds will be used to pay down a portion of the outstanding principal under the Senior Credit Agreement The Preferred Stock, which will be, subject to approval by the Company s stockholders, convertible into shares of Class A common stock upon the earlier of (i) four years from the date of issuance or (ii) such time as the market price of the Company s Class A common stock exceeds $8.50 per share, will have a 6% annual dividend and be convertible at the option of the holder after 18 months from the date of issuance.

In connection with the acquisition of Helio, the Company entered into a Second Amendment to its Senior Credit Agreement and a Second Amendment to its Revolving Credit Facility, each of which will be effective upon the closing of the proposed acquisition of Helio. The Second Amendment to the Revolving Credit Facility increases the Virgin Group s lending commitment from $75 million to $100 million and adds SK Telecom as a new lender with a lending commitment of $35 million. The Second Amendment to the Senior Credit Agreement (i) requires that the $50 million of proceeds from the issuance of the Preferred Stock be used to pay down a portion of the outstanding loan balance under the Senior Credit Agreement, (ii) increases the interest rate applicable to outstanding balances by 100 basis points per year, and (iii) decreases the leverage ratio covenant for each quarterly period by 0.25 times (for example, for the quarterly period ending December 31, 2008, the leverage ratio would decrease from 3.00 to 1.00, to 2.75 to 1.00).

6

Table of Contents

Virgin Mobile USA, Inc.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Basis of Presentation

The accompanying condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and with Article 10 of Regulation S-X of the Securities and Exchange Commission for interim financial reporting. Accordingly, they do not include annual disclosures necessary for a presentation of the Company s financial position, results of operations and cash flows in conformity with accounting principles generally accepted in the United States of America. In the opinion of management, the interim financial information provided herein reflects all adjustments (consisting of normal and recurring adjustments) necessary for a fair presentation of the Company s financial position, results of operations and cash flows for the interim periods presented on a basis consistent with the Company s historical audited financial statements and accompanying notes for the year ended December 31, 2007. The financial statements provided herein should be read in conjunction with the financial statements and accompanying notes included in the Company s annual report on Form 10-K for the year ended December 31, 2007.

The Company has accounted for the Reorganization, for periods prior to the completion of the IPO, using a carryover basis, similar to a pooling-of-interest, as the reorganization transactions were premised on a non-substantive exchange in order to facilitate the IPO, resulting in the retention of historical based accounting. This is consistent with Financial Accounting Standards Board Technical Bulletin 85-5, *Issues Relating to Accounting for Business Combinations, including Costs of Closing Duplicate Facilities of an Acquirer; Stock Transactions between Companies under Common Control; Down-Stream Mergers, Identical Common Shares for a Pooling of Interests; and Pooling of Interests by Mutual and Cooperative Enterprises*. Under this method of accounting, the companies are treated as if they had always been combined for accounting and financial reporting purposes and, therefore, the condensed consolidated financial statements for the three and six months ended June 30, 2007 are presented on the same basis as those for the three and six months ended June 30, 2008. The weighted average shares outstanding for the three and six months ended June 30, 2007 are based on the number of member units in Virgin Mobile USA, LLC retroactively adjusted for the conversion into Class A common stock of the Company. The Company began recording minority interest during the three months ended June 30, 2008 since the Company currently has cumulative earnings since the date of the Reorganization. The Company presents minority interest in a manner consistent with Emerging Issues Task Force Issue (EITF) No. 94-2*, Treatment of Minority Interests in Certain Real Estate Investment.*

Liquidity

The Company has incurred substantial cumulative net losses and negative cash flows from operations since inception, and has a stockholders deficit of $401.0 million, negative working capital of $163.7 million and non-current debt of $267.7 million as of June 30, 2008. The Company makes significant initial cash outlays to acquire new customers in the form of handset and other subsidies. Additionally, the Company has been incurring increasing costs to maintain current customers through the sale of replacement handsets at a loss to the Company. Management expects these costs to be funded primarily through service revenue generated from the Company s existing customer base and borrowings under its Revolving Credit Facility. Although it is difficult for the Company to predict future liquidity requirements with certainty, based on the Company s expected cash flows from operations and available funds from its Revolving Credit Facility, management believes that the Company has the ability to finance its projected operating, investing and financing requirements of existing operations and planned customer growth through at least June 30, 2009. In addition, the Company s ability to make scheduled principal and interest payments, or to refinance indebtedness and to satisfy other obligations, including obligations under the PCS Services Agreement with Sprint Nextel, as well as the Company s ability to meet long-term liquidity needs, will depend upon future operating performance, as well as general economic, financial, competitive, legislative, regulatory, business and other factors beyond the Company s control. If the Company materially underachieves its operating plan and the availability under the Revolving Credit Facility, and cash flow from operations become insufficient to allow the Company to meet its obligations, the Company is committed to taking certain alternative actions that could include reducing inventory purchases, reducing planned capital expenditures, extending the payment for certain liabilities within contractual terms with vendors, curtailing marketing costs and reducing other variable costs. In addition, management may also seek additional increases in its borrowing capacity under the Revolving Credit Facility, seek to raise additional funds, through public or

7

Virgin Mobile USA, Inc.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

private debt, equity financing to support operations, or restructure debt repayment obligations. Additional funds, however, may not be available to the Company on commercially reasonable terms, when required, or at all, and any additional capital raised through the sale of equity or equity-linked securities, if possible, could result in dilution to existing stockholders. There is no assurance management will be successful in achieving its operating plan or would be able to implement its alternative actions or obtain additional borrowing capacity on acceptable terms.

The Company s Senior Credit Agreement and Revolving Credit Facility require compliance with covenants, including a consolidated leverage ratio and fixed charge ratio which become more restrictive in future periods. Based on projected operating results and financial position, the Company expects to remain in compliance with the required covenants through at least June 30, 2009. If the Company does not meet these covenants its borrowing availability under the Revolving Credit Facility could be eliminated and outstanding borrowings under the Senior Credit Agreement and the Revolving Credit Facility could become due.

Upon the closing of the acquisition of Helio, each of the Virgin Group and SK Telecom, or one of its respective affiliates, will invest $25 million in the Company in exchange for the issuance by the Company of 25,000 shares of Preferred Stock. The $50 million of proceeds received by the Company will be used to pay down a portion of the outstanding principal under the Senior Credit Agreement.

Recently Issued and Newly Adopted Accounting Pronouncements

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

In December 2007, the FASB issued SFAS No.141 (R), *Business Combinations* (SFAS 141R) and SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements an amendment to APB No. 51* (SFAS 160). SFAS 141(R) requires the acquiring entity in a business combination to recognize all (and only) assets acquired and liabilities assumed in the transaction; establishes the acquisition date fair value as the measurement objective for all assets acquired and liabilities assumed; and requires the acquirer to disclose to investors and other users all of the information they need to evaluate and understand the nature and financial effect of the business combination. SFAS 160 requires companies to measure an acquisition of a noncontrolling (minority) interest at fair value in the equity section of the acquiring entity s balance sheet. SFAS 141(R) and SFAS160 are effective for fiscal years beginning on or after December 15, 2008. The Company is evaluating the impact that the adoption of SFAS 141(R) and SFAS 160 may have on its financial condition, results of operations or cash flows.

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

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

Table of Contents

Virgin Mobile USA, Inc.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

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

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

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

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

Assets and liabilities measured at fair value on a recurring basis consist of a liability for an interest rate swap. The fair value was derived based on market prices or dealer quotes on securities with similar characteristics (level 2) and was $(1.8) million as of June 30, 2008. The adoption of SFAS 157 for nonfinancial assets and liabilities will not have a material impact on the financial condition, results of operations or cash flows of the Company.

2. Inventories

Inventories consist of the following (in thousands):

	June 30, 2008	December 31, 2007
Handsets and accessories	$ 77,912	$ 72,094
Refurbished handsets	3,496	3,590
Handset inventory on consignment	47,332	61,680
	$ 128,740	$ 137,364

3. Stock-Based Compensation

Stock Options

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

	Shares under Option	Weighted Average per Share Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value (000 s)

Outstanding at December 31, 2007	4,144,982	$	14.07			
Granted	31,892		8.71			
Exercised						
Forfeited	(288,870)		15.41			
Expired	(67,114)		17.34			
Outstanding at June 30, 2008	3,820,890	$	13.86	4.13	$	
Vested or expected to vest at June 30, 2008	3,598,202	$	13.77	4.57	$	
Exercisable at June 30, 2008	2,193,047	$	12.52	3.45	$	

Table of Contents

Virgin Mobile USA, Inc.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

The weighted-average per share grant-date fair value of options granted during the six months ended June 30, 2008 was $5.29. There were no grants during the six months ended June 30, 2007. The total fair value of stock options vested during the six months ended June 30, 2008 and 2007 was $5.9 million and $3.6 million, respectively. As of June 30, 2008, there was a total of $7.3 million of unrecognized compensation expense, net of estimated forfeitures, related to nonvested stock options, which is expected to be recognized over a weighted-average period of 2.5 years.

Restricted Stock and Restricted Stock Units

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

	Nonvested Restricted Stock Units		Nonvested Restricted Stock	
	Number of Awards	Weighted Average Grant Date Fair Value	Number of Awards	Weighted Average Exercise Per Unit
Outstanding at December 31, 2007	810,981	$ 14.84	495,075	$ 27.22
Granted	932,018	3.44		
Vested	(70,753)	15.00	(33,812)	27.83
Forfeited	(59,134)	15.00	(17,606)	27.83
Outstanding at June 30, 2008	1,613,112	$ 8.26	443,657	$ 27.83

As of June 30, 2008, the total unrecognized compensation expense, net of estimated forfeitures, for nonvested restricted stock units and restricted stock was $8.7 million and $7.3 million, respectively, which is expected to be recognized over a weighted-average period of 2.4 years and 2.0 years, respectively.

Performance-Based Restricted Stock Units

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

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

As of June 30, 2008, the total unrecognized compensation expense, net of estimated forfeitures, for nonvested performance-based restricted stock units was $1.7 million, which is expected to be recognized over a weighted-average period of 2.7 years.

Table of Contents

Virgin Mobile USA, Inc.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

4. Related Party Transactions

Sprint Nextel

On March 12, 2008, the Company and Sprint Nextel entered into the Second Amendment to the PCS Services Agreement to provide that the Company would not be subject to any true-up process and the related payment obligations with respect to the fiscal year ended December 31, 2007. The amendment further provided that, in the event that the true-up with respect to the fiscal year ending December 31, 2008 indicates that the actual cost to Sprint Nextel of the services it sells to the Company is higher than the rates charged to the Company for such services, the Company will only pay Sprint Nextel the difference between (A) the lower of (i) the rates that Sprint Nextel provided in advance for planning purposes and (ii) the rates based on Sprint Nextel s actual costs, and (B) the rates charged to the Company during such year. Pursuant to the terms of this Second Amendment, beginning with the first quarter of the fiscal year ending December 31, 2009, the true-up and pricing process set forth in the PCS Services Agreement prior to the amendment will apply unless otherwise agreed by the parties.

On May 12, 2008, the Company and Sprint Nextel entered into the Third Amendment to the PCS Services Agreement to provide that the Company would be required to pay Sprint Nextel at least $298 million, for wireless network services, including voice, messaging and data traffic, according to a monthly payment schedule during the year ending December 31, 2008, and will receive off-peak rates for a two-hour period each weekday until (pursuant to the Fifth Amendment to the PCS Services Agreement, as described below) the closing of the proposed acquisition of Helio. If the amounts due based on actual usage exceed the spending commitment, the Company will pay the total annual amount for such actual usage owed to Sprint Nextel. This amendment was contingent upon the Company obtaining approval from the Virgin Group to increase the lending commitment under the Revolving Credit Facility from $75 million to $100 million by June 30, 2008.

On June 27, 2008, in connection with the Helio Agreement, the Company and Sprint Nextel entered into the Fourth and Fifth Amendments to the PCS Services Agreement. The Fourth Amendment to the PCS Services Agreement eliminated the requirement for the Company to secure an increase in the Virgin Group s lending commitment under the Revolving Credit Facility from $75 million to $100 million by June 30, 2008, which had been a requirement to the continued effectiveness of the Third Amendment to the PCS Services Agreement. The Fifth Amendment to the PCS Services Agreement, which will become effective with the closing of the proposed acquisition of Helio and supersede the Third Amendment to the PCS Services Agreement, eliminates the annual true-up process and related payment obligations, and provides that the Company will be required to pay Sprint Nextel at least $320 million, $370 million and $420 million during the years ended December 31, 2008, 2009 and 2010, respectively, for wireless network services, including voice, messaging and data traffic. Under the Fifth Amendment to the PCS Services Agreement there will be no minimum annual commitment for 2011 and beyond and the pricing will be based on the pricing schedule for 2010, unless amended. The monthly rates for such services for the year ended December 31, 2009 and beyond will be determined by calculating the actual revenue to Sprint Nextel for all monthly bill cycles which commenced during the four immediately preceding calendar quarters, with the sum of the revenue for those quarters used to determine the rates for monthly bill cycles in the subsequent calendar quarter. Additionally, effective July 1, 2008, Sprint Nextel will provide the Company with a $2.50 network usage credit for each gross addition through December 31, 2009, up to a maximum of $10 million. The Company will be eligible to receive this credit provided that, beginning with 45 days after the closing of the proposed Helio acquisition, no undisputed amounts invoiced to the Company under the PCS Services Agreement are past due.

In May 2008, the Company and Sprint Nextel amended their Master Services Agreement for wireline communication services for business operations. Under the terms of the amended Master Services Agreement, the Company is committed to pay Sprint Nextel $1.8 million per year for 2009 and 2010 and $0.9 million in 2011.

Table of Contents

Virgin Mobile USA, Inc.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

See the table below for selected financial information related to the Company s transactions with Sprint Nextel (in thousands):

	June 30, 2008	December 31, 2007
Due from related parties	$ 2,055	$ 94
Due to related parties	63,326	51,530

	Three months ended June 30, 2008	Three months ended June 30, 2007	Six months ended June 30, 2008	Six months ended June 30, 2007
Net equipment revenue	$ 82	$ 327	$ 171	$ 749
Cost of service	66,608	72,936	133,893	149,325
Selling, general and administrative	2,527	7,277	7,082	14,865
Interest expense	497	1,082	1,589	2,107
Other expense (income)	2,656		3,525	

Tax Receivable Agreement

In connection with the IPO and the Reorganization and the IPO, in October 2007 Sprint Nextel sold a portion of its interest in Virgin Mobile USA, LLC to the Company for $136.0 million of the net proceeds from the Company s IPO. In addition, from time to time, Sprint Nextel may exchange its partnership units in Virgin Mobile USA, L.P. for shares of the Company s Class A common stock. Virgin Mobile USA, L.P. intends to make an election under Section 754 of the Internal Revenue Code for each taxable year in which an exchange of partnership units for shares occurs. The initial sale and future exchanges by Sprint Nextel are expected to result in increases in the tax basis of the assets owned by Virgin Mobile USA, L.P. at the time of each exchange of partnership units. These anticipated increases in the tax basis will be allocated to the Company and may reduce the amount of tax that would otherwise be required to be paid in the future. The Company entered into a tax receivable agreement with Sprint Nextel that provides for the payment to Sprint Nextel the amount of cash savings, if any, in U.S. federal, state and local income tax that the Company actually realizes as a result of these increases in tax basis. For the three and six months ended June 30, 2008, the Company recorded $2.6 million and $3.5 million, respectively, in Other expense (income) for the estimated payments to Sprint Nextel under this tax receivable agreement. The actual amount of the payment will be determined when the Company files its 2008 federal and state income tax returns.

The Virgin Group

See the table below for selected financial information related to the Company s transactions with the Virgin Group (in thousands):

	June 30, 2008	December 31, 2007
Due from related parties	$ 170	$ 227
Due to related parties	11,073	4,956
Related party debt	40,000	45,000

	Three months ended June 30, 2008	Three months ended June 30, 2007	Six months ended June 30, 2008	Six months ended June 30, 2007

Net equipment revenue	$ 161	$ 59	$ 212	$ 146
Selling, general and administrative	827	878	1,770	1,808
Interest expense	1,203	1,055	2,756	2,041
Other expense (income)	3,380		4,591	

Table of Contents

Virgin Mobile USA, Inc.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Tax Receivable Agreement

In connection with the IPO and the Reorganization, the Virgin Group contributed to the Company its interest in Bluebottle USA Investments L.P. (Investments), which resulted in the Company receiving approximately $309.7 million of net operating loss carryforwards. If utilized, the net operating loss carryforwards will reduce the amount of tax that the Company would otherwise be required to pay in the future. The Company entered into a tax receivable agreement with the Virgin Group that provides for the payment to the Virgin Group the amount of cash savings, if any, in U.S. federal, state and local income tax that is actually realized as a result of the utilization of these net operating loss carryforwards. The tax receivable payment considers the impact of section 382 of the Internal Revenue Code which imposes an annual limit on the ability of a corporation that undergoes an ownership change to use its net operating loss carryforwards to reduce its tax liability. For the three and six months ended June 30, 2008, the Company recorded $3.4 million and $4.6 million, respectively, in Other expense (income) for the estimated payments to the Virgin Group under this tax receivable agreement. The actual amount of the payment will be determined when the Company files its 2008 federal and state income tax returns.

5. Income Tax

The Company accounts for income taxes in accordance with the provisions of SFAS No. 109, *Accounting for Income Taxes*, which requires that deferred income taxes be determined based on the estimated future tax effects of differences between the financial statement and tax basis of assets and liabilities given the provisions of enacted tax laws. Valuation allowances are used to reduce deferred tax assets to the extent that their realization is not more likely than not.

In determining the quarterly provision for income taxes, the Company uses an estimated annual effective tax rate, which is based on the Company s expected annual income, statutory rates and tax planning opportunities and includes the effects, if any, of uncertain tax positions accounted for in accordance with FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109*. The estimated annual effective tax rate for 2008 is 4.28%. This effective rate is the result of alternative minimum tax after the utilization of net operating loss carryforwards.

Significant or unusual items are separately recognized in the quarter in which they occur. The Company has recorded a federal and state tax expense for the three and six months ended June 30, 2008 of $432 thousand and $867 thousand, respectively. Prior to the Reorganization, all federal, state and local taxes were the responsibility of the owners of Virgin Mobile USA, LLC.

The Company has entered into tax receivable agreements with both Sprint Nextel and the Virgin Group which would require payments to these parties for certain tax benefits inuring to the Company. The Company expects to make payments under these agreements for the year ending December 31, 2008 (see Note 4).

Virgin Mobile USA, Inc.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

6. Earnings Per Share

The following table shows information used in the calculation of basic and diluted earnings per share (in thousands):

	Three months ended June 30, 2008	Three months ended June 30, 2007	Six months ended June 30, 2008	Six months ended June 30, 2007
Numerator:				
Net income	$ 3,546	$ 7,140	$ 8,295	$ 26,312
Denominator:				
Weighted average shares outstanding basic	52,787	25,803	52,772	25,800
Stock based compensation plans		1,209	69	1,245
Sprint Nextel ownership in Virgin Mobile USA, L.P. convertible into common stock		23,012		23,012
Weighted average shares outstanding diluted	52,787	50,024	52,841	50,057

The following weighted average shares were excluded from the diluted earnings per share calculation as their effect would be anti-dilutive (in thousands):

	Three months ended June 30, 2008	Three months ended June 30, 2007	Six months ended June 30, 2008	Six months ended June 30, 2007
Sprint Nextel ownership in Virgin Mobile USA, L.P. convertible into common stock	12,059		12,059	
Stock based compensation plans	5,687	1,033	5,026	914
	17,746	1,033	17,085	914

7. Commitments and Contingencies

Commitments

During the quarter ended June 30, 2008, the Company entered into two non-cancellable purchase obligations with two handset vendors totaling $97 million. As of June 30, 2008, the remaining purchase obligations under these contracts were $47 million, which is required to be fulfilled before the end of 2009.

Contingencies

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

Virgin Mobile USA, Inc.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Patent Litigation

Antor Media Corp. v. Nokia, Inc., et al. On May 16, 2005, the Company was named as one of twelve defendants sued in the United States District Court for the Eastern District of Texas for alleged infringement of U.S. Patent No. 5,734,961, which pertains to a system for transmitting information from a central server to a customer over a network. The plaintiff has requested monetary damages of an amount equal to no less than a reasonable royalty, enhanced damages, attorney fees and a permanent injunction. Nine defendants have since settled. The Company filed an answer denying infringement and all other claims and has asserted patent invalidity and inequitable conduct as defenses. The Company has filed counterclaims seeking declaratory judgments of patent invalidity, unenforceability, and non-infringement. The Company sought indemnification from Kyocera, Nokia, UTStarcom, Moderati and Infospace. Kyocera has agreed to indemnify the Company for certain legal fees and retained a law firm to lead the defense. The Court has stayed the action pending an ongoing reexamination of the relevant patent in the United States Patent and Trademark Office.

Visual Interactive Phone Concepts, Inc. v. Virgin Mobile USA, LLC. The Company is defending itself in a patent infringement action brought in May 2005 by Visual Interactive Phone Concepts, Inc. (VIPC) in the United States District Court for the District of New Jersey. The plaintiff asserts that the Company has infringed two patents involving the transmission of information among videophones, a central data center/mailbox facility, and vendors. The plaintiff has requested monetary damages of an amount equal to no less than a reasonable royalty, trebled for willful infringement, attorney fees and a permanent injunction. The Company filed an answer denying infringement and all other claims and has asserted patent invalidity and inequitable conduct as defenses. The Company has filed counterclaims seeking declaratory judgments of patent invalidity, unenforceability and non-infringement. On February 22, 2008, following the completion of related state court litigation between VIPC and a third-party, the Company filed a motion for summary judgment regarding all claims based on judicial estoppel and VIPC s lack of standing to sue for infringement of the patents. The parties have completed briefing and will argue the motion before the court in August 2008.

Barry W. Thomas v. Alltel Communications, Inc. et al. In December 2005, Barry W. Thomas sued the Company and five other defendants in the United States District Court for the Western District of North Carolina. The plaintiff alleged that the Company infringed upon U.S. Patent No. 4,777,354, which relates to a system for controlling the provision of services including telephone services to a customer where a central computer controls the activation/deactivation of services based on account information read from a magnetic strip-type card. In light of a decision in a related case, the plaintiff dismissed the lawsuit against the Company voluntarily and with prejudice on June 26, 2008, Kyocera is indemnifying the Company for certain legal fees.

Minerva Indus., Inc. v. Motorola, Inc. et al. On June 6, 2007, Minerva Indus., Inc. (Minerva) filed this action against Virgin Mobile USA, LLC and 42 other defendants in the United States District Court for the Eastern District of Texas for alleged infringement of U.S. Patent No. 6,681,120, which relates to a mobile entertainment and communication device. The plaintiff requests monetary damages of an amount equal to no less than a reasonable royalty, trebled for willful infringement, attorney fees and a permanent injunction. The Company sought indemnification from Kyocera, Nokia, and UTStarcom. Kyocera and Nokia have agreed to indemnify the Company for certain legal fees and the parties have appointed counsel to defend the Company. The defendants entered into a joint defense agreement and filed a joint answer to Minerva s complaint on January 7, 2008. A new patent was issued to Minerva on the same day. Minerva filed a new action alleging infringement of the new patent. The defendants have answered the new complaint. A claim construction hearing has been scheduled for January 6, 2010, with a trial scheduled to begin on June 7, 2010. The parties have begun discovery.

Electronic Data Systems Corp. v. Online Wireless, Inc. et al. On February 4, 2008, Electronic Data Systems (EDS) filed suit against the Company and five other providers of prepaid wireless services. The lawsuit alleges that the defendants have infringed on two EDS patents, each of which sets forth a system and method that allows a consumer to use a personal computer or ATM machine to purchase prepaid telephone services electronically using funds debited from a designated financial account. EDS seeks an injunction, damages, and costs. The Company is investigating the allegations made by EDS and will vigorously defend the lawsuit. The Company is seeking indemnification from several sources. The defendants have entered into a joint defense agreement.

Intellect Wireless, Inc. v. T-Mobile USA, Inc., et al. On February 28, 2008, Intellect Wireless, Inc. filed a complaint against the Company in the United States District Court for the Northern District of Illinois for alleged infringement,

15

Virgin Mobile USA, Inc.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

contributory infringement, or induced infringement of United States Patent Nos. 7,257,210, 7,305,076, and 7,266,186. The plaintiff alleges that the Company directly or indirectly infringed the patents by offering wireless plans, packages, and services that include Caller ID, picture messaging, and multimedia messaging services, which it asserts are covered under the subject patents. The plaintiff requests damages equal to no less than a reasonable royalty, attorneys fees, and a permanent injunction. The Company has entered into a joint defense agreement with the other defendants in the matter.

Trade Secret Litigation

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

Class Action Litigation

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

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

Nevels v. AT&T Mobility LLC et al. The Company is one of seven defendants named in a class action lawsuit filed on May 14, 2008 in the United States District Court for the Southern District of Mississippi. Plaintiffs seek compensatory damages, restitution, attorneys fees, and other costs under the Communications Act of 1934 based on their allegations that the defendants improperly (1) prohibit customers from disabling text messaging services and (2) charge customers for receipt of unsolicited text messages. The Company is investigating the allegations and will defend itself vigorously against the lawsuit.

Lockyear v. Virgin Mobile USA, Inc. and Virgin Mobile USA, L.P. On July 10, 2008, two plaintiffs initiated a purported class action lawsuit against the Company in California state court alleging (1) breach of contract, (2) violations of the California Consumer Legal Remedies Act, (3) violation of California s Unfair Competition Law, (4) unauthorized

16

Virgin Mobile USA, Inc.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

telephone charges in violation of California s Public Utilities Code, (5) violation of California s Computer Crime Law, (6) unjust enrichment, and (7) trespass to chattels. The allegations relate to allegedly improper billing by the Company for allegedly unwanted services provided by third party content providers. Plaintiffs seek compensatory and punitive damages, attorneys fees, costs, and injunctive and declaratory relief. The Company is investigating the allegations and will defend itself vigorously against the lawsuit.

Conrad v. Virgin Mobile USA, Inc. and Flycell, Inc. On July 29, 2008, a plaintiff initiated a purported class action lawsuit against the Company and another defendant in Illinois state court, alleging breach of contract and violations of the Illinois Consumer Fraud and Deceptive Business Practices Act. The allegations, which are nearly identical to those raised in the *Lockyear* matter filed in California state court, allege improper billing for unwanted services provided by third party content providers. Plaintiff seeks actual, consequential, and compensatory damages, as well as injunctive, statutory and/or declaratory relief. The Company is investigating the allegations and will defend itself vigorously against the lawsuit.

Botts v. Virgin Mobile USA, Inc. and Virgin Mobile USA, L.P. On July 22, 2008, a plaintiff initiated a purported class action lawsuit against the Company in Florida State Court alleging breach of contract. The allegations, which are nearly identical to those raised in the *Lockyear* matter filed in California state court, relate to allegedly improper billing for allegedly unwanted services provided by third party content providers. Plaintiff seeks actual, consequential, and compensatory damages, as well as injunctive, statutory and/or declaratory relief. The Company is investigating this matter and will defend itself vigorously against the lawsuit.

Securities Litigation

Plaintiffs have brought two class-action federal lawsuits one in the District of New Jersey and the other in the Southern District of New York against the Company, certain of the Company s officers and directors, and other defendants. Each suit alleges that the prospectus and registration statement filed pursuant to the Company s IPO contained materially false and misleading statements in violation of the Securities Act of 1933, and additionally alleges that at the time of the IPO the Company was aware, but did not disclose, that results for the third quarter of 2007 indicated widening losses and slowing customer growth trends. On January 7, 2008, the Company filed a motion to consolidate all cases in the United States District Court for the Southern District of New York for pre-trial purposes. On April 7, 2008, the United States Judicial Panel on Multidistrict Litigation granted the motion and consolidated the cases in the District of New Jersey. On March 17, 2008, the district court judge in the New Jersey matter appointed the New Jersey plaintiffs as lead plaintiffs for the litigation. Plaintiffs filed a consolidated amended complaint on May 16, 2008. On July 15, 2008, the Company filed a motion to dismiss the amended complaint.

8. Subsequent Event

On July 3, 2008, the Company signed an outsourcing agreement (the IBM Agreement) with IBM. Management of the Company believes that outsourcing much of its information technology needs to IBM will enhance its technological capabilities and help to enable the Company to improve its product portfolio for new and existing customers. The IBM Agreement requires IBM to provide information technology services to the Company through May 15, 2013. The Company has the right, but not the obligation, to extend the IBM Agreement an additional year, or to May 15, 2014, if certain conditions are met.

As part of the IBM Agreement, the Company s information technology and infrastructure, and applications development will be transitioned to IBM s service environment and 45 of the Company s employees transferred to IBM. In connection with the outsourcing and related restructuring, approximately 126 employees will be terminated by December 31, 2008 and the Company s facility in Walnut Creek, California will be closed. Restructuring charges for severance, retention bonuses, lease and contract termination costs, write-off and disposal costs of certain fixed assets, accelerated stock compensation costs, and other items are expected to aggregate approximately $8.9 million in the second half of 2008 and approximately $2.2 million in 2009. Of these amounts, cash expenses, which the Company expects to fund from cash generated from operations, are anticipated to aggregate $4.5 million, $5.1 million, and $0.4 million in 2008, 2009, and 2010, respectively. Employees being terminated are required to remain with the Company through a specified transition period in order to be eligible to receive any severance and retention payments. The transition of the Company s information technology and infrastructure, and applications development to the IBM service environment is expected to be completed by December 31, 2008.

In accordance with the IBM Agreement, the Company prepaid $5.5 million in service charges to IBM in July 2008 and will prepay an additional $4.6 million in service charges to IBM over the period from August 2008 to March 2009. The prepayments will be applied to future charges for IBM services to the Company over the five-year term.

Table of Contents

Virgin Mobile USA, Inc.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

The IBM Agreement calls for IBM to provide a baseline level of service at agreed-upon dollar amounts. The Company expects to incur the following charges, inclusive of the amortization of the prepayments discussed above, as follows (in thousands):

Year	Amount
2008	$ 5,925
2009	29,654
2010	29,420
2011	28,884
2012	27,001
2013	7,360
	$ 128,244

The baseline services incurred will be adjusted monthly to reflect changes in the underlying currencies of countries in which IBM provides services to the Company. In addition, beginning in January 2010, the baseline service payments above will be adjusted on a monthly basis to reflect inflation or deflation in the U.S. and other countries in proportion to the services that IBM provides from each country.

The Company may increase or decrease the level of baseline services provided by IBM, along with related payments, based upon certain restrictions and circumstances.

Either party can terminate the IBM Agreement early under certain circumstances, but if the Company terminates the IBM Agreement solely for its convenience, it would be required to pay certain termination fees and wind-down charges. The minimum termination fees that the Company would be obligated to pay at the beginning of the IBM Agreement are approximately $13.9 million, which decrease over the life of the IBM Agreement. Wind-down charges are defined as non-cancelable lease payments, lease termination fees, certain salaries, benefits, relocation costs, severance costs relating to IBM employees that were former Company employees, and certain other costs. Wind-down costs cannot be reasonably estimated at this time but could be material to the Company s financial position if the Company elects to terminate the IBM Agreement.

Table of Contents

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

The following discussion of our financial condition and results of operations should be read in conjunction with our unaudited financial statements for the three and six months ended June 30, 2008 and 2007 and the notes thereto included elsewhere herein and with our annual report on Form 10-K for the year ended December 31, 2007, filed with the Securities and Exchange Commission in March 2008. This discussion contains forward-looking statements that are subject to known and unknown risks and uncertainties, including those discussed in Item 1A, Risk Factors, in Part II.

Unless we state otherwise or the context otherwise requires the terms (1) we , us and our refer to Virgin Mobile USA, Inc., and its consolidated subsidiaries; (2) Sprint Nextel refers to Sprint Nextel Corporation, a Kansas corporation, and its affiliated entities; and (3) the Virgin Group refers to Virgin Group Holdings Limited, a British Virgin Islands company and its affiliated entities.

Introduction

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

We have accounted for the Reorganization, for periods prior to the completion of the IPO, using a carryover basis, similar to a pooling-of-interest, as the reorganization transactions were premised on a non-substantive exchange in order to facilitate the IPO, resulting in the retention of historical based accounting. This is consistent with Financial Accounting Standards Board Technical Bulletin 85-5, *Issues Relating to Accounting for Business Combinations, including Costs of Closing Duplicate Facilities of an Acquirer; Stock Transactions between Companies under Common Control; Down-Stream Mergers, Identical Common Shares for a Pooling of Interests; and Pooling of Interests by Mutual and Cooperative Enterprises*. Under this method of accounting, the companies are treated as if they had always been combined for accounting and financial reporting purposes and, therefore, the condensed consolidated financial statements for the three and six months ended June 30, 2007 are presented on the same basis as those for the three and six months ended June 30, 2008. We began recording minority interest during the three months ended June 30, 2008 since we currently have cumulative earnings since the date of the reorganization. We present minority interest in a manner consistent with Emerging Issues Task Force Issue (EITF) No. 94-2*, Treatment of Minority Interests in Certain Real Estate Investment.*

Company Overview

We are a leading national provider of wireless communications services, offering prepaid, or pay-as-you-go, services targeted at the youth market. Our customers are attracted to our products and services because of our flexible terms, easy to understand and value-oriented pricing structures, stylish handsets offered at affordable prices and relevant mobile data and entertainment content. As we offer products and services without an annual contract or credit check, we attract a wide range of customers. Approximately half of our current customers are ages 35 and over. We offer our voice plans on a flat per-minute basis and on a monthly basis for specified quantities, or buckets, of minutes purchased in advance, allowing customers to use text messaging, picture messaging and email on our per usage basis or in monthly packs.

We were founded as a joint venture between Sprint Nextel and the Virgin Group and launched our service nationally in July 2002. As of June 30, 2008, we served 5.0 million customers, an increase of 3.4% over the 4.8 million customers served at June 30, 2007 and a decrease of 1.8% compared to the 5.1 million customers served at December 31, 2007. Historically, we have grown our business organically, but, subject to our existing and future contractual obligations, we may consider mergers, acquisitions and strategic investments from time to time that enable us to achieve greater scale, cost or technology advantages. On June 27, 2008, we announced our plans to acquire Helio LLC, or Helio, a provider of wireless products and services, with a customer base of approximately 170,000.

We market our products and services under the Virgin Mobile brand, using the nationwide Sprint PCS network. We control our customers experience and all customer touch points, including brand image, web site, retail merchandising, service and product pricing, mobile content options, marketing, distribution and customer care, but as a mobile virtual network operator, or MVNO, we do not own or operate a physical network, which frees us from related capital expenditures. This allows us to focus our resources and compete effectively against the major national wireless providers in our target market. We focus primarily on wireless consumers, who use 200 to 1,200 minutes per month, which we estimate encompasses 80% of all wireless consumers. Pursuant to our PCS Services Agreement with Sprint Nextel, as amended (and as described in the following paragraphs), effective with the closing of the proposed acquisition of Helio, our cost of service for wireless network services will be based on fixed rates set forth in the Fifth Amendment to the PCS Services Agreement. We expect this to reduce volatility in our network costs and secure decreasing per-user costs for the duration of the PCS Services Agreement.

On March 12, 2008, we entered into the Second Amendment to the PCS Services Agreement with Sprint Nextel to provide that we would not be subject to the true-up process and the related payment obligations with respect to the year ended December 31, 2007. The amendment further provided that in the event that the true-up with respect to the year ending December 31, 2008, indicates that the actual cost to Sprint Nextel of the services it sells to us is higher than the rates charged to us for such services, we will only pay Sprint Nextel the difference between (A) the lower of (i) the rates that Sprint Nextel provided to us in advance for planning purposes and (ii) the rates based on Sprint Nextel s actual costs, and (B) the rates charged to us during such year. Pursuant to the terms of this Second Amendment, beginning with the first quarter of the fiscal year ending December 31, 2009, the true-up and pricing process set forth in the PCS Services Agreement prior to the amendment will apply unless otherwise agreed by the parties.

On May 12, 2008, we entered into the Third Amendment to the PCS Services Agreement with Sprint Nextel to provide that we would be required to pay Sprint Nextel at least $298 million for wireless network services, including voice, messaging and data traffic, according to a monthly payment schedule during the year ending December 31, 2008, and will receive off-peak rates for a two-hour period each week day until (pursuant to the Fifth Amendment to the PCS Services Agreement, as described below) the closing of the proposed acquisition of Helio. If the amounts due based on actual usage exceed the spending commitment, we will pay the total annual amount for such actual usage owed to Sprint Nextel. This amendment was contingent upon us obtaining approval from the Virgin Group to increase the lending commitment under the related party subordinated credit agreement with the Virgin Group, or the Revolving Credit Facility, from $75 million to $100 million by June 30, 2008.

On June 27, 2008, in connection with our proposed acquisition of Helio, we entered into the Fourth and Fifth Amendments to the PCS Services Agreement with Sprint Nextel. The Fourth Amendment to the PCS Services Agreement eliminated the requirement that we secure an increase in the Virgin Group s lending commitment under the Revolving Credit Facility from $75 million to $100 million by June 30, 2008, which had been a requirement to the continued effectiveness of the Third Amendment to the PCS Services Agreement. The Fifth Amendment to the PCS Services Agreement, which will become effective with the closing of the proposed acquisition of Helio and supersede the Third Amendment to the PCS Services Agreement, eliminates the annual true-up process and related payment obligations, and provides that we will be required to pay Sprint Nextel at least $320 million, $370 million and $420 million, during the years ended December 31, 2008, 2009 and 2010, respectively, for wireless network services, including voice, messaging and data traffic. Under the Fifth Amendment of the PCS Services Agreement there will be no minimum annual commitment for 2011 and beyond and the pricing will be based on the pricing schedule for 2010, unless amended. Our monthly rates for such services for the year ended December 31, 2009 and beyond will be determined by calculating the actual revenue to Sprint Nextel for all monthly bill cycles which commenced during the four immediately preceding calendar quarters, with the sum of the revenue for those quarters used to determine the rates for monthly bill cycles in the subsequent calendar quarter. As aggregate revenue amounts delivered to Sprint Nextel over prior quarters increases, the rates that we pay for wireless voice and data services for the following calendar quarter will decrease. Additionally, effective July 1, 2008 Sprint Nextel will provide us with a $2.50 network usage credit for each gross addition through December 31, 2009, up to a maximum of $10 million. We will be eligible to receive this credit provided that, beginning with 45 days after the closing of the proposed Helio acquisition, no undisputed amounts invoiced to us under the PCS Services Agreement are past due.

Table of Contents

During the six months ended June 30, 2008, 5.5% of our customers accessed our services through Sprint Nextel s third-party PCS affiliates and we generated approximately $24 million in revenues from such customers. Until recently, every three years, each of these third-party PCS affiliates had the right to discontinue the activation of service for our new customers in their respective regions, but two of the remaining three affiliates have now agreed to provide services to Virgin Mobile through the expiration of our PCS Services Agreement with Sprint Nextel (unless their relationship with Sprint Nextel terminates before that time). The inability to provide service to new customers within the third party PCS affiliates territories could have an adverse effect on our business and could adversely affect our financial condition, results of operations and cash flows.

We operate in the highly competitive and regulated wireless communications industry. The primary bases of competition in our industry are the prices, types and quality of products and services offered. As the wireless communications industry continues to grow and consolidate, we continually reassess our business strategies and their impact on our operations. Our strategies have included pricing our handsets competitively to grow and maintain our customer base. We expect these strategies to continue in the future. As a result, handset subsidies may increase and could result in lower results of operations and cash flows. In addition, lower handset prices may increase the number of subsidized replacement handsets sold to existing customers at a loss as the customer replaces their existing handsets, resulting in additional cost to our business which would have an adverse impact on our results of operations and cash flows.

The lower handset prices may also make our services more accessible to new, lower-value, customers with less disposable income available to spend on our services. In addition, as handset prices decline and handsets become more disposable, customers without contracts may change their wireless providers more frequently, thereby increasing our customer turnover, or churn, and resulting in additional acquisition costs to replace those customers. Depending on how quickly a customer churns, we may not be able to recoup our initial investment expended in acquiring the customer. A shift to lower value or less stable customers could have an adverse impact on our financial position, results of operations, and cash flows.

We continually monitor the impact of handset prices on the profile of our new customers, the behavior of our existing customers and our financial performance, and will make adjustments to our pricing strategy accordingly, including potentially raising prices.

We primarily rely on four third-party retail distribution channels for product placement within their stores to promote the sale of our handsets to grow our customer base. Our relationships with these distribution partners are strong and we expect the relationships to continue. However, there is no assurance that our distribution partners will continue to distribute our products. The loss of any of these four retail distribution partners could result in lower gross additions, account replenishments, or Top-Ups , and increased churn and therefore lower results of operations and cash flows. In the first half of 2008, we entered into three important agreements which will expand our retail presence. We entered agreements with American Wireless and Sears, and agreed to expand our relationship with Wal-Mart. Collectively, these agreements are expected to expand our retail footprint by more than 2,000 doors by year end 2008.

The Federal Communications Commission, or FCC, and state Public Utilities Commissions, or state PUC s, regulate the provision of communication services. Future changes in regulations and compliance could impose significant additional costs on us either in the form of direct out-of-pocket costs or additional compliance obligations. We could be forced to increase our rates to cover these costs, making our service pricing less attractive to customers.

We earn revenues primarily from the sale of wireless voice and mobile data services, along with the sale of handsets through third party retail locations, our website or call center. Our services are available through a variety of different pricing plans, including flat-rate and monthly plans that offer the benefits of long-term contract-based wireless plans with the flexibility of pay-as-you-go services. During the first half of 2008, we rolled out revamped pricing plans to our customers, all of which were fully deployed by June 30, 2008. These plans were designed to simplify the competitiveness and value of our offers to our customers. These new plans provide our customers the ability to purchase, in a variety of ways and on a flexible basis, packages of minutes, or minute packs, in denominations ranging from $20 to $50. They also include, subject to certain restrictions, a roll-forward feature. On July 1, 2008, we further enhanced our calling plans by unveiling our Totally Unlimited nationwide calling plan for $79.99 per month, with no roaming or long-distance charges. We believe that the flexibility and competitive price points on these plans will help us retain customers and stimulate growth. We expect these new monthly plans to contribute an increasing portion of our revenue going forward. If our current customers are using certain plans that will be discontinued, they are not required to switch to one of our new plans.

We continue to assess the various competitive offers and pricing actions in the marketplace and will continue to monitor the offers and pricing actions our competitors take to assure that our offers remain competitive.

From time to time, we evaluate strategic opportunities, including mergers and acquisitions, partnerships and co-marketing opportunities, to improve our products and services, accelerate growth and increase shareholder value.

Proposed Acquisition of Helio LLC

On June 27, 2008, we entered into an agreement, or the Helio Agreement, to acquire Helio, a provider of wireless products and services. The acquisition of Helio will facilitate our entry into the postpaid market and allow us to take advantage of Helio s proprietary technology. Helio will become a wholly owned subsidiary of Virgin Mobile USA, L.P.

Under the terms of the Helio Agreement, we will acquire Helio from SK Telecom USA Holdings, Inc., or SK Telecom, EarthLink, Inc. and Helio, Inc. in exchange for limited partnership units in Virgin Mobile USA, L.P. and our Class A common stock, equivalent to 13 million shares of our Class A common stock. Each of the newly issued Virgin Mobile USA, L.P. partnership units will be convertible into shares of our Class A common stock on a one for one basis. The estimated purchase price, based on the closing price of our Class A common stock two trading days before and ending two trading days after the date of the announcement, will be approximately $38 million plus costs of the acquisition. The transaction is expected to close by the end of the third quarter of 2008, subject to regulatory approval and other customary closing conditions.

Under the terms of the Helio Agreement, each of the Virgin Group and SK Telecom or one of their respective affiliates, will invest $25 million in exchange for the issuance of 25,000 shares of our newly issued convertible preferred stock, or the Preferred Stock. The $50 million proceeds will be used to pay down a portion of the outstanding principal under the third party senior secured credit agreement, as amended, or the Senior Credit Agreement. Subject to approval by our stockholders, the Preferred Stock, which will be convertible into shares of Class A common stock upon the earlier of (i) four years from the date of issuance or (ii) such time as the market price of our Class A common stock exceeds $8.50 per share, will have a 6% annual dividend and be convertible at the option of the holder after 18 months from the date of issuance.

In connection with the acquisition of Helio, we entered into a Second Amendment to the Senior Credit Agreement and a Second Amendment to our Revolving Credit Facility, each of which will be effective upon the closing of the proposed acquisition of Helio. The Second Amendment to the Revolving Credit Facility increases the Virgin Group s lending commitment from $75 million to $100 million and adds SK Telecom as a new lender with a lending commitment of $35 million. The Second Amendment to the Senior Credit Agreement (i) requires that the $50 million of proceeds from the issuance of the Preferred Stock be used to pay down a portion of the outstanding loan balance under the Senior Credit Agreement, (ii) increases the interest rate applicable to outstanding balances by 100 basis points per year, and (iii) tightens the leverage ratio covenant by 0.25 times (at December 31, 2008, the leverage ratio would decrease from 3.00 to 1.00, to 2.75 to 1.00).

IBM Outsourcing Contract

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

As part of the IBM Agreement, our information technology and infrastructure, and applications development will be transitioned to IBM s service environment and 46 of our employees transferred to IBM. In connection with the outsourcing and related restructuring, approximately 126 employees will be terminated and our facility in Walnut Creek, California will be closed. Restructuring charges for severance, retention bonuses, lease and contract termination costs, write-off and disposal costs of certain fixed assets, accelerated stock compensation costs, and other items are expected to aggregate approximately $8.9 million in the second half of 2008 and approximately $2.2 million in 2009. Of these amounts, cash expenses, which we expect to fund from cash generated from operations, are anticipated to aggregate $4.5 million, $5.1 million, and $0.4 million in 2008, 2009, and 2010, respectively. Employees being terminated are required to remain with the Company through a specified transition period in order to be eligible to receive any severance and retention payments. The transition of the Company s information technology and infrastructure, and applications development to the IBM service environment is expected to be completed by December 31, 2008. Beginning in 2009, we anticipate average annual savings of approximately $12 million.

Table of Contents

In accordance with the IBM Agreement, we prepaid $5.5 million in service charges to IBM in July 2008 and will prepay an additional $4.6 million in service charges to IBM over the period from August 2008 to March 2009. The July 2008 prepayment was paid from funds generated from operations which we expect will also be the source of funding for the remaining prepayments of $4.6 million. The prepayments will be applied to future charges for IBM services to the Company over the five-year term.

The IBM Agreement calls for IBM to provide a baseline level of service at agreed-upon dollar amounts. We expect to incur the following charges, inclusive of the amortization of the prepayments discussed above, as follows (in thousands):

Year	Amount
2008	$ 5,925
2009	29,654
2010	29,420
2011	28,884
2012	27,001
2013	7,360
	$ 128,244

The baseline services incurred will be adjusted monthly to reflect changes in the underlying currencies of countries in which IBM provides services to us. In addition, beginning in January 2010, the baseline service payments above will be adjusted on a monthly basis to reflect inflation or deflation in the U.S. and other countries in proportion to the services that IBM provides from each country.

We may increase or decrease the level of baseline services provided by IBM, along with related payments, based upon certain restrictions and circumstances. We expect to increase the baseline services for new applications development in the future.

Either party can terminate the IBM Agreement early under certain circumstances, but if we terminate the IBM Agreement solely for our convenience, we would be required to pay certain termination fees and wind-down charges. The minimum termination fees that we would be obligated to pay at the beginning of the IBM Agreement are approximately $13.9 million, which decrease over the life of the IBM Agreement. Wind-down charges are defined as non-cancelable lease payments, lease termination fees, certain salaries, benefits, relocation costs, severance costs relating to IBM employees that were our former employees, and certain other costs. Wind-down costs cannot be reasonably estimated at this time but could be material to our financial position if we elect to terminate the IBM Agreement.

Seasonality

Our business experiences significant seasonality that is driven by the traditional retail selling periods. We typically generate our highest level of gross additions in the fourth quarter of the year due to increased consumer spending during the holiday season. Additionally, our first quarter typically reflects a relatively low level of churn, due, in part, to the impact of the relatively high level of new customers added in the prior quarter and the way in which we measure churn, as we do not consider a customer to have churned until there has been 150 days of account inactivity. As a result, our net customer additions are often favorably impacted in both the fourth quarter and the first quarter of the following year. In contrast, our net customer additions for the second and third quarters reflect both the lower level of gross additions in those periods as well as the higher churn, from the fourth quarter gross additions.

The seasonality of our customer acquisitions is reflected in our financial statements whereby the higher subsidies in the third and fourth quarters to support the fourth quarter customer acquisition surge, result in a decline in our operating income and cash generated from operations during those quarters. The greater the number of customer acquisitions we are able to achieve in the latter part of the year, the greater the temporary negative impact on Adjusted EBITDA and cash generated from operations, however, such additional customers future cash flows are expected to increase our value in the longer term. Our cost per gross addition, or CPGA, is typically the lowest in the fourth quarter, reflecting the seasonality of our gross additions.

Table of Contents

Results of Operations

Key Performance Metrics

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

	Three months ended June 30,		Six months ended June 30,	
	2008	2007	2008	2007
Gross additions	728,370	785,326	1,523,945	1,666,992
Churn	5.6%	5.7%	5.3%	4.8%
Net customer additions	(111,273)	(53,424)	(93,501)	256,297
End-of-period customers	4,992,385	4,830,387	4,992,385	4,830,387
Adjusted EBITDA ($ thousands)	$ 32,321	$ 31,155	$ 61,023	$ 72,884
Adjusted EBITDA margin	11.1%	10.1%	10.3%	11.5%
ARPU	$ 19.32	$ 20.97	$ 19.63	$ 21.68
CCPU	$ 11.71	$ 13.54	$ 11.86	$ 13.50
CPGA	$ 113.38	$ 100.03	$ 114.53	$ 99.32

Gross additions represents the number of new customers that activated an account during a period, unadjusted for churn during the same period. In measuring gross additions, we begin with account activations and exclude retailer returns, customers who have reactivated and fraudulent activations. These adjustments are applied in order to arrive at a more meaningful measure of our customer growth. For the three and six months ended June 30, 2008, gross additions were 0.7 million and 1.5 million, respectively, as compared to 0.8 million and 1.7 million for the same periods last year. The decline versus last year, of 7.2% and 8.6%, respectively, primarily reflects the current economic conditions and their impact on consumer behavior, as well as more intense competitive pressure, including the recent expansion of certain of our competitors in key markets. Also, growth in the wireless industry overall is slowing as the industry matures. We continue to focus on consumer preferences and on developing competitive product and service offerings that differentiate us in the marketplace, and we anticipate being able to continue to attract new customers to our company. In particular, we believe that the flexibility and competitive pricing on the restructured and expanded suite of offers we began to introduce in the first quarter of 2008, our recent introduction of our Totally Unlimited voice offer and our acquisition of Helio, which is expected to open up the postpaid market to us, will help us retain customers, stimulate growth and, we believe, maintain healthy revenue and cost metrics. The narrowing decline in our gross additions for the second quarter reflects the impact of our newly launched offers. Also, we have been continuing to attract higher-value customers with attractive handsets such as the Wild Card, which has been bringing in significantly higher than average data usage, and the new Slash. The integration of Helio is expected to enable us to offer more sophisticated handsets, with more advanced data services and unique user applications. This, along with our expanded suite of offers, should strengthen our position in the marketplace. The specific level of our gross additions in the future will depend, in part, on the level of competitive activity and customer movement in the marketplace, along with the availability of attractive new offers and handset technology. Gross additions will also continue to be impacted by the seasonality of our business and the state of the economy.

Churn is used to measure customer turnover on an average monthly basis. Churn is calculated as the ratio of the net number of customers that disconnect from our service during the period being measured to the weighted average number of customers during that period, divided by the number of months during the period being measured. The net number of customers that disconnect from our service is calculated as the total number of customers that disconnect less the adjustments noted under gross additions above. These adjustments are applied in order to arrive at a more meaningful measure of churn. The weighted average number of customers is the sum of the average number of customers for each day during the period being measured divided by the number of days in the period. Churn includes those pay-by-the-minute customers who we automatically disconnect from our service when they have not replenished, or Topped-Up, their accounts for 150 days, as well as those monthly customers who we automatically disconnect when they have not paid their monthly recurring charge for 150 days (except for such monthly customers who replenish their account for less than the amount of their monthly recurring charge and, according to the terms of our monthly plans, may continue to use our services on a pay-by-the-minute basis), and such customers that voluntarily disconnect from our service prior to reaching 150 days since replenishing their account or paying their monthly recurring charge. We utilize 150 days in our calculation as it represents the last date upon which a customer who replenishes his or her account is still permitted to retain the same phone number. This calculation is consistent with the terms and conditions of our service offering. We believe churn is a useful metric to track changes in customer retention over time and to help evaluate how changes in our business and services offerings affect customer retention. In addition, churn is also useful for comparing our customer turnover to that of other wireless communications providers. For the three and six months ended June 30, 2008, our churn was 5.6% and 5.3%, respectively, as compared to 5.7% and 4.8% for the same periods last year. This increase in our churn for the six month period, as compared to last year, reflects a couple of factors. First, we experienced a year-over-year decline in our gross additions in the fourth quarter of 2007, driven by the weaker economy as well as by temporary aggressive pricing on the part of our competitors. As a result, we did not see a benefit on our first quarter churn of strong fourth quarter gross additions. Second, economic conditions for the first half of 2008 are weaker than they were during the same period in 2007. Despite the weaker economic conditions, for the more recent three month period, our churn was slightly improved as compared to the same period last year, which reflected some incremental losses associated with changes across our bucket offers, including the cap on unlimited usage for our $44.99 offer and higher pricing on over-the-limit usage. In addition, our level of churn for the six months ended June 30, 2007 reflected the incremental impact of approximately 75,000 customers who had totally disengaged at the point of these offer changes and who were recorded as having churned in the second quarter of 2007 instead of the third quarter, as they would have under normal churn rules. As with gross additions, the trends in our churn will continue to reflect competitive activity in the marketplace and the availability of attractive new offers and handsets. In particular, as noted earlier, we believe that the flexibility and competitive price points on the restructured and expanded suite of offers we started to introduce in March of 2008, and the expansion of our products and services with the upcoming acquisition of Helio, including our move into the postpaid market, will help us retain customers. Also, we believe our customer behavior will continue to be affected by the seasonality of our business and by the state of the economy. In addition to continually improving our offers and handsets, our ongoing lifecycle management programs, which target and incent specific customer segments deemed valuable to our business, will help to mitigate both economic and competitive pressure in the future.

Net customer additions and end-of-period customers are used to measure the growth of our business, to forecast our future financial performance and to gauge the marketplace acceptance of our offerings. Net customer additions represents the number of new customers that activated our handsets during a period, adjusted for churn during the same period. End-of-period customers are the total number of customers at the end of a given period. For the three months ended June 30, 2008, we experienced a net loss in customers of 111 thousand, resulting in a net loss of 94 thousand customers for the first half of the year. This compares to a net loss of 53 thousand and a net gain of 256 thousand for the same periods last year, respectively. As of June 30, 2008, we had approximately 5 million customers. This represents growth of 3.4%, as compared to June 30, 2007. Net customer additions reflect a percentage share of new users in the marketplace as well as a percentage of customers that have switched to us from our competitors net of our competitive losses, or churn. The decrease in net customer additions as compared to last year reflects both the increased competitive pressure as well as the continuing sluggish economy, both discussed earlier. The initiatives we are taking to strengthen our market position should help us improve gross additions and churn and maintain a positive trend in net additions.

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

Adjusted EBITDA is calculated as net income (loss) plus interest expense, income tax expense, tax receivable agreements expense, depreciation and amortization, write-offs of fixed assets, non-cash compensation expense, minority interest, equity issued to a member, debt extinguishment costs and expenses of Bluebottle USA Investments L.P. prior to the completion of the IPO. Beginning this quarter, we updated our definition of Adjusted EBITDA to exclude minority interest and write-offs of fixed assets. Although they are necessary elements of our cost structure, they are customary adjustments in the calculation of supplemental metrics. We believe Adjusted EBITDA is a useful tool in evaluating performance because it eliminates items related to taxes, as well as the tax receivable agreements, non-cash charges relating to depreciation and amortization, write-offs of fixed assets and minority interest, and items relating to both the debt and equity portions of our capital structure. Adjustments relating to interest expense, income tax expense, depreciation and amortization, write-offs of fixed assets and minority interest are each customary adjustments in the calculation of supplemental measures of performance. We also exclude tax receivable agreement related expenses for payments to the Virgin Group for the utilization of net operating loss carryforwards, and to Sprint Nextel, for the increase in tax basis that will be allocated to us, as we consider them to be the functional equivalent of paying taxes. We believe such adjustments are meaningful because they arrive at an indicator of our core operating results which our management uses to evaluate our business. Specifically, our management uses Adjusted EBITDA in their calculation of compensation targets, preparation of budgets and evaluations of performance. Similarly, we believe that the exclusion of non-cash compensation expense provides investors with a more meaningful indication of our performance as these non-cash charges relate to the equity portion of our capital structure and not our core operating performance. The expenses of Bluebottle USA Investments L.P. also do not relate to our core operating performance and are, therefore, excluded. These exclusions are also consistent with how we calculate the measures we use for determining certain bonus compensation targets, preparing budgets and for other internal purposes. We believe that the exclusion of equity issued to a member and debt extinguishment costs is appropriate because these charges relate to the debt and equity portions of our capital structure and are not expected to be incurred in future periods.

We find Adjusted EBITDA to be useful as a measure for understanding the performance of our operations from period to period and although not every company in the wireless communications industry defines these metrics in precisely the same way, we believe that this metric, as we use it, facilitates comparisons with other wireless communications companies. We use Adjusted EBITDA in our business operations to, among other things, evaluate the performance of our business, develop budgets and measure our performance against those budgets. We also believe that analysts and investors use Adjusted EBITDA as a supplemental measure to evaluate our company s overall operating performance. However, Adjusted EBITDA has material limitations as an analytical tool and you should not consider this in isolation, or as a substitute for analysis of our results as reported under GAAP. The items we eliminate in calculating Adjusted EBITDA are significant to our business: (i) interest expense is a necessary element of our costs and ability to generate revenue because we incur interest expense related to any outstanding indebtedness, (ii) to the extent that we incur income tax, it represents a necessary element of our costs and our ability to generate revenue because ongoing revenue generation is expected to result in future income tax expense, (iii) depreciation and amortization are necessary elements of our costs, (iv) write-offs of fixed assets eliminate non-productive assets from our balance sheet, reconciling it to our earnings, (v) tax receivable agreements expenses are the costs related to our tax receivable agreements, as they are reimbursements to the Virgin Group, for the utilization of net operating loss carryforwards we received as part of the IPO, and to Sprint Nextel, for the increase in tax basis that will be allocated to us, (vi) non-cash compensation expense is expected to be a recurring component of our costs and we may be able to incur lower cash compensation costs to the extent that we grant non-cash compensation, (vii) minority interest is the income related to the minority owners of Virgin Mobile USA, L.P. and, therefore, not available to our common stockholders, (viii) expense resulting from equity issued to a member represents an actual cost relating to a prior contractual obligation, and (ix) expenses associated with Bluebottle USA Investments L.P. prior to the IPO. Furthermore, any measure that eliminates components of our capital structure and the carrying costs associated with the fixed assets on our balance sheet has material limitations as a performance measure. In light of the foregoing limitations, we do not rely solely on Adjusted EBITDA as a performance measure, only as a supplement to our GAAP results. Adjusted EBITDA is not a measurement of our financial performance under GAAP and should not be considered as an alternative to net income, operating income or any other measures derived in accordance with GAAP. Because Adjusted EBITDA is not calculated in the same manner by all companies, it may not be comparable to other similarly titled measures used by other companies. As a result of the acquisition of Helio, in the future, we will also exclude the amortization of intangibles. We believe that these are customary adjustments in the calculation of supplemental measures of performance.

Table of Contents

For the three and six months ended June 30, 2008, Adjusted EBITDA was $32.3 million and $61.0 million, respectively, as compared to $31.2 million and $72.9 million for the same periods last year. Despite a challenging economic environment, our Adjusted EBITDA for the three month period increased, reflecting continued operating efficiencies. These were partially offset primarily by a decline in our net service revenue, driven by lower usage, the benefit realized during the three months ended June 30, 2007 due to the move to consignment for certain of our retailers and higher advertising and media spending this year to support the rollout of our new offers. The decline in our Adjusted EBITDA for the six month period primarily reflects a decline in our net service revenue, again driven by lower usage, the benefit realized last year due to the move to consignment for certain of our retailers, and higher advertising and media spending this year to support the rollout of our new offers. In addition, the decline for the six month period reflects a $5.3 million impact due to an E911 tax refund and favorable settlements with taxing jurisdictions last year as well as the impact of contributing to additional state E911 funds this year. These factors were partially offset by continued operating efficiencies. As we may experience some decline in revenue resulting from lower usage and lower pricing, we have considered, and will continue to consider, appropriate measures to align our costs with the revenue that is being generated, including reducing our administrative costs or potentially raising our handset prices in order to reduce our subsidy.

Adjusted EBITDA margin is used to measure our Adjusted EBITDA performance relative to our net service revenue so that we can gauge the performance of Adjusted EBITDA normalized for the changing scale of our business. Adjusted EBITDA margin is calculated by dividing Adjusted EBITDA by our net service revenue. For the three and six month periods ended June 30, 2008, our Adjusted EBITDA margin was 11.1% and 10.3%, respectively, compared to 10.1% and 11.5% for the same periods last year. The increase in our Adjusted EBITDA margin for the three month period reflects our continued operating efficiencies, including a reduction in Sprint Nextel network rates. These factors were partially offset by a decline in customer usage, the benefit realized during the second quarter of last year of the move to consignment for one of our retailers and higher advertising and media spending to support the rollout of our new offers. The decline in our Adjusted EBITDA margin for the six month period reflects the decline in usage, the benefit realized during the first half of last year of the move to consignment for two of our retailers and the higher advertising and media spending noted earlier. The decline for the six month period also reflects the impact, noted earlier, of the E911 tax refund and favorable settlements last year and the impact of contributing to additional state E911 funds this year. These factors were partially offset by our continued operating efficiencies.

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

	Three months ended June 30,		**Six months ended June 30,**	
(in thousands, except Adjusted EBITDA Margin)	**2008**	**2007**	**2008**	**2007**
Net income	$ 3,546	$ 7,140	$ 8,295	$ 26,312
Plus:				
Depreciation and amortization	8,844	8,650	17,522	16,731
Interest expense - net	7,933	13,859	17,272	27,448
Income tax expense	432		867	
Tax receivable agreements expense	6,036		8,116	
Non-cash compensation expense	3,340	1,409	6,761	2,190
Write-offs of fixed assets	230		230	
Bluebottle USA Investments L.P. expenses prior to the IPO		97		203
Minority interest	1,960		1,960	
Adjusted EBITDA	**$ 32,321**	**$ 31,155**	**$ 61,023**	**$ 72,884**
Net service revenue	$ 291,364	$ 309,713	$ 595,128	$ 632,050
Adjusted EBITDA margin	**11.1%**	**10.1%**	**10.3%**	**11.5%**

Table of Contents

ARPU is used to measure and track the average revenue generated by our customers on a monthly basis. ARPU is calculated as net service revenue for the period divided by the weighted average number of customers for the period being measured, further divided by the number of months in the period being measured. The weighted average number of customers is the sum of the average customers for each day during that period being measured divided by the number of days in that period. ARPU helps us to evaluate customer performance based on customer revenue and forecast our future service revenues. For the three and six months ended June 30, 2008, ARPU was $19.32 and $19.63, respectively, as compared to $20.97 and $21.68 for the same periods last year. The 7.9% and 9.5% decline in ARPU, respectively, as compared to the same periods last year reflects a decline in average voice usage per customer, driven, in part, by a weaker economy, the migration of high-usage, traditional pay-as-you-go, customers to the lower-priced bucket offers and a trend towards substitution of lower priced text messaging for voice services. In addition to these factors, the decline for the six month period also reflects the impact, noted earlier, of the E911 tax refund and favorable settlements with taxing jurisdictions last year, and the impact of contributing to additional state E911 funds this year. These factors more than offset increased customer penetration and usage for our mobile data services, the latter stimulated by new offerings and new handsets. We expect to continue to experience some downward pressure on ARPU as prices decline and as the economic downturn may continue to cause some customers to reduce their usage due to decreased disposable income; however, such pressure may be partially offset by a continued shift to higher value customers and by increased penetration of new services. For example, we have seen an increase in data usage from our customers who purchased the Wild Card and Slash handsets, and customers on our new offers, including our new Totally Unlimited voice offer, are currently generating significantly higher ARPU than average. The following table illustrates the calculation of ARPU and reconciles ARPU to net service revenue which we consider to be the most directly comparable GAAP financial measure.

	Three months ended June 30,		Six months ended June 30,	
(in thousands, except number of months and ARPU)	**2008**	**2007**	**2008**	**2007**
Net service revenue	$ 291,364	$ 309,713	$ 595,128	$ 632,050
Divided by weighted average number of customers	5,026	4,923	5,053	4,859
Divided by number of months in the period	3	3	6	6
ARPU	**$ 19.32**	**$ 20.97**	**$ 19.63**	**$ 21.68**

CCPU is used to measure and track our costs to provide support for our services to our existing customers on an average monthly basis. The costs included in this calculation are our (i) cost of service (exclusive of depreciation and amortization), excluding cost of service associated with initial customer acquisition, (ii) general and administrative expenses, excluding Bluebottle USA Investments L.P. general and administrative expenses prior to the IPO and non-cash compensation expenses, (iii) write-offs of fixed assets, (iv) net loss on equipment sold to existing customers, (v) cooperative advertising expenses in support of existing customers and (vi) other expense (income), excluding tax receivable agreements expenses, debt extinguishment costs and Bluebottle USA Investments L.P. These costs are divided by our weighted average number of customers for the period being measured, further divided by the number of months in the period being measured. CCPU helps us to assess our ongoing business operations on a per customer basis, and evaluate how changes in our business operations affect the support costs per customer. Given its use throughout the industry, CCPU also serves as a standard by which we compare our performance against that of other wireless communications companies. For the three and six months ended June 30, 2008, our CCPU was $11.71 and $11.86, respectively, as compared to $13.54 and $13.50 for the same periods last year. The improvement in CCPU as compared to the same periods last year was a result of lower average customer voice usage, decreasing costs on the per-minute rate charged to us by Sprint Nextel, the allocation of fixed costs over a growing customer base and a decline in our care center expenses reflecting significantly lower cost per minute rates as a result of the move to offshore service, as well as lower call volumes. These factors were partially offset by net additions to our hybrid plan customers that have a higher CCPU as a result of their higher usage profiles. Our net loss on equipment sold to existing customers for replacement handsets declined for the three month period, as compared to last year, reflecting a decline in the number of replacement handsets, partially offset by a shift to higher-end handsets. For the six month period, these costs were relatively flat with last year. We anticipate that there may be some pressure on CCPU in the future due to potentially increasing customer usage, as the economy improves, and the growing trend for our existing customers to purchase subsidized replacement handsets; however, efficiencies driven by the increasing scale of our business are expected to help offset that pressure. In addition, we will consider appropriate cost reductions and pricing action necessary to maintain a balanced relationship between ARPU and CCPU. As noted earlier, the Fifth Amendment to the PCS Services Agreement with Sprint Nextel, which is expected to become effective with the close of our proposed acquisition of Helio, provides that we be required to pay Sprint Nextel at least $320 million, $370 million and $420 million, during the years ended December 31, 2008, 2009 and 2010, respectively, for wireless network services, including voice, messaging and data traffic. This commitment could impact our CCPU costs going forward. We project that we will spend at least the minimum commitment under the PCS Services Agreement this year.

Table of Contents

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

(in thousands, except number of months and CCPU)	Three months ended June 30, 2008	Three months ended June 30, 2007	Six months ended June 30, 2008	Six months ended June 30, 2007
Cost of service (exclusive of depreciation and amortization)	$ 82,407	$ 90,001	$ 165,899	$ 183,979
Less: Cost of service associated with initial customer acquisition	(461)	(516)	(961)	(1,125)
Add: General and administrative expenses (excluding Bluebottle USA Investments L.P. expenses prior to the IPO)(1)	80,143	88,752	164,656	175,270
Less: Non-cash compensation expense	(3,340)	(1,409)	(6,761)	(2,190)
Less: Write-offs of fixed assets	(230)		(230)	
Add: Net loss on equipment sold to existing customers	18,778	22,535	37,139	36,475
(Less) add: Cooperative advertising expenses in support of existing customers	(867)	669	(260)	1,390
Add: Other expense (income), net of tax receivable agreements expense, debt extinguishment costs and Bluebottle USA Investments L.P.	74	4	74	(201)