
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

- Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the quarterly period ended September 30, 2004

- Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the transition period from _____ to _____

Commission File Number 000-21091

FIRST AVENUE NETWORKS, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

52-1869023
(I.R.S. Employer
Identification No.)

230 Court Square, Suite 202, Charlottesville, VA 22902
(Address of principal executive offices)

(434) 220-4988
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Section 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by the court: Yes No .

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Securities Exchange Act of 1934): Yes No .

Indicate the number of shares outstanding of each of the registrant's classes of common stock as of the latest practicable date: The registrant had 21,288,016 shares of its common stock outstanding as of October 22, 2004.

[Table of Contents](#)

FIRST AVENUE NETWORKS, INC.

INDEX

	Page
PART I. FINANCIAL INFORMATION	
Item 1. Financial Statements	3
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	9
Item 3. Quantitative and Qualitative Disclosures about Market Risk	14
Item 4. Controls and Procedures	14
PART II. OTHER INFORMATION	
Item 6. Exhibits and Reports on Form 8-K	15
Signatures	16
Exhibit Index	17

[Table of Contents](#)

ITEM 1. Financial Statements

FIRST AVENUE NETWORKS, INC. AND SUBSIDIARIES
Consolidated Balance Sheets
(unaudited)
(in thousands, except share data)

	September 30, 2004		December 31, 2003
Current assets:			
Cash and cash equivalents	\$ 4,800	\$	3,599
Certificate of deposit	2,000		—
Accounts receivable, net	17		34
Prepaid expenses and other current assets	388		88
Inventory	234		234

Total current assets	7,439	3,955
Property and equipment, net of accumulated depreciation	3	7
FCC licenses (Note 4)	21,662	21,600
Other assets	4	4
Total assets	\$ 29,108	\$ 25,566
Current liabilities:		
Accounts payable	\$ 126	\$ 22
Accrued compensation and benefits	199	252
Accrued taxes other than income taxes	350	350
Deferred revenue	26	4
Other accrued liabilities	107	188
Total current liabilities	808	816
Senior secured notes to shareholders, net of unamortized discount	12,215	10,694
Deferred revenue, noncurrent	300	—
Accrued taxes other than income taxes, less current portion	3,760	3,760
Total liabilities	17,083	15,270
Commitments and contingencies (Note 5)		
Stockholders' equity:		
Common stock, \$0.001 par value; 100,000,000 and 50,000,000 shares authorized, 21,288,016 and 20,048,846 shares issued and outstanding at September 30, 2004 and December 31, 2003, respectively	21	20
Additional paid-in capital	47,687	42,181
Accumulated deficit	(35,683)	(31,905)
Total stockholders' equity	12,025	10,296

Total liabilities and stockholders' equity	\$	29,108	\$	25,566
--	----	--------	----	--------

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

[Table of Contents](#)

FIRST AVENUE NETWORKS, INC. AND SUBSIDIARIES
Consolidated Statements of Operations
(unaudited)
(in thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
es	\$ 25	\$ 33	\$ 77	\$
nd ses:				
technical and network operation s	—	1	1	
les and marketin g	122	98	477	
eneral and administr ative	558	349	1,908	
preciation and amortizat ion	1	3	4	
Total cos ts and exp ens es	681	451	2,390	
m tions	(656)	(418)	(2,313)	

and other:			
interest expense to shareholders	(514)	(487)	(1,521)
interest income	8	12	32
other	4	23	24
Total interest and other	(502)	(452)	(1,465)
\$	(1,158) \$	(870) \$	(3,778) \$
and diluted loss per non share			
Net loss \$	(0.06) \$	(0.04) \$	(0.18) \$
and average non shares	21,288	20,000	21,146

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

[Table of Contents](#)

FIRST AVENUE NETWORKS, INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Cash Flows
(unaudited)
(in thousands)

Nine Months Ended
September 30,

	2004	2003
Cash flows from operating activities:		
Net loss	\$ (3,778) \$	(1,969)
Adjustments to reconcile net loss to net cash used in operating activities:		

Depreciation and amortization	4	7
Non-cash interest expense to shareholders	1,521	1,443
Non-cash stock-based compensation expense	1,245	106
Changes in operating assets and liabilities	9	(821)
Net cash used in operating activities	(999)	(1,234)
Cash flows from investing activities:		
Purchase of certificate of deposit	(2,000)	—
Purchase of 24 GHz license in FCC spectrum auction	(62)	—
Net cash used in investing activities	(2,062)	—
Cash flows from financing activities:		
Net proceeds from the sale of common stock	4,262	—
Net cash provided by financing activities	4,262	—
Net increase (decrease) in cash and cash equivalents	1,201	(1,234)
Cash and cash equivalents, beginning of period	3,599	5,300
Cash and cash equivalents, end of period	\$ 4,800	\$ 4,066
Supplemental Disclosure of Cash Flow Information:		
Non-cash financing and investing activities:		

Issuance of senior secured notes to shareholders for paid-in-kind interest	\$	908	\$	830
<hr/>				
Amortization of original issue discount on senior secured notes issued to shareholders	\$	613	\$	612
<hr/>				

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

[Table of Contents](#)

First Avenue Networks, Inc. and Subsidiaries
Notes to Consolidated Financial Statements

Note 1—The Company and Basis of Presentation

First Avenue Networks, Inc. (collectively with its subsidiaries, the “Company”) owns over 750 wireless telecommunication licenses granted by the Federal Communications Commission (“FCC”) that provide coverage of substantially all of the continental United States with 39 GHz spectrum. This license portfolio represents over 1 billion channel pops, calculated as number of channels in a given area multiplied by the population covered by these channels.

The Company was previously known as Advanced Radio Telecom Corp. (“ART”). In February 2002, the shareholders approved amendments to the Certificate of Incorporation to change the Company’s name to First Avenue Networks, Inc. ART, with its subsidiaries, filed a voluntary petition with the United States Bankruptcy Court for the District of Delaware (the “Bankruptcy Court”) for protection under Chapter 11 of Title 11 of the United States Code (the “Bankruptcy Code”) on April 20, 2001 (the “Petition Date”).

On October 31, 2001, the Bankruptcy Court approved the Company’s Plan of Reorganization filed with the Bankruptcy Court on September 27, 2001 (the “Plan”). On December 20, 2001 (the “Effective Date”), the Company met all of the Conditions Precedent to the Effective Date (as defined), the Plan was effective and the Company emerged from proceedings under Chapter 11 of the Bankruptcy Code. For financial reporting purposes, the Company reflected its emergence from bankruptcy as of the close of business on December 31, 2001.

The Company is subject to all of the risks inherent in an early-stage business in the telecommunication industry. These risks include, but are not limited to: limited operating history; management of a changing business; reliance on other third parties; competitive nature of the industry; development and maintenance of efficient technologies to support the business; employee turnover; and, operating cash requirements. Management expects operating losses and negative cash flows to continue for the foreseeable future. Failure to generate sufficient revenues could have a material adverse effect on the Company’s results of operations, financial condition and cash flows. The recoverability of assets is highly dependent on the ability of management to execute its business plan.

Interim financial statements – Certain information and footnote disclosures normally included in financial statements have been condensed or omitted pursuant to rules and regulations of the Securities and Exchange Commission. The accompanying interim condensed consolidated financial statements are

unaudited. In the opinion of Company management, these financial statements include all adjustments, consisting of normal recurring adjustments, necessary for a fair presentation of the Company's financial position and results of operations for the interim periods presented. The unaudited condensed consolidated financial statements should be read in conjunction with the Company's 2003 audited consolidated financial statements and notes thereto contained in the Company's 2003 Annual Report on Form 10-K.

Use of estimates – Preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect amounts reported in the financial statements. Actual results could differ from those estimates. The more significant estimates made by management include fair values of assets and liabilities, accrued property and use taxes and realization of deferred tax assets.

FCC licenses – FCC licenses are granted for initial ten-year terms with renewal dates ranging from 2006 to 2011. Under the provisions of Statement of Financial Accounting Standards No. 142 "Goodwill and Other Intangible Assets" ("SFAS No. 142"), FCC licenses are deemed to have an indefinite useful life and are not amortized.

Impairment of long-lived assets – The Company evaluates its long-lived assets for impairment and continues to evaluate them as events or changes in circumstances indicate that the carrying amount of such assets may not be fully recoverable. In cases where undiscounted expected cash flows associated with such assets are less than their carrying value, an impairment provision is recognized in an amount by which the carrying value exceeds the estimated fair value of such assets. Recoverability of the carrying value of FCC licenses is dependent on successful deployment of networks and radio links or sales of such assets to a third party. The Company considers the FCC licenses to have an indefinite useful life under the provisions of SFAS No. 142. The Company performs an annual impairment test on this asset. If events and circumstances indicate the assets might be impaired, the Company will perform such a test on an interim basis. The impairment test compares the fair value of the FCC licenses with the carrying value of the asset. If the fair value is less than the carrying value an impairment loss will be recorded.

Net loss per share – Calculation of loss per share for the three months and nine months ended September 30, 2004 excludes the effect of warrants and options to purchase 5.2 million and 1.3 million, respectively, shares of common stock since inclusion in such calculation would be antidilutive. Calculation of loss per share for the three months and nine months ended September 30, 2003 excludes the effect of warrants and options to purchase 4.0 million and 940,000, respectively, shares of common stock since inclusion in such calculation would have been antidilutive.

[Table of Contents](#)

Stock options – The Company applies Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations, including Financial Accounting Standards Board Interpretation No. 44, "Accounting for Certain Transactions Involving Stock Compensation" for its stock-based compensation plan. Accordingly, compensation cost for stock options granted to employees and directors is measured as the excess, if any, of fair value of Company stock over exercise price at the measurement date, except when the plan is determined to be variable in nature. The Company accounts for equity stock options granted to non-employees at fair value.

In September 2003, the Company canceled 940,000 options to purchase common stock at a strike price of \$3.96 which represented all of its outstanding options. The Company replaced these options with 1.4 million options to purchase common stock at a strike price of \$0.14. At September 30, 2004, 506,000 are vested. These options are accounted for as variable options. The remainder vest annually at a rate of 278,000 on each December 20 through December 20, 2006. As a result of this variable method of accounting, the Company has recorded a non-cash compensation charge of \$1.2 million and \$106,000 during the nine months ended September 30, 2004 and 2003, respectively.

The following table summarizes relevant information as to reported results under the Company's intrinsic value method of accounting for stock awards, with supplemental information as if the fair value recognition provisions of SFAS No. 123, "Accounting for Stock Based Compensation," (SFAS 123) as amended by SFAS 148, "Accounting for Stock-Based Compensation – Transition and Disclosure," (SFAS 148) had been applied (in thousands, except per share data):

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2004	2003	2004	2003
Loss, as reported	\$ (1,158)	\$ (870)	\$ (3,778)	\$ (1,158)
Stock-based compensation expense included				
Reported net loss	329	106	1,245	1,245
Stock-based compensation expense determined using fair value based method for awards	—	(53)	—	—
Loss, as adjusted for fair value method for all stock-based awards	\$ (829)	\$ (817)	\$ (2,533)	\$ (1,158)
and diluted earnings per share, as reported	\$ (0.06)	\$ (0.04)	\$ (0.18)	\$ (0.06)
and diluted earnings per share, as adjusted	\$ (0.04)	\$ (0.04)	\$ (0.12)	\$ (0.04)

Note 2—Sale of Common Stock and Warrants

In January 2004, the Company sold 1.2 million units, each unit comprised of one share of common stock and one warrant, for \$3.60 per unit, yielding gross proceeds of \$4.4 million. The five-year warrants are exercisable immediately with an exercise price of \$1.83 (“Stock Purchase Warrants”). As a condition of the sale, the holders of the senior secured notes agreed to extend the maturity of these notes from December 20, 2006 to December 20, 2008. The notes continue to bear paid-in-kind interest at the rate of 9% per annum that is payable quarterly through the issuance of additional senior secured notes.

Note 3—Related Party Transactions

Holders of approximately 62% of the common stock own \$12.9 million or 93% of the outstanding senior secured notes and 3.7 million Class A Warrants. Holders of approximately 38% of the common stock own 833,333 or 69% of the Stock Purchase Warrants. Representatives from two entities holding approximately 45% of the outstanding common stock serve on the Company’s Board of Directors. A member of our Board of Directors periodically serves as a consultant to a holder of approximately 17% of the outstanding common stock. The Company issued \$908,000 and \$830,000 of senior secured notes for paid-in-kind interest during the nine months ended September 30, 2004 and 2003, respectively, to holders of the senior secured notes, all of whom are shareholders. The Company amortized original issue discount of \$613,000 and \$612,000 on senior secured notes issued to shareholders during the nine months ended September 30, 2004 and 2003, respectively.

Note 4—FCC Licenses

In June 2004, the Company deposited \$3.4 million with the Federal Communications Commission (“FCC”) for participation in the FCC’s auction of 24 GHz spectrum. In the July 2004 auction, the Company purchased a license for one channel of 24 GHz spectrum in the Denver Basic Economic Area for \$62,400. In August, the FCC refunded the remainder of the deposit.

[Table of Contents](#)

Note 5—Commitments and Contingencies

Contingencies – The Company is subject to certain claims and assessments and makes routine filings with the FCC and state regulatory authorities. Management believes that resolution of any such claims or matters arising from such filings, if any, will not have a material adverse impact on the Company’s consolidated financial position or results of operations.

Note 6—Acquisition of Teligent’s Assets

On July 7, 2004, the Company signed a Letter of Intent for the acquisition of certain assets of Teligent, Inc. (“Teligent”) including its 24 GHz spectrum licenses. On November 8, 2004, the Company signed a definitive purchase agreement for the acquisition of substantially all of the assets and fixed broadband wireless operations of Teligent. The Company will acquire Teligent’s 24 GHz spectrum licenses, radio assets and fixed wireless operations, including an operational cellular backhaul network in New York City. In consideration for these assets, the Company will issue approximately 25.2 million shares of common stock and warrants to purchase up to 2.5 million shares of common stock. The terms and conditions of the acquisition agreement are subject to FCC and other regulatory approvals. The Company expects to complete this acquisition in late 2004.

[Table of Contents](#)

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read the following discussion in conjunction with the section below titled "Cautionary Statement," our Consolidated Financial Statements and related Notes, and other financial information appearing in our most recently filed Annual Report on Form 10-K.

Overview

The Company holds over 750 licenses granted by the Federal Communications Commission ("FCC"). It leases the spectrum represented by these licenses to others to construct high-speed wireless telecommunications links and networks. Our leasing products, Express Link and Express Net, offer a way for telecommunications carriers and enterprise customers to access interference-free, carrier class, licensed spectrum.

The Company's leasing strategy allows it to utilize its FCC licenses to facilitate wireless telecommunications services in a capital efficient manner. It seeks to identify, contact and serve existing telecommunications carriers in a manner that does not require significant sales and marketing, operating and capital expenditures. The recoverability of the Company's investment in its FCC licenses is dependent on the successful execution of its business plan.

The Company currently has more than 35 leases for spectrum on a link-by-link basis and has leased spectrum in three urban regions. Additionally, the Company has retained nine fixed transmission links originated by its predecessor which customers incorporate into their telecommunication networks and utilize to provide a primary telecommunication link or, in other cases, redundancy, back up or diversity to other telecommunication services. In December 2003, the Company entered into an Express Net contract with a large telecommunications carrier with nationwide coverage. Under the terms of this contract, the Company has leased a portion of its spectrum in two urban regions for seven years.

From its inception in 1993 through the first quarter of 2001, the Company acquired airwave capacity, or spectrum rights, through FCC auctions and purchase transactions, raised capital through public and private offerings of securities, acquired equipment and roof rights, and developed operating and support systems and networks. From 1996 to 2000, the Company utilized several strategies to provide broadband Internet services. It invested heavily in the testing and deployment of fixed wireless links and networks. In 1998, it began to sell a variety of Internet services to end-users in Seattle, WA, Portland, OR, and Phoenix, AZ. In late 1999, the Company's strategy evolved to providing high-speed transmission services, including Internet access to businesses. During 2000, it launched these services in ten markets. In the first quarter of 2001, the Company was unable to secure additional funding sources to continue to finance operations and service debt.

Reorganization

The Company sought reorganization under Chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court for the District of Delaware ("Court") on April 20, 2001 (the "Petition Date"). It terminated nearly all of its employees, terminated operation of its networks and eliminated customer support. A Joint Plan of Reorganization ("Plan") was developed and was approved by the Court on October 31, 2001. On December 20, 2001 ("Effective Date"), the Plan was effective and the Company emerged from the proceedings under Chapter 11 of the United States Bankruptcy Code pursuant to the terms of the Plan.

Under the Plan, the Company issued 20 million shares of new post-Chapter 11 common stock ("New Common Stock") to unsecured creditors and holders of Series A Preferred Stock ("Old Preferred Stock"). Each holder of an unsecured claim received its pro rata share of 19 million shares of New Common Stock. Each holder of Old Preferred Stock received its pro rata share of 1 million shares of New Common Stock. Holders of pre-chapter 11 common stock ("Old Common Stock") and holders of any other equity interest received no distributions under the Plan. All Old Common Stock, Old Preferred Stock and all other equity interests such as employee stock options and warrants were cancelled on the Effective Date.

Results of Operations

Nine months ended September 30, 2004 compared to nine months ended September 30, 2003

Revenues for the nine months ended September 30, 2004 decreased 37% to \$77,000 from \$123,000 for the nine months ended September 30, 2003. This decrease was the result of the decline in the number of dedicated wireless links the Company has remaining from its predecessor. The number of links continued to decrease from 13 at September 30, 2003 to nine at September 30, 2004. The Company has begun recognizing revenue from its spectrum leasing program which it launched in 2003. Revenue under these leases is recognized ratably over the individual lease periods which currently range from 12 to 84 months. At September 30, 2004, the Company had more than 35 leases for its spectrum on a link-by-link basis and three leases for geographic areas.

Table of Contents

Technical and network operations costs and expenses are comprised primarily of frequency coordination fees related to spectrum leases and roof-top rent and backhaul for dedicated wireless links. Technical and network operations costs and expenses decreased 67% to \$1,000 for the nine months ended September 30, 2004, compared to \$3,000 for the nine months ended September 30, 2003. This decrease resulted from the 2004 reduction in the number of facilities rented to provide service to dedicated wireless links. Technical and network operations costs and expenses were 1% and 2% of revenues for the nine months ended September 30, 2004 and 2003, respectively.

Sales and marketing costs and expenses are comprised primarily of compensation and related costs. These costs increased 141% to \$477,000 for the nine months ended September 30, 2004, compared to \$198,000 for the nine months ended September 30, 2003. The increase during the nine months ended September 30, 2004 was a result of the following: (i) an increase of \$166,000 in non-cash stock-based compensation expense; (ii) \$84,000 increase in sales commissions; and, (iii) \$30,000 increase in spending for trade shows and public relations regarding the Company's spectrum leasing program. Sales and marketing costs and expenses were 619% and 161% of revenues for the nine months ended September 30, 2004 and 2003, respectively.

General and administrative costs and expenses primarily consist of compensation, occupancy expenses, professional fees and insurance. General and administrative costs and expenses increased 103% to \$1.9 million for the nine months ended September 30, 2004 from \$938,000 for the nine months ended September 30, 2003. The increase in general and administrative costs and expenses during the nine months ended September 30, 2004 was primarily a result of an increase of \$974,000 in non-cash stock-based compensation expense. General and administrative costs and expenses were 2478% and 763% of revenues for the nine months ended September 30, 2004 and 2003, respectively.

Depreciation and amortization expense decreased to \$4,000 for the nine months ended September 30, 2004 from \$7,000 for the nine months ended September 30, 2003. Depreciation and amortization expense was 5% and 6% of revenues for the nine months ended September 30, 2004 and 2003, respectively.

Interest and other expenses increased to \$1.5 million for the nine months ended September 30, 2004 from \$946,000 for the nine months ended September 30, 2003. This change primarily is attributable to (i) a \$78,000 increase in paid-in-kind interest expense as a result of the increased senior secured note balance and (ii) a \$435,000 decrease in other income. During the nine months ended September 30, 2003, the Company recorded other income as the result of settling disputed bankruptcy claims for amounts less than the recorded liability. The Company had no similar income for the nine months ended September 30, 2004.

During the nine months ended September 30, 2004, the Company increased its deferred tax valuation allowance to equal its deferred tax asset based upon management's determination that the recognition criteria for realization had not been met.

Three months ended September 30, 2004 compared to three months ended September 30, 2003

Revenues for the three months ended September 30, 2004 decreased 24% to \$25,000 from \$33,000 for the three months ended September 30, 2003. This decrease was the result of the decline in the number of dedicated wireless links the Company has remaining from its predecessor. The number of links continued to decrease from 13 at September 30, 2003 to nine at September 30, 2004. The Company has begun recognizing revenue from its spectrum leasing program which it launched in 2003. Revenue under these leases is recognized ratably over the individual lease periods which currently range from 12 to 84 months. At September 30, 2004, the Company had more than 35 leases for its spectrum on a link-by-link basis and three leases for geographic areas.

Technical and network operations costs and expenses are comprised primarily of frequency coordination fees related to spectrum leases and roof-top rent and backhaul for dedicated wireless links. The Company incurred no technical and network operations costs and expenses for the three months ended September 30, 2004, compared to \$1,000 for the three months ended September 30, 2003. This decrease resulted from the 2004 elimination of facilities rented to provide service to dedicated wireless links. Technical and network operations costs and expenses were 0% and 3% of revenues for the three months ended September 30, 2004 and 2003, respectively.

Sales and marketing costs and expenses are comprised primarily of compensation and related costs. These costs increased 24% to \$122,000 for the three months ended September 30, 2004, compared to \$98,000 for the three months ended September 30, 2003. This increase was a result of an increase of \$30,000 in non-cash stock-based compensation expense during the three months ended September 30, 2004. Sales and marketing costs and expenses were 488% and 297% of revenues for the three months ended September 30, 2004 and 2003, respectively.

General and administrative costs and expenses primarily consist of compensation, occupancy expenses, professional fees and insurance. General and administrative costs and expenses increased 60% to \$558,000 for the three months ended September 30, 2004 from \$349,000 for the three months ended September 30, 2003. The increase in general and administrative costs and expenses during the three months ended September 30, 2004 was primarily a result of an increase of \$193,000 in non-cash stock-based compensation expense. General and administrative costs and expenses were 2232% and 1058% of revenues for the three months ended September 30, 2004 and 2003, respectively.

Table of Contents

Depreciation and amortization expense decreased by 67% to \$1,000 for the three months ended September 30, 2004 from \$3,000 for the three months ended September 30, 2003. Depreciation and amortization expense was 4% and 9% of revenues for the three months ended September 30, 2004 and 2003, respectively.

Interest and other expenses increased to \$502,000 for the three months ended September 30, 2004 from \$452,000 for the three months ended September 30, 2003. This change is attributable to a \$27,000 increase in paid-in-kind interest expense as a result of the increased senior secured note balance.

During the three month period ended September 30, 2004, the Company increased its deferred tax valuation allowance to equal its deferred tax asset based upon management's determination that the recognition criteria for realization had not been met.

Liquidity and Capital Resources

During the nine months ended September 30, 2004, operating activities used cash of approximately \$999,000 as compared to \$1.2 million during the nine months ended September 30, 2003. Cash used by

operating activities during the nine months ended September 30, 2004 and 2003 resulted primarily from the Company's net loss reduced by non-cash interest expense and non-cash stock-based compensation expense.

During the nine months ended September 30, 2004, financing activities provided cash of approximately \$4.3 million. In January 2004, the Company sold 1.2 million units (the "Units"), each unit comprised of one share of common stock and one warrant, for \$3.60 per unit, yielding gross proceeds of \$4.4 million. The Company incurred \$88,000 of professional expenses as a result of this transaction.

In connection with its exit from bankruptcy in December 2001, the Company issued \$11.0 million of five-year senior secured notes (the "Notes") and 4 million fully-vested five-year New Class A Warrants, with an exercise price of \$0.01, to holders of the Notes for aggregate consideration of \$11.0 million. In connection with the sale of the Units, the maturity of the Notes was extended from December 20, 2006 to December 20, 2008. The Notes are collateralized by all assets of the Company. They bear interest at the rate of 9% per annum that is payable quarterly through the issuance of additional Notes at the Company's option. Interest is mandatorily payable in cash in the event of a continuing event of default. During the nine months ended September 30, 2004 and 2003, the Company issued \$908,000 and \$830,000, respectively, of additional Notes for interest. The Senior Note and Class A Warrant Purchase Agreement contains covenants which limit the Company's ability to incur additional debt, pay dividends or make other distributions, incur liens, merge or sell assets and enter into certain transactions with related parties.

The Company recorded the original issuance of the Notes net of the estimated fair value of the New Class A Warrants at the issuance date. Amortization of debt discount of \$613,000 has been determined utilizing the effective interest rate method and is a component of interest expense for the nine months ended September 30, 2004 and 2003.

In June 2004, the Company deposited \$3.4 million with the Federal Communication Commission ("FCC") for participation in the FCC's auction of 24 GHz spectrum. In the July 2004 auction, the Company purchased a license for one channel of 24 GHz spectrum in the Denver Basic Economic Area for \$62,400. In August, the FCC refunded the remainder of the deposit.

On November 8, 2004, the Company signed a definitive purchase agreement for the acquisition of substantially all of the assets and fixed broadband wireless operations of Teligent, Inc. The Company will acquire Teligent's 24 GHz spectrum licenses, radio assets and fixed wireless operations, including an operational cellular backhaul network in New York City. In consideration for these assets, the Company will issue approximately 25.2 million shares of common stock and warrants to purchase an additional 2.5 million shares of common stock. The terms and conditions of the acquisition agreement are subject to FCC approval. The Company expects to complete this acquisition in late 2004.

The Company had cash and cash equivalents and certificate of deposit totaling \$6.8 million at September 30, 2004. The Company believes that the cash balance at September 30, 2004 is sufficient to cover its operations and capital requirements through and including 2005.

Since its inception, the Company has incurred losses from operations and expects to continue to incur losses in the foreseeable future. The Company has altered its business plan to minimize expenditures and the amount of future capital required. At September 30, 2004, it had three employees and non-cancelable financial commitments of less than \$8,000 due in 2004. Management expects operating losses and negative cash flows to continue for the foreseeable future. Failure to generate sufficient revenues could have a material adverse effect on the Company's ability to pay the debt on its due date. The Company's ability to generate sufficient cash to meet its future debt payments is highly dependent on the ability of management to execute its business plan.

The preparation of consolidated financial statements requires management to make judgments based upon estimates and assumptions that are inherently uncertain. Such judgments affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. Management continuously evaluates its estimates and assumptions, including those related to long-lived assets, inventories, income taxes, contingencies and litigation, and the carrying values of assets and liabilities. Management bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions.

A summary of our most critical accounting policies and significant estimates used in the preparation of our consolidated financial statements is as follows:

- Given the nature of the Company's 39 GHz spectrum, significant judgment is required in making an assessment as to whether the recorded carrying value of these assets exceeds the estimated fair market value. At December 31, 2003, the Company's FCC licenses had a carrying value of \$21.6 million. During 2003, the Company performed a valuation of its spectrum under SFAS No. 142 which resulted in a \$50.8 million valuation. In performing this evaluation, the Company identified a number of factors that are considered to be indicative of the value of its FCC licenses, including (i) the increase in its public equity value; (ii) private purchases of similar licenses; and, (iii) the increase in the public equity value of companies providing similar services or holding similar FCC licenses. Each of the factors was then quantified and weighted in deriving the estimated fair value. No impairment of the FCC license value occurred during the nine month period ended September 30, 2004.

Several key assumptions were included in the valuation model: (i) the value of the FCC licenses directly correlates with public trading value of the Company's stock and that of other public companies in the telecommunication industry; (ii) certain private purchases of similar licenses are reflective of the fair value of the underlying assets; (iii) the relative weights assigned to each factor represents the level of the factor's relevance to the estimation of the fair value of the FCC licenses; and, (iv) the model captures relevant information impacting the fair value of these licenses. Any change in the above assumptions could lead to a different result. The Company will continue to evaluate the fair value of its FCC licenses for impairment as events or changes in circumstances indicate that the carrying value of these assets may not be fully recoverable.

The Company faces various contingencies including the renewal of its FCC licenses in 2006 to 2011 and changing FCC regulations. The loss of some or all of the FCC licenses or the imposition of FCC usage restrictions could adversely affect the Company's future business prospects and operations and result in an impairment to the carrying value of these intangible assets.

- The Company holds inventory, primarily radios, for demonstration and installation purposes and has written it down to estimated net realizable value. If actual market conditions are less favorable than those projected by management, additional write-downs may be required.
- In December 2001, the Company issued \$11.0 million of Notes, with 4 million New Class A Warrants. The Company recorded the issuance of the Notes and New Class A Warrants by allocating proceeds of \$11.0 million to the Notes and New Class A Warrants based on their estimated relative fair values at the issuance date, resulting in \$4.1 million assigned to New Class A Warrants and \$6.9 million to the Notes. The fair value of warrants was determined using the Black-Scholes option pricing model with key assumptions related to the risk free rate of return, volatility and Company stock price on the issuance date. The value ascribed to the New Class A Warrants was recorded as debt discount and an increase in additional paid-in capital of the Company. Annual amortization of debt discount is determined utilizing the effective interest rate method and is included as a component of interest expense. The Notes are reported at their face value less unamortized debt discount as of the balance sheet date.
- The Company has recorded a full valuation allowance to reduce its deferred tax assets to the amount

that is more likely than not to be realized. In the event the Company were to determine that it would be able to realize the deferred tax assets in the future in excess of the net recorded amount, an adjustment to the deferred tax valuation allowance would increase income in the period such determination is made.

[Table of Contents](#)

- At September 30, 2004, accrued taxes other than income taxes include accrued property tax and use tax liabilities of approximately \$2.6 million and \$1.5 million, respectively, that were incurred prior to reorganization. Such liabilities are expected to be released as the Company reaches settlement with the respective tax jurisdictions or at such time that a basis exists for the reversal of this liability. While management believes the amounts represent reasonable estimates of the amounts potentially owed by the Company, the amounts ultimately paid to the respective jurisdictions could differ from the accrued amounts.
- In connection with its emergence from bankruptcy, the Company reflected terms of the Plan in its consolidated financial statements by adopting the fresh start accounting provisions of SOP 90-7 on December 31, 2001. Fresh start accounting creates a new reporting entity and the recorded amounts of assets and liabilities are adjusted to reflect their estimated fair values. In adopting fresh start accounting, the Company utilized the reorganization value or fair value of the entity. The reorganization value of a company is the amount of value available and to become available for the satisfaction of post-petition liabilities and allowed claims, as negotiated between the debtor-in-possession and the creditors and holders of equity interests. A committee of unsecured creditors together with the Company determined a reorganization value of approximately \$53.7 million which was deemed fair value of the assets of the reorganized business, with FCC licenses comprising 86% of the reorganization value. The Company's recoverability of its investment in FCC licenses is dependent upon its successful execution of its business plan.
- The Company is subject to all of the risks inherent in an early-stage business in the telecommunication industry. These risks include, but are not limited to: limited operating history; management of a changing business; reliance on other third parties; competitive nature of the industry; development and maintenance of efficient technologies to support the business; employee turnover; and, operating cash requirements. Management expects operating losses and negative cash flows to continue for the near term. Failure to generate sufficient revenues could have a material adverse effect on the Company's results of operations, financial condition and cash flows. The recoverability of these assets is highly dependent on the ability of management to execute on its business plan.

Cautionary Statement—This report includes “forward-looking” information, as that term is defined in the Private Securities Litigation Reform Act of 1995 or by the Securities and Exchange Commission in its rules, regulations and releases, regarding, among other things, our financial and business prospects, the deployment of our services, capital requirements and financing prospects. The Company cautions investors that any such statements are based on currently available operational, financial and competitive information, and are subject to various risks and uncertainties. Actual future results and trends may differ materially depending on a variety of factors. Those factors include, among others, those matters disclosed as Risk Factors at the end of the business section of the Company's most recently filed Annual Report on Form 10-K.

[Table of Contents](#)

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company's existing long-term debt has a fixed interest rate; however, future borrowings may bear interest at variable rates and accordingly, the Company's exposure to market risk for changes in interest rates may change in the future.

At September 30, 2004, the Company had cash and cash equivalents of \$4.8 million that were held in bank accounts and in money market accounts bearing interest at a rate of 0.85% and have an original maturity of less than three months. The Company also held a certificate of deposit bearing interest at a rate of 1.25% which matures in December 2004. The Company's investment policy provides that funds in excess of current operating needs may be invested in cash equivalents, marketable securities issued by the U.S. Government, its agencies and commercial paper of domestic corporations. Its policy prohibits investing in instruments with maturities that exceed 35 days without prior approval of the Board of Directors. The Company's investment priorities are to minimize short-term risk and preserve capital. The Company has had no holdings of derivative financial or commodity instruments in the past and has no current plans to do so in the future. The Company has not conducted business in foreign currencies in the past and has no current plans to do so in the future.

The Company's long-term debt has a face value of \$14.1 million and bears interest at a fixed rate of 9%. The debt is due in full in 2008.

ITEM 4. CONTROLS AND PROCEDURES

The Company has carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures as of September 30, 2004 pursuant to Rules 13a-15 and 15d-15 of the Securities Exchange Act of 1934. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective in ensuring that all material information required to be filed in this quarterly report has been made known to them in a timely fashion.

During the quarterly period covered by this report, there were no significant changes in the Company's internal controls over financial reporting that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.

[Table of Contents](#)

PART II — OTHER INFORMATION

ITEM 6. Exhibits and Reports on Form 8-K

(a) Exhibits:

- 31.1 Certification of Dean M. Johnson under Section 302 of the Sarbanes-Oxley Act.
- 31.2 Certification of Sandra Thomas Watson under Section 302 of the Sarbanes-Oxley Act.
- 32.1 Certification of Dean M. Johnson under Section 906 of the Sarbanes-Oxley Act.
- 32.2 Certification of Sandra Thomas Watson under Section 906 of the Sarbanes-Oxley Act.

(b) Reports on Form 8-K:

A current report on Form 8-K under Items 5 and 7 announcing the Company's intent to acquire Teligent, Inc.'s 24 GHz spectrum licenses, fixed wireless broadband operations and radio assets was filed with the Securities and Exchange Commission on July 8, 2004.

[Table of Contents](#)**SIGNATURES**

Pursuant to the requirements of the Securities Exchange act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

FIRST AVENUE NETWORKS, INC.

November 12, 2004

By: /s/ DEAN M. JOHNSON

Date

Dean M. Johnson
President, Chief Executive Officer and Director

Pursuant to the requirements of the Securities and Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant in the capacities and on the dates indicated:

Signature	Title	Date
_____ /s/ DEAN M. JOHNSON _____ Dean M. Johnson	_____ President, Chief Executive Officer and Director	_____ November 12, 2004
_____ /s/ SANDRA THOMAS WATSON _____ Sandra Thomas Watson	_____ Chief Financial Officer, Principal Financial and Accounting Officer	_____ November 12, 2004

[Table of Contents](#)**EXHIBIT INDEX**

Exhibit No.	Title
31.1	Certification of Dean M. Johnson under Section 302 of the Sarbanes-Oxley Act.
31.2	Certification of Sandra Thomas Watson under Section 302 of the Sarbanes-Oxley Act.
32.1	Certification of Dean M. Johnson under Section 906 of the Sarbanes-Oxley Act.
32.2	Certification of Sandra Thomas Watson under Section 906 of the Sarbanes-Oxley Act.