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GOGO.OQ - Q3 2023 Gogo Inc Earnings Call

EVENT DATE/TIME: NOVEMBER 07, 2023 / 1:30PM GMT

## NOVEMBER 07, 2023 / 1:30PM, GOGO.OQ - Q3 2023 Gogo Inc Earnings Call

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### PRESENTATION

#### Operator

Good day, and thank you for standing by. Welcome to the Q3 2023 Gogo Inc. earnings conference call. (Operator Instructions) Please be advised that today's conference is being recorded.

I would now like to hand the conference over to your speaker today, Will Davis, VP of Investor Relations. Please go ahead.

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**William G. Davis** - *Gogo Inc. - VP of IR*

Thank you, Bella, and good morning, everyone. Welcome to Gogo's Third Quarter 2023 Earnings Conference Call. Joining me today to talk about our results are Oakleigh Thorne, Chairman and CEO; and Jessi Betjemann, Executive Vice President and CFO.

Before we get started, I would like to take this opportunity to remind you that during the course of this call, we may make forward-looking statements regarding future events and the future performance of the company. We caution you to consider the risk factors that could cause actual results to differ materially from those in the forward-looking statements on the conference call. Those risk factors are described in our earnings release filed this morning and are more fully detailed under Risk Factors in our Annual Report on 10-K and 10-Q and other documents that we have filed with the SEC. In addition, please note that the date of this conference call is November 7, 2023. Any forward-looking statements that we make today are based on assumptions as of this date. We undertake no obligation to update these statements as a result of more information or future events.

During the call, we will present both GAAP and non-GAAP financial measures. We've included a reconciliation and explanation of adjustments and other considerations of our non-GAAP measures to the most comparable GAAP measures in our third quarter earnings release.

This call is being broadcast on the internet and available on the Investor Relations website at [ir.gogoair.com](http://ir.gogoair.com). The earnings press release is also available on the website. After management comments, we'll host a Q&A session with the financial community only.

It is now my great pleasure to turn the call over to Oakleigh.

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**Oakleigh Thorne** - *Gogo Inc. - Chairman & CEO*

Thanks, Will, and welcome to our Q3 2023 earnings call.

Gogo achieved solid bottom line results in the third quarter despite aviation industry headwinds and a slowing of orders as customers await the launch of Gogo 5G and Galileo, both of which will reaccelerate our growth starting in the second half of 2024. On the positive side, several of the

headwinds I discussed last quarter, like suspensions and deactivations, which are mostly temporary in nature, have started to normalize, and in fact, we achieved the highest third quarter ever for new activations.

On the flip side, supply chain issues and labor shortages continue to impact our OEM and aftermarket partners. Delaying new aircraft deliveries and extending maintenance cycles, which in turn have reduced equipment revenue and slowed the growth of service revenue for Gogo. Despite that we've maintained our profitability levels, partly due to a shift of 5G investment dollars to 2024 and partly due to strong cost management. As a result, we're lowering our revenue guidance for 2023, but raising guidance for adjusted EBITDA and free cash flow to the high end of our prior ranges.

Though changing guidance is very disappointing, these near-term headwinds do not change our view that Gogo is poised for explosive growth in 2025 and beyond. And we're not changing our long-term targets. First, we serve a highly unpenetrated market with 78% of the world's business aircraft flying without a broadband solution today. Second, we see unprecedented demand with a surge of travelers choosing to fly private aviation post-COVID and those travelers demanding connectivity. Third, we have an attractive business model based on recurring service revenue that drives strong cash flow. Fourth, we're incorporating new technologies into our platform to deliver order of magnitude improvements in service to dramatically increase our TAM by having products that meet the needs of every segment of the global BA market and to enhance our competitive position. And finally, we have a strong balance sheet that enables us to make the investments necessary to deliver those new technologies.

The price for reaching that explosive growth and driving substantial returns for shareholders is a heavy investment cycle we're now in to build Gogo 5G, develop Gogo Galileo and execute the FCC Rip and replacement project, all of which I will deep dive in a few minutes.

This morning, I'm going to start by highlighting the demand we see in the BA market. I'll then go through the data from the quarter, and I'll close by touching on Gogo's progress against our key strategic initiatives. Jessi will then walk through the numbers and the rationale behind our guidance update.

So let me start with industry demand. Industry observers typically use flight count as a proxy for private aviation demand. And in Q3, Gogo flight counts were down only 2% from the very high counts in 2022, which is an improvement from the 5% decline we experienced in Q2. More importantly, flight counts remained significantly elevated from pre-COVID 2019 at plus 28%, signaling to many in the industry that stronger demand is here to stay. Those numbers are supported by the surge in OEM order books and in the sale of fractional ownerships that we have seen over the past few years.

Meanwhile, data usage per flight hour for Q3 increased 15% over Q3 2022 and increased 77% from Q3 2019. In global market research conducted by Gogo, when offered all current and currently announced IFC offerings from Gogo and its competitors, 74% of all business aviation industry participants would opt to add connectivity to those aircraft today. That stands in stark contrast to broadband connectivity in the global fleet, which stands at only 23%. Some of this demand is driven by a generational shift in who was flying. Among the silent generation of older flyers, only 65% would opt for connectivity. Among baby boomers, that goes up to 78% and Gen X and Y, that goes up to 87%. And for Gen Z, that jumps to 98%. We believe those demographic trends bode very well for broadband connectivity penetration in business aircraft over the next 10 years.

Now let me turn to Q3 results. Overall, revenue was down 7% from prior year, with equipment revenue down 24%, but our high-margin recurring service revenue up 6%. The biggest drivers of this performance were part shortages, labor shortages, and frantically busy maintenance schedules at the OEMs and dealers. Part shortages have caused OEMs to push out deliveries, which combined with a fair amount of Gogo inventory in that channel, has caused them to push out equipment orders from us, which has hurt equipment sales and by extension dampened aircraft online and slowed growth in service revenue.

Part shortages have also forced dealers to hold aircraft for extended maintenance times as they wait for critical parts, which has delayed reactivation time for Gogo, which in turn has dampened aircraft online and slowed service revenue growth. And finally, labor shortages, combined with heavy demand for critical maintenance has forced dealers to prioritize needed to fly maintenance over discretionary spending like IFC, which has dampened equipment revenue and by extension, you guessed it, growth in aircraft online and service revenue.

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On that last point, as 5G technology and LEO satellite technology are poised to dramatically improve our product performance and potential new offerings from others, customers have extra impetus to wait and see what gets delivered and avoid discretionary spending in IFC in the short run. We saw the same phenomenon in Q1 2015 to Q1 2017 timeframe when aftermarket quarterly shipments fell 28% in the 2 years before we launched AVANCE. And SmartSky was making their first big marketing splash.

Despite those headwinds, AOL grew 86 units in Q3, down from 123 last year, but up substantially from the 18 we grew in Q2 this year. This stronger AOL performance was driven by continuing strong new activations and a normalization of our suspension rate, all of which was partially offset by continuing weaker reactivation rates due to the elongated maintenance events I mentioned a moment ago.

New activations and upgrades from Classic to AVANCE were particularly encouraging. Though short of expectations, we had our highest third quarter ever for new activations at 214, up 11% from prior year. And our highest quarter ever for upgrades at 60, up 28% from prior year. Strategically, because AVANCE allows customers to upgrade with Gogo to new technologies like 5G and low earth orbit satellites, much more quickly and economically than moving to a competitor. We believe that this continued migration to AVANCE is very important.

In total, AVANCE now accounts for 53% of our fleet, up from 45% at the end of the Q3 last year, and that percentage will grow as our FCC rip and replacement program rolls out. What is important to note is that based on extensive interviews with customers, we are not losing planes to competitors. We're just losing time to a parts and labor shortage.

Now let me turn to shipments and field inventory. Inventory in the field decreased by about 47 units in the quarter to roughly 857, of which only 140 are not committed to a particular aircraft. And of those 140, only 32 units that are at dealers that did not install a high volume of Gogo systems. For the reasons I discussed a moment ago, we had a significant decrease in AVANCE shipments this quarter to 192 versus 388 in Q3 last year when we had a blockbuster quarter. To put the quarter in a little more perspective, however, we still expect to have the second highest AVANCE shipment year ever in 2023, and we have seen encouraging signs of new orders were much stronger in October than earlier in the year.

Now let me turn to an update on our strategic initiatives and how we intend to accelerate growth with our three-pronged strategy. First, we want to expand our addressable market by broadening the AVANCE platform hardware and network offerings to meet the needs of each segment of the global BA market. Second, we want to drive customer loyalty by continually improving our networks and leveraging the AVANCE platform to provide easy upgrade path to new technologies as new technologies emerge. And third, we're focused on offering the best product and customer support to each segment of the market at the lowest total cost of ownership. We're making great strides in our strategic initiatives to achieve those goals, including our SEC secure networks program, our 5G network and our global broadband LEO offerings, Galileo HDX and FDX.

I'll start with the FCC secured networks program and an encouraging announcement from the Biden administration. You'll recall that last year, Gogo was awarded a \$334 million grant under the SEC's secure and trusted communication networks program to reimburse it for expenses associated with accelerating the removal of Chinese telecom technology from our 4G network. Because there were more qualified grants than originally planned, funding for all grants were cut back to 39% of the original award, which in Gogo's case was cut back to \$132 million.

The good news last week was that the White House included full funding for the program in its supplemental funding request to Congress. Given that full funding has brought bipartisan support in Congress, we feel that it has a good chance of passage this year. Full funding will help Gogo defray the cost of replacing all ETE ground equipment and moving Gogo Classic customers to airborne equipment that are compatible with the replacement ground equipment. Because the functionality of replacement ground-based equipment will be better than the equipment installed in our 4G network today, Gogo will get some significant benefits from this network refresh. Including a 40% improvement in connectivity performance for AVANCE L3 customers and almost doubling of the number of aircraft at the ATG 4G network can simultaneously manage and a significant acceleration of Gogo Classic customers upgrading to AVANCE, which, as I described earlier, has the strategic benefit extending Gogo customer lifetimes and the lifetime of our very profitable ATG networks.

We've already started work on the network side of this project and expect to go live in early 2026. On the customer side of this transition, our goal is to convert all of the 3,300 tails flying with our Classic product today to new LRUs with LTE air cars over the next 2 years. We've been in touch with all of those customers and have actually spoken to more than 90% of them. And of those that already have a preference, the overwhelming majority

are leading towards an AVANCE upgrade with the majority of those selecting the L5s. Jessi will provide more details on the SEC program in a few minutes and how the costs and reimbursements, which are coming in quicker than expected, fit into our guidance.

Now let me turn to our Gogo 5G Air-to-Ground network program. As a reminder, this product will have coverage limited to North America, but deliver mean performance around 25 megabits per second, 5x to 10x the mean speeds of Gogo's current offerings with peaks of up to 75 to 80 megabits per second. All at a more affordable price than competitive satellite products. In global market certainties of business aviation professionals, the 5G package is the #1 pick, ahead of all current and currently announced competitive ATG and GEO or LEO satellite offerings, which bodes well for the durability of Gogo's high-margin ATG revenue stream.

This is partly driven by the fact that the North American medium and lighter aircraft market segments are by far the largest in the world, with more than 80% of all global flights beginning and ending in North America. And though they want quality connectivity, many operators in those segments wanted an affordable price.

Last year, Gogo completed build-out of its 150 tower 5G network with a Cisco core that provides nationwide coverage. And next year, we'll complete our Canadian network. We've also completed every aspect of the airborne equipment except one, our 5G chip. As I'm sure you're aware, we have had 2 significant delays to this program because of issues in bringing the 5G chip up after completing fabrication at the chip foundry. It's important to note that the issue of the chip was not in the 5G block, but was in the peripheral sub-block.

Since July, we've been working with our 5G network and chipset suppliers on a remedy to the bring-up problem. Sadly, that remedy involves a full re-spin, which establishes our ship date in the third quarter at the outside perimeter of our earlier guidance. That said, we're confident we'll hit that time frame because, first, our team feels that our chipset supplier has conducted a much more thorough analysis and has fully identified the root cause of this issue and is currently implementing a complete remedy.

Second, our chipset supplier has brought a new design house into the project. It has superior simulation and modeling capabilities to the old design house. Third, the design house has a very solid record of getting it right the first time. And fourth, we'll be utilizing new higher-speed 50 megahertz field programmable gate array technology, better known as FPGAs, to test many aspects of the chip before we have the chip itself. Gogo expects to have the FPGA technology in place from our vendors in late Q1 and to begin flight testing with it in Q2, which will enable us to burn down all software testing risk, of 5G design testing risk and our system integration risk. And it will allow us to fine-tune our network before ever receiving the natural 5G chip. Other milestones that Gogo will share as they occur next year include the start-up and of chip fabrication, Gogo receipt of the chip after bring up and Gogo flight test of the chip.

Finally, we're having considerable commercial success with the product already. Not only have we had no cancellations due to the delay, we have orders from 5 OEMs and have built an \$8.5 million backlog for chip sets. We're also having success with 5G pre-provision kits, which allow customers to install the AVANCE L5 with full 5G provisions and operate on Gogo's 4G network while waiting for the LX5 5G box. Once the LX5 is ready, it can be installed quickly and 5G service can begin immediately saving downtime and expense. We've shipped 133 of those kits, including 67 in Q3. And what's really cool is that more than 30 of those chip sets have already been installed in the aftermarket alone. And what's even cooler is that 2 OEMs are already installing the 5G MD13 antennas on every plane in which they install an AVANCE L5 so that those planes will be ready to move to 5G when the 5G chip is ready.

Now I'll turn to our LEO-based global broadband initiative, Galileo, which adds a flat panel, fuselage mounted electronically steerable antenna to the AVANCE platform and add the Eutelsat OneWeb low earth orbit satellite constellation to our network offerings. Galileo comes in 2 flavors, a smaller HDX terminal and a larger FDX terminal. The Galileo HDX terminal is a small antenna that fits on almost all business aircraft and targets midsized and smaller jets that; A, domicile outside North America and have no broadband solution today; and B, domicile inside North America and often fly international missions.

The Galileo FDX terminal is a larger antenna that deliver significantly higher bandwidth and targets global super midsized and larger heavy jets that fly transcontinental emissions. The market survey, as I mentioned a moment ago, also tested Gogo HDX and FDX bundles against all current and currently announced competitive ATG and LEO GEO offerings. And they show those bundles outperforming all competitive satellite offerings by a considerable margin. We've demonstrated our Galileo technology this year at both the Geneva and Las Vegas MAAE-based conferences

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using the Eutelsat OneWeb network and Hughes antennas. And have achieved mean speeds consistently approaching 200 megabits per second. It's worth noting that these speeds will increase dramatically when Eutelsat OneWeb launches its Gen 2 satellite constellation in just a few years.

A huge advantage for Gogo in these markets is that Galileo is a simple upgrade from any AVANCE installed aircraft when only needs to add either our HDX or FDX antenna on the fuselage and then run data and power cabling into the aircraft. Given that AVANCE is already a line-fit option at every OEM and has STCs on every currently flying model of aircraft in the aftermarket, this will make it easier from the engineering and certification perspective for OEMs and dealers to offer Galileo as an option to their customers. We've already signed a line-fit agreement with one OEM and have discussions underway with several others. We plan to start shipping HDX terminals in the second half of 2024 and FDX terminals in the first half of 2025.

In our satellite partner, Eutelsat OneWeb and our antenna partner, Hughes, continue to make great progress driving towards those dates. Eutelsat OneWeb has completed launch of its 648 satellite Gen-1 constellation and should complete its ground network and be ready for aero use in Q2 2024 before our launch in the second half of the year. We expect to receive preproduction test units of the HDX antenna from Hughes in the first quarter and production equivalent units for flight testing early Q3 and are targeting first shipments a few months after.

With the addition of Galileo, Gogo will have the most complete product portfolio in the business aviation IFC industry with products that offer the right performance, with the right coverage, at the right total cost of (inaudible) with great customer support for every segment of the highly unpenetrated 38,000 aircraft global business aviation market. Overall, we're excited for the future and believe Gogo has the right strategy in place to continue to capitalize on the significant opportunity in our market and deliver long-term value creation.

I want to end by thanking the Gogo team on both the front line and those that support the front line. It's because of you that we're in this position. With that, I will turn it over to Jessi to do the numbers.

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### **Jessica Betjemann - Gogo Inc. - Executive VP & CFO**

Thanks, Oak, and good morning, everyone. Gogo delivered solid bottom line financial performance as we continue to invest in our strategic and operational initiatives, including Gogo 5G and Gogo Galileo to enhance our competitive position for the future.

In my remarks today, I'll start by walking through Gogo's third quarter financial performance, then I will turn to our balance sheet and capital allocation priorities. Next, I will provide an overview of the financial impact of the FCC program. And finally, I will provide additional context around our revised 2023 outlook and wrap up by reiterating our long-term targets.

Total revenue for the third quarter was \$97.9 million, down 7% from the prior year and down 5% sequentially. We delivered record service revenue of \$79.5 million in the third quarter, a 6% increase year-over-year and a 1% increase sequentially.

Our ATG aircraft online reached 7,150 units as of the end of the third quarter, representing 6% growth versus the prior year and 1% growth sequentially. While Gogo show an improvement in incremental ATG aircraft online from 18 in the second quarter to 86 in the third quarter, these remain muted due to temporary suspensions driven by elongated maintenance cycles, which took aircraft off-line. In addition, we had record upgrades in the third quarter. And while strategically important, it also contributed to the muted aircraft online growth as it replaces existing aircraft online.

AVANCE aircraft online grew to 3,784 and now comprise 53% of our total fleet, up from 45% last year. Increasing aircraft online with the penetration of our AVANCE products remains critical to Gogo's strategy, both in the North American market and globally as we prepare for Gogo 5G and Galileo. As we mentioned last quarter, we continue to expect the AVANCE aircraft online growth rate to accelerate over the next several quarters as maintenance events start to return to normal levels, reducing suspension time and dealers work on addressing supply chain issues that are contributing to slower installation rates.

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Total ATG ARPA of \$3,373 slightly increased sequentially and slightly decreased versus the prior year, driven by a shift in product mix. The anticipated launch of Gogo 5G and Galileo next year will further expand our ARPA growth opportunity over time, partially offset by continued L3 sales into smaller aircraft and lower priced data plans to drive incremental revenue growth down market.

Now turning to equipment revenue. Gogo generated \$18.4 million in equipment revenue in the third quarter, a 39% decrease year-over-year and a 24% decrease sequentially as AVANCE equipment units shipped decreased to 192 in the third quarter. As Oak noted, the decrease in advanced equipment units shipped largely reflects the impact of lingering inventory in the channel, shifts in OEM orders to 2024 as well as delays in customer purchases as they wait for the expected launch of Gogo 5G and Galileo in 2024.

Gogo remains confident that our strong position in a global market that is only 22% penetrated with in-flight connectivity, coupled with the expected launch of Gogo 5G in Q3 2024 and Gogo Galileo in the second half of next year will continue to propel our equipment sales in the future.

Turning to profitability, Gogo delivered service margins of 77% in the third quarter, which remains flat compared to the prior year quarter. We continue to expect long-term service margins in the 75-plus percent range, positioning service as the primary lever for free cash flow generation and long-term value creation. Equipment margins were 33% in the third quarter, 3 percentage points lower than prior year period and 6 percentage points higher sequentially. The increase in our equipment margin compared to last quarter was primarily due to an accrual of \$2.8 million for the expected FCC reimbursement of costs incurred to replace a large number of EVDO air cards in AVANCE equipped aircraft with dual modem air cards.

Out of the \$2.8 million accrual, \$0.8 million related to Q3 shipments, while \$2 million was related to prior quarter's activity back to 2022. The positive impact of the accrual for expected FCC reimbursement was partially offset by an increase in production cost as a percentage of revenue due to lower equipment revenue in the quarter. We expect Q4 equipment margin to decline as there is no catch-up accrual for the FCC reimbursement.

Moving on to operating expenses. Third quarter combined engineering, design and development, sales and marketing and general and administrative expenses of \$25.5 million declined slightly year-over-year and decreased 3% on a sequential basis. Our operating expenses decreased sequentially primarily due to lower marketing-related costs. Gogo continues to expect 2024 will be a significant investment year as we complete our Gogo 5G program and ramp spending for Gogo Galileo. We expect to see the benefit of these investments through sustained strong top line growth and an inflection point in free cash flow growth in 2025 and beyond in our core operating business.

In terms of Gogo 5G in the third quarter, our \$1.8 million of 5G spending was comprised of \$0.5 million in OpEx and \$1.3 million in CapEx. As Oak mentioned, Gogo is working with our 5G network and chipset suppliers to resolve the 5G chip issue, and we now expect the commercial launch of Gogo 5G to take place in Q3 2024. We maintain our estimate of \$100 million in total cost for our 5G program, but the delay will push approximately \$10 million of CapEx and \$7 million of OpEx from our original plans in 2023 into 2024. Gogo expects this delay to dampen revenue, EBITDA and free cash flow in 2024.

Now on to our Gogo Galileo initiative. In the third quarter, Gogo recorded \$2.6 million in operating expenses related to Gogo Galileo and \$6.6 million year-to-date. We continue to expect external development costs for Gogo Galileo to be less than \$50 million in total, of which \$10 million will be incurred in 2023 and approximately \$30 million in 2024. We anticipate approximately 90% of Gogo Galileo's external development costs will be in OpEx.

Moving on to our bottom line. Gogo's third quarter adjusted EBITDA of \$43.2 million stayed relatively flat year-over-year. EBITDA margin expanded to 44.1%, up 140 basis points from last quarter and up approximately 300 basis points year-over-year as we had growth in high-margin service revenue, while maintaining strong cost control. Gogo delivered net income of \$20.9 million in the third quarter, up 4% year-over-year, translating to \$0.16 in basic and diluted earnings per share. As a reminder, last quarter, we reported net income that included an income tax benefit of \$63.8 million due to the partial release of the valuation allowance on our deferred tax assets related to the Section 163(j) interest limitation carry-forward.

As of December 31, 2022, Gogo had \$562 million in Federal net operating losses, \$448 million in state net operating losses and \$292 million in Section 163(j) interest limitation carry-forwards. As a reminder, our financial statements reflect non-cash income tax expense as we continue to

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generate positive pretax income. Based on our substantial NOL position, we do not expect to pay meaningful cash taxes for an extended period, but we may pay a modest amount by the end of our 5-year planning horizon.

In addition, our Shareholder Rights Plan, that is designed to preserve NOLs, expire in September. The Shareholder Rights Plan was not renewed as changes in the shareholder base over a 3-year period have lasted. Thus, we still have access to our large NOL position, but new shareholders are no longer restricted from purchasing over 5% of the outstanding shares of Gogo's common equity.

In the third quarter, we generated \$21 million in free cash flow, up \$12.5 million versus prior year, primarily due to lower 5G CapEx. Free cash flow is also up \$7.7 million sequentially, largely due to lower interest paid this quarter as we switched to a monthly cadence of interest payments on our term loan, resulting in 5 months of interest paid in the second quarter.

Now I'll turn to a discussion of our balance sheet. We ended the quarter with \$110.8 million in cash and short-term investments and \$608.7 million in outstanding principal on our term loan with our \$100 million revolver remaining undrawn. Gogo's net leverage was slightly lower to 2.9x, in line with our target range of 2.5X to 3.5x. As we previously mentioned, we have a hedge agreement in place, and we currently have 86% of our loans hedged. The next step down in the hedge to \$350 million occurs in July 2024 with an increase in strike rate from 0.75% to 1.25%.

As a reminder, Gogo's capital allocation priorities remain unchanged and are aligned with our strategic goals and include, first, maintaining adequate liquidity; second, investing in strategic opportunities to drive competitive positioning and financial value, including Gogo 5G and Galileo; third, maintaining an appropriate level of leverage for the economic environment with a target net leverage ratio of 2.5x to 3.5x. And finally, returning capital to shareholders as appropriate in the future.

With a strong cash balance, our Gogo 5G, Galileo and other strategic projects well-funded and our net leverage ratio at 2.9x, including the \$100 million debt paydown earlier this year and our strong confidence in the business. We were comfortable moving to priority 4 in returning capital to shareholders. Our Board of Directors approved a share repurchase program in September with no set expiration date that grants authority to repurchase up to \$50 million of shares of common stock. This gives us the ability to opportunistically repurchase shares when we find that doing so offers an attractive value proposition. However, we need to continue to balance the use of cash over the next year across our capital allocation priorities and especially in allocating funds between further paydown of debt, considering high interest rates and a step down in our hedge and future share repurchases.

I would now like to provide an update on the expected financial impact of the FCC Secure and Trusted Communications Networks reimbursement program. As Oak mentioned, we are encouraged that the White House recently issued a supplemental funding request that includes the call to Congress to fully fund the FCC program, which would significantly increase our total reimbursement value as we were granted up to \$334 million. As mentioned in previous quarters, we currently expect to receive partial funding of \$132 million.

As a reminder, we submitted our first claim in July, which triggered the start of the 1-year clock to complete the program by July 21, 2024. In our application, we stated that we will need to have multiple extensions to complete the program and are waiting to see if the FCC will grant a blanket extension or we will request an extension in the coming months on our own.

Gogo has incurred and will continue to incur costs for this program in 3 areas: First, network equipment to cell sites and datacenters; second, airborne equipment for the swaps of LTE air cards to replace EVDO air cards and partial rebates for customers' installation costs to enable existing customer aircraft to communicate to the new network; and third, operating expenses primarily for flight testing, network design and professional services. We expect the spent will be partially offset by the FCC reimbursements.

As of September 30, we recorded a \$16.2 million receivable from the FCC, which is included in prepaid expenses and other current assets in our balance sheet for the reimbursement of the costs I previously mentioned, with corresponding reductions to property and equipment, inventory and contract assets and with a pickup in the income statement. Going forward, since the program is currently partially funded, we have some optionality in what we request reimbursement for, which could impact where grant money received would be recorded between the income statement and balance sheet.

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Previously, Gogo expected 2023 and 2024 free cash flow to be negatively impacted by the FCC program and a benefit in 2025 due to the timing of reimbursement proceeds. However, we are currently seeing reimbursements coming in quicker than expected, potentially changing the swing effect on free cash flow over the years. For example, in 2023, we expect to spend approximately \$20 million for the FCC program and recoup approximately \$2 million in cash reimbursements. But with the reduced lag in the reimbursement process, we could receive more this year. Nonetheless, with partial funding, reimbursements are expected to be short of the total expected cost of the program through 2026.

Turning to our financial outlook. Gogo updated its fiscal 2023 financial guidance to reflect current market dynamics. Gogo now expects 2023 total revenue to be in the range of \$390 million to \$400 million. The decrease is driven by a reduction in our equipment revenue, which was largely affected by shifts in OEM orders to 2024 and a delay in customer orders as they wait for the expected launch of Gogo 5G and Galileo, as I noted earlier.

We now expect 2023 adjusted EBITDA to be in the high end of our previously guided \$150 million to \$160 million range. We were able to increase adjusted EBITDA guidance despite lower revenue as we continue to prudently manage costs down as well as push out additional 5G spend due to the delay. This guidance includes spending on operating expenses of approximately \$15 million compared to \$20 million previously for strategic and operational initiatives, which include approximately \$3 million in expected Gogo 5G spending, approximately \$10 million of Gogo Galileo development spend, and approximately \$2 million in additional operational initiatives. Our adjusted EBITDA guidance also includes approximately \$7 million of costs related to the FCC program, offset by \$6 million of accruals for the expected FCC reimbursement.

We now expect our 2023 CapEx to be in the range of \$25 million to \$30 million, including \$12 million for the Gogo 5G program and approximately \$2 million related to the FCC program. We also now expect our 2023 free cash flow guidance to be in the high end of the previously guided range of \$60 million to \$70 million, including FCC-related spend and the expected lag of FCC reimbursements. Even with our investments in strategic initiatives and the FCC program, we expect nearly 20% year-over-year free cash flow growth in 2023. And excluding the FCC impact, it would be nearly 50%.

As we previously stated, 2024 will continue to be an investment year with an increase in Gogo Galileo expenses anticipated, but further burdened due to the push out of 5G spend. These investments, coupled with the lower shipments and lower aircraft online this year versus our original expectations and delay in 5G launch are expected to negatively impact our financials, causing 2024 to be a trough free cash flow year.

However, Gogo's long-term targets were made unchanged. They reflect our expectations for the launch of Gogo 5G in Q3 2024 and the launch of Gogo Galileo in the second half of 2024. We reiterate revenue growth at a compound annual growth rate of approximately 15% to 17% from 2022 through 2027. We continue to expect annual adjusted EBITDA margin in the mid-40% range by 2027 and free cash flow in the range of \$150 million to \$200 million in 2025 without the effect of the FCC program and growing thereafter. We plan to provide 2024 guidance metrics and update our long-term targets as appropriate on the fourth quarter earnings call as we typically do.

In conclusion, we will continue to deliver solid bottom line financial performance, and we are committed to creating long-term value for our shareholders and customers.

Before we open the call up to questions, I would like to join Oak in thanking our entire team for their continued commitment to Gogo and providing unparalleled service to our customers.

Operator, this concludes our prepared remarks. We are now ready for your first question.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) And our first question comes from the line of Richard Prentiss with Raymond James.

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**Richard Hamilton Prentiss** - *Raymond James & Associates, Inc., Research Division - Head of Telecommunication Services Equity Research & Research Analyst*

I want to probe into, first, the competition side, Oak, you talked a little bit about testing your offers versus others. It's not on the BA side, but interesting with Hughes announcing the Delta Regional Jet contract. I'm wondering if you're thinking of will others start coming into the BA space as well? And then maybe an update on the SmartSky lawsuit, if there has been any changes.

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**Oakleigh Thorne** - *Gogo Inc. - Chairman & CEO*

Yes. So I mean, the Delta Hughes deal is a large antenna GEO product at this point. So they're using the ThinKom 1717 antenna set, which is about 5-feet long. It's not a BA aircraft type of antenna. And it's not ESA and it does not use LEO satellites at present. I think it's KA, which is important. It's really meant to be a way for Hughes to sell Jupiter capacity. So they're our partner, this is consistent with our agreements, and we have no issue with it at all.

Second, I think you were asking about potential entrants.

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**Richard Hamilton Prentiss** - *Raymond James & Associates, Inc., Research Division - Head of Telecommunication Services Equity Research & Research Analyst*

Yes.

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**Oakleigh Thorne** - *Gogo Inc. - Chairman & CEO*

Yes. I think our confidence against potential entrants has really grown. We spent a lot of time over the summer, doing a lot of detailed market research and surveys around the world. And we did those on a branded and an unbranded basis. And the top 4 offers were always Gogo. Are we really cheap L3 product? The 5G product for North American flyers, generally medium-size jets on down that want higher capacity and then the FDX and HDX for planes flying outside the U.S. or medium-sized jets in the U.S. who want higher capacity and then FDX for the global [Transcon].

And so that gave us added confidence that we're developing the right products. We have the right service. We're looking at the right price points, the right coverage. And our whole strategy is to understand the complexities of this pretty small vertical. The fact that there's a lot of different segments that have different needs and to be able to take advantage or understanding all those different segments and create the right products, the right coverage, the right cost, et cetera, for each of those segments.

So we feel very good about that. Most people worry about Starlink coming in. I think they're still trying to find their way. They keep changing their mind about what they're going to do. And of course, that just doesn't resonate very well with the business aviation market, which has long lead times and where people want very steady partners that they know they can trust to actually deliver products, service products, et cetera. So we feel good about that.

And then the last question was on the SmartSky litigation. There's still no decision in their appeal of the lower court denial of a temporary injunction. And we view that as a good sign because it's been close to half a year now since that was heard. And if the court really felt that there was an urgent need to grant an injunction, one believes they would have granted that by now. Because when asking for a temporary injunction when it has to serve assert that time is of the essence. So we feel good about that.

And the general trial, which was to come later, I believe that goes to trial in April of 2025 or August of 2025. I can't remember which month it was. So that still lays out, and there will be a lot of Markman hearings and all that over the next year or so. So that will go into discovery. And it will be a time-consuming and somewhat expensive process.

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**Richard Hamilton Prentiss** - *Raymond James & Associates, Inc., Research Division - Head of Telecommunication Services Equity Research & Research Analyst*

And I just want to make sure I also understand the 5G Galileo operating initiatives. Jess, I think you said the \$15 million impact OpEx-wise in 23 is like \$3 million for 5G, \$10 million for Galileo and \$2 million for others. The 24 Galileo looks like it's going to be \$30 million. Is the 5G, is that just \$7 million? Has that got pushed out? I'm just trying to think what the total 24 impact is to compare to the \$15 million EBITDA impact for those 3 items?

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**Jessica Betjemann** - *Gogo Inc. - Executive VP & CFO*

Yes. So Galileo, as you mentioned, you have that right, it's expected to be around \$30 million -- approximately \$30 million next year. 5G, so we pushed out \$7 million of OpEx from this year to next year. So we're expecting \$7 million in OpEx next year. And then for CapEx, we're expecting that to be more like \$14 million. So we pushed out \$10 million from CapEx this year to next year, but we had originally planned to have a little bit of additional CapEx next year, so a total of \$14 million next year. The 5G spend in total will be \$20 million next year.

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**Richard Hamilton Prentiss** - *Raymond James & Associates, Inc., Research Division - Head of Telecommunication Services Equity Research & Research Analyst*

And then last one for me is, obviously, the balance sheet is strong, the bottom line, you've been working to that. How much cash do you want to keep on the balance sheet to run the business as we think about all the different components you're looking at, also, obviously, the FCC reimbursement?

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**Jessica Betjemann** - *Gogo Inc. - Executive VP & CFO*

Yes. So we like to be fairly conservative on this. I mean I think the range is around 50 to 75, which is higher than what we would need to run the business, but we'd like to be conservative. So when we talk about maintaining adequate liquidity, that's usually the amount that we're keeping in mind.

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## **Operator**

And your next question comes from the line of Lance Vitanza with TD Cowen.

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**Lance William Vitanza** - *TD Cowen, Research Division - MD & Cross-Capital Structure Analyst*

Just a couple around the new product launches. First, on 5G, what are the milestones that you can point us to that would help us get more comfortable around the certainty, if not the exact timing of this launch, I mean, what specifically needs to happen between here and there?

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**Oakleigh Thorne** - *Gogo Inc. - Chairman & CEO*

Right. So I try to run through some of those in the call. I'd say the first would be the chip actually going into production in the foundry as that sort of the clock starts then. I would say second would be the delivery in late Q1 of the FPGA technology to us. Because that sort of new 50 megahertz capacity FPGA version of the chip, we will be able to burn down a lot of risk. We'll be flying that in Q2. And because it's an exact software replication of the chip, we can burn down all software integration risk, we can burn down all integration testing across the network risk. So those are very significant. The only risk we cannot burn down, that is an issue in the 5G chip from a hardware perspective. You have to test it after it comes off the foundry.

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And then later dates would be when that chip comes off the foundry. And then when we take delivery because there's a bring up process between it coming off the foundry and being delivered to us. And then our start of flight testing. I think those are the major milestones.

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### **Lance William Vitanza** - TD Cowen, Research Division - MD & Cross-Capital Structure Analyst

And how long does the flight testing component take, would you expect?

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### **Oakleigh Thorne** - Gogo Inc. - Chairman & CEO

But we start testing flying the whole network, it takes about 2 months, but once we have the chip, but we will burn down most of the risk around flight testing and fine-tuning with the FPGA ahead of that.

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### **Lance William Vitanza** - TD Cowen, Research Division - MD & Cross-Capital Structure Analyst

Right. I'm not so much worried about the risk as I am just trying to think about the time frame in calibrating there, but that's helpful. And then just sort of a related question, I guess, with the Galileo launch set to launch relatively quickly on the heels of the 5G launch, do we have to worry about the 5G launch being softer than expected or pressured by aircraft operators basically saying, well, gee, you know what, I was going to go with 5G, but now Galileo is going to be here in a couple of months, maybe I should hold off and wait for that?

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### **Oakleigh Thorne** - Gogo Inc. - Chairman & CEO

Yes. Look, it's not ideal to have these 2 product launches land on top of each other, and that wasn't the design, as you well know, we were going to originally have 5G out last year. But I think that we don't see a conflict because we see these products as being positioned to very different segments of the market. And while the delays have sort of confused that communication, I think we're starting to see it get straightened out. The 5G is really aimed at North American market because that's its coverage. It's aimed at those sort of medium-sized jets on down that want a really good product but are still somewhat cost conscious, right? They want an affordable product. And 5G will be cheaper than any satellite product.

The HDX is aimed at sort of medium-sized jets on down outside the U.S. And those planes today have no connectivity option whatsoever. No broadband connectivity option whatsoever. And medium-size jets on down that fly outside the U.S. like to the Caribbean or Canada or Mexico, et cetera, Hawaii, which is in the U.S., of course, but it's over a large piece of ocean. So that's where that's aimed. And then the FDX is a heavy jet product. And that's for the big jets that either fly around the U.S. and won a lot of connectivity or fly transcontinental routes. So it's going to be more aimed probably at the transcontinental planes.

So they're very different segments, and we're trying to be very prudent with the market in terms of communicating which products should be the right products for each segment.

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### **Operator**

And your next question comes from the line of Scott Searle with ROTH MKM.

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### **Scott Wallace Searle** - ROTH MKM Partners, LLC, Research Division - MD & Senior Research Analyst

I appreciate all the detail. And maybe just to dive in quickly in terms of the maintenance events, engine part availability, et cetera, that has been delaying AOL. The last quarter, shipments or ETG units were down pretty significantly. I think they're about 100 units below where it averaged over the last 6 quarters or so. It sounds like despite that, you're having record activations and you're starting to see a pickup in terms of suspensions going away in the month of October. And I believe you indicated as well that there are only about 40 units in the channel that are unspoken for.

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So implied in the fourth quarter guidance is another weak ATG unit quarter. So the question is, as we get into 2024, are we completely burned down and normalized in terms of channel inventory and that balance now with prolonged maintenance events, but now that's starting to work its way through the channel and we start to see a reacceleration both of ATG units being shipped and AOL aircraft starting to ramp back up again?

### **Oakleigh Thorne - Gogo Inc. - Chairman & CEO**

Yes. I think that the inventory burn down is definitely taking place. When you really look at the \$850 or so, there's an awful lot of those that have actually already been installed. We talked about 200 last quarter. This quarter, that's down to 187%. And actually, it's much more dynamic than that. Of the 200, 79 were actually activated that was then offset by increased shipments that took that number back up to 187%. So feel much better about that part of the inventory, if you will.

And yes, like we said, all about 140 are spoken for, 32 of those really are dealers that took inventory 1 or 2 units during COVID, hoping they get an order, they haven't and that may be sitting there. But the rest are just a couple of dealers that move a lot of inventory. So we feel that that is normalizing and that that will help orders somewhat. I think that the countervailing for us next year will be people wanting to make sure that they don't end up with a lot of L5 inventory after we launch LX5. So their order is fulfilled, current orders, but I don't think people will be stocking up for (technical difficulty)

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