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GOGO.OQ - Q1 2023 Gogo Inc Earnings Call

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## CORPORATE PARTICIPANTS

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

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

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

## CONFERENCE CALL PARTICIPANTS

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

**Landon Hoffman Park** *Morgan Stanley, Research Division - Research Associate*

**Michael Louie D DiPalma** *William Blair & Company L.L.C., Research Division - Analyst*

**Philip A. Cusick** *JPMorgan Chase & Co, Research Division - MD and Senior Analyst*

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

## PRESENTATION

### Operator

Good day, and welcome to the first quarter 2023 Gogo Inc. earnings conference call. (Operator Instructions) Please be advised that today's conference is being recorded.

It is now my pleasure to introduce Vice President of Investor Relations, Will Davis.

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

Thank you, Andrew, and good morning, everyone. Welcome to Gogo's First 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 Form 10-K and 10-Q and other documents we have filed with the SEC.

In addition, please note that the date of this conference call is May 3, 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 first 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.

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

Thanks, Will, and good morning, everyone. Thanks for joining us today. I'll focus my remarks on 3 main areas: First, I'll provide a state of the business aviation industry as seen from Gogo; second, I'll provide key highlights of Gogo's first quarter results; and third, I'll give an update on the key strategic initiatives we're working on to drive accelerated growth in 2024 and beyond. Jessi will then walk through our quarterly performance and 2023 outlook before we open up the call to your questions. So let me start with the state of the industry.

The business aviation industry continues to serve demand at much higher levels than the pre-pandemic period, driving excellent new installation numbers for Gogo, which we expect will translate into high-margin current service revenue, the primary driver of Gogo's long-term value creation model. The dealers and OEMs are still navigating some supply chain and labor laws. The avionics industry is in the midst of a return to normal operations, though at higher levels, as I noted a moment ago, and with some bumps still in the road.

For Gogo, that means dealers are returning to normal order patterns due to the extended lead times induced by COVID and fear that supply may not be available at all, many dealers ordered more equipment than they had immediate need for over the past 2 years, culminating with our record-setting Q4 2022 shipments. Fortunately, for Gogo, our great production ops team was able to meet that demand. However, as lead times have come down, dealers can use current inventory for new orders and don't immediately need to backfill for those installs, which is why despite having our second best new in-store quarter ever, we do not have as much equipment revenue to show for those installs as we normally would.

We've seen this movie before. After a very strong Q4 in 2020, we suffered a 30% decline in equipment revenue in Q1 2021, only to finish 2021 with very strong equipment revenue growth for the year. We also saw this in 2019, '20. Regardless, we're confident that our record 2022 shipments will translate into strong activations in 2023. According to our dealers and OEMs, 75% of Gogo inventory in the channel now has either a named customer or an aircraft serial number associated with it. As for the rest of the inventory, we expect demand to take care of that. However, we're also launching some dealer incentives to help that process along and we're working with some of our smaller dealers to shorten install times so that they can sell Gogo as a standalone outside of a large maintenance event.

We've had some great success thus far and have brought stand-alone upgrade install times down to 5 to 7 days with some dealers and are on track to get advanced upgrade times down to 3 days on some models with another dealer. In general, the larger dealers are extremely busy. The elevated flight activity that started with COVID is accelerating the pace at which planes need to get in for required inspections and maintenance events. Many charter and fractional sleeps literally have planes parked on the tarmac grounded until they can get into the shop from maintenance.

Meanwhile, dealers continue to suffer labor shortages and some parts shortages. For Gogo, this has translated into more opportunities for dealers to install a quip, but that's been tempered by dealers sometimes not having enough workers to install our equipment if the work is to occur during a fixed maintenance window. Similar, post-COVID return to normalcy trends temporarily impacted our AOL count in the first quarter. The first is the higher level of maintenance events. Most owners turn off their Gogo service while they're in the shop or grounded on the tarmac waiting to get into the shop. The second is the increase in secondhand aircraft inventory, though still well below the historical average of 5.6% of the U.S. fleet. There's been a big jump in used aircraft for sale this year from around 2.5% to 3.6% of the fleet, which impacts our AOL because customers typically turn off their WiFi when they park the aircraft for sale. However, those sales are also an opportunity as the new owners usually reactivate our service and often upgrade before the plane comes back into service.

Taking a step back, Gogo's installed base is evidence of both our strong market position today as well as the immense opportunity we see ahead. Of the 15,000 business jets in North American market, almost 50% of them have a Gogo IFC system installed today, of which almost half are installed with AVANCE. AVANCE is a perfect stepping stone for high-performance-oriented customers with easy upgrade path to either 5G or GBB as they both utilize the same advanced infrastructure on the airplane, making it easier and cheaper to stay with Gogo and an upgrade and to move to competitors' products. For this reason, the continuing to expand advanced penetration is a cornerstone of our strategy.

Meanwhile, based on our research, the rest of our customers, that's non-AVANCE, are generally satisfied with their current level of classic product, which will continue to benefit from improvements to our ATG network. Our loyal installed base provides a solid financial foundation for our business for years to come. And the other 50% of the business jet segment and the highly unpenetrated 10,000 aircraft turboprop market represent an opportunity for future growth.

So let's move to our Q1 performance. The message is that despite some bumpiness as the industry returns to pre-COVID patterns, we had our second best new install quarter ever and our best first -- sorry, first quarter installs ever. We delivered first quarter revenue of \$98.6 million, up 6% over prior year, driven by record service revenue, our primary value driver. The impacts on our equipment revenue were most significant in January and February, but in March, shipments were back on track. April was much better than January and February, but still a little off track. So we feel we're on the right trajectory, but still a wood to chop to get back on flight.

Our operating metrics for the quarter were strong, with twice as many customers upgrading service as downgrading and continuing strong aircraft retention rates of greater than 90%. On the bottom line, Gogo delivered first quarter adjusted EBITDA of \$39.7 million, down 7% year-over-year, reflecting softer equipment revenue, as we just discussed, and increased spending on our strategic initiatives, which Jessi will discuss in a moment.

As for guidance, the factors I discussed in my business aviation state of the union persists. However, we believe we are poised for strong performance in the second half, especially given the pent-up demand we see for Gogo 5G, and we still expect to finish the year in line with the full year 2023 revenue, adjusted EBITDA and free cash flow guidance we reiterated this morning.

Now let's turn to the drivers of business aviation demand. The underlying secular trends driving demands for business aviation connectivity remains strong and continue to support our growth runway. First, passengers who flew commercial that could afford private aviation, tried flying private during COVID and have generally not gone back to commercial. Many have now ordered their own jet or a fractional interest in the jet. Second, the demographic of passengers is going through a shift to a younger generation that expects high-quality Internet connectivity wherever it goes. And last, almost all passengers went through a technology transformation during COVID.

As we all lived in isolation and had to master heavy data consumption apps like Zoom or Teams for work, in Instagram or Snapchat for our social lives. These trends drove a 137% increase in data usage across our networks between pre-COVID Q1 2019 and Q1 2023 and a 79% increase in usage per hour over the same period. Though flight counts are not a revenue driver for our business, industry observers use that as a proxy for demand. Our Gogo fleet flights in Q1 were about even with prior year, but up approximately 30% compared to Q1 2019, which represents significant growth in the overall market.

Additionally, Wall Street analysts project that OEM jet deliveries will hit 700 this year, up from 565 3 years ago and with currently committed purchases will grow to almost 800 in 2025. Our OEM relationships are very important to us. In advance it's either standard and an option on all 29 models of aircraft currently in production. This is a huge advantage for us as we launch 5G and GBB -- they are merely extensions of systems that are already certified and installable on all makes of aircraft.

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 service addressable market by broadening the advanced platform product offering and adding networks to meet the needs of each segment of the BA market globally. Second, we want to drive customer loyalty by continually improving our networks and leveraging the advanced platform to provide easy upgrade path as new technologies emerge. And third, we'll offer the best product and the best service 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 5G network, our GBB LEO offering, our FCC replacement program and the numerous operating initiatives I discussed on the last call.

So let me start with our Gogo 5G system. We remain on budget and on track for commercial launch in the fourth quarter of this year. Once live, our 5G network is expected to deliver speeds roughly 5 to 10x faster than Gogo's current ATG networks, with peak speeds up to 25 to 30x faster, enabling multiple streaming sessions and video conference applications to be opened at the same time on the same aircraft and all at lower cost than competing satellite solutions. In the meantime, customers who want Gogo 5G service can install the AVANCE L5 system today with full 5G provisions and operate on Gogo's 4G network until the 5G X3 box is available.

Once the X3 is ready, it can be installed quickly and 5G service can begin immediately, saving downtime and expense. We're extremely pleased by the market's excitement for Gogo 5G, evidenced by our pre-provisioning momentum. We delivered 52 pre-provision shipsets to customers in Q1. We have 116 end customers that have signed up for pre-provisioning promotions, and we have 98 dealer purchase orders in-house. We also have order commitments from 4 OEMs and are in discussions with several others. And we have STCs in process for 20 aircraft models representing roughly half of the business jets in North America.

Now turning to our LEO-based global broadband initiative, which adds an electronically steerable antenna to the advanced platform and adds the OneWeb low-earth orbit satellite constellation to our network offerings. LEOs are particularly well suited to business aviation because their low altitude enables an equivalent link budget with less power than with geo satellites. Thereby enabling a global coverage with small antennas that fit better on most business aviation aircraft. Our goals for the global broadband offering are to, first, expand our total addressable market to include 14,000 business aircraft registered outside of North America, most of which have no access to broadband connectivity today.

Second, to add a satellite feature for the thousands of U.S. super mid and heavy jets supply global emissions that have Gogo advanced ATG installed for use over North America today; and third, drive enhanced stickiness in our core North American medium-sized and smaller aircraft segments by offering an easy path to add a Leo product if they desire more capacity. We expect GBB will enable streaming directly from your favorite video services, multiple simultaneous video conferencing sessions, VPN access and all the other connectivity-enabled solutions you use today, the same service levels you expect in your office or living room today. We continue to make great progress alongside our partners.

OneWeb will supply the LEO network, completed launch on its 588 satellite global constellation in April and is on track to have the network deployed and aero ready in 2024 as expected. We completed preliminary design review in February with Hughes, our partner on the antenna side and are currently on track to deliver GBB commercially 2 months ahead of schedule in the second half of 2024. Our GBB product has received a very enthusiastic response from our OEMs, dealer partners and fleet managers, and we hope to have some exciting news on that front in the not-so-distant future.

Now let me talk about a couple of the competitive advantages of GBB. First, our small form factor antenna is designed to work on all sized aircraft, while our only current LEO competitors trying to deliver a very large intent that will work best in the already very competitive heavy jet segment of the market. Second, Gogo offers much better customer service in a very small, but complex and service-sensitive market. And third, Gogo will be the only inflight connectivity provider that can deliver a combination of LEO and leading ATG services, enabled by our unique advanced multi-bar capability.

Together, the combination of Gogo 5G and GBB will deliver a truly unparalleled experience for passengers using heavy data applications like Zoom or gaming, offering a unique performance advantage over competitors by virtue of our proprietary ATG spectrum and technology. Importantly, we're well positioned to leverage our existing international footprint to support GBB customers outside the U.S., the 20-plus dealers already in place and 900 narrowband customers in 90 countries today.

Before turning it over to Jessi, I'd like to provide an update on our SEC reimbursement program. Last summer, Gogo was awarded a \$334 million grant under the Federal Communications Commission's Secure and Trusted Communications Networks program that would reimburse the company for expenses associated with accelerating the removal of Chinese telecom technology from the 3G and 4G networks. Because there were more qualified grants than originally planned, all grants were cut back to 39% of the original award, which in Gogo's case is \$132 million.

Legislation with bipartisan support has just been introduced, that would fully fund the grants awarded by the SEC, and we are hopeful that, that will be approved. Because the functionality of replacement ground-based equipment will be better than the equipment installed on our 3G and 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 the network can simultaneously hand.

Jessi will provide some directional guidance on the expected financial impact of this program, which is not yet reflected in our guidance and which we will address on our Q2 earnings call. Jessi will also provide more detail on our recent \$100 million debt paydown and our Moody's upgrade. I will just state that we are committed to using our capital wisely. While returning capital to shareholders remains a priority, given the current interest rate environment and that our interest rate hedge will come down by \$125 million in July, we thought it was most prudent to reduce our leverage at the current time.

Overall, we're excited about 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. We're confident that our fundamental business model provides a strong foundation to support the strategic and operational initiatives we have underway and that our investment strategy continues to support a release of free cash flow in 2025 and beyond. And now I'll turn it to Jessi for the numbers.

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

Good morning, everyone. Gogo continues to generate strong financial performance even as we've undertaken significant strategic investments like Gogo 5G and our Global Broadband Product or GBB. This is a true testament to the strength of our underlying business model and financial position. In my remarks today, I'll start by walking through Gogo's first quarter financial performance in more detail. Then I'll provide an update on our balance sheet and capital allocation strategy, including the paydown of debt we executed today. And I'll finish off with some additional comments on our 2023 and long-term outlook.

Total revenue of \$98.6 million in the first quarter grew 6% year-over-year. Our top line was driven by record service revenue of \$78.5 million, up 11% year-over-year and 1% sequentially. Our ATG aircraft online reached a record 7,046 units as of the end of the first quarter, representing 8% growth versus the prior year and 2% growth sequentially. AVANCE units online included 3,447 units, up 28% year-over-year and now comprise 49% of our total fleet. We expect our advanced aircraft online growth rate to accelerate in the coming months as dealers resolve stocking challenges that are contributing to slower installation rate and more of the equipment we shipped at the end of last year is brought online.

We continue to expect the primary service revenue growth driver to be from additional aircraft online as we execute in a global market that is only 22% penetrated with in-flight connectivity, and we launched 2 new products, 5G and GBB. Total ATG ARPU grew 2% year-over-year to \$3,389 driven by recurring revenue and higher priced service plans. The launch of Gogo 5G in Q4 of this year, followed by our GBP product in the second half of 2024 are catalysts to further expand our ARPU growth opportunity over time.

Moving to equipment. Gogo delivered \$20.1 million in equipment revenue in the first quarter, a 9% decrease year-over-year and 35% decrease sequentially from the seasonally high and record fourth quarter. We shipped 223 advanced units this quarter, down 9% year-over-year and down 43% sequentially, reflecting standard seasonality for our business that was particularly pronounced due to record shipments in the second half of last year as well as the normalization towards pre-pandemic order dynamics that Oak had discussed.

We remain confident that the strong secular underlying drivers of IC demand and our strong position in an underpenetrated BA market will continue to propel our equipment sales in the future. We ended the quarter with a strong backlog and about half of our expected 2023 equipment revenue budget already secured. Overall, we're expecting our 2023 top line performance to skew towards the second half of the year with stronger activations and shipments in the third and fourth quarters.

Now turning to profitability. Gogo delivered strong service margins of 79% in the first quarter, consistent with the prior year period and slightly above our budget, driven by lower network costs. We continue to expect long-term service margins in the 75-plus percent range and to be the primary lever for free cash flow generation and long-term value creation. Equipment margins were 10% in the first quarter, 26 percentage points lower than the prior year period and 22 percentage points lower sequentially.

The decrease in our equipment margin was primarily due to additional costs related to the FCC reimbursement program and increased production costs driven by our expected 5G launch in the fourth quarter. As Oak described, we have determined to participate in the FCC reimbursement program. And by doing this, we incurred \$1.3 million in inventory write-off costs. In addition, we incurred \$1 million in cost this quarter, replacing a large number of EV-DO air cars and advanced equipped aircraft with dual modem or (inaudible). These FCC-related costs drove down equipment margins by 12 percentage points. We expect equipment margins to go back to planned levels in the 25% to 30% range in the quarters ahead.

Now moving on to operating expenses. First quarter combined engineering, design and development, sales and marketing and general and administrative expenses increased 15% year-over-year to \$29 million, and on a sequential basis, operating expenses were flats. The year-over-year increase reflects development expenses for GBB as well as higher personnel costs. As we previously stated, we expect that 2023 and 2024 will continue to be investment years as we complete our 5G program and ramp up spending for GBB. We continue to anticipate that these investments will support sustained strong top line growth and once completed, will be a key driver to significant free cash flow growth in 2025 and beyond.

In terms of Gogo 5G spending, we continue to stay on track and on budget for Gogo's 5G's commercial launch in the fourth quarter of 2023. While our time line has shifted, we have remained on track with the cost expectations we set back in 2019 that Gogo 5G and external development and

deployment costs would be approximately \$100 million. In the first quarter, our \$2.6 million of 5G spending was comprised of \$2.2 million in CapEx and \$0.4 million in OpEx.

Now on to our GBB initiative. In the first quarter, Gogo incurred \$1.5 million in operating expenses related to GBB. We continue to expect external development costs for GBB to be less than \$50 million over 3 years with approximately \$14 million in 2023 and the remaining spending to occur in 2024. As we previously stated, we anticipate that approximately 95% of GBB external development costs will be in OpEx. This spending profile is reflected in our 2023 adjusted EBITDA and free cash flow guidance.

Moving on to our bottom line. Gogo's first quarter adjusted EBITDA decreased 7% year-over-year to \$39.7 million, primarily due to lower equipment revenues and increased operating expenses, including GBB. Gogo delivered net income of \$20.4 million in the first quarter, down 8% year-over-year, translating to \$0.16 in basic earnings per share and \$0.15 in diluted earnings per share. As a reminder, our financial statements reflect noncash income tax expenses as we continue to 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 planning horizon. We continue to expect additional reversals of portions of a valuation allowance against deferred tax assets within the 2023 fiscal year. In the first quarter, we generated \$20 million in free cash flow, up \$11.2 million compared to Q1 2022 due to a decrease in net working capital from lower accounts receivable and lower 5G CapEx. Free cash flow was down \$5 million sequentially, primarily driven by employee bonus payments made in the first quarter.

Now I'll turn to a discussion on our balance sheet. We ended the quarter with \$712.3 million in outstanding principal on our term loan and \$188 million in cash and short-term investments with our \$100 million revolver remaining undrawn. At the end of the quarter, Gogo had a net leverage of 3.1x, in line with our target range of 2.5 to 3.5x. As we announced on May 1, Gogo made a strategic decision to pay down an aggregate principal amount of \$100 million on our outstanding term loan debt facility. As mentioned in previous calls, while we have a hedge agreement in place and before the paydown we were more than 90% hedged, the first step down to \$525 million will occur in July.

The paydown will materially reduce our interest expense, minimizing our exposure to the current volatile financial environment and ultimately strengthen our financial and strategic flexibility. As a result of the paydown, Gogo will reduce its term loan B outstanding principal to \$612.3 million. Gross leverage at the end of Q1 was 4.2x, and it will be reduced to 3.6x after the paydown. On an annualized basis, we expect to reduce cash interest by approximately \$8.5 million based on current SOFR rates. And in 2023, interest cost will be reduced by approximately \$4.5 million based on the April forward SOFR curve and (inaudible) interest income.

As a result of executing a more conservative financial policy with a lower leverage target and pay down of debt, this week, Moody's upgraded our credit rating to be one with a stable outlook. The paydown of our debt is in line with our balanced capital allocation strategy. As a reminder, our priorities are: first, to maintain adequate liquidity; second, investing in strategic opportunities to drive competitive positioning and financial value, including 5G and GBB; third, maintaining an appropriate level of leverage for the economic environment with a target net leverage ratio of 2.5 to 3.5x, and finally, returning capital to shareholders as appropriate in the future.

Now I'll turn to our outlook. Gogo is reiterating our fiscal 2023 financial guidance and long-term targets. We continue to target 2023 revenue in the range of \$440 million to \$455 million. While we've had a slower start to 2023 due to the dynamics Oak discussed earlier, we continue to believe 2023 will be a strong year for aircraft online growth as the record units we shipped in 2023 are activated, driving recurring high-margin service revenue and additional equipment sales follow, particularly in the second half of the year.

We expect 2023 adjusted EBITDA in the range of \$150 million to \$160 million, reflecting operating expenses of approximately \$30 million for strategic and operational initiatives, including \$9 million in expected 5G spending, which reflects the shift of \$6 million from 2022 to 2023 related to the shift delay approximately \$14 million of GBB development spend and approximately \$7 million in additional operational initiatives focused on penetrating the 78% of the global business aviation in-flight connectivity market that remains untapped and maintaining our long-term competitiveness. We expect 2023 free cash flow of \$80 million to \$90 million, which includes capital expenditures of approximately \$30 million to \$40 million, of which \$20 million is tied to Gogo 5G.

Even with our investments in exciting new products, we expect year-over-year free cash flow growth in 2023 of nearly 50% at the midpoint of the guidance. Importantly, our 2023 guidance does not reflect the impact of Gogo's participation in the SEC's Secure and Trusted Communications Networks reimbursement program. As previously mentioned, Gogo plans to proceed with the SEC program by submitting an initial reimbursement request before the July deadline. Since the program is currently partially funded, we have some optionality in what we request reimbursement for that could impact where money received will be recorded between the income statement and balance sheet. We will be solidifying our plans over the next couple of months, but in the interim, I want to provide some directional context on how the reimbursement program could impact our 2023 outlook.

At a high level, we expect 2023 free cash flow to be impacted by increased use of working capital as we build airborne inventory and tower equipment. The government reimbursements would partially lag those purchases, and then we see a cash flow benefit in subsequent years as the program unfolds. We will update our guidance on our Q2 call to reflect the program once our plans are finalized and provide more complete information on the financial impact of the SEC reimbursement program. Our long-term targets also remain unchanged, reflecting our expectations for the launch of Gogo 5G in late 2023 and the launch of our GBB product in the second half of 2024.

We reiterate that we expect revenue growth at a compound annual growth rate of approximately 17% from 2022 through 2027 with global broadband materially contributing to revenue in 2025. We also expect annual adjusted EBITDA margin to be in the mid-40% range by 2027, which includes continued investments in engineering, design and development to fund innovation and market competitiveness in the out years. And finally, we continue to expect free cash flow of more than \$200 million in 2025 and growing in 2026 and beyond. We believe that our value proposition is underpinned by the strong growth in free cash flow as we complete our 5G and GBB investments and execute in an underpenetrated global market.

Gogo's business continues to perform extremely well. Our outlook underscores the immense value creation potential for our customers and shareholders that we expect to unlock as we execute our strategy and invest in the strategic initiatives that will extend and enhance our long-term growth. Before we open the call up for questions, I would like to thank the entire Gogo team for their continuous hard work and dedication to our business and for providing unparalleled service to our customers. Operator, this concludes our prepared remarks. We are now ready to take our first question.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) Our first question comes from the line of Rick 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*

A couple of questions, if I could. First, Oak, you started with obviously the state of the business. You mentioned 15,000 business jets out there. You guys have about 50% of that, 50% of AVANCE. Help people understand why do you think that market is so underpenetrated. You talked a little bit about the technology changes and demographics, but help people understand how you think that curve plays out of what drives people to say, yes, I want in-flight connectivity on that pool of business jets.

And then on the 10,000 turbojets sticking with the U.S., what is it there? Does it require price? Is it antenna? What is it that gets turbojets to come on board? And then the third part of the question is obviously the global side of it. What do you think spurs people to come to say, yes, I'm ready to pay for in-flight connectivity?

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

So we'll start with the jet. 50% given that this has been line fit for, I don't know, roughly 10 years or so, I would say isn't that bad when you think about it. A lot of the jets are frankly older than -- significantly older than the amount of time that this has been -- our service has been line fit available at the OEMs. So all that has to come through the aftermarket. And frankly, I think that service levels have to do with it. I think that the incredible increase in the capacity we'll be delivering with 5G and GBB, et cetera, will be a real incentive for people to install service.

Second, you have to do it. Generally, it takes a long time to install. Our systems are faster sold than others, but still probably haven't been fast enough. So we've been really focused on reducing install times so that you not only have to wait for -- you don't have to wait for a big maintenance event. You might even just go in and do a stand-alone upgrade or install rather. I'd say the lower end of the business jet market, there's some price sensitivity, but that's where we've got L3 positioned and lower price plans that go with that. So I think that's why we've been pretty successful in driving penetration of the light jet market over the last couple of years.

So it's a combination of all those things. It's generational. I mean a lot of business jets 5, 10 years ago, were owned by people my age and many of those people didn't want to have connectivity on the jet or feel a need for it. That's really shifted as today. I think we did a poll of our user base last year and 67% of them are now Gen X, Y and Z, not baby boomers, like myself. So I think those are all contributing factors. I think we've seen a real turn there and a much -- a real acceleration of the number of people installing. So that's that market.

In the turboprop market, I think it's a couple of things. I think price is definitely a factor in a lot of that market. And again, we've been trying to go down market. We've announced some deals with some of the turboprop fractional, for instance. We've got our Cirrus deal, which is actually not a turboprop, it's a small jet, but sort of same market in some ways. But what we're seeing is more interest in -- from the turboprop market, especially the charter part of that market because people expect connectivity when they charter. So I think that, that is going to shift.

And of course, with AVANCE, we've been designing new form factors that are smaller and will fit in those more compact aircraft. So I think we have high hopes for that market. It's not going to be a high ARPU market, but it's a large market. So we make it up with quantity. And then overseas, the real issue is that most aircraft don't have an option today. Of the 14,000 business aircraft outside of the United States, about 3-ish are heavy jets. And they have an option, they have a geo satellite option. And about less than 1/3 of those have that service today, and that's, I think, largely related to expense. It's very expensive to install and very high service cost. So that part of the market, I think cost will be an issue and sort of ease of install. And I think our GBB product is well positioned for that.

And then in the medium-size jets on down, there's nothing overseas that they can really use. There's the EAN ATG network in Europe, but that's really not been sold to business aviation. And I think -- I don't know all the reasons why they haven't done that, but they haven't. So there's really not much of an option. And the good news about GBB is it's a small form factor and competitive pricing will enable people to fit GBB on all those aircraft. So we think that's going to be a great opportunity for us.

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

Great. That's very helpful to help people kind of frame it. And I think Jessi mentioned that GBB could be material in '25. Is that kind of the hope then is that GBB opens up and unlocks that 14,000 global opportunity that haven't had the availability before and that's why -- and what those material kind of can you give us a hand on what material might mean in '25?

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

I am not in charge of the definition of material. So I'll let Jessi deal with that. But we're looking to commercially launch the GBB antenna and network in the fourth quarter of 2024. So you can imagine installs starting to hit at the end of '24 and going into '25. So that's, I think, why we say material and we'll start getting service revenue really in 2025 on it.

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

It's still going to be heavily weighted on the equipment side, but you'll start getting some service revenue.

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

Great. Last one for me, and of course, I know I love service revenue guidance rather than just total revenue guidance because I do think the overall value of the company is going to be more driven by service than the onetime equipment revenue. But the final one, \$100 million debt paydown. That sounds nice to get the debt reduced as the hedge kind of comes down for step down. How much cash do you think you need on hand to run the business, particularly as you look at maybe the working capital pressure with the FCC program? And then remind us of what the other step downs on the hedge are as far as timing.

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

Yes. So I mean, towards the cash that we would like to have on hand. As a reminder, we have the \$100 million revolver available to us. So we always have that. But somewhere between \$50 million to \$75 million, we'd like to be a little bit more conservative and making sure that we have that cash on hand. And especially, as you noted, with some inventory requirements with FCC initially until we get the reimbursement back from the government. So there could be a small lag in that initially.

And with regards to the hedge paydown, we've got the \$125 million paydown that happened in July of this year. And then the next paydown is in December of 2024. So it goes from \$525 million down to \$350 million and then it will step down to \$250 million in terms of what's hedged, it will step down to \$250 million December of 2025, and then December 2026 down to \$200 million.

**Operator**

Our next question comes from the line of Phil Cusick with JPMorgan.

**Philip A. Cusick** - JPMorgan Chase & Co, Research Division - MD and Senior Analyst

Just a couple of follow-ups on Rick's questions. And maybe talk about the long poles to launch the GBB network. Any update on OneWeb's progress there? And what else has to happen for you to get that up and launched in '24, what are the big pieces? And you talked about what the alternatives are today, but what are the alternatives that look like they're coming down the line? Who else is working on products for global private aircraft?

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

Yes. Sure. So there's 2 long poles. One is the OneWeb network. They've launched now all the satellites they need to complete their global network. They do have, I think, another 2 launches, but those are all spare satellite. So what they need to provide our service is actually in the space. They need to position those satellites now in their orbital planes and get them up and operational. I think that they will -- and there's some software changes they make for aero. So that will all get done, I think, by the middle of next year, and I think that will be a slightly shorter pole than the other one, which is our building of our terminal, our aircraft terming, which we're doing with Hughes. That program is in great shape.

I have to say, working with Hughes is a real pleasure that their operational maturity and program maturity is outstanding. And so we've been able to actually move that project in. It was going to be an early '25 delivery and now we're into the fourth quarter of '24. It's moved to the left. And I think we see, frankly, some opportunity perhaps to even move in a little more. So that's going extremely well.

I'm not going to give away any secrets, but we're going to have some fun news about that at EBACE in Geneva at the end of May, the big global business aviation convention. So those are really the 2 poles, and I think both are in very good shape at the moment. And in terms of alternatives right now, I think Starlink would be the main one. They have a large antenna today, 39 inches long, 31 inches wide, which is quite large for business aviation. That's installed on some Embraer 145 line for JSX Airlines and on some G650s, which I believe are all pretty much owned by some Musk or (inaudible) or another. They've been seemingly having difficulty in getting STCs for that. And they're sort of making halting progress trying to get into the market.

Personally, I think that -- we have great respect for Starlink and the people at SpaceX, they're literally a group of rocket scientists. But we think that we'll be very competitive with them in our market. With our combination of ATG and LEO, frankly, we think we're going to have the best product in the market. When it comes to return link will be much better than they are and other factors I won't bore you with in terms of the geeky stuff, but we think we have a very competitive product. We'll have much better service in a market that is very complex and very service sensitive and adhering to many service.

So that's good. And I think that on pricing will be very competitive. So we think we can compete effectively with them. And then I guess the third point I'd make is coming into this market makes no sense for them. They're a great company. They do some things extremely well, obviously, on the satellite side. But when it comes to markets, they're generally do it 2 ways. One, they have a very standardized offering and you're going after a very large markets like direct-to-home, and it's relatively simple on the service side and the Musk marketing just is enough to sell that product. And so that works well for them, and they do it at real scale, and they get cost way, way down.

But they have to manufacture millions of terminals and the like to actually have the cost come down to where they need it. The other thing they do really well is really large customized programs like for the Department of Defense and the like and their deals are worth billions and it's worth them committing huge teams of geniuses to build those programs and deliver them. But what does it really make sense is adding -- getting into markets that require -- that are very small and require lots of customization and cost. And I'm not sure they're really good at that.

When it comes to the antenna, they're going to try and take a consumer-grade antenna and beef it up for aero, that doesn't really work in aero, okay? It's got to be a ruggedized aero standard manufactured piece of equipment, which is a lot different than what you can put on a home, right? They're the same with routers. The same with every single component of what they have. So the level of customization for a very small number of units doesn't make sense. The level of service that you have to have for a very small number of units it doesn't really make sense either. So I think -- and if they come in and they dramatically cut pricing, they're going to take us \$300 million or \$400 million service market today and make it a \$150 million service revenue market.

That doesn't really make sense because that's a rounding error in their numbers. So that's our take on them. And then I think Satcom Direct has a deal with OneWeb as well as we do. We don't see a lot of progress from them on that front. They seem to be pushing some of their other products more heavily. But I mean, I think we always have to take them seriously. They're a good competitor. So I think that's kind of the competitive landscape.

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## Operator

Our next question comes from the line of Landon Park with Morgan Stanley.

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### **Landon Hoffman Park** - *Morgan Stanley, Research Division - Research Associate*

I was wondering if we could start on the OEM side. I'm wondering if maybe you could comment on what kind of take rates you guys have been seeing out of that channel and maybe how that's trended over the last couple of years? And any early indications you've had from them regarding GBB, just what the outlook looks like there? And then separately, I was just wondering if you could talk about what the EBITDA cadence might look like through the year given that the 1Q level was already at sort of the high end of your guidance, it seemed to include some onetime expenses. So how should we think about the puts and takes through the rest of the year there?

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

Sure. So I'll take the OEM part and leave Jessi with the hard numbers part on EBITDA. Our take rates are very widely by OEM, I would say. We have very high take rates at the Textrons and OEMs and Embraers today, less so at Gulfstream coming out of line-fit for instance, but we often get put in, in the aftermarket there, same at Bombardier. So it's a little hard to say exactly what the take rate is because often we're installed sort of just after it comes off the line in a service center or something like that.

However, I think that the way to think about it, about 65% of OEM delivery stay in the United States, something like that. And so we're kind of limited to that side of the opportunity, if you will. And we would be on almost all Textron planes delivered to that market, very high percentage of number of airc and then less so like I just add on the Gulfstream and Bombardier and the cells. However, we have very high penetration of the Bombardier Gulfstreams into cells. But again, that generally comes in, in the aftermarket.

I would say our take rates have been growing, which is good. And then I would say that on GBB, the receptivity is just outstanding. And I've never seen the OEMs as excited as I see them now across that.

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

In terms of the EBITDA for the rest of the year. So definitely, the revenue is going to be higher on the second half of the year than the first half as we talk through. But we will have some increase in expenses. So in Q1, the GBB expenses was only \$8.5 million and 5G expenses was only \$0.4 million. So both for 5G and GBB, those expenses are going to be picking up as well as the other operational initiative expenses. So that will have some impact on the EBITDA going forward while the revenue is growing.

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**Landon Hoffman Park** - Morgan Stanley, Research Division - Research Associate

And then just a follow-up on the OEM side, maybe just including the aftermarket installs would come shortly after delivery? What of those 700 with the 65% in the U.S., is it nearing 90-plus percent in terms of what you guys can get off of that? And just maybe more broadly, are you seeing anything on the macro side? Have you picked up any customer sensitivity or anything along those lines?

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

We haven't shared the attachment rates at the OEMs. We can contemplate sharing those in the future -- so I'm not going to give you exact numbers. But like I said, if you -- first of all, read today, we are limited to those that are being delivered in the U.S. I'm going to give you a little wrinkle, which is sometimes those that are ordered overseas do install our equipment, but they don't activate it and they install it in order to have a -- get better pricing in the aftermarket and when they go to sell that aircraft. So they think they have our product in and all there. So there's a little bit of a wrinkle there.

But I think that if you look at Textron deliveries in the U.S., we're probably close to 90%, something like that. If you look at Gulfstream, it's going to be at the other end. It's going to be sort of 20%. And so then -- and because sometimes in the aftermarket, at least if it's a relatively new Gulfstream, it's going to be at a Gulfstream aftermarket facility generally. We don't look at that, I would say, as a line-fit OEM install. So we don't really count it that way. So that is contemplated whether we'll share that in the future, and, but I think I've given you the color.

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**Landon Hoffman Park** - Morgan Stanley, Research Division - Research Associate

And is there anything on the macro that you would note?

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

When you say macro, mean macro economy?

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**Landon Hoffman Park** - *Morgan Stanley, Research Division - Research Associate*

Yes.

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

How it impacts people's saving. Well, it's on people's minds. We did a little poll of our Dealer Advisory Council in some road shows to dealers. And so -- and all I would say, let's call that 12 to 15 dealers. And only one mentioned the economy being the issue. There are a lot of other things that got mentioned that might ultimately be economic, but we're more, I would say, micro in reality. So there's been no real impact on orders at the OEMs, right. I mean they continue to be strong.

And from the dealer perspective, they are busier than they can really handle right now, catching up on maintenance from COVID times. I mean, there are literally planes parked on tarmacs that can't fly because they're no longer in compliance on their maintenance logs. And they're trying to get that work done, so those planes can start flying again. So everybody is very, very busy. So I don't think the macro economy has really hurt the market.

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**Operator**

Our 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*

And maybe just to stay with the theme of the dealers and the shipments and activations and the turbulence there, I think the concern is that it does raise the specter of perhaps the macro pressures are kind of leading into the business jet demand. But just to be clear, it sounds like really what happened is that the dealer has requested a lot of shipments historically because the lead times have become concerning and now that's reversing.

And it doesn't sound like the underlying kind of final demand has changed much. Is that fair? And I think you said, if anything, it's stronger than pre-COVID and presumably, it's also stronger than where it was before the supply chain sort of got challenging. Is that fair?

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

Yes. I think that's all fair. We had a huge Q3 and Q4 shipments, record breaking, some of that, I think, was driven by the still COVID ordering patterns. I think also our equipment prices go up every January 1. So I think people were loading up ahead of time on equipment before the price increases kicked in. And I think that they bought enough inventory to last them well into this year. And they don't need to backfill, but they're taking off the shelf to install if they got -- already got plenty of inventory on the shelf.

So I think that's the real impact right now. The important thing to us is getting the gear on the plane and activate it and producing service revenue because as Rick pointed out earlier, that's the real goal here. So we're happy with that and a little inside baseball, we had a really good activation quarter. It doesn't show so much in AOL because when people go into maintenance or they put the aircraft up for sale, they often almost, always spend the service for a couple of months or however long it takes to sell the debt. So there's a little dampening there because those sales activities have picked up in the last year and the maintenance activities are picking up. So but that's all temporary, right?

Most of those -- the ones that go for sale almost all come back online, often was an upgrade, which we like. And the ones that go into the shop, they turn it back on as they come out of the shop. So -- and obviously, they're grounded and waiting to get into shop, they're really not going to -- they're really going to turn it off once that they're paying megabits they're not using. So those tend to dampen AOL, but we had good demand on the install side and activation side. And so we feel pretty good about that.

The issue we found a couple of times is this place meant to come in for 2 months. It's going to get all the following things done and the dealer want to sell them an IFC system. However, if I do because of my labor issues, I got to add 2 weeks to the 2 months and the customer won't accept that extension to the maintenance window. So those are the types of things that do dampen things a little bit. But like I said, it was our second best activation month ever quarter ever and certainly our best first quarter activation.

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### Operator

And our next question comes from the line of Louie DiPalma with William Blair.

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**Michael Louie D DiPalma** - *William Blair & Company L.L.C., Research Division - Analyst*

Jessie, congrats on your first call as CFO. You provided several metrics for the 5G pre-provisioning. What are the next technical milestones to look for with the 5G launch? And is there a risk that the launch could slip until early next year?

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

Well, we're on track right now in terms of getting the chip fabrication completed at Samsung and getting that ship to GTT, Airspan and us on schedule. That looks to all be on schedule. We've done almost all the testing we need to do on the system already, but we have not tested as anything that just relates to the 5G chip. So clearly, that testing has to take place, which will happen generally late second quarter, early third quarter, we'll be flying it in the third quarter.

There's always the black swan possibility that something goes crazy at Samsung again or whatever. But with the amount of attention, Samsung, Airspan and GTT, and we have all paid to this chip at this point. It would be shocking if there was a problem with it. So we're quite confident we'll be delivering in Q4. But now it appears to be completely on schedule.

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**Michael Louie D DiPalma** - *William Blair & Company L.L.C., Research Division - Analyst*

And you also discussed how the 5G service is expected to be 5x to 10x faster than your current AVANCE ATG product. And as it relates to small and midsize aircraft that only fly in the U.S., I know you were just talking about Textron aircraft. But do you think that those aircraft, the small and midsize aircrafts would be good candidates for the global broadband product? Or do you think that for small and midsize aircraft that only fly within the U.S. that most likely they will stick with your ATG products as that appears to be fast enough for most of their needs as it relates to streaming or video gaming and phone calls and what not?

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

Yes, that's 100% right. And I think also, it will be priced to appeal to that market, right? So I think that ATG, if the mission is generally U.S. is a very good answer and 5G is a very good answer. So that's where we're positioning that product. The GBB product, we're really positioning for obviously, the international planes that fly outside the U.S. most of the time. For heavy jet in the U.S. that fly outside the U.S. often enough to want to have a system that can handle that overseas. And in that market today, we've already got like in the heavy jet market, where over 50% of the U.S. heavies have our system, our ATG system on today, probably about half of the heavy, the super mids have our system on the mid.

And a lot of those are advanced already. So for them to add GBB is going to be a pretty heavy -- pretty easy lift and it can replace their current geo satellite products, often they have us and the geo product. So a lot of that market looks at this and just agree I'd really love to have one throat to strangle, one provider and one price for the bundled package that I can pay one bill. And I think that the LEO will provide a better service than GEO. So that market -- that's the other market where GBB is really aiming.

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**Michael Louie D DiPalma** - *William Blair & Company L.L.C., Research Division - Analyst*

Great. And one last one for Jessi, will there be a material step-up in recurring cost of service expenses with the launch of 5G this year and the global broadband networks next year? Like will there be like significantly higher like backhaul costs and tower expenses and other data center software fees that we should be thinking about? I know Oak and Jessi, you previously outlined expectations for significant margin expansion. And I'm just wondering what types of additional costs we should be thinking about?

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

So 5G backhaul, it's in our guidance and it's in our long-term forecast that we've been providing. So there will be some increase in the 5G backhaul. And as mentioned, with GBB, we're paying by the drink on that with OneWeb so that will be flowing through cost of service as well. But we still expect the margins to be in the 75-plus percent range in the long term. So that's included all in our plans.

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**Operator**

I would now like to turn the call back over to Vice President of Investor Relations, Will Davis for any closing remarks.

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

Thank you, everyone, for joining our first quarter earnings call. This now concludes our call, and you may disconnect. Thank you.

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