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# **EDITED TRANSCRIPT**

GOGO - Q3 2016 Gogo Inc Earnings Call

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## NOVEMBER 03, 2016 / 12:30PM, GOGO - Q3 2016 Gogo Inc Earnings Call

### CORPORATE PARTICIPANTS

**Varvara Alva** *Gogo, Inc. - VP of IR and Treasurer*

**Mike Small** *Gogo, Inc. - President and CEO*

**Norman Smagley** *Gogo Inc. - EVP and CFO*

**Michael Small** *Gogo Inc. - President and CEO*

### CONFERENCE CALL PARTICIPANTS

**Dick Ryan** *Dougherty & Company - Analyst*

**Phil Cusick** *JPMorgan - Analyst*

**Louie DiPalma** *William Blair & Company - Analyst*

**Denny Galindo** *Morgan Stanley - Analyst*

**Andrew DeGasperi** *Macquarie Research Equities - Analyst*

**Lisa Friedman** *UBS - Analyst*

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### PRESENTATION

#### Operator

Good day, ladies and gentlemen, and welcome to the Q3 2016 Gogo earnings conference call.

(Operator Instructions)

This call may be recorded. I would now like introduce your host for today's conference, Ms. Alva, Vice President of Investor Relations and Treasurer.

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**Varvara Alva** - *Gogo, Inc. - VP of IR and Treasurer*

Thank you.

Good morning, everyone, and welcome to Gogo's third-quarter 2016 earnings conference call. Joining me today to talk about our results are Michael Small, President and CEO, and Norman Smagley, 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 financial performance for 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 this conference call.

These risk factors are described in our earnings press release and are more fully detailed under the caption Risk Factors in our 10K which was filed with the SEC on February 25, 2016, and our other documents filed with the SEC. In addition, please note the date of this conference call is November 3, 2016. Any forward-looking statements that we may make today are based on assumptions as of this date. We undertake no obligation to update these statements as a result of new information or future events.



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During this call, we will present both GAAP and non-GAAP financial measures. We include an explanation of adjustments and other reconciliations to the most comparable GAAP measure in our third-quarter earnings press release.

This call is being broadcast on the Internet and is available on the Investor Relations section of Gogo's website at [www.ir.gogoair.com](http://www.ir.gogoair.com). The earnings press release is also available on our website. After management's remarks we will host a Q&A session. Now it's my great pleasure to turn this call over to Michael.

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**Mike Small - Gogo, Inc. - President and CEO**

Thanks, Varvara.

Good morning, everyone. Congratulations to the Chicago Cubs!

We had another strong quarter and continue to build momentum around 2Ku. I cannot emphasize enough the importance of this technology, as it is the fuel powering our continued growth. As of today, 2Ku was installed on 47 planes across five airlines. We remain on track to meet our guidance of 75 to 100 installs by the end of the year.

More importantly, we are spearheading an unprecedented operational ramp-up to bring more than 500 2Ku aircraft to the sky by the end of 2017. Quite simply, 2Ku is the best-performing solution in the world. We are seeing streaming-class connectivity speeds of more than 50 megabits per second today, and we will more than double that figure next year with our new proprietary modem and the availability of high-throughput satellites.

This market-leading performance in all regions, not just certain parts of the United States, is why we have grown our backlog to more than 1,500 aircraft, 1,000 of which were awarded this year alone including additional aircraft with Delta. The more high-bandwidth 2Ku aircraft we have in play, the higher our pull will be. Therefore, we remain keenly focused on reducing 2Ku installation time.

We expect to ramp up to an annual install rate of about 750 planes in 2018 and to maintain that level in subsequent years. We expect CapEx to decline in 2019, both in aggregate dollars and, more significantly, as a percentage of revenue. We expect to be solidly generating cash in 2020.

During the quarter we announced our next-gen North American ground network that will launch in 2018. It will deliver a ground-like experience for business aviation and commercial regional aircraft operating in the United States and Canada. With our regional next-gen ATG network and our global satellite 2Ku network, we are uniquely positioned to serve far more aircraft at 100 megabits-per-second service than any other ISD provider. More importantly, we are delivering results now. Our growth remains strong, with revenue for the quarter of \$147 million, up 17% year over year. Adjusted EBITDA was up 57% to over \$15 million.

In our Commercial Aviation business, we saw key advancements in each region of the world. In Europe, after a highly competitive process, Air France-KLM selected 2Ku for its long-haul aircraft. This award, along with British Airways, Iberia, Virgin Atlantic, Delta and Air Canada wins brings our share to about 40% of all transatlantic flights.

The quarter also marked several important global expansion milestones. In Asia, we secured regulatory approvals and are now providing service to our airline partners flying over China. In South America, we launched 2Ku service for GOL. For its inaugural flight, 2Ku was offered free of charge. GOL had close to 100% take rate with passenger streaming and Web browsing. The CEO of GOL even did a Facebook live session in-flight.

Operationally, our focus continues to be on accelerating 2Ku installations. Since our Investor Day a month ago, we have more than tripled the number of installed 2Ku aircraft to 47. We now have 12 installation lines up and running, and have added two new SDCs in the past month bringing our total to 10. With the summer travel season behind us, we are seeing installs steadily increasing and have cut our 2Ku install time down to three and a half days from eight days just a month ago. During the quarter, we also installed and upgraded an additional 180 aircraft to ATG-4 and are on pace to meet our guidance of about 600 such installs for the year.



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Turning to Business Aviation, we continue to generate outstanding financial results, including significant cash flow. During the quarter, we began selling Gogo Biz 4G in anticipation of launching the service in the first half of next year. We also announced partnerships with Constant Aviation Partners and Duncan Aviation to secure SGCs for Gogo Biz 4G on select business aviation aircraft.

To augment our VA product and service offerings, we signed agreements with leading ad at providers, Garmin, Jet Fuel X and flightplan.com. Pilots will soon have real-time information, enabling them to fly more safely and efficiently and also resulting in considerable cost savings. By continuing to add new partnerships and by enhancing our VA capabilities with the addition of Gogo Biz 4G and next-gen ATG, we remain well-positioned for long-term revenue growth in this important segment.

Before turning it over to Norm, I want to clarify a few things about our next-gen ATG technology that we first introduced a month ago. This new offering was made possible by patent and proprietary technology we have developed over the last two decades. By leveraging more than 60 Megahertz effectiveness in 2.4G bands, we can offer a streaming class ATG experience similar to our global satellite network.

In addition to our R&D capabilities, two other things really set our next-gen solution apart from the competition. First, ours is a fully-integrated solution that combines our existing licensed spectrum with unlicensed spectrum in the 2.4 gigahertz band. Unlicensed spectrum alone is not enough. The integrated nature of our offering is the only way to reliably provide the industry-leading speeds that our VA and CA customers demand. Our new ATG network will deliver 6 Ds of 100-plus megabits per second and 99% of our higher reliability and availability.

Secondly, in launching our new offering, we have significant economic advantages, including time to market because we can leverage our existing ground infrastructure, distribution channels operational capabilities and aircraft hardware. For a relatively low-cost, we will be able to bring forth more than a tenfold capacity increase. In sum, we will have the best ground network at the lowest cost in the United States and Canada.

Now I'd like to turn it over to Norm.

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### **Norman Smagley - Gogo Inc. - EVP and CFO**

Thank you Michael.

Good morning, everyone.

We had a great third quarter. Total revenue was up 17% to \$147 million. Service revenue grew 20% to a record \$129 million. Adjusted EBITDA increased 57% to over \$15 million representing a 10% margin.

Turning to segment results, CA North America service revenue increased 14% to nearly \$89 million, driven largely by an increase in airfare onlines to over 2,600. This reflects 70 installs and 37 retirements.

As Michael mentioned, we started production of 2Ku installs for our North American airline partners this quarters and are rapidly deploying 2Ku on more aircraft. We had approximately 170 net new awarded or not-yet-installed aircraft at quarter end. We expect to install most of these aircraft by the end of 2018.

In addition the number of CA/MA aircraft to be converted to 2Ku is now about 800. Remember that most of these planes are mainlined, high-bandwidth aircraft. While will they currently account for approximately one-third of our North American connected fleet, these aircraft are a more significant portion of current bandwidth consumption. We expect to see meaningful growth in CA/MA ARPA when these aircraft convert to 2Ku.

For the quarter, we achieved annualized ARPA of \$134,000, flat to the third quarter of last year. ARPA grew 8% year over year, adjusting for the dilutions in additional RJs and aircraft donated by new airline partners. We expect to be largely done with RJ installs by the end of this year. We also expect about three-quarters of our 2Ku aircraft installs in 2017 to be in North America. Both of these factors will start fueling ARPA growth later in 2017.

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CA North America segment profit was up 23% \$15 million, representing a 16% margin. This was up 1 percentage point from last year, despite incurring some one-time costs associated with the ramp-up of 2Ku installs. Our investment in 2Ku installs drives lower costs and a more rapid installation pace.

Turning to the rest of the world, total revenue for the quarter was \$7.6 billion, more than double the prior year, driven by strong aircraft online and ARPA growth. Aircraft online increased 96 from the prior year. We added seven aircraft during the third quarter, including our first Ku installs for GOL and Virgin Atlantic, and ended with 256 aircraft online. We have now completed Ku installs for Delta and expect to complete the job by year end.

Our CA rest of the world awarded but not yet installed aircraft increased about 600 at quarter end following the recent Air France-KLM win. We expect to install the majority of our awarded aircraft by the end of 2018, with installations ramping up during 2017 and further accelerating in 2018.

For the quarter, we generated annualized ARPA of \$174,000, up 22% from the prior year, driven primarily by higher airline paid usage. (Inaudible) provided their passengers with free fifteen-minute sessions on all of their flights, driving usage up threefold. This demonstrates the significant ARPA growth opportunity of the multi-payer model, in which connectivity is paid for by airlines, sponsors and other third parties, in addition to passengers. We expect ARPA growth to moderate in the rest of world as we launch new airline partners in the next several quarters until the new fleets begin to mature.

Rest of world segment loss for the quarter was flat to prior year at roughly \$20 million, despite continued investments and the rollout of 2Ku including STCs and OEM installation activities.

Now turning to BA, service revenue was up 28% to \$33 million, driven by 20% growth in APG aircraft online to nearly 4,000 and about a 9% increase in ATG service ARPU, over 2,500 per month. BA equipment revenue of \$16 million was down from the prior year. The primary driver of the decline was the deferral of revenue on ATG equipment shipped under a sales program in which the equipment will be upgraded to Gogo Biz 4G next year, at which point the revenue will be recognized. We deferred \$2 million of equipment revenue in the quarter and \$2.8 million year to date.

Segment profit was up 14% to \$2,100, representing a nearly 42% segment profit margin, driven by growth in high margin service revenue which represented almost 70% of BA revenue for the quarter.

Third-quarter consolidated Cash CapEx of \$36 million was \$24 million higher than the prior year due to increased 2Ku equipment purchases to support our 2Ku installations.

Turning to full-year 2016 expectations, we are reiterating adjusted EBITDA guidance of between \$55 million to \$65 million and continue to expect revenue to be above the midpoint of our guidance range of \$575 million to \$595 million. Based on our success to date with 2Ku installs, we are now guiding toward the top end of the guidance range of \$110 million to \$135 million from Cash CapEx this year.

I'd like to give some additional color on Cash CapEx in 2017 and 2018. We are successful accelerating the rate of 2Ku installs and want it to go even faster. These are high-return investments for us. For next-gen APG, we expect approximately \$50 million of capital investment that will be likely phased in between 2017 and 2019.

As Michael mentioned, this investment will enable us to deliver 100 megabits per second speeds with business aviation and the regional jet markets starting in 2018, driving continued revenue growth in this highly-profitable business. After 2018, we expect Cash CapEx to decline in both absolute dollars and as a percent of revenue, driven by lower co-investment per aircraft, stable installation rates and largely complete next-gen APG network.

In conclusion, I'd like to share with you how our quarterly performance fits into our long-term path to profitability outlined during our recent Analyst Day.

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Our path to profitability is centered around four key pillars: aircraft online, investment for aircraft, ARPA and margins. During the quarter, we made significant progress on all these metrics. 2Ku momentum remains strong following the Air France-KLM win, and at the same time it reduced both install costs and the time required to install 2Ku.

Further, by ramping up 2Ku installs and announcing our next-gen ATG solution, we are now in great position to unlock significant ARPA growth across all aircraft types. Getting more bandwidth and more aircraft online will help us leverage our operating investments, drive margins higher, and ultimately generate profitability and drive increased shareholder value.

Operator, we are ready for our first question.

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### QUESTIONS AND ANSWERS

#### **Operator**

(Operator Instructions)

Our first question comes from Dick Ryan with Dougherty.

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#### **Dick Ryan - Dougherty & Company - Analyst**

Thank you and congratulations on a good quarter. Michael, it looks like you've added a nice number of orders, just shy of maybe 200 since the analyst day. Can you discuss where those are going? And maybe an extension, you talk about ramping installs pretty significantly next year in 2018 as well. What, if any, supply-chain challenges are you seeing, and how confident are you in that installation capability?

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#### **Michael Small - Gogo Inc. - President and CEO**

The primary increase in 2Ku backlog comes from fleet decisions at Delta and the supply-chain confidence is rising dramatically every day. You have seen the pace of installs over the last month and we're often doing about one a day right now. We have very good confidence that we will exceed 500 2Ku installs by the end of next year.

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#### **Dick Ryan - Dougherty & Company - Analyst**

Okay. With a month gone in Q4 you've got a pretty broad range, \$11 million to \$21 million, for EBITDA, what happens to get either to the low end of that range or to the upper end of the range?

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#### **Norman Smagley - Gogo Inc. - EVP and CFO**

We feel really good about our ability to deliver consistent results during the quarters and we feel that's a very comfortable range for us. So we don't see significance [where you have to] drive any big change in the quarter.

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#### **Dick Ryan - Dougherty & Company - Analyst**

Okay. And, one last one for me, Norm, on Gogo Vision revenue, Delta and American are offering free movies. We were kind of looking for maybe a sequential increase in that number. It came in at \$7.8 million. What is driving Vision at this point?

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### **Norman Smagley** - *Gogo Inc. - EVP and CFO*

What is driving vision? It's converted to the wholesale model that's over our [KLM] partners and we are getting very good adoption from passengers, driving a lot of usage.

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### **Michael Small** - *Gogo Inc. - President and CEO*

American went free at the start of this month, so that will kick in, in the fourth quarter.

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### **Dick Ryan** - *Dougherty & Company - Analyst*

Okay. Maybe one last one, China, looks like you got the flyover rights, what's left to get for certification there, and what's the status with Shareco?

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### **Michael Small** - *Gogo Inc. - President and CEO*

We did get the right to operate in the Ku band over China and now our partners that fly over there, most often being Delta, to maintain over China, and we are making great progress towards our launch with Shareco.

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### **Dick Ryan** - *Dougherty & Company - Analyst*

Okay, thank you.

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### **Operator**

Our next question comes from Phil Cusick with JPMorgan.

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### **Phil Cusick** - *JPMorgan - Analyst*

Hey, guys, thanks. Norm, thanks for the preview of CapEx but can you add some more detail? How should we think about the cash CapEx structure of your new 2Ku contracts versus historical?

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### **Norman Smagley** - *Gogo Inc. - EVP and CFO*

We are seeing overall economics are attractive and (inaudible). We are seeing a trend toward lower (inaudible) for aircraft and we are focusing very closely on bringing the cost of equipment and installs down to further prove those.

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### **Michael Small** - *Gogo Inc. - President and CEO*

So the cost for aircraft [proofs] two ways: the strength of 2Ku is the leading solution in the marketplace, becomes clearer every day, and then we continue to drive cost out of the system.

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### **Phil Cusick** - *JPMorgan - Analyst*

I just want to make sure I understand. So a trend toward lower coinvestment means that they're putting in less -- a smaller percent of return?



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**Michael Small** - Gogo Inc. - President and CEO

No, we put it less.

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**Phil Cusick** - JPMorgan - Analyst

Got it. And, what does the RFP pipeline look like today, Michael?

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**Michael Small** - Gogo Inc. - President and CEO

It continues strong and, again, 2Ku is clearly the superior global solution in the marketplace and I would expect it to be able to continue to add to our backlog.

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**Phil Cusick** - JPMorgan - Analyst

Okay. And, last, you said that GOL was free the first day. Are they now charging and how does that look? Also, is Aeromexico able to charge yet? Thanks.

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**Michael Small** - Gogo Inc. - President and CEO

At this stage of the 2Ku deployment, we're focused on network performance, technical performance, and it's been extraordinary, not only in speed but also in reliability and availability. We continue to begin charging, which is either getting regulatory approvals or deploying the platforms, or just getting agreement with the airlines. (Inaudible) we are moving out of data and into full customer mode and that is happening steadily. But it's premature. Across 47 aircraft and across five airlines, it's way too early to begin talking about the financial performance but the technical performance is off the charts good.

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**Phil Cusick** - JPMorgan - Analyst

Got it, thank you.

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**Operator**

Our next question comes from Louie DiPalma with William Blair.

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**Louie DiPalma** - William Blair & Company - Analyst

Good morning, thanks for taking the question, Mike, Norm, and Varvara. When you gave the high-level target of generating cash in 2020, is that on a levered basis?

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**Michael Small** - Gogo Inc. - President and CEO

Yes.



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### **Louie DiPalma** - William Blair & Company - Analyst

Okay. And secondly, I have a high-level question regarding an alternative perspective of value in Gogo. Many of the investors on this call also follow the telecom tower operators, which have 10- to 20-year contracts with their customers, and you're one of those customers, and many of the investors on the call also cover wholesale data center operators which have 10- to 20-year contracts.

Traditionally, Gogo has had 10-year contracts with its airline partners, and because of these long-term contracts, the high-switching costs and how success-based investments such as building a new tower or installing a new 2Ku system on aircraft -- because those comprise most of CapEx, one of the key investor metrics that some investor uses adjusted funds from operations which focuses on maintenance CapEx. So, along those lines I was wondering if you could provide any color into what maintenance CapEx would be for 2017, 2018, or 2019 if you were to strip away some of the success-based CapEx associated with 2Ku?

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### **Michael Small** - Gogo Inc. - President and CEO

We haven't made that forecast to the market but you are absolutely right that a significant majority of our capital expenditures are success based for installing 2Ku. There is very minimal maintenance CapEx.

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### **Norman Smagley** - Gogo Inc. - EVP and CFO

CapEx is really driven by expansion rather than maintenance.

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### **Louie DiPalma** - William Blair & Company - Analyst

Right. Is there anything quantitative that you could say if, hypothetically, assuming that installation decreased from the 700 installation target down to 100, how much CapEx would decrease?

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### **Norman Smagley** - Gogo Inc. - EVP and CFO

Let me help you think about it this way. CapEx has three components to it: success-based airborne CapEx; capitalized software; and network infrastructure. So, we're not -- barring 2.4G aside from that, we are not spending a lot of money on network infrastructure because it's established. And the capitalized software piece, the bulk of that is really development of new technologies and deploying them into the field. There is a portion of it for maintenance and enhancements and those of kinds, our existing technology. So the lion's share of our CapEx is really success-based airborne spending.

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### **Louie DiPalma** - William Blair & Company - Analyst

Got you. Thank you very much, Norm.

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### **Operator**

Thank you. Our next question comes from Denny Galindo with Morgan Stanley.

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### **Denny Galindo** - Morgan Stanley - Analyst

Good morning, this is Denny Galindo calling in for Simon. I had a question on the activity rate in North America, and also the ARPA price per session. It looks like there is a trade-off where the activity rate's going up and the price per session's going down. Is there anything that's happening there

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in North America? You mentioned some international activity, but there is anything on revenue models that is happening in North America that is causing that? And do you expect these trends to go in the same direction, or reverse back to the previous direction?

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### **Norman Smagley - Gogo Inc. - EVP and CFO**

You're seeing the impact of the promotion we have been doing with T-Mobile. As we've talked about in lots of previous calls, and we do large [bunches] of different promotions, it can have the effect of -- have an impact on RPS down and usage up, and that's what you're seeing this quarter with T-Mobile.

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### **Denny Galindo - Morgan Stanley - Analyst**

It looked like the margins were little bit lower. Is that the direction -- is it better direction to go the other way, or is it just one quarter and it's going to bounce around a lot?

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### **Norman Smagley - Gogo Inc. - EVP and CFO**

North American margins were lower because of the cost of install lines for 2Ku. It wasn't driven by fundamental business changes.

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### **Denny Galindo - Morgan Stanley - Analyst**

Okay. And then, on a different direction, on the 75 to 100 2Ku, it seems like you are on pace to be very close to 100 if not over 100. I'm curious why you didn't adjust that guidance, 75 to 100. Is this kind of monthly install rate something that you would expect to bounce around quite a bit with airline schedules? Or is October a steady-state rate that you can keep getting in the future?

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### **Michael Small - Gogo Inc. - President and CEO**

We have the capability to install at this rate but you have to marry that up with aircraft availability. You don't install continuously. The summer months being the prime example. We really get aircraft during the summer travel season. So this is our capability plus -- married up with the availability of the aircraft, at least for the forecast.

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### **Denny Galindo - Morgan Stanley - Analyst**

That's it for me, thank you.

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### **Operator**

Our next question comes from Andrew DeGasperi with Macquarie.

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### **Andrew DeGasperi - Macquarie Research Equities - Analyst**

DeGasperi, thanks. First question, I was wondering, can you maybe go into the [serable] phaser antenna that you've announced a few -- two weeks ago?

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### **Michael Small - Gogo Inc. - President and CEO**

Sure. The phaser antennas -- phased-array, fully electronic, fleet [serable] antenna -- this is early-stage R&D; it's done to make sure we are always leaving the marketplace with new technology and the future proof the 2Ku and actually the ATG platform. We actually think this is the effective way to extend the life of both those platforms.

Early stage, nothing is happening fast in that area, but we think it's important long run. It's where antenna technology is going over the next decade.

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### **Andrew DeGasperi - Macquarie Research Equities - Analyst**

Very interesting. And then, secondly, I'm not sure if you -- have you had a talk with American Airlines as far as next year's pace of activity as far as either 2Ku or potential churn coming from the legacy aircrafts?

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### **Michael Small - Gogo Inc. - President and CEO**

Yes, we are in discussions every day about getting our 2Ku installed on American, and that program going very well, as are the ATG-4 upgrades. And we expect our installs of 2Ku to begin next year. We have no further information on de-installation, but we do not expect a lot of activity in that regard in 2017.

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### **Andrew DeGasperi - Macquarie Research Equities - Analyst**

Got it. And, last question for me, your Business Aviation obviously had revenue growth, but I'm noticing that your air-to-ground shipments were down significantly in 3Q -- or decelerated significantly in 3Q (inaudible). I was wondering, is there a trend as far as on the top-market level side or is there -- is this due to competition? Thanks.

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### **Norman Smagley - Gogo Inc. - EVP and CFO**

It relates to the deferral of the -- under the sales program for Gogo Biz 4G.

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### **Michael Small - Gogo Inc. - President and CEO**

What's going on there is the customers who want Gogo Biz 4G are taking our current system now, and then we will upgrade the system next year when Gogo Biz 4G is available. We do not book the sale until the final delivery of the upgraded Gogo Biz 4G.

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### **Norman Smagley - Gogo Inc. - EVP and CFO**

25 units were deferred in the third quarter.

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### **Andrew DeGasperi - Macquarie Research Equities - Analyst**

Got it. Very helpful, thank you. Thank you.

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### **Operator**

(Operator Instructions)



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Our next question comes from John Hodulik with UBS.

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### **Lisa Friedman - UBS - Analyst**

It's Lisa Friedman for John. Just wanted to see if, Norm, you could give some more color on what you have to do to get the next-gen ATG up and running, what is the equipment that needs to be [flogged out] on the planes or on the towers, what can be reused, and whether you can front load any of that as you're doing ATG-4 upgrades so those planes are ready to go when the system is operational?

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### **Michael Small - Gogo Inc. - President and CEO**

Hi, Lisa, this is Michael. I'll take that question. We have to upgrade our 250 cell sites with basically new antennas and radio equipment and other networking equipment, and that takes advantage of the existing tower and power and that call that we have. So, relatively low-cost upgrade for cell site.

Then we have to add a new antenna and radio to the aircraft but we take advantage of the existing server and wireless access points that are already on the plane. All that work is underway. We have very good facility to exceeding 100 megabits per second and we have very good visibility to exceeding 99% availability and reliability of the system. We think both those will be industry-leading solution. This will be deployed in 2018.

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### **Lisa Friedman - UBS - Analyst**

Okay. And then, you're not the only ones who are using unlicensed spectrum for next-gen ATG, I know there are some competitors in the BA space that don't have the licensed spectrum that you do. But I'm just wondering, as those competitors start to make more noise, and there's also a company that's promoting a microwave-based point-to-point solution, are you seeing any impact from those in the marketplace? Are your customers considering those options? Any color you could provide on the competitive landscape would be great.

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### **Michael Small - Gogo Inc. - President and CEO**

We are feeling great about the competitive landscape. It's a real risk to put something unproven on your plane. We have 6,500 planes flying on our ATG network, and we will only enhance that proven network with the 2.4G upgrade to the network. So this is dramatically less risky. It's going to be way lower cost for us to do it, it's going to be way lower cost for our existing customers who want to upgrade than to go to a totally new system.

So, we think we're going to have a lower-cost, higher-speed, more reliable solution from a proven operator than anything else in the marketplace. We are seeing very little impact.

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### **Lisa Friedman - UBS - Analyst**

Okay. And then, just one more, which is, any progress on [line fed] with Boeing and Airbus?

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### **Michael Small - Gogo Inc. - President and CEO**

Great progress with both of them. As we build our order book, the airlines want our technology as Airbus and Boeing see how well 2Ku performs, and it's only going to perform better as the new modem comes on and the high throughput satellite. We are actively working to get 2Ku on line fed and it's going very well.



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**Lisa Friedman** - *UBS - Analyst*

Any sense of when you might reach that milestone?

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**Michael Small** - *Gogo Inc. - President and CEO*

As we said at investor day, the first factory install should happen in 2017. We fully expect that and we expect to be ultimately OEM installable on all major aircraft types.

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**Lisa Friedman** - *UBS - Analyst*

Okay, thanks.

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**Operator**

Thank you. Our next question comes from Andrew Spinola with Wells Fargo.

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**Andrew Spinola** - *Wells Fargo Securities, LLC - Analyst*

I just want to follow up on that prior question about the business jet market. With your new -- several new technologies coming, both the 4G and the next gen, it seems like a lot of change for that market and maybe there would be some decision-making pauses and things like that. Do you think some of the people that are looking at adding Wi-Fi to their business jets might pause until the next-gen network's available, or are you going to do something similar with what you're doing with 4G where you will provide a hardware solution and upgrade them when that next-gen is available?

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**Michael Small** - *Gogo Inc. - President and CEO*

I don't think there will be -- there will be limited freezing of decision making. The 4G is going to be most applicable to the larger business jets, almost all of which have our service today. So this is an upgrade decision, not a new purchase in most cases. The primary use in commercial aviation is going to be the regional jets where satellite solutions are awkward, in some cases almost impossible. So, I don't see a lot of freeze.

The primary softness in Business Aviation is general market, at the moment. And then, as Norm explained, this quarter and a tiny bit earlier in the year was just deferral of recognition of the sale as we sell -- until we openly upgrade these sales to Gogo Biz 4G.

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**Andrew Spinola** - *Wells Fargo Securities, LLC - Analyst*

Right. And the second question, I just wanted to ask, when you're talking about the competitive advantage you are going to have with the next-gen network, you referenced how, having the two networks -- the licensed and the unlicensed -- will give you a competitive advantage.

It is unclear to me why the existing network will provide you an advantage with the future network. Clearly, you are the established operator, you have certain benefits. But what I don't understand is how the two networks will be better than one network, and I was wondering if you could elaborate on that, because I'm trying to figure out what competitive advantage looks like in the next-gen world. Thanks.

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**Michael Small** - *Gogo Inc. - President and CEO*

The primary factor, pure and simple, is we're building on what we have today. So, if you're a 4G phone, there was no 3G network anywhere, you would notice gaps in service. If you offload to Wi-Fi and there was no 4G network behind it, you would notice gaps in service. So this is the upgrade

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path that the wireless industry uses generally to maintain backward compatibility and across network availability to ensure the call always goes through.

There are also more subtle technical issues of the nature of the 850 megahertz network versus the 2.4 gigahertz that allow us to more easily locate the aircraft in space and know where it is and how to do handoffs. We have significant advantages technically, but I would also point out the cost issue is highly relevant on all the existing towers and airborne equipment is already out there and the back-up network's already out there.

As an integrated solution it is dramatically cheaper, it's dramatically more reliable and it's also going to allow us to get to 100 megabits per second, which we don't see others being able to achieve.

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### **Norman Smagley - Gogo Inc. - EVP and CFO**

To make it really tangible, if you are flying over New York City, it's a high-noise floor in the unlicensed spectrum. There's a reasonable probability that the quality of the connectivity goes dramatically on 2.4 gig. If you don't have the back-up network that we have, where we can ensure the reliability and connection, you are running into a potential issue there. We avoid that issue by having the licensed spectrum to back up the 2.4G.

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### **Andrew Spinola - Wells Fargo Securities, LLC - Analyst**

That's very helpful. Thanks for that.

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### **Operator**

Our next question comes from Lance Vitanza with Cowen.

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### **Lance Vitanza - Cowen and Company - Analyst**

Thanks for taking the questions. I had a couple. The first, Norm, I think you touched on this in your prepared remarks but could you walk me through the rationale for adjusting ARPA to exclude the regional jets and the aircraft operated by new airline partners that have been added since 2015?

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### **Norman Smagley - Gogo Inc. - EVP and CFO**

Sure. Generally speaking, the ARPA of RJs is lower than that of mainline. So, as you add additional RJs into the mix, you will have a natural dilutive impact on the overall ARPA. We take those out to get effectively like a same-store sales type of approach and that is the rationale behind doing that, so you get a real sense of underlying what is happening with ARPA, on a meaningful apples-to-apples basis.

We've had an impact -- we saw an 8% increase year over year for the quarter. There are new airlines that came on board that fleets haven't matured yet, as well, so as they add more aircraft, there is a second dilutive impact from those. So we take those out as well.

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### **Lance Vitanza - Cowen and Company - Analyst**

Okay, thanks for that. And then, on the claim that the 2Ku is the superior global solution in the marketplace, (inaudible) others are arguing that Ka is a better solution, what are the data points that you are looking at, or that you can point us to, that confirm that this is really the superior global solution? Or is it just a function of the fact that you've got more installs than anyone else, or is there something else that we should be thinking about?

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### **Michael Small - Gogo Inc. - President and CEO**

That we have installs that are flying allows us to collect the data, but we are seeing superior peak speeds. We are seeing more consistent streaming across a larger number of customers and, very importantly, we're seeing a reliability and availability numbers that are dramatically higher than anything else we see in the marketplace.

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### **Lance Vitanza - Cowen and Company - Analyst**

Okay, thanks. Last one for me, could you talk a little bit about the recent Verizon announcement -- and if you did already, I apologize for missing it, but clearly that appears to be focused on drones for now but there was certainly a lot of confusion I think around that release that. Do you envision Verizon as an eventual competitor in the NA-CA marketplace?

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### **Michael Small - Gogo Inc. - President and CEO**

No, Verizon will not compete with -- at least the current contemplated solution. It is for drones which are much lower altitude, much slower speed, and network architecture that works for that will not work for 500-plus-mile-an-hour aircraft at over 30,000 feet.

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### **Lance Vitanza - Cowen and Company - Analyst**

Great. Thanks for the clarification.

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### **Operator**

Our next question comes from Louie DiPalma with William Blair.

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### **Louie DiPalma - William Blair & Company - Analyst**

Thank you. You have provided a tremendous amount of margin commentary regarding 2018 and 2019, and I was just wondering, as more aircraft are upgraded from ATG to 2Ku, do you still expect the Business Aviation segment margin will remain in the low 40% range?

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### **Michael Small - Gogo Inc. - President and CEO**

Yes. The fuel for the growth of our business is bandwidth, and the more bandwidth you bring to the air the better everything gets. This is all good news, financially, is to bring -- to keep upgrading the network.

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### **Norman Smagley - Gogo Inc. - EVP and CFO**

The ATG network will maintain the high utilization, which is I think the question you're getting to.

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### **Louie DiPalma - William Blair & Company - Analyst**

Great. Is there going to be a headwind I guess as the 800 aircraft are upgraded from ATG to 2Ku, and are some of those costs going to be transferred from the Commercial segment to the Business Aviation segment?



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### **Michael Small - Gogo Inc. - President and CEO**

I think there will be an increased amount of the network capacity of the air to ground going to Business Aviation over time. We are already seeing that trend that we have with over 4,000 planes flying in BA we have plenty of scale to support that.

More bandwidth equals more revenue. I think your question is, if you're asking that question about us, with 4,000 planes and growing, imagine a new competitor trying to support an air-to-ground network, even if they claim they might have a possible intention to get to 300 aircraft, you still take thousands of aircraft to support a regional air-to-ground network, and we have them, and I'm very comfortable with the economics in our case.

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### **Louie DiPalma - William Blair & Company - Analyst**

Great. And how far away do you envision low-profile antennas such as the phaser antenna that you're working on, how far away do you think those are from becoming more mainstream in the business aviation market?

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### **Michael Small - Gogo Inc. - President and CEO**

There may be some applications in the next few years, but it is several years before they're even possibly the primary solution in the marketplace.

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### **Louie DiPalma - William Blair & Company - Analyst**

Thanks.

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### **Operator**

Thank you. Our last question comes from Carter Mansbach with Jupiter Wealth.

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### **Carter Mansbach - Jupiter Wealth Strategies - Analyst**

Good morning, gentlemen. Congratulations on another solid quarter. I don't believe you answered the first question directly. So, since the analyst day it seems like you've had an increase of about 150 to 200 planes, who are the airlines that you signed with?

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### **Michael Small - Gogo Inc. - President and CEO**

There have been no unannounced signings in that -- we said primarily it is an increase in Delta aircraft count. But our airline partners make decisions on a regular basis about which aircraft to upgrade now, and this is -- that's a result of those conversations and decisions by airlines.

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### **Carter Mansbach - Jupiter Wealth Strategies - Analyst**

Got you. So no new airlines, just increase with airlines you currently have.

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### **Michael Small - Gogo Inc. - President and CEO**

That's correct.



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### **Carter Mansbach - Jupiter Wealth Strategies - Analyst**

I have been involved with the Company for three years, and I'm sure you would agree the Company is in the best position for growth going forward. However, stock is down 10%, 50% of the companies sold short. The perception of the product in the public eye is weak, and the stock clearly is negative. What is the mission and how are you going to go about changing that perception?

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### **Michael Small - Gogo Inc. - President and CEO**

We created this industry with an air-to-ground solution that became congested, we have acknowledged that for some time. The answer is bandwidth, and we have 2Ku coming to market right now. Hop on a plane, fly 2Ku, you'll change your perception of the Company. We have the winning position for the next stage of growth in this industry.

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### **Carter Mansbach - Jupiter Wealth Strategies - Analyst**

Okay. Congratulations again on a great quarter. Thanks for taking my questions.

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### **Operator**

Thank you. I would like to turn the call back to Michael Small for any closing remarks.

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### **Michael Small - Gogo Inc. - President and CEO**

Thank you. We are again thrilled that 2Ku is getting installed on planes every day. It is a superior solution. And now that we are seeing it go on planes, we've removed one more -- we've gone over one more step of the journey to delivering bandwidth to the sky. And we are in great shape -- stronger than we've ever been -- and we look forward to a great 2017 and beyond. So thank you all for joining the call today, and go Cubs.

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### **Operator**

Ladies and gentlemen, thank you for participating in today's conference. This concludes today's program. You may all now disconnect.

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