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EDITED TRANSCRIPT

GOGO - Q4 2019 Gogo Inc Earnings Call

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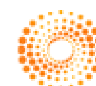

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Fourth Quarter 2019 Gogo Inc. Earnings Conference Call. (Operator Instructions)

I would now like to turn the conference over to your speaker today, Will Davis, Vice President of Investor Relations. Please go ahead, sir.

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

Thank you, Sonia, and good morning, everyone. Welcome to Gogo's Fourth Quarter 2019 Earnings Conference Call. Joining me today to talk about our results are Oakleigh Thorne, President and CEO; and Barry Rowan, 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 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. These risk factors are described in our press release filed this morning and are more fully detailed under the caption 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 March 13, 2020. 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 new information or future events.

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

This call is being broadcast on the Internet and available on the Investor Relations section of the Gogo website at ir.gogoair.com. The earnings press release is also available on the website. After management comments, we'll host a Q&A session with the financial community only.

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

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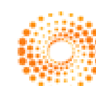

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Oakleigh B. Thorne - *Gogo Inc. - President, CEO & Director*

Thanks, Will. Good morning, all, and welcome. We had a great fourth quarter and a great full year, but with the stock down substantially in recent weeks, with the uncertainty around the coronavirus and the Delta Airlines' free WiFi program, people are less interested in past performance than they are and trying to understand future unknown.

So I'm just going to start with the coronavirus today and then discuss in order, the Delta free program and then get back to some of the fundamentals of our business. Trends in the satellite industry that are driving down our costs, then discuss industry consolidation and how we might fit into that consolidation, and discuss the change we're making to our equity compensation plans. And finally, I'll discuss the quarter and the year and provide some high-level thoughts on what will be a very difficult to predict 2020.

So let me start with the news of the day, the coronavirus. This is a very, very, very fast-moving situation in our industry. And in fact, it's a -- a great deal has just changed in the last 48 hours. Needless to say, our primary concern is the health and safety of our employees and our customers. But our next concern is with the financial health of Gogo. As I discuss the impact of coronavirus on our different CA regions, I think it will be helpful to give you the regional breakout of our 2019 in air sales revenue so you have a frame of reference. Roughly 73% of our in-air revenue is from flights originating in North America, 19% originating in Asia, 5% in Europe and 3% somewhere else. In January and February, we are on track for a great start to the year at both our Business Aviation division and our Commercial Aviation division. And 2 weeks ago, we started to see a significant decline in Asia for our CA division as U.S. airlines canceled flights to the region and domestic travel in Japan declined significantly.

In the first week of March, we saw a decline in international travel more broadly, which lowered our total CA in-air sales by 6.7% versus trend for the prior 2 months. This week, we're seeing a more pronounced decline in U.S. traffic, with some of our larger commercial airline customers down as much as 15%, and we expect a further decline in European traffic with the flight band that goes into effect tonight.

In the CA division, it's very hard for us to predict exactly how this will play out. And different airlines are predicting a wide variety of different potential solutions -- outcomes. We'll, obviously, be negatively impacted as airlines take claims out of service. How badly we're hit will depend on what happens with load factors, and then how long the travel is impacted by the virus. We also anticipate that there could be a reduction in installations and equipment revenue as airlines cut back on capital spending. Though perversely, that could help cash flow if those are older, subsidized equipment deals.

We had $204 million of cash on hand as of -- in the bank as of last night. We're planning through a variety of scenarios and taking immediate steps to match our revenue declines with cash expense reductions in order to preserve our liquidity. That starts today with the CEO deferring his 2019 bonus until Gogo is in happier times. We'll provide more guidance on our coronavirus actions as events and our plans unfold.

The only good news in all this is that we see no impact yet on our Business Aviation segment. Some analysts believe that this could drive demand for private aviation in the future.

Now let me turn to Delta free. As I said before, we'll leave it to Delta to announce their plans. Our role is to provide the operational support to make those plans happen. Under today's turnkey contract, we subsidize the installation of Delta's jets, we charge Delta's passengers for connectivity and then we pay Delta a royalty for access to their aircraft. In a free model, that will completely change. And assuming we come to terms, Delta would pay for equipment and pay us for passenger connectivity. However, as Delta will now have to pay for connectivity, Delta will want to make sure it is getting competitive pricing and competitive service levels. Hence, may want to move to a multi-supplier model for domestic mainline airline -- aircraft.

Though we would not relish the idea of having a competitor join us at Delta, we coexist with competitors at most of the airlines we serve. And we compete very well on price and customer satisfaction at those airlines. We expect demand to grow significantly when Delta goes free. And though no agreement has been reached, we and Delta expect us to grow our revenue from Delta in a post-free environmental, even when you include the impact of some planes potentially moving to a competitor. We further believe that Delta's move to free service will be a catalyst for other airlines to provide free service, thereby driving more demand for our product and more revenue and cash flow for Gogo.

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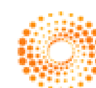

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Now I'm going to talk about some trends in our business because we believe we're going to survive coronavirus. And I think it's important that investors understand the underlying strategic issues and trends in our industry. So let me start with developments in the satellite industry. I'd like to start with a few comments on what we're seeing in Satcom pricing and the impact that it has in our CA Rest of World segment's future profitability. As we replace expiring Rest of World satellite contracts with new contracts, on average, we're seeing a 67% decline in per unit pricing. If all of our current capacity in Rest of World were priced at those levels today, our Rest of World segment would breakeven on a segment profit basis in 2021 and be profitable in 2022. Of course, not all those contracts are at those prices today, but 2/3 of the current contracts in Rest of World will expire in the next 3 years, and we'll have the opportunity to replace them with much cheaper capacity.

Two other positive trends, our Non-Geosynchronous Orbit satellites, NGSOs, which we expect to start coming online in 2022. And the emergence of managed services, which give us much more flexibility in terms of what we can provide our airline customers.

Let me start with why NGSOs are important. As we study the most frustrating aspects of in-flight connectivity to passengers, many of them are a result of the high latency inherent in geostationary satellites. NGSOs such as Medium Earth Orbit satellites, MEOs, and Low Earth Orbit satellites, LEOs, are much closer to earth. So packets from the teleport, to the satellite, to the aircraft, travel a much shorter distance and to arrive much faster than with a GEO satellite. In our lab testing, complex web pages downloaded more than 3x faster with a MEO satellite than with a GEO satellite. This type of responsiveness is not only important for web pages, but also for cloud-based applications like Microsoft 360 or VPN connectivity for gaming, for interconnective chat and IM apps and the like. It's very important for driving passenger satisfaction in the future.

And since a number of airlines tell us that quality IFC is now their #1 driver of customer satisfaction, we believe airlines will value low-latency solutions. We're working with potential NGSO partners on a variety of fronts and hope to soon demonstrate that our ThinKom 2Ku antenna can work with LEO constellations and hope to have an announcement in that regard, shortly. I should note that all of our competitors used traditional gimbal antennas and they won't work with LEO constellations. So airlines installing that equipment will have to go through an expensive upgrade if they want the benefits of LEO low latency.

The other innovation is around managed services. Many years ago, when we decided to expand into satellite-based IFC, we had to either become a reseller of our competitors' network or build our own network, what I'll call the network ownership model. We chose to build our own Ku-band spectrum at that time because it was the only spectrum with enough global coverage, capacity and redundancy to meet our global airline partners' needs. In the network ownership model, we must buy capacity wherever our airlines fly. And we pay for it no matter how little we use it. The new trend is that some satellite operators are developing enough of their own coverage if they can begin to offer us a managed service, where we buy by the drink instead of in bulk. This model has the benefits of reducing our fixed costs, increasing the burstable capacity we can bring to airlines, improving our capacity utilization and enabling us to tailor solutions to individual airlines' needs. Though we remain committed to supporting our current customers of Ku connectivity, we also see opportunities to introduce regional managed service Ka solutions that will require very little capital investment upfront from us.

The point of my discussion of NGSOs and managed services is that because of our asset-light model and the open architecture flexibility we've built into our solutions, we're able to quickly pick best-of-breed solutions provided by our partners and deliver them to our customers. In contrast, our vertically integrated competitors have committed their next several years of capital investment to Ka-band GEO solutions and will have a hard time augmenting those investment plans to compete with all the innovation our satellite partners are bringing to market.

Now let me turn to some of the dynamics inside the IFC industry itself. At Gogo, we have 2 businesses, Business Aviation and Commercial Aviation, and we believe our current enterprise value significantly underestimates the value of those 2 parts. Our Business Aviation segment is a solid franchise. It produces solid growth in a relatively underpenetrated market. It produces strong recurring cash flows, it has proprietary technology and intellectual property, a compelling product road map and a very strong position in a relatively price-sensitive market. Our Commercial Aviation segment also represents real value. It has leading share in a fast-growing industry, a very attractive customer base, a very strong product road map and strong product integration, engineering and distribution capabilities. The issue in the Commercial Aviation IFC space is that there are too many competitors, and nobody yet has enough scale to build a sustainable business for the long term. We believe that some consolidation will occur in the CA IFC space. And we're working hard to leverage our leading market position to make sure that our shareholders are among the beneficiaries of that consolidation.

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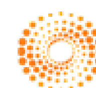

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In order to make the value of the parts of our business more evident, in the 10-K we'll file today, we've broken out our corporate expenses from the BA and CA segment expenses so investors can see the performance of our operating segments on a stand-alone basis.

Now I'd like to touch briefly on some changes to our stock-based compensation that our Compensation Committee has approved. It's important to understand that Gogo's most important asset are its employees. We work in an industry that demands very specific knowledge and skills. Our employee equity compensation plans were put in place years ago and no longer act as the retention vehicle we need. 84% of our stock options are more than 300% out of the money and more than 99%, or at least 180%, out of the money. Given the issues we face with coronavirus and other challenges, we think it's time to bite the bullet and offer an options exchange to our employees that receive equity compensation, so that we have a real retention tool and employees have a piece of paper with real value. The exchange, which will be in the proxy, has the added benefit of returning roughly 3 million shares into our employee Omnibus Incentive Plan pool, thereby reducing the need for us to come back to shareholders to replenish the pool in the near future. I think this is very important because retaining our highly skilled employees will be very important to realizing the strategic value for Gogo that I discussed a moment ago.

Now let me turn to the quarter and the year. As I mentioned, we had a really solid quarter and a great year. We exceeded our revenue, adjusted EBITDA and free cash flow expectations by wide margins. Perhaps the most important metrics are, first, free cash flow, where we improved dramatically despite having an extra interest payment in the year. And second, unlevered free cash flow, which improved from a very negative number in 2018 to a very positive number in 2019, demonstrating the underlying earnings power of the business. As always, I'm very proud of my Gogo teammates for delivering such a great year. We worked hard to improve our operations, execute on our strategy and achieve our financial goals. And I think we're making great progress. So thank you.

Our Business Aviation division had a really solid quarter with record revenue for both service and equipment and good cost control, which in turn delivered record segment profit. The BA division added 142 ATG aircraft online in the quarter to reach just under 5,700 at year-end, up 9% from prior year, and achieved accelerating average service revenue per aircraft throughout the year to end at $3,200 per unit in Q4, up 5.4% from prior year. Shipments were strong, especially for the AVANCE L5 product, which shipped 171 units in the quarter, tied for our highest quarter ever.

Turning to our CA segments. If you add the 2 segments together, we crossed an important threshold with positive combined annual segment profit for the first time. In our Commercial Aviation North America segment, we achieved quarter-over-quarter growth in aircraft online with a positive 20% for the quarter. In CA Rest of World, we installed a gross 77, net 71 planes in the quarter, which was up over prior quarter and flat with prior year. ROW service revenue was flat with prior quarter because claims installed this quarter have yet to produce solid take rates, but was up 21% over prior year as some planes and newer fleets began to mature. Across CA segments, we installed exactly 400 aircraft online, which was at the bottom of our guidance as a result of the MAX grounding, the federal government shutdown and internal operating issues at certain airlines.

We crossed the major product mix threshold in the quarter with more than 50% of all aircraft, now -- of all CA aircraft, now on satellite IFC as opposed to ATG IFC. We also finished the quarter with a strong 2Ku backlog of nearly 950 aircraft as we picked up 150 aircraft new commitments from existing customers on top of the 70 aircraft on order from [cutting].

With that, let me turn to 2010 -- '20. Needless to say, it's a year of considerable uncertainty due to the coronavirus. So we're going to share what our guidance would have been without the coronavirus and update as the situation solidifies. In order to manage growth expectations, as it would have been, I think it's important to remind you that over the course of 2019, we highlighted approximately $35 million of nonrecurring revenue benefit, which equated to a benefit of $31 million of nonrecurring adjusted EBITDA. When you adjust to these items, 2019 adjusted EBITDA would have been roughly $115 million. So well ahead of guidance and in prior year, but less than our reported adjusted EBITDA of $146 million.

If you think of our trajectory, we had $71 million of adjusted EBITDA in 2018. Excluding the nonrecurring revenue and adjusted EBITDA of $115 million in 2019, in our pre-coronavirus budget, we continued that trend in 2020. The point of sharing what our 2020 plan would have been is to show that ex-coronavirus, we have a healthy business. It is now going to suffer a setback. But I believe we can fight our way through this and preserve Gogo's franchise value. We'll continue to serve our employees and customers well. We're going to focus on maintaining our liquidity. And when we get through this pandemic, I believe we'll be stronger than we were before.

With that, I'm going to turn it over to Barry for the numbers.

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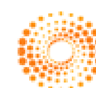

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Barry L. Rowan - *Gogo Inc. - CFO & Executive VP*

Thanks, Oak, and good morning, everyone. I'll start with an overview of our financial and operating performance and conclude with a summary of our approach to the way we're handling our 2020 outlook in the context of the coronavirus outbreak.

Gogo delivered another strong quarter and year. With adjusted EBITDA in the mid-$30 million range for the fourth quarter in a row, record annual segment profit for both BA and CA and a $163 million improvement in free cash flow in 2019 as compared to 2018.

2019 adjusted EBITDA of $146 million was more than double the $71 million achieved in 2018 and over 70% above the midpoint of the expectations we set coming into 2019. As Oak mentioned, there were some nonrecurring benefits included in the 2019 results. But even considering those factors, 2019 represented a dramatic turnaround in Gogo's financial performance. In addition to the strong adjusted EBITDA performance, we reduced our cash burn during the year very substantially. For the first time since Gogo went public 7 years ago, the company achieved positive unlevered free cash flow on an annual basis. And it was meaningful at $85 million. The $163 million improvement in free cash flow over 2018 was well ahead of the at least $100 million improvement we guided to coming into the year. And this was despite $39 million more in interest payments in 2019 due to the refinancing we completed in May.

This improved cash flow performance is the result of 3 factors: lower investment in airborne equipment; adjusted EBITDA coming in well ahead of plan; and improvements in other working capital, primarily accounts receivable.

We exceeded the aggressive targets we set for reducing inventory purchases and improving accounts receivable during the year. This pulled forward some of the improved cash flow performance we had previously expected to occur in 2020, and enabled us to finish the year with a very strong cash balance of $170 million. This additional liquidity is even more important, given the uncertainties created by the coronavirus outbreak.

While we're on the balance sheet, it's worth reiterating that a significant accomplishment during the year was the comprehensive refinancing we completed in May. We are now in a very different situation than we were coming into 2019. We pushed out 80% of our debt maturities to 2024, lowered the interest rate on our senior secured notes by 2 5/8% and added a $30 million ABL facility to provide some additional liquidity buffer.

Before turning to our operating performance, let me touch on the change in financial information discussed on this call and reflected in our earnings release and 10-K. You'll see that we have excluded corporate costs from segment expenses in calculating segment profit. This new reporting provides greater visibility into the specific performance of our operating divisions as well as corporate spending. You'll also see that 2019 corporate cost of $33.4 million, excluding stock-based compensation, were reduced by 17% from $40.3 million in 2018. Of course, reducing these costs was also a focus of our 2018 integrated planning process.

I'll now turn to a discussion of our fourth quarter operating results, beginning at the consolidated level. Total revenue of $221.3 million increased 2%, with service revenue growing 4% and equipment revenue declining by 5%. BA equipment revenue was up 22% over the prior year period, while CA's equipment revenue declined from the prior year, primarily due to fewer aircraft installations under the airline-directed model.

Adjusted EBITDA of $34.4 million for the quarter significantly surpassed internal and external expectations, resulting in 78% growth from Q4 2018. This quarter's performance was driven by strong BA segment profit of $41.7 million, up 17%, and a 37% reduction in our ROW losses to $15.1 million. Our bottom line performance has benefited from disciplined cost management across both CA and BA. Department and SatCom expenses were $34 million below our internal budget for the year as a whole while approximately $2 million of these savings related to timing, a tangible demonstration of the improved operational and financial discipline in the company achieved during the past year.

Let's now turn to a discussion of our business segments. In summary, both BA and CA delivered excellent results for the year. BA overcame the ADS-B channel constraints of the first half of the year to achieve a record $144 million in annual segment profit, with service revenue growing 13% year-over-year.

On a combined basis, CA-NA and CA-ROW posted positive annual segment profit for the first time, totaling $36 million, excluding corporate costs and was still modestly profitable when including these costs.

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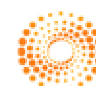

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Now let's review the BA operating results in detail. BA had an outstanding fourth quarter. Total revenue of $85.9 million grew 17% from the prior year period on the strength of both services and equipment. Service revenue of $58.6 million grew 14%, with 9% growth in ATG units online. For the fourth quarter, ATG average monthly service revenue grew 5% year-over-year, up from a 1% increase in this metric during the first quarter of 2019 over the first quarter of 2018. This represents a reacceleration in the growth of BA's unit economics, as measured by average monthly service revenue, and was largely driven by a higher mix of advanced products.

BA's equipment revenue came back strongly in the second half of the year as OEM sales picked up and as the aftermarket channel began buying more product as previously constrained installation capacity due to the ADS-B began to relax. Total AVANCE equipment shipments in the second half of the year were up almost 60% from the levels in the first half of the year and L5 shipments more than doubled. On the strength of this service and equipment revenue growth, BA segment profit grew to a record $42 million in the fourth quarter, representing 49% segment profit margin, very close to BA's all-time high.

For the full year, BA achieved total revenue of $309 million, up 6% with a service revenue of $222 million, which is an increase of 13%. Equipment revenue was down 7% to $87 million as we manage through the ADS-B overhang and comparisons to very strong shipments in 2018, which was the first full year after our advanced L5, L3 product introduction. This product line has been the most successful product launch in BA's history of strong product launches and continues to be well received in the market.

BA reported record segment profit of $144 million for the year and segment profit margins of 47%, within 1% of BA's all-time high. ATG aircraft online grew 8.5% to end the year at 5,669. This number has grown by nearly 1,000 AOLs since the end of 2017 and carries with it the strong recurring revenue stream, which characterizes the BA business.

As Oak mentioned, our BA division has not yet seen any meaningful impact from the coronavirus outbreak. Assuming this continues to be the case, as we look towards 2020 for Business Aviation, we expect service revenue to grow approximately 10%. We wouldn't be surprised to see equipment revenue decline somewhat, largely due to some expected rebalancing of inventory in the distribution channel. We expect to see segment profit dollars increase for the year, in spite of a planned increase of $10 million to $15 million in OpEx during 2020 for the development of Gogo 5G, which is scheduled to be introduced before the end of 2021. We expect BA's CapEx to increase by $15 million to $20 million in 2020 versus 2019. We're very enthusiastic about Gogo 5G, and it is on track in terms of both schedule and cost. As we said from the outset of this program, we expect to spend approximately $100 million in total OpEx and CapEx for Gogo 5G. Although we now expect CapEx to comprise approximately 2/3 of this total versus the 50-50 split we previously expected.

We remain convinced of the value of our Business Aviation division, though it has not yet been unlocked. As Oak described, BA has a strong market position, and the business is very well positioned strategically with a robust product road map.

As we look at BA over the longer term, we believe this business can generate over $200 million in annual segment profit in the 2022, 2023 time frame with a strong flow-through to free cash flow.

Now I'll turn to a discussion of our Commercial Aviation division, starting with CA North America and Rest of World on a combined basis.

Overall, CA made very substantial progress during the year, both operationally and financially. We announced the signing of our first Middle Eastern airline of 70 planes with Qatar, which will drive increased usage of our Satcom network in this region of the world. We're also in the final stages of negotiating contracts for some awards with current customers, representing 150 additional aircraft, which reflect the improved economics we had targeted during our integrated business planning process.

CA segment profit performed well ahead of expectations in 2019, with cost controls running ahead of our IBP plans and with the benefit of the nonrecurring revenue Oak described. For the year as a whole, combined CA-NA and CA-ROW segment profit swung from negative $28 million in 2018 to positive $36 million in 2019.

Importantly, this 30 -- this $63 million improvement reflects a 31% year-over-year reduction in CA-ROW segment loss to a $62 million loss for the year. The strong CA-NA and CA-ROW combined segment profit is largely due to Satcom expenses underrunning plan and the reduction in other

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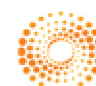

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operating expenses we had targeted. Satcom cost came in at $23 million below budget for the full year 2019, and we see the opportunity for significant unit cost reductions and future Satcom pricing, as Oak described.

The cost savings we had identified through our integrated business plan process have also been achieved more rapidly than planned. As you will recall, the IBP identified $75 million in annual savings and CA spend, excluding Satcom expense, between the time we announced that plan in mid-2018 and the end of 2020. Coming into the year, we said we expected to achieve at least half of those annual savings in 2019. In fact, we achieved 75% or approximately $55 million of those savings during 2019. The $63 million improvement in combined CA-NA and CA-ROW segment profit over the previous year was clearly a major contributor to our dramatically improved free cash flow performance in 2019.

In parallel, we've also made significant strides in working capital management. Most of the cash flow improvement from working capital has come through inventory management practices we implemented across the company during the year and improving accounts receivable in our Commercial Aviation division.

Now I will turn to a discussion of the operating performance for Commercial Aviation in North America. Service revenue of $85.5 million declined 4% in the fourth quarter due to the American Airlines deinstalls. Excluding American Airlines, service revenue grew 16% from Q4 2018 and 8% sequentially and was up 14% for the year as a whole. Segment profit was helped by continuing reduction in operating expenses in CA-NA.

Reported net profit -- excuse me, net ARPA of $112,000 for the quarter was essentially flat with the prior year. But excluding American Airlines, net ARPA was $133,000, up 5% year-over-year. Take rates of 13.6% were up from 12.9% in the year-ago quarter and were 15.1% excluding American Airlines.

Now let's turn to CA-ROW, which also delivered a strong fourth quarter. Service revenue of $23.1 million grew 20% over the prior year period, driven by an increase in the number of aircraft online. Equipment revenue of $20 million declined from $27 million in the prior year period. Both years included the same number of aircraft installations at 77. The decline in equipment revenue this year was due to a lower mix of installations under the airline-directed model. Net ARPA declined as expected due to dilution caused by new airline partners as we saw an 89% year-over-year increase in AOL from new airlines.

The segment loss of $15.1 million represents a 37% improvement from the fourth quarter of 2018 and is a result of strong cost controls and increased Satcom utilization. Operating expenses, defined as ED&D, sales and marketing and G&A, were reduced by 22% or $4 million from the prior year period. These operational improvements reduced the CA-ROW segment loss by 31% for the full year from a $91 million loss in 2018 to a $62 million loss in 2019.

As we move from a discussion of our historical numbers to our outlook, let me describe how we are approaching this in the context of a highly uncertain environment created by the coronavirus situation. Gogo is in the midst of a significant transformation. And before the coronavirus upset all of our worlds, we were looking forward to sharing our confidence in the structural improvements in our business, which we expected to continue into 2020 and beyond. In that spirit, I'll provide an overview of the expectations we would have set for the year in the absence of the coronavirus outbreak. But we will not be providing formal 2020 guidance as we would normally do on this call.

First, let me provide some context for both our adjusted EBITDA and free cash flow expectations and then I'll share the numbers. As Oak described, adjusted EBITDA was on track for a very nice 3-year trajectory coming out of the turnaround beginning in 2018. Free cash flow was also on track. As we've cited throughout 2019, we were able to achieve the working capital improvements faster than expected. While this dampened the year-over-year improvement in free cash flow from 2019 to 2020, the aggregate 2-year cash flow improvements we cited on our IBP call in late 2018 were very much on track. The accelerated working capital improvements have resulted in cash being higher at the end of 2019 than previously expected. Also as a result of cash flow timing, we had expected flat to slightly declining year-over-year free cash flow improvement from 2019 to 2020, but we were still targeting positive free cash flow in 2021.

We have many levers we can pull to preserve cash. Let me highlight just one. On the current schedule, our total spending for Gogo 5G peaks at just under $50 million during 2021, with about 3/4 of this spend in CapEx during that year. We are very enthusiastic about the prospects for Gogo 5G, but the pace and number of towers we deploy is within our control and could be varied as may be required by external circumstances. In this

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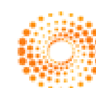

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context, the 2020 guidance we would have provided on this call, without the impact of coronavirus, is summarized as follows: total consolidated revenue of $830 million to $875 million, reflecting the absence of $35 million in nonrecurring CA revenue we saw in 2019. We expected service revenue to be higher in the second half of 2020 versus the second half of 2019, including growth in CA-NA as the underlying growth is no longer masked by American Airlines deinstalls. We expected CA-NA revenue of $350 million to $370 million, with approximately 5% from equipment revenue. We expected CA-ROW revenue of $165 million to $180 million, with 40% from equipment revenue. We expect BA revenue of $315 million to $325 million, with segment profit in the mid to high 40% range. We would have provided adjusted EBITDA guidance of $120 million to $145 million. Finally, we expected an increase in 2Ku aircraft online of 325 to 375.

Again, we believe we were set up for a very solid year, and our financial performance was ahead of our internal plan for the first 2 months of 2020. We will plan to provide an update on our outlook on our first quarter earnings call or earlier, if appropriate.

As I conclude my prepared remarks, I want to join Oak in thanking our employees for their contribution to our strong financial results in 2019. We know that as we look forward, we have our work cut out for us as we face a new set of challenges none of us could have predicted. We are grateful for your extraordinary talent and commitment as we face them together.

Operator, we're now ready for our first question.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Scott Searle of Roth Capital.

Scott Wallace Searle - *Roth Capital Partners, LLC, Research Division - MD & Senior Research Analyst*

Oak and Barry, great job in the fourth quarter. I know it's an unprecedented environment that we're operating in. So we really appreciate the thoughtful commentary both in business, the industry and really appreciate the transparency. Barry, just quickly, in terms of gross margins within CA Services, looked like it was down. I was wondering if you could clarify if there was anything going on there. and then if I could, on the CA side of the business, can you give us some idea in terms of what subscriptions revenue looks like relative to onetime usage? And maybe give us an idea of what the real-time ARPA per plane is looking like on a daily basis to help us kind of calibrate the impact that's ongoing. And lastly, if I could, on the BA front, continues to do extremely well. It seems like it's unfazed at this point in time. I was wondering if you had any additional color related to traffic patterns with private jets, in general, that you're seeing on that front. And remind us in terms of some of the contracts because it's subscription based, what historic churn maybe has been? What cancellation policies look like? Because it still looks like that business is pretty healthy. And I know the parallels early in terms of international travel in the Asia Pacific region were still strong and actually increasing. Wondering if there's been any near-term impact on that front. And I apologize for the lengthy questions.

Oakleigh B. Thorne - *Gogo Inc. - President, CEO & Director*

Yes. I mean -- this is Oak, I'll try and take a couple of those and I'll turn it over to Barry for the margin question. We don't -- I mean, in terms of ARPA per aircraft, I can't really give you that for this week. We -- the way our reporting works is we don't get that on a daily basis. we should, but we don't. Trends, I noted the trend this week. We see our big airline customers in the U.S. down around 15%. Yesterday's numbers, we're probably -- we're off that a little bit, it's interesting. Take rates, yesterday, take rates were quite high. Flights were about even with the week before. But I suspect load factors were much lower because revenue was down.

So that's kind of current view of what's going on in the North American market. The -- you asked about Business Aviation. We've actually been talking to our charter customers as well as some of the fleet operators. There have been a few cancellations on the corporate side because events are being called off, et cetera. And there's been a sort of a pickup on what I call the personal side of people needing to get from point A to point B

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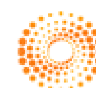

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and not wanting to take commercial airlines or unable to take commercial airlines. So that's that one. You had ARPA, you had BA, you -- what was the one on the Pacific, I'm sorry, your Asia Pacific question?

Scott Wallace Searle - *Roth Capital Partners, LLC, Research Division - MD & Senior Research Analyst*

Sorry. That was more related to just the parallels in terms of traffic, how it'd trended early on with the coronavirus spread there. But you already addressed that. Just one other, if I could, on the BA side. So is the business now segmented? I know you're trying to provide more transparency and clarity in terms of corporate overhead. But is the BA business segmented that it could actually easily be split at this point in time in terms of your additional costs in satellite costs, et cetera? And then again, just for Barry, gross margins on CA North America -- North American services?

Oakleigh B. Thorne - *Gogo Inc. - President, CEO & Director*

Yes. We'll come back to the gross margin point in a sec. Yes, the BA now, we've moved the whole ATG network into the BA segment to run out of Business Aviation. So it is a self-contained unit at this point and could be split off quite easily. So we did that so that we could demonstrate the value of the 2 businesses in a pretty clean way. I'll turn it over to Barry to talk about the gross margin at CA.

Barry L. Rowan - *Gogo Inc. - CFO & Executive VP*

Yes. Scott, the primary drivers in CA North America, it was an increase in the dollar spend in Satcom. The actual department costs came down, as we described, in conjunction with our overall IBP plans. I mean, I would say, just as a reminder, the Satcom cost overall came in well below budget, as I highlighted in the prepared remarks. But for the fourth quarter, the dollar amount increased as expected for that period of time. There are kind of -- there's some lumpiness in the timing of those increases in Satcom. So that's what was reflected primarily in the fourth quarter.

Oakleigh B. Thorne - *Gogo Inc. - President, CEO & Director*

When -- I'll follow-on with one point on the Asian traffic. We saw an impact there early on with the Hong Kong protests last year, and some of that lingered into early this year. The Japanese traveled down a lot, starting the last week of February into early March, like down 50% in-site. This is travel within Japan. Interestingly, now they're starting to open up travel within China. That -- if you can believe the statistics from China, they've done -- the number of new cases is down -- way, way, way down and the number of deaths is way, way down. And so we are hearing rumors actually that they are starting to fly again in China. So it might be a little spring of green hope that the travel markets can rebound.

Operator

And our next question comes from Simon Flannery of Morgan Stanley.

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

This is Landon Park on for Simon. A couple of questions for us. Can you run through maybe on the revenue side on CA, what is your fixed versus subscription revenue or fixed versus variable revenue on that front? And as well on the cost side, maybe, can you size your fixed versus what's including how much contracted Satcom costs you have for 2020? And then just lastly on Delta. Is your base case assumption at this point that you will begin to lose your sole provider status with them? And are -- to your knowledge, are you still in the running for the A321neo award?

Oakleigh B. Thorne - *Gogo Inc. - President, CEO & Director*

Okay. That's a lot of questions, Landon. Let me start with the beginning, which was the breakdown -- about 25% of our revenues are monthly service pass and about 75% are in-air purchases. The data I shared earlier were around the in-air purchases. We have not seen a drop-off in monthly

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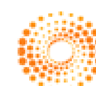

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service passes yet but those do churn. And we could see a drop in that if travel is impacted for a long period of time and people don't see any value in having those passes. So I don't think we can take some comfort in that -- some of that will persist, but we could see a drop-off in that as well. And we're planning -- and that's in our planning right now.

Second question, I believe, was variable versus fixed costs. Our biggest counterparties are obviously airlines and satellite companies. And the -- one can look at the satellite contracts and think they're fixed, but they also can be renegotiated. And we have -- we've identified 16 levers of cost control that we're working here and the counterparties is one of them. We are a very valuable customer to the satellite companies. We are the largest customer for a few of them. We are the fastest-growing customer prior to coronavirus, and we will be the largest customer and the fastest-growing after coronavirus passes. So there's a lot of incentive for them to work with us to help us get through this pandemic.

On the airline side, too, we have a lot of subsidized equipment deals and other things. And we will be going back to airlines and asking for ways to restructure our contracts. And you might say, well, why would they do that? Well, like I said in my comments, IFC had a number of airlines is the #1 driver of how their Net Promoter scores go or their customer satisfaction scores go. So it is actually very important. And I think that the airlines view it as being very important that their biggest supplier of IFC remain healthy. So we will be talking to them as well. So there is counterparties that are going to be involved in our cost reduction plans. And so I think that is a way to look at our cost structure and say, "Okay, it's fixed, but one can modify those arrangements."

The last part of your question, Landon, was on Delta. Look, there have been no decisions made, but we know that -- they have let us know that they may consider that. So we wanted to make sure the markets knew that. So I think that's -- I'll just put that out there. I think, we are -- we have a contract to go through 2027. And there are some outs in those contracts for Delta that we think we have solid arguments as to why those would not be validated, probably about arguments why they think they would be valid. So it's a negotiation. We -- Delta wants -- tremendously increase the amount of capacity they're going to be using. They want -- I think they're going to want to have a competitive situation on the supplier side. So that they can make sure they're getting competitive pricing and service levels. And they want to change our contracts as they go free, they have to. The turnkey contract is conflict-free. We want to grow our financial relationship with Delta, and we'd like to get out of emerging cash on equipment sales, which we do with Delta. So everybody wants something and it's in negotiation. And I think in the end, it will benefit both parties.

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

Just 2 quick clarifications. Can you tell us what your current contracted Satcom costs are for 2020? I assume it will be in the K, but if you can give us that color. And then on Delta, are you -- understood on the existing contracts, but are you still in the running for new awards? Or is it your sense that, that is no longer the case?

Oakleigh B. Thorne - *Gogo Inc. - President, CEO & Director*

Yes. Well, I mean, right now, we're planning to be line-fit on the A321 when the first one rolls off and -- Airbus. So...

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

Okay. And on the Satcom cost?

Oakleigh B. Thorne - *Gogo Inc. - President, CEO & Director*

Landon, Satcom cost, I mean, we don't -- I don't -- not sure if we put out the exact number. We do put out the commitments in the K or it's in the proxy. But they -- as a percentage of what we expect -- we expect our spend, we're managing that very carefully right now. So commitments and actual are probably right about the same.

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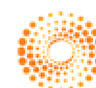

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Barry L. Rowan - *Gogo Inc. - CFO & Executive VP*

Yes. There are also some contracts expiring during the course of the year. So as Oak described, we're seeing very substantial reductions in price when we renew those contracts. So we'll certainly be having those conversations with satellite providers. But the number that are expiring enough for renewal on the order of 10% to 15% during the course of this year, and then that comes down very substantially, as Oak described, over the next 3 years. the number of commitments that you'll see in the K is $141 million.

Operator

And our next question comes from Lance Vitanza of Cowen.

Lance William Vitanza - *Cowen and Company, LLC, Research Division - Former MD and Credit & Cross-Capital Structure Analyst*

I'm trying to get that the relationship between declines in commercial airline traffic and what we should expect in terms of your declines in commercial airline service revenue. So appreciate the answer that you gave a second ago about the 25% monthly passes versus 75% in air purchases. But I want to try to come at it a little bit of a different way. First, I guess is, can you tell us what the percent of revenues that are coming from airline-directed versus turnkey contracts? And then really, within each of those or in -- perhaps, it's only in the airline-directed contracts, what, if any, percent of your service revenues are being paid by the airlines sort of as flat fees irrespective of flights, passenger load, passenger data usage, et cetera? Or is the answer is that virtually 100% of your service revenues are going to vary directly with airline passenger traffic?

Barry L. Rowan - *Gogo Inc. - CFO & Executive VP*

Let me come at your question, first, at kind of a macro level and kind of what is the impact overall to us and how much of that flows through. So we are doing a lot of scenario planning on this, as you would imagine. And I'll give you a couple of bookends here. So for example, one of the scenarios that we're planning is, if you look at Asia traffic being down by about 60%. And you look at the Rest of World being down by about 25%. So that includes CONUS, Canada, Europe for the rest of the year. So for the full year, those very significant percentage declines. That creates about a $70 million kind of hole on the cash front. And alternatively, if there were no revenue from CA for 3 to 4 months, it's a similar $70 million hole. So we have identified opportunities for cash savings that, as I've mentioned, we have these 16 levers that we've already identified the pool. those amount to more than $50 million. As you also said, though, some of those require negotiations with counterparties. So we want to be clear about that. But we are very actively managing our way through that. Importantly, also, we had the cash of -- increased from the end of the year to yesterday at now $204 million, and we have the ABL of $30 million, it's undrawn. So that's the way we're thinking about it.

More specifically, on your question about in the short run, how much of that revenue decline flows through to EBITDA. It's a very high percentage in the short term. Because of the relative fixed cost of that satellite spend. But having said that, those are some of the conversations that we want to be able to have, is to help with the -- have the discussions with our partners to ensure that we're all kind of sharing in the pain here.

Oakleigh B. Thorne - *Gogo Inc. - President, CEO & Director*

Right. And like Barry said, that's one scenario. We're also developing plans for more [draconian] scenarios if they should emerge.

Lance William Vitanza - *Cowen and Company, LLC, Research Division - Former MD and Credit & Cross-Capital Structure Analyst*

Well, that's really helpful, guys. The $70 million is the cash shortfall. Is that versus your previous model? Or when you say $70 million hole, do you mean that is -- that you would be without doing something that you would -- you would be $70 million below the minimum amount of cash that you need to run the business? I'm just not sure what you meant when you said $70 million hole.

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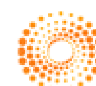

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Barry L. Rowan - *Gogo Inc. - CFO & Executive VP*

It's a relative to current plans, basically.

Lance William Vitanza - *Cowen and Company, LLC, Research Division - Former MD and Credit & Cross-Capital Structure Analyst*

Okay, great. Got it, got it. And then just again, I mean, I'm not sure, I mean, we can follow up off-line, if necessary. But really, what I'm trying to get at on the -- on my question about the flat versus variable revenues, right? If not the flow-through to EBITDA, but just if -- just to take it to its logical extreme, right? So if you have had an airline customer that had 0 flights in the quarter, would that airline customer pay Gogo $0? Or would there be some monthly amount that would get paid just because you're still standing ready to provide service?

Oakleigh B. Thorne - *Gogo Inc. - President, CEO & Director*

We have monthly revenue guarantees in some of our contracts, but not a lot. And we are -- in more and more recent contracts, we have been negotiating monthly revenue guarantees. We do have one relatively new contract, which is a flat fee CIR contract. But a lot of the revenue yet, it does depend on in-flight connectivity sessions for use of our Gogo Vision product or free messaging usage, et cetera. We do get -- we have some of our free messaging, it is on a per passenger ported basis. Again, that's not a huge amount.

Lance William Vitanza - *Cowen and Company, LLC, Research Division - Former MD and Credit & Cross-Capital Structure Analyst*

Okay. And just one last question for me on the Delta dual sourcing front, and I apologize if I missed this on your last answer. But would this refer only to new planes? Or is there some thought that Delta could deinstall some of the existing Gogo jets, like what happened with American Airlines a few years ago?

Oakleigh B. Thorne - *Gogo Inc. - President, CEO & Director*

Yes. It's not like the American Airlines situation in that -- the American Airlines contract was a lot different from the Delta contract. And so -- and was -- and frankly, close to the end of the contract as well as the fact that we didn't have really a mature satellite product at that point. And now we've got 2Ku, and I think that 2Ku is as good or better than any other ISP product in the world right now. So that the situation is a lot different than American. I'm not going to comment on what Delta's plans are. I will say this applies to the domestic fleet. We -- I'm going to leave it to Delta to talk about their plans. They have not -- right now, frankly, nothing is decided. So I would be making things up if I gave you an answer and I don't want to do that.

Operator

And our next question comes from Philip Cusick of JPMorgan.

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

Oak, can you talk more about industry consolidation? And are you considering selling parts of your business as well as buying or merging other things?

Oakleigh B. Thorne - *Gogo Inc. - President, CEO & Director*

Yes. I mean, I would say everything is kind of on the table because these are dynamic times and industry needs to see some consolidation, and there's a lot of conversations taking place between different players in the ecosystem. Some people looking at more vertical integration plays, some people are looking at more horizontal integration plays. So we do think the CA business does need to see some consolidation. And we think

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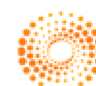

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that Gogo, by virtue of our market share, by virtue of our really strong distribution, product road map, engineering, systems integration capabilities, et cetera, is a very important component of the industry, and it would be of a lot of values to somebody who really wants to be a big player in the industry. So that's how we look at it. I think there's -- I don't want to mislead people in thinking that there's anything imminent going on, but there is a lot of conversation taking place.

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

Okay. And then second, on the $125 million to $140 million or was it $120 million to $145 million, that you would have guided to. Is that a clean comp versus the $115 million in 2019? What are the puts and takes there?

Barry L. Rowan - *Gogo Inc. - CFO & Executive VP*

Yes. So it is a clean comp in the sense that it does not include recurring revenue. So that benefit that we saw in 2019 is excluded. So of course, that takes out the $146 million from this -- from 2019 down to the $115 million. So the $120 million to $145 million is what we would have guided to just as of -- on a straight-up basis, coming into the year.

Operator

Thank you. And ladies and gentlemen, this does conclude our question-and-answer session. I would now like to turn the call back over to Oakleigh Thorne for any closing remarks.

Oakleigh B. Thorne - *Gogo Inc. - President, CEO & Director*

Thank you. Thank you for attending Q4 2019 earnings conference call. And as we've pointed out, you all know we are in very uncertain times. We expect revenue to fall pretty dramatically, as we said, until the pandemic has passed, but we start with a strong cash balance. And we feel we have identified levers that, if we execute, will allow us to reduce cash spend in concert with revenue declines and to maintain our liquidity. Underneath it all, we have 2 very valuable businesses and growing in under-penetrated markets, and we're determined to realize the strategic value of those businesses for our shareholders and employees. So thanks again, and we look forward to talking to you in the future.

Operator

Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.

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