Accounting Impact of Business Model Changes and New Revenue Recognition Standard on Commercial Aviation

February 22, 2018

Safe harbor statement

Safe Harbor Statement

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This presentation is being provided for the exclusive purpose of providing an illustrative overview of the expected impact on Gogo’s financial statements of the transition to the airline-directed model by certain of Gogo’s commercial aviation airline partners and Gogo’s adopting of revenue recognition standard, ASC 606 (“ASC 606”). For further information on the airline-directed model, as compared to the turnkey model, and ASC 606, as compared to Gogo’s historical revenue recognition standard, ASC 605 (“ASC 605”), see Gogo’s Annual Report on Form 10-K, filed with the Securities and Exchange Commission on February 22, 2018. In addition, (i) this presentation may not be relied upon as a projection or expectation of Gogo’s future financial results under any particular business model, (ii) for comparative purposes only, this presentation, in certain instances, reflects as assumptions identical economics to Gogo under each business model, including with respect to equipment costs and service revenues, and Gogo makes no representation regarding the actual economic comparability between such models (as they may differ significantly) and such comparability in no way reflects Gogo’s existing contracts or expected performance under these contracts, (iii) this presentation illustrates the primary line items from Gogo’s financial statements that are expected to be impacted solely as a result of the application of the airline-directed model as compared with the turnkey model and/or ASC 606 as compared to ASC 605, and does not represent a complete or audited presentation of Gogo’s financial statements for any period, and (iv) the contract term and economic assumptions included in this presentation, including cost of service revenue, equipment cost, contract term and service revenue, are not intended to be projections or expectations and are provided solely for illustrative purposes.

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Agenda

1. Commercial airline arrangements and business model discussion
2. New revenue recognition accounting standard

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Commercial Airline Arrangements

Commercial airline arrangements description

- Pursuant to contractual agreements with our airline partners, we place our equipment on commercial aircraft operated by the airlines for the purpose of delivering our in-flight connectivity and entertainment services to passengers on the aircraft. There are currently two types of commercial airline arrangements: turnkey and airline-directed.
  - Under the turnkey model, we account for equipment transactions as operating leases of space for our equipment on the aircraft.
  - Under the airline-directed model, which we have historically used on a limited basis, equipment transactions qualify for sale treatment resulting in recognition of equipment revenue. Starting in 2018, the airline-directed model will become the primary model of operation.
- Assuming the same economics, turnkey and airline-directed models have the same free cash flow.
- Recognition of equipment revenue and cost under the airline-directed model will impact Adjusted EBITDA, although the degree of such impact will be based on the terms of the contract and the expected service revenue.

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Commercial airline business model comparison

	Financial metric	Turnkey model (TK)	Airline-Directed model (AD)
Income Statement	Equipment revenue	No	Yes
	Equipment cost	No	Yes
	Service revenue	Yes	Yes
	Service costs:		
	Revenue share and transaction costs	Yes	No
	Amortization of deferred leasing proceeds	Yes	No
	Network and other costs	Network and other costs are the same	
	Depreciation of airborne equipment	Yes	No
Cash Flow	Capital expenditures [cash flows used in investing activities]	Yes	No
	Inventory [cash flows used in operating activities]	No	Yes
	Free cash flow	**Free cash flow is the same ***	

* Assumes identical economics, such as equipment cost and service revenue, under each model, solely for illustrative purposes, and does not represent Gogo's expectations regarding the economic impact of the transition to the airline-directed model by airline partners.

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Accounting impact of airline-directed model – Income statement and cash flow summary

The following is a summary of the accounting and financial statement impact over the life of an agreement, solely as a result of the transition from a turnkey to airline-directed business model:

Financial Metric	Airline-Directed (AD) vs Turnkey (TK)	Comments
Equipment revenue	↑	Equipment sold and recognized over the duration of the contract as revenue.
Service revenue and ARPA	↓	Gogo pays revenue share under the TK model. Under the AD model, there is no revenue share. Therefore, service revenue and ARPA are lower under AD.
Equipment gross margin	↓	AD model will have lower equipment gross margin due to equipment co-investment. We expect equipment co-investment to decline over time.
Service gross margin	VARIES	Service Cost of Sales will change due to lack of revenue share offset by lack of airborne lease amortization.
Adjusted EBITDA	↓	AD model Adjusted EBITDA impacted by equipment co-investment.
Airborne spend	=	Total airborne spend does not change; however, classification of airborne equipment purchases varies depending on turnkey or airline-directed model.
Free cash flow	=	No impact on free cash flow.*

* Assumes identical economics, such as equipment cost and service revenue, under each model, solely for illustrative purposes, and does not represent Gogo's expectations regarding the economic impact of the transition to the airline-directed model by airline partners.

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Airline-directed model vs. turnkey model – Illustrative example (under ASC 605)*

	Turnkey model			Airline-directed model - 605		
	Install Period	Years 1-10	Total Contract	Install Period	Years 1-10	Total Contract
Income Statement						
Equipment revenue	-	-	-	-	164	164
Service revenue	-	900	900	-	656	656
Equipment cost	-	-	-	-	(120)	(120)
Service cost	-	(530)	(530)	-	(450)	(450)
Depreciation and Amortization	-	(120)	(120)	-	-	-
Net income	**-**	**250**	**250**	**-**	**250**	**250**
EBITDA adjustments						
Amortization of deferred lease incentive	-	(100)	(100)	-	-	-
Depreciation and Amortization	-	120	120	-	-	-
EBITDA	**-**	**270**	**270**	**-**	**250**	**250**
Balance Sheet						
Assets						
Cash (net of equipment cost)	(20)	250	250	(20)	250	250
Airborne Fixed Assets	120	120	120	-	-	-
Accumulated Depreciation (Turnkey) / Deferred Asset (Airline-directed)	-	(120)	(120)	120	-	-
Total Assets	**100**	**250**	**250**	**100**	**250**	**250**
Liabilities						
Deferred Airborne Lease Incentive (ST and LT) (Turnkey) / Deferred revenue (Airline-directed)	100	-	-	100	-	-
Equity						
Net income (cumulative)	-	250	250	-	250	250
Total liabilities and equity	**100**	**250**	**250**	**100**	**250**	**250**
Cash Flow						
Net income	-	250	250	-	250	250
Depreciation and amortization (Turnkey) / Change in deferred asset (Airline-directed)	-	120	120	(120)	120	-
Deferred airborne lease incentive (Turnkey) / Change in deferred revenue (Airline-directed)	100	(100)	-	100	(100)	-
Total operating activities	**100**	**270**	**370**	**(20)**	**270**	**250**
Gross Capex	(120)	-	(120)	-	-	-
Total investing activities	**(120)**	**-**	**(120)**	**-**	**-**	**-**
Free cash flow	**(20)**	**270**	**250**	**(20)**	**270**	**250**

Illustrative transaction assumptions:

- Gogo equipment cost $120K; airline equipment price $100K; Gogo co-investment $20K; contract term 10 years
- Service revenue over 10 years $900K
- Revenue allocation under airline-directed model:
  - revenue allocated to equipment revenue $164K
  - revenue allocated to service revenue $656K
- Cost of service revenue of $530K, comprised of:
  - Cost of providing services is estimated at 50% of service revenue, or $450K
  - Revenue share 20% of service revenue, or $180K
  - Non-cash deferred lease proceeds ($100K), amortized as a reduction to cost of service revenue over the duration of the contract

- Only represents accounting impact and does not represent Gogo's expectations regarding the economic impact of the transition to the airline-directed model.

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New revenue recognition accounting standard (ASC 606)

New revenue recognition accounting standard (ASC 606) summary

- Accounting Standards Codification Topic 606 (ASC 606) became effective January 1, 2018.
- Gogo is adopting ASC 606 under the modified retrospective approach, whereby the cumulative effect of adoption is recorded as an adjustment to equity as of January 1, 2018. Prior period results are not restated. Gogo will provide quarterly reconciliations to ASC 605 during 2018.
- While ASC 606 applies to all segments, the Business Aviation segment is not materially impacted by the change.
- The Commercial Aviation – North America and Commercial Aviation – Rest of World segments are impacted by ASC 606 but only for contracts under the airline-directed model:
  - Equipment and service deliverables are now separate deliverables, which results in accelerated recognition of equipment revenue and related costs
  - Optional and variable revenues are now required to be considered in day-one accounting
  - Supplemental Type Certificate (“STC”) costs incurred under airline-directed contracts are now deferred and amortized over the contract term

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Impact of new revenue recognition standard

Financial Metric	606 (AD) vs 605 (AD)	Comments
Equipment revenue Equipment gross margin	↑	Equipment revenue recognized when installed as opposed to recognized over the duration of the contract. A higher portion of forecasted service revenue is now allocated to equipment.
Service revenue Service gross margin ARPA	↓	Service revenue lower due to higher portion of forecasted service revenue allocated to equipment.
Engineering, design and development expense	↓	STC costs incurred under airline-directed contracts are now deferred and amortized over the contract term.
Adjusted EBITDA	=	Over life of the contract, Adjusted EBITDA impact will be neutral.
Free cash flow	=	No impact on free cash flow

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New revenue recognition accounting standard (ASC 606) – illustrative example

Section		Airline-directed model - 605 Install Period	Years 1-10	Total Contract
Income Statement	Equipment revenue	-	164	164
	Service revenue	-	656	656
	Equipment cost	-	(120)	(120)
	Service cost	-	(450)	(450)
	Depreciation and Amortization	-	-	-
	Net income	**-**	**250**	**250**
	EBITDA adjustments			
	Amortization of deferred lease incentive	-	-	-
	Depreciation and Amortization	-	-	-
	EBITDA	**-**	**250**	**250**
Balance Sheet	**Assets**			
	Cash (net of equipment cost)	(20)	250	250
	Airborne Fixed Assets	-	-	-
	Deferred Asset	120	-	-
	Total Assets	**100**	**250**	**250**
	Liabilities			
	Deferred revenue	100	-	-
	Equity			
	Net income (cumulative)	-	250	250
	Total liabilities and equity	**100**	**250**	**250**
Cash Flow	Net income	-	250	250
	Change in deferred asset	(120)	120	-
	Change in deferred revenue	100	(100)	-
	Total operating activities	**(20)**	**270**	**250**
	Gross Capex	-	-	-
	Total investing activities	**-**	**-**	**-**
	Free cash flow	**(20)**	**270**	**250**

Section		Airline-directed model - 606 Install Period	Years 1-10	Total Contract
Income Statement	Equipment revenue	164	-	164
	Service revenue	-	656	656
	Equipment cost	(120)	-	(120)
	Service cost	-	(450)	(450)
	Depreciation and Amortization	-	-	-
	Net income	**44**	**206**	**250**
	EBITDA adjustments			
	Amortization of deferred lease incentive	-	-	-
	Depreciation and Amortization	-	-	-
	EBITDA	**44**	**206**	**250**
Balance Sheet	**Assets**			
	Cash (net of equipment cost)	(20)	250	250
	Airborne Fixed Assets	-	-	-
	Deferred Asset	64	-	-
	Total Assets	**44**	**250**	**250**
	Liabilities			
	Equity			
	Net income (cumulative)	44	250	250
	Total liabilities and equity	**44**	**250**	**250**
Cash Flow	Net income	44	206	250
	Change in deferred asset	(64)	64	-
	Total operating activities	**(20)**	**270**	**250**
	Gross Capex	-	-	-
	Total investing activities	**-**	**-**	**-**
	Free cash flow	**(20)**	**270**	**250**

Illustrative transaction assumptions:

- Gogo equipment cost $120K; airline equipment price $100K; Gogo co-investment $20K; contract term 10 years
- Service revenue over 10 years $720K
- Revenue allocation under airline-directed model:
  - revenue allocated to equipment revenue $164K
  - revenue allocated to service revenue $656K
- Cost of service revenue of $450K
- New account labeled *Deferred Asset* represents the amount of revenue recognized ahead of cash received
- For simplicity, the illustrative example assumes:
  - Same allocation between service and equipment revenue under both ASC 605 and ASC 606
  - Fixed consideration during the term of the contract (i.e., variable consideration is excluded from this illustrative example)

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