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GOGO - Q4 2016 Gogo Inc Earnings Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Q4 2016 Gogo Inc. earnings conference call.

(Operator Instructions)

As a reminder, today's conference call is being recorded. I would now like to turn the conference over to Ms. Alva, Vice President of Investor Relations and Treasurer. Please go ahead.

Varvara Alva - *Gogo Inc. - VP of IR & Treasurer*

Good morning everyone. Welcome to Gogo's fourth-quarter 2016 earnings conference call. Joining me today to talk about our results are Michael Small, President and CEO; John Wade, Executive Vice President and COO; 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 will 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 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 annual report on Form 10-K and our other documents filed with the SEC.

In addition, please note that the date of this conference call is February 27, 2017. 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 will present both GAAP and non-GAAP financial measures. We include an adjustment and reconciliations to other non-GAAP measures to the most comparable GAAP measure in our fourth-quarter earnings release.

This call is being broadcast on the Internet and is available on the investor relations website on Gogo's website at 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 I would like to turn this call over to Michael.

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

Thanks, Varvara. Good morning everyone.

We had an outstanding quarter and another strong year. We reported record revenue of $160 million and adjusted EBITDA of $23 million for the quarter. For the year we exceeded guidance with revenue of $597 million and adjusted EBITDA of $67 million.

We now expect levered free cash flow to go positive in 2019, a year earlier than our prior guidance due to an acceleration in 2Ku installs. 2Ku has taken flight and creates a critical inflection point. The week before last we took 2Ku's performance to the next level by demonstrating speeds in excess of 100 megabits per second on our test plane with our next-gen modem and our high throughput satellite.

Our rapid installation of 2Ku means we are moving from a period of significant bandwidth constraint to an era of much greater bandwidth abundance. More bandwidth is the key to better experiences for our airline partners and their passengers and more flexibility in pricing our products and services. The multi-payer trend where a mix of passengers, airlines, and third parties pay for our offerings, is already reducing the percentage of our revenue that comes from passengers and commercial aviation, down 8 percentage points in Q4 from a year ago.

Today most airline partners and certain third-party sponsors offers some of our services at no cost to passengers. For example, Alaska now offers free access to messaging services like WhatsApp and Facebook Messenger, JAL now offers free WiFi on every flight and Timo has added additional levels of free in-flight WiFi. Additionally, Delta and American are offering Gogo Vision free to all passengers, as are many of our other airline partners.

Our airline partners also are buying bandwidth for their own consumption. More than 50,000 flight attendants are now carrying tablets and pilots from several airlines are running applications that make their flights safer and more fuel efficient.

The key point is more bandwidth is the underlying driver of more usage, users and payers for connectivity. More bandwidth also results in both a better passenger experience and faster ARPA growth. This vast need for bandwidth is why we are working so hard to accelerate the deployment of our 2Ku service in 2017.

By year-end between the over 130 installed today and what we expect to install during the remainder of the year we will have about 600 2Ku aircraft online, almost 3/4 of which will be in CA-NA.

Our technology roadmap will continue to bring more bandwidth to the market at lower costs. We are doing this by taking advantage of rapid satellite innovations to enhance our global satellite network, and we continue to lead the market in developing aircraft hardware technology.

Our satellite efforts performance now and in the future is greatly enhanced by leasing rather than owning satellite capacity. Leasing is the right approach to capture the rapid innovation cycle underway in the satellite industry, allowing aircraft operators to benefit from lower bandwidth cost and far more robust capacity and geographic coverage.

In 2016 we signed capacity agreements with our largest satellite providers Intelsat and SES for use of their high throughput and wide beam satellites. Three of these HTS satellites have launched and four more launch this year.

OneWeb, our partner for LEO satellite capacity, recently received $1.2 billion of equity funding from SoftBank and Qualcomm. Leasing capacity and the open architecture of our proprietary 2Ku platform is the combination that enables us to take advantage of these new satellites without taking an aircraft out of service.

While we are capturing the benefits of continuous satellite innovation, we also are enhancing our airborne equipment: our antennas, modems servers and wireless access points. Our airborne system is proprietary and incorporates Gogo's patented intellectual property. When combined with the upgrades in our satellite network, peak speeds increase and bandwidth costs decrease.

Advancements in our hardware technology also provide outstanding reversed link performance, unparalleled network availability rates, faster handoff times between satellites and more expansive geographic coverage. Our industry-leading performance has been on display on more than 35,000 commercial 2Ku flights as far north as Alaska and as far south as the tip of South America. Many more regions will experience 2Ku's performance this year.

Our network performance is a key driver of aircraft awards. With wins for 2Ku exceeding 1,000 aircraft in 2016 from several of the world's leading airlines including Delta, American, Air Canada, Air France, KLM and British Airways we now have more than enough awarded aircraft to achieve profitability both on a consolidated basis and in CA-ROW.

We will capitalize on this momentum in 2017 by expanding our sales operations in Asia and the Middle East. We also will look to grow our share of the new aircraft market through the OEM channel.

In 2016 we announced plans for our next-generation air-to-ground network. This solution leverages our existing 250 cell site networks and our 25 years of developing proprietary ATG technology.

Next-gen ATG will bring unrivaled performance to regional commercial jets and larger business aircraft in North America. We plan to launch this network in 2018.

We are now engineering our solutions to achieve speeds in excess of 100 megabits per second and with 99% availability. This is true for both our next-generation air-to-ground and our global satellite solutions. We expect these figures to continue to improve.

No other Company has our combination of network technology and airborne equipment that makes this performance possible.

Our cutting-edge network solutions also benefit Business Aviation. In this segment we will launch our Gogo Biz 4G connectivity service in the next few months. Business Aviation customers have already embraced this 10 megabit per second service.

We have close to 400 orders including from key partners such as Constant Aviation and Delta Private Jets.

Beyond Gogo Biz 4G, the business aviation market is eagerly awaiting the arrival in 2018 of our 100 megabits per second next-gen ATG solution. Finally, owners of very large aircraft from 737 Boeing business jets to 747 are also very interested in 2Ku, the only global 100 megabit per second service in the market today. We will see 2Ku sales in Business Aviation.

Before Norm goes through the results and guidance I want to introduce John Wade, our Chief Operating Officer. John was promoted last August to take our operational capabilities to the next level. For more than eight years John led our BA business and grew its revenue eightfold to $200 million while expanding segment profit from $3 million to $83 million.

With that I will turn it over to John to highlight our recent operational milestones. John?

John Wade - *Gogo Inc. - EVP & COO*

Thank you, Michael. Good morning everyone.

2Ku is now installed in over 130 aircraft and we have two dozen installation lines operating at locations around the world. This year we plan to significantly increase the number of production lines globally with a goal of building capacity to complete more than 750 2Ku installs each year.

In peak months starting this fall we will install 100 aircraft or more each month. Last year we reduced our install times down to about three days, which is both ahead of schedule and the best time in the industry. We now expect to add between 450 and 550 2Ku aircraft in 2017, which is up from earlier projections of 350 to 450.

In 2018 we expect to add between 650 and 750 2Ku aircraft, up 100 from prior guidance. This includes approximately 150 2Ku installations in the rest of the world in 2017 and 320 in 2018. The increased installation pace will help us work through most of our current 2Ku backlog by the end of 2018.

In addition to increasing install capability, last year our supply chain reduced 2Ku system costs by 15%. As we scale 2Ku production in our global operations we expect to further reduce the cost per 2Ku install.

Now turning to our OEM programs. Today all of our CA installs come from our aftermarket progress. We ended 2016 with 2Ku STCs for airframes that represent 35% of the world's addressable fleet.

By the end of 2017, we will have 2Ku STCs for airframes that represent 80% of the world's addressable fleets and for all leading aircraft types. And we are highly focused on the OEM channel, as well.

Getting our equipment installed by OEMs is critical to fully embedding our 2Ku technology in the aviation ecosystem and opening up new opportunities for aircraft awards. About 2,000 new aircraft are delivered annually by the major OEMs, which represents significant opportunity for us. We have already made stronger progress in our 2Ku OEM programs, particularly with Boeing, Airbus and Bombardier.

Today 200 of our existing 1,500 2Ku aircraft awards will be installed by OEMs. By the end of this year we will have both Boeing, B787 and Airbus A350 aircraft installed by the OEM.

Now let me switch to discussing our ATG operations. With more than 2,600 commercial aircraft and 4,000 business aircraft flying our ground network in the US and Canada, our ATG network remains a key component of our business. During 2016 we installed or upgraded approximately 1,100 commercial aircraft and 700 business aircraft.

In Business Aviation our Gogo Biz 4G program continues to track to plan with certification expected late Q1 and delivery starting early 2Q of this year.

With that I will turn it over to Norm to walk you through the numbers.

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

Thank you, John, and good morning everyone. We ended the year with a very strong fourth quarter.

Total revenue was up 16% to $160 million. Service revenue grew 20% to a record $139 million. Adjusted EBITDA nearly tripled from the prior year to over $23 million, representing a 14% margin.

Turning to segment results, CA-North America total revenue exceeded $100 million for the first time. Service revenue increased 15% to $95 million, driven largely by an increase in aircraft online to nearly 2,700.

For the quarter, ARPA grew 2% to 141,000. ARPA grew 8% year over year adjusting for the dilution from additional RJs and aircraft added by new airline partners. We expect to see improved ARPA growth in 2017 driven by a significant increase in available bandwidth and a stable regional jet count.

CA-North America's segment profit tripled to nearly $25 million, representing a 25% margin. This is up 14 percentage points from last year due to increased operating leverage including hitting fewer development milestones. Excluding the timing of certain non-cash accruals our segment profit margin would have been approximately 20%.

Turning to CA-Rest of World, total revenue for the quarter was $7.4 million, up 76% from the prior year driven by growth in ARPA and aircraft online. Aircraft online increased to 267 at year-end, up 65 versus the prior year.

Our CA-Rest of World's 2Ku awarded but not yet installed aircraft was approximately 560 at year-end. For the quarter, we generated annualized ARPA of 172,000, up 17% from the prior year, driven primarily by higher airline paid and third-party paid usage as Michael discussed earlier.

Rest of World segment loss for the quarter increased to $25 million from $20 million in the prior year due to higher ED&D expenses related to 2Ku certification and OEM programs and increased satellite capacity to support upcoming new airline launches.

Now turning to BA, service revenue for the quarter was up 28% to a record $36 million driven by a 20% growth in ATG aircraft online to nearly 4,200 and a 7% increase in ATG service ARPU to over 2,600 per month. BA equipment revenue of $15 million was down $6 million from the prior year.

About half of the revenue decline was due to the deferral of the equipment revenue associated with the 4G [sign] in-flight program with the remainder due to general market conditions. For the year we deferred $5.5 million under the 4G sign in-flight program. We expect to recognize this deferred revenue in the second quarter of 2017 as 4G units are shipped.

Segment profit was up 19% to $23 million, representing a 45% segment profit margin. This is up 6 percentage points from last year, driven by lower ED&D expense and growth in high-margin service revenue, which represented 70% of BA revenue for the quarter. Fourth-quarter consolidated cash CapEx was $34 million, was $20 million higher than the prior year due to increased airborne equipment purchases to support 2Ku installations.

Turning to full-year 2016 results, our revenue grew 19% to $597 and our adjusted EBITDA increased 83% to $67 million for the year. Both exceeded our 2016 guidance.

Cash CapEx of $133 million was within guidance range and up $53 million from the prior year, driven by purchases of 2Ku equipment to support 2016 and 2017 installations. We ended 2016 with $456 million of cash on hand. In January we added $16 million of net proceeds from the issuance of additional senior secured notes.

With that let me now address 2017 guidance starting with revenue. Total revenue is expected to range from $670 million to $695 million, reflecting year-over-year growth of 12% to 17%. This includes CA-North America revenue of $405 million to $425 million, CA-Rest of World revenue of $40 million to $50 million, and BA revenue of $220 million to $230 million.

We expect our adjusted EBITDA to range between $60 million and $75 million. This includes approximately $20 million of incremental expense for technology development in North America and $30 million of launch costs for new airlines in the Rest of World.

Let me now give more color for the profitability trends for Rest of World. We will more than double our 2016 installs as we launch several new airlines in 2017 including long-haul partners such as British Airways, Air France and Air Canada. Though the new airline launches will initially have a dilutive impact on overall ARPA, the underlying ARPA on existing Rest of World airlines will continue strong double-digit growth.

With increased expenses for OEM and aftermarket programs and satellite capacity to support the new airline launches we expect 2017 to be the peak year of segment loss in Rest of World. Starting in 2018 ARPA growth combined with increased aircrafts online will drive Rest of World service margin improvement.

Higher service margins combined with operating leverage realized from higher aircraft count will drive segment profit. This will continue to improve as more aircraft come online and mature. Our current Rest of World 2Ku backlog of 560 aircraft provides enough critical mass to achieve segment profitability.

Our North America businesses will continue profitable growth in 2017 despite increases in next-gen ATG development spending, $9 million of which is expected to hit in the first quarter. As next-gen ATG is deployed the increased bandwidth will drive incremental revenue. Overall on a consolidated basis we expect to see meaningful EBITDA growth starting in 2018, including improving profitability in Rest of World and are well-positioned to deliver on our 30% EBITDA margin target by 2021.

Now turning to installs and cash CapEx. We now expect installs between 450 and 550 of 2Ku aircraft in 2017, up 100 from previous guidance. This includes approximately 150 installs in Rest of World.

We expect 2017 cash CapEx of $230 million to $260 million, which includes equipment purchases for accelerated 2Ku installs and next-gen ATG network expenditures. For 2018 we are also increasing our 2Ku install guidance to between 650 and 750, raising the low-end by 100 aircraft. This includes approximately 300 aircraft in Rest of World.

We expect a significant decline in cash needs in 2018 versus 2017 due to a substantial decline in Gogo's average investment for 2Ku installation and a significant increase in consolidated adjusted EBITDA. We expect 2018 cash CapEx of between $70 million and $120 million. The decrease in cash CapEx versus prior guidance includes an estimate that 70% to 80% of 2018 2Ku equipment transactions will be under our airline-directed business model. Under this model equipment transactions are accounted for as revenue and cost of goods sold rather than as capital expenditures and deferred airborne leasing proceeds.

In summary, we remain well-positioned on our path to profitability as we increase aircraft online, ARPA and margin while simultaneously reducing our investment per aircraft. Accelerated 2Ku installs and improved operating leverage will enable us to reach free cash flow now in 2019.

Operator, we are ready for our first question.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) John Hodulik, UBS.

Lisa Friedman - *UBS - Analyst*

Hi, it's Lisa Friedman for John. I just wondered if you could give us more color on the move to the airline-directed model? I know that's something you guys have been talking about for a while, but what gives you confidence that in 2018 that is the direction things are going to move?

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

The confidence is the contracts we've agreed to with the new airlines. So this move is for primarily Rest of World airlines that will be coming online in that time period.

Lisa Friedman - *UBS - Analyst*

And then just a follow-up, I know there's been a transition in management at some of your competitors. And I'm wondering if you think this gives you an opportunity for some win-back or for some incremental growth that maybe wasn't possible before?

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

We think we have a very strong offering in the marketplace in 2Ku and next-gen ATG. We think we have developed global operating capabilities and global supply chains that are powerful. We think our platform capabilities that offer great ease-of-use and flexibility for our airline partners is what allows us to win in the marketplace and puts a lot of pressure on competitors.

Lisa Friedman - *UBS - Analyst*

Thanks so much.

Operator

Ash Birla, Dougherty.

Ash Birla - *Dougherty & Company LLC - Analyst*

Yes, thank you guys. Congrats on a great quarter. I had a quick question for Norm regarding breaking down this CapEx.

So 70% to 80% of your aircraft in 2018 are going to move to airline-directed model. So my question is that's like let's call it roughly 525 aircraft moving in 2018 to a airline-directed model, then only 175 will be recognized as CapEx and you drop CapEx by $100 million. So how much is it moving, that $100 million is moving to cost of goods sold?

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

So two things happen in the airline-directed model. The equipment transactions are accounted for as revenue cost of goods sold, but because the equipment and the service provision are tied together, it also triggers multi-element accounting.

So the equipment revenue and the cost of goods sold are both recognized over the life of the contract. So it won't be all recognized in the year of the equipment transaction itself.

Ash Birla - *Dougherty & Company LLC - Analyst*

So the way you will recognize it is whatever the dollar amount is you will divide it by 10 and then you will recognize that as cost of goods sold? Is that what you are saying, Norm?

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

Yes, revenue and cost of goods sold.

Ash Birla - *Dougherty & Company LLC - Analyst*

Okay. And then the next-gen ATG CapEx is already included in the 2017 and 2018 CapEx guidance?

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

Yes. That's correct.

Ash Birla - *Dougherty & Company LLC - Analyst*

Okay, that's great. One last question from me.

Take rates are very strong at 7.3%. Was there sponsorship or airline free giveaway, can you guys comment on why take rates are 7.3% versus it has been 6% or lower, somewhere around that?

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

Yes, we are starting on the path to dramatically higher take rates driven by the availability of more bandwidth. Some of the ways we're capitalizing on the bandwidth availability is Japan Airlines, for example, offers now free WiFi to all their passengers on their domestic fleet. They are very short flights, generally around one hour.

We have the Timo plan going. That's also contributing to take rate.

And, of course, we did 771 ATG-4 additions. We did 94 2Ku additions during the year. The bandwidth is starting to show up which will drive take rates.

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

(multiple speakers) demonstrates the power of the multi-payer model for sponsorships and airline paid connectivity, as well, behind the bandwidth.

Ash Birla - *Dougherty & Company LLC - Analyst*

Okay great. Hey, Norm, just one last one.

The $100 million that will go to the cost of goods sold, what will be the cash implications that you can you tell me? Because the antennas will be installed, but there will be no cash CapEx. So where will the cash flow through?

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

So regardless of the model whether it's airline-directed or turnkey, the underlying economics of the transaction and the cash flow pattern are exactly the same. The only difference is how it is accounted for.

Ash Birla - *Dougherty & Company LLC - Analyst*

Okay, great. I will jump back in the queue. Thanks.

Operator

Robert Gutman, Guggenheim Partners.

Robert Gutman - *Guggenheim Partners - Analyst*

Hi, thanks for taking the questions. Good quarter, guys, congratulations.

In the BA segment I see, again, because of the deferred equipment that segment profit remains elevated. I was just curious how this, how you see this playing out through the year?

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

So in BA we have the program where you take the current Gogo Biz solution now and it gets upgraded to Gogo Biz 4G. That will happen later this year. And as we make that final upgrade we will recognize the revenue and the gross margin associated with those sales. In general our gross margin on BA sales is about 50%.

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

For equipment. Overall EBITDA margin will normalize we would expect next year.

Robert Gutman - *Guggenheim Partners - Analyst*

Next year. Okay. So it should stay consistent around (multiple speakers) for the year?

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

Next year being this year, 2017.

Robert Gutman - *Guggenheim Partners - Analyst*

Okay. Thank you.

Operator

Lance Vitanza, Cowen.

Lance Vitanza - *Cowen and Company - Analyst*

Hi, thanks for taking the questions. I had a couple.

I guess the first, just back on the Rest of World segment, and I appreciate the commentary there about 2017 being the peak year for the drag on EBITDA. Is the right way to think about that, I mean I did some numbers, it looked like ex-Rest of World consolidated EBITDA would have been close to $50 million in Q4.

Is that the number that you guys are working with? And is there any way that you could help us think about what that drag will be quantified in that drag on EBITDA for 2017? I'm just trying to get to what your guidance suggests the two profitable segments will be totaling up to.

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

So we haven't provided that specific guidance, but you are right that it is approximately $50 million if you add back Rest of World in the fourth quarter. The guidance we did give for next year is this will be approximately $30 million of launch cost for the new airlines such as British Airways and Air France and Air Canada, the international fleets coming on.

Those launch costs are made up of in some cases STCs for retrofits, line fit investment for new aircraft delivered and buying satellite capacity in advance of the launch. So that is the way tried to describe the costs we are bearing next during Rest of World.

Lance Vitanza - *Cowen and Company - Analyst*

But not all of that would be incremental, though I presume you would have had some of that in a lesser amount most likely, but some of that would have been in place in 2016 for different airlines.

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

Yes. So I would also -- there will be some, of course, revenue growth in Rest of the World and we guided to that. But it just takes a while when you are launching a new fleet to get the revenue growing.

Some information I think would be helpful is when we look at the Rest of the World fleet to date, we have watched over the last two and a half years that that fleet has been going the ARPA nearly triple from about $60,000 to $170,000 at the end of this year. And we expect on those established fleets with Delta and channel fleets that continued strong double-digit growth.

So when you have a satellite solution that isn't capacity constrained we see strong ARPA growth, but it starts at a low number when you launch a new fleet. So that's the dynamic in the Rest of World. You have the launch cost, slow ARPA but then great ARPA growth after the first year.

Lance Vitanza - *Cowen and Company - Analyst*

That's really helpful. I appreciate it.

On the CapEx and the change to the greater participation of the airline-directed business model, a lot of moving pieces on the accounting but as you said no change to the underlying economics. Is it possible for you to walk me through those economics more on a unit basis? In other words, how much are you investing whether it's per fleet or per plane and what sort of payback you would expect over what period of time?

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

So we haven't given very specific guidance there. But I can tell you two things, we have said that based on current ARPA we get a two- to three-year payback on the success-based co-investment.

Also we said that the trend of the success-based co-investment per aircraft is declining. And as I said in the script actually 2018 will continue to see a significant decline versus 2017.

Lance Vitanza - *Cowen and Company - Analyst*

Great. Last one for me, someone had asked about management changes among some of your peers.

I wanted to ask you about the changes at Gogo, if you could give me a status update. I know, Norm, you had announced that you would be leaving at some point and any update there?

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

I will take that question for Norm. And I would also like to take the opportunity to thank Norm for 6.5 years, and that's probably in normal years like 50.

But it's helping to grow Gogo he has put in place a tremendous finance organization and we have delivered solid financial reporting quarter in, quarter out for that time. And that's no easy task when you were growing at our rate and going global as we have.

The search is actively underway for a new CFO. Norm has been incredibly supportive and cooperative during this process and is available to us through the end of the year. So all that is going very well.

Lance Vitanza - *Cowen and Company - Analyst*

Thanks very much.

Operator

Andrew De Gasperi, Macquarie.

Andrew De Gasperi - *Macquarie Securities Group - Analyst*

Yes, good morning. My first question is on Business Aviation.

I believe you flagged in your release and also in your prepared remarks about weaker market conditions. Could you maybe expand on that?

Secondly, could you maybe update us on what your aircraft funnel looks like for the rest of the year, particularly new orders or airline announcements? Thanks.

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

Okay, we will have John Wade, who has run Business Aviation for over eight years, comment on the market conditions.

John Wade - *Gogo Inc. - EVP & COO*

Sure. What we saw in terms of the performance of the business unit was very much in line with what the other major OEMs such as Rockwell and Honeywell announced in terms of overall softness. We see this as just a typical economic cyclic response and we expect to see it recover as the rest of the Business Aviation sector picks up.

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

I would add fortunately we are now up to 70% of our revenue from recurring service revenue and equipment is only 30%. So the impact to us of the cyclical nature of that business has minimized greatly since several years ago.

As far as the funnel and our business, 2Ku is performing exceptionally well. The airline industry is seeing that. Not only are we saying it but flyers are increasingly saying it and fleets and reporter articles.

So we are feeling good about how that is being received. I mentioned in the script we are emphasizing Asia and the Middle East this year. As you look out over the next decade or two that is where a lot of the planes are going to be.

And I am looking forward to adding to Japan Airlines in that region. And then to maintain long-run growth rates getting into the OEM channel is critical and we will make significant progress there this year. We expect to deliver with our equipment on it a new 787 and the new A350 this year.

That will happen. So those are the two things, two areas of focus for us to keep our growth rate and aircraft high.

Andrew De Gasperi - *Macquarie Securities Group - Analyst*

Great, thank you.

Operator

(Operator Instructions) James Breen, William Blair.

James Breen - *William Blair & Company - Analyst*

Thanks for taking the question. Just a couple.

One, first, could you just talk about what you potentially see as the financial impact from the American planes that will be rolling off and the timing that you might see around them, how long of a time period that will take?

Secondly, on the free cash flow you obviously moved up that free cash flow positive by a year. What gives you confidence in that and how do you feel about the capital structure now relative to that in terms of the necessity for more capital? Thanks.

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

Okay, so on the American Airlines it will take a few years for the planes to be de-installed. When we talked in terms of financial impact of the de-installations, those are built into our forecast already. So our going free cash flow positive in 2019 already incorporates the impact of the American airlines de-installations.

In terms of what we have confidence in saying 2019 is a free cash flow positive year, I will give you the answer, kind of tying into the four parameters we talked about the drive our business model at the Analyst Day. And if you remember those four were planes, success-based co-investment, ARPA and margins. So in terms of planes with the contracts we have in place we have effectively locked down installations and planes through 2018 going into 2019.

So that's pretty certain. The success-based co-investment per plane also driven by the same factors. That's pretty well locked down.

Next is ARPA. Michael has talked about ARPA tripling on existing aircraft in Rest of World, continuing to grow double digits this year. So we have a good sense of where new airlines will come on and grow from there.

Lastly is margins, and we have our bandwidth costs very well locked down. We know what our costs are going to be, so you put all those four things together and gives us a pretty good level of confidence in being able to say the 2019 will be the year for turning cash flow positive.

James Breen - *William Blair & Company - Analyst*

Great, thanks.

Operator

Carter Mansbach, Forte Capital.

Carter Mansbach - *Forte Capital LLC Wealth Management - Analyst*

Good morning, gentlemen. Congratulations on a great quarter, great guidance. I have a question again back to marketing.

So two parts. Clearly on social media people are raving about 2Ku. So I want to know from Gogo's perspective will there be any money spent on marketing the new technology?

And I think more importantly on the onboarding process both in person and online when, let's say, Delta is getting a new customer to book a flight, will they begin to include an offer for the technology and when you get on the flight be more communicative about it? Do you see them being bragging about it more and putting it more front and center? Thank you.

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

2Ku will sell itself at least out-of-the-box. The challenge to grow revenue and increase take rate is getting more bandwidth into the system. And, yes, we are actively talking with all our airline partners how we will better market our service once the bandwidth is there.

But the fundamental issue is bandwidth. And you saw how much take rate went up this quarter, and you will see continued increase in take rate.

So I agree with you, Carter, we are going to have to spend more focused on marketing now that we have the bandwidth. But fundamentally what is going to make revenue growth is that we are moving to an era of much greater bandwidth abundance.

Carter Mansbach - *Forte Capital LLC Wealth Management - Analyst*

Thank you very much.

Operator

That concludes the question-and-answer session for today. I'd like to turn the conference back over to Mr. Small for closing remarks.

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

Thank you for participating today, everybody. We are very thrilled with the progress both 2Ku, and we didn't talk about it too much today but next-gen ATG is right behind that. We have, I think, established the leadership in bringing the most bandwidth to the most planes and the most regions around the world.

So we are thrilled with that and that ultimately is what will continue to drive great financial results from Gogo. Thank you everyone.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program and you may all disconnect. Have a great day, everyone.