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PRESENTATION

Operator

Good day, and thank you for standing by. Welcome to the Second Quarter 2022 Gogo Inc. Earnings Conference Call. (Operator Instructions) Please be advised that today's conference is being recorded. I would now like to hand the conference over to your speaker today, Will Davis, Head of Investor Relations. Please go ahead.

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

Thank you, Crystal, and good morning, everyone. Welcome to Gogo's Second Quarter 2022 Earnings Conference Call. Joining me today to talk about our results are Oakleigh Thorne, Chairman and CEO; and Barry Rowan, Executive Vice President and CFO. Also listening in on the call is Jessi Betjemann, Senior Vice President of Finance and Chief Accounting Officer. Jessi will assume the role of Gogo's CFO in early 2023.

Before we get started, I would like to take this opportunity to remind you that during the course of this call, we may make forward-looking statements regarding future events and the future performance of the company. We caution you to consider the risk factors that could cause actual results to differ materially from those in the forward-looking statements on the conference call. Those risk factors are described in our earnings release filed this morning and are more fully detailed under the 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 at the date of this conference call is August 5, 2022.

Any forward-looking statements that we make today are based on assumptions as of this date. We undertake no obligation to update these statements as a result of more information or future events. During the call, we will present both GAAP and non-GAAP financial measures. We've included a reconciliation and explanation of adjustments and other considerations of our non-GAAP measures to the most comparable GAAP measures in our second-quarter earnings release. This call is being broadcast on the Internet and available on the Investor Relations 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.

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

Thanks, Will, and thank you all for joining us this morning to discuss Gogo's record-breaking second quarter results. Since our last call, the macro trends around inflation and interest rates have created a major challenge -- major challenging economic environment for many companies. The companies with clear competitive advantages and recurring revenue streams to drive robust cash flow are well positioned to deliver for shareholders even in these turbulent times. And after the transition we've gone through the last 2 years, Gogo is now one of those kinds of companies.

As I'll discuss in detail today, the fundamental trends driving business aviation connectivity are still intact, resulting in continued strong demand for Gogo's equipment and service. Gogo also benefits from a business model that mutes the impact of inflation, which Barry will discuss in a few minutes. We're the leader in VA IFC today and the innovative products we bring to market like our advanced platform and our 5G network truly differentiate Gogo and derisk our strong cash flows for years to come.

And we're putting our strong balance sheet to work toward additional innovation, such as our recently announced low-rotorbit satellite global broadband product or GBB, that will give Avance customers an easy upgrade path to even more enhance capacity and expand our addressable market outside of North America. Combined these capabilities with the fact that we're able to still generate strong cash flow even in network upgrade cycles like 5G and combine that with Gogo's huge market opportunity, 30,000 out of the roughly 40,000 business aircraft around the globe today still have no connectivity, and we feel Gogo represents a very attractive investment opportunity. I'll focus my remarks today on 2 main buckets.

First, trends in the business aviation industry that drive demand for connectivity and drove Gogo's strong second quarter results; and second, our progress in 2 of Gogo's key strategic initiatives, the launch of our 5G network and the global broadband project. Barry will then walk through the details of our quarterly financial performance and update our 2022 and long-term outlook before we open the call up to your questions. So let's start with demand for connectivity in BA and Gogo's strong quarter. We delivered record revenue of nearly $98 million, up 19% year-over-year, fueled by strong service and equipment revenue.

Our results demonstrate the demand for BA travel and connectivity remains very strong. Gogo's backlog made up of dealer purchase orders and OEM commitments reached record levels in Q2 and now covers our full year 2022 revenue projections and stretches well into 2023. This is one quarter ahead of our usual pattern of next year orders starting to flow in Q3 and Q4. An early look at 2023, including new sales and upgrades from plastics to Advance suggest that we'll grow shipments by more than 15% over the $1,300 we've raised guidance to this year. As a result, we expect 2023 revenue growth to be above the 15% CAGR in our long-term model that we guided to earlier this year.

Also, importantly, these increased equipment shipments translate into recurring revenue, which sets us up well to accelerate free cash flow growth from 2023 and beyond. This long-term demand is driven by a number of factors. The younger profile of today's BA passenger has resulted in reliable and robust in-flight connectivity becoming table stakes. Passengers demand the ability to work, videoconference, e-mail and connect on social media in the sky, the same way they do in their home office.

That demand was once again reflected in our Q2 results as data usage by Gogo customers across our networks was up 33% over prior year and usage per flight hour, up 11%. We also saw about twice as many customers upgrading plans as downgrading plans, contributing to our ARPU growth. Additionally, BA flight counts the general bellwether for BA demand remain at all-time highs. Charter and fractional jet flight count soared during the pandemic. But in the last several months, we've finally seen corporate jets, which represent about 60% of Gogo's fleet come back to life. The flight counts up 27% for the quarter and data usage up a whopping 81% over prepandemic Q2 2019 levels.

To that point, the demand for travel is having ripple effects across the BA industry. Used aircraft for sale are at an almost all-time low at 2.6% of the U.S. fleet, and many operators are now buying Jets overseas to bolster supply, which is good for Gogo because they often require in-flight connectivity installation. And order books at the OEMs remain strong, four out of five publicly traded OEMs reported Q1 book-to-bill ratios of greater than 2x or better, meaning that for every jet they deliver, they had 2 on order. Since 2009, only one OEM had previously ever reported a book-to-bill ratio above 2%, and that was in 2021, which is already part of the recovery.

All of this activity is driving broader Gogo adoption. We shipped a record 310 units in Q2 and finished the quarter with 6,654 ATG units online, a 10% increase over Q2 2021. We've booked and secured supply to ship 1,300 units this year, roughly 45% more than last year, and we expect Advance to account for almost 50% of our installed base by year-end. The good news is that with our strong supply chain management, strong balance sheet and common componentry strategy, we secured the supply we need to deliver on our fiscal year 2022 expectations, and we're confident in our ability to secure supply to meet our 2023 projections. As a result of our continued progress and strong performance, we now expect to deliver full year 2022 revenue at the high end of the $390 million to $400 million guidance range that we raised last quarter.

As we look ahead, we believe we can continue to grow our top line for the following reasons. First, roughly 16,000 business aircraft in North America have no connectivity today and are addressable with our current ATG network and best-in-class Avance platform technology. And second, there are roughly 13,000 business aircraft outside the U.S. that don't even have access to connectivity today, and that will be addressable with our global broadband initiative.

On the earnings front, despite 2022 being an investment year, we continued to deliver growth, with Q2 adjusted EBITDA up 12% year-over-year to $41.2 million, and we expect to finish the year at the high end of our $150 million to $160 million guidance rates. As Barry will discuss, we're maintaining that expectation despite $9 million in fiscal year 2022 expenses that were not included in our original fiscal year '22 guidance. Namely our global broadband initiative, which was an overlay at that point in legal fees in connection with our SmartSky litigation and increased interest rates.

As we look forward to 2023, our business is firing in all cylinders, and we're excited about GBB and our strong order book. Now let me turn to our strategic initiatives. Gogo's strategy is focused on deepening our competitive moat and driving long-term shareholder value by creating easy upgrade path for our customers as technology, digital infrastructure and customer preferences evolve. That starts with enhancing our ATG network in the launch of Gogo 5G, which will improve average performance 5x to 10x over Gogo's current ATG networks with peaks of 3x those numbers.

On the commercial side, we're extremely encouraged by the response from our market. We're taking orders for 5G from end customers, making progress towards getting line set with major OEMs and pre-provisioning some aircraft now with our 5G antennas and harnesses so operators can install the 5G box quickly once the network is available. It's great to see this level of traction with a product that isn't even on the market yet and demonstrates how much BA market trust Gogo to deliver.

We've passed many significant milestones, including FAA certification of our 5G box, which combined with prior approvals for our Avantel 5 box and our multiband 5G antennas means we now have received all required approvals for our 5G airborne hardware. As of this morning, we've completed construction of 95 towers, nearly 2/3 of the 150 towers needed for us to offer complete nationwide coverage. And we have clear line of sight to the equipment and resources required to finish the remaining 55 sites. One recent unfortunate development. The manufacturer of our 5G chip has just notified us of a new issue in late-stage testing, which could delay ramping up to full production volume until mid-2023. This wrinkle has been factored into the 15% unit growth projection I shared a moment ago. We believe the impact of this delay will be muted because customers that want 5G can pre-provision and by our L5 and MD13 5G antennas today and operate on our 4G network while they wait for the 5G box next year. This shift will also delay some 5G expenses from 2022 to 2023, which Barry will cover in a moment.

Our second key strategic initiative is driving advanced penetration and leveraging the platform capabilities of Avance to strengthen our competitive position, provide an easy upgrade path for customers and allow us to serve new markets. 6 years ago, when we designed Advance, we designed it with multi-barrier capability, anticipating that evolving satellite technology would support Gogo's expansion to the rest of the world market over the long term. Our global broadband initiative is the realization of this long-anticipated next chapter for IFC and for Gogo. As we announced in May, we've partnered with Hughes Network Systems to develop a small electronically steered antenna ESA to access the OneWeb low Earth orbit LEO satellite constellation, and expect to deliver the first reliable LEO global broadband service to the global business aviation market.

Gogo's exclusive antenna assembly will be small enough to fit on virtually all sizes of business aircraft from super light jets and large turbo props to ultra long-range heavy jets. We're also very excited about partnering with OneWeb. They've launched 428 out of 648 satellites and are ahead of other LEO constellations in achieving global coverage, which we expect will enable us to be first to market with a reliable product. Their Gen1 network will deliver a significant boost in speed over our 5G product and is fully funded. And with their proposed merger with Utilsat, they should be in a good position to fund their Gen 2 network, which will deliver an even bigger boost in speed, thereby giving Gogo Avance customers a very easy path to an order of magnitude improvement over the speeds BA passengers experience today.

Once launched Gogo Global Broadband or GGB, as we call it, will allow us to first pursue the 14,000 business aircraft outside North America, a huge increase in our TAM. Second, pursue large North American jets that fly global missions that today use Gogo ATG in the U.S., but geo-satellite connectivity outside the U.S. And third, drive enhanced stickiness in our North American customer base by offering an easy upgrade to GBB and a unique dual ATG and LEO solution that combines the capacity of both networks. For customers that already have Avance, the upgrade to GBP will be simple. They'll just install an ESA antenna on top of the plane and run 2 cables inside, one for data and one for power. GBB is projected to significantly accelerate our revenue and free cash flow growth from its launch through the second half of the decade, and Barry will give more details on the financials and long-term targets in his remarks.

Finally, what's most exciting about GBB is the overwhelmingly positive responses received from customers, dealers and OEMs. It's really encouraging to see this level of interest and further proof that our strategy is working. To wrap up, I want to thank my Gogo teammates. We've completed an extraordinary turnaround in the last 2 years. We're working hard, we're innovating, we're beating expectations and delivering a major strategic projects to set Gogo up to exceed our customers' expectations and drive long-term value for shareholders. And with that, I'll turn it over to Barry.

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

Thanks, Oak, and good morning, everyone. In my remarks today, I'll start by walking through Gogo's second quarter financial performance. Then I'll provide an update on our capital allocation priorities. And finally, I'll finish up with some additional context around our updated 2022 financial guidance and long-term targets, which now reflect our expectations for our global broadband initiative. During the second quarter, we achieved several record highs, including total revenue, service revenue and advanced unit shipments. For the second quarter, our record total revenue of $97.8 million grew 19% year-over-year.

Our top line was driven by record service revenue of $73.1 million as ATG units online grew 10% year-over-year and 2% sequentially. Notably, we continue to expand our reach in the market with 63% of ATG activations in the quarter coming from new customers. As we discussed previously, just over 30% of North American business aircraft have in-flight connectivity, so there's plenty of open space in the market to support our future growth expectations. As Oak described, increasing penetration of events and leveraging its platform capabilities remains a centerpiece of our strategy, both in the North American market where we operate today and globally as we implement our GBV initiative in the future. In the second quarter, Avance units online grew 40% year-over-year to 2,893, an increase of 7% sequentially. We continue to expect Avance to reach approximately 50% of our total ATG units online by the end of 2022.

As we grew our ATG units online, our ATG ARPU grew 1% year-over-year to $3,328. As a reminder, ATG ARPU in the second quarter of 2021 benefited from the recognition of $1.8 million in deferred revenue related to a customer contract. Excluding the impact of this deferred revenue, our second quarter 2022 ARPU increased 4% year-over-year, demonstrating the increased utilization of our services by our customers. Continuing growth in demand for data by our customers is driving upgrades to Gogo's high-rate data plans, supporting our continued ARPU growth. It's also worth noting that this ARPU growth includes the impact of our rapidly growing L3 product line designed for smaller aircraft, which has lower ARPU, but still reflects our exceptionally attractive unit economics. The launch of Gogo 5G will further expand our ARPU growth opportunity over time.

Now turning to equipment revenue. Gogo delivered $24.8 million in equipment revenue in the second quarter, a 41% increase year-over-year as we shipped a record 310 Avance units. As we said previously, equipment shipments are typically back-end loaded during the year and tend to be strongest in the fourth quarter due to a combination of promotional activity and the seasonal dynamics of our customers. Thanks to outstanding work by our supply chain team, coupled with our ability to leverage our strong balance sheet to acquire inventory and capitalize on unprecedented demand for our products, we are expecting to ship approximately 1,300 total Avance units in 2022. This would be a 45% increase versus 2021. 556 of these units were shipped in the first half of the year with all the remaining 744 ship sets already secured and committed to customers. Our equipment shipment expectations for the year, combined with our exceptionally strong backlog and 18-year average equipment life materially derisked our long-term targets as more units installed drive growth of recurring high-margin service revenue, leading to stronger cash flow.

We delivered strong service margins of 78.4% in the second quarter, a 2 percentage point increase year-over-year, driven by our high-margin ATG service revenue and 1% decrease sequentially due to an expected increase in network costs. This service margin is within our target range of 75% to 80% for ATG for both 2022 and in the long term. Equipment margins were 31.9% in the second quarter, a 6 percentage point decrease year-over-year. As we have previously said, we expect equipment margins of approximately 30% for the remainder of 2022, consistent with our strategic objective of driving advanced penetration. Moving now to operating expenses. Second quarter combined engineering, design and development, sales and marketing and general and administrative expenses increased 27% year-over-year to $29.4 million. This was primarily driven by increases in stock-based compensation expense and our investment in 5G as well as development expenses for GBB.

As a reminder, the executive employment agreements we updated in March of 2022 as part of our comprehensive succession planning will continue to contribute to increased levels of noncash stock-based compensation expense in 2022 and 2023 as compared to 2021. As we've also stated previously, 2022 is an investment year, particularly as we ramp investments for Gogo 5G. While the investment levels have fluctuated and will continue to fluctuate quarter-to-quarter, spending for the strategically important project will drive increased operating expenses for the year. We also started to invest in development for our GBB initiative in this quarter, and this will continue through 2024. One of the hallmarks of Gogo's business model is our strong operating leverage, which undergirds our long-term target of adjusted EBITDA margin approaching 50% in 2026. Importantly, we are already seeing the impact of this operating leverage as in the second quarter, our cost of service was up just 4%, while service revenue grew 13% over the second quarter of 2021. Which translates into a 93% incremental service margin.

Now I will provide some additional detail on both our Gogo 5G and GBB initiatives and their respective spending profiles. Starting with our Gogo 5G program. Our $9.6 million of 5G spend in the second quarter was comprised of $1 million in OpEx and $8.6 million in CapEx. The CapEx came in lower than expected due to the timing of invoices and related cash outflows. We expect our 5G spend with a significant majority in CapEx to continue to ramp through the second half of 2022. We expect 5G CapEx to be approximately $50 million in 2022. However, some of the spend could push into 2023 due to the timing of invoices, which are hard to predict.

While it's too early to fully quantify the financial impact of the chip delay Oak described, we believe it would fall into 3 primary areas: first is a pushout of Gogo 5G milestone payments in 2022 to 2023, affecting both CapEx and OpEx. Secondly, our backhaul costs may be lower as we expect to delay the ramp in spending to support Gogo 5G. And thirdly, we could see some impact to 2023 revenue. Based on our assessment of the revenue impact from this chip delay, we still expect to achieve greater than 15% equipment unit growth in 2023 over the 1,300 units we are expecting to ship in 2022.

Now on to our GBB initiative. As Oak highlighted, Gogo has partnered with OneWeb and use to launch the first LEO-based global broadband service and business aviation. GBB represents a high priority use of our capital, and we believe this program is well positioned to deliver a healthy return on investment, including attractive service margins, underpinned by a pay-by-the-drink business model. In the second quarter, Gogo spent $1.2 million related to GBP.

And even with this additional spend, we continue to exceed our financial performance targets for the quarter. We expect external development costs for GBB to be less than $50 million over 3 years. As a frame of reference, this is approximately half of the investment that was required for Gogo 5G. We anticipate that approximately 85% of the total GBB external development costs will be OpEx, including approximately $3 million in 2022 and $10 million in 2023. I'll talk more about GBB and its impact on our revised cash flow guidance in a few moments.

Moving on to profitability. Gogo's adjusted EBITDA increased 12% year-over-year to $41.2 million, primarily driven by a 13% increase in service revenue. This is the second highest adjusted EBITDA performance in Gogo history, even though it includes the $1.2 million expense for GBB, higher 5G expenses and higher SG&A resulting from legal fees for the SmartSky litigation.

Adjusting EBITDA, excluding the GBB operating expense would have been approximately equal to the record we set in the first quarter of this year. Gogo delivered net income of $22 million in the second quarter, translating to $0.18 in basic earnings per share and $0.17 in diluted earnings per share. Net income in this quarter reflects on for the balance of 2022 and 2023 will continue to reflect the increased stock-based compensation expense due to the executive employment agreements I mentioned earlier as well as the annual equity grants to all employees.

You may recall that we first granted equity to all employees in 2021, and we continued that practice this year. Employee equity is a core piece of our retention strategy, and we believe that our broad-based grants are contributing meaningfully to Gogo's track record of low turnover in the constrained labor market. We expect to incur a noncash income tax expense in future quarters as we did this quarter as we continue to generate positive pretax income. We also expect to see within the next 12 to 18 months, additional reversals in portions of our remaining valuation allowance against deferred tax assets. As a reminder, based on our substantial NOL position, we do not expect to pay meaningful cash taxes for an extended period, but we may pay a modest amount by the end of our planning horizon.

Now turning to free cash flow. In the second quarter, we generated $15.5 million in free cash flow. Our second quarter free cash flow was higher than the prior year period due to a decrease and change in the timing of our interest payments following our refinancing last year. On a sequential basis, the $15.5 million in free cash flow was up from $8.8 million in the first quarter of 2022, primarily driven by the annual bonus paid in the first quarter. I'd like to highlight the beginning in the second quarter, we are updating our free cash flow definition to include payments and receipts related to interest rate caps executed as a part of our interest rate hedging strategy.

We believe this change will more accurately reflect the economics of our interest payments and their impact on cash. I will explain in more detail later the structure of these agreements and their impact on mitigating our exposure to increases in interest rates. From an accounting standpoint, the interest payments are considered operating cash flows, but the offsetting receipts from interest rate caps are classified as investing cash flows and were not included in our previous free cash flow definition. We've updated our free cash flow definition to include the cash flows associated with interest rate caps to reflect the net cash interest paid, including the impact of our hedging agreements.

Now I'll turn to a brief discussion of Gogo's balance sheet. Gogo maintained its strong liquidity position as we ended the quarter with $164 million of cash on hand, and our $100 million revolver remains undrawn. As expected, all $103 million in outstanding convertible notes were converted to common stock in mid-May, simplifying Gogo's capital structure and reducing our net leverage ratio to below 4x. As of the end of the second quarter, we had approximately $717.8 million in outstanding debt on our term loan B. Our strong balance sheet affords Gogo's significant strategic flexibility, particularly in today's volatile macroeconomic and geopolitical environment. We anticipated rising inflation and have built it into our forecast. We do not believe that inflation has had a material effect on our financial results.

At a high level, we think about inflation in 3 parts: wage cost increases, component cost increases and cost of service decreases. Starting with wage cost increases in recognition of these economic trends, Gogo factored larger wage cost increases into our 2022 budget than in the past. We manage our supply chain risk by using our balance sheet to purchase inventory up to 2 years in advance through highly active supply chain management and through our strategy of employing common componentry across our product form factors, which allows us to obtain better pricing by driving higher volumes with our suppliers. As a result, we are seeing component costs in aggregate rise gradually over time, not sharply, as inventories used and follow-on orders are placed. To provide additional context, cost of equipment represents just 20% of our total OpEx spending.

Finally, regarding cost of service, a meaningful portion of our cost structure, like backhaul is not subject to inflation. And in fact, our overall ATG megabyte unit costs are expected to stay flat or decline over the 5-year planning horizon. As a result, the impact of inflation on our business while present, is relatively muted. The rising interest rate environment also impacts Gogo. As a reminder, our $725 million Term Loan B we put in place in April of 2021, which, by the way, has proven to be a very opportunistic time to have done this comprehensive refinancing, carries an interest rate of LIBOR plus 3.75%. In May of 2021, we executed a hedging agreement with interest rate caps to offset a large portion of our exposure to interest rate changes.

As disclosed in our 10-Q, the initial aggregate notional amount of the interest rate caps was $650 million, and this amount decreases over the life of the caps. The first step down to $525 million will occur in July of 2023 and will be followed by other step-downs before the cap terminates in July of 2027. The strike rate increases over the life of the caps from 0.75% initially to 2.75% beginning in July of 2026. To help quantify our interest rate exposure, based on the July forward LIBOR curve, our annual cash interest expense would increase by approximately $12 million from $34 million in 2022 to $46 million in 2026. This level of interest rate exposure is very manageable in our view.

Now I'd like to focus briefly on the topic of capital allocation. The thinking behind our capital allocation priorities remains unchanged. Our capital allocation priorities are aligned with our strategic priorities, which include launching Gogo 5G, maintaining a target leverage ratio of less than 4x, investing in strategic initiatives, which now include GBB and returning capital to shareholders. Given the current volatility of the financial markets and the rising interest rate environment we find ourselves in, we, along with our board, believe it is prudent to be a bit more conservative during these uncertain times.

Therefore, for the time being, we're choosing to maintain higher levels of cash on hand than we otherwise would. This dry powder also provides us with the flexibility to evaluate potential new strategic investments and to maintain our strategic optionality. We will visit returning capital to shareholders more explicitly after the macro environment stabilizes and in conjunction with our ongoing assessment of financially attractive strategic investment opportunities.

Now let's turn to our financial outlook. Our previous 2022 guidance and long-term targets were derived from the company's baseline forecast and long-term plan and did not include potential strategic initiatives such as GBB. Now that our GBB plan has been announced, our guidance incorporates the expected level of investment associated with this program. Our guidance does not reflect the impact of other potential strategic investments or the Federal Communication Commission's secure and trusted communications networks reimbursement program as we await further information regarding whether Congress will appropriate (inaudible) commissions, secure and trusted communications networks reimbursement program as we await further information regarding whether Congress will appropriate additional funds for eligible expenditures under the program.

I'll now offer a few comments on our continued strong performance and the demand environment Oak described. Gogo now expects to deliver full year 2022 revenue at the high end of the previously guided range of $390 million to $400 million. We continue to expect to be at the high end of our previously guided adjusted EBITDA range of $150 million to $160 million for the year. This includes a combined $9 million of expenses related to GBB and estimated legal fees in connection with the SmartSky litigation, which were not reflected in the initial 2022 guidance. We continue to expect to deliver full year 2022 free cash flow in the $35 million to $45 million range, which includes capital expenditures of approximately $65 million, of which approximately $50 million is tied to Gogo 5G.

Turning to our long-term targets. We now expect revenue to grow at a compound annual growth rate of approximately 17% from 2021 through 2026 with GBB expected to contribute to revenue beginning in 2025. This growth rate is up from the 15% we targeted at the end of Q1, which did not include GBB. We continue to expect annual adjusted EBITDA margin to approach 50% in 2026, up from the low 40s in 2022 and 2023. While our free cash flow target for 2023 has shifted modestly due to the investment in GBB and other expenses, our 2025 target remains the same. We now expect free cash flow of approximately $110 million in 2023.

This reflects additional 2023 expenses of $10 million of operating expenses tied to GBB and an aggregate of $5 million of additional interest expense and estimated ongoing legal expenses tied to the SmartSky litigation. Note that this additional $15 million of expenses was not reflected in the prior 2023 free cash flow target of $125 million. Free cash flow and adjusted EBITDA in 2022 and 2023 could be impacted by Gogo 5G, as I outlined. 2023 free cash flow could also be affected by other factors such as additional inventory purchases in response to higher demand. And as we discussed, it does not include any potential impact from the FCC's secure and trusted communications networks reimbursement program. We continue to expect to deliver free cash flow of over $200 million beginning in 2025.

In conclusion, Gogo's business continues to perform extremely well. Our outlook reflects our strong momentum as we continue to capitalize on BA demand, prepare to launch Gogo 5G into the market and pursue the development of our global broadband product. Before we open up the call to your questions, I would like to extend our heartfelt thanks to the entire Gogo team as Oak did as well. Your commitment, your creativity and can-do attitude inspire us as your leaders, delight our customers and create significant value for our shareholders. So thank you. Operator, this concludes our prepared remarks, and we're now ready for our first question.

QUESTIONS AND ANSWERS

Operator

And we'll take our first question from Scott Searle from ROTH Capital Partners.

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

Nice job on the quarter and nice to see all the details on the growth as we go into 2023, even with a little bit of a wrinkle on the 5G front. Maybe to dive in on the 5G issue, Oak, if I could. Is the timing delay -- is there a new spend that's required on the chipset? Is there somewhat technology issue? Or is this really related to capacity and availability at certain process geometries for the chipset supplier? And I'm wondering also as well, if you could couple into that discussion. It sounds like you're seeing some 5G attach rates in terms of current installations being made to support 5G when it becomes available. I wonder if you could talk about how that is as a percentage of the new units that are going out? And maybe also just to position that to the competitive landscape in terms of what you're seeing from SmartSky and Star Lake.

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

All right. Scott, that's a lot of questions, but I'm going to start with 5G. So we got here on Monday ready to declare victory on this project and that we were going to launch in Q4. So this is very late-breaking news that we got on Tuesday. And ironically, the chip is stuck in test mode and can't be moved to operational mode. So in testing, it got stuck in test. And the issue there is that the way these chips are built and the multiple layers, test mode touches almost every layer. And so they have not been able to identify the exact source of the problem with the test mode. The sort of worst case, Scott, would be a respin, and that's why we've kind of talked about midyear, that would be if there was a respin.

It may be that won't have to be a respin, we'll know that in the next couple of weeks. We are working with the subcontractor to Airspan, who's producing this chip hard right now on ways to get the chip done sooner than midyear. Looking at some pretty, frankly, innovative ways of actually starting our ability to test on that chip before they would do a spin even. And so giving us the ability to kind of replicate the chip in our system and continue with our end-to-end testing. So we're working on all that. We're trying to derisk it. We did reflect a change in projected sales next year when I talked about the 15%, we've been higher than that before this news. So more to come on that, Scott. We're still somewhat in discovery mode, and as I said, it's very recent news.

Second part of your question, was that the SmartSky Provision? Yes, we just started this. We had a pretty positive response because what customers can do is the L5 box is actually part of the 5G product, right? So they can take L5, they can take the NB13 antennas, which are the new antennas for the 5G product and install that on the aircraft. Those antennas, obviously work with both 4G and 5G so they'll just be flying on the 4G network for some period of time. And we're selling them the harnesses and everything else that goes in place to handle the X3 box that sits next to the L5 and gives you the 5G capability.

So what happened is that they can fly, they will have an L5 experience. until we can ship them the X3 and then they just swap it in place and everything is already there, very easy to put in. So that's what we're doing, and we've had has a pretty positive response. I mean I think the only limit right now is we're just ramping up production of the NB13. So we're a little bit -- we're sort of supply constrained there. We weren't planning on being launched quite this soon. But that production is ramping up. And I think we've got something like 15 that are going to be shipped this year. And I think we're looking at orders already for next year of 30 of those, and we've only been taking them for couple a couple of weeks. So that's that.

Then I think the last piece of your question was around SmartSky and competition. They put a press release out last week that they are "live nationwide". I mean we would agree with that. They're live in parts of the nation across the nation. They're live in the Southeast. It goes up a bit to Chicago. They've got some towers around Wichita. We're obviously flying for a lot of the OEMs and big dealers up there. They're live in Las Vegas where they've tested and demonstrated several times, and they're certainly live out California where they were getting ready for the GSX launch that they lost. But we don't think they have nice abide coverage. And so that's still to come. And so there, the dealers aren't taking them seriously right now. We don't see any traction. They've made some announcements with a couple of dealers, but even those dealers haven't sold anything. We've heard of one or two planes that might be getting installed, mostly to be used as test aircraft to see if the system works. So that's, I think, where that stands.

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

Great. And if I could, just a quick financial follow-up for Barry then. Given the timing of the 5G network turning on, I would imagine gross margins on the services side stay a little bit higher in the second half of this year until you start depreciating the network and maybe some of the 5G OpEx kind of slips into 2023. Is that correct?

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

Yes. Regarding the turn on, that's correct, Scott. So I appreciate it won't start until it gets fully deployed and turned on. And we do expect some of those expenses to slip, as I mentioned, the backhaul expenses, we would not have to start quite as soon. So we'd see some benefit from that relative to what our previous expectations were. And then there could be some timing in slippage from the expenses on both the OpEx and CapEx side because they're tied to milestones. So if and as those milestones slipped, the time the expenses would slip also, and that could go from 2022 to 2023.

Operator

And our next question comes from Rick Prentiss from Raymond James.

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

Busy earnings day so I'm going to take you right to the updated long-term guidance, if I could. The change from 15% revenue CAGR to 17% revenue CAGR. Help us unpack that about how much of that is coming from product versus services? And within Services, it sounds like there you're still thinking probably the bulk of service revenue comes from units with some benefit from ARPA, but help us understand the change from the 15% to 17% kind of the components.

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

Sure. Really, the primary driver going from 15% to 17% is the addition of GBB. That was not included in the previous projection. It was, as we described, an overlay. So while it's early days, we do expect that to begin to contribute to revenue in 2025, and so for that planning period, we do see that having a 2% lift in the CAGR. And we see that continuing to really drive revenue growth for the balance of the decade.

So that's really the hope for that project. It's an attractive return on investment and importantly, by sustaining growth in the revenue growth. In terms of the drivers of the growth, that has not shifted meaningfully between aircraft online and ARPU. So the lion's share of that on the order of 3/4 of that 15% previous CAGR was from increased some of aircraft online with the balance coming from increased ARPU.

And the drivers of the ARPU are as people upgrade their plans and use more data, as Oak described, we're seeing a lot more upgrades to plans and downgrades. And then as you see the benefit of the 5G product coming online, that also has -- the offset to that is as we get into the more L5s and come into the smaller aircraft, they have lower ARPU, but importantly, the unit economics, like on a revenue per megabyte basis are still very attractive to those customers.

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

And the change from 15% to 17% with GBB. Is GVB kind of the same 75% units or? Kind of help us understand the split, what does GBB look like as well as that incremental? Is it units? Is it ARPA? Is it equipment?

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

Well, in the earliest days, we'll get the benefit of equipment that very similarly, it will translate into service revenue. So it's a very comparable service model where we would sell the equipment. We lead margin and then that drives into the high-margin service revenue.

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

Right, as far as sales, because I think EchoStar mentioned yesterday, we expect to start selling you the ESAs earlier, probably some supplemental type certification has to happen. But as far as GBB revenues are thinking more of a 25 thing?

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

Yes, that's our expectation.

Operator

And we'll take our next question from Lance Vitanza from Cowen.

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

Congrats on the quarter. I want to start with the strong shipment outlook. What does greater than 15% shipment growth translate to in terms of aircraft online? Which is how I drive my model at least. Will aircraft online be up 15% in '23 versus '22 or is there sort of a walk down to something lower than that?

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

Yes. I think what we'd expect, Lance, is for us to see that proportionately carry forward as it does for our ongoing business. And as you know, a meaningful portion of the unit shipments are for upgrades and so that modestly helps the ARPU. But very importantly, that is very much in line with our strategy of driving advanced penetration. So that's really what we're trying to do. And so that will supplement that objective as well.

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

Yes. I'd say right now, about 1/3 of units are upgrades as we go forward, we're projecting that to pick up somewhat and 2/3 are new. Remember, Lance, we'll be getting more planes -- a lot of what we ship this year will lag -- won't get installed until next year. OEM orders, in particular, usually bulk orders. And so they can sit on the shelf for a while. We have seen a lengthening in the time between shipment and install and the dealers just because in the supply-constrained world, dealers are ordering sooner than they did in the past. And I think that's gone from, what, Jessi, four months to five months, something like that in terms of right-time so we've seen a little extension there. So in terms of the unit ship, we're going to do about 1,300 this year, as we said, and you can just flat that 15% on top of that in terms of the number of units that will be going out.

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

And just to maybe add one other piece quantification, Lance, is that the units online really represented about 12% of that 15% CAGR that we had before. So that's the primary driver still of the overall revenue growth.

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

Just back on the supply piece that you mentioned, I mean, so for me, I've never been worried about the demand. It seems like the question has always been, can you get the parts and the labor and so forth to be sure that you can fulfill the demand to get to this 15% plus shipment guide. And how are you feeling about that from where you sit to next?

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

Actually, we're feeling much better. We as I said in my comments, we have secured the supply for the 1,300. We're feeling confident about that. The issue for us right now, frankly, is we're getting a bit late in the year for people to order more. But we are seeing some loosening in supply and think that we could actually perhaps ship some more units or very close to having everything we need to build more units. But I think given the lateness of the year that, that will actually just help supply for next year. And our supply chain guys who we sat down with day before yesterday, are quite confident about the guidance I just gave you on the 15% above the 1300.

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

And then just lastly for me. The decision to carry more cash certainly seems prudent given the macro headwinds, but you also mentioned some potential strategic items. And I'm just wondering, are you referring to bolt-on M&A or big new investment projects or both or something different?

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

No. We've always said, Lance, that we had a number of strategic initiatives we were thinking about. A lot of them focused on leveraging advance or strengthening our ATG network. And we still have some of those in the hopper in terms of analysis and figuring out the business model or whatever partnerships might have to happen to make them work. And so there's nothing really new there. We said in the past, we have we're really not looking at M&A, I think that's still true today. Not saying that sometime down the line, that wouldn't change, but today, we're not looking at M&A. So it's the same consideration set, frankly, that we've had for a while.

Operator

And our next question comes from Louie DiPalma from William Blair.

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

Barry, what did you say will be your net cash interest expense for 2023 and at the end of the time horizon in 2025?

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

Yes. What we said, Louis, to provide some quantification of the impact of the interest rates is that we'd expect that to go up about $12 million on an annual basis. So that goes from $34 million to $46 million in 2026. Based on the LIBOR forward curve so certainly, that could change. But just going off the July forward curve, those are the numbers.

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

And for that $34 million, is that the net cash interest expense that we should expect for 2023 that's in the $110 million free cash flow guidance?

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

It's $34 million in '22, and then we expect that to tick up $1 million or $2 in 2023 because it's largely hedged based on the comps, but that again would...

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

Yes. And it is reflected in that guidance?

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

Right. So the $5 million just to do the quick walk forward the change from the $125 million in previous free cash flow expectation for 2023. That's reduced by $10 million for GBB and then by additional $5 million for the interest expense, and we have set aside some additional expense for our ongoing litigation with SmartSky carrying into 2023.

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

And for the longer-term 2025 free cash flow guidance, would you say, in theory, you raised like the core free cash flow since you reiterated the guidance, and now you have -- I think you just said a $13 million increase in cash interest expense from the floating rate debt?

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

Well, we're still maintaining the view that we'll be over $200 million in 2025. So that does accommodate some additional increased expense and interest. We will begin to see the impact of global broadband in 2025. I'd point out that the expenses carry through '24. And that, as you can see, they ramp pretty meaningfully from '23 and '24. So we would expect to see kind of an inflection point increase in free cash flow as we get on the other side of the GBB investment. So that inflection would begin in 2025. And it's the continuing strength of the core business as the strong unit shipments translate into service revenue, and that's a big part of what's driving it.

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

And one question for Oak, if I may. What visibility do you have on the approximate 1,500 in ATG shipments that you are expecting for 2023? Do you need to win more orders or are most of those in the backlog?

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

Well, not most of them are in the backlog, but we have a lot in backlog. And frankly, we've got more in backlog than we've ever had before this time of year so we feel very good about it. This is based on our conversations now that are going on with dealers in terms of what they're going to order. They haven't put POs in, but we've got a lot of indications in terms of what they're going to want, especially the big dealers. We're in conversations with them now and the OEM so it's based on that. We don't have firm orders for all 1,500 we would (inaudible) sold out. And in fact, in terms of just to give you a frame of reference, with the 1,300 units, I think we sold out finally a couple of weeks ago, we're now kind of sold out for the year, but -- and we're taking orders for January of next year. But that's in a very strong year. That's when we sort of closed the book on the year, if you will.

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

Oak, did you imply in one of your earlier comments that the 1,500 ATG shipments guidance would have been higher if you didn't receive that call on Monday or Tuesday from Airspan about the 5G chip delay?

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

Yes. We think we can mitigate some of that delay because you have to get an L5 anyway to install 5G. So the people that we're going to be selling L5 boxes and MV13s with the harness kits for the X3 box for 5G add-on, but we still just being prudent right now. We haven't worked this through or anything else so we thought we ought to take the number down.

Operator

And our next question will come from Landon Park from Morgan Stanley.

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

Just on the global broadband, the 17% revenue, can you just share what specific unit sale expectations you have for 25 and 20 spirits that are driving the 17%? And Hughes yesterday, I think, indicated the $170 million revenue or payments that you've agreed to with them covered about 2,000 of the antenna units. Is that correct in terms of what we should be thinking about in terms of the cost of those units to you? And then just one last one on Global Broadband. How should we think about your positioning against SATCOM Direct and their partnership with OneWeb and their own antenna supplier?

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

Yes, Lan, let me take the first 2, and I'll let Oak answer the third one. So regarding the units, we're not going to get into the unit projections. But what I would say is that the market share projections that we have underlying the revenue, we believe, are very conservative when we look at the overall size of the market and our ability to penetrate that. We have disclosed the $170 million in commitments that we've made to Hughes. We have not disclosed the units associated with that. But again, we're comfortable with that level of commitment. It's over a long period of time, and we think relative to what we believe are very conservative market penetration assumptions, that's why we got comfortable making that kind of a commitment.

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

Yes, in terms of competition with SATCOM Direct, we compete quite effectively with them today. There are a niche provider at the high end of the market and a reseller of other people's satellite networks, a very successful company. We a lot of respect for them. Their antenna technology is different than ours. It has remarkably similar initials, but they don't stand for the same thing. And it's a very different approach. We think our antenna will fit better and be a better option, especially for the medium-size jets on down than theirs. And they're obviously -- they're another OneWeb partner. So I think they will have success. I think we'll have success. There's 30,000 jets in the business -- and turboprops to split between the 2 of us. plenty of growth for everybody.

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

Okay. Can you maybe just elaborate in terms of what you're -- beyond the Avance platform, obviously, just what are some of those key differentiating factors on the antenna side?

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

Well, there is made by CASK. It's essentially, the approach is very different. Ours is a silicon board essentially that forms electronic beams across some micro elements, if you will, that are embedded in that board, and it's flat. Theirs uses these little ones, and it's essentially a -- I think of it as a as a typical array antenna that sort of just chopped up and lots of little pieces and flattened out, it's made of metal. It's going to be heavier than ours and I think it's a little uncertain on the size yet. I've seen different data on that, but the data we know about from test on this is that it's quite a bit larger than our antennas. It's not going to fit on medium-size jets on down. I'm going to say, which is where the bulk of the numbers are in the market, right?

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

Well, they have said that they will be able to fit on medium and small jets right there.

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

Yes. They said that in a press release that was kind of rushed out at the EBACE convention in Geneva when they saw that we were announcing. So I would challenge them on that assertion.

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

I guess, on the '23 free cash flow, you issued that last year, you've had some operational outperformance since then. What should we think about in terms of the limiting factor that didn't allow you to absorb some of that $15 million in additional expense, at least partially.

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

Well, we're basically -- I think being pretty clear about what's in that. So we knew that the global broadband initiative expenses were not going to be reflected in that. So we tried to condition the street to understand that, that was coming. And so that is very much in line with what we expected.

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

So you might remember, Lan, that $125 million was an upgrade from 100. We've been saying we were going to exceed $10 million and $125 million reflected the improved performance that we have.

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

But you have had operational outperformance since even the 125 was issued, right? So I'm just wondering, should we just view that as conservative? Or are there any other factors that we should be thinking about.

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

Well, it's also -- I would just point out, we haven't been through the full-blown budget for next year. So the way our planning process works is we do a forecast update every month and then midyear, we do an early look at the following year. So this is our first early look so we just want to make sure, as always, what we say we're going to do, we are able to do. So I think that's what we're going.

Operator

And I am showing no further questions at this time. I'd now like to turn the conference back over to Will Davis for any closing remarks.

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

Thank you, everyone, for joining our call this morning. Have a great day. This concludes our call. This concludes our call.

Operator

Thank you for your participation, and you may now disconnect. Everyone, have a wonderful day.