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PRESENTATION

Operator

Good day, and thank you for standing by. Welcome to the Gogo Third Quarter 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, Vice President of Investor Relations. Please go ahead.

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

Thank you, Liz, and good morning, everyone. Welcome to Gogo's Third 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. Jesse 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 filed with the SEC.

In addition, please note that the date of this conference call is November 3, 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 third 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. Good morning, everyone, and thanks for joining us today. In the third quarter, Gogo continued to demonstrate its ability to deliver record performance in a highly dynamic macroeconomic and supply chain constrained environment. Strong demand for inflight connectivity, combined with Gogo's innovative advanced platform and strong operational execution enabled us to deliver a very strong quarter. We believe all those factors will remain intact for the foreseeable future and position us to generate growing recurring revenues and robust cash flow for the next several years.

A key to our success is our advanced platform, which allows us to deliver equipment form factors designed to serve every sized business aircraft, all running in the same software and all capable of being easily upgraded to our future 5G and global broadband products. As a result, we're bullish on our ability to retain our current customers and to capture a large portion of the roughly 30,000 business aircraft around the world that today fly without broadband connectivity.

Today, I'll focus my remarks on first, our strong third quarter results and updated guidance. Second, the VA connectivity tailwinds helping to drive our growth; and third, our progress on Gogo's key strategic initiatives, our 5G ATG network and our global broadband or GBB project.

So let's start with our Q3 performance. We delivered record third quarter revenue of over $105 million, up nearly 21% over prior year, fueled by outstanding service and equipment revenue growth. We're very proud of our production operations and supply chain teams for meeting the surge in demand we've seen this year. We shipped a record 388 advanced units in Q3 and now expect to ship more than 1,300 total advanced units this year, well ahead of our initial guidance of $1,100 and up more than 47% from the 887 we shipped in 2021. And we see this strong demand continuing. Our backlog is very close to an all-time high, and we've already received orders for almost 40% of our projected units for next year.

The boost in 2022 shipments is allowing us to raise our full year 2022 revenue guidance range from $390 million to $400 million, up to $395 million to $405 million. On the bottom line, Gogo delivered record third quarter adjusted EBITDA of $43.7 million, up 7% year-over-year, driven predominantly by growth in service and equipment revenue. Given the strong performance of our business, we're raising our 2022 adjusted EBITDA guidance from the high end of $150 million to $160 million range to a range of $165 million to $170 million. This new 2022 guidance does reflect some puts and takes, including a $5 million reduction in 5G OpEx as a result of the delay in our 5G chipset, the majority of which will shift to 2023, offset for the full year by $6 million in a combination of legal fees related to the SmartSky litigation and GBB spending that were not in our original 2022 guidance.

Now let me turn to some of the business aviation tailwinds driving our growth. Demand for BA connectivity remains very strong. Long term that demand is driven by a number of factors that are secular and sustained. First, the digital transformation of how we all lead our social lives and new business and the younger profile of today's BA passenger make connectivity table stakes for business aviation passengers. Today's passenger expects an in-flight connectivity experience that is equivalent to their home office or living room, and that is translating to higher data usage for Gogo.

Data consumption per hour by Gogo customers continues to grow significantly. It was up 14% over the prior year in Q3, which is consistent with the growth that we've seen for the past 6 quarters. Consistent usage increases are driving customers to upgrade to Gogo's higher rate plans at a ratio of about 2 upgrades for every downgrade, which drove ARPU to $3,376 per month, up $112 or 3.4% from prior year.

We also grew Aircraft Online or AOL, significantly over prior year, up 10% to 6,777 aircraft, of which 3,079 or 45% were on the AVANCE platform, up 36% from prior year. We're pleased with the growth of our AVANCE installed base because AVANCE allows customers to easily upgrade to new bearers like our Gogo 5G and OneWebs LEO networks at much lower cost than ripping out our equipment and replacing it with competitive equipment.

Increased travel demand is another factor that continues to boost activity across the BA industry. Even in the face of macroeconomic pressure, Gogo flights were up 5% over prior year in Q3 and 30% over Q3 2019, with corporate flight departments showing the greatest growth. Across our distribution channels, we continue to see strong demand. We were at the NBAA convention 2 weeks ago, where I talked with a number of our dealers, all of whom said they were as busy as they've ever been. Increased flight hours have driven a faster pace of maintenance events, which in turn gives them more opportunities to install more Gogo systems on more aircraft. This has translated into a bump in 2023 orders versus where we were on 2022 orders at this point last year.

However, a bigger change from last year is our confidence in our ability to meet them. From a supply chain perspective, we're in great shape. We brought lead times down to 3 months. We've built a sizable buffer stock pool for drop-in orders. We've got a clear line of sight to meet almost all component demand for 2023. And in the very few cases where we see potential constraints, those constraints don't appear until late in the year, giving us plenty of time to remediate.

On the OEM side, demand also remained strong. Last week, both Textron and Gulfstream reported solid third quarter results, strong order books, backlog and book-to-bill ratios. Further, at the NBAA show last month, Honeywell increased its annual 10-year business jet forecast to 8,500 new jet deliveries, up 15% from the 2021 forecast for 7,400 deliveries. And finally, the expanded cohort of BA passengers catalyzed by the pandemic appears to be sticky. New research this month shows that 94% of all flyers who started using private aviation since the pandemic plan to continue flying private aviation post-pandemic.

So now let me turn to our strategic initiatives, which are focused on continuously improving our products and services, creating easy upgrade paths for our customers, and expanding our addressable market. Before getting into the initiatives, I think it's worth pausing for a moment to reflect on how far we've come and how far we'll go over the next few years in improving connectivity to aircraft. Not long ago, we were delivering kilobytes per second over our legacy ATG network in narrow-band satellite products. That's gone to multiple megabytes per second today with AVANCE L5. That will grow to dozens of megabytes per second with Gogo 5G by the end of next year and will grow to hundreds of megabits per second over the next couple of years as we deliver and evolve Gogo global broadband standalone and in combination with ATG.

So let me start with 5G. As I'm sure you're all aware, we received some disappointing news immediately before our Q2 earnings call. Our 5G supplier Airspan, informed us that there was a flaw in Samsung's fabrication of our 5G chip that locked the chip in test mode. We have just received final commitments from Airspan and their chip supplier that Samsung will need to respin the entire chip. Airspan will now receive the chip in Q2 next year. We will test fly in Q3, and that should put us solidly on track for commercial launch in Q4. That said, our 5G team has done a tremendous job delivering all non-5G chip-related milestones on time and on budget, including installation of 900 antennas on 150 towers across the country and completing all manufacturing capability and certification of the equipment that goes on the aircraft. All we're waiting for is a small 5G chip, which will be a minor amendment to our existing certifications and then we'll be off and running.

In fact, we've already started selling, shipping and installing that equipment, which includes the 5G antennas and the harnesses to install our 5G box. This equipment can be installed with our AVANCE Firefox today and run in our 4G network and then easily accommodate the box with the 5G chip in the preprovisioned and installed harness at a later date.

Our dealers are on board with this approach. So far, we've delivered 8 chipsets to customers and have more than 60 in backlog. The market remains very excited about our 5G product as it will deliver roughly speeds roughly 5 to 10x faster than Gogo's current ATG network with peak speeds up to 30x faster, enabling multiple streaming sessions and video conferencing applications to be opened at the same time on the same aircraft and all at a lower cost than competing LEO or GEO satellite solutions.

On the commercial side, we were continuing to hear tremendous excitement about our 5G product from jet and fleet owners of all sizes. The energy around this launch at NBAA was palpable, and we believe the preprovisioning momentum we've seen so far is indicative of that. Gogo is working closely with each of the BA OEMs on line fit and with several authorized Gogo dealers to complete STCs that will cover most major makes and models of BA aircraft.

Now let me turn to GBB, the latest extension of our growth pipeline. We're making great progress on delivering the first global broadband product to serve all the business aviation market. That includes all sizes of aircraft in all corners of the globe. We're partnered with OneWeb to utilize their global LEO network, which is already more than 2/3 launched. We'll be deploying an electronically steerable antenna or ESA, in conjunction with our partners, Hughes, it is small enough for installation on the fuselage of the full range of business aircraft, and super light jets, large turboprops all the way up to large ultra-range aircraft.

Gogo Global Broadband will allow us to first pursue the 14,000 business aircraft outside North America, a huge increase to our total addressable market; second, pursue large North American jets that fly global missions and today often use Gogo in the U.S. and GEO satellite solutions outside the U.S.; and third, drive enhanced stickiness in our core North American medium-sized and smaller aircraft segments by offering an easy upgrade path to a LEO product when they want the additional capacity that LEO can provide.

A critical point is that our advanced multi-bearer capability will allow us to serve North American aircraft with LEO and ATG at the same time, significantly enhancing capacity and providing redundancy for those owners who want it. Critical to the success of GBB is the ease of our upgrade and installation. For customers that already have AVANCE, the upgrade to AV LEO will be simple. They will install an ESA antenna on top of the plane and run 2 wires inside, one for data and one for power, and they'll then have LEO connectivity with all the added functionality of AVANCE.

For customers new to Gogo, they can choose from an array of AVANCE form factors, including the economical SES box and then pair that device with the ESA antenna for a relatively low-cost solution. GBB will enable streaming directly from your favorite services, multiple simultaneous video conferencing sessions, VPN access and all the other connectivity enabled solutions you use today at the same service levels you expect in your office or living room today. We're excited about the opportunity this initiative will create for Gogo and our customers, both in the near and long term. Our investment in GBB today is setting us up for success in the next era of LEO satellite technology and expanding our reach while capitalizing on our expertise and tailored solutions that exceed the expectations of customers across all segments of the BA market.

To wrap up our key strategic initiatives, driving AVANCE penetration, launching Gogo 5G and developing global broadband are in service of our long-term strategy, deepening and expanding Gogo's hard-earned competitive advantages to support our long-term growth. I'm very proud of our nimble, creative and energetic Gogo team for their accomplishments in the third quarter. We're innovating and delivering on major strategic projects to set Gogo up to exceed our customers' expectations and drive long-term value for shareholders. Thank you, team.

With that, I'll turn the call 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 record third quarter financial performance, then I'll touch on Gogo's capital allocation priorities. And finally, I'll finish up with some additional context around our guidance. For the third quarter, our record total revenue of $105.3 million grew 20.8% year-over-year. Our top line was driven by record service revenue of $75.3 million as ATG units online grew 10% year-over-year and 2% sequentially. As Oak mentioned, increasing penetration of AVANCE 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 launch our GBB product in the future.

The third quarter AVANCE units online grew by 186 units, up 38% year-over-year and 6% sequentially. As we grew our ATG units online, ATG ARPU grew 3.4% year-over-year to 3,376 as our customers continue to upgrade their plans, including to our high data rate plans, which have been very well received since their introduction in early 2021.

The launch of Gogo 5G, followed by our GBB product will further expand our ARPU growth opportunity over time.

Now turning to equipment revenue. Gogo delivered a record $30.1 million in equipment revenue in the third quarter, a 43% increase year-over-year as we shipped a record 388 AVANCE units. This is an increase of 47% year-over-year and 25% compared to the previous quarterly record we just achieved in the second quarter of this year. Our excellent supply chain team and ability to leverage our strong balance sheet to acquire inventory is allowing Gogo to capitalize on unprecedented demand for our products. We now expect to ship more than 1,300 total AVANCE units in 2022, representing at least a 47% increase compared to 2021. Our equipment shipment expectations for the year, combined with our exceptionally strong backlog and 18-year average equipment life materially derisk our longer-term targets.

The impact of our higher 2022 equipment shipments has allowed us to once again raise our 2022 revenue guidance, which I'll touch on later in my remarks. Total delivered service margins of 77% in the third quarter, a 3% decrease year-over-year primarily due to the $2 million catch-up credit for federal universal service fund regulatory surcharges reported in Q3 2021. Service margins decreased sequentially due to an expected increase in network costs associated with the deployment of the Gogo 5G network. The service margin is within our target range of 75% to 80% for ATG for both 2022 and in the long term.

Equipment margins were 35.9% are. This represents a 5% decrease year-over-year, which was planned as a part of our strategic initiative to drive AVANCE penetration. However, equipment margins actually increased 4% sequentially due to higher revenue and lower production costs as a percentage of revenue. This improvement was also driven by a higher mix of AVANCE sales, which carry higher margins than our legacy satellite products. The percentage of AVANCE sales increased from 83% to 87% sequentially with our legacy satellite products declining by a corresponding amount.

Moving now to operating expenses. Third quarter combined engineering, design and development, sales and marketing and G&A expenses increased 11% year-over-year to $29.7 million. This increase reflects legal expenses related to the SmartSky patent litigation and development expenses for GBB, partially offset by a decrease in stock-based compensation expense.

Noncash stock-based compensation expense in the third quarter decreased year-over-year due to the catch-up expense incurred last year relating to vesting for employee retirements, which primarily impacted G&A. As a reminder, the executive employment agreements put in place as part of our succession planning will continue to contribute to increased levels of stock-based compensation expense in 2022 and 2023 as compared to 2021.

We also began granting equity to all employees beginning in 2021. This has contributed meaningfully to our employee retention and also results in higher stock-based compensation expense. We've always viewed 2022 as an investment year due to the planned ramp in spending for Gogo 5G. Operating expenses were actually slightly lower this quarter than initially expected due to the reduction in 5G expenses related to the chip delay. However, that spending as well as 5G operating expenses previously expected to be incurred in the fourth quarter will now shift to 2023.

In addition, we continue to invest in development for our GBB initiatives in the quarter, and this will ramp up through 2024. Now I'll provide some additional detail on our Global 5G and GBB initiatives and their respective spending profiles. Before jumping into the details of our Gogo 5G spending, I want to be very clear that the delay in our 5G chipset availability only impacts the timing of when our 5G spending occurs. We do not expect it to have any negative impact on the overall 5G program cost, which remains on budget.

In the third quarter, $18.5 million of 5G spend was comprised of approximately $0.9 million in OpEx and $17.6 million in CapEx. We expect 5G CapEx of approximately $40 million in 2022, a reduction from our prior expectations due to the chipset. The financial impact of the chip delay falls into 3 primary buckets. First, a pushout of 5G milestone payments, certification and testing costs from 2022 to 2023; second, lower backhaul costs in 2022, given the delay in spending to support Global 5G. Note that our lower backhaul costs in 2022 represent actual savings this year. And thirdly, our 2023 revenue expectations will be impacted by the postponed 5G commercial launch that is now expected in the fourth quarter of 2023.

The reduction in 5G spending is comprised of an approximately $9 million shift from 2022 to 2023, $4 million of which is operating expense and $5 million as CapEx, along with approximately $1 million in backhaul expense savings. These reductions are reflected in our revised 2022 adjusted EBITDA, CapEx and free cash flow guidance.

Now on to our GBB initiative. We are excited by the opportunity GBB will create for Gogo as it is well positioned to deliver a healthy return on investment, including attractive service margins. Importantly, it is also based on a variable cost pay by the drink business model as prescribed in our partnership agreement with OneWeb. In the third quarter, Gogo recorded $1.8 million in GBB operating expenses related to the achievement of project milestones with Hughes on antenna development partner.

We continue to expect external development costs for GBB to be less than $50 million over 3 years with spend ramping from approximately $3 million in 2022 to $10 million in 2023, with the remaining approximately $35 million to be incurred in 2024.

We also anticipate that approximately 85% of GBB external development costs will be in OpEx. This spending profile is reflected in our 2022 adjusted EBITDA and free cash flow guidance and in our combined 2022 and 2023 free cash flow guidance.

Now moving on to profitability. Gogo's third quarter adjusted EBITDA increased 7% year-over-year to $43.7 million, primarily driven by our record equipment sales. This is the highest adjusted EBITDA performance in Gogo's history. Gogo delivered net income from continuing operations of

$20.2 million in the third quarter, up 2.5% year-over-year. I would note that the Q3 2022 net income is net of an $8 million income tax provision compared to a $100,000 income tax provision in Q3 2021.

Our financial statements reflect noncash income tax expense as we continue to generate positive pretax income. While we may have fluctuations in our effective tax rate, we believe that using the combined federal and state income tax rate, 25% at current rates, would be a reasonable assumption for modeling purposes. Net income before income taxes increased 42% year-over-year, reflecting the profit-generating capability of the Gogo business model as we continue to execute on our strategy. Third quarter net income translates to $0.16 in basic earnings per share and $0.15 in diluted earnings per share. These figures reflect the final settlement of our 2022 convertible notes, which occurred in the second quarter of 2022.

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 2026 planning horizon. We continue to expect to see additional reversals of portions of our remaining valuation allowance against deferred tax assets over the next 12 to 18 months.

In the third quarter, we generated $8.5 million in free cash flow, down 65% year-over-year, driven by the expected increase in CapEx for Gogo 5G.

Now I'll turn to a brief discussion of our balance sheet. Gogo maintained its strong liquidity position as we ended the quarter with $152 million of cash on hand, and we have yet to draw on our $100 million revolver. Our cash balance decreased from $164 million as of June 30, 2022, reflecting the share repurchase executed in September. You will recall that we repurchased 1.5 million shares of common stock owned by affiliates of BlackRock in a private transaction for $18.4 million at a price of $12.23 per share. As of the end of the third quarter, we had approximately $716 million in outstanding debt on our term loan B and a net debt leverage ratio of 3.4x, below our target of less than 4x, which we achieved in the second quarter of this year.

Now I'll touch on our capital allocation strategy. Our capital allocation priorities are in service of our strategic goals. These priorities include launching Gogo 5G commercial service, maintaining a target leverage ratio of less than 4x, which may include paying down debt, investing in strategic initiatives, including GBB and finally, returning capital to shareholders.

The comprehensive refinancing we completed in the second quarter of 2021, which includes our 7-year term loan B carrying a variable interest rate of LIBOR plus 3.75% meaningfully limits our exposure to refinancing risk. We are also well hedged with interest rate caps offsetting a significant portion of our exposure to interest rate changes. Of note, the fair market value of our hedge contract has increased by $46 million before taxes since putting it in place in May of 2021 on the heels of our comprehensive refinancing.

As outlined in our 10-Q, the portion of our term loans subject to interest rate cap reduces beginning in mid-2023, which will increase our exposure to higher interest rates. To quantify that exposure based on the October forward LIBOR curve and with the interest rate caps we have in place, our annual cash interest expense would increase by approximately $13 million from $37 million in 2022 to $50 million in 2026. Given the current volatility of the financial markets and particularly the rising interest rate environment, we believe it is prudent to take a somewhat more conservative approach during these uncertain times.

As we mentioned last quarter, we are choosing to maintain higher levels of cash on hand given these external circumstances. Our higher cash reserves allow us to preserve maximum strategic and financial flexibility. We saw the benefit of having this flexibility in the third quarter.

As previously mentioned, Gogo repurchased 1.5 million shares of common stock at a value of $12.23 per share. This share repurchase was indicative of our confidence in the long-term value creation opportunity we see ahead.

Now let's turn to our updated financial outlook. As a reminder, our guidance does not reflect the impact of the Federal Communications Commission's secure and trusted communications networks reimbursement program as we await further information regarding whether Congress will appropriate additional funds for eligible expenditures out of the program.

We once again raised our top line guidance for the year. Gogo now expect to deliver full year 2022 revenue in the range of $395 million to $405 million versus prior guidance at the high end of the range of $390 million to $400 million. This increase was primarily driven by our exceptionally strong equipment shipments as we've described.

We also raised our 2022 adjusted EBITDA outlook to the range of $165 million to $170 million versus prior guidance at the high end of the range of $150 million to $160 million. This increase reflects a $5 million reduction in operating expenses associated with the delay in the commercial launch of Gogo 5G, but it also includes a combined $6 million of expenses related to the SmartSky litigation in Global Broadband, which were not included in our original 2022 guidance.

We are raising our 2022 free cash flow guidance to a range of $50 million to $60 million versus prior guidance of $35 million to $45 million due primarily to a $10 million reduction in 5G spending. Our 2022 free cash flow guidance includes capital expenditures of approximately $55 million, of which $40 million is tied to Gogo 5G. This compares to prior CapEx guidance of approximately $65 million with $50 million tied to Gogo 5G. It also reflects an expected $3 million in external spend related to our GBB project.

We expect that aggregate free cash flow for 2022 and 2023 combined will be roughly equivalent to the range of $145 million to $155 million, which we provided on our Q2 earnings call in August. Free cash flow for 2023 will be impacted by, among other things, the Gogo 5G delay and potentially by the FCC reimbursement program.

Looking further into the future, our 2024 free cash flow will reflect ramp spending for our Gogo GBB project of approximately $35 million in that year, as I mentioned. We continue to expect to generate free cash flow of over $200 million beginning in 2025 as we get on the other side of our investments in Gogo 5G and GBB with our long-term growth rate elevated by our GBB product offering.

Our other long-term targets remain unchanged. We reiterate that we 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. We also continue to expect annual adjusted EBITDA margin to approach 50% in 2026, up from the low 40s in 2022 and 2023.

Strong operating leverage is a hallmark of Gogo's transformed business model since the sale of our CA business in 2020 and is the driving assumption behind the growth in adjusted EBITDA margin over time. We plan to provide updated 2023 and long-term guidance on our fourth quarter earnings call as we typically do.

In conclusion, Gogo's business continues to perform extremely well. Our raised outlook reflects our strong momentum as we prepare for the commercial launch of Gogo 5G and pursue the development of our global broadband.

I would also like to join Oak in thanking our entire team for their continued commitment to Gogo and to providing unparalleled service to our customers. It's because of you that we are in such a strong competitive position today.

Operator, this concludes our prepared remarks, and we're now ready for our first question.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Phil Cusick with JPMorgan.

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

A couple, if I can. First, I guess, Barry, I hear your comment about being more careful with liquidity. But how should we think about capital return from here? And maybe discuss the BlackRock share repurchase during the quarter? And then second, Oak, maybe think about the strategic value of Gogo as a stand-alone business versus a potential sale. You had a lot of interest a few years ago. The business has stabilized, the outlook is much better. How do you think about the value of the company in the market today versus what it could be worth in a sale?

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

Sure, let me take the first part of your question. I guess 2 questions really regarding the capital returns from here. So I think we've laid out our priorities for capital returns and starting with making sure that Gogo 5G is fully funded to and in the right place on our debt revenue ratio, which we're in good shape on both of those, certainly is to make sure we have dry powder to execute on our strategic initiatives, including Gogo Global Broadband and there could be some others. And then we will actively consider return of capital to shareholders. So we're still proceeding down that path with those criteria in mind. We have, as I mentioned, a achieved 2 of those.

We do believe that Gogo has significant cash flow generative capability in the coming years, and we would expect that to result in return to capital over time. But again, we just want to be prudent for now as things unfold and as we see the macro environment unfolding over the coming 6 months or so, that will inform what we do. But then that's how we're looking at it. We recognize it's something that is of interest to shareholders, including our largest shareholders, Oak and GTCR, so it's something that we are mindful of.

On the BlackRock question, yes, as some of you are aware, BlackRock acquired stock in Gogo exceeding the 4.9% maximum that is provided for in our NOL poison pill as we call it. When we discovered that, we with them recognized that they needed to sell down. And as they needed to do that, it provided an opportunistic -- opportunity for us to execute on a share repurchase, and we felt like it was an appropriate thing to do. It sent, we think, the right message to the market, which is we very much believe in the long-term outlook here at a price of $12.23 at the time, we felt like that was a very good investment. And yet it was not such a large amount that it dampen the objective we have in maintaining it.

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

So Phil, on your question about valuation, I think we are very focused on maximizing shareholder value. Our Board and I believe that there's tremendous unrealized value in our current stock price, if you will, and that there's tremendous runway for growth in this business when you look at the market enough, about 30% penetrated today, and we're developing products that will give us the ability to address the full global market. So we're very bullish on the future. If somebody came along and offered us a price that we felt reflected what we think the opportunity is. I'm sure our Board would consider that. But today, we're not actively pursuing a sale. And we're very focused on our strategic initiatives, delivering on 5G, delivering on GBB, and we think that those will drive a lot of shareholder value in the future.

Operator

Our next question comes from the line of Landon Park with Morgan Stanley.

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

I was hoping you could comment on 2023. Are you still expecting the 15% unit shipment growth that you talked about last quarter?

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

Yes, Landon, we still expect to be in that range. We have the news on the 5G chipset being pushed back to us delivering commercially in Q4 is relatively new news. And so we need -- we'll be factoring that into our budgeting for next year. We also have the impact of the FCC grant program that removed the ZTE equipment, and that's not factored into our unit count projections yet either. So we'll give firm guidance on that in our Q4 call, but we still expect to be in that rough range.

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

And just a follow-up on the 5G. Are you confident at this point that the 4Q commercial launch is sort of doubt or is there remaining uncertainty? And I think you mentioned, is it 60 units in the backlog? Was that a 5G comment? Or if it wasn't, is there a 5G backlog number that you can provide? And just a final question just on the... Sorry, go ahead.

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

Yes. On that point, those are orders for the 5G antennas, the harness for this -- the box that houses the 5G chipset in your card and getting the plane fully ready to accept that little box when the 5G chip is done. So those are orders that are 5G orders, yes. Go ahead with the rest of your question, sorry.

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

Is that the full 5G backlog? Or is there another number that we should be thinking about from a 5G backlog perspective?

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

No. That's -- I mean, that would be the backlog now. Yes. But those are people that are putting good stuff in the head they even have 5G done. I just want to make that clear.

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

And then just one last question. Just sorry, go ahead.

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

Go ahead.

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

Just on the competitive side, Starlink has obviously come out with a premium product for their services. How are you thinking about the impact to your business today and the impact to what you would expect for GBB over time and just your competitive positioning against them?

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

Sure. I'll go back to the confidence question. What happened with the fabrication of the chip was highly unusual. And this is really a Samsung problem with their subcontractor around the test mode of the chip. So it's got a lot of attention at Samsung. It's got a lot of attention at GGV. It's got a lot of attention at Airspan and a lot of attention at Gogo. And I'd have to say we appreciate the additional transparency we've been able to get from all of those players here since this problem first arose.

So given the high level of attention on this and tremendous focus, we're fairly confident that we're going to get this chip on time. You can never say that there can't possibly be a real problem. There are milestones in every project and milestones are called that for a reason, which is, you got to get past them successfully. So there are a couple of key milestones going forward. But at this point, I'd say we're very confident based on just how well the project is being managed and how well it's going.

On Starlink, I almost do a victory lap on this. We projected this in Q1 2021. On our earnings call then, we were asked about them. And we said, look, we think that they will come into the market with something that goes after the high end of the BA market because they're very focused on commercial aviation, mil/gov. They'll be designing a relatively large antenna that works in those markets and would work in the high end of the BA market. And so that's what they've done. They've set a real premium price and it looks to us like they're really going after competing with the geo satellite providers that serve business aviation today.

In terms of our strategy, we all along have been more focused on the customer than on Starlink, we really appreciate what LEO technology and LEO constellations can bring to the market. It's a very good type of satellite offering for BA because of the fact that you can make smaller antennas due to the proximity of the satellites to the earth. So we went out and decided we were going to try and develop a product that can serve the entire BA market, all segments from light jets, turboprops all the way on up and would be global. And so that's what we've done.

And I think our product is positioned very differently than Starlink's. We're a much smaller antenna than they have, which is why it sits on all those aircraft. We are at a much lower price point than they are. We have, as part of our model, we have a very high service component to what we do. If your aircraft on the ground somewhere and your connectivity is not working and the principal is going to show up in a couple of hours and the pilot is going to get a spear through his chest we get a guy there to fix it. And that's the type of service that customers really appreciate, and we have a broader offering. So we have our DASH product, our mix products, our entertainment products and the like. So we think we're well positioned.

I think that there will be some customers in the market that will go for the, what I'll call, the low service kind of self-service model that Starlink has in. So I wouldn't be surprised if they had some success up in the larger jets. That said, there's 30,000 aircraft out there that don't have anything today. And we think our offering will appeal to an awful lot of them. So we think we should be able to grow significantly there. And finally, I'd say we also have ATG, which is an advantage in the North American market. The ability to combine ATG with LEO satellite presents a lot of tantalizing opportunities, you can run -- receive on one and transmit on the other, for instance, and do other things that would actually really boost capacity -- the capacity that you deliver. So we find that very exciting. And we feel good about where we're positioned.

Operator

Our next question comes from the line of Scott Searle with ROTH Capital Partners.

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

Hey, Oak, if I could dive in on the 5G front, it's nice to hear that you've got some confidence around the time line now, the third and fourth quarter of next year. But I wanted to delve in. I think you talked a little bit about STCs and line-fit on that front. I'm wondering if you could dive into that a little bit more in terms of the development on that front. Kind of what you're also seeing from a competitive landscape standpoint in terms of the delays of 5G? Is it having an impact on demand?

And then I wanted to clarify, I thought there was a comment around some lower revenue related to 5G. If I recall correctly, I don't think there were big numbers built into 2023. And most of the AVANCE units in general are able to support that upgrade path. So I'm just -- I just want to make sure I understand the comment in terms of what you're seeing out into 2023 at this point? Because it sounds like you've got pretty good demand. I'm not sure what the coverage is for that 15% growth in '23.

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

So I think we're talking about STCs -- that was your first part of your question.

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

Yes. Competitive landscape as it relates to any of the delays there, is that causing additional problems? And then really kind of your prior expectations for 5G in 2023. I know AVANCE again is, right, it's future-proof upgradable. So is that really having any sort of a material impact in terms of how you guys were viewing it's certainly the second half of '23.

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

Yes. So I'll start with the STCs. I mean we have our STC and PMA for 5G today. We will have to do a minor amendment when we get the new chip. Today that box has a 4G chip in it, and we'll have to replace that chip with a 5G chip. That is an amendment that will be not an issue at all. There's really no change at all. So it should not be an issue at the FAA. We have dealers who have already done STCs and installed. We're installed in Russell Wilson's aircraft, and that was done with an STC for that type of aircraft. So we have lots of STCs that are all sort of waiting for that final 5G chip amendment at the last moment. So I think we've probably got about 30-plus STCs either in works or very close to complete and they're waiting for the 5G chip.

So yes, moving into production with STCs is not going to be anywhere on the critical path in terms of commercial launch. We don't see any impact on sales today of the delay in terms of competitive inroads that the market is basically just the same as it was a quarter or 2 ago. What we see that's great is an order backlog next year and dealers -- our big dealers place their orders for the next year around this time of year. And what we've seen so far is a pretty nice growth in those orders, the size of those orders. So we're feeling very good about that. The OEM bookings come in a bit later. So we're going to know exactly where that will end up. So we're reserving judgment there because there would have been some 5G orders in that.

The risk is the planes that you miss that went in for maintenance, they go in for a major maintenance event and would have had 5G installed. They might already have L5 in which case we don't have a sale opportunity or they might just put in L5 and wait. And L5 at lower price points than 5G product. On the OEM side, again, you get cut in on line fit, you don't want to miss that. And potentially, that date might impact when we get cut in at certain places. So I'm not saying we are, but these are all things we're working with the OEMs and dealers right now to assess the impact.

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

Your question around the impact of shift on 2023 revenue. I think the way to think about this is there are really 2 factors to consider. One is how many current L5 customers upgraded to 5G as we launch that separately or new tests. So we do expect to see equipment revenue in particular, impacted by the delay, which we would have seen ramping during 2023. So that will impact the revenue. We have accommodated that in the combined guidance that we've given on cash flow for years 2022, 2023.

On balance here, we expect L5 to continue to be the most widely -- widespread and sold product by the OEM partners. And so we don't expect a drop off in L5 sales in the near term due to 5G launch, and L5 will continue to be the best option for many customers, it delivers fast reliable connectivity and the option upgrades that I talked about and so on. But over time, we saw this certainly ramping. But even by the end of our planning horizon, that we saw 5G on the order of 20% of units online. So it's a very attractive product, but…

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

And lastly, if I could, just to follow up on the rip and replace program. I know a portion of it, about 1/3 has been approved by the FCC. I'm not sure what the -- could you update us on the time line of when you would expect to hear back on the additional allocation? And it seems this is more of an upside opportunity than anything else. I just want to clarify how that swings or impacts your OpEx or otherwise CapEx in terms of if the FCC approves the additional $3 billion to go to the Rip and Replace Program?

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

So I'll address the timing questions and all that, and I'll let Barry handle the hard part, which is the impact on the accounting next year. So to be clear, the FCC has approved us for the $330-some-odd million. The FCC's program is underfunded is the issue. They had predicted $1.5 billion in total grants when the bill was first going through Congress. The applications that came in significantly exceeded that. They cut lots of them back because parts of them didn't qualify.

But even after cutting them back, the $1.9 billion only reflected now 39% of the total number of approved grants. So they've been working with Congress. There were 2 bills in Congress. They ended up being very similar. A Senate bill and a House bill. House bill was approved by the House. Senate bills in Committee. But there was broad bipartisan support for the bill. And there were letters written by, I think, 36 senators signed a letter for instance, and they -- it was an unlikely grouping.

Chuck Schumer and Ted Cruz signing the same letter is kind of unusual, right? So there's broad support for the bill, which is good. But that this Congress ends when the new Congress comes in, in January 3. And if it's not passed by then, it would be a do-over. So we're very hopeful that it will be addressed then -- by then. And I think it -- problem well, but this is Congress. So it's very hard to predict exactly what will happen or what will divert their attention. So timing is hard to project.

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

And on the financial impact, Scott, it will certainly be a net cash flow benefit to Gogo if the funds are allocated at those higher levels. As you know, the initiative to remove ZTE equipment was always in our long-term strategic plan, but it was under a much longer timetable with standing well beyond '26 planning horizon. So those costs were originally captured as part of our ongoing maintenance CapEx spread across those years.

And the purpose of the program, of course, is to accelerate that timing through the Chinese equipment. So as that happens, we would be reimbursed for that. So it's too early to talk about the real cash flow impact of that. But in general terms, kind of the puts and takes out of this is that we would probably have to make some investment upfront in inventory and so on, and then we would get reimbursed for that later. So there could be some negative but on balance, it's going to be a positive. We'll certainly provide that more detailed outlook if and when that gets approved at the high levels.

Operator

Our next question comes from the line of Louie DiPalma with William Blair.

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

For Oak, what is the timing for aircraft flying with the new NB-13 combo, the 4G, 5G antenna.

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

Well, there's one flying today with the NB-13 antenna in it. Russell Wilson's aircraft came down to the NBAA convention fully fitted with the 5G system minus a 5G chip. And dealers -- I'm sorry, dealers are installing. There's 6 sets out there right now, which our dealers are installing minus the small box that holds the 5G air card with the 5G chip on it.

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

And my next question, where should we expect the AVANCE penetration to settle out? And are there a significant number of Gogo classic customers that are satisfied with their existing performance such that they probably won't upgrade to the AVANCE system?

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

It's a great question. And the answer is there are -- today, we're about 45% of our installed base is AVANCE and 55% is still classic. We see steady migration, but there are customers that are happy with what they've got with the classic product. When you're going to see an upgrade there is when they go to sell that aircraft. And generally, people these days have to solve a better connectivity service to sell the aircraft or the new owner will put in an improved system. So aircraft turnover every 7 years, roughly. And so there's certainly some that could be on the classic products for quite a while.

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

And one final one. This could be for any of you. If you were a sell-side analyst such as myself or even a buy-side analyst, how many aircraft would you project for the industry at the end of 2024 would be live with a LEO broadband satellite product for the business aviation industry.

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

That's a great question, Louie. It's not going to be hundreds. It's going to be probably under 100 by then. But I think it will be ramping up rapidly the next year.

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

Yes. And the reason I'm asking is, in your comments, you were talking about how you see there being demand for the Starlink service as they probably will be. And I was just wondering what your expectations are for that and potentially others that may come after Starlink and how that fits into your long-term plan.

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

Yes. I mean I don't -- I'm not sure you have quoted me exactly correctly. I said I think that their model might be appealing to some customers who if do-it-yourselfers and you can go on the website and you can reserve the system. You don't know when you're going to get it. And there's no FTCs yet. They say they're working on a bunch of FTCs. And then you're going to find an install it. It's not clear if they're going to have an installation manual. I mean there's just so many things you don't know yet about what Starlink is doing that it's kind of hard to predict.

I think that it's competing with a geo satellite product that's very, very expensive at a price point that's right around the same as the geo and it's going to provide a significantly better service than the geo. So I think that there are going to be people who have plenty of money, who are going to go for that and would install it. The question is when, and it's very hard to get on these jets, the timing of doing something like -- it's a big antenna. I mean it's a really big antenna, and it has some challenges. It's -- it has to have this mounting plate that's quite high and it's going to require decompression and things like that. There's a lot of complexities in what they've done that we're not running into based on our design. But that all can be overcome.

But to me, it means it's going to have to be installed in a major maintenance event, and that happens every 3 years, let's say, of the big aircraft. So you don't get out of that often. Before anybody is going to order it, they're going to make -- there's an FTC for what they're doing, et cetera. So it's going to take some time. And it remains to be seen how the competitors will react; how Inmarsat, ViaSat react to what Starlink's doing. So that's all very hard to predict. I would say right now, in the geo satellites there are about 1,600 roughly aircraft in the world that have a geo satellite product on them. And that's been available for a long time.

So I'm not sure that this is cutting so much new ground that there's a whole new segment out there that's all of a sudden going to want satellite. It's probably going to replace geo, I would think, in most instances. It's a very different setup, the geo satellite products all are up in the tail. This is going to be mounted on the fuselage, and it's a pretty large item going on the fuselage. So a lot to be seen there. It's nothing is going to happen lightning fast. There's a great man over at Duncan Aviation who I quote often on this. He says, "Business aviation, is where things go to slow down." And I think he's right about that.

Operator

Our next question comes from the line of Rick Prentiss with Raymond James.

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

Jesse, looking forward to hearing more from you in the future in early '23. But Barry, do we get you one more time?

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

Well, I'll still be here through the call. So we'll have to decide whether Jessi's (inaudible) better at or I am, but I'll be around through that.

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

Yes. Yes. But we want to get those cases out there, too, right?

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

Yes.

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

Question to follow up on some of the other questions. The 17% long-term revenue CAGR, what's the split between like units sold, driving product revenue versus ARPU increasing with the different service plans out there? And has that changed at all given the chip delays?

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

Yes. I don't think the chip delay really affects that mix, Rick, as you look out there to break it down a little bit. So we've had a 15% compound annual growth rate in our model prior to announcing GBB. That added the 2 points additional when we saw that with those sales beginning in 2025. The lion's share of the split is coming from increasing its online, about 13% of that is from AOL. The balance is from ARPU. So it really is driving more penetration in units online. As you know, that's really the opportunity in this market overall being just 30% penetrating.

And on the ARPU side, we see it going up for a couple of reasons and then unit for one reason that we expect it to go up as people have higher data rate plans, which they're interested in to have a more living room like experience. Secondly, as we add 5G and then GBB that will drive ARPU on the high side. The muting influence on that will be as we get down into the general aviation market a bit worse, you don't have as high an ARPU, but frankly, what matters ultimately is the revenue per megabyte, and that those are still very attractive unit economics we get out of that, so those are kind of the puts and takes.

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

I appreciate the color on the interest rate potential for mid-'23, something like $13 million additional interest, $37 million goes to $50 million. I assume that's for a half year impact. So obviously, the full year impact would be more than that. Is that factoring into the Phil's question on the return on capital? Are you going to be watching is the calculus at some point, I think you mentioned it even that maybe there is pay down or buy down of debt that's a better accretive value to free cash flow and free cash flow per share? And how should we think about the timing as you look at that?

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

Yes. Just to clarify the point about the $13 million increase, that's an annual cash interest expense. That is now -- that is in 2026. So it goes from the $37 million today to $50 million based on the forward curve as of October. So that's really the impact of that longer term on interest rates. So just to make sure we're talking about the same thing here.

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

That's an annual effect, not a half year effect?

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

That's correct. Yes. It's an annual effect in 2026.

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

So based on October rate...

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

And then…

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

Go ahead, sorry.

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

Does that answer that part of the question?

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

But then kind of the calculus as far as how you look at buying down debt or...

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

Yes. We...

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

That's the impact in 2026. Yes, I just want to make sure not 2023.

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

And then the impact of -- on all this on kind of our thoughts about debt pay down, it does inform it. If we were in a low interest rate environment, we would be having different conversations and we'd be thinking about it a little bit differently. So we tend to be pretty conservative, as you know. There is more interest rate exposure. Again, we think it's pretty managed, but the interest rate caps, for example, stepped down from $650 million to $525 million is the next step down. So that happens in '24. So they do step down over time. And so there is that exposure. But we just -- we want to keep some dry powder for this as well as for other things that we might do opportunistically right, to be able to have that flexibility for the share buyback in September. So yes, it does influence us. But over the long term, I think the cash generation capability of the business is such that you would swamp out those interest rate issues because of that...

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

Last one for me. You kind of alluded to it there. You talked about potential for other strategic initiatives, keep dry powder for global broadband and there could be others that was mentioned in some other places that there could be some other strategic initiatives. You probably can't tell us a lot of what those are, but conceptually high level, what would make sense philosophically to say might be interesting to bolt on to the Gogo go-to-market kind of offers.

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

Yes. I mean we've always said that we're always looking for ways to improve the performance of our ATG network. We think that a large part of the market will stay on ATG for a long time. We have good economics there. And of course, we make improvements in terms of capacity and what we're delivering there that will prolong that life. So I'd say they're mostly in that arena. We do look at other opportunities in terms of bolt-ons or other types of things. We don't have anything in mind right now, so I'm not going to get out on a limb on that one. But I think the main focus would be improving ATG.

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

And is there any need for more spectrum? Is that something that might be looked at as well?

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

Well, spectrum is something I never talk about because it only leads to trouble. So I'll delicately dodge that question.

Operator

That concludes today's question-and-answer session. I'd like to turn the call back to Will Davis for closing remarks.

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

Hello, everybody. That concludes our third quarter earnings call. Thank you for your participation, and we look forward to speaking next quarter. Thank you. You may now disconnect.