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GOGO.OQ - Gogo Inc to Discuss Increased Long-Term Financial Targets Call

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PRESENTATION

Operator

Good day, and thank you for standby. Welcome to the Gogo Inc. Market Update Call. (Operator Instructions) Please be advised that today's conference is being recorded. (Operator Instructions)

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, Shannon, and good morning, everyone. Welcome to our conference call to discuss Gogo's increased long-term financial targets and to review our investor presentation that was released as an 8-K earlier this morning. Joining me today from Gogo are Oakleigh Thorne, Chairman and CEO; Barry Rowan, Executive Vice President and CFO.

Before we get started, I would like to take this opportunity to remind you that during the course of this call, we may make forward-looking statements regarding future events and the future financial performance of the company. We caution you to consider the risk factors that could cause actual results to differ materially from those in the forward-looking statements on the conference call. These risk factors are described in our earnings -- or in our press release filed on Tuesday morning, September 28, 2021 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 that the date of this conference call is September 30, 2021. Any forward-looking statements that we make today are based on assumptions as of this date. We undertake no obligations to update these statements as a result of more information of future events. During the call, we'll present both GAAP and non-GAAP financial measures. This call has been broadcast on the Internet and available in the Investor Relations website of the Gogo website at ir.gogoair.com. Gogo's new investor presentation is also available on the website. After management comments, we'll host a Q&A session with the financial community only.

Oak, over to you.

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

Thanks, Will. Good morning, and thank you for joining us. As those of you who follow Gogo are aware, our equipment sales this year have exceeded our expectations, leading us to raise our 2021 guidance on both of our last 2 quarterly earnings calls. This has given rise to questions about how the follow-on service revenue to those equipment sales will impact the long-term guidance we provided to the Street on our Q4 2020 conference call.

In order to facilitate our 2022 planning, we recently updated our long-term model to reflect this service revenue flow-through. We've reviewed those projections with our Board, and our Board approved them last week. We think that given the significant improvement we project for future performance, we should share those projections with the financial community, hence our press release on Tuesday and this conference call today.

On this call, I'd like to share what is driving our projections and why we feel Gogo is a compelling value creation opportunity. A little more than a year ago, we announced the sale of our commercial aviation division to Intelsat for $400 million, which has allowed us to focus on being a pure-play business aviation connectivity provider. As a result of our 30-year history of focusing on the unique needs of the BA market, 85% of all broadband connected BA aircraft in North America use Gogo, giving us a leading position in a fast-growing market that is still only 30% penetrated. But we're not resting in our lows. We're working hard to leverage and build upon our competitive advantages, including our proprietary ATG network, our unique and future-proof AVANCE platform and the deeply embedded relationships we have with our OEM and dealer partners. Together, these advantages enable us to provide an unmatched value proposition to business aircraft manufacturers, dealers and owners.

Finally, we have a compelling financial profile. We sell equipment at a profit and then reap the benefit of extremely sticky cash-generative service revenue, 95% of which is subscription-based. Service revenue, in turn, drive strong cash flow. Once passed the once-in-a-decade network upgrade with 5G in 2022, we expect to return to very strong EBITDA to cash conversion as our normal maintenance CapEx is very low, particularly when measured against telecommunications industry standards.

We also have a very strong balance sheet. In April, we completed a comprehensive refinancing that significantly lowered our leverage multiple and interest payments, allowing us to focus our resources on driving value for customers and for shareholders. In fact, turning to Slide 4, on a standalone basis, our BA business has always had a record of strong financial performance with a 22% revenue CAGR from the time we went public in 2013 through 2020. As you can see on the left, we've had consistent equipment unit growth and very strong growth of our AVANCE platform in the last few years, even through the pandemic. And I note that 2021 growth in this chart only represents the first half of the year. We typically have much stronger unit sales in the second half.

As I mentioned a moment ago, AVANCE shipments this year have exceeded all expectations and should run greater than 850 units, 30% above our original budget and more than 30% above prior year, and we expect strong growth to continue with 20% to 25% growth in units projected for next year. Equipment sales, in turn, drive service plans. And as you can see in the light blue portion of the bars in the middle chart, service revenue growth has been very strong with the exception of a small blip in the 2020 COVID year. We expect to return to strong service revenue growth this year. We don't normally guide to service revenue, hence, the red 2021 bar in the middle chart does not break that out. However, on the Q2 earnings call, we stated that we expected service revenue to grow 20% this year over 2020, which equates to approximately 15% growth over the pre-COVID 2019 year, so a return to strong growth.

Service revenue, in turn, drives adjusted EBITDA on the right. Again, we had a blip in 2020, but we've resumed growth once again in 2021, which is represented here by the guidance we gave on our Q2 earnings call. We're not going to update 2021 guidance on this call. We'll address that on our Q3 call. My final point on this slide is that with the exception of network upgrades like 5G, which we have to go through every 10 years or so, our normal CapEx is quite low, and we drive very high free cash flow conversion of our adjusted EBITDA.

Turning to Slide 5. We're in the midst of a significant increase in demand for business aviation and in-flight connectivity as the COVID pandemic drove new flyers to private air travel, and those new flyers demanded the Internet. We look at aircraft utilization as one precursor to future demand. And in Gogo's most recent quarter, we saw 13% growth in flight counts in the Gogo fleet compared to the same period in 2019. But more significantly, counts grew each month of the quarter and had grown to 26% above 2019 levels in July. These trends are expected to be sustained and recent market data proves it. In a survey of private flyers, 69% that they expect to fly private aircraft more frequently post killed it than they did before. 28% said they'd try about the same amount and only 3% said they would fly less after COVID. In a Jefferies survey, 70% of industry participants said that current industry growth was driven by people who started flying during COVID, and Textron reported that 20% of their new business this year was from first-time flyers.

As a result of increased demand, fractional and charter fleets are looking to add capacity, with net jets recently placing $2.5 billion of orders for new aircraft and suspending retirements of older aircraft. As a result of demand for newer jets, OEMs like Gulfstream and Textron are reporting significant increases in their book-to-bill ratios as orders for new jets pile in. The convergence of these factors sell significant opportunity for Gogo. As we'll discuss more later, Gogo's deep relationships with all 9 business aviation OEMs and long-standing relations with its charter and fractional fleet customers positions us well to capture our fair share of this growth in aircraft online.

Next slide. Not surprisingly, the shift towards new flyers is also driving a shift towards much higher data consumption, as business travelers will increasingly rely on technology to support the remote work environment, require seamless video conferencing and VPN access. And leisure travelers expect living room quality streaming capabilities for Internet browsing, entertainment and access to video intense social media. The net result is that passengers are using more in-flight data than ever. Across our entire fleet, customers consumed 52% more data in Q2 2021 than they did in Q2 2019, driven predominantly by a 26% increase in megabytes consumed per flight hour and a 20% increase in flight hours per day.

No other company is as well positioned to deliver this service, quality and capacity to BA flyers that better than Gogo. Our AVANCE L5 platform, coupled with our 4G ATG network delivers the low latency got applications like video conferencing demand and that GEO solutions cannot deliver. Gogo's upcoming 5G launch will take that quality one step further, enabling enhanced streaming and multi-device video confessing from a single aircraft. Capitalizing on this trend, we launched 4 new unlimited and high gigabit streaming plans for AVANCE customers in Q2 and sold more than 50 of them in a matter of weeks, driving an increase of $193 of ARPU per month across our entire AVANCE fleet. If this demand for data continues, we expect significant ARPU upside as AVANCE customers take advantage of over-the-air software updates to purchase higher capacity data plans and ultimately migrate to Gogo 5G.

Turning to Slide 7. It might surprise you that the BA market is largely not connected. Less than 1/3 of the United States BA market has IFC capabilities installed today. And as I've said, Gogo is a supplier to 85% of those connected aircraft. We expect the number of connected BA aircraft to grow by approximately 50% by the end of 2025, substantially increasing our market opportunity. We expect to win our fair share of those aircraft by virtue of our strong relationships with OEMs for capture of new aircraft and with dealers for capture of aftermarket aircraft. Today, we are line fit at all 9 business aviation OEMs and offerable with standard equipment or as an option on 27 of the 28 models of business aircraft that are in production today.

In the aftermarket, where we're seeking tremendous -- where we're seeing tremendous demand right now, we have an unparalleled network of 120 dealers that sell and install our systems and have 93 FAA certifications for installation of Gogo equipment on 200 makes and models of aircraft. So turning to Slide 8. Besides distribution, why is Gogo uniquely positioned to capture this market opportunity? First of all, because we have the largest addressable market of any BA IFC provider. Gogo's equipment is smaller and lighter than our GEO satellite competitors' equipment. But only Gogo fits on all sizes of business aircraft. This is especially important in midsized and smaller aircraft where space is at a premium. And now they're limited to North America by virtue of our network. It's important to consider that 65% of all business aircraft are registered in North America and 87% of all business aviation flights are flown in North America.

Next, second, we provide the best customer experience. Though our speeds are comparable to our GEO satellite competitors, our low latency is vastly superior and has a real advantage over GEOs in delivering today's latency sensitive applications like video conferencing and video intensive web browsing. We also offer the greatest set of features, including in-flight entertainment, flight deck applications, engine monitoring, self-reporting diagnostics and much more. We're often cheaper, both for equipment and service and represent a very small cost, somewhere between 0.5% and 2% of the purchase price of a private jet and we provide great service. We've been ranked #1 by AIN Magazine, which is the industry standard for support in the flight deck and the cabin electronics category for 9 out of the last 11 years, and we were second the other 2 times.

And third, because of our vertically integrated business model, which I'll discuss in more detail in the next few slides, but quickly, we own, operate and sell our own proprietary equipment and network. Unlike competitors, we typically partner for equipment or network or for sales and service. This gives us tremendous flexibility to adapt to changing market conditions and very profitable owner economics.

And finally, we sell a true product platform like Tesla or Apple, that future proofs our customers' investment in IFC, so that they can be confident that they will be able to add new technologies as they evolve at relatively low cost. I'll talk about all that in a moment in more detail. So let me take a minute now to dive a bit deeper into our ATG network and our unique AVANCE platform. Think of our ATG network as your terrestrial network, you got towers, backhaul, data centers, et cetera. And think of AVANCE as your Apple device, an iPad, an iPhone, iWatch and iOS, the operating system that ties all those devices together. Let me start then with the network. We own 4 megahertz of spectrum in the 850 megahertz range that was auctioned by the FCC in 2006 for ATG use. And given the value of spectrum for terrestrial use today, it's very doubtful that the FCC will ever auction ATG spectrum again. The spectrum ownership guarantees that we will always have access to a clean channel, which is not true of a would-be ATG competitor that I'll talk about in a few minutes.

Today, we operate 260 towers that broadcast cone shaped beams into the sky, similar to a cellular phone system on the ground. Those beams communicate to antennas and associated equipment on our 6,000-plus ATG aircraft and is supported by fiber and microwave backhaul from all towers to our redundant data centers. When we launch 5 G, we'll use 150 towers, many of which will coexist with our current 4G towers, giving us some economies of scale. And we'll use 5G beam forming and that each private aircraft will have its own private beam. Our current AVANCE L5 product on our 4G ATG network has mean and peak speeds 3x to 4x faster than our 3G network. And our 5G network will have mean speeds 10x faster than our 3G network and will hit maximum speeds approaching 100 megabits per second. Because aircraft are never more than a couple of hundred miles from a tower, our ATG networks have much lower latency than GEO satellites that are 22,000 miles above the earth, hence my earlier point that our network is more conducive to work-from-anywhere applications like video conferencing. Also, because we own our own network, our maintenance and operating costs are fairly fixed and incremental service revenue above our fixed cost drives substantial margin.

A brief note on our network performance. When we first launched our ATG network, we served the commercial airlines as well as business aviation markets. Back in 2017, when the commercial airlines usage peaked on our network, they seriously degraded performance for business aviation aircraft. But since that time, virtually all mainline aircraft have come off the network, and we currently run about 1/3 of the amount of data over the network as we did then. Given that offload and improvements we've made in handling capacity, we believe we can triple the number of aircraft we have on the network without degrading service, even with expectations that data usage for aircraft will continue to grow. And finally, our proprietary technology is protected by 30 years of R&D and know-how and a robust portfolio of over 375 patents.

Now let me turn to AVANCE. Again, let me use the Apple analogy. Like Apple, which delivers hardware in many form factors, iPads, iPhones, et cetera, so do we with AVANCE. L5 for big planes, L3 for small planes, SCS for plants that only need a router, and all that is supported in the cloud. And as in the case with Apple, those are all -- they all run the same operating system, iOS. And in our case, they all run GOS, the Gogo operating system. Like iOS, GOS or G-O-S is the software-centric extensible platform. We can add new apps or services over-the-air but will drive stickiness in ARPU. Our Gogo vision entertainment product is a good example. It's embedded in GOS. We can promote it to customers by offering them free access. They decide they want to buy it, we can activate the subscription with a flick of a simple software switch. And we keep adding new apps.

Last year, we added DASH, an app that allows fleet managers to monitor the connectivity performance across their entire fleet and proactively address issues before they impact the passenger. And soon, we'll be adding MIX, which will allow operators to allocate different levels of capacity to different people on the plane. So perhaps the CEO gets lots of capacity and the flight attendant, not so much.

All of these apps help drive stickiness in ARPU. AVANCE also allows us to deliver world-class customer service. It has self-service diagnostic capabilities that notify us of issues on the air so that we can address them, often before the passenger or operators know a problem exists. Great service helps drive stickiness. And like your cellphone, which has the ability to tie into many different channels depending where it is, AVANCE has multi-bearer capabilities that we can tie into our 3 networks, but also the new networks, including satellite networks. For instance, we could develop an ESA antenna that we would install on top of the plane as an add-on to AVANCE that could support only your satellite network coming into the plane, and we could operate ATG and LEO in combination.

For an AVANCE customer, adding an ESA antenna to an existing AVANCE installed that entail very little change to the interior of the aircraft, thereby avoiding the time-consuming and expensive rip and replace that would be associated with installing a competitor product. The rest of the install would simply be an over-the-air software upgrade, just like a Tesla. Also like Apple, our hardware products are built on common componentry, enabling us to drive higher demand with our suppliers to drive lower unit costs and to simplify our manufacturing and testing footprint to deliver low cost and high quality. For all these reasons, expanding AVANCE penetration is a cornerstone of Gogo's strategy to drive long-term revenue and ARPU growth.

Turning to Slide 11. Today, we have one set of real competitors, the GEO satellite companies, Inmarsat and ViaSat, and one potential ATG competitor, SmartSky. I'll go over advantages versus both, starting with the GEOs on the right. As I mentioned, we have a latency advantage over the GEO providers that is manifesting itself with our superior performance in real-time video conferencing applications. We also have an addressable market advantage and that we fit on all sizes of aircraft, whereas because of their size and weight, GEO installations are relegated to the heavy and super midsized segments of the market.

Our disadvantage to GEOs is coverage. They are near global, and we are limited to North America. However, large aircraft often have both systems on board and use GEOs for international flights that use Gogo domestically to achieve lower latency and lower cost. From both an installation and ongoing monthly cost perspective, GEO is significantly more costly than Gogo. And that may be why even in the heavy jet segment, Gogo is installed on slightly more jets than ViaSat and Inmarsat combined.

As for speed, today, our AVANCE L5 product on our 4G network is roughly equivalent to GEO speeds. However, when we deliver 5G, we believe we will have a speed advantage as well. The other competitor people often ask about is SmartSky, an aging start-up that has raised and spent significantly more than $300 million since 2014, trying to build a competitive ATG network. If they had launched in 2016 as originally announced, it may have had a compelling product. But now their solution is old technology. It's 4G, and if ever launched, it will be slower than our 5G offering. Given the fact that they have repeatedly missed launch dates, they have very little credibility in the market. They are going to need to complete and operate their network to demonstrate that they are real before any dealers will sell their product. Their technical and market challenges are compounded by significant financing challenges. In spite of raising hundreds of millions of dollars to date, they require significant cash -- additional capital to build out the network. If they build it, they'll then face the challenge of funding large operating losses for several years while trying to sell and install the several thousand aircraft they'll need to get to breakeven.

Turning to Slide 7. While we're very well positioned in business aviation today, we're not complacent. Looking ahead, we see several highly attractive long-term growth opportunities for Gogo, which are noted at a high level on this slide, but not included in our baseline plan or factored into our long-term guidance. The first is expanding our addressable market with a global LEO satellite partnership, which would accelerate our growth in the latter half of this decade. As I mentioned earlier, with a relatively modest investment, Gogo could develop an ESA antenna that would take advantage of our AVANCE multi-bearer capability. We could partner with a LEO provider and drive substantial revenue growth and a very positive return on investment. It's a win-win-win model. Customers have told us they want a single provider of domestic and international connectivity services. Our LEO partner would immediately access our large AVANCE installed base and our broad AVANCE certification base would give us a tremendous head start over any competitive offerings.

From a market perspective, a LEO offering would solidify our position in the North American heavy jet market, give us an avenue to add capacity of smaller North American aircraft if needed and add 14,000 rest of world aircraft to our total addressable market. Another area for growth is expanding into the general aviation market, made up of approximately 200,000 recreational and personal aircraft. The large portions of that market may not be addressable for some time, lowering our service floor to 3,000 feet and rolling out our smaller form factor AVANCE L3 product has enabled some success as evidenced by our recent Cirrus announcement.

And lastly, the gateway to the cockpit, also known as connected aircraft services, we've pursued CAS solutions for some time and AVANCE is designed with an API that allow us to access data that can be used for safety services, maintenance and performance monitoring, among other applications. None of these are Board approved projects at this point as they are all still in the planning stage, but they do represent meaningful upside to our baseline plans.

Turning to Slide 13. So how should you look at Gogo? After all, we're a pretty unique animal. We look at ourselves as a digital infrastructure provider because we share many of the same financial characteristics. Like some of the digital infrastructure sectors listed on Slide 13, we have a very sticky customer base, high recurring subscription based revenue, high cash conversion after our 2022 5G investment and low ongoing Capex. Of course, we understand there are reasons that sectors listed on Slide 13 might trade at higher multiples than Gogo. They offer higher EBITDA margins and larger revenue bases and greater liquidity among other traits. But Gogo also has some significant advantages that they do not have, such as much greater revenue growth, access to an underpenetrated market and numerous opportunities to accelerate growth with modest investments of capital and our adjusted EBITDA margin should grow over time as we scale our business.

So turning to Slide 14. As you saw in our release the other day, we raised our long-term targets, driven by powerful, positive market tailwinds as well as strong equipment sales. We now target revenue growth at a compound annual growth rate of approximately 15% from 2020 through 2025 versus prior guidance of at least 10%. The adjusted EBITDA margin going from 40% in 2021 to 45% in 2025 versus prior guidance of a range from 35% to 40%. And finally, free cash flow of approximately $125 million in 2023, following the deployment of the Gogo 5G network in 2022 and approximately $200 million in 2025 versus prior guidance of more than $100 million in 2023 with significant free cash flow growth thereafter.

As I mentioned at the top of the call today, Gogo and our Board are aligned on these targets, and our increasingly positive outlook is driven by significant growth in Gogo equipment sales, supported by strong industry tailwinds. Our financial model is a virtuous circle. Long equipment sales drives high-margin service revenue, which in turn provides cash flow that we can invest in enhancing our network, which in turn attracts more users and drives more equipment revenue. That cash flow also enables us to further deleverage to drive more cash flow, invest in new growth opportunities and ultimately return capital to investors. We're excited about the future and Gogo's ability to deliver for our customers and shareholders as we execute on our strategy for long-term value creation.

Now I'd like to turn the call over to Q&A. My colleague, Barry Rowan, our CFO, is also here today to answer your questions. Operator, please open the line. Thanks.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Scott Searle with ROTH Capital.

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

A lot of details that you've got in there, Oak. So maybe to dive in on a couple of follow-ups. It looks like from your financial guidance and how you're talking about the market through 2025, it looks like the market is still maybe about 40%, 45% penetration. And you still have pretty high market share, I think, implied in that, about 80% plus. As part of that, I'm wondering if you could take us through some of the thoughts in terms of penetration of different markets. For example, attach rates on new OEMs versus retrofit, where does turboprop fit in there? And then when you look at those and you combine kind of turboprop versus the higher end of AVANCE, like, how should we be thinking about ARPUs as we go along over the next couple of years? And then I had one quick follow-up.

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

Barry, do you want to take that?

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

Yes. Let me start with the ARPU, and then we can talk about the penetration level. So Scott, we do see ARPU continuing to increase as we go forward. As we have talked about on the -- when we described the at least 10% growth rate, about 8% growth in aircraft, 3% growth in ARPU, the growth in ARPU is driven by a couple of things. It's driven by people increasing their plans as they want more data, as Oak described, it's also projected to increase as we roll out the 5G product, and we believe we're able to charge more for that because of the enhanced service.

On the other hand, there is some downward pressure on ARPU as we get into the lower end of the market or really the broader market for the light jet turboprop market. But importantly, the service margin is comparable for those smaller planes and the profitability for megabyte is also comparable. So it's still a very good business. But as you'd expect, there are shorter flights and so lower revenue per unit.

If you look at the penetration levels, the penetration levels for the smaller end of the market, turboprop, are much, much lower than the heavy iron aircraft, as you'd expect. So they're in the kind of single-digit range for the light jet turboprop market. When you get up into the higher end of the market, they're in the north of 50% kind of penetration levels. So as we see this playing out, there will be an opportunity to drive penetration across all of those segments. But because of the real white space in the light jet turboprop market, we see that opportunity there. And even though it was not in our original plan to get into the general aviation market, it still does, as I've mentioned, represent an upside opportunity, and we had some success with this important Cirrus contract that we've announced. So that's how we see it kind of unfolding.

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

Great. Very helpful. Sorry, go ahead.

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

Yes. Let me just say that -- let me add on the sort of market share question. I think we really don't focus on market share. We focus on unit growth because that drives the bottom line. However, in our planning, we have assumed that all of our competitors continue to grow and that SmartSky launches. We don't -- we're not sure they will, but we assume that they do for our planning purposes. At the end of 2025, because that's the end of the current planning period for us, the market is still than 50% penetrated, between 45% and 50% penetrated. So still a lot of white space even at the end of '25.

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

Great. And if I could just quickly follow...

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

I realized I didn't address your question about the OEM and retrofit market. So what we're seeing is that historically, connectivity was not installed on all OEM products. If you go back a few years, which is one of the reasons the market is not as penetrated as you might expect it to be with connectivity. Going forward, the number of installations of connectivity for planes coming offline is much, much higher. So with the high book-to-bill ratios and the OEMs accelerating their production levels with more of those planes having connectivity when they roll off the line, that's also going to drive the connectivity going forward.

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

Great. And if I could, just on the 5G front, just want to confirm that you're on track in terms of second half of next year. And Oak, talking about some of the further upside opportunities, it sounds like it's still embryonic and early, but I'm wondering if you could give us a relative sizing when you start to think about a strategic GEO or LEO relationship, the general aviation market, what does that do to the overall TAM as you look out towards the end of the decade.

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

Yes. So 5G is in good shape. We recently passed a critical milestone where our 5G chip provider actually confirm formally that they will deliver on schedule, which keeps our project on track for second half delivery next year. So we're feeling really good about that, very confident about delivery.

In terms of the TAM, what a LEO partnership would do for us is really give us access to the rest of world market. And there are 14,000 business jets and turboprops in the rest of the world that are addressable. And that's from large jets all the way down to turboprops, so a significant expansion of TAM. And we already have distribution and service relationships around the world because we currently sell narrowband satellite connectivity products globally. We have about 1,000 some odd customers outside the United States. So we've got a footprint we can lever to actually go sell. And I think it could be a very exciting opportunity for us.

Operator

Our next question comes from Simon Flannery with Morgan Stanley.

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

This is Landon on for Simon, actually. Just a couple of questions. Could you -- just following up on the prior question, could you just disaggregate the 15% between ARPU and unit growth? And then separately, maybe you could talk about how you guys are thinking about equipment margin over time as you look to get that legacy base upgraded to the AVANCE platform? And then finally, could you just clarify what was behind the timing of this update to guidance? We thought that you would previously plan to update it towards the beginning of next year. So just curious what drove the timing of the announcement?

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

So I'll start with that one, and then I'll let Barry talk about the other 2 questions. Yes, we did an interim revision of our long-term model because we have -- for demand planning, we have to figure out those long lead times now. We have to figure out what we think our demand is going to be out 18 months. So our Board has asked us to upgrade our long-term model. There was also a lot of questions from the Street about, look, you've got this great equipment sales, what's the service flow-through going to look like over the long term? So we are in the middle of our planning process and the beginning of our budgeting process right now and felt that it was important to actually project the flow-through of the equipment sales into service, understand demand, et cetera.

So we redid the model for the Board. We presented it to them last week. Given the significant improvement in projected performance, the Board and we felt that we should share up with the Street also because it would be, frankly, material non-public information and having that sit around for months didn't seem like a very wise thing to do. So we thought it would be better just to be public.

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

And Landon, on your question about the drivers of the revenue, the 15% guidance that we've provided, about 2/3 of that comes from increasing aircraft online, and the balance of that comes from increasing ARPU and some things that are outside of ARPU like the Intelsat revenues, for example. But 2/3 of it comes from the increase in units online. And then you had a question about equipment revenue and how those margins we expect to trend over time, correct?

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

Correct.

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

Yes. So the real driver of the value of Gogo, of course, is service revenue, and that recurring revenue stream and 95% is subscription-based. So clearly, equipment revenue leads to service revenues. So one of the things that we are willing to do, that we make good money on and good margins on selling equipment revenues, so we're willing to take some margin on the equipment revenue. So as we look at that trending over time, we do see the equipment margins coming down a bit from where they had been. Historically, they had been in the high-30s and 40s. And we do see them coming down a little bit as we are willing to drive AVANCE penetration, because really the key strategic thrust here is to get as many AVANCE units in the market as possible because that really future proofs our business and really is a benefit to customers. So we see those margins coming down over time as we introduce 5G, and also, as we see a higher mix of the L3 products versus the L5 products getting into the parts of the market that use that less expensive equipment.

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

Great. And just one final question. Just on the GEO side of the equation, what percent of your unit base and what percent of your revenue base would you say is addressable by that competitive set?

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

Of the GEO satellite providers?

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

Yes. Basically, what part of your base is those large jets and how much of your revenue is attributable?

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

I'm going a little bit of shooting from the hip a bit, but 20%, 25%, somewhere in that range. That market, the heavies, there are really, I would say, 3 missions. There are those that fly overseas all the time, most of which have been grounded due to COVID for a while here. But they have a predominant need for GEO satellite coverage. And some of them would have our ATG as well for when they're flying over the U.S., because they flipped to ATG to save money and because of the low latency.

Then there's a middle group, which might fly around the U.S. most of the time, but are -- do go overseas, and maybe they're not traveling, they're going to Mexico or South America or whatever. They're not -- they may -- might not have GEO at all. And then there's a large group, about 40% of that market that just flies inside the United States, and they predominantly have a need for ATG and not for GEO. That's kind of the breakdown. We actually have -- I think we count that segments about between 3,500 and 4,000 aircraft, and we have a little more than 50% of that market.

Operator

Our next question comes from Louie DiPalma with William Blair.

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

For Barry, with the cash flow visibility, can you discuss the potential for a stock buyback in 2023?

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

Sure. With this increased guidance, it certainly accelerates our ability to do the kinds of things that we have talked about. We've discussed the prioritization of our capital allocation, I think, on the last call. We certainly are interested in driving shareholder value, and that can mean return cash to shareholders over time. But the way we think about it is we want to get 5G deployed, we do want to continue to drive reduced leverage, thirdly is we want to continue to invest in some -- in the business. And as Oak laid out, we see some significant opportunities for investment that don't take a tremendous amount of capital, but can drive meaningful top line growth like the global broadband product getting down into general aviation and so on.

And then the fourth priority is the return of capital to shareholders. So we haven't decided on what that timing might be. But certainly, with the expectations for increased cash flow based on the acceleration of the top line that really has the very high flow-through to free cash flow, that could pull those opportunities up somewhat. But that -- we'll evaluate it as we get on the other side of 5G, and I don't want to speak totally for it, but I can tell you about the return of capital to shareholders is something that he is interested in.

Operator

Our next question comes from Lance Vitanza with Cowen.

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

Obviously, you've got some really strong tailwinds here, but let me play devil's advocate for a minute. 2 questions. First, why exactly is your license spectrum a differentiator? I understand the ability to fall back to a dedicated channel and why that's important. But why can't a would-be competitor contract for spectrum with Verizon -- contract for spectrum with Verizon, AT&T, something like that? And then secondly, on the competitive front, in the past, you've talked about LEO, MEO as well as GEO as a potential threat. But on Slide 11, you do not today. So I'm wondering, has there been a change in your thinking there? Why shouldn't investors be worried about Elon Musk with Starlink or OneWeb or guys like Telesat that are building LEO, MEO constellations?

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

Sure. Let me jump on the last part first and then the first part. The last part, we've never seen them as a threat, investors did. And so we kept getting asked about it, so we responded to that. But Telesat and OneWeb are both clearly focused on B2B models. If you look at the deals that they've announced, and they're not going to go directly into markets, especially markets as small as ours themselves, they're going to sell capacity to other people. That's what their business is. As far as Starlink goes, we recently did a study of this, and it's kind of -- when you really look at the numbers, it would be almost ridiculous for them to come into our market. They're going after the $200 billion consumer fixed market. They're going after the $80 billion defense market, mil/gov market. You can walk down in terms of the markets that are going after that you measure in tens of billions of dollars.

When you look at our industry, today, the entire service revenue in our business industry is $500 million [for us]. And the study we did projects that it will reach $900 million by the end of 2025. That's not a market that they will bother spending a lot of time investing in. And the market itself is very complicated. It's a very fragmented market, so you need to go at it in a lot of different ways. You've got to go through dealers, you got to go through OEMS, you got to appeal to the end user market. You've got to have special relationships with the big fractional providers, et cetera. And there's a lot of regulatory complexity to our industry. It's very complicated. The engineering is very complicated. It's very hard to get activity to an aircraft at 40,000 feet, 400 miles an hour.

So for such a small market, it would be remarkable for Starlink to want to commit a lot of resources to come in here. So I can see Starlink going after commercial airlines, that's a $9 billion market. And if they fit on large regional jets, maybe they will want to sell to some of the large aircraft at the very large end of the business aviation market, but that's a relatively small market. And frankly, the amount of service, the amount of work to go after even that segment of the market is probably not worth their time. So -- and the answer to LEO, of the 3 constellations that are most likely to be up today, 2 are clearly focused on B2B models, and so it would be publicly more in the partner vein. And from a Starlink perspective, it would be hard to imagine them wanting to focus on a market as small as ours. So that's the second -- first part of your question.

Your other question -- I'm sorry, could you repeat it?

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

Sure. It was the spectrum as a differentiator, your home spectrum, and I understand that having a fallback channel, a dedicated channel is important. But I'm just wondering why can't the next would-be competitor just simply lease spectrum from someone like Verizon or AT&T or Sprint or something like that and recreate it without having to get a new auction or the FCC involved?

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

Because they're not allowed to use it for air to ground. That spectrum is terrestrial. So it can go up a couple of hundred feet, but it's not supposed to be used for air to ground. It's not legal, so.

Operator

Our next question comes from Phil Cusick with JPMorgan.

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

A couple of quick ones. First, Oak, you said that virtually every mainline aircraft has come up the network. Can you expand on that? And what does that mean for the revenue stream you're getting from Intelsat?

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

Yes. We still have regional jets on the network. We support all the regional jet that went to Intelsat as part of the CA sale. But I think it's probably 100 or less mainline aircraft that are left, mostly those were older models that airlines didn't want to upgrade to 2Ku because they were going to retire them pretty soon. So right now, it would be a very, very small number of mainline jets left on the network. And then, yes, the regionals, it's about 1,000 jets, but of course, they have a much lower usage footprint than the mainlines did.

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

Any indication on what that revenue stream looks like over the next few years?

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

Barry, I will turn that to you.

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

Yes, we have a contract with Intelsat that runs over 10 years. It's a $178 million over that 10-year period. It ramps during the course of that 10-year period. So the expectation for this year is in the kind of middle to high single digits, and then it grows up from there to high-single-digit millions.

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

Okay. And then just a quick follow-up on Landon's question about timing. This was a good overview. But was there any strategic reason that this needed to happen now as opposed to after earnings?

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

No.

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

Well, the other piece I would just add that, I described before, though, was that we did update the model and we did it sooner than we had planned. On our last earnings call, we said we planned as an amount of normal course to update that ahead of our Q4 call. But because of the equipment strength and all the benefits that we're seeing in the business, it was materially affecting our outlook. And we provided the updated guidance for 2022 on our last earnings call, these top line guidance. And so we then did a formal refresh of that model more recently. And as Oak said, it was just approved by the Board last week. So once we saw that, our expectations had increased. We wanted to get that information out promptly.

Operator

Last question is from Ric Prentiss with Raymond James.

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

Although we are surprised, it's happening now because of COVID, so I appreciate the answer (inaudible). So couple of ones just for me. Oak, you had mentioned ESA. Can you talk to us a little bit about how you see antenna technology, where we're at and how it's playing out over the next few years?

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

Yes. Ric, you were a little garbled, but I think you were asking about how we see ESA antenna technology developing over the next couple of years?

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

Yes.

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

Yes. I mean ESA exists, obviously, in the military, and they've been around, they're just very expensive and very hot. There are a couple of dozen companies that are trying to develop ESA technologies to serve various markets. There are some that are focused on aero, I'd say more generally, probably in the large commercial aircraft and in the business aviation market. We have dialogues going with many of those companies. And as you probably are aware, Rick, we actually had an investment in one of them at one point. And we pride ourselves in our ability to design equipment that fits the unique needs of the business aviation market. It's that deep knowledge of how you engineer to fit on these small aircraft that is a unique competitive advantage of ours. And so we're working and working on who our partner ought to be for -- to help us develop an ESA that we could take into our market. So -- and we think that's a couple of year project once it launches and that should coincide relatively well with when we think some of the first LEO networks will become available.

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

Excellent. And you hinted a couple of times, but can you talk a little bit about how you see maybe industry structure or M&A or anything else that you guys might want on your wish list?

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

I think we've got a great industry structure. So we've got a highly fragmented market where we have deep relationships. There are -- in terms of the suppliers to our industry, there's 9 OEMs instead of 2 that can kind of control everything in the commercial aviation business. And then because of our ATG network and the unique nature of that, we're -- have a highly differentiated product. So we like that. I don't think that we see any M&A as necessary for us to succeed in our mission. That's not to say we wouldn't look at opportunities down the road. But right now, we don't have anything on our list.

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

Okay. And last one for me. We get this question. These are the frequency from investors. Why be a public company? Should you be a private company? Should be part of something bigger? Do you want to get bigger? But just kind of as you think of your size, how do you guys view kind of the public versus private maybe side of that equation?

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

Yes. Well, we're hoping. I mean part of today's effort, and as you know, Rick, over the last couple of years we've talked about, when do we relaunch Gogo to the public market to try and communicate the value of this business to the public markets. And today, as part of that effort, I think that we've been fortunate in terms of the increase in demand in business aviation. It gives us a great opportunity to talk to the market about the value we see in the company. And frankly, we hope that the public markets see that, and we're going to do our best to communicate it effectively.

Operator

I would now like to turn the call back over to Will Davis for any closing remarks.

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

Okay. That concludes the conference call this morning. Thank you for your attendance, and we will talk to you soon. Thank you.

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

Thanks all.

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

Appreciate it.

Operator

This concludes today's conference call. Thank you for participating. You may now disconnect.