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GOGO - Q1 2020 Gogo Inc Earnings Call

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CORPORATE PARTICIPANTS

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

Oakleigh B. Thorne *Gogo Inc. - President, CEO & Director*

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

CONFERENCE CALL PARTICIPANTS

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

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

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

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

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Q1 2020 Gogo Inc. Earnings Conference Call. (Operator Instructions)

I would now like to hand the conference over to your speaker today to Mr. Will Davis, Vice President of Investor Relations. Thank you. Please go ahead, sir.

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

Thank you, Dilem, and good morning, everyone. Welcome to Gogo's First Quarter 2020 Earnings Conference Call.

Joining me today to talk about our results are: Oakleigh Thorne, President 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 press release filed this morning and are more fully detailed under the risk caption -- caption 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 May 11, 2020. 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'll present both GAAP and non-GAAP financial measures. We included a reconciliation and explanation of adjustments and other considerations of our non-GAAP measures to the most comparable GAAP measures in our first quarter earnings press release.

This call is being broadcast on the Internet and available on the Investor Relations section of the Gogo 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 B. Thorne - *Gogo Inc. - President, CEO & Director*

Thanks, Will, and good morning, everyone. I'm not going to spend a lot of time on Q1 2020 as people are far more focused on our response to COVID-19 than they are in the quarter. But I am going to steal a little Charles Dickens to put the quarter in perspective. And that is that Q1 was definitely a tale of 2 quarters. It was the best of times in January and February and close to the worst of times in March. I would say it was close to the worst of times because only April was worse.

We finished February ahead on service revenue, gross profit, EBITDA and free cash flow. And while we managed to still exceed our EBITDA and free cash flow targets for the quarter, we finished behind plan on service revenue, equipment revenue and gross profit. I'm going to leave most of the numbers to Barry, but share a few that demonstrate the drop-off in our March business.

In our CA North American segment, service revenue averaged $28 million per month in January and February and fell 35% to $18 million in March. ARPA fell 36% from January and February to March, and gross passenger opportunity fell 18%.

In our CA Rest of World segment, aircraft online grew 30% over prior year for the quarter. But despite that, gross passenger opportunities fell 25% in March.

And in our Business Aviation segment, daily flights dropped 27% from the month of January, February to the month of March. The drumbeat of week over week steady declines began in Asia in late February, but by mid-March was in full effect in the U.S. and Rest of the World and carried through April. Only now in May do we see some green shoots with a big increase in BA flights per day and encouraging increases in CA passenger traffic and daily sales.

In these troubled times, we're laser-focused on our liquidity and long-term solvency. And towards those ends, we've developed a 3-track plan of attack: an operating track, focused on medium-term liquidity; a strategic track, aimed at realizing the value of our 2 businesses; and a financing track, aimed at backstopping the first 2 tracks should we need it.

So let me talk about those 3 tracks in more detail, starting with the operating track. The impact of COVID on our markets has been profound. There's been a litany of bad news coming out of the airlines, OEMs and the travel industry generally. I

n the commercial airline market, TSA reports that U.S. air travelers were down 95% in April from 2019 levels.

IATA projected global airline revenues will be down $314 billion or 55% this year versus last. The Coronavirus Flight Cancellation Tracker reports that of the 193 airlines it monitors around the world, 105 weren't even flying at all at the end of April.

And Cirium, a consulting firm that tracks aircraft, estimated that nearly 17,000 of the world's 26,000 commercial aircraft were grounded at some point in the month of April.

In the business aviation market, there's also been a big impact. Business aviation market research firm WINGX, which tracks business aircraft flights around the world, reported that business aviation flights were down 80% in April versus prior year. So the corresponding impact in Gogo has also been dramatic.

In April, our Commercial Aviation segment's flight counts were down 73% versus prior year. And because there were very few passengers on those planes, session counts were down 91%, and sales were down 66%. And the reason sales are not down as much as sessions because we have subscription plans and monthly revenue guarantees from some airlines.

We also saw a significant impact on our Business Aviation flights with April average flights per day down 78% versus prior year and a decrease of 90% from prior year at the low point on April 12.

Because of the dramatic reduction in flights, many aircraft owners, this is in BA, parked their aircraft in the March-April time frame, and approximately 30% of our 5,700 ATG accounts took some action to reduce their spending with Gogo, including 940 account suspensions and more than 750 service plan downgrades. This will have a negative impact on Q2 revenue. But the magnitude of that impact can't be determined until we see the rate of reinstatements.

All that said, it looks like we bottomed out mid- to late April and now are seeing green shoots in both our businesses. So there is some cause for optimism.

In our Commercial Aviation division, though still way below last year, TSA passenger accounts last week were up 70% from the lowest week in April.

For the first time since early March, our flight counts were up for the week. In fact, until last week, we had not had a single day when the flight count was up from prior week. And last week, we were up 6 out of 7 days. Also, last week, for the 10 airlines that feed us daily data, we saw passenger counts up 70% from our low point in mid-April. And also last week, daily in-air sales, now that doesn't include service plans or revenue guarantees, were up 40% over the prior week. Granted that's off a very low base, but hopefully, it indicates the beginning of a rebound.

In BA, the green shoots are more pronounced with average daily flights last week, up more than 200% from the low point in mid-April, and up a little more than 60% over the April average. We're also starting to see suspended accounts reactivated with 218 reactivations as of last Friday for a 23% reactivation rates.

We see these reactivations really accelerating and accelerated a lot late last week, and we expect that to continue.

More generally, in Commercial Aviation, we hear from airlines that bookings are starting to overtake cancellations. They're starting to add some international routes back in May, and load factors are picking up. Assuming that as a society we continue to make progress against the pandemic, we think that commercial air travel will come back faster than it did after 9/11 because the airline industry is much more sophisticated in managing this product and marketing its product than it was 15, 20 years ago.

On the Business Aviation side of our company, many industry experts are saying that COVID-19 may be a catalyst for the industry. As those that can afford to fly privately, will be more inclined to do so out of concerns over the pandemic.

But enough on green shoots. We can't afford -- we can't count on an industry recovery, and we need to plan for the worst and hope for the best. So let me turn back to the COVID operating plan I mentioned a moment ago.

The first goal of our plan is to protect the health and safety of our employees and our customers. This is especially true in our production facilities, where we implemented new work rules and schedules to ensure safety and redundancy, and in our labs where scout and crews have maintained access to critical pieces of equipment. Elsewhere, we've implemented work-from-home policies and our team of over 1,000 employees has done a great job of working remotely, but staying connected and working as a team.

Today, we're starting our Phase 3 entry into our Business Aviation headquarters in Broomfield, Colorado, as we follow Colorado's shift from work-from-home to safer-from-home guidelines. I'm really proud of the way our employees have risen to the challenge of adopting the new ways of working, communicating and staying aligned in these challenging times.

After safety, our next priority is focusing on the financial health of Gogo and creating value for shareholders. To do this, we established 3 goals to guide our planning efforts. They are: first, to ensure we maintain the minimum liquidity we need to run our company; second, to continue paying the interest we owe on our debt; and third, to achieve the first 2 while preserving the strategic franchise value of our 2 businesses.

Our approach has been to develop and continually pressure test multiple scenarios for the depth and duration of the COVID pandemic in our markets and then develop operating plans to address those scenarios. The operating plans in turn drive 16 cost levers that we can pull to push, to manage our cash expenses. To give you a flavor for the process, our original worst-case scenario for the CA business assumed a 2-month ground stop in the US and a 3-month ground stop in the Rest of the World, with recovery starting at 20% of former traffic and severing back up to 80% of former traffic in 2021.

So let me walk through the levers in no particular order and give you a sense of where we are. The first lever is our satellite partners. We're asking them to reduce our costs commensurate with the reduction in capacity we need to satisfy demand. Generally, they've been very cooperative as they value our future business once the pandemic has passed. We're close to completing documentation on terms with more than half of our satellite partners and are very close to reaching terms with most of the rest. We'll obviously favor partners in the future who help us today.

The second lever is airlines who are themselves quite cash strapped but are amenable to ways we can both reduce costs. In our case, that generally is around delaying installations, especially installations tied to older deals where we heavily subsidized equipment. As Barry will share in a moment, this has gone very well and leave very few installs planned for the rest of this year.

The third lever is delaying purchases, which is mostly centered around the inventory side of the airline installations I just discussed, but has required extensive negotiations with suppliers where we had pre-existing orders.

The fourth, fifth and sixth levers are travel, marketing and nonessential spending. Obviously, our need to travel has been curtailed, and most of the shows that consume our marketing dollars have been canceled.

The seventh lever is focused on working capital, especially the timing of payments.

The eighth and ninth are product initiatives, like our Gogo 5G and Ka initiatives, where in our best-case scenarios, we do not trim expenditures at all, but in our worst-case scenarios, we can delay projects and save substantial amounts of money.

Levers 10 through 16 are all personnel-related actions. 10 was to delay payment of my bonus for 2019, which is done.

11 was to delay merit increases for 2020, which has also been completed.

The 12th was a hiring freeze, largely done except for critical backfills.

The 13th was reducing contractor headcount, which is largely complete.

The 14th was salary reductions, which went into effect last week, starting with a pay cut for our Board of Directors and then for almost all employees who were not furloughed.

The 15th is the furlough program which also went into effect last week, impacting approximately 54% of our workforce.

And finally, the 16th would be a reduction in force, which we hope to avoid but could become necessary if we need to go there to ensure our solvency in the future.

In our best-case scenario, these reductions save us roughly $170 million in cash between now and the end of 2021. And in the worst-case scenario, they save us $330 million in cash over that same period.

We believe these savings should be adequate to tie us through to sunnier days. However, we continually model new scenarios in case this downturn is substantially deeper and longer than our current worst-case projections, and we're developing plans to address those scenarios if need be.

I want to thank the Gogo team for the hard work and creativity they have displayed in developing these plans, and also, for the sacrifice, all of them are making to ensure the long-term survival of our company. This has truly been a team effort, and it is deeply appreciated.

Now let me turn to the strategic track. As we've said many times in the past, we have 2 valuable businesses, and management views our job as realizing the value of those businesses for our shareholders. Our Business Aviation division operates in a very attractive industry, with relatively little consumer -- little customer concentration and underpenetrated market, strong market position and little direct competition.

We offer the industry's leading product at an attractive price relative to competitive solutions, and we have significant barriers to entry due to our proprietary spectrum and ATG network. Financially, our recurring revenue model generates strong cash flow, which allows us to invest in enhancing our product offerings and maintaining our product advantage as we did with the launch of our AVANCE product line 2 years ago and as we will do with Gogo 5G.

Though our BA business has been affected by the COVID pandemic, we expect that it will recover more quickly than Commercial Aviation as destinations open for business and aircraft start to fly again.

Our CA business operates in a more challenged industry with high customer concentration, a more heavily penetrated market and a lot of competition. Everyone agrees that broadband commercial aviation IFC is an attractive growth industry. Passenger adoption is growing quickly, and OEMs and airlines are poised to drive more operational applications as the quality of in-flight broadband grows in the future. But no player in the industry has yet built a sustainable business. And they won't unless the structure of the industry fundamentally changes through either horizontal or vertical business combinations.

Gogo Commercial Aviation brings an attractive and unique set of assets to such a combination. We have leading market share with attractive customers and strong customer relationships. We have industry-leading competencies in engineering, software, sales, support, network management and other areas. We have the leading IFC product in the world in Gogo 2Ku, and we have an asset-light business model that affords us tremendous flexibility as the satellite industry moves quickly toward a multi-orbit, multi-spectrum future.

On the multi-orbit front, Gogo's unique 2Ku mechanical phased array antenna is the only terminal technology proven capable of working with an NGSO satellite constellation, as demonstrated with OneWeb earlier this year.

On the multi-spectrum front, Gogo has developed the ability to cost effectively convert a 2Ku antenna into a 2Ka antenna, which could open up the Gogo 2Ku fleet to Ka operators as well as Ku operators.

Our multi-orbit, multi-spectrum position is important to customers as well as potential merger partners. For customers, it means that we have the flexibility to continually integrate the latest and best satellite technologies from whomever and in whichever band they may emerge. This has always been important and is particularly important in times of uncertainty like now.

Our open technology platform also means that our leading market position and capabilities can be combined with a wide range of potential partners regardless of spectrum band or orbit. We think consolidation could take a few different forms. Either vertical integration with satellite operators who want to enter the aviation market directly, horizontal integration with another service provider to drive scale economics or consolidation by an aviation company seeking to further integrate connectivity into its product portfolio.

We believe the consolidation is overdue in the CA IFC space if the depressed revenue across the industry will be a catalyst to drive that consolidation, and we want to make sure our shareholders are a beneficiary of that consolidation.

Now let me finish with the financing track. We're not in the market for financing at this time. But we always entertain conversations with many different actors to make sure we understand the realm of the possible should our operating and strategic tracks that I discussed a moment ago, not generate satisfactory results. The only financing activity we're pursuing at the present with the U.S. Treasury Department under the CARES Act, which provides 2 potential opportunities for Gogo to receive assistance.

The $32 billion short-term payroll-protection grants for air carriers and contractors, and the $29 billion in loans and loan guarantees for air carriers, including Part 145 repair stations like Gogo.

We applied for $81 million under the grant program and $150 million under the loan program, and have heard that we are under consideration, but not yet approved for either. Should we receive government assistance, we would roll back all or most of the furloughs and pay reductions that I discussed earlier, and obviously defer any other employee actions until after September 30.

With that, let me turn it over to Barry to do the numbers.

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

Thanks, Oak. Given these extraordinary times, we thought (inaudible) quarterly comments to begin with the questions on the top of everyone's mind. I'll start with the financial impact of the COVID-19 pandemic on our business then move to a discussion of the financial implications of our scenario planning, and I'll conclude with an abbreviated review of our operating results.

Some important context for determining Gogo's ability to weather the COVID crisis is understanding our financial position coming into it. Over the course of the previous year, Gogo had strengthened in 2 important ways. First, the business was finding its financial and operational footing; and secondly, we were in a much stronger cash position than anticipated. As Oak described, the first quarter results represent a tale of 2 quarters.

Through February, consolidated adjusted EBITDA was $13.3 million ahead of our internal budget and consolidated service revenue was also running ahead of plan. Driven by the strength of the first 2 months, consolidated adjusted EBITDA of $25.7 million the full first quarter slightly beat our internal budget. This was in spite of the dramatic impact of the coronavirus pandemic during the third month of the quarter. We believe the operational and financial discipline underlying these results provides an important foundation to build on once things begin to normalize. Even more important than this operational foundation is the company's strong liquidity position exiting 2019 and continuing through the first months of this year.

You'll recall that we significantly overachieved our free cash flow objective last year as we improved free cash flow by $163 million in 2019 versus the at least $100 million improvement we had targeted going into the year. This was the result of lower investment in airborne equipment, adjusted EBITDA coming in well ahead of plan during 2019 and improvements in other working capital, primarily accounts receivable.

We continue to build our cash balance through the first 4 months of this year from $170 million at the end of 2019 to $211 million at the end of April. The 2020 figures include $22 million in proceeds from our ABL drawn in March. Excluding this additional liquidity, cash increased by nearly $20 million since the end of the year. Without the cash flow overachievement throughout last year and the first quarter of this year, our cash position would have been approximately $130 million versus the balance of well over $200 million exiting April. These strong cash balances position us well to achieve the first 2 financial objectives oak described, which we set for ourselves as we began planning our response to the pandemic.

First is maintaining the minimum liquidity we need to run the business, and second is meeting the interest obligations on our debt. We are current on our interest payments, including $45.7 million paid on May 1, and we are in complete compliance with all of our debt covenants.

Now I'd like to expand on the operational planning approach Oak described, focus on the financial and liquidity implications for Gogo. We started by establishing best-case and worst-case scenarios, and then went through a detailed bottoms-up planning process to quantify the levers required to save sufficient cash to achieve our liquidity objectives. We brought a very sober-minded approach to this process. Oak described the worst-case scenario and the 16 cost saving levers in some detail. Even our best-case scenario reflected a very severe impact on our industry.

For this case, we divided the world into 8 segments, and we modeled passenger declines of at least 90% in 6 out of 8 of these segments. We're taking a very dynamic and conservative approach to planning in this period of high uncertainty. While we are seeing some green shoots, we are fully prepared to execute on the actions mandated by our worst-case scenario and we continue to update this scenario as new information comes to light.

Let me dimensionalize the 16 cost levers a bit more from a financial point of view. To reiterate, the reductions we've identified drive roughly $170 million in savings during 2020 and 2021 in the best case scenario and $330 million in a worst-case scenario over the same period.

The cost reductions are also front-end loaded with the overwhelming majority coming in 2020. Approximately 3/4 of these cost savings are either directly in our control or savings where we have already reached agreement with the requisite counterparty. The 3 primary counterparties include airlines, equipment suppliers and Satcom providers. Importantly, we have agreed with our airline partners to significantly delay installation. This action represents very significant cash savings to Gogo between now and the end of 2021. We have already renegotiated our purchase commitments to align with these installation delays, reducing our 2020 expenditures by at least $80 million.

Netting the foregone airline proceeds we would have received for these installations, these delays represent approximately $40 million in net cash savings to Gogo during 2020.

As Oak described, we've also made very good progress with our satellite partners. We are papering the agreements we've reached with over half of them, and the majority of the rest are in the final stages of negotiation.

If necessary, there is also a substantial amount of program spending we could reduce. Gogo 5G is the most significant of these. We expect to spend approximately $100 million in combined OpEx and CapEx for Gogo 5G with CapEx comprising approximately 2/3 of this total. On the current schedule, our spending for this program peaks at just under $50 million during 2021. We could delay our Gogo 5G spending, if required, to meet our financial objectives.

So what is the outcome of the detailed planning exercises? Even under the worst-case scenario, we meet our key financial objectives of maintaining the minimum liquidity that we need to run the company and making our interest payments. Interestingly, under the more optimistic scenario, our cash balance at the end of 2020 actually increases by about 10% versus our original budget. This is because a significant portion of the cost savings take hold this year, and we also benefit from the ABL proceeds.

Under the worst-case scenario, cash declines more steeply in 2020 than originally budgeted, but we achieve approximately breakeven free cash flow in 2021 because a significant portion of our cost structure is sized to match the revenues. Of course, this free cash flow metric includes making our scheduled interest payments.

Let me offer 2 other data points which corroborate our expectation of maintaining adequate liquidity through this crisis.

First, for the purposes of our first quarter 2020 report on Form 10-Q, which we are filing today, we have concluded, and our auditors have agreed that we do not have substantial doubt about our ability to operate as a going concern.

As you know, the accounting rules required that this assessment be made at the time of periodic report is filed with the SEC and for the 12-month period thereafter, which would be through May of 2021.

Secondly, Moody's recently issued a statement with a stable outlook. Moody's stated their expectations that "Gogo's cost savings initiatives will help the company mitigate the impact of the disruption caused by the coronavirus on its EBITDA and that the company will maintain adequate liquidity over the next 12 to 18 months".

Importantly, our financial planning does not assume any benefit from government funding, although we have applied for an $81 million grant and $150 million loan under the CARES Act. We've not yet heard whether we will be allocated any of this capital, we would hope to hear a response within the coming weeks, and as we do, we will respond accordingly.

I'll now turn to a discussion of our first quarter operating results, beginning at the consolidated level. Total service revenue was $150.8 million for the first quarter, down 9% over the prior year period. This is driven by a 23% reduction in service revenue in March versus the average for January and February, reflecting the impact of COVID-19.

In spite of this revenue decline, we recorded adjusted EBITDA of $25.7 million for the quarter, which was well above consensus estimates. Free cash flow was solidly positive at $22.7 million for the first quarter. This was an improvement of $57 million year-over-year, but a large part of this improvement was due to the shift in the timing of our interest payments as a result of the refinancing completed in May of 2019. Adjusting for the impact of this change, free cash flow improved $11 million from the year ago quarter.

For clarity, let me summarize the impact of the COVID pandemic on this quarter's financial results.

In addition to the low

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one affected adjusted EBITDA and the other 2 are excluded from adjusted EBITDA. The first item was a charge of $6.8 million for credit loss reserves, the majority of which was related to a single international airline partner, which went into administration during April. This charge is reflected in our G&A expense for the quarter. Adjusted EBITDA would have been 32.2 -- $32.5 million without this charge on par with the fourth quarter, and this is in spite of the significant revenue impact of COVID in the month of March.

We also recorded 2 asset impairment charges totaling $49.4 million during the quarter which were largely related to COVID 19. First and most significantly, we wrote down airborne lease assets by $46.4 million for 3 airlines where future cash flows are not expected to exceed current book value. These are airlines operating under the turnkey model under which we carry assets on our books. And it primarily affected agreements, which include significant equipment subsidies, which have been offered in the years past.

COVID negatively impacted our assessment of the revenue from these airlines resulting in an asset impairment charge this quarter.

The second impairment charge was a $3 million write-off of an investment in a technology development company made in 2017. The company had recently come to terms to be sold at a price, which have -- would have resulted in a profit to Gogo, but the sale was canceled due to the pandemic, which forced the company into administration. I'll now discuss the operating results for our business segments, starting with Business Aviation.

BA posted another great quarter. Service revenue increased 8% to $57.7 million, with units online increasing 7% to 5,713 and ARPU increasing 2% over the prior year period.

During the past 2 quarters, BA has grown ATG units online by 19% cumulatively on the strength of the AVANCE product line.

Total revenue increased 1% to $70.9 million as equipment revenue declined 24% over the prior-year period. This decline was due in part to the record equipment sales we achieved in the fourth quarter, which included higher year-end purchases by our dealer channel. BA achieved $35.9 million in segment profit for the quarter with a record high 51% segment profit margin. This was driven by a 5 percentage point increase in service revenue margin over the prior year period. This record segment profit margin was in spite of $2.1 million in operating expenses incurred for the development of Gogo 5G during this quarter.

Now let's turn to a discussion of our Commercial Aviation division results, starting with CA North America and Rest of World on a combined basis. CA, in particular, represents a tale of 2 quarters. Combined service revenue for the month of March was down 34% versus the average for January and February and the ARPA results followed a similar pattern.

For the first 2 months of the quarter, CA-NA and CA-ROW generated nearly $10 million in combined segment profit, significantly exceeding plan. CA incurred an $11 million loss for the last month, resulting in negative $1.5 million in combined segment profit for the quarter as a whole.

We increased 2Ku aircraft online by 104 during the quarter as installations were generally on pace with the levels of 2019. As we've discussed, a major source of cash savings in our COVID-19 response plan comes from the delay in 2Ku installations we are planning with our airline partners.

As a result, we now expect installations for the balance of the year to be minimal. We also continue to monitor the number of parked aircraft and those that may come out of service as these actions could affect the number of aircraft online.

CA North America total revenue declined 17% to $80.1 million and service revenue declined 20% over the prior-year period, reflecting the impact of COVID-19. The year ago quarter included approximately $7 million in nonrecurring product development revenues as well as the impact of the American Airlines business model shift and the deinstallations.

Excluding these 2 factors, revenue was almost flat over the prior year and would have grown, but for the impact of the pandemic.

CA-NA segment profit declined by $15 million from the prior year, driven by lower service revenue. The impact of this revenue shortfall was significantly mitigated by a 32% reduction in operating expenses, including ED&D, sales and marketing and G&A over the prior year. This demonstrates the financial and operational discipline being exercised across the company. CA-NA aircraft online increased to 2,480 at March 31, 2020, from 2,412 at March 31, 2019.

This increase in AOL was despite the planned removal of 103 older mainline ATG aircraft, which occurred in the last 3 quarters of 2019.

The CA-ROW business posted total revenue for the quarter of $33.4 million, an increase of 1% over the prior year period. Service revenue decreased 3% to $19.2 million

(technical difficulty)

partially offset the impact of COVID-19. Equipment revenue increased 8% versus a year ago.

ROW segment loss was $17 million, a modest improvement from a year ago. Our substantially improved equipment margins would have narrowed this loss further but this quarter's ROW segment profit includes $5.4 million of the charge for credit loss reserves I previously described. Excluding the impact of these reserves, which are largely related to COVID-19, segment loss would have improved 36% over the prior year period.

ROW aircraft online increased to 833 at March 31, 2020, up 192 or 30% and from 641 at March 31, 2019. ARPA declined due to the increased mix of aircraft on unseasoned airlines and the impact of COVID-19.

ARPA for the month of March was approximately 30% lower than the January-February average as we began to see the impact of COVID during the last month of the quarter.

As I conclude my prepared remarks, I want to emphatically reaffirm our commitment to successfully steer Gogo through these times. Of course, the impact on the aviation industry has been dramatic, and we are swept up in these challenges. But we have worked very hard to bring an objective perspective to this situation, and have developed 16 levers we can pull to significantly reduce costs, and we are executing on these plans. And there's more we can do if necessary, both operationally and strategically. We will size our cost savings actions to match the magnitude of the COVID impact as it unfolds. And we will continue to press forward with the industry consolidation opportunities we see in front of us.

I also want to join Oak in thanking our employees for your courage, commitment and creativity in addressing these challenges. You have brought real solutions, are reinventing processes and your can-do spirit is inspiring, and you're doing it all while working remotely. Thank you again.

Operator, we're now ready for our first question.

QUESTIONS AND ANSWERS

Operator

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

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

Oak, we've been talking about M&A in the space since you came back as CEO and for a long time before. Does this crisis create any urgency for strategic decisions? And the vertical or horizontal seem more viable today?

Oakleigh B. Thorne - *Gogo Inc. - President, CEO & Director*

Yes. I think people's revenues are down in the IFC space. And I think that, that accentuates the issue of scale. And I think it makes it to always bear the fact that nobody has scale horizontally. Vertically, people are also obviously taking a hit on the reduction in IFC spending. People like us and other service providers coming to satellite companies and looking to sharing the pain, if you will. And that remains an attractive market for both satellite operators and service companies in the long term.

And I think that the opportunities created by combining in terms of scale are highlighted by the fact that your revenues are down. You could -- you combine, you've got more revenue and you combine cost structures, makes a lot of sense. So I think if anything, it accentuates it. I wouldn't want to speculate whether vertical or horizontal more likely. I think there's a lot of industrial logic for either, to be honest. And obviously, I think there's a lot of conversations taking place right now. And I think it will all come out in the wash in terms of what makes the most economic sense to the boards and various companies involved.

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

So just to push back a little bit, and the satellite ecosystem is beaten up. There's not a lot of equity value there. The IFC space is beaten up. I can't imagine that a lot of airline suppliers are feeling great right now.

How do you actually get anything done here? Or does somebody have to just come in with new capital to roll the space up?

Oakleigh B. Thorne - *Gogo Inc. - President, CEO & Director*

Well, first of all, all valuations are relative. So if you're looking at stock merger opportunities, that type of thing, and everybody's stock is beaten down, that helps to some extent. And also, frankly, in our case, I think the public markets don't really understand the value of the company, and I think strategics do. So I think that there's just a dislocation there. Hopefully, we would look for some adjustment in that dislocation as part of the deal.

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

Okay. And one more, if I can. Any update you can give us on the satellite deals you said half are close to signing something new. What kind of pricing could you see out of that? And then also, are you concerned about availability over time? Are there any changes in construction or launch time incoming?

Oakleigh B. Thorne - *Gogo Inc. - President, CEO & Director*

You know what, I would say this, in terms of structural price reductions long term, we see that coming as new launches take place. And obviously, we're still talking to our various providers about their launch plans, and most launch plans appear to be sort of on track or delayed by months, not years.

In terms of the breaks we're getting, it's a sharing in the pain. So it's kind of what we're getting from the satellite company says, "look, okay, well, if your revenues are down here, we'll share in that pain here." But that's not going to -- those deals won't be long term. If we recover, they're going to go back to the pricing they were getting from us before COVID.

So I would say there's really two things to think about. One is helping Gogo get through this period when demand is way down. And that's not long term structural, I don't think. And then on the other side, what is structural is that as new satellites go up, pricing is coming down dramatically. I think in the last call, I talked about the number of contracts we have up in our Rest of World segment over the next 3 years. And it's something like 60% or something like that. And all of those are rolling over, and they're going to be in much cheaper satellites going forward. And that's, I think, more where the structural pricing change takes place. That will improve our economics on the long term.

Operator

Our next question comes from Ric Prentiss from Raymond James.

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

I wanted to circle on some of Phil's comments then. You mentioned the satellite contracts would not last a long time, help you through the period. How should we think about when do you know are you headed towards the best case? When do you know you're headed towards the worst case? What are kind of the intermediate steps that kind of let you know which path we're on?

Oakleigh B. Thorne - *Gogo Inc. - President, CEO & Director*

Yes, Ric, it's all, frankly, tied to flights, load factors would be the 2 biggest drivers. We actually -- we don't stay locked into our best and worst either because circumstances have changed a lot. And if one stayed locked in, what one when I thought was the worst-case 8 weeks ago would look like a very rosy case today. So we consistently are revising and trying to develop new scenarios that might be worse than worst case, et cetera, et cetera. So we have to stay flexible in that regard. Kind of the structure for how we go about planning and the 16 levers remain consistent across all those scenarios, but we just obviously pull them to different levels depending on the scenario.

So that's the big thing, our return of passenger traffic in the things that will drive that. We've seen very high take rates during the crisis, but there haven't been many passengers. So it's not very meaningful. If we can hold on to -- probably won't hold on to the -- as high as the take rates are today because of the fact that flight attendants, for instance, were all online and they are not -- they're not going to increase the number of flight attendants on flights as flights come back. But if we can -- if more people will use in-flight connectivity when they come back because they're more used to being connected, they've been working online from home now. Everybody is connected at this point, it seems. I think that people are going to want to be connected when they fly. So we expect the take rates to be up. And if passenger traffic comes up, we think that will be the key trigger for us in terms of understanding how much we have to cut and win.

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

Sure. And obviously, a lot of moving pieces here on the satellite costs, the furloughed employees and compensation reduction. Any thought about providing quarterly guidance given how many moving pieces there are, but not much clarity on the full year?

Oakleigh B. Thorne - *Gogo Inc. - President, CEO & Director*

Yes. I think we thought about it for this quarter, and there were just still too many moving parts. I mean some of the green shoots I talked about in my script, literally appeared last week. So things are happening and the situation is changing. It's very dynamic. As soon as we sort of think we've got clear path of view of what's going to happen. I think we'll go back to giving quarterly guidance first and then probably back to annual at some point.

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

Okay. And you gave a little bit of color on April. Any thoughts about how we should think of overall revenues or EBITDA performance in April if that does prove to be mid-April was kind of a low point maybe?

Oakleigh B. Thorne - *Gogo Inc. - President, CEO & Director*

Yes, you can pretty much nail the low point at April 12. That was the lowest day for our Business Aviation flights, and I think that was the lowest day for passenger count on our airlines. In terms of guidance around that stuff, I'm going to turn it to Barry because he does the numbers.

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

Well, Ric, as you know, it's just very difficult to predict at this point. So I think we would just be getting probably too far out over our skis to offer too much about that. But to your question about quarterly guidance, I think as the situation does stabilize, which we hope to see beginning to happen in this quarter, it may make sense for us to provide quarterly guidance. And I would just underscore the point Oak made about this being a very dynamic planning process, and we are continuing to work with scenarios real-time as the information comes in. So I think as that finds it's putting in is if we begin to have some better view of the future, we may be able to give some guidance in the short-term and out over time.

The BA business, I would just comment is under the same general dark out of COVID, obviously, but not nearly the same effect. And also the drivers of that coming out, we think, are going to happen more quickly. So I think we also monitor the differences in those very carefully.

And so as we look forward to what BA and CA look like over time, we may be able to think about those differently, too.

Oakleigh B. Thorne - *Gogo Inc. - President, CEO & Director*

Yes. I think we -- yes, well, I think we ain't people, let's say -- we thought April revenue was down 60%, 80% in our CA business. And it's coming back a bit, Ric now, but it's hard to tell how fast that will come back.

BA, on the other hand, we talked about the suspensions. Those obviously will hurt revenue in April but we've already had a pretty big comeback in terms of the number of suspensions being reactivated. The suspension normally as somebody goes in for maintenance, and they want to turn the service off for a month, and we let them do that, that usually runs like 40 a month. We all of a sudden, we had 900 something in the March-April time frame, 200 of which have come back mostly in the last week. So it's very hard to predict. If that rate continues, in terms of reinstatements, April could be impacted, but may pick up pretty good and June could be back to normal. But it's hard to predict. If that pace of reinstatements will continue or not.

Operator

Our next question comes from Lance Vitanza from Cowen. .

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

I wanted to focus on liquidity. A few questions there. And first, maybe just an easy one. The $20 million, I think you called out the $20 million increase in cash pro forma for having drawn the revolver from the end of 2019. Was that through March 30 -- 31 or was that through today's date?

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

That was really through April, Lance. So that cash build went from $170 million to $211 million at the end of April. As I mentioned, that we have the payments for our interest that are in May. So the first of those for $45-plus million was made on May 1 and then the payment for the convert interest is also in May. So the point we were trying to make was that the cash has significantly improved during last year and since the end of last year, in part due to the ABL, but also because of the operations.

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

That's great. Okay. So you've said in the past, I think, that you consider sort of $100 million as your minimum liquidity threshold. I'm wondering if that's still the case or if that is become a smaller number in response to changes that you may have made. And presumably, whatever your threshold is, the threshold is lower the day after you make your bond coupon, is that fair?

Oakleigh B. Thorne - *Gogo Inc. - President, CEO & Director*

Barry?

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

Yes. Let me just clarify one thing you said there, Lance, which is we didn't really view the minimum threshold for liquidity as $100 million. Previously, what we had said is our projections maintained liquidity above $100 million. We can operate with meaningfully less than that. And to your point, the minimum amount and the requirement will fluctuate based on the timing of the interest payments, also expense levels change as we implement some of these cost levers. But in generally, we think about targeting at least in the order of about $50 million or so for operating liquidity and of course, this includes making our interest payments is after the interest payment. So that's kind of the zone that we have targeted as we go through these planning exercises.

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

Great. Okay. So then I think, Barry, you actually, you called out, I believe it was $40 million of, call it, net cash savings that I believe was related to slowing the pace of the 2Ku installs. Did that $40 million include equipment revenue associated with the installs as well, sort of like the all-in kind of number?

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

Yes. So the actual slowdown in purchases will be at least $80 million. And those are the deals that we've already negotiated with our supplier channel. And then that $80 million number gets offset by the foregone proceeds from airlines that we would have received.

So you're right, the net amount was $40 million, and that's just the amount for 2020, so just to clarify that. So the savings amounts that Oak and I both quoted in aggregate were for '20 and '21. So that $40 million really comes this year, which is important.

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

Got it. Understood. What about satellite capacity? Can you -- and obviously, it's a big bucket, can you range that for us in terms of best-case, worst-case scenarios?

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

Yes, it is -- go ahead, Oak.

Oakleigh B. Thorne - *Gogo Inc. - President, CEO & Director*

No, you go ahead, Barry.

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

Well, I mean, as you know, it's our single line item -- largest line item cost. And our philosophy or our strategy going in is to sharing the pain. So we're really asking the Satcoms to reduce cost commensurate with the reductions in capacity, we need to satisfy demand. So -- but that number is -- it's in the tens of millions of dollars also for this year as we look to what we think is an appropriate amount. And so it's a very substantial number. I wouldn't want to get too far over that because we're still in these conversations. But I think what we've been very pleased with the benefit that we received so far. And I think the satellite companies have been cooperative. And I would just say that the numbers that we are seeing from those we have come to terms with are at or -- there at the numbers that have modeled.

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

What about the 5G rollout? Could you repeat what you said about the cadence of spending 2020 versus 2021? And how that might be deferred?

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

Yes. So the total amount of spending for that program is about $100 million, of which 2/3 is CapEx and the balance, OpEx. So we think about this in terms of the development costs associated with really developing the technology and then the rollout of the Gogo 5G as we deploy the cell site.

So $50 million, 5-0, of that is spent in 2021. So that's the peak year of spending. So in the likely case scenario, there's very little delayed. But we could certainly delay that program. We would think about it in those 2 parts. In the ideal, we would maintain the development, and so we have the technology deployable, and then we can easily then vary the deployment of the cell site. So you don't have to have, of course, nearly all the cell sites up in order to get the Gogo 5G experience. They can be deployed in part, and then you layer in the additional cell site deployment as required to service the capacity needs. So that's something that we could do. It saves a meaningful amount of cash of that $50 million really in 2020.

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

So last one for me is on the CARES Act. With respect to the $150 million loan application, your first-lien note indenture, I don't think permits incremental debt of any kind at the guarantor level whether secured or otherwise. So if the application -- well, first of all, maybe I'm misreading that, but if the application is approved, would you expect to just ask note holders for a waiver? Or am I misreading the covenants?

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

Well, first, we'll have to see kind of if we receive that money, how it's structured. So is it at the HoldCo level or at the OpCo level, I think that if the debt were structured at the HoldCo level, so it's structurally subordinated to the first-lien debt. That's obviously the first-lien holders would be more amenable to that. But I think the other part about this is that by bringing this additional buffer liquidity or helpful liquidity, and I think we could have a very constructive conversation with our holders around that.

Operator

(Operator Instructions)

Our next question comes from Louie DiPalma from William Blair.

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

Oak, on the subject of potential industry consolidation, 3 of the potential horizontal consolidators use Ka-band. Can you provide any more color on your comments regarding the optionality of being able to potentially migrate a 2Ku system to Ka or 2Ka?

Oakleigh B. Thorne - *Gogo Inc. - President, CEO & Director*

Yes. So we've worked with our supplier on a way to essentially pull out the disks on the top of the aircraft that sit inside the antenna terminal structure thought the Ku definitely replaced them with Ka disk. And then there are a couple LRU boxes inside the aircraft that would need to be swapped out as well. But it doesn't require any real change to the structure of the aircraft. You're not taking the antenna super structure off, that all stays the same, the adapter plate and fairings and how the whole structure is attached to the aircraft. So it's a pretty easy conversion for those who want to go from a Ku to Ka. So that's a new development on our part, and one we think gives us a lot of flexibility with our -- in terms of spectrum use in the future, if, for some reason, Ka ends up being a preferred band -- preferred spectrum by our customers. And also in the business combination context gives us a lot of flexibility.

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

Oak, and one last one for me. And this is probably for Barry. Barry, if we assume that April represents the bottom, can you estimate roughly like how much consolidated revenue was down in April in terms of a ballpark percentage?

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

Well, that was the amount for CA. So I think probably just the easiest way to do that is you can look at what the normalized revenue was for the first couple of months of this year, January, February, and that decline that we said was on the order of 60% to 80% would be reflected in those April numbers. I wouldn't want to do that math at the top of my head, but that would be basically the foundation for doing that calculation.

Oakleigh B. Thorne - *Gogo Inc. - President, CEO & Director*

On the CA side.

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

Correct, that's just CA, as I mentioned, yes.

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

Okay. So when taking into account, if we assume like flattish BA, should, like, we expect 50% year-over-year decline in total consolidated revenue? Or do you have a ballpark for what we should expect for like the trough year-over-year decline?

Oakleigh B. Thorne - *Gogo Inc. - President, CEO & Director*

Yes.

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

No, it's going to be -- go ahead, Oak.

Oakleigh B. Thorne - *Gogo Inc. - President, CEO & Director*

Yes. Well, the one thing I want to remind you, Louie, is that these account suspensions and planned downgrades will have an impact on BA revenue. We don't have revenue for April yet, but that will be down. And if you think about the ATG part of our business and just the numbers I shared with you, and when you think of percentages, you're going to get to something close.

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

Got you. And are there -- I know that you've spoken a lot or you mentioned one of the international customers not being able to pay or a credit write-down, what are your expectations for potential credit losses on the business jet side for the rest of the year?

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

We don't expect to see meaningful credit losses there. The way the subscription business works is over 90% of the BA service revenues are from subscription businesses. So -- and those payments are largely made on credit cards. And so we have just seen very, very little losses historically in that case. And then there are some of the larger fleet operators, for example, in BA that are under larger -- that are under contracts. And as we've talked about, I think that people are going to want to be using the business jets, particularly as this -- as we come out of the coronavirus situation. So we really don't expect to see meaningful credit losses there. The exposure is on the CA side. And so as we mentioned, that was from 1 international airline partner that went into administration, that we could see more losses, credit reserves taken for -- on the CA side as we go forward if the situation deteriorates. There's the new standard now, as you know, requires you to assess the situation and to take those losses currently as opposed to waiting until they happen. So it's based on the assessment. So as we do that assessment now quarterly, it could be that we would see that those charges taken.

And just to clarify, in the CA business, those charges are both for current receivable balances as well as against the contra asset account that sits on the books. So not all of it is a write-down of current receivables, but part of it is the write-down of basically the value of that contract over time.

Operator

This concludes our Q&A session. At this time, I'd like to turn the call back over to Mr. Oakleigh Thorne, President and CEO of Gogo for closing remarks.

Oakleigh B. Thorne - *Gogo Inc. - President, CEO & Director*

Thanks all for attending our Q1 2020 earnings call. I'd like to finish with a quick summary, if I could.

First of all, in-flight connectivity is not going away because of the corona crisis. If anything, we think passenger adoption will accelerate as more people are connecting online during this pandemic and that they want to stay connected once in-flight when the pandemic is over.

Second, we have a 3-track plan to ensure our long-term solvency and drive value for our shareholders. The first track is our operating plan. We constantly adjust scenarios and develop action plans along our 16 cost levers to hit our objectives. Those objectives being to maintain the minimum liquidity. We need to safely operate the company to pay the interest due on our debt and to preserve the strategic franchise value of our 2 businesses. We've identified and are implementing $170 million to $330 million of cost savings to achieve those objectives and are well on our way to doing just that.

Second track is our strategic track. We believe our Business Aviation division is a very attractive business that can stand on its own, and we believe our Commercial Aviation business is the leading service provider to the commercial aviation industry, and we believe it could bring tremendous value in a vertically- or horizontally-integrated business combination.

Finally, we have a financing track, should the first 2 tracks fail. We're not currently pursuing financing. However, we're keeping our eyes open for appropriate opportunities if they arise. We've applied to the federal government under the CARES Act for grants and loans earmarked to the airline industry and airline contractors. And if we receive government assistance, we would reinstate employees that have been furloughed and restore salaries that were reduced last week.

I want to thank you for your attention, and we look forward to speaking to you again in the future. And as usual, stay safe. Thank you.

Operator

Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.