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GOGO - Q3 2019 Gogo Inc Earnings Call

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by. And welcome to the Q3 2019 Gogo, Inc. Earnings Conference Call. (Operator Instructions) Please be advised that today's conference call may be recorded. (Operator Instructions)

I would now like to hand the conference over to your speaker today, Mr. Will Davis, Vice President or Investor Relations. Sir, please go ahead.

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

Thank you, and good morning, everyone. Welcome to Gogo's Third Quarter 2019 Earnings Conference Call. Joining me today to talk about our results are Oakleigh Thorne, President and CEO; and 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 this conference call. These risk factors are described in our press release filed this morning and are more fully detailed under the 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 November 7, 2019. Any forward-looking statements that we make today are based on assumptions as of this date. We undertake no obligation to update these statements as a result of new information or future events.

During the call, we will present both GAAP and non-GAAP financial measures. We include a reconciliation and explanation of adjustments and other considerations of our non-GAAP measures to the most comparable GAAP measures in our third quarter earnings press release.

This call is being broadcast on the Internet and available on the Investor Relations section of Gogo's website at ir.gogoair.com. The earnings press release is also available on the website. After management comments, we will 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. Good morning, and welcome to our Q3 2019 Earnings Call.

We're pleased to announce a very strong quarter, with adjusted EBITDA and free cash flow well above our expectations. Though, as we predicted on our last call, service revenue was down as a result of the final American Airlines deinstalls and conversions in turnkey to the airline directed model.

Though we're not happy about that decline in revenue, it's worth noting that underlying growth has made up for a lot of that loss. We achieved $158 million of service revenue in Q3 this year, which is right about where service revenue stood. [In quarter], the deinstall program began in earnest in early 2018. I'm also pleased that despite having an extra interest payment in the year, we remain on target to improve free cash flow by $100 million over the prior year.

I'll leave the rest of the numbers to Barry and now move on to some of the operational aspects of the business. And then I'll turn to strategy.

It goes without saying that these are very exciting times at Gogo as we scaled our operations in support of Delta Airlines' desire to provide free internet service to its passengers, as we make great progress on our Gogo 5G product initiative and as we work with our satellite partners on new and exciting ways to serve the aero IFC market. It's also exciting to see a nice bounce back on our Business Aviation division, as OEMs made some nice catch-up orders in the quarter and some of the ADS-B congestion cleared up in the aftermarket.

And perhaps most exciting. Today, we expect to sign a contract with a very prestigious EMEA airline, install Gogo 2Ku and live TV on a significant portion of their wide-body fleet. A formal announcement will be forthcoming. But needless to say, I'm happy to get Gogo back in the wind tunnel.

I'm very proud of my Gogo teammates for delivering such a great quarter. We've worked hard over the past year to improve our operations, execute on our strategy and achieve our financial goals. And I think we're making great progress. So thank you.

Let me touch on strategy for a minute. And then I'll turn to our three business segments to discuss some operational aspects of the quarter.

Strategic front. Today, I'd like to talk about our network strategy. We believe that the market for and revenue from the connected aircraft is poised for accelerating growth as airlines increasingly look at providing free IFE to passengers, as the aviation ecosystem looks for cheaper and faster ways to access operational data. Our strategy is to take advantage of this explosion in demand by positioning ourselves as the provider of the most trusted broadband communication systems in the aviation ecosystem. Today, we serve that market with two network solutions: the Ku satellite network and air-to-ground network.

In the satellite world, we pursue an open architecture asset-light operating model. Today, we work with 11 satellite providers and use 33 satellites to create and manage a seamless near-global network. Though we're band agnostic, today we operate in the Ku-band because there are hundreds of Ku satellites. And we can layer capability where it's needed, we can scale as demand grows and we can provide more redundancies in closed Ka constellations.

I want to highlight the importance of redundancy for just a second. In the last 8 months, three important satellites have failed on orbit or on launch. With the loss of Intelsat 29E this year, Ku supply in [conus] is tight. The Ku service providers have still been able to serve their customers by utilizing other Ku satellites. In contrast, if they were on a three-satellite closed Ka system, the networks for one-third of the world would be dead to their airline customers for an extended period of time.

The satellite world is going through a tremendous amount of change. And our asset-light model gives us the flexibility to harness that change to do what is best for our customers. We see the costs of satellites coming way down, as manufacturers apply assembly line techniques to satellite manufacturing and as innovation in the launch sector drives down launch costs. That enables satellite operators to get more bang for their CapEx bucks and lower the unit price they charge service providers like Gogo.

New software-defined payloads will improve capacity utilization, both for operators and for service providers like Gogo, further driving down our unit costs. The advent of LEO or NEO constellations should give us the ability to drive down latency, which will improve the user experience in our customers' aircraft and provide truly global coverage.

Finally, we've always said that we were band agnostic. And with the arrival of more open Ka capacity, we're getting the chance to prove that. And we've actually started pitching regional Ka solutions where appropriate. We'll have more to say on that in the future.

Our satellite partners are talking to us about all of these opportunities, because we're a very attractive partner. IFC is the fastest-growing market segment for satellite operators, and we're the largest player in the IFC space. So if you want to play in this segment, you want Gogo as a partner. Given all that change, we want to be nimble, take advantage of the best of what our satellite partners have to offer to deliver the best experience for the dollar to our airline and business jet owners.

Now let me turn to our air-to-ground network. Starting more than 25 years ago, Gogo pioneered air-to-ground networks for aviation. Today, our ATG 4G network supports more than 5,500 business aircraft and more than 1,500 commercial aircraft. Our competitive advantages in ATG are our proprietary 4 MHz of spectrum, our deep knowledge of how to build ATG networks and our portfolio of intellectual property. We've built three ATG networks and are now building our fourth, Gogo 5G.

We just announced our three strategic partners in making the new network come to life: Cisco, Airspan Networks and First RF Corp; all leading U.S.-based providers of wireless network technology. We'll be building our network on 5G standards and be able to deliver higher throughput and lower latency for a better passenger experience than potential competitive offerings. We'll also be bonding our 4 MHz of licensed spectrum with 60 MHz of unlicensed spectrum to provide more bandwidth than our classic ATG products without sacrificing the resiliency that licensed spectrum provides.

We're starting to talk about 5G to airlines for regional fleets and even some mainline fleets. And we're talking to business aviation owners, operators and dealers about 5G for their business aircraft. And so far, we're getting a very positive response. We remain on track to deliver this product in 2021 and are very excited about the value it could create for our company and our partners.

Now let me turn back to the quarter. As I said earlier, we had strong results, though we want to be cautious about Q4 . The American deinstalls and AD conversion will continue to be a drag on revenue versus prior year. Satellite expense will increase as more 2K aircraft come online, as usage grows and as we ramp in anticipation of significantly more demand in 2020. And we expect to incur increased investments in key programs like line-fit and Gogo 5G. Some of these headwinds and others will persist in 2020. And Barry will discuss those in his comments.

As for our segment results. Let me start with the star of the quarter, our BA division. Before I even get into the operational metrics, I want to talk about the National Business Aviation Association show I attended in Las Vegas 2 weeks ago. We announced our 5G partners, we had a great panel discussion, and our booth was packed all week. It's a real pleasure to talk to our BA customers. They love our products, whether they have AVANCE or the classic products. And they love our service, which is testimony to our great Business Aviation team.

BA achieved record revenue of 11% over prior year, record segment profit and record aircraft online for the quarter. Equipment revenue significantly outperformed expectations due to AVANCE sales in both the OEM and aftermarket channels. OEM sales were driven by some nice catch-up orders for AVANCE L5. And aftermarket sales improved as some of the ADS-B congestion began to subside at the large dealers. We still expect to see some ADS-B-related drag on aftermarket sales through the second quarter of next year. But it's nice to see the logjam start to break.

As a result of these trends, we're raising our previously revised 2019 revenue guidance for BA to the high end of the $290 million to $300 million range we shared last quarter. Our BA division continued to exercise strong expense control in the quarter and is expected to hit their cash flow target for the year despite the weak sales it experienced in the first half.

BA ATG installed plane count grew to 5,527, up 508 aircraft or 10% from Q3 2018; and increased by 65 aircraft from Q2 this year. Even more encouraging, we shipped 293 ATG units in the quarter, almost as high as the record 296 ATG units shipped in Q3 last year.

Service ARPU for ATG units grew to $3,087 per month, up 2.6% from $3,008 per month in Q3 2018. We're now up to seven OEMs that have cut AVANCE into line-fit and expect two more in 2020, which bodes well for future equipment sales.

We think our Business Aviation division is a great business. It addresses a large underpenetrated market, it has an exciting new product pipeline, it provides a resilient recurring service revenue stream, and it exhibits nice operating leverage because of the low fixed cost nature of our proprietary ATG network.

Now let me make a few comments on the combined CA segments and then dive into the Rest of World and North American segments separately. I'll start with some good news, which is that our 2Ku product is operating well, with record net promoter scores at customers that provide us with NPS numbers. NPS scores have also improved nicely for our ATG network, as traffic has been offloaded to our satellite network. And in fact, at one customer, our ATG NPS beat some of our competitors' satellite NPS scores.

We're also proud that Delta Airlines, who exclusively uses Gogo for WiFi in their aircraft, won the prestigious APEX Passenger Choice Award for best WiFi, voted on by 1.4 million passengers, beating JetBlue, who won the year before and is supplied by a competitor.

Also on the positive side, we continue to make progress in supporting Delta Airlines in their announced intention to bring free WiFi to their passenger base. We're very excited about this endeavor. However, we'll leave it to Delta to announce their plans for what and when they plan to roll out.

Turning to CA combined revenue. As we discussed in our Q2 call, Q3 was the first quarter to suffer the full impact of the American Airlines deinstalls and transition from the turnkey model to the airline-directed model. In total, these changes created a $100 million hole in our service revenue from when the deinstalls started early 2018, which we've been able to largely offset by growth at our other airlines and in our Business Aviation division.

Costs remained in check at CA this quarter, and we got some benefit from positive equipment margin as well. We now expect growth in aircraft online at our combined CA segments throughout our planning horizon and feel that the CA segments will return to revenue growth in 2020.

The end of the quarter, we had almost 1,302 Ku aircraft online, a net increase of 73 with another 845 in backlog. 62% of our 2Ku backlog is in Rest of World, which represents great new revenue potential. And 38% is in North America, which are mostly ATG upgrades and represent an opportunity for increased ARPA as they move to faster 2Ku service.

Take rates grew slightly in CA-NA over prior year and were down slightly in CA-Rest of World due to new fleet installations. The combined profits of the CA segments was slightly negative but well ahead of expectations and well ahead of prior year.

Overall, we expect a lot of activation activity in Q4 but still expect to be at the low-ish end of our guidance of 400 to 475 installs for the year, as some airlines have held back planes to make up for missed MAX deliveries, as others have delayed for internal scheduling reasons, and some as a result of the government shutdown earlier in the year.

As far as MAXes generally, we've installed seven for the year. And in total, we have a backlog of 36, which includes our first line-fit Boeing aircraft, scheduled for the fourth quarter this year. Obviously, that schedule could change given the fluid MAX situation. But when it does occur, it will be our first major OEM line-fit installation and a watershed moment for Gogo. We had one first-of-type induction in Q3, the Cathay Pacific A330-300.

In summary for the combined CA segments. We're excited about the potential of our CA business. Global wireless usage trends are solid and improving and will drive demand for free WiFi in aircraft, which will spur demand for our products and services. And the total addressable market is large and relatively untapped, with only about 35% of aircraft globally installed with a broadband IFC product today. We believe there will be 18,000 new or retrofit aircraft installed with broadband over the next decade and that we can win our fair share of that addressable market.

Now I'll get into a little detail on Commercial Aviation North America and then on Commercial Aviation Rest of World.

We had 69 gross additions in CA-NA for the quarter, down a little from 74 prior year, down from 92 in Q2. Net additions were at negative 21 for the quarter. As many of the gross installs were ATG upgrade, some airlines retired older ATG aircraft. We expect a significant uptick in installs for Q4, most of which will be turnkey ATG upgrades. I should note that as we look at Q4 we expect to take a small revenue hit from one third-party payer that is experiencing financial difficulties.

In Rest of World. Obviously, our new airline contract is our biggest news. But more generally, we had a good quarter. We signed a restructured contract with one of our Latin American partners that will lower our equipment subsidies and improve Gogo cash flow over the next few years. As for installs, it was a seasonally slow quarter, with 31 gross additions versus 50 for Q2 and one deinstall. We expect to significantly increase in ROW installations for Q4, most of which will be under the airline-directed model. And we should approach 200 net additions for the year.

We plan to drive our ROW segment to profitability over the next few years by installing our backlog, ramping ARPA, reducing costs as line-fit gets completed, utilizing our Satcom capacity more efficiency and driving down Satcom unit costs.

So let me conclude my comments by saying that we had a strong first three quarters of the year. And though we're not all the way out of the woods, we have made great progress.

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

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

Thanks, Oak. Let's jump right in, beginning with a summary of our third quarter results.

Gogo delivered another great quarter of financial performance, with adjusted EBITDA and cash flow both substantially exceeding our expectations. This was the third quarter in a row that adjusted EBITDA exceeded $35 million. This quarter's outperformance was driven by a rebound in Business Aviation and Commercial Aviation expenses remaining below budget.

On a sequential basis, BA equipment revenue was up 58%, and segment profit was up $6 million. CA's expenses have continued to run below plan for both Satcom and overall operating expenses. From January through September, we have delivered $111 million in adjusted EBITDA, exceeding 2018's full year performance of $71 million by over 50%. We are raising our adjusted EBITDA guidance as we have done in each of the last five quarters, this time to $120 million to $130 million for the full year 2019. At the midpoint, this represents a 76% year-over-year increase in adjusted EBITDA.

In addition to the strong adjusted EBITDA performance, we have dramatically reduced our cash burden. During the quarter, we achieved record positive free cash flow of approximately $34 million. During the first three quarters of 2018, we've earned $216 million in cash versus just $3 million for the comparable period this year. For the second quarter in a row, unlevered free cash flow was above $30 million at a positive $33 million. We continued to project positive unlevered free cash flow for the full year 2019.

This improved cash flow performance is the result of the very strong adjusted EBITDA achieved during the first three quarters of the year, lower airborne equipment investments and improvements in networking capital. We are achieving the aggressive targets we set for reduced inventory purchases and improving accounts receivable during the year.

As we have guided since the beginning of the year, we are on target to improve free cash flow this year by at least $100 million over 2018. This is a particularly important achievement, considering that our net cash interest expense for the year will be $39 million higher in 2019 versus 2018. This year's higher interest expense is primarily due to making three interest payments on our senior secured debt during the year due to the timing of our refinancing.

We are, of course, very pleased with the adjusted EBITDA improved cash flow performance we've been able to achieve for the first three quarters of 2019. However, we do want to make sure that we properly set expectations for the balance of the year. In that spirit, I'll offer some perspective on how we view both adjusted EBITDA and free cash flow developing for the fourth quarter.

First, regarding adjusted EBITDA. While Satcom expense is still running well below plan, we do expect these expenses to increase again in the fourth quarter as we enter into contracts to serve the increasing demand from our customers. In addition, some CA expenses were delayed from this quarter that we will expect to incur in future periods.

As you will note, our raised 2019 adjusted EBITDA guidance implies fourth quarter adjusted EBITDA of $19 million at the high end of the range. This compares to the over $35 million we achieved in each of the first three quarters.

As we look at free cash flow for the fourth quarter, there are some known outflows that will reduce it from this quarter's record level. Given that free cash flow has improved by over $200 million for the first three quarters, let me highlight the primary reasons we expect it to come in closer to $100 million improvement for the year.

First, we have $54 million in interest payments due during the fourth quarter and had none in the third quarter. Secondly, we expect working capital to be a use of cash in the fourth quarter due to some anticipated swings in the timing of working capital.

Before we turn to our operational performance, let me highlight a couple of additional points regarding our balance sheet. We did put the asset-backed loan facility in place, as we indicated on our last earnings call. This $30 million facility carries an interest rate of LIBOR plus 2%, translating to approximately 4% at today's rate. While these funds are not available to us, we have not [inaudible] on the facility. We're also pleased that the debt instruments within our capital structure are performing well. Both the senior secured notes and the 6% convertible notes are trading well above par.

I'll now turn to a discussion of our third quarter operating results, starting at the consolidated level. Consolidated revenue was $201 million, down 7% from a year ago, reflecting the planned reduction in revenue from American Airlines. Consolidated service revenue was $158 million for the quarter, essentially flat from a year ago. We expect revenue to increase in 2020 as we add new aircraft in CA and with an outlook for resumed growth in BA's total revenue.

Our bottom-line performance has benefitted from disciplined cost management across both CA and BA. For the first 9 months of this year, department and Satcom expenses are approximately $28 million below our internal budget on a combined basis. As we will discuss, some of this expense benefit is timing related. While there is more we can do to continue driving operational and financial discipline in the company, it has improved substantially during the past year.

Now let's move to a discussion of the business segments, starting with Business Aviation. We were very pleased to see the BA business rebound in the third quarter. Total revenue for BA increased to $81 million, up 11% from the third quarter of 2018, as both service and equipment revenue grew during this quarter.

Service revenue increased to $55 million, up 12% from the prior year period. This was primarily driven by a 10% increase in ATG aircraft online to 5,527 at the end of the quarter. Monthly service revenue for ATG aircraft online increased to $3,087, up nearly 3% from $3,008 in the prior year period.

The weakening trends in equipment revenue we saw during the first half of the year tied to the ADS-B delay are starting to reverse. BA equipment revenue increased 58% sequentially on the strength of our premier AVANCE L5 product line. We are seeing OEMs accelerate their purchases ahead of planned [airtran] sales, and dealers are again building inventory. Equipment revenue for this quarter matched the all-time high of $26 million achieved in the second quarter of 2018 during the highly successful AVANCE product rollout.

Driven by this growth in equipment revenue and an attractive product mix, BA equipment margins increased from 28% in the second quarter of this year to 43% this quarter. This is back in line with BA's historical equipment margins. Segment profit of $37 million was up sequentially by $6 million or 18%, primarily driven by the growth in revenue. Based on these strong operating results, segment profit margin grew to 45.4% during the quarter, up from 43.9% sequentially.

Now I'll turn to a discussion of our Commercial Aviation division, starting with CA-North America and Rest of World on a combined basis. It's worth highlighting three developments with four separate airlines which influence CA's results this quarter and going forward.

First is the completion of the American Airlines deinstallations and the full impact of the airline switch to the airline-directed model. This has meaningfully reduced our revenue and associated profitability, as I've mentioned, and will make for a difficult comparison through the second quarter of 2020.

Second is the successful renegotiation of the contract with a Latin American carrier, as Oak also described. This represents a significant improvement in the 5-year NPV of the contract and is a great validation of one of the key objectives we established as part of our integrated business plan.

Third, we said on our February earnings call that we expected two airlines to switch back from the airline-directed business model to the turnkey business model during 2019. The first one of these occurred in the first quarter, and the second occurred in the third quarter.

The headlines for our Commercial Aviation business in 2019 are that even as CA has endured some significant headwinds, service revenue for the first 9 months is up almost 3% over the same period last year. And CA's bottom line has performed well ahead of expectation due to strong cost controls and the timing of expenses.

For the first three quarters of last year, CA's segment profit was negative $52 million. For the first three quarters of this year, it is a positive $10 million, including a modest loss of less than $2 million this quarter. Importantly, this $52 million segment profit improvement also reflects a considerable narrowing of the year-to-date losses in CA-ROW.

The strong CA segment profit is largely due to Satcom expenses [under-running] plan and the reduction in other operating expenses we targeted. We anticipate that our Satcom expense will come in more than $15 million below our 2019 budget. However, we do expect Satcom expenses to increase again on an absolute basis in the fourth quarter and next year to meet the demand created by growing passenger usage.

As you'll recall, through our integrated business plan process, we identified $75 million in annual savings in CA department spend excluding Satcom expense between the time we announced that plan in mid-2018 and the end of 2020. On our last earnings call, we said we expected to achieve approximately $45 million of those savings or 60% of the target this year. We now expect to achieve approximately $50 million or two-thirds of that reduction this year. However, it is also important to note that some of this is due to deferred expenses, which we expect to incur in future periods.

CA's $62 million improvement and year-to-date segment profit over the previous year has clearly been a major contributor to our dramatically improving free cash flow performance this year. In parallel, we've also made significant strides in working capital management. Most of the cash flow improvement from working capital has come through our planned slowing of inventory purchases and improving accounts receivable.

Now I'll turn to a discussion of the operating results for Commercial Aviation North America. Total revenue for CA-NA decreased to $84 million in the third quarter, down 22% from the third quarter of 2018, reflecting anticipated declines in both service and equipment revenue. Service revenue was approximately $80 million, down 14% from the third quarter of 2018, primarily due to the impact of American Airlines. Excluding this airline, service revenue was up 7% over the prior year. We continue to expect revenue growth to resume for CA-NA in 2020.

Equipment revenue declined 76% to $3.7 million, as compared with $15 million for the prior year period. This decline was due to lower 2Ku installations and a shift in mix from airline-directed to turnkey installations. As Oak described, we expect total 2Ku installations to increase meaningfully in the fourth quarter on a sequential basis.

Total take rate for CA-NA grew year-over-year to 12.7% and, excluding American Airlines, net ARPA was up 3% year-over-year to $132,000. Largely driven by expenses coming in well below plan, CA-NA contributed about $42 million of the over $60 million improvement in CA's combined segment profit for the first 9 months of this year.

Now let's turn to CA-ROW, which also delivered a strong third quarter. CA-ROW total revenue was approximately $36 million, up 1% from a year ago. Service revenue increased to $22.6 million, up 28% from the third quarter of 2018 as we brought additional aircraft online. Equipment revenue decreased to $13.1 million, down from $17.6 million in the third quarter of 2018, due to a lower number of installs under the airline-directed model.

As expected, ROW take rates and ARPA both decreased over the year-ago quarter due to the significant growth in new aircraft fleets coming online. As we've described on previous calls, both the ARPA and take rates are substantially higher for existing airlines as the new aircraft fleets mature.

Aircraft from new airlines represented 49% of total ROW aircraft online at the end of the quarter, up from 30% a year ago. ROW aircraft online increased to 721, up 41% from 513 as of September 30, 2018, and we still have a healthy backlog of over 500 aircraft to be installed.

We're very pleased to see the losses narrowing for our CA-ROW segment. Segment loss in CA-ROW of $13.7 million improved 40% over the prior year period, driven by higher service revenue, continuing improvement in Satcom utilization and lower operating expenses. Through the first three quarters of this year, we reduced ROW losses by nearly 30% from negative $70 million in 2018 to negative $50 million for the comparable 9-month period this year.

I will now turn to a discussion of our 2019 guidance, which is summarized as follows. Total consolidated revenue in the range of $800 million to $850 million is unchanged. We expect CA-NA revenue to be at the high end of the previously guided range of $355 million to $380 million, with approximately 5% from equipment revenue, no change from prior guidance. We expect CA-ROW revenue to be at the high end of the previously guided range of $135 million to $150 million, with approximately 40% coming from equipment revenue, no change from prior guidance. We now expect BA revenue to be at the high end of the previously revised range of $290 million to $300 million.

We're raising our adjusted EBITDA guidance to a range of $120 million to $130 million, an increase from our prior guidance of $105 million to $115 million. As a reminder, the adjusted EBITDA guidance provided on our February 2019 call was $75 million to $95 million. We expect the increase in 2Ku aircraft online to be at the low end of the previously guided range of 400 to 475.

While we won't be discussing 2020 guidance on this call, we thought it might be helpful to offer some perspective on the puts and takes as we look forward to next year. We're very positive about the progress we have made in the last 12 months, as evidenced by this year's strong financial performance. But we also want investors to maintain a balanced perspective as we continue to build on Gogo's achievements.

In assessing our 2019 performance, it's important to recognize that year-to-date adjusted EBITDA has benefitted from about $9 million of nonrecurring items. Now as we look to 2020, within BA, we'll be making meaningful investments in our 5G network in preparation for its commercial rollout planned for 2021.

These plans aren't new but are worth reiterating now that we have named our 5G vendors. BA revenue rebounded well in this quarter. But we are monitoring the potential impact on longer-term service revenue from the temporary delays in equipment sales due to ADS-B.

In CA, we will have effectively lapped the issues with American Airlines by the third quarter of 2020, including the deinstalls and the airline completing its shift to the airline-directed business model. As I said previously, 2019 is also benefitting from the deferral of some operating expenses into future periods. And some additional program spending will occur in 2020.

Finally, regarding cash flow. We're extremely pleased with the progress we've made in 2019. But do bear in mind that these results reflect a meaningful portion of the cash flow improvements we have targeted to come from working capital, which are largely nonrecurring.

As I conclude my prepared remarks, I want to join Oak in thanking our tremendously committed employees for their contribution to our strong financial results. I also want to add my thanks to our investors for this quarter.

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

QUESTIONS AND ANSWERS

Operator

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

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

Two -- I guess first, congratulations on the deal to be signed today. Can you give us, Oak, an idea of the scale of that contract and what type of usage the customer envisions? Maybe what kind of competition did you see on that?

And then, Barry, you were just going through some of the issues in jumping off from 2019 EBITDA and free cash flow into 2020. Not to ask you for guidance yet for 2020, but maybe if you can give us some of the net impacts on both of those numbers, that would be helpful.

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

Yes, Phil, Oakleigh first.

I don't want to get in front of the airways announcement, so I don't want to go too far. But I'll say that it's global route structure wide-body jets. We are -- the competition, where other IFC players that can offer global coverage, the usual suspects there. I think they are impressed with the quality of 2Ku; they flew it a lot on other airlines. And I would say it's an airline that's extremely focused on quality of service. So it's very rewarding to win that deal. It is both 2Ku as well as our IPTV product.

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

And Phil, on your question about 2020 -- thanks for not pressing us for giving guidance on this call. As you know, we do that on our quarter four call, and we're still in the midst of budgeting for next year. But here are some things to think about.

So this year, there is that $9 million one-time benefit to adjusted EBITDA in 2019. As we look the next year -- the IBP savings are coming in ahead of plan. As we said coming into the year, we expect about half of those or a little more to be realized, half of the $75 million this year. And now it is more like two-thirds of the $50 million, so that certainly helps.

I would say on IBP, really most of the operational disciplines and process improvements are happening as planned. There's one project running behind plan that'll extend throughout 2020, having to do with driving efficiency and production operations. And we will look to be increasing some expenses for some important investment areas, 5G being the major one in BA. And that's on the order, on the OpEx side, of kind of $10 million to $15 million. And we'll also be doing things like adding to our really talented satellite team to meet the significant demand. And there may be some programs also that we would implement to take advantage of some new opportunities, things like line-fit and so on. So hopefully, that gives you a little more color on how we see 2020 unfolding.

Operator

Our next question comes from Lance Vitanza of Cowen.

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

Nice job on the quarter.

On the Business Aviation segment, you obviously talked a lot about kind of rolling past the FAA ADS-B installation mandates. Those were a big deal in second quarter. I'm guessing that you didn't really see any impact of that in the third quarter, given the near record volume of shipments. But was that true? Or was there perhaps even some lingering impact in the beginning of the quarter, maybe? And I guess I'm just trying to think about what, if anything, that suggests for the next few quarters.

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

Yes. No, there's still impact. In talking to the dealers, the big dealers in particular have handled all the larger aircraft at this point. There are more, I'd say, lower-value hauls that are still getting ADS-B. They've moved a lot of that out to what they call satellite facilities, so more remote airports where they have hangars, et cetera. And they've been able to open up shop floor space in their major facilities and get back to selling IFC and other product, which are frankly more profitable to them than ADS-B is.

So that said, there's still some pressure there. And I think we expect to see ADS-B installs continue through the first half of next year. I think the dealers expect that. So I don't think we're ever fully out of the woods on it. But it was nice to see it pick up in those orders. Remember, those aren't all activations; those are units that are shipped. And in the BA business, we sell them and then we book revenue. When we ship to the OEM or the dealer, they then actually install those. So some of those will go on the shelf and be installed over time.

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

And just to add to Oak's point about the mix on OEM versus aftermarket, too, Lance -- I mean, the OEM has particularly picked up. And so where you see the impact of ADS-B is on the aftermarket side. So that's what we're -- still continue to see that during the course of the year.

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

And then, if I could just ask a follow-up, again in the BA segment? But the monthly revenue for aircraft online on the ATG side for the last several quarters has been sort of stuck in the low single digit range. Is that just sort of what we should expect going forward? Or do you see an opportunity for reacceleration either under the current AVANCE L5 program or perhaps when you've eventually rolled out the 5G systems?

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

Sorry, are you asking about ARPU in the ATG part?

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

Yes.

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

Well, there's a little bit of downward pressure there. But the people had unlimited -- a lot of people were buying unlimited plans when AVANCE first rolled out. And of course, when they go over certain thresholds, they would be getting charged more, et cetera, et cetera. So they've gone to more managed plans, I guess. So that's been little downward pressures holding it down. But you still see a lot of people upgrading plans as well.

We don't have 5G -- I don't want to get out and speculate too much about what our 5G pricing for plans will be. We haven't decided that yet.

Operator

Our next question comes from Scott Searle of Roth Capital.

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

Nice job on the quarter, guys.

Just a real quick question on Satcom capacity. I know you guys have been working hard to go back, renegotiate, expand the footprint to give you guys some diversity and reliability and backup in terms of satellite failures. But can you help us understand how some of those contract renegotiations get feathered into your Satcom costs, particularly on the international front, where utilization is a lot lower, just given the number of aircraft that are currently live?

And if you could extrapolate that, now with the new EMEA customer and 500 aircraft in backlog, does that get you to breakeven results in international once they're fully deployed?

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

Well, let's start with the renewals. I mean, when we're renewing now, first of all, we're not using renewing on the same satellite. We're committing to a new satellite, like we did with EUTELSAT 10B, which was announced, I think, last week. And those new satellites are at a much lower unit cost than the contracts that are rolling off, dramatically lower. So those are improving our economics in Rest of World. And that's going to be one of the major drivers towards profitability in that division.

I'm sorry, the second part of your question on capacity was . . .?

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

Well, Oak, just kind of extrapolating your backlog out in the Rest of World with 500 aircraft plus the new deal that's announced today -- as you start to get some better utilization with that footprint, and better costs, does that get you to breakeven just deploying against what [you've got] visibility and under contract to now in international markets?

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

Yes, Scott, as we've said, and as Oak kind of reiterated on this call, the drivers remain what they've been, getting those installed, increasing the ARPU with new fleets [inaudible] as we do see some of the OEM costs coming down over time as we get those programs behind us and so on. Clearly, the increased demand being driven for satellite capacity helps worldwide, so just to underscore Oak's point on that.

And I would say that this order that we're announcing today certainly helps. And you also saw the announcement that we made about EUTELSAT for capacity over that region. So that also helps as current contracts come off and we're able to deploy that 10B satellite at attractive pricing. So I wouldn't want to say specifically about what that looks like for ROW losses. But clearly, this helps, and it's part of the strategy to add airlines in those regions where we have excess capacity and can drive it down and continue to drive the cost structure lower.

Operator

Our next question comes from Rick Prentiss of Raymond James.

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

A couple questions, if I could. I want to follow up on some of Phil's questions, in particular to Satcom. If I wrote the numbers down fast enough, Barry, that you were giving, sounded like Satcom is down $20 million below plan year-to-date but that for the year it might be $15 million? Is that kind of the timing item you were getting at, or just increased demand?

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

Yes, Rick, just to clarify that -- that $28 million year-to-date was the amount that we are under for Satcom as well as the department operating expenses. And then, for the year, we expect Satcom to be $15 million below the budget. And just as a reminder, it's growing, of course, on an absolute basis from second quarter, it grew in third quarter, will grow again in fourth quarter as demand grows. But even with that, growth in absolute terms, it's running below plan along the lines we talked about.

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

And as far as versus plan, is that your internal plan? Or is that kind of plan you would've communicated to the street? Is it doing like significantly better than the internal plan as well?

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

No, that's versus the internal plan. And we've talked about the EBITDA exceeding expectations -- certainly is true versus the street, but it's also true based on our internal budget because of these expenses coming in below plan. And we talked about that on the last call, that part of that is due to the great work by the engineering team as we put policy management in place as we've introduced new network elements like modems that helps the overall usage to deliver the same user experience. So part of that has been the benefit of that kind of engineering work.

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

And back in the early prepared remarks, Oak, you might've mentioned something about a revenue hit in fourth quarter from a third-party character. Can you help us frame that, what kind of size you're talking about, which line item that would hit?

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

Yes, it's a couple million. And I'll tell you it's [Ipass], which is -- it's pretty public the financial troubles that the parent company is in.

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

And last one for me. Obviously, it's up to Delta to make the announcement, but what kind of time frame should we be expecting updates from Delta, kind of on their view of unlimited WiFi? Is there a time line you can at least point us to to keep watching for?

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

No. I go down to Delta pretty regularly. And it's pretty well articulated to me that they prefer to make those announcements themselves. So we're going to [inaudible] their wishes. Our job is to support them operationally and let them manage the program commercially.

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

And any final update on the MAX delays, how it affects your business? Looks like it's slipping out into 1Q, obviously. But just kind of help us update the thought of what MAX delays are meaning to not just installs but then also service revenues?

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

Yes. I'll let Barry get to the service revenue component of it. I don't know that we really calculated it. We don't have a lot of MAXes. Like I said, there's 36 in backlog, which includes the seven that have already been installed. So we'd have presumably ARPA already from 36 more aircraft. And you can take an average ARPA number multiplied times that, and that would kind of be the hit on, I'm sure, MAX planes.

And then, of course, there are the planes that are not being given to us for installs. And kind of hard to quantify that exactly. We actually tried to for this call. Because when the airlines start delaying things, often there's a raft of reasons. MAX delays might be one of them, right? They're not going to get a MAX, so they need to keep some other plane in service and can't give it to us for a 2-day install.

So we can't really quantify that. But I would say there have been roughly 100 installs that got pushed out on us this year. MAX is probably 25%, 30% of those, something like that. That's what we sort of roughly estimate.

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

And Rick, the revenue impact is really very small.

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

At least for now, for sure. And obviously, the MAX is a big part of our future. Once we are line-fit on that aircraft, that's an aircraft that will be -- there'll be a lot of those manufactured presumably, and it'll be one of the leading aircraft in the world in terms of unit counts. And so line-fit on that is very important.

Operator

Our next question comes from Louie DiPalma of William Blair.

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

Free cash flow generation has never really been associated with Gogo, and appropriately. You announced further measures to improve free cash flow on this earnings call, on top of this quarter's strong performance. Is the general plan to refinance your debt in June of 2021, assuming that you're still an independent company then?

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

Yes, let me take those one at a time, Louie. First on the question about improvement to free cash flow. The drivers of that have been the increased EBITDA, the working capital management and the benefit from lower airborne equipment investment. What I tried to say is that we've had really an extraordinary improvement of free cash flow of $200 million or so in the first three quarters. That improvement over last year will decline as we exit the year for the reasons I mentioned. So we have an over $50 million interest payment in the fourth quarter, and we also expect there to be a use of cash from working capital in the fourth quarter. So that'll take the improvement year-over-year in free cash flow performance down from where it is year-to-date. But still, we feel very good about achieving at least $100 million improvement year-over-year.

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

Regarding your question on refinancing -- yes, as you know, when we did the refinancing of the $925 million, we purposefully took a lower turn, and we could've taken a 5-year. So we did a 5-year term with a 2-year non-call period, with the understanding that that would enable us to refinance sooner. We expected at that time, and still do, for continuing improvement in the operations, and that even though we got a good improvement in the interest rate during the last refinancing, we expect to continue to be able to be in a position to refinance the balance sheet at more and more attractive rates.

So in terms of the timing, the next big event is the maturity of the 6% convertible notes, which is in May of 2022. So you could look to us getting something done with that in more than a year in advance of that is the way we think about that. So that puts you into getting something done by early 2021.

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

And now I have an extended, high-level industry question. Oak, I want you to address the topic of industry pricing power and negotiating leverage. It seems that when airlines had your ATG solution or no in-flight WiFi solution at all, it seems that the airlines had all of the pricing power. And that manifested itself with how the airlines, especially your largest partners, pressured you for heavy subsidies, which is why you accumulated over $1 billion of debt. Now that satellite antennae across the industry are now on over 8,000 planes, is there any evidence that airlines have switched a material number of planes from one Satcom antenna to another? And even if the Satcom solution is considered poor, is there any evidence of switching from one Satcom provider to another?

So whereas the airlines brutally exercised their pricing power over Gogo for the past decade, is it possible that all of the in-flight connectivity service providers have some degree of pricing power now when negotiating contract amendments, since they have a Satcom antenna that seems very difficult to switch off?

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

That was a rich and long question, Louie.

So I think in the early days, we would subsidize antennas heavily in order to win airlines in anticipation -- and those were usually turnkey deals, where we then had the commercial right on the aircraft to sell our product and to bring in third-party payers, et cetera. The world is obviously switching more to an airline-directed model, where the airlines want to control more of that, especially the large airlines. And so they're getting probably more sensitive on the -- well, they never had costs in the turnkey model, but they do have costs in the airline-directed model. Because they're the ones that are paying us for sessions or getting a sponsor to pay us.

So I think that there is less sensitivity on the equipment side. Most of our deals today are not heavily subsidized. Very few of our -- well, there are still some old deals that we're honoring that were somewhat subsidized a little bit. But there are new deals that are pretty much all at cost or very close to cost on the equipment. And then, I think the airlines are going more price sensitive on the sessions, and especially as they look at going free.

So we are very focused on driving our unit costs down, our Satcom unit costs down, and with 2Ku and other ways of delivering more efficient solutions to the airlines than our competitors can. So I think that might answer your question.

On the renewals, these contracts are long contracts generally. So there have been very few renewals. We did renew American Airlines earlier this year, because they have an unusually short contract with us. And we announced that, I think, on a quarter call. And they were, I'd say, a little bit less price-sensitive than they'd been in the past. But as I said, I think that service pricing is going to be where there's going to be competition going forward. That make sense, Barry?

Operator

Our next question comes from Simon Flannery of Morgan Stanley.

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

This is Landon Park on for Simon.

We're just wondering if you could expand on any other conversations you're having with your partners around offering free WiFi. And you also made some allusion to tightness in the continental U.S. satellite supply market. So how should we think about your ability to meaningfully ramp your service offerings in North America, and when new supply might be coming online to support new services?

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

Yes. Well, I think what I was alluding to was that Intelsat 29E, which had 9.3 gig of Ku on it but went out of service earlier in the year. So that took a fair amount of capacity out of the U.S. market.

But there's capacity for what we're trying to do. Right now, we are still in negotiation with a number of players. We got eight different suppliers we're working with. We're focused on getting the right pricing with them, and we're able to start a lot of competition between them. So we feel pretty good about that. So that's the capacity part of your question.

And what was the other part of your question?

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

Any other conversations you're having with your partners around free WiFi, outside of Delta, of course?

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

Yes. I mean, it's the conversation at every airline, of course. Some of them think it's great, and some of them are scared to death of it but feel that they may have to react. If one of the big majors goes free, what are they going to do? They're going to probably have to go free as well.

So I think free will sweep across the industry over the next, say, 5 years. Different airlines will do that differently. Lower-cost airlines are not going to give away high-quality sessions, probably. But they're probably going to give away something. And they will [have] everything in between. So yes, it's a major -- every airline's talking about it.

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

And one last one -- CA-NA, the ARPA was modestly down year-over-year. How should we be thinking about that as we move into 2020 as we start to fully lap the American deinstalls?

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

So as you look at this quarter versus last, Landon, this doesn't reflect the impact of American Airlines. Their full shift to the airline-directed model also in the second quarter did have a one-time benefit from the renegotiation of that contract that we talked about on the last call. As you look at that quarter also, excluding American Airlines, it did include in the second quarter the revenue from the distressed customer that Oak described. So we're not accounting for that revenue until we see what happens with them. And then there's some seasonality a bit in Q3.

And as we look forward to 2020, we will still see that impact of American Airlines. And that'll be with us on a comparable basis through the second quarter. And we see ARPA sort of flattish from the current level. But I would point out that we do, as we said, expect revenue growth in CA-NA in 2020.

And then, of course, the biggest discontinuity in all of this is major airlines going free, which is going to completely change the level of take rates as we go forward. So that really has been what we've been playing for since 2Ku got established, and putting in a much fatter pipe to the plane. So that's why that's such an exciting development for us.

Operator

Our last question comes from Greg Gibas of Northland Securities.

Gregory Thomas Gibas - *Northland Capital Markets, Research Division - VP & Senior Research Analyst*

Congrats on the quarter.

I understand you didn't want to say too much here. But when should we expect to see the installs from the newly signed airline to begin? And can you really give us a better sense of how large that fleet size is on a relative basis maybe?

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

Installs start in 2020. And I think if I start talking about relative size and geographies, people probably vector too much in on what the airline is. And I don't want to do that. Because last thing I want to do is piss them off on the day we're signing a contract.

Gregory Thomas Gibas - *Northland Capital Markets, Research Division - VP & Senior Research Analyst*

And then secondly, it looks like you continue to have that dynamic of new airlines in Rest of World that install 2Ku to have roughly half the take rate levels that we've seen on seasoned aircraft. So I guess I was just kind of wondering, roughly how long does it take for those new airlines to reach those seasoned take rate levels? And is there any color you can provide on how those take rates grow over time, and when we should start to see the Rest of World take rates start to improve again?

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

Yes. So you're right, it's about half as we look at that. And it's for the reasons that you pointed out. I mean, it actually varies a fair bit by airline. I mean, generally, it's several years. But there have also been airlines where it can happen faster, particularly in a world where there's an impetus to go free. So as airlines do that -- and now that that's out there and some airlines are doing that internationally -- that in some cases can accelerate it. But generally, we for our internal purposes do model that to take several years.

And there are two parts to that that matter. One is that the full fleets really need to be installed. Because an airline is not going to promote the WiFi service until they can demonstrate they offer it on every plane. So you don't want to get on a plane where it doesn't have service. And then secondly, even once the planes are fully installed, it generally takes some time for them to sort through exactly what their offering is going to be. And they tend to tweak that and leg into their ultimate WiFi offering.

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

Yes. I mean, I would just add to that that international wide-body fleets that are fully installed tend to have our highest ARPA numbers. But they are the hardest to install if they're traveling international routes. Because they're really utilized very heavily. And getting them out of service to install takes more time. So some of our great European brands we've been installing for 2 years or so. And we've still got time to go in order to get fully installed. And again, it's really because those aircraft spend so much time in the air that it's harder than with a domestic fleet, where we can [go] nose-to-tail and just bang in the antennas and churn them out. So it takes a little longer, but the reward is much better, the way I look at it.

Operator

Thank you. I would now like to turn the conference back over to Mr. Oakleigh Thorne for any closing remarks.

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

Thank you. And thank you for attending our Q3 2019 Earnings Conference Call.

I'd like to leave you with a few thoughts. First, we have a very strong cash flow-generating business in BA. Not only does it have a unique competitive advantage by virtue of our spectrum ownership but it's also a relatively unpenetrated market and has ample runway for growth.

Second, Commercial Aviation Rest of World is growing. It's also an extremely large and unpenetrated market. And with our global 2Ku platform, our progress in line-fit and our strong backlog, we're well positioned to win our share of that attractive market.

Third, Commercial Aviation North America revenue is bottoming out as the impact of American Airlines deinstalls and their conversion to the airline-directed model is finally behind us. And we expect to start growing revenue again next year.

Fourth, we've strengthened our balance sheet, given ourselves strategic flexibility by pushing our senior notes out to 2024, and further strengthened our balance sheet this quarter by closing our $30 million ABL.

And finally, by virtue of our industry-leading market share and our asset-light operating model, we're well positioned to take advantage of the opportunities for this by the satellite industry. And we look forward to demonstrating that to you in the quarters to come.

Thanks again for your time. And look forward to talking to you again next quarter.

Operator

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