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GOGO - Q4 2017 Gogo Inc Earnings Call

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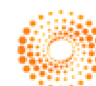

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Gogo Inc. Fourth Quarter and Full Year 2017 Earnings Conference Call. (Operator Instructions) As a reminder, this conference is being recorded. I would now like to turn the conference over to Ms. Alva, Vice President of Investor Relations and Treasurer. You may begin.

Varvara Alva - *Gogo Inc. - VP of IR*

Thank you, and good morning, everyone. Welcome to Gogo's Fourth Quarter and Full Year Earnings Conference Call. Joining me today to talk about our results are Michael Small, President and CEO; John Wade, Executive Vice President and COO; 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 earnings press release and are more fully detailed under the caption risk factors in our annual report on Form 10-K and our other documents filed with the SEC. In addition, please note that the date of this conference call is February 22, 2018. Any forward-looking statements that we may 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 this call, we will present both GAAP and non-GAAP financial measures. We include an explanation of adjustments and other reconciliations of our non-GAAP measures to the most comparable GAAP measure in our fourth quarter and full year earnings release. This call is being broadcast on the Internet and is available on the Investor Relations section of Gogo's website at ir.gogoair.com. The earnings press release is also available on our website. After management's remarks, we'll host a Q&A session.

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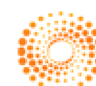

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And now it's my great pleasure to turn this call over to Michael.

Michael J. Small - *Gogo Inc. - President, CEO & Director*

Thanks, Varvara. Good morning, everyone. We delivered strong results for the fourth quarter with record revenue and EBITDA. We also made important progress on the initiatives we outlined at our Investor Day in November, including: increasing bandwidth, introducing new products and services and moving towards positive free cash flow. I will expand on this in a moment, but I want to begin with this quarter's results.

Our record revenue in the fourth quarter of $188 million was up 18% year-over-year, and represented the highest year-over-year quarterly growth rate for 2017. We also grew EBITDA by 8% to a record $25 million. We are starting to realize the benefits of operating leverage in our multi-payer strategy.

Take rates in North America grew by 36% driven by the introduction of free messaging passes on Delta and Alaska Airlines as well as our T-Mobile partnership. This increased engagement helped drive CA-NA satellite ARPA to $223,000 on an annualized basis. And we're also pleased that Business Aviation continued to deliver impressive performance with service revenue growing 25% year-over-year. We are confident in BA's long-term growth opportunities and continued contribution to Gogo's success, which John will discuss in detail in a few minutes. In short, this was a fantastic quarter and year in which we hit or exceeded all major aspects of our 2017 guidance.

Let me now turn to the progress we've made on the objectives we outlined at our Investor Day. Our singular focus on building and delivering the best connectivity products and services for aviation has us better positioned than ever to add aircraft and drive profitability. Our 2,000 aircraft awards for 2Ku are a direct result of this focus, and we are excited to add Cathay and LATAM to the 2Ku family, which added more than 200 aircraft to our 2Ku awards. We have won approximately 40% of global aircraft awarded for connectivity service since we unveiled 2Ku in 2014. We expect to have the most planes from the world's leading airlines over the long term. Delivering the best connectivity products and services for aviation starts with bandwidth. We are at an inflection point in terms of bandwidth. Our bandwidth allows us to engage more users, whether that's passengers, pilots or crew. Increased bandwidth equals increased take rates, which translates into more revenue and drives profitability. You saw this dynamic at play in Q4. We expect take rates to grow in 2018, particularly in the second half of the year. More bandwidth is predominantly driven through more 2Ku aircraft online. We installed over 225 aircraft with 2Ku in Q4, double what we did in Q3. Furthermore, we are rapidly upgrading to our new modem and layering in new high-throughput satellites, most recently moving nearly 200 aircraft to SES 15 in January. As a result, average peak speed per aircraft in Q4 increased approximately 30% sequentially, and approximately doubled from Q4 2016. We will continue to increase bandwidth rapidly in 2018 and beyond.

We are also turbocharging our ATG network in 2018. ATG-NG is now being flight-tested with a steerable beam antenna over a 10 cell site network in the Midwest, and is on track for nationwide coverage and commercial availability later this year. Increasing bandwidth is the foundation for new products and services. In CA, we launched Gogo Messaging Pass on Alaska and Delta. We continued our partnership with T-Mobile, and now have almost every airline partner offering at least 1 Gogo product for free to their passengers. Most recently, we launched Gogo TV, our live TV product on GOL, and expect other airline partners to launch Gogo TV in 2018.

In 2017, we also announced Gogo Vision Touch, which offers airlines a lightweight, low-cost solution that leverages Gogo's in-cabin network to wirelessly stream content to a tablet mounted in the seat. We expect to launch this product on Delta C Series in 2018.

We are also developing a unified portal service for airlines that have multiple connectivity providers. We expect to deploy this solution in [2019,] and you will hear more about it in the coming months. This is an important service because airlines want a consistent passenger experience. It's also important because most large airlines have multiple connectivity providers. Diversification of ISP providers is the norm, and Gogo is a beneficiary of this trend. In fact, today, half of our existing airline partners had competitor services when they chose Gogo.

Serving our airline partners also means delivering products and services under a business model that makes sense for them. Today, we have 2 models: turnkey and airline directed. We like both. Barry will provide more color on accounting for the airline-directed model compared to the turnkey model we started with.

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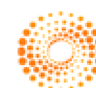

On the Business Aviation front, we are pleased with its strong trajectory of profitable growth. In 2017, we strengthened our product leadership in this underpenetrated market. With the highly successful introduction of AVANCE L5 and, more recently, the announcement of L3, we have significantly expanded our ability to address this market of more than 20,000 aircraft. We also have now installed 2Ku on private aircraft and, more recently, announced a Ku satellite service for private jets with global range. With ATG-NG commercially available in 2018, we will further extend our leadership position in BA. We expect continued strong profitable growth from this segment.

To wrap up. We made significant progress against our strategy in 2017. As we look ahead to 2018, we expect: first, bandwidth growth will be significant due to 2Ku installs, modem upgrades and layering in of HTS satellite capacity. ATG is on track to be our next major source of more bandwidth in North America; second, more bandwidth positions us to win more aircraft and grow ARPA in both CA and BA. Planes and ARPA leverage our core investments and drive profitability; third, the de-installation of American Airlines' aircraft that was announced in 2016 will commence in earnest this year. Even with this headwind, we expect strong growth in consolidated revenue and EBITDA in 2018. Barry will provide more details on this; and finally, BA will continue its very strong growth trajectory. We are well positioned to extend our leadership and continue on our path to profitability.

Now I'd like to turn it over to our Chief Operating Officer, John Wade.

John Wade - *Gogo Inc. - Executive VP & COO*

Thanks, Michael. We closed out the fourth quarter with 227 2Ku installs, which puts us at 473 for the year, within our guidance of 450 to 550 installs. Beyond installations, we are also deploying our next-generation modem, which will enable us to optimize system performance, bringing more bandwidth to the aircraft and further improving the passenger experience. We expect to have all satellite aircraft, Ku and 2Ku, upgraded to this new technology before the end of 2018. As we've mentioned in earlier releases, we've shortened installation times for 2Ku to as low as 30 hours, which is less than half the time it typically takes to install a broadband satellite system. We continue to focus on helping our airline partners achieve installation process efficiencies. Our extraordinary pace of 2Ku installs and modem upgrades has not been without its challenges. The performance of the systems has been expected; however, any time you introduce high-tech systems of this scale and speed we've been doing it, there are likely to be early-stage growing pains. 2Ku is not exempt from that phenomenon; on some aircraft we saw degraded reliability. We've identified the root cause of all of these issues, and have fixes for all of them that have either been deployed or in the process of being deployed. By midyear 2018, we expect the entire 2Ku fleet to operate at the same market-leading performance levels that most 2Ku aircrafts are now achieving.

We have clearly established our ability to retrofit our in-flight systems. So now I want to give you an update on our plans to offer our systems on a production line as part of new aircraft manufacturing. We've been working to pursue factory fit of 2Ku on the major OEM aircraft types. This is important because we project more than 18,000 aircraft that will see connectivity solutions over the next 10 years, with 9,000 of those new aircraft installed through OEM and line-fit programs.

I'm very excited by the activity we're starting to see on the line-fit front. We're on track for our final Airbus line-fit approvals, and expect to see our first Airbus line-fit orders in the first half of 2018. We continue to work with Bombardier on the line-fit of 2Ku on the C Series, and expect that Delta will take delivery of their first Bombardier C Series aircraft, with both 2Ku and Gogo Vision Touch installed by Bombardier at the factory later this year.

We've also made progress with Boeing, particularly the 737 MAX, and expect that the first aircraft delivery of a MAX aircraft with 2Ku will take place in 2019.

We expect to end 2018 with between 1,100 and 1,200 2Ku aircraft online, including approximately 450 aircraft in CA Rest of World. This will approximately double the 2Ku aircraft online. In addition, we will also be deploying our ATG Next-Gen solution, which will bring a 2Ku-like experience to select commercial mainline and regional jets [and much of its] aviation aircraft in the U.S.

Before I turn it over to Barry, I want to talk about Business Aviation and give you an update on how our new products and services are performing in the market. As Michael mentioned, we have products and services to address every aircraft segment and geography, and we're starting to see real momentum in each segment. We have shipped over 200 of our AVANCE L5 systems. We continue to see significant numbers of our current

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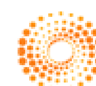

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customers recommitting themselves to Gogo by upgrading to L5. L5 brings a streaming, video-class Internet experience to Business Aviation, and we saw a significant increase in sales with the introduction of this new system.

Our new Business Aviation products will allow us to further expand the markets we serve. Our global Ku band tail-mount system will launch later this year and will serve the large jet market with market-leading performance. Our AVANCE L3 product is built to serve the light jet and turboprop market, with the most affordable options in Business Aviation. We received the first orders for L3 within days of announcing it, and expect it to be a strong contributor to the business moving forward.

With ATG NextGen connectivity coming online later this year, Business Aviation is set up for another strong year and significant long-term growth opportunities. We built this business for the last 25 years through our relationships with dealers, OEMs and customers, and providing the best services, systems and networks. We have continually enhanced our capabilities to support the aviation industry's changing needs, and we are more confident than ever that we will continue to lead our industry as the preferred connectivity provider for aviation.

With that, I'd like to turn it over to Barry.

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

Thank you, John, and good morning, everyone. We delivered continuing strong revenue growth and record adjusted EBITDA in the fourth quarter. Service revenue was up 18% to $164 million, and total revenue of $188 million was also up 18% from the prior year. Service revenue grew across all 3 business segments, fueled by growth in CA-ROW and BA, which increased 119% and 25%, respectively.

Adjusted EBITDA was up 8% from the prior year to a record $25 million. Adjusted EBITDA nearly doubled from the first half to the second half of the year, consistent with the expectations we discussed on our second quarter earnings call.

Let me now turn to the performance of our business segments. Commercial Aviation North America generated service revenue of more than $103 million in Q4, delivering its first $100 million quarter and increasing 8% over the prior year. This was the result of increased aircraft online to 2,840 and higher ARPA. We installed or upgraded 197 aircraft in the quarter, and the annualized CA-NA ARPA grew to $144,000. We continued to see the benefits of increased bandwidth per plane that Michael quantified, which provides a foundation for executing our multi-payer strategy and drives passenger engagement higher.

Take rate for the quarter increased to a record 9.9%, up 36% from 7.3% last year. We expect this trend to continue as we increase bandwidth across our fleet by adding 2Ku aircraft and as ATG NextGen becomes commercially available.

CA-North America segment profit was $23 million. The segment profit margin was 22%, up 500 basis points from 17% margin in Q3, and flat year-over-year when adjusting for the Q4 2016 benefit from a positive noncash adjustment related to the company adopting a new time-off policy.

Turning to CA-Rest of World. Quarterly service revenue more than doubled for the fourth consecutive quarter to $15.3 million. Service revenue growth was driven by a 57% increase in equivalent aircraft online and a 17% increase in CA-ROW ARPA at $201,000 annualized. Aircraft online increased to 391, up 124 versus the prior year, and was up 39 aircraft quarter-over-quarter. As expected, CA-ROW ARPA declined sequentially, reflecting the dilution of more aircraft from new airline partners, which represented approximately 40% of aircraft online in Q4 2017. CA-ROW ARPA for airlines on which Gogo service was commercially launched prior to 2017 grew sequentially, and increased 66% year-over-year.

As we discussed at our Investor Day, consolidated CA-ROW ARPA is expected to decline during 2018 with the acceleration in the mix of aircraft from newly launched airlines, which we expect to represent approximately 75% of the base by the end of the year. We expect CA-ROW ARPA to resume growth in 2019 as newly added aircraft become more seasoned and generate higher ARPA.

Service revenue margin improved in Q4 from a negative 95% in Q4 2016 to a negative 17% in this quarter as we continue to leverage the investment in our global satellite network. Rest of World segment loss for the quarter was $25 million, approximately equivalent to the prior year, but materially improved as a percentage of revenue. As we bring online our large ROW-awarded but uninstalled aircraft, which now stand at approximately 770,

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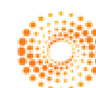

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we expect to see continued leverage of CA-ROW operating expenses, improving service revenue margin and CA-ROW segment profit margin. We believe these awarded aircraft and our demonstrated capacity to rapidly install 2Ku aircraft meaningfully de-risk the financial projections for our ROW business. We now have more than enough awarded aircraft to achieve profitability in this region, which represents a major growth opportunity for Gogo.

Let's now turn to our Business Aviation segment. BA continues to outperform. Service revenue was up 25% to a record $45 million, with 12% growth in ATG aircraft online to nearly 4,700 planes, and a 13% increase in ATG service ARPU to more than $2,900 per month. BA equipment revenue was $21 million for the quarter, up 36% from the prior year, driven by growth in ATG shipments as demand for our new AVANCE platform products has been very strong. Our ATG shipments increased 31% year-over-year, and 12% sequentially to 235 units, with our latest generation L5 system comprising nearly 50% of these units. Total revenue was $66 million for the quarter, up 28% year-over-year.

Our comprehensive portfolio of products and services is simply second to none in the global BA market. Segment profit for the quarter was $27 million, and the segment profit margin was 41%, returning to the 40%-plus levels from the 35% we reported last quarter due to charges incurred in that period.

Turning to CapEx. Consolidated cash CapEx of $43.1 million was $9.6 million higher than the prior year, reflecting our investment in bringing significant numbers of 2Ku aircraft online. As we discussed during our Investor Day, approximately 70% of our 2017 cash CapEx is related to success-based airborne equipment investment and equated to approximately $240,000 per aircraft for 2017. We expect this co-investment in airborne equipment to decline to less than $200,000 for 2018 and 2019, further improving upon our already attractive unit economics.

We ended the year with a substantial liquidity position of $409 million in cash equivalents and short-term investments, and we continue to target becoming free cash positive in 2019 and for the full year 2020.

Let me now turn to a summary of our results for the full year 2017 and our outlook for 2018. First, I believe it's important to point out that we either met or exceeded our full year 2017 guidance in all major respects, including total revenue, adjusted EBITDA, cash CapEx and total 2Ku installations. This represents a great achievement by our team, and demonstrates our ability to deliver on our objectives.

Total revenue grew 17% to $699 million, exceeding the high-end of our guidance range, driven by growth in business aviation and CA-ROW. Adjusted EBITDA was $63 million, and within our guidance range, when excluding the $4.5 million in charges related to write-downs of legacy product lines and the retirement of Gogo test aircraft we discussed on our Q3 earnings call.

While we hit all our guidance for 2017 in all material respects, I'd like to review the puts and takes. First, BA hit it out of the park. Also, the ROW airlines that launched service prior to 2017 grew faster -- grew ARPA faster than we expected. On the negative side, total 2Ku installations came in at the low end of guidance, and the launch of new airlines in ROW happened slightly slower and at a somewhat higher cost than planned. We added 130 ROW planes in 2017 versus guidance of 150. Finally, our ability to grow revenue from CA-NA aircraft on the ATG network was highly bandwidth constrained until the accelerated rate of conversion to 2Ku in Q4 began to provide meaningful relief.

Cash CapEx of $220 million was up $87 million from the prior year, reflecting purchases of 2Ku equipment to support 2017 and 2018 installations, but it did come in below the $230 million to $260 million guidance range we provided for the year.

I'll now turn to our outlook for 2018. Before getting into those numbers, let me outline 3 important business and accounting changes that will impact our financials. First, the de-installation of the American Airlines' aircraft impact CA-NA beginning this year, and we expect to replace these ATG aircraft with primarily satellite-based aircraft. While we don't control the rate of de-installations, we have modeled approximately 400 de-installs to occur between 2018 and early 2019, with a majority of these de-installs happening this year. In parallel, over this year and next, we expect to replace these aircraft with 2Ku installs for other airlines. Initially, we expect ARPA for these new airlines to be lower than the de-installed aircraft from American but, over time, we expect ARPA will grow as the aircraft become seasoned. To support these satellite-based aircraft, we expect to spend approximately $30 million more in satellite communication cost during 2018 versus 2017. Most of which will be in support of the North American-based aircraft, and this will free up significant capacity on our ATG network. These factors are reflected in our guidance.

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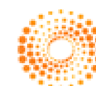

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Secondly, as you know, we have historically offered 2 primary business models to our Commercial Aviation partners: turnkey and airline-directed. Starting in 2018, we expect the mix of aircraft under the airline-directed model to be significantly higher than in prior years, shifting from about 10% at the end of 2017 to approximately 50% by the end of 2018. This is due to American Airlines switching from a turnkey to the airline-directed model in January of 2018, and continued growth in aircraft in CA-ROW, which primarily operate under the airline-directed arrangement. Under the turnkey model, the impact of airborne equipment co-investment is not included in adjusted EBITDA because it is recorded as a capital expenditure. Under the airline-directed model, airborne equipment revenue and cost, including the co-investment with our airline partners, flow through the income statement and are reflected in adjusted EBITDA. As a result, our adjusted EBITDA for 2018 is negatively impacted by the shift to the airline-directed model.

The third change affecting Gogo's 2018 financial statements is the implementation of the new revenue recognition standard, ASC 606, which went into effect on January 1, 2018. It means that equipment revenue will be recognized at the time of installation for our airline-directed installs rather than deferred over the life of the airline agreement. At the end this call, we will post a presentation on Gogo's IR website, which will provide supplemental material and discuss in detail the accounting implications of both the shift in our business model toward more airline-direct arrangements and the implementation of the new ASC 606 revenue recognition standard.

On this call, I will provide our outlook for 2018, including a bridge between the numbers under our historical and new accounting standards. We expect total 2018 revenue to range from $865 million to $935 million under the new revenue standard, which compares to $750 million to $790 million under the historical revenue recognition standard, reflecting a growth rate of 7% to 13% over 2017. We expect CA-NA revenue to range from $445 million to $485 million, approximately 20% of which will be equipment revenue. This compares to $380 million to $415 million under our historical revenue recognition standard, which, at midpoint, is flat to our reported CA-NA revenue for 2017.

We expect 2018 CA-ROW revenue to range from $125 million to $165 million, approximately 50% of which will be equipment revenue. This compares to $75 million to $90 million under our historical revenue recordation standard, and represents a 30% to 56% growth rate, driven largely by new aircraft being installed during the year.

We expect 2018 revenue for Business Aviation to range from $285 million to $295 million, representing 18% to 23% growth over 2017. Business Aviation revenue will not be materially impacted by the implementation of the new revenue recognition standard.

Adjusted EBITDA for 2018 is expected to range from $75 million to $100 million based on the 606 revenue standard, or $65 million to $90 million under ASC 605. We estimate that 200 -- 2018 adjusted EBITDA under ASC 605 would be approximately $15 million higher when adjusting for the financial impact of certain existing airlines switching from the turnkey model to the airline-directed model, and new airlines coming online under the airline-directed model in 2018.

We expect a quarterly profile of 2018 adjusted EBITDA to follow a similar pattern to what we experienced in 2017. Our expectation that second half adjusted EBITDA will nearly double the first half's is largely the result of the cumulative impact of additional bandwidth and aircraft coming online during the year, combined with the benefit of operating leverage that comes from our planned reduction in the growth rate of operating expenses in 2018 versus prior years.

Demonstrating this operating leverage, 2018 revenue and adjusted EBITDA are expected to grow 10% and 33%, respectively, based on the midpoint of our guidance and using the 605 revenue standard for comparability. The adjusted EBITDA growth rate would be further increased if adjusted for the increasing mix of airlines under the airline-directed model.

With regard to 2Ku aircraft online, we expect to end 2018 with between 1,100 and 1,200 aircraft, including approximately 450 2Ku aircraft in CA-ROW.

Let me now summarize our expectations for 2018 capital expenditures. We expect gross capital expenditures of $150 million to $170 million, and cash CapEx of $110 million to $130 million, of which approximately 35% is related to airborne cash CapEx, with the balance reflecting investments in our ATG-NG network and capitalized software. In addition, airborne equipment inventory purchases related to airline-directed installations are estimated to range from $15 million to $30 million in 2018, lower than previous guidance due to utilization of airborne equipment purchased

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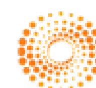

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during 2017 for 2018 installations. In total, combined cash CapEx and inventory purchases for 2018 are expected to be approximately $20 million lower than our previous guidance.

On balance, 2017 was a solid year. As we delivered on our objectives and ended on a very strong quarter. We believe 2018 will be an important transition year as we continue to increase bandwidth, revenues and adjusted EBITDA. We're excited to continue executing on our plan as we target achieving positive free cash flow in 2019.

Operator, we're ready for the first question.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) The first question is from Robert Gutman of Guggenheim.

Robert Ari Gutman - *Evercore ISI, Research Division - Research Analyst*

Can you just elaborate again, the -- on the ATG NextGen spending? The proportion -- the total amount and the proportion '17 and '18? And if there's any in '19? And can you also walk through a little bit the -- in terms of the application for line-fit on -- with Boeing, you've emphasized the, I think, the 737 MAX, but how broadly does that -- does the process apply throughout their overall fleet of planes?

Michael J. Small - *Gogo Inc. - President, CEO & Director*

Okay. Rob, good morning. It's Michael. I will make a couple general comments on the ATG NextGen, and then turn over to John Wade for the line-fit. So ATG-NG, we spent a high percentage of the R&D dollars in 2017. We will continue to spend some dollars there in '18 and possibly even a few to roll into '19. But that's becoming a declining number. The CapEx -- we built the 10 cell sites in 2017 for the test network. We will deploy nationwide coverage in 2018 and then we will do some fill-in sites in 2019. We will spend approximately $25 million this year in CapEx on ATG-NG.

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

And Rob, just to add to that. On the spending on ATG-NG, as you know, we guided to spend approximately $20 million in OpEx in 2017. We came in just under that number. That number will go down but continue at a lower level in 2018 versus 2017. And then, as Michael pointed out, the CapEx spend really starts in earnest at that level in 2018.

John Wade - *Gogo Inc. - Executive VP & COO*

As it relates to the Boeing situation, a lot of what you do when you're going through a line-fit offerability program, is not just related to your technology but it's actually related to you as a company. They look at your quality management systems, the way you manage material and so on and so forth. So while the initial airframe, we anticipate being (inaudible) is the 737. A lot of what we're doing is actually going to be applicable to the other airframes in due course.

Operator

The next question is from Philip Cusick of JPMorgan.

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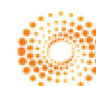

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Philip A. Cusick - *JP Morgan Chase & Co, Research Division - MD and Senior Analyst*

Barry, I guess, first, can you quickly review the practical changes from the airline-directed model? How does your responsibility, revenue and profitability change as American, for example, shifts to airline-directed?

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

Yes. So from an accounting standpoint, Bill, the primary changes are twofold as we go to the airline-directed model. First is that revenues will be lower, since we do not have a rev share. So revenues will be lower. But what was recorded in cost of service will not be there also. So those basically wash. The second change is that the -- now the co-investment for new airlines, as you know, goes through the P&L and is reflected in EBITDA. So -- but for the American Airlines' situation specifically, it's primarily the difference in that rev share, and then they are price -- they have control over pricing now. So we'll have to see how that plays out during the course of the year.

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

So again, not from an accounting standpoint but from a practical standpoint, do you anticipate your sort of owned revenue and owned profitability changing substantially?

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

Initially they have taken pricing down from where it was. So currently, that's the case. So that does impact us. So over time, we'll have to see how that increases as we continue to -- as they continue to optimize the pricing model.

Michael J. Small - *Gogo Inc. - President, CEO & Director*

So day 1, we get -- let's just -- let's isolate the accounting change and the model change from the issue of the de-installation. So our revenue from American will go down because this -- we're just doing essentially net revenue. That rev share is out of the equation. So that comes down -- whether we believe -- and we've seen evidence in the past that when the airlines go airline-directed, they tend to increase volume. And we make more money when they increase volume. So Japan Airlines is our biggest success story to date, but we see real indications that all airlines want to drive take rate up. They want to increase the passenger engagement and, over time, we would suspect that happens. So we actually view the airline control of pricing as a good thing. They are likely to put more marketing dollars behind this, increase distribution channels. We believe this will drive take rate upward over time.

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

Understood. And then second, where are you on commercial uptake of NextGen ATG?

Michael J. Small - *Gogo Inc. - President, CEO & Director*

So NextGen ATG is -- we're now flying it on test aircraft, and performing to expectations. It's been a -- it's a complex R&D development and it's helped time lines for a very long time now, and it's meeting all anticipated performance specs. It will be commercially available this year to -- in both BA and CA. And we'll have nationwide coverage by the end of this year. It will come down to STCs and installation dates on whether the aircrafts are in-service this year, but we're going to be actively out there selling it. And we believe it will be a hot seller. So the aircraft will follow behind very quickly.

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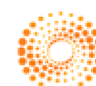

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Operator

The next question is from Simon Flannery of Morgan Stanley.

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

Hi. Yes. This is Landon Park on for Simon. Just in terms of the American Airlines guidance. Thank you for that color. Are you able to provide what kind of cadence your guidance assumes? Can you maybe lay out what revenue impact in dollar terms you guys are including in guidance? And then secondarily, in terms of the replace in airlines that you called out, how long do you expect -- or to be until you're able to grow net plane count in CA-NA?

Michael J. Small - *Gogo Inc. - President, CEO & Director*

So to answer your questions, we tried to be pretty clear that over 400 aircraft will be installed during the remainder of this year and into early 2019. That's what we've modeled. We do not control this process. We can't see it going a whole lot faster than that and we don't think we take much financial risk even if it were to go faster. But that's our modeling assumptions. We will be replacing the aircraft principally in Rest of World over the same time period. We have the 300 forecasted 2Ku adds in the Rest of World for this year. So the financial impact is based -- to the overall company is basically the spread in ARPA between the de-installed American planes and the new installations, principally in the Rest of the World. We provided guidance at Analyst Day on what a new add in Rest of World, that a new airline looks like, and we provided guidance on what a mature plane flying in North America on the ATG network has in ARPA. So there's a negative spread there. Those Rest of the World planes, though inherently are high ARPA aircraft. They will season, the ARPA will grow so -- but for 1 year or 2, during the launch period, there will be a negative ARPA spread.

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

Okay. And just 2 quick follow-ups. Are you able to give more specific guidance around what kind of spread that would be? And then also, just to follow up on John's comments earlier regarding the 2Ku issues, regarding the new modem. Can you give any more details on what exactly was going wrong? And what was the degree of the issue? And what gives you confidence in being able to have that fixed?

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

Let me take the first part of that question, which is on the ARPA spread. As Michael mentioned, we did break that out during the Investor Day, and you saw about a 3 to 1 difference in the airlines that have -- are coming online versus those that have been seasoned. So you can look at those numbers and see that mix change. We also highlighted on this call that the ARPA had grown year-over-year for the existing airlines that have been in service for a period of time in Rest of World. So that really is the dynamic, is just bring those new airlines on with lower ARPA; as those build, and particularly as the airlines get -- the aircraft get installed for an airline to the point that they can then market it comprehensively as a fleet, that's when you start to see the benefit of the growth in ARPA as a larger percentage to those fleets gets installed.

John Wade - *Gogo Inc. - Executive VP & COO*

And on the reliability issues. It was actually really caused by the de-icing fluid, which was able to penetrate under some of the [radar,] which caused the antennas to temporarily get sticky, if you will. The fix to that was very easy to do, and we've deployed that on a number of aircraft and we're not seeing any further issues around that at this time.

Operator

The next question is from John Hodulik of UBS.

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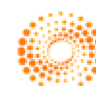

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John Christopher Hodulik - *UBS Investment Bank, Research Division - MD, Sector Head of the United States Communications Group, and Telco and Pay TV Analyst*

The -- Barry, in your prepared remarks, you talked about a higher take rate, especially in the second half of the year. Could you -- is that around the NextGen network? And things you're doing to increase speeds on the plane -- planes? If you could just flesh that out a little bit. And then, I guess, following up on the turnkey versus the airline-directed. Maybe for Michael, do you guys expect, over time, that your domestic fleet to move over to more of an airline-directed model? And I guess, sort of -- from a 30,000-foot view -- more to Phil's question -- I mean, can you guys, at this point, say that the economics in that model are similar to or better or worse than what you've sort of traditionally seen on the turnkey side per plane?

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

Thanks, John. Let me take the first part of that and I'll have Michael take the second. Regarding the take rates. Just as you saw, we had take rates rise meaningfully up, 30% year -- 36%, excuse me, year-over-year. So we're thrilled with seeing more of the plane engaged. That is the beginning of the business model that we have laid out, which is, as we bring more bandwidth to the plane, we're able to service a higher percentage of the plane. So the drivers of that are not so much ATG NextGen in 2018 because that really comes on later, but it really is benefit of the 2Ku aircraft line. As more of those are flying and more capacity is coming online, that we expect that trend that's already started in take rate increase -- increases and increased faster engagement to continue in 2018.

Michael J. Small - *Gogo Inc. - President, CEO & Director*

And to the second part of the question, there's an undeniable trend towards airline-directed. As Barry indicated at the end of last year, we had about 10% of the fleet on airline-directed, and by the end of this year, it will be approximately 50%. I do expect more U.S. airlines to go that direction, but in some cases, there'll even be a hybrid solution within the airline. Some of their plans will be turnkey and some will be airline-directed. So this is not quite an either/or, but the overall trend is there. The under -- we priced airline-directed so we were indifferent, relatively speaking, between airline-directed and turnkey. It doesn't mean the results are necessarily identical under either scenario. But what we -- ultimately, whichever model drives higher take rate, is going to be the model you prefer more. And we see increasing airline interest in driving take rate. And I think when they take control, they have the bigger marketing budgets, they have more ways to reach their passengers. I think we're actually in a better position to drive take rates and -- which is ultimately economics, in the airline-directed model than we have historically been in the turnkey model.

Operator

The next question is from Paul Penney of Northland Capital.

Paul Richard Penney - *Northland Capital Markets, Research Division - MD& Senior Research Analyst*

What was ARPA for CA-NA if it wasn't annualized? And how much of the take rate was the result of promotions, like free texting? And then third is, when is the material lift in ARPA going to come to get to your doubling of ARPA prediction for 2021?

Michael J. Small - *Gogo Inc. - President, CEO & Director*

I'll take the last one first. ARPA will grow, all factors considered, beginning in 2019. The dilution this year in ARPA comes from 2 basic areas. The conversion to airline-directed in North America. So you take the rev share out of the ARPA. And the new aircraft coming on in Rest of the World. But going forward, 2019 on, we will see the ramp. Barry and -- do you want to take the other 2 questions?

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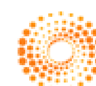

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Barry L. Rowan - *Gogo Inc. - CFO & Executive VP of Finance*

And the question about monthly ARPA for CA-NA was $12,000, which is the remainder of your question, I believe.

Michael J. Small - *Gogo Inc. - President, CEO & Director*

And we don't disclose, excluding the take rates, but I can point out, you saw very strong revenues in the fourth quarter. In fact, I think, we came in about $14 million above your fourth -- your guided -- your forecasted revenues. In the fourth quarter, we did $188 million versus $174 million. So we're starting to see the benefits of all this work in the marketplace.

Paul Richard Penney - *Northland Capital Markets, Research Division - MD& Senior Research Analyst*

Sure. But -- I guess why the shift in reporting standards now? Was this change insisted upon by your auditors? Was it expected? And if my math is right, in terms of 2018, it's confusing in terms of previous guidance and standards, that under the new standards, if my math is correct, the -- using the old standard that everyone was using, the guide would have been $65 million to $90 million of EBITDA. Just can you confirm that?

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

Well, Paul, the reporting -- there are 2 changes in the reporting. One is the shift to the airline directed-model that we described. Secondly is under 606, which all companies are required to report under 606. So that is why we are reporting under 606 and why we're reporting it under the 2 standards.

Paul Richard Penney - *Northland Capital Markets, Research Division - MD& Senior Research Analyst*

Okay. And can you confirm that using the previous numbers that everyone was using, that the guide would have been $65 million to $90 million? I think a lot of people are just confused in terms of what truly is apples-to-apples?

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

No. What we had said -- and that's why we provided the guidance under the two different [moons] is that adjusted EBITDA is $65 million to $90 million under is 605, and $15 million in addition would come as a result of the shift in the airline mix -- the standard -- that shift to the airline-directed plan.

Michael J. Small - *Gogo Inc. - President, CEO & Director*

So to cut through that, approximately $15 million that previously went through cash CapEx now moves up into the income statement. So no change in cash flow. You just move $15 million out of cash CapEx and into EBITDA. And which is why our cash CapEx was lighter than previously forecast and why the EBITDA was lighter than previously forecast.

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

So the most apples-to-apples comparison is to take the $65 million to $90 million and add the $15 million on that. So you get $80 million to $105 million.

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Paul Richard Penney - *Northland Capital Markets, Research Division - MD& Senior Research Analyst*

Okay. One more question. With SmartSky's recent FAA approval and others' enhanced product offerings, have you seen any pricing degradation? Or any customer movement yet in your -- this aviation unit?

John Wade - *Gogo Inc. - Executive VP & COO*

Not at all. The business continues to do really well. We're selling the L5 unit at rates that exceeded our expectation. The market interest in L5, it continues to be very strong. We obviously are going to have our own NG version available later this year. So that business just continues, as Barry said, to knock it out of the park.

Operator

The next question is from of Lance Vitanza of Cowen.

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

Just, I think, 2 quick ones for me. Michael, your comments early on, about winning. I think you said 40% of contract wins since 2Ku was unveiled, and presumably that's based on number of planes rather than number of contracts, but could you clarify? And then my other question was with respect to the, I think, it was $30 million of incremental satellite capacity to support the planes that are going to be offsetting the de-installs from American Airlines. And just hoping you could provide a little bit more color on exactly what that spend gets you in terms of bandwidth, length of time, number of planes that you expect it will cover and so forth?

Michael J. Small - *Gogo Inc. - President, CEO & Director*

Okay. Sure, Lance. Yes, the 40% is based on aircraft awards, not number of contracts. We target the larger awards, and have generally been adding awards, about 100 aircraft each, which, we think, is about double what a typical award is. So we get a smaller percentage of awards but a higher percentage of the planes. And obviously, 40% win rate of planes is industry-leading. This year, to your second question, we are bringing on a lot of the high throughput satellites. This is very cost-effective bandwidth, but we're really putting it in place, SES 15 being perhaps the signature satellite because it is so clearly targeted over North America, and that came on in January. We will dramatically improve the utilization of the capacity during the course of 2018 and beyond. But we are now into the high throughput satellite era. The performance of the 2Ku network is improving as that capacity puts on. This is really good news for us. The financial benefit of doing this -- our ATG costs don't go down when we move stuff to satellite but we're freeing up capacity on the ATG network. It allows us to continue to grow the BA business and maintain high service levels. It will allow us to increase the take rate on the regional jets and the other aircraft that remain on the ATG network.

Operator

(Operator Instructions) The next question is from Louie DiPalma of William Blair.

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

I just had a quick clarification question. Barry, I believe you mentioned that the company's expectations are for 400 American Airlines de-installations. And I was wondering how that number compares to your prior commentary around the potential for 550 de-installations?

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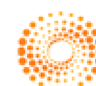

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Michael J. Small - *Gogo Inc. - President, CEO & Director*

I'll take it. Okay, so American Airlines has the option to de-install up to 550 planes. What we are saying here, of those built into our model, on which we base guidance, at least 400 of those will be done between now and into early 2019. There will likely be some more de-installs, but it will be at a lower rate. But -- and we think, the way we've modeled it, we've given you a good conservative outlook on what will happen in 2018.

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

Okay. And just to dig a little deeper on that, I guess, are all of your current A321s and 737-800s projected to be de-installed? Or has American Airlines told you that all of those planes will be de-installed?

Michael J. Small - *Gogo Inc. - President, CEO & Director*

Yes, we would expect those to be de-installed. And I think, we -- we're assuming at a fairly rapid rate.

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

Okay. And on the other side of the business, I guess, your guidance projects for another double-digit topline growth for the business jet division. And on that topic, since -- in my view, there's a general lack of awareness for this business jet division. I was wondering if you could provide a brief overview of the history of the -- this division dating from -- to 1996 with Jimmy Ray to 2006 with the acquisition of a air-to-ground spectrum? And if you could just talk about how much capital you guys have cumulatively invested in this air-to-ground network? And how that positions you for the future?

Michael J. Small - *Gogo Inc. - President, CEO & Director*

Yes. So it is a great business, and it has been around for more than a quarter century. And originally, it was primarily an equipment sales business that used other people's networks, until we built the air-to-ground network. We got the license in 2006 and built it by 2008. And then, we had a nationwide air-to-ground network and what had been a relatively small equipment based business now became a large service revenue based business going from about $25 million in revenue to now over $200 million in revenue, mostly equipment to mostly service. What's exciting is there's still lots more planes to get. And now not only will we leverage our air-to-ground network, we'll also leverage the global satellite network we've built. So this is a great channel to leverage the core investments we made in this business, and we uniquely capitalize on the Business Aviation segment compared to our customers. And so now we have a company -- a segment with almost no CapEx associated with it that is now approaching $100 million of EBITDA.

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

Okay. And my last question, I'm sorry if you already addressed this, but in association with your debt raise, I believe it was in late September, you discussed the potential for vendor financing. Is there any update on that?

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

Yes. We made an amendment to the agreement to accommodate that, Louie, so we do have the ability to do that. We will look at various alternatives for financing, kind of covering the waterfront, including opportunities to refinance the debt over time to drive -- push maturities out to -- lower the cost of capital over time. So it's one of the potential arrows in our quiver that we could use, so we were pleased that we had that accommodation. We haven't announced any plans for that, but at least it's allowed for under the agreements currently.

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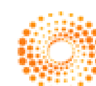

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Operator

The next question is from Carter Mansbach of Forte Capital.

Carter Mansbach

So I want to go back to the debt. So first, is there an opportunity to refi? And secondly, will you guys need to raise additional capital?

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

So the second part of your question first, Carter. We are fully funded, as we have said previously, based on our expectations of airline awards. We do have additional airline wins in our model and we are fully funded to be able to accommodate those. With regard to the debt, yes, we will continue to monitor what the opportunities for that are. With regard to the high yield, as you know, the way we would look at that is the cost of refinancing the debt, there is the breakage cost for make-whole payments, primarily that come down over time offset against being able to raise debt at lower rates than we're currently receiving. As you know, the coupon is at 12.5% and our debt trades substantially below that. So based on where the business is and the view of the debt holders, I think that there's certainly an opportunity to refinance that, and it's just a matter of what the right time is based on the economics for doing that.

Operator

And we will take our last question from Ned Zachar of KLS.

Ned P. Zachar - *KLS Diversified Asset Management LP - Portfolio Manager*

A couple questions. First, with regard to the guidance. Barry, I thought I heard you say that the apples-to-apples guidance for 2018, based on how The Street has been modeling the company so far, is $80 million to $105 million. I want to make sure that that's correct, if I have that right, because there are a lot of numbers and the accounting changes are somewhat confusing. Second one -- secondly, assuming that you and SmartSky end up at a duopoly type structure, have you ever seen in the course of your long careers, a duopoly industry structure compete on price?

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

Let me take the first question, is yes. The short answer to your question is that, on an apples-to-apples basis, we think that is the best comparison. So it's $80 million to $105 million because that reflects the impact of the shift to the airline-directed model. So -- and that is the basis of -- on which The Street has been looking at the company prior to these changes.

Michael J. Small - *Gogo Inc. - President, CEO & Director*

So -- and to the second question, I would say most vendors to the aviation industry often do end up in a duopoly. And most of those vendors are very profitable and make a good living. So it's a -- it's an attractive scenario. And -- but secondly, right now, we have close to 5,000 broadband planes and 5,000 satellite planes in Business Aviation, and SmartSky is still looking for their first. So we've got a long ways to go before you can even conceivably have a duopoly. We think our position is extraordinarily strong in Business Aviation.

Operator

I would now like to turn the call back over to Mr. Small for closing remarks.

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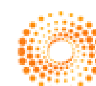

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Michael J. Small - *Gogo Inc. - President, CEO & Director*

Okay. Thanks, everybody, for joining the call today. 2018 will be a transformational year for Gogo as we grow revenue and adjusted EBITDA even after the effects of the de-installations. This strong underlying fundamentals of our business are driven by bringing massive amounts of bandwidth to our growing fleet of aircraft, improving the in-flight experience on these aircraft, deploying our leading ATG-NG network and rolling out products and services with our airline partners to drive passenger engagement and monetization. Also, Business Aviation is expected to continue its formidable trajectory of revenue and profitability growth. We look forward to a strong 2018. Thank you.

Operator

Thank you. Ladies and gentlemen, this concludes today's conference. You may now disconnect. Good day, everyone.

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