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PRESENTATION

Operator

Good day, and thank you for standing by, and welcome to the Third Quarter 2021 Gogo Inc. Earnings Conference Call. (Operator Instructions)

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

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

Thank you, Nika, and good morning, everyone. Welcome to Gogo's Third Quarter 2021 Earnings Conference Call. Joining me today to talk about our results are Oakleigh Thorne, Chairman and CEO; and Barry Rowan, Executive Vice President and CFO.

Before we get started, I would like to take this opportunity to remind you that during the course of this call, we may make forward-looking statements regarding future events and the future financial performance of the company. We caution you to consider the risk factors that could cause actual results to differ materially from those in the forward-looking statements on the conference call.

These risk factors are described in our earnings release filed this morning and are more fully detailed under the Risk Factors in our annual report on Form 10-K and 10-Q and other documents we have filed with the SEC. In addition, please note that the date of this conference call is November 4, 2021. Any forward-looking statements that we make today are based on assumptions as of this date. We undertake no obligation to update these statements as a result of more information or future events.

During the call, we'll present both GAAP and non-GAAP financial measures. We've included a reconciliation and explanation of adjustments and other considerations of our non-GAAP measures to the most comparable GAAP measures in our third quarter earnings release. This call is being broadcast on the Internet and available on the Investor Relations website at ir.gogoair.com. The earnings press release is also available on the website. After management comments, we'll host a Q&A session with the financial community only.

It is now my great pleasure to turn the call over to Oakleigh.

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

Thanks, Will, and thank you all for joining us this morning. A few weeks ago, we hosted a call to discuss our recently updated long-term financial targets, so I won't repeat those today. But instead, we'll focus on Gogo's third quarter and why we believe it provides further evidence that we're on track to deliver the long-term financial targets that we recently discussed.

Q3 was a quarter of record performance. Gogo delivered record total revenue, record service revenue, record service gross profit, record advanced shipments and record adjusted EBITDA. We also achieved a couple of notable firsts, generating both positive net income and positive earnings per share for the first time. We were certainly helped by the powerful tailwinds driving demand for private jet travel, but we're also well prepared to capitalize on that strong demand and deliver excellent top and bottom line growth. Our advanced platform and 4G network are well positioned to meet the needs of our growing customer base and take advantage of the accelerating demand for BA connectivity and our vertically integrated and scalable business model is converting that demand into shareholder value.

I'll begin with a summary of the highlights of our third quarter results, then provide some context on the current competitive landscape and Gogo's competitive advantages. And finally, introduce our updated 2021 financial guidance, which reflects the impact of continued strong equipment sales in the high-margin recurring subscription service revenue that tracks those sales. Barry will then walk through our quarterly performance and latest 2021 guidance before we open the call up to your questions.

So let me start on Q3 with our demand drivers. As has been written about the media extensively recently, the business aviation industry is on fire. Flight counts continue to grow with third quarter flight counts and Gogo equipped aircraft up 8% from Q2 and up 24% compared to pre-COVID Q3 2019. That demand for flights is driving demand for aircraft, with fleet operators deferring retirements, acquiring as many aircraft as they can in the preowned jet market and placing ever larger orders for new aircraft with OEMs. That activity is good for Gogo and fleet customers want -- as fleet customers want connectivity on those new and used jets and deferred retirements often retain Gogo connected aircraft in the fleet.

But even more impressive is the growth in demand for data on those flights. In Q3, we saw a 78% increase in megabytes consumed per day on our network, and a 44% increase in megabytes per flight as compared to pre-COVID Q3 2019. Those metrics were driven by a 33% increase in flight hours per day, a 34% increase in megabytes concern per hour, and a 17% increase in the number of aircraft-s flown. Those increases drove all-time high monthly ARPU in aircraft or AOL aircraft online for Gogo. ARPU continues to grow as more than 3x as many customers upgraded plans in Q3 as downgraded plans, up from 2.3x in Q3 2020 and up from 2x in Q3 2019.

In ATG aircraft online, AOL, also continues to grow and hit an all-time high of 6,154 aircraft at the end of Q3, up 10% from Q3 2020. That combination of ARPU and AOL growth delivered record total revenue of $87.2 million, fueled by record service revenue of $66.2 million and outstanding equipment revenue of $21 million. The strong equipment sales growth that drove us to raise our long-term financial targets in late September has continued, and our service revenue is growing nicely as more of those units are installed and activated.

I think it's also important to note that once installed and activated, our service revenue is extremely sticky. From the time we started computing churn in 2017 until now, we've averaged a 0.5% monthly churn rate, which implies a 17-year equipment life on an aircraft. That's driven by high customer satisfaction, combined with the fact that it's very expensive and time-consuming to install a new system. All of these factors continue to derisk the long-term targets we shared a few weeks ago and are a perfect demonstration of our virtuous circle business model.

Equipment sales profitably expand our base of subscribers, and that in turn generates recurring, sticky, high-margin service revenue, which in turn drives cash flow, enabling us to invest in improving our network, which in turn attracts new customers, generates more usage and drives more equipment shipments. Importantly, we think this demand will continue. So 85% of today's broadband connected aircraft use Gogo, approximately 70% of the market still does not have broadband, creating white space for us but raising questions from investors as to why that penetration is so low.

There are a couple of reasons for that. First, the average age of the aircraft in today's business aviation fleet is 20 years, so much of today's fleet was manufactured before a line fit with WiFi was an option. Second, when Gogo launched, the iPhone hadn't even been developed and inflight connectivity was considered a business productivity tool, mostly for doing e-mail. And many business travelers didn't even do that.

But it's a different world now. Today, broadband connectivity is line fit on all 28 models of business aircraft and Gogo as line-fit on 27 of them. And today, passengers insist on being online, whether they're business travelers using Zoom or leisure travelers surfing video intent social media. I also think our advanced platform is accelerating market penetration with customers loving the L5's interactive video capabilities for Zoom calls and the small form factor L3 driving penetration of the light jet and turboprop markets where today's geo satellite providers can't compete.

As we talked about a few weeks ago, based on these trends, we expect a number of broadband connected BA aircraft to grow by approximately 50% by the end of 2025, substantially increasing our market opportunity. We expect to win our fair share of those aircraft by virtue of the competitive advantages I plan to talk about in more detail in a minute, namely our unique ATG network and rollout of our new 5G network, the versatility of our advanced platform and our strong relationships with our customers and distribution partners.

Another important driver of Gogo's ability to drive revenue this quarter and hit our targets for the next few years is our ability to meet demand. Supply chain challenges have been systemic across our industry. However, due to a combination of our long-standing relationships with suppliers, our common componentry strategy for AVANCE and our strong balance sheet, we secured all the supply we need to not only meet our 2021 demand, but also to meet the 25% unit growth we project for 2022, further derisking the targets we shared a few weeks ago.

Finally, but most important, because of the great work of our Gogo sales and production teams, we've been able to not only meet demand but convert that demand into bottom line profitability and value for shareholders. In Q3, we generated positive net income of $19.7 million from continuing operations, which computes to $0.16 a share on a fully diluted basis. And we achieved record adjusted EBITDA of $40.8 million, up 35% year-over-year and 11% above last quarter.

We expect to have positive net income going forward as our high-margin service revenue grows and our operating costs remain relatively fixed, driving operating leverage and strong growth in cash generation. We're proud of our results and the momentum we're building, and I'm really proud of the Gogo team, which continues to rise to the challenge of exceptional demand while preparing to deploy the world's first 5G ATG network. Our team's focus on our customers' needs and on continuous improvement is the key ingredient that drives our success.

Now I want to turn our attention to the BA competitive landscape. Gogo has developed 3 main competitive advantages in our 30 years serving the BA market, including our proprietary ATG network, our unique and future proof AVANCE platform, and our deeply embedded relationships with our OEM and dealer partners. Together, these advantages enable us to provide an unmatched value proposition to BA manufacturers, dealers, owners and passengers. And importantly, we continue to invest in strengthening each of them.

So let me start with our proprietary network. Today, we operate the only air-to-ground network in North America and we have exclusive licenses to the only radio spectrum authorized to provide ATG connectivity to aircraft in North America. The advantage of ATG are that, first, it provides lower latency than our current GEO satellite competitors can deliver by virtue of having ground antennas that are no more than 200 miles from the aircraft, as opposed to GEO satellites, which are 22,000 miles from the aircraft.

Second, because of that close proximity, our ATG airborne antennas require less power than GEO antennas, which allows us to have much smaller form factors and to fit on far more makes and models of aircraft, thereby having a much larger total addressable market than our GEO competitors. And finally, ATG costs much less than GEO satellite-based connectivity on an equipment installation and service basis. I should add that it's not easy to build an ATG network nor is it easy to fund the operating loss as a network operator suffers between lighting up their network and activating enough customers to cover their operating costs. In Gogo's case, we need to raise more than $800 million in equity. And at that time, we were fortunate to have positive margin from providing ATG to commercial airline customers that cover some of those costs.

A key pillar of our strategy is that we will continue to improve the performance of our ATG network to keep pace with customer expectations based on what they experience on the ground. To that point, we remain on track to deploy the world's first 5G ATG network with nationwide coverage from 150 sites in the second half of 2022. In the third quarter, Gogo achieved several significant deployment milestones. We moved from the design development phase into qualification and certification of the aircraft hardware and ground stations. We placed orders for all of our 7 tower testbed equipment, and NETGEAR is on its way for a Q4 buildup. And third, we released installation manual, service pricing and hardware pricing to the OEMs and dealers.

Beyond deployment, we've made significant progress across our 5G program. Based on recent testing and modeling across 8 commonly traveled city pairs, we announced that we expect Gogo 5G to deliver approximately 25 megabits per second on average with peak speeds in the 75 to 80 megabits per second range, a significant improvement from the 2 to 7 megabits per second that Gogo AVANCE L5 customers, interviewed by the Boston Consulting Group, reported the experience today. As business travels increasingly require seamless video conferencing and VPN access and leisure travelers expect living room quality streaming capabilities for accessing video intense social media, Gogo 5G data speeds will be a top differentiator for Gogo.

We also announced Jet Edge, the largest operator of super midsized and large cabin private jets as our launch customer. Jet Edge has advanced L5 installed across the majority of its managed large-cabin fleet, and we'll upgrade 50 of them to Gogo 5G post-launch. A key selling point for the AVANCE L5 platform is that the upgrade path to our Gogo 5G network is much simpler than installing a new ISC system. We replaced the 2 current L5 antennas with new 13-inch antennas that fit in the exact same location as the L5 antennas and had a small box inside the aircraft. The wiring access points and main LRU all stay the same. The rest is just a software update that is done seamlessly over the air. And Gogo 5G is not the end of our ATG enhancements, and we have a road map of future enhancements aimed at improving the performance of our ATG network for years to come.

Our second major competitive advantage is our AVANCE platform. Like Apple products, AVANCE is a software-centric platform that includes a set of hardware devices built on common components that all operate on a single operating system that transcends the cloud and all of our devices. AVANCE allows us to first provide a whole new level of customer service, which drives stickiness. Second, allows us to seamlessly add apps over the air to drive increased ARPU and/or stickiness. And third, allows us to add new network technologies as they evolve to provide more capacity, coverage and performance for our customers.

A good example of our AVANCE customer service features would be the automated ticket creation feature. The system constantly monitors itself and as it identifies issues, it auto creates trouble tickets, thereby allowing us to take corrective actions often before the customer even knows they have a problem. A good example of seamlessly adding apps to drive stickiness is our recent mix app, which allows flight departments to remotely scale different levels of service to different users on the aircraft, thereby ensuring that each passenger gets the appropriate experience.

And a good example of AVANCE flexibility in incorporating new network technologies would be the LEO networks that are being launched over the next few years. AVANCE could support a LEO network aggregated with our ATG network over North America to deliver more bandwidth than either network to deliver on its own. It would also expand our total addressable market to include the 14,000 business aircraft that are registered and predominantly fly outside North America.

AVANCE gives us a tremendous advantage addressing the LEO opportunity, because we could add an electronically steerable antenna, ESA, on top of the aircraft and run wiring down to the advanced LLU and that would be the extent of the hardware upgrade. The rest of the upgrade would be completed with an over-the-air software update. Our third major competitive advantage is our relationships with dealers and OEMs. I discussed OEMs a moment ago, so we'll focus these comments on dealers and MROs. As we've said before, Gogo has a high-quality network of 120 dealers worldwide. These mutually profitable relationships are incredibly valuable and took many years to build. Our distribution partners are invested in Gogo and they know we can be relied upon to deliver quality products on a timely basis, and that those products will make their customers happy.

Evidence of the strength of these relationships with the announcement by Duncan Aviation, the largest independent MRO in the United States, to modify all of its full equipment AVANCE L5 STCs to include Gogo 5G, which will cover more than 30 aircraft models, including aircraft manufactured by Bombardier, Gulfstream, Dassault and Textron.

Now let me turn to the competitive landscape. Competitors fall into 2 buckets. GEO satellite service providers and the potential new ATG service provider. Let's start with GEO satellite service providers. Their main advantage is that they have broader coverage than Gogo. However, since 87% of all BA flights are in North America, Gogo can still serve most BA aircraft missions. As mentioned earlier, Gogo's advantages over GEOs are: a, smaller form factors, allowing us to serve all makes and models of aircraft while GEO providers have heavier and larger form factors and are limited to larger jets; b, a significant latency advantage, which is very important for interactive video applications like Zoom; and c, Gogo is cheaper on all fronts, including equipment, installation and service.

Now let's turn to the potential new ATG entrant. They faced many challenges, starting with a lack of credibility with the distribution channels and customers. After originally announcing that they would deploy a nationwide network in 2016, they have missed a series of launch dates over the last 5 years and have recently said they would complete their network by the end of this year, but have now slipped once again and are now saying they will complete the network by the end of the second quarter next year. As a result of these delays, this potential competitor has no credibility in the distribution channels and they will need to complete and successfully operate their network for some period of time before they can regain credibility.

Even then, they'll face challenges. They recently announced their network will generally achieve speeds in the 5 to 8 megabits per second range, with peak speeds up to 15 megabits per second. Their speeds are roughly equivalent to what our L5 customers on our 4G network experience currently and well below the average speeds in the 25 megabits per second range and peak speeds of 75 to 80 megabits per second that we expect customers to experience with Gogo 5G. Besides our distribution channel and speed advantages, we also expect they will face challenges around the size of their antennas and they will need to raise considerably more capital to finish their network and operate it to profitability, which, given all the other challenges they face, is a challenge in its own right.

More broadly in the market, we also see exciting opportunities to partner with potential new entrants in the LEO satellite service space. Of the 3 LEO providers launching or likely to launch over the next few years, 2 are committed to B2B models, and we are in discussions with them about us providing a LEO global broadband product to our vertical market. This would allow us to add the 14,000 business aircraft outside of North America to our total addressable market, and to provide an integrated advanced ATG and LEO product to the North American market, which we think would be especially valuable to North American heavy jets that fly globally and use both ATG and GEO satellite solutions today.

Thirdly, our provider of Starlink, which is currently in beta test in pursuing the global broadband market, estimated at $350 billion in revenue this year with a direct-to-consumer model. They have discussed also pursuing the $80 billion military gov market, the $25 billion connected car market and a $7 billion U.S. commercial aviation market, among others. Business aviation connectivity is tiny compared to those opportunities, estimated at less than $500 million in service revenue this year.

Given the relative size of the BA market opportunity and given the BA, business aviation connectivity is highly regulated as complex distribution channels and has a highly fragmented customer base, we would be surprised if entering our market were a high priority for Starlink. Meanwhile, we think we are well positioned to launch a LEO add-on to our AVANCE platform given our current distribution channel relationships, given that we will have a large AVANCE installed base that would be LEO ready and given that we will be able to leverage AVANCE certifications for our LEO product, just like we're doing today for 5G.

Now I'll touch briefly on our updated 2021 financial guidance before turning the call over to Barry. This morning, we raised our 2021 adjusted EBITDA and free cash flow guidance and noted that our full year revenue is expected to come in at the high end of our previous guidance range. This is the third time we've raised 2021 guidance and our raised expectations are driven by significant growth in Gogo equipment sales, supported by strong industry tailwinds and growth of the high-margin recurring subscription service revenue that follows activation of our equipment. That margin growth and the relatively fixed nature of our operating costs creates tremendous operating leverage and will drive substantial cash generation after completion of our 5G network in 2022.

A brief note on next year. We expect continued strong revenue growth, but would like to remind investors that it will be an investment year as we complete our 5G network. And those investments will mute growth in our adjusted EBITDA and net income until the 5G tower investments are largely installed. We're excited about the future of Gogo's ability to deliver for our customers, shareholders and employees as we execute on our strategy for long-term value creation.

And with that, I'll turn it over to Barry.

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

Thanks, Oak, and good morning, everyone. As Oak mentioned, the tailwinds driving the business aviation market are strong and by all indications are sustaining and picking up momentum. This, coupled with Gogo's business execution, creates a strong foundation for continued profitable growth.

As we have demonstrated, our financial model is a virtuous circle. Strong equipment shipments drive high-margin recurring service revenue, leading to strong cash flow that we can invest in enhancing our network, which in turn attracts new customers, generates more usage and drives more equipment shipments. Our record third quarter results demonstrate that our model is firing on all cylinders as we reach an exciting inflection point for the company, which was that Gogo generated positive net income and EPS for the first time, as Oak mentioned.

Strong equipment shipments are derisking our long-term targets, and we continue to strengthen our balance sheet to enhance our foundation for innovation, investment in future success, and eventually, capital returns.

I'll walk through the key results of the quarter, starting with the top line, which are a reflection of the accelerating strength of the business aviation market and Gogo's unique ability to capitalize on that growing demand. Total revenue for the third quarter was a record $87.2 million, increasing 31% year-over-year and 6% sequentially, driven by strong growth in both service and equipment revenue as demand continues to exceed our expectations. Our record service revenue of $66.2 million in the third quarter represents an increase of 24% year-over-year and was driven mainly by more AVANCE units coming online.

On a sequential basis, our third quarter service revenue grew 5%, excluding the onetime benefit of $1.8 million in our second quarter from recognizing deferred revenue from a specific customer contract. Growth of our recurring subscription-based service revenue is a key long-term value driver of our business. ATG aircraft online reached 6,154, up 10% compared to the third quarter of last year and 2% compared to the second quarter of this year. New customer activations remain strong, representing over 60% of total activations during the quarter, which is in line with the last several quarters.

As we said over the past year, penetration of the AVANCE platform into both our installed base and with new customers is a centerpiece of our long-term strategy. AVANCE provides unparalleled extensibility as our technology evolves, laying the foundation for even stickier enduring relationships with our customers. In the third quarter, total AVANCE units online grew to 2,237, an increase of 46% compared to Q3 2020. This is comparable to AVANCE growth for the last 5 quarters, which ranged from 42% to 51%. AVANCE units comprised 36% of total AOL as of September 30, 2021, a meaningful increase from the 27% a year ago.

As we grew our AOL, ARPU also grew to $3,264, representing an increase of 9% year-over-year. Excluding the onetime benefit from last quarter's deferred revenue, ARPU increased 2% sequentially. Looking ahead, we expect our 2021 revenue to be at the high end of the guidance range we announced last quarter, reflecting our expectations that service revenue for the full year 2021 will grow at least 20% over the full year 2020.

Turning now to equipment revenue. Gogo delivered very strong equipment revenue of $21 million, a dramatic 59% increase year-over-year and a 19% increase sequentially due to strong demand for our AVANCE L3 and L5 products. We had a record 264 AVANCE product shipments in the third quarter, which represents 58% growth from Q3 2020 and 33% growth sequentially. It's worth noting that our expectations for 2021 AVANCE shipments are now more than 30% ahead of our original 2021 internal budget.

Our 2021 revenue guidance reflects equipment revenue for the full year 2021 at 30% above 2020 levels. This strong performance is based on the underlying strength of the market, as well as the seasonal dynamics of our business. We generally see equipment sales backloaded to the second half of the year, and we expect that same seasonality to occur this year. As we shared at the end of September when we updated our long-term financial targets, we expect continuing strength in AVANCE shipments with growth of 20% to 25% next year, and this, on top of this year's strong performance.

Let me add one final point regarding equipment shipments, and that is to underscore the important results achieved by our production operations team in the face of the global supply chain crisis. As Oak described, our efforts to efficiently manage our supply chain benefit from our AVANCE platform hardware strategy, which is focused on standardizing common componentry across our L3 and L5 products to manage our costs and drive quality. Gogo is also committing $10 million in cash for additional inventory purchases during 2022 to ensure we meet demand and to reduce our quoted lead times.

The outstanding results achieved by our supply chain team certainly derisked our long-term guidance by ensuring that we can deliver on equipment orders that already stretch well into 2022.

Now I'll turn to a discussion of our profitability for the quarter. Our stronger-than-expected performance in the third quarter reflected the power of our business model, which flows from our recurring high-margin service revenue. Gogo delivered service margins of 80% in the third quarter, an increase of 300 basis points sequentially. This increase was mainly driven by a onetime $2 million catch-up credit for federal universal service fund regulatory surcharges from which we have recently become exempt. Telecommunications companies must pay a percentage of their interstate end user revenues to the fund. And due to changes in our operating structure in 2020 prior to the sale of the CA division, Gogo is now exempt from these surcharges, and this credit was for the 7 months, from January through July of this year.

Beginning in August 2021 and going forward, we will have $3 million in annual savings as a result of the exemption, and this impact was favored in the -- factored in the long-term targets we announced in late September. Excluding this credit, service margin would have been in line with expectations and approximately even with last quarter's 77%. As we've said previously, we anticipate service margins to come down to the mid-70s in the fourth quarter of this year and for 2022 and then to increase over the longer term as we benefit from increased operating leverage.

On the equipment side, margins increased to 41% in the third quarter, an increase of 320 basis points sequentially, driven by strong equipment sales and mix -- skewing more significantly toward advanced products in line with our strategy. This profitable customer acquisition is a significant differentiator of the unit economics of our business, particularly relative to traditional telecom and other digital infrastructure businesses. We continue to expect equipment margins for the full year 2021 to be above the 2020 levels, even as margins in the second half are expected to be lower than in the first half of the year, largely due to mix between L3 and L5 equipment shipments.

It's important to note that while equipment margins are lower on the less expensive L3 product, service margins are quite similar across the 2 product offerings which, of course, is most important for our overall business model. Our L3 product is delivering on its strategic objective of penetrating the market for smaller airframes, as demonstrated by our continued momentum in personal jets including our previously announced agreement with Cyrus as well as the HondaJet announcement Oak referenced on this call.

Moving to operating expenses. Gogo's third quarter combined engineering, design and development, sales and marketing and G&A expenses of $26.7 million increased 16% year-over-year. This was primarily due to a onetime catch-up in noncash stock-based compensation expense related to vesting that occurs on employee retirements and primarily impacted G&A. Q3 OpEx spending did benefit from a reduction of $3 million relative to our previous expectations, half of which are permanent savings and half being deferred to future periods. We expect -- we continue to expect G&A to decrease in 2021 relative to 2020. We also remain on track to deliver our targeted $10 million reduction in G&A, excluding noncash stock-based compensation from the 2020 level by the end of 2022.

Now I'll provide some additional detail on our Gogo 5G program and spending profile. As I've mentioned, we are on track to deploy our 5G ATG network in the second half of 2022. In the third quarter, we spent a total of $1.8 million in external Gogo 5G development and deployment costs, split evenly between CapEx and OpEx. Two factors contributed to the level and timing of Gogo 5G related spending. First, we have reached the accounting requirements to capitalize Gogo 5G spend earlier than originally budgeted. We demonstrated technical feasibility in early 2020 and achieved R&D completion milestones for Gogo 5G in July of this year. As a result, we expect to capitalize $3 million of Gogo 5G costs in 2021 that were initially anticipated to be treated as OpEx.

Secondly, we are expecting that some OpEx and CapEx spend projected previously in Q4 2021 will shift to the first quarter of 2022. I want to be clear that these shifts in our spend schedule do not change our expectations on the timing of network deployment. As we look ahead, our Gogo 5G spend is expected to ramp significantly in the fourth quarter and to peak in the first quarter of 2022 in anticipation of our launch in the second half of next year. We expect that over 90% of our total Gogo 5G investment of approximately $100 million will be completed by the end of 2022.

It's significant that we are able to fund the entire remaining amount of Gogo 5G deployment costs from internally generated cash flow. To reiterate our long-term expectations after Gogo 5G is launched, we expect ongoing capital expenditures in the $15 million to $20 million range annually, supporting an even stronger adjusted EBITDA to free cash flow conversion rate in 2023 and beyond.

Now on to our bottom line. Our adjusted EBITDA of $40.8 million was a new record and represents a 35% increase year-over-year and an 11% increase sequentially. This record certainly reflects the strength of our business model and the underlying trends driving our business. As I mentioned a few minutes ago, our third quarter adjusted EBITDA does include some benefits that we don't expect to recur, namely the $2 million credit for federal universal service fund surcharges. Our full year 2021 guidance for adjusted EBITDA, which we increased to a range of $140 million to $145 million from our previous guidance of more than $130 million reflects our somewhat lower adjusted (inaudible) fourth quarter versus this quarter. This is due to the onetime surcharge credit in Q3 and lower equipment margins and higher operating expenses related to 5G deployment expected in the upcoming quarter.

As we mentioned earlier in the call, Gogo achieved a tremendous milestone in our third quarter. We achieved positive net income for the first time. During this quarter, we achieved $19.7 million in net income from continuing operations, which translated into $0.18 in basic earnings per share and $0.16 in diluted earnings per share from continuing operations. Free cash flow for the quarter was $24.6 million. This reflects our strong top line growth and healthy 47% adjusted EBITDA margins, as well as the impact of the comprehensive refinancing we completed in April, which materially reduced our annual interest expense and enhances our strategic and financial flexibility. While there will certainly be variation from quarter-to-quarter, particularly due to the timing of our Gogo 5G investment, our expectation is to deliver positive annual free cash flow going forward. Based on this performance, we have increased our free cash flow guidance for 2021. And as you know, we substantially increased expectations for free cash flow in 2023 and 2025 several weeks ago.

Now let's turn to a discussion of our balance sheet. Gogo is in a very strong liquidity position with $133.2 million in cash on hand as of September 30 and our $100 million revolver remains undrawn. As of the end of the third quarter, we had approximately $826.2 million in outstanding debt including the $723 million Term Loan B we recently put in place and approximately $103 million in outstanding convertible notes. Our strong financial performance has reduced our net leverage ratio to 4.7x based on our year-to-date annualized results as of September 2021. This is a dramatic improvement over where we were a year ago just before the CA divestiture. Based on annualizing 3 quarters of adjusted EBITDA from continuing operations for the first 3 quarters of 2020, our net leverage ratio for continuing operations was 10.1x at September 30 a year ago, more than double our current leverage ratio.

I'm also pleased to highlight one of the provisions we're able to negotiate as a part of our most recent financing, which was that our interest rate would decline as our leverage declines. During the third quarter, our lower leverage ratio enabled us to achieve the maximum 50 basis point reduction in the interest rate on our Term Loan B as provided by our contract. Our interest rate will be reduced to LIBOR plus 3.25% with a 75 basis point LIBOR floor and our revolver commitment fee will be reduced by 25 basis points. These reduced rates will take effect in November and in aggregate will result in approximately $3.8 million in annual savings.

Assuming we settle conversions of the $103 million in convertible notes maturing in May of 2022 in stock as currently planned, we expect our net leverage ratio to be below 4x by the end of 2022. With this final step in our comprehensive refinancing plan, our annual interest expense will have been reduced from $111 million before our April refinancing to approximately $30 million annually after the equitization of the remaining convertible notes and reflecting the reduced interest rates due to our lower leverage ratio, as I mentioned a moment ago.

Our strong balance sheet and financial performance afford Gogo unprecedented levels of strategic and financial flexibility. On previous calls, we indicated that we would pursue a balanced capital allocation strategy focused on 4 primary areas in the following order of priority. First is enhancing our network through the deployment of Gogo 5G. Second is reducing overall leverage to an appropriate operating level. Third is strategically investing in our business in ways that capitalize on market opportunities or further strengthen our competitive position, such as the global broadband opportunity. And fourthly, over the longer term, considering returning capital to shareholders as appropriate.

We have made considerable progress on the first 2 of these with Gogo 5G on track and on budget and the natural deleveraging that has occurred on an accelerated basis with a stronger-than-expected operating performance. We are now in a position to more actively consider the latter 2 priorities. Over the coming quarters, we will continue to assess value-creating investment opportunities like the LEO-based global broadband opportunity. We will then be in a position to begin considering the potential timing of returning capital to shareholders in the context of a targeted capital structure.

With that, I'll provide some additional color on our updated financial guidance. As we announced in our press release this morning, we expect our full year revenue to come in at the high end of the $325 million to $335 million range we had previously communicated. We also raised our 2021 adjusted EBITDA guidance to a range of $140 million to $145 million versus at least $130 million as we previously expected. This guidance excludes approximately $2 million of separation and migration costs related to the sale of the CA division.

In terms of free cash flow, we now anticipate generating at least $40 million in free cash flow for the 2021 fiscal year compared to the $25 million to $30 million to which we have previously guided. And finally, given the Gogo 5G spend dynamics I spoke to earlier, we now anticipate 2021 capital expenditures at the low end of our $20 million to $25 million range. While we plan to provide full year 2022 guidance on our next earnings call, as we normally do, we thought it would be helpful to offer some high-level perspectives as we finish out 2021 and look forward to 2022.

We continue to expect significant top line growth. However, we want to be clear that we don't expect our bottom line to continue to grow at the pace we are delivering in 2021. For one, we will not have the approximately $4 million onetime benefit as we did in 2020 with the deferred revenue recognition in USF surcharge credit. We expect service and equipment margins to contract somewhat next year and we will be significantly ramping investments to deploy our Gogo 5G network. In addition, Gogo will be returning to more normalized postcode spending on sales and marketing, particularly as we continue to commercialize Gogo 5G. And we anticipate that meeting the significant growth in advanced unit shipments expected in 2022 will require some investments in working capital.

Over the longer term, we continue to drive towards the long-term financial targets for revenue growth, adjusted EBITDA margin and free cash flow we announced in late September, which remain unchanged. As a reminder, the long-term financial targets are as follows: revenue growth at a compounded annual growth rate of approximately 15% from 2020 to 2025, annual adjusted EBITDA margin reaching 45% in 2025. Adjusted EBITDA margin may decline modestly from the higher-than-expected level achieved this year due to the investments we described for next year, for example, but our target of 45% in 2025 remains unchanged. Free cash flow of approximately $125 million in 2023 following the deployment of the Gogo 5G network in 2022. And approximately $200 million in 2025.

In conclusion, our business is really hitting its stride leveraging our unique competitive advantages to capitalize on the positive trends driving growth in the attractive, underpenetrated BA market. Our equipment shipments and supply chain strengths continue to derisk our long-term financial projections as more aircraft come online and feed the virtuous circle that creates value for our customers, shareholders and employees.

Before we turn the call over for your questions, I'd like to thank the Gogo team for the outstanding performance we delivered this quarter again. Our continuing progress, including reaching the exciting milestone of achieving positive net income, is a testament to the hard work of our talented team. So thank you. Operator, this concludes our prepared remarks, and we're now ready for our first question.

QUESTIONS AND ANSWERS

Operator

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

Amir Reza Razban - *JPMorgan Chase & Co, Research Division - Research Analyst*

This is Amir for Phil. I wanted to know when you look at your 2022 goal for the 5G launch, where are the puts and takes into hitting that? And how does the supply chain kind of work today for that? And then in addition to that, another one, if I may. Are you guys -- can you confirm that you're seeing revenues from that Intelsat agreement? And should that ramp as the airlines start to kind of come back in flight counts stop?

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

Thanks, Amir. I'll take the first part and let Barry deal with the Intelsat part. I wouldn't say that we have any puts and takes on when we're going to deliver. We're very confident in delivering the second half of 2022. As you know, we had a 5G chip issue. That's been resolved. That's being delivered on schedule. That was a 6-month delay in that chip, but we actually managed the project to still stay on schedule, and we're very confident in that. And the other, the second part of that question was supply chain. In terms of supply chain, we are in very good shape. We have secured all the supply, all parts required to meet our commitments this year and for the first quarter next year and second quarter next year.

And for Q3 and Q4 next year, we have secured all parts needed to meet our current projections of 25% unit growth. If we are actually putting demand into our systems now for greater than 25% unit growth in case, we see a similar surge in orders as we have this year, next year. And so we still are a bit yellow on that surge in additional demand if that occurs in Q3, Q4, but we're working that down. And I think we feel pretty confident we could handle it. And then we are ordering already -- we're ordering 18 months ahead right now in order to secure supply. And so we're now actually placing orders for demand for 2023. So we're feeling pretty good about that, and I think we performed really well in that area.

As far as 5G itself, most of the supply right now is around the network and the actual equipment to run the network. That's coming in right now on schedule in terms of the airborne equipment. That's all on the certification process right now. But we don't see a lot of -- any supply issues there is that we are -- we have very focused vendors, let's put it that way. There are 3 very good vendors who are supplying us on that project and there are no alarm bells whatsoever. Remember, it also leverages a lot of the same componentry that we use for our AVANCE L5 and L3 products. So the supply chain is pretty consistent across 5G and AVANCE. We feel good.

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

And Amir, on your second question regarding the Intelsat revenue, yes, that is on track. As a reminder, we have a 10-year contract with them and the amount of the minimums grow over time to total $177 million over that 10-year period. We are on track for that, and there is a step-up in that rev share amount as the 5G deployment takes place.

Operator

Your next question comes from the line of Scott Searle from ROTH Capital.

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

Nice quarter. Thanks for the color as always. Just a real quick clarification. Looking to '22, talking about 20% plus unit growth. It sounds like you've got the supply chain well in order. I'm wondering what you have in terms of visibility to order coverage at this point in time and kind of how that breaks down when you think about the attach rate on new aircraft coming off versus retrofits? And then I had a couple of follow-ups.

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

Yes, I'll take the beginning of that. And right now, about 6% of our units are committing to our aftermarket and about 40% line-fit. And that's been kind of a skew we've seen develop here as I think we get more penetration in older aircraft in the market. So that is a trend we would anticipate to continue. Barry, do you want to talk about the order flow?

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

Yes. In terms of the orders, Scott, we have a strong backlog, actually the highest we've had in our company's history. And the lead times are a bit longer than where they had been. They normally run from the time that somebody -- something to shipment 1 to 2 months. Those are stretching out closer to 6 months now as the demand has so significantly scripted our previous expectations. But so we're now taking orders to be delivered in the May time frame. But with the supply chain work, we're continuing to work that down and expect to be able to return to those shorter lead times over time. But it's really based on the booming demand for the equipment that we've seen.

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

Great. Very helpful. And lastly, if I could. Looking at the equipment gross margins are very high at 40%, but then you start to talk about how AVANCE is growing both for the L3 and the L5 and then the low churn rates that translates to basically aircraft 18 years in the field and what you can do with the AVANCE in terms of the easy upgrade to 5G. So basically, you're securing that customer. So I'm wondering how you're thinking about being more aggressive on the AVANCE front because that really locks in your customer effectively for the next 10 to 15-plus years. If you accelerate that, do you get more aggressive on the gross margin or if you don't have to at this point in time simply because of the supply-demand balance within the industry? And also, as part of that, I'm kind of wondering what you think the overall installation capacity from an industry standpoint is in 2022?

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

Yes. I'll jump in at the start of that. I mean, driving AVANCE penetration for all the reasons you mentioned, Scott, is a central pillar of our strategy. And right now, frankly, yes, we don't need to drive a lot more orders just because there are some supply chain constraints. We are trying to manage ourselves to -- well, first of all, we have managed ourselves to 25% unit growth above this year next year. And we are actually trying to now make sure we can satisfy demand in case it's greater than that. We do -- we have in our guidance -- you talked about lower equipment margins over the next couple of years, and that is built-in partly in order to take account of incentives we might create in order to get people to upgrade from the classic products to AVANCE products.

And the one thing I would add to what you mentioned is benefits of AVANCE is because of its multi-bearer capabilities, we think that we could add a global broadband LEO product relatively easily as an add-on to that, which we think gives us add-on advantage in our space and is a way we can fend off potential other satellite competitors coming into our space. So yes, getting people to move in AVANCE is a major thrust. It's growing about 46% this year, which is great. We hope that by the end of next year, it's 50% of our -- roughly 50% of our installed base and growing, and we're going to keep driving that.

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

And Scott, to your question on the margins, yes, as you know, the service margin is really the driver of the overall economics and accounts for about 90% of the gross margin dollars. So that's really the factor that drives the value creation for Gogo. And in terms of the margins on equipment, they were high this quarter. As we've said, we expect those to come down even as we launch Gogo 5G, because it's very much worth it to us to invest in driving the conversion to 5G and also driving the AVANCE penetration because for all the reasons talked about. So as we get more AVANCE products online, it adds to the stickiness of the customers, it future-proof enables the upgrade as we described. So -- but even as we see those equipment gross margin percentages compressing somewhat over the next couple of years, it's very good for the overall business model.

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

Yes. Then in terms of the MRO capacity, I think there's plenty of MRO capacity to go -- to install. I don't think that's really an issue. Another thing is that you have to be a compelling product for the MROs to sell, that's something that they make money on and that makes their customers happy. And right now, we're really in the catbird seat on that and the distributors are very happy with their relationships with Gogo. So that's the way to keep another sort of weapon and driving that penetration. And that, right now, we don't really see that as a limiting factor.

Operator

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

Brent Matthew Penter - *Raymond James & Associates, Inc., Research Division - Research Associate*

This is Brent on for Rick. ED&D came in a little bit lower than expected this quarter. Were there any deferred costs within that category or one-timers? And how should we think about that trending going forward?

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

Yes. It did come in a little bit lower. There were a couple of reasons, some of which we pointed out. One was that we were able to capitalize more of the cost than we had previously anticipated because of having crossed the technical feasibility proof and milestones for the global 5G products. So that certainly helped. There was a couple of million dollars that will be deferred, some of which will be deferred into next year. So we do expect ED&D spending to ramp in the next quarter as we continue to invest in the Gogo 5G product.

Brent Matthew Penter - *Raymond James & Associates, Inc., Research Division - Research Associate*

Got it. And then my other question is, you guys have talked about some of these new markets that could provide upside to your expectations, general aviation and international and connectivity to the cockpit. Just could you provide an update on where you're most encouraged? And which of these markets you think could provide the most upside to your long-term expectations?

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

Yes, I'll take that. The -- I think the one that would have the most upside would be the global broadband initiative. However, that's still in the business case stage, and we have not formed any -- formed relationships with external parties or gotten board approval to move ahead with that. That's something we'll talk about in more detail when we get there. Where we're having the most success right now, of course, is moving down market. And by that, I mean into smaller aircraft, that's both general aviation aircraft like the Cirrus Vision Jet and small business aircraft like the HondaJet STCs we announced a couple of weeks ago.

So right now, we're having good success. We're in an area where it's hard for our competitors to compete, and that is an aircraft that require small form factors like our AVANCE L3, and we're going to keep driving that. And we keep looking at other ways we can modify our products to further drive penetration there. The 2 big things were -- so far have been the small form factor L3 and then the lowering of the flight floor or altitude floor from getting connectivity to 3,000 feet because smaller planes tend to fly shorter routes and not get over 10,000 very often.

So -- but there's other things we can do that we're working on to further drive that. So those would be the 2 big ones. But GGV, by far, the biggest, that would drive -- probably wouldn't start driving revenue until the second half of the decade, but we think accelerate our growth dramatically for the second half of the decade.

Operator

Your next question comes from the line of Louie Dipalma from William Blair.

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

Great. Have you been able to test the bonding of your licensed 4 megahertz of 850 megahertz band spectrum with the unlicensed 60 megahertz of WiFi spectrum? And have the results been positive? Does the bonding work?

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

Yes. It's actually aggregation, not bonding. There's an engineering difference between the 2 of them. That's actually -- we right now have our first end-to-end all the way aircraft through tower equipment to data center set up, and we're testing that right now, Louie. So more to come on that in the next call.

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

Great. And Oak, you also mentioned how the existing AVANCE system will easily support future LEO broadband antennas and systems. Will AVANCE also support the new Iridium Certus L-band service? And are you still working on developing your own Iridium Certus antennas?

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

It could support Certus or any other -- with a new antenna, just like the LEO. The LEO installation was required to get a antenna. We're not a Certus dealer, I don't think. So we have -- we still sell a lot of Iridium product, and we have plans around what I'll call the narrow band that I don't think we're really ready to talk about yet. So -- but that would not add a lot of bandwidth for us like LEOs would. So we're not focused on that.

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

Right. And one final one, financially for Barry. Even with this quarter's upside, do you still project that your 2022 revenue growth will be at the upper end of your 10% to 15% long-term guidance growth range?

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

Well, we actually going to increase the expectations for service revenue growth saying that we expect it to be 15% each year compounding from '22 forward. So yes, we do expect it to be up at that 15% range for next year.

Operator

Your next question comes from the line of Jonnathan Navarrete from Cowen.

Jonnathan A. Navarrete - *Cowen and Company, LLC, Research Division - Research Analyst*

Jonnathan in for Lance. Congrats on the quarter. My first question is what are the trends that the company is seeing in terms of unit expansion and pricing into the fourth quarter? And perhaps any viewpoint on how the beginning of 2022 would look in terms of unit expansion in pricing?

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

Barry, do you want to take it?

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

You're talking, Jonnathan, about basically what we see happening in the ARPU over time. That's your question in the fourth quarter and going forward?

Jonnathan A. Navarrete - *Cowen and Company, LLC, Research Division - Research Analyst*

Right. Like what are the trends that you're seeing right now and what we can expect in '22 -- the beginning of it at least.

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

Yes. Just to put it in context, our ARPU has grown over the last number of years. And a big part of that is people have this demand for more bandwidth that they are upgrading plans. So we have seen that and expect that to continue going forward. As you look at the longer term, there are kind of two upward pressures on ARPU and one downward pressure, but also for a good reason. Two upward pressures are the continued migration to higher value, higher megabyte plans, which we have seen, including the addition of the full streaming plans. So we expect that trend to continue as people want to consume more megabytes. The second uplift is from Gogo 5G. And so we are confident that we're going to be able to charge more for Gogo 5G because of the increased performance. So those 2 things will lift ARPU over time.

The downward pressure is as we get into the light jet turboprop market. As we talked about, those planes, as you know, fly shorter routes. The average revenue per user tends to be lower as a result. But very, very importantly, the revenue for megabyte is comparable to the other. So it's a very quality business, but that will have a debit effect on ARPU going forward. But as we go forward from this point over the longer term, we expect ARPU to continue to increase.

Jonnathan A. Navarrete - *Cowen and Company, LLC, Research Division - Research Analyst*

Understood. That's very helpful. And just 2 more on my end. How many L5s were installed during the quarter? And the last one is, in terms of the 15% revenue CAGR from 2020 to '25, what percent of the market share does that imply?

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

Yes. On the -- Oak, do you want to take the second part of that question on how we see unit volume market share growing over time.

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

Yes, I'll take that and then we'll pick up the data point on installs. We don't really look at market share as an internal measure, to be honest. It's more something that investors are concerned with. We focus on unit growth and growth in the number of service plans we have and pricing of those service plans. So there is a lot of room in this market if there are other entrants. 70% roughly of the market is unpenetrated today. And frankly, we project -- we've shared our projections through the end of '25. And at the end of '25, assuming success of a potential ATG entrant and assuming that our GEO competitors succeed on their plans and continue their current growth trajectories, the 50% of the market is still unpenetrated in 2025. So there's enough white space for everybody and some market share isn't what we focus on as much as is unit growth and our own growth.

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

And then to answer your question, Jonnathan, about the shipments, there were 139 shipped in the last quarter.

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

That shipment, because I think he was asking about installs. In total, there are 244 AVANCE platform shipped. You gave the L5 number. I don't have the install number handy, but it would be simply the growth in units online for L5.

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

Yes, 107 units online growth for L5.

Operator

Your next question comes from the line of Chris Sakai from Singular Research.

Joichi Sakai - *Singular Research, LLC - Equity Research Analyst*

I have a question on your marketing spend. You recently talked about you're going to increase it going forward. And I wanted to see -- do you have a metric state of your spend per new customer? And how is that going to increase in the near term?

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

Marketing spend was artificially low during COVID for obvious reasons. It didn't make sense to do marketing during that period of time, really. So marketing spend is coming back up. We see remaining relatively constant as a percentage of revenue going forward, but it will grow as the overall top line grows. And as we look to 2022, as we mentioned, we expect the marketing spend to grow during that year as we, one, normalize it back to those levels. But secondly, as we invest in marketing and promoting the exciting Gogo 5G product.

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

Yes. And I would say...

Joichi Sakai - *Singular Research, LLC - Equity Research Analyst*

Okay, great. And then for -- when would you expect L3 sales to really pick up and maybe become higher than L5 sales?

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

We don't necessarily see them getting higher than L5, but they certainly have picked up. And when you look at the relative percentages of L3 versus L5, if you go back a couple of years ago, it was about half the number of L3s versus L5. So now it's over 80%. So we see that ratio continuing to grow, but we also expect L5s to be very strong going forward, and particularly because you have the upgrade capability directly from L5 to Gogo 5G, for example. Oak, did you want to add something there?

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

Yes. We do see L3 sales to be projected, they will narrow with L5 sales over the 4-year plan. They don't quite reach that level, though, the L5 level.

Operator

There are no further questions at this time. I'll turn it over back to William Davis.

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

Thank you, Nika, and thank you, everyone, for joining our third quarter conference call. This call has now concluded, and you may disconnect.

Operator

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