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GOGO - Q2 2016 Gogo Inc Earnings Call

EVENT DATE/TIME: AUGUST 04, 2016 / 12:30PM GMT



CORPORATE PARTICIPANTS

Vavara Alva *GoGo Inc. - VP of IR & Treasurer*

Michael Small *GoGo Inc. - President & CEO*

Norman Smagley *GoGo Inc. - EVP & CFO*

CONFERENCE CALL PARTICIPANTS

Simon Flannery *Morgan Stanley - Analyst*

Jonathan Schildkraut *Evercore - Analyst*

Phil Cusick *JPMorgan - Analyst*

Dick Ryan *Dougherty - Analyst*

Lisa Friedman *UBS - Analyst*

Louie Depalmo *William Blair - Analyst*

Andrew De Gasperi *Macquarie - Analyst*

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the GoGo second quarter 2016 earnings call. (Operator Instructions). As a reminder, this conference call is being recorded. I would now like to introduce your host for today's conference, Miss Alva, Vice President of Investor Relations and Treasurer. Ma'am, you may begin.

Vavara Alva - GoGo Inc. - VP of IR & Treasurer

Thank you. Good morning, everyone. Welcome to GoGo's second-quarter 2016 earnings conference call. Joining me today to talk about our results are Michael Small, President and CEO, and Norman Smagley, 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 will 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 10-K, which was filed with the SEC on February 25, 2016.

In addition, please note that the date of this conference call is August 4, 2016. Any forward-looking statements that we might 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. A reconciliation of GAAP to non-GAAP measures is included in today's earnings press 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 will host a Q&A session. And now it is my great pleasure to turn the call over to Michael.



Michael Small - GoGo Inc. - President & CEO

Thanks, Vavara. Good morning, everyone. We had a great quarter and continued to build significant momentum behind our 2Ku technology. The service is now flying on three airlines. We've also made considerable progress in the development of our GoGo Biz 4G product for business aviation. We flight tested the technology and announced a launch partner in Delta private jets.

We also announced a groundbreaking new partnership with IBM and The Weather Company that serves as yet another example of how we continue to move beyond passenger connectivity and to helping our aviation partners realize the benefits of the connected aircraft.

In June we closed a \$525 million bond deal. With this financing we extended debt maturities and added more than \$200 million of cash on our balance sheet to support 2Ku installs. This investment will pay off. We see a revenue lift every time we bring more bandwidth to the plane. Based on Q2 average mainline ARPA, we achieved a two to three-year gross margin payback on our 2Ku installs.

Finally, and very importantly, our financial results were strong. Revenue for the quarter was nearly \$148 million, up 22% year over year. Adjusted EBITDA was up 33% to just over \$14 million.

Now I want to point out a few highlights within each of our operating segments. In commercial aviation during the quarter we grew our 2Ku backlog to more than 1,200 awards from IAG, Delta and American. 2Ku is now flying on AeroMexico, Delta and Virgin Atlantic and we've installed the technology on 10 aircrafts.

We received 6 supplemental type certificates to install 2Ku on various aircraft types including the narrow body Airbus A319 and the Boeing 737-800 and the wide body 8330 and 8340. In July, the first factory retrofit of the 2Ku system as installed on the A350 aircraft.

Now that we have some key STCs in hand, and with the summer travel season nearing an end, we will start to see installs pick up. We expect to end the year with between 75 and 100 2Ku installs. We plan to have an additional 350 to 450 2Ku installs in 2017.

With the new funding, we are building our supply chain capacity to install at least 750 2Ku aircrafts annually. Increasingly, our CapEx is success based driven by the number of planes installed with 2Ku.

We've now flown over 3,500 flights with 2Ku. Its vastly increased bandwidth has provided airlines with the ability to develop new inflight connectivity experiences for their customers. For example, AeroMexico is offering passengers free Netflix streaming on 2Ku flights. As we deliver more and more bandwidth, we expect that you will continue to see a whole new range of opportunities from our airline partners.

One of the key attributes of 2Ku is that it can be upgraded remotely without taking an aircraft out of service. For example, we recently introduced a software upgrade that more than doubled throughput to the seat without us ever touching the plan. We expect to see 2Ku performance improve even more to over 100 megabits per second in 2017.

Moving on to the BA side of the business, we are on track to launch our new GoGo Biz 4G technology in the second quarter of 2017. This technology will offer enough bandwidth to bring a ground-like experience to the business aviation market including the ability to stream video. As I mentioned, Delta private jets selected us as a launch partner for this new technology, further strengthening our ties with a key airline partner. Our ATG network continues to be a powerful asset in the BA market.

As I mentioned, we are partnering with The Weather Channel to crown source data off of GoGo equipped business aviation aircraft. This allows us to offer pilots real time turbulence information resulting in a safer, more comfortable flying experience. It also decreases wear and tear on the aircraft and will contribute to lower fuel costs over time which translates into lower operating costs for the aircraft owner.

Looking through to the end of the year, I want to highlight our key priorities. First, our goal is to get 2Ku installed as quickly as possible. On this front we have made great progress and that is why we are increasing our 2Ku guidance for 2016 and 2017. Second, we are very focused on scaling our operating capabilities to support our airline partners around the globe and this includes continuing to invest in aircraft certification and



installation, talent and processes, aircraft maintenance, and supply chain. Third, we will continue to focus on getting GoGo Biz 4G into the market, ramping up sales of the new technology.

With more than \$500 million of cash on the balance sheet, a strong backlog, a robust sales pipeline and continued strong performance, we have great momentum moving into the second half of the year. With that, I'd like to turn it over to Norm.

Norman Smagley - *GoGo Inc. - EVP & CFO*

Thank you, Michael, and good morning, everyone. We had a great second quarter. Total revenue was up 22% to \$148 million. Service revenue grew 26% to a record \$128 million. Adjusted EBITDA increased 33% to over \$14 million, representing a 10% margin.

CA North America -- I'm sorry, now turning to segment results, CA North America service revenue increased 19% to nearly \$90 million, driven largely by an increase in aircraft online and, to a lesser extent, ARPA growth. We ended the quarter with nearly 2,600 North American aircraft online which reflects 132 installs and 36 retirements. We also had nearly 200 net new awarded but not yet installed aircraft at quarter end.

During the quarter we installed or upgraded over 180 ATG-4 aircraft. This brings our total ATG aircraft online to over 1,300, representing more than half our North American installed fleet. We are increasing our installed ATG-4 installed guidance to approximately 600 aircraft for the year, up from 400 previously.

For the quarter, annualized ARPA of 138,000 was slightly ahead of prior year, but grew 14% year-over-year when excluding aircraft we added since the beginning of 2015, primarily regional jets and aircraft with new airline partners. Regional jets now represent 34% of our North American fleet.

Looking ahead, we expect ARPA growth to remain modest over the next couple of quarters as we finish installing regional jets and launch new airline partners. The dilution from these aircraft will start to diminish as these new fleets become seasoned and as we install 2Ku on more mainline aircraft. CA North America segment profit was up 66% to \$18.6 million, representing a 20% margin.

Now turning to BA, service revenue was up 36% to \$32 million. Total revenue for the quarter was up 13% to \$49 million. Consistent with the overall business aviation market, BA equipment revenue of \$17 million was down from the prior year due to lower ATG and satellite units shipped.

ATG aircraft online increased 20% to nearly 3,800 and ATG service ARPU increased nearly 14% to over 2,500 per month. Segment profit was up 8% to \$19 million representing a nearly 39% segment profit margin.

Turning to CA rest of world, we added 12 aircraft during the quarter as we near completion of Ku installs with Delta and Japan Airlines, ending with 249 aircraft online. Total revenue for the quarter was \$5.7 million, more than double the prior year. For the quarter we generated annualized ARPA of \$145,000, up 30% from the prior year, the strong growth from connectivity and entertainment services. We expect second half ARPA growth to moderate as we launch new airline partners, but to reaccelerate as we get closer to full fleet installations and increased passenger awareness.

Our CA rest of world awarded but not yet installed aircraft stands at approximately 500. We expect to install the majority of our awarded aircraft by the end of 2018. Rest of world segment loss for the quarter increased to \$23.3 million from \$18 million last year. We continue to invest in the rollout of 2Ku including STC and line fed activities and adding more satellite capacity. Year to date results remain on track unless the expenses vary quarter to quarter.

Q2 cash CapEx of \$40 million was \$17 million higher than the prior year due to increases in airborne equipment purchases for 2Ku as we prepare for increased installations in the fall. We ended Q2 with \$509 million of cash on hand. As Michael mentioned, we completed a \$525 million bond financing in June and retired existing senior debt. This resulted in a one-time \$15 million debt extinguishment charge impacting EPS by \$0.20.

With that, let me now turn to guidance starting with aircraft installs. In addition to the guidance Michael provided on 2Ku, we now expect to install approximately 300 net new CA NA aircraft in 2016, up from previous guidance of more than 200. In CA rest of world, we continue to expect to install approximately net new 75 aircraft in 2016 and more than 200 in 2017, unchanged from our previous guidance.

Based on these estimates and increased guidance for 2Ku installs, we expect our cash CapEx to be in the range of \$110 million to \$135 million for 2016 consistent with prior guidance, and from \$140 million to \$165 million for 2017. For 2016 we expect consolidated revenue to be above the midpoint of the guidance range of \$575 million to \$595 million.

Finally, we expect our adjusted EBITDA to range between \$55 million and \$65 million for 2016.

Operator, we are now ready for our first question.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Simon Flannery, Morgan Stanley.

Simon Flannery - Morgan Stanley - Analyst

Great, thanks very much. So nice to see the increasing install targets. Michael, can you just talk about what's behind that? What gives you the confidence that you can accelerate those installs? And how should we be thinking about this year Q3, you talked about the fall, are we going to see much in Q3 or is most of this year still in Q4? And then any updated comments on next gen air-to-ground? Thanks.

Michael Small - GoGo Inc. - President & CEO

Okay. What gives us confidence is first, how well 2Ku is working. Secondly, how badly the airlines want it on their planes. We also have confidence from having received those 6 STCs, very important to start clearing the path. And we've made substantial investments in our supply chain that now give us confidence we can actually do up to 750 per year.

The next gen ATG, as I said before, we are working on a next gen solution. We moved beyond 14G. That is taking too long and no longer is compelling an alternative to us given how well 2Ku is doing. And before the end of this year, we will announce that next gen ATG solution.

Simon Flannery - Morgan Stanley - Analyst

And any broad comments just about the pipeline out there and of potential future rewards?

Michael Small - GoGo Inc. - President & CEO

We remain confident that we will continue to add airlines to our roster.

Operator

Jonathan Schildkraut, Evercore.

Jonathan Schildkraut - Evercore - Analyst

Hi, this is Rob for Jonathan. I was wondering where you stand in terms of the number of STC programs, now that you've received some STCs, how many are still ongoing and how does the timing of the expenses related to that look going forward? And secondly, I was wondering if you could



provide some color on how your expenses fall between the segments. This quarter it looked like the margin on the NA side was very strong and ROW came in lower than we expected, net about the same. Is the margin on the NA side at this point from here sustainable?

Michael Small - GoGo Inc. - President & CEO

Okay, so I'll answer the first part of your question and Norm will take the second half. The number of STCs, we said we're going for about 15 this year and a similar number next year and we're still very much on track for that. The first ones are always the hardest, so we are so pleased to have 6 in our pocket, particularly for those aircraft with large fleets which is the 737, 800 and the A319. Norm?

Norman Smagley - GoGo Inc. - EVP & CFO

In terms of how expenses fall between the segments, it's really based on the work that's being done and the programs that are being addressed by that work. So as we've talked about before, in general ED&D will fluctuate, can fluctuate significantly from quarter to quarter based on how many STC milestones we hit. This particular quarter, with all the 2Ku activity going on, we hit a bunch of milestones and that increased line expense spending in the rest of the world. So expenses hit there. In terms of CA margin, is it sustainable? Yes, we believe it is sustainable and we'll see in terms of rest of world between the first two quarters and the average it represents a reasonable run rate.

Operator

Phil Cusick, JPMorgan.

Phil Cusick - JPMorgan - Analyst

Hey, guys, thanks. Following up on Simon's question, how should we think about the RFP pipeline today? And how many of the awards that we've seen in the last few months for competitors have you been competing for?

Michael Small - GoGo Inc. - President & CEO

We remain, as I just said, very confident that we will continue to add airlines to our roster. In general we focus on the larger fleets, we think that's a more efficient way to grow the company and have complete confidence. We aren't in every deal, as we look at probably most I'd say in the industry, but we don't fit every single deal.

Phil Cusick - JPMorgan - Analyst

Okay, and how is 2Ku on AeroMexico shaping up and Delta as well? What have you learned so far?

Michael Small - GoGo Inc. - President & CEO

We've learned that it's a great technology. It's exceeded even our expectations. It's the fastest, most reliable and the best coverage in the marketplace. And for this early stage of its deployment it's doing extraordinarily well and it will keep getting better over time.

Phil Cusick - JPMorgan - Analyst

Are we at the point yet where AeroMexico is charging for this?

Michael Small - GoGo Inc. - President & CEO

No, we have not yet started charging. That should happen soon and that's only for regulatory issues, so that day is coming here very shortly.

Operator

Dick Ryan, Dougherty.

Dick Ryan - Dougherty - Analyst

Thank you. Michael, just to look at China for a second, you had an announcement with Shareco a while back for 50 airplanes. Could you give us an update there? And has that moved to a firm contract yet?

Michael Small - GoGo Inc. - President & CEO

We are making great progress with Shareco as we would expect with any new relationship, so I have no concerns there and we should have service going with Shareco next year. The other comment I'd make about China is we expect before the year is out to have flyover rates which will be extremely helpful for the Delta international fleet in particular.

Dick Ryan - Dougherty - Analyst

Okay. Is there any update with American? They kind of left this 400 or so aircraft to be determined. Any updates you can provide us as to what the timing of that decision might be?

Michael Small - GoGo Inc. - President & CEO

No updates as to the timing. We still will compete for those 400 aircraft and we think the best thing we can do is earn the right for those 400 aircraft by doing extraordinarily well with the 140 planes that have been awarded to us, and we're actively working to get 2Ku on those planes.

Dick Ryan - Dougherty - Analyst

Okay, and maybe just a broader question. I think you've said in the past you've taken capacity on One Web. You've got a lot going on out there. SpaceX has a pretty ambitious plan, multiple thousands of LEOs going up over the next few years. Is that a constellation that interests you or are you considering capacity on that constellation at this point?

Michael Small - GoGo Inc. - President & CEO

We consider all our options in the long run. Right now we are very confident 2Ku is the best solution in the marketplace today and if airlines are making a decision today, that's the right alternative. We'll continue to monitor the market and go wherever the best bandwidth is available at the time.

Operator

Lisa Friedman, UBS.



Lisa Friedman - UBS - Analyst

Hi, it's Lisa for John. I just wondered if you could give us an update on progress with line fit with both Airbus and Boeing?

Michael Small - GoGo Inc. - President & CEO

We're making great progress with both those OEMs and across all the major aircraft types. As we announced in the script, we are -- the factory retrofit -- so there's two ways to do it. You get on the line when they're making the plane and you install then or after it comes off the end of the line, the OEMs can then install our equipment. So the first approach is the factory retrofit where they do it after it comes off the line and that's going to be sooner. But we are actively involved in the full line fit and believe it's going to happen on all, in due course, across all aircraft types.

Lisa Friedman - UBS - Analyst

Is that something we could see by the end of the year?

Michael Small - GoGo Inc. - President & CEO

You will continue to see a stream of announcements such as we just made about the ability to factory retrofit the A350. This will be a multiyear effort by the time we have all aircraft types done across both OEMs.

Lisa Friedman - UBS - Analyst

And then with the recent debt deal and your plans to ramp up installation capacity, at this point are you fully funded to install all 1,200 of the planes that are in 2Ku backlog?

Norman Smagley - GoGo Inc. - EVP & CFO

Yes, we are.

Operator

Louie Depalmo, William Blair.

Louie Depalmo - William Blair - Analyst

Thank you. Good morning. Regarding 2Ku price elasticity and passenger willingness to pay, I was wondering what your studies have shown that the average revenue per aircraft could potentially be if there were no capacity constraints?

Michael Small - GoGo Inc. - President & CEO

With 100 million sessions served at this stage, we obviously have a lot of data on price elasticity. And we are so thankful with 2Ku that we can now analyze what it means to take down prices rather than what it means to increase prices. Bandwidth helps as we've said many times. Upgrades, ATG to ATG-4 produced double digit increased. ATG-4 to Ku, not only give more bandwidth but more coverage, produce substantial kind of 30% like increases in average revenue per aircraft. So we see a substantial, substantial opportunity to increase ARPA with the more bandwidth. Ultimately bandwidth drives ARPA.

Louie Depalmo - *William Blair - Analyst*

And do you think that it could reach as high as 25% or 30%?

Michael Small - *GoGo Inc. - President & CEO*

Well, I just said that 30% was what we saw going from ATG-4 to Ku, so those are certainly reasonable. We're not making a prediction, but this is not a tiny impact, it's a big impact bringing this amount of additional bandwidth to an aircraft.

Louie Depalmo - *William Blair - Analyst*

Okay, and by 30% I was referring to the take rate. I was wondering if like pricing were reduced to like \$5 or \$7 and you had unlimited bandwidth, if we could see jumps as high as the current 6% rate to as high as 20% or 30%?

Michael Small - *GoGo Inc. - President & CEO*

We won't make a prediction there, but we routinely see big jumps in take rates as you change price, or the extreme, make it for free. So I think there will be a lot of -- to the passenger. So we just saw in Japan Airlines, they introduced a 15-minute free session to their passengers on all their planes and that's been extraordinarily successful. And we've seen pretty dramatic increase in take rates as a result of that. So the passengers are happy, the airline is happier, and we were happier, it was a win-win-win.

Louie Depalmo - *William Blair - Analyst*

Great. And regarding your commentary that the first STCs are always the hardest and the fact that you've obtained a lot of STCs this year and you're projected to obtain a lot of STCs next year, I was wondering what is like your long term projection for how ED&D should scale? And should that flat line at some point as you obtain all of these more difficult STCs or should that continue to scale as you invest in newer technologies?

Michael Small - *GoGo Inc. - President & CEO*

There's two aspects to it, the investment in new technology, and then there's getting that new technology onto aircraft. We will get a lot of leverage out of both. It's more consistent spend against technology over time, but there's no doubt there's a big, heavy upfront investment in the certification process. So we should see significant leverage. By the end of next year, with approximately 30 STCs, we will have an STC for most of the major if not all of the major plane types.

Operator

(Operator Instructions). Andrew De Gasperi, Macquarie.

Andrew De Gasperi - *Macquarie - Analyst*

Thanks. So first quick question, can you remind us of the economics for the regional jets generally? Whether it be on American, do you think if those remaining aircraft that you could potentially lose, went away due to competitive bidding, do you think that 2Ku can make up for that loss? And secondly, are you seeing overall an issue wide decrease in the number of flights flown by your airline partners?



Michael Small - GoGo Inc. - President & CEO

On the last question, on number of flights, minor changes in their flight schedules in our early growth stage of the company don't have a meaningful impact on us one way or the other. The RJs, they're very profitable. Every plane we add is accretive to our economics. They do have lower APRAs, but they're in some ways, the ATG technology is already on there and some cost to the network and they're very profitable on the margin.

And your last question was -- oh, can you make up -- so right now there's 400 planes up for grabs with American and we have 1,200 in backlog for 2Ku, so there's no doubt that the opportunity to sell 2Ku is much, much larger than what's up for grabs at American.

Andrew De Gasperi - Macquarie - Analyst

Got it. And one last question, SS in June mentioned that some RFPs are requiring or asking for aircraft speeds that are over 200 megabits per second. Are you seeing that as well?

Michael Small - GoGo Inc. - President & CEO

No, I don't think we're seeing that a lot. I can't say it hasn't shown up somewhere. But with our clear visibility to going north of 100 megabits per second per plane, we've taken the issue off the table. You can talk about higher numbers but I don't think it's going to matter to anybody in all practical purposes. We've hit the bogey that is going to matter. The capacity issue is off the table as far as I'm concerned.

Operator

I'm showing no further questions at this time. I'd like to turn the call back to Mr. Small for closing remarks.

Michael Small - GoGo Inc. - President & CEO

Thank you, Operator. As you can tell, we're extraordinarily pleased with the progress that 2Ku is making and the visibility that we will have it on a lot of aircraft. Really starting right after Labor Day is looking good to us and we think that drives a lot of good stuff for GoGo and this industry. Thank you, everybody.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program and you may all disconnect. Everyone have a wonderful day.

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