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IRDM - Q1 2018 Iridium Communications Inc Earnings Call

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PRESENTATION

Operator

Good day, ladies and gentlemen and welcome to the Iridium First Quarter 2018 Earnings Conference Call. (Operator Instructions) As a reminder, this conference call is being recorded. I would now like to turn the conference over to your host, Ken Levy, Vice President of Investor Relations, sir, you may begin.

Kenneth B. Levy - *Iridium Communications Inc. - VP of IR*

Thanks, Shannon. Good morning and welcome to Iridium's First Quarter 2018 Earnings Call. Joining me on today's call are our CEO, Matt Desch and our CFO, Tom Fitzpatrick. Today's call will begin with a discussion of our first quarter results followed by Q&A. I trust you've had an opportunity to review this morning's press release, which is available on the Investor Relations section of Iridium's website. Before I turn things over to Matt, I'd like to caution all participants that our call today may contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements are statements that are not historical fact and include statements about our future expectations, plans and prospects. Such forward-looking statements are based upon our current beliefs and expectations and are subject to risks, which could cause actual results to differ from forward-looking statements. Such risks are more fully discussed in our filings with the Securities and Exchange Commission. Our remarks today should be considered in light of such risks. Any forward-looking statements represent our views only as of today and while we may elect to update forward-looking statements at some point in the future, we specifically disclaim any obligation to do so even if our views or expectations change.

During the call, we'll also be referring to certain non-GAAP financial measures. These non-GAAP financial measures are not prepared in accordance with Generally Accepted Accounting Principles. Please refer to today's earnings release in the Investor Relations section of our website for reconciliation of these non-GAAP financial measures to the most directly comparable GAAP measures. With that, let me turn things over to Matt.

Matthew J. Desch - *Iridium Communications Inc. - CEO & Director*

Thanks, Ken. Good morning, everyone. As you saw in our press release this morning, 2018 is off to a great start. Subscriber growth remains robust. In fact, we recently surpassed 1 million subscribers on our network, we continue to attract distribution partners for our new broadband offering,



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Iridium Certus, and we're getting ever closer to completing our new constellation having launched another 10 Iridium NEXT satellites last month. We're definitely entering the home stretch there.

To start this morning, I thought I'd provide some context for the overall industry competitive environment. This is a question I received frequently during our recent high yield offering road show and I believe it still has relevance. Overall, the satellite industry is in transition with significant changes potentially coming to the competitive landscape. Lower launch costs and a resurgence of interest in low-earth orbit networks have attracted a slew of satellite newcomers seeking to deliver lower cost broadband for consumers and commercial enterprises. This flood of interest and the promise of new investment are already impacting existing FSS providers who are now adjusting their strategies and capital spending. Even investors are worried about overcapacity and pricing sending some of their corporate valuations lower. Some of these new satellite entrants promise to launch satellite constellations into low-earth orbit where Iridium's constellation operates. These projects however are focused on communication services targeting commodity broadband using Ku or Ka-band spectrum rather than the reliable and scarce L-band spectrum we use, it also supports many regulated safety services. These entrants are really looking to compete with existing fixed satellite VSAT companies for broadband connections and must still show viability by completing their funding plans and deploying their constellations in a reasonable time which are not insignificant challenges in themselves.

In any case, this is not the market we play in today and I consider the specialty broadband services we are soon introducing as complementary to their plans, not competitive with them. Closer to home, we find ourselves in actually an improving competitive environment. Some of Iridium's traditional direct competitors in the MSS sector find themselves without a continuity path to replace their aging satellites or a time honored value from their spectrum as they realize they can't compete as well for mobile satellite customers. So as we near the final stages of deploying Iridium NEXT, our view is that we see a great opportunity for continued growth of our unique L-band business. Iridium enjoys a strong differentiated position in mobile satellite services, an industry with high barriers to entry particularly in light of our L-band spectrum and true global coverage. What these proposed networks have done I think is to heighten the awareness of our one of a kind network and bring attention to the many unique features that differentiate Iridium's offering from others.

Iridium has a premier position in safety services and mobile satellite IoT and will soon add best-in-class L-band broadband capabilities to our portfolio. While the total addressable market in L-Band is not as large as the commodity Ku and Ka-band market, we're excited to finally be able to go after a broadband market with Iridium Certus that offers an incremental addressable revenue opportunity of about \$700 million per year according to a top industry analyst. Best of all, this market is excited for choice and the distribution channel is very positive about our potential for success.

So now in regard to the Iridium NEXT program, we have 50 of the 66 operational Iridium NEXT satellites in orbit and working well. We launched our fifth batch of 10 satellites last month and expect to have all 10 operational in the next 2 weeks. We've come a long way since our first launch early last year and now the majority of the traffic on our network is connecting through Iridium NEXT satellites. This upgrade has improved the performance of our core services and the quality is discernible to our customers. Continued progress on Iridium NEXT deployment is also attracting new companies to our partner ecosystem which bodes well for our future growth. I want to congratulate our engineering and flight teams on their tremendous success to date. I cannot stress enough the Herculean effort they have put forth to integrate the new satellites without disrupting service to our existing customers. They make this stuff look easy even though it really is rocket science.

SpaceX has scheduled our sixth launch, a rideshare with the GRACE follow on mission for a little over 3 weeks from today on Saturday, May 19. This launch will place 5 more Iridium NEXT satellites into space bringing the total of 55 of the 75 total we're launching. The launch itself is unique as it will first deploy the 2 GRACE satellites before moving on to release our 5 Iridium NEXT satellites into orbital plane number 6. We expect to finish our remaining launches with SpaceX later this year completing our Iridium NEXT constellation and starting a long, well-deserved CapEx holiday.

Moving on to our business results, the first quarter provided a good start with year-over-year top line revenue growth of 14%, subscriber growth of 15%, and operational EBITDA growth of 6%. This performance really demonstrates the unique position that Iridium occupies in the satellite industry and highlights the ongoing demand for our services. IoT continues to be a particular source of strength driving 17% revenue growth and more than 100,000 new commercial subscribers to our platform over the last year. This momentum continues to validate the quality of our network offering as well as our strategy of aligning with strong growth-oriented partners who can develop valuable Iridium solutions for their customers and end markets. While commercial growth drove service revenue this quarter, I cannot overstate the importance, strength and potential of our



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U.S. government relationship. This was a Iridium's first customer and the partnership has driven investment and technical advances over the course of our more than 18-year relationship. Subscriber growth within the U.S. government continues to accelerate with voice and IoT subs growing 21% from last year to a record 104,000 users in the first quarter of 2018. As we work with DISA to complete another renewal of the EMSS contract, we know that Iridium's best days of collaboration with the government lie ahead.

Turning to Iridium Certus, we've moved quickly since the beginning of the year to finalize the selection of service providers who will sell our broadband service. We have now announced 19 distribution partners across maritime, aviation and land mobile. It's an impressive list already with more to be announced soon. We are going to market with industry leaders and communication, equipment manufacturing and satellite services. The development of Iridium Certus terminals for maritime and land mobile continues to progress well towards commercial availability. Cobham and Thales are close to wrapping up their at-sea trials of their new broadband terminals and we are still expecting to launch commercial service of Iridium Certus this summer.

We expect aviation terminals will begin testing later this year and expect activations in this sector to start to ramp in mid-2019. On the maritime GMDSS front, we continue to feel good about our plan for certification with the IMO. The Maritime Safety Committee which recognizes companies and services to provide GMDSS will meet next month to assess Iridium's application. This meeting follows the very successful live testing of our GMDSS capabilities last year. It's clear that the maritime market is seeking a choice for GMDSS and we're looking forward to satisfy that need. To me it's not about whether we will be approved it's just about when and we feel good that certification approval will happen this year.

Finally, there is a lot of good things happening right now with Aireon. Aireon remains active in discussions to sign up additional new customers, ready its service for commercial launch as the Iridium NEXT constellation completes, and is working to close its financing. We continue to believe the company will be in a position to remit its first hosting payments to Iridium in the coming months.

The first of several civil aviation mandates goes into effect this year and will start the long-anticipated move to improve flight safety to enhanced aircraft tracking. It requires that aircraft outside of radar coverage be able to report their position to air traffic controllers every 15 minutes and by 2021 on a minute-by-minute basis in the event of distress. Aireon and their partner FlightAware have been beta testing the aircraft tracking service called GlobalBeacon with initial airline customers. The Aireon system has already demonstrated the ability to exceed the regulatory requirement with 8-second or better average reporting intervals and will be able to far exceed the aircraft tracking requirements outlined by ICAO all using existing equipment that is mandated to be on every aircraft.

Before I turn things over to Tom, I want to comment on the high yield offering we completed last month. As we met with a lot of new institutions during the course of our road show, we found widespread enthusiasm for our story and financial outlook. While Tom will recap the details of this transaction, I was pleased that the deal was well oversubscribed and closing the deal allowed us to build new relationships with debt investors who will surely be important as we look to refinance our credit facility in the coming years. This deal was a great success in that it provides us with a solid liquidity position and allows Iridium to confidently complete the full deployment of our new constellation.

Realizing the promise of Iridium NEXT remains our focus. We enjoy a strong network of world-class partners and our wholesale model helps ensure that all parties are aligned and incentivized to drive sales and grow subscribers. We are committed to complete the deployment of Iridium NEXT this year and with it reduce our capital spend. I believe our strong financial start and momentum in subscriber growth in recent months is a good harbinger of things to come. We feel very good about the underlying strength of our businesses and the opportunities that Iridium NEXT will bring. This should be increasingly apparent as Iridium Certus launches this summer. So with that, I'll turn it over to Tom. Tom?

Thomas J. Fitzpatrick - Iridium Communications Inc. - Chief Administrative Officer, CFO & Director

Thanks, Matt and good morning everyone. I'll get started by summarizing our key financial metrics for the first quarter and provide some color on the trends we're seeing in our major business lines. Then I'll recap the 2018 guidance we affirmed this morning and close with a review of our capital structure and the debt offering we completed last month. Iridium generated total revenue of the \$119.1 million in the first quarter, which was a 14% increase to last year's comparable quarter. Operational EBITDA was \$68.5 million, which was up 6% from the prior year's quarter. This was particularly strong given that last year's first quarter results included a \$3.2 million non-recurring gain related to the Boeing Insourcing Agreement.

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On the commercial side of our business, we reported service revenue of \$67.7 million in the first quarter, which was 13% higher than the prior year's period. This increase reflected growth in both IoT and voice revenues, as well as increases in newer revenue streams from hosted payload and satellite time and location services. During the quarter, we added 23,000 net new commercial subscribers with the gain coming entirely from our IoT business.

Commercial IoT data subscribers now represent 60% of billable subscribers, up from 55% in the year ago period. In commercial IoT, we continue to see strong growth from existing partners, including an expanding relationship with Caterpillar and strong subscriber growth from Garmin. Maritime and oil and gas are also sectors that contributed meaningfully to subscriber growth this quarter. As a result, net subscriber activations rose 47% from the year ago period. Voice and data revenue was strong this quarter, rising 5%. This increase was a result of the recording of higher revenue on prepaid cards, as well as from higher usage of our Iridium OpenPort service. Voice and data ARPU reflects this increased usage and rose to \$41 from \$39 in last year's first quarter.

Hosted payload and other data service revenue was \$4.2 million in the first quarter compared to \$1.2 million a year earlier. The growth came from hosted payload revenue as well as satellite time and location services. With 37 Iridium NEXT satellites operational through the first quarter, hosting and data service revenues contributed \$1.9 million to our commercial results, up materially from about \$37,000 in the year ago period. This quarter, we received and recognized \$1.5 million of data services revenue from Aireon, but did not recognize any hosting revenue from Aireon. We will continue to defer our recognition of Aireon hosting fees until the earlier of either Aireon's debt financing closing in the first installment under this financing being made to Iridium, or upon the FAA making a positive decision on utilizing space-based ADS-B which we expect in the second half of 2018. Aireon still expects to close their financing late in the second quarter this year. We anticipate revenue from hosting and data services will continue to ramp this year as we put the remaining Iridium NEXT satellites into service.

Turning to our government service business, we reported revenue of \$22 million this quarter, which reflects the contractual terms of our EMSS contract with this DISA. Government subscribers again grew at a rapid clip rising 21% year-over-year. Total U.S. government customers reached a record 104,000 this quarter driven in part by IoT growth of 24% from the year ago period. We reported better than expected subscriber equipment sales in the first quarter driven by handset sales. We believe this strength is an outgrowth of the multiple hurricanes from last fall, which heightened emergency preparedness. The \$25.8 million in revenue generated from equipment sales was a 51% increase from the year ago period. Equipment margin remained at 41%. We had expected equipment sales for the full year 2018 to be lower than 2017, but given the strength of the first quarter, we now expect that 2018 equipment revenue will be in line with 2017. We will evaluate the impact of this improved performance on our full year OEBITDA guidance in the coming quarters. Engineering and support revenue, which is largely episodic and primarily driven by work done in the government gateway was \$3.6 million in the first quarter as compared to \$5.5 million in the prior year's quarter.

Moving on to our financial outlook. This morning we reaffirmed our 2018 full year guidance as well as our long range financial outlook. Our first quarter continued to reflect broadening growth in IoT and our success with OpenPort in maritime. We anticipate that hosting and data services revenue will continue to climb as new Iridium NEXT satellites are placed into service in the coming months. Per our previous guidance, we anticipate revenue from hosting and data services of approximately \$25 million this fiscal year, \$14 million of which will be attributable to hosting fees from Aireon. Revenue from the government business will remain steady this year keeping with the terms of the EMSS airtime contract. We anticipate subscriber growth from the U.S. government to continue to climb with the government's use of Iridium's voice and IoT services.

Finally, depreciation and amortization expense will be meaningful this year as incremental Iridium NEXT satellites are placed into service. We anticipate depreciation and amortization will ramp each quarter as new satellites become operational. Based upon these inputs, we continue to forecast total service revenue growth of between 10% and 12% in 2018 and OEBITDA between \$280 million and \$290 million. As we complete the Iridium NEXT program, capital spending this year will be approximately \$500 million.

Moving to our capital position, Iridium completed a number of balance sheet activities in the first quarter to bolster our liquidity and improved capital efficiency. First, we exercised our option to convert our Series A preferred stock on March 20. This action required Iridium to declare and pay all unpaid dividends on its preferred Series A and B shares that accumulated since Iridium's board suspended preferred dividends on May 16, 2017. This dividend payment, which was approved by our credit facility lenders totaled \$15.4 million during the first quarter. The conversion results in the discontinuation of \$7 million in annual preferred dividend payments on a go-forward basis. We also announced the re-suspension of the Series B dividend as required by the amended credit facility. At a rate of 10.6 common shares for each preferred share, the conversion of the Series



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A preferred shares had the impact of increasing Iridium's basic share count by 10.6 million shares. These shares however had already been reflected in Iridium's fully diluted share count. Of note, the conversion of the Series A preferred shares into common coincided with the decline in Iridium short interest. It is common for convertible shareholders to hedge their positions by selling common stock short. As a result, we would expect a similar impact on our short position with the conversion of Iridium Series B preferred stock, which is available for conversion as early as May 2019.

Second, Iridium closed its offering of \$360 million in aggregate principal senior unsecured notes on March 21. The 5-year notes can be called in 2 years and pay interest semi-annually at a rate of 10.25%. The net proceeds of the notes were used to retire approximately \$60 million of bills in exchange issued to Thales Alenia Space and replenished \$87 million of the debt service reserve account under the BPI credit facility. The balance of the proceeds are reflected in our cash balance as of March 31, which totaled \$450 million and will be used for general corporate purposes including payment when due of about \$45 million of milestone payments to Thales that were previously subject to deferral. In conjunction with our \$360 million high yield offering, our credit facility lenders agreed to reschedule certain principal repayments. Specifically, \$162 million in aggregate principal payments, which were scheduled to be paid in 2018, 2019 and 2020, will now be due in 2023 and 2024. The agreement is also very flexible in that it provides Iridium with access to a portion of the DSRA if required. The net impact of our capital activities in the first quarter was to provide Iridium with ample liquidity into 2022. We have ensured that our liquidity is not reliant on expected payments from Aireon. When those payments are received, they will pay down our BPI credit facility. In light of these activities, we can now complete Iridium NEXT launch program without liquidity concerns.

I'm very pleased with the progress we've made since the beginning of the year. Our core business is firing on all cylinders and launch execution continues to run smoothly. Our lending partners have been very flexible with all the capital activities we've undertaken. I'm glad that we were able to raise debt and not materially impact our net leverage. The net proceeds of the offering paid down existing debt and increased our cash balance. In closing, Iridium's balance sheet is in good shape. Our team is executing well in the Iridium NEXT constellation and I'm optimistic as I assess the operational trends that continue to drive our financial performance and broaden our subscriber base. With that, I'll turn things back to the operator for the Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Ric Prentiss with Raymond James.

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

Couple of questions if I could. First, you mentioned that the Aireon funding think it will come in the coming months late in the quarter. What's the process there and what could cause that to get delayed further and associated the FAA obviously a lot of stuff going in Congress, can you update as far as the privatization maybe not happening with the FAA and what it means for them getting funded and looking at signing on with Aireon?

Thomas J. Fitzpatrick - *Iridium Communications Inc. - Chief Administrative Officer, CFO & Director*

Sure, so as we said before, the closing of the Aireon financing, they need to clear some conditions precedent, which they are actively working to do. The loan is substantially documented and it has been -- they have placeholders for the syndication. So it's -- they have the view to the syndication so it's really just clearing the conditions precedent, which they can get done at the cost of closing late in the second quarter.

Matthew J. Desch - *Iridium Communications Inc. - CEO & Director*

And as far as the second one, you said in terms of you were asking specifically about privatization. Privatization or whether it would happen or not happen really had no effect whatsoever on -- on Aireon's ability to sell oceanic space-based ADS-B to the FAA. In fact in some ways I was a little concerned if it did privatize that might cause even more confusion in the short-term while they are in their final stages of their evaluation and final



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decision making process that they're going through in the next few months, which all seem to be going well, you know, to the extent you can get visibility into all that kind of activity. I think what's most important for FAA is sort of funding clarity to their long-term budgets and that sort of thing and I know it as today, I think they're bringing forward their FAA re-authorization which is a multi-year funding package which that's only good for the FAA to have clarity in terms of what their budgets are that was probably much more important than whether or not privatization would go through or not.

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

Okay and then on the cadence for the remaining satellites, you mentioned later this year. Any update to the cadence of what we should expect assuming a successful launch, [6 here in a few weeks, what 7 and 8] might look like timing?

Matthew J. Desch - *Iridium Communications Inc. - CEO & Director*

Yes, I struggle to try to avoid giving a specific date because I do have tentative dates right now for launch 7 and 8 and they're still meeting sort of our expectations here. That would be completed in really the next couple of months here. I've been trying to avoid pointing to a specific date just in case things moved around in the final stages, but it looks like rockets are available, satellites should be available in time and everything else seems to be lining up well to complete it, but I'd say third quarter is pretty safe.

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

Good, that feels good. And final one for me is you mentioned the maritime and the IMO certification, the meeting coming up in May. Help us understand kind of the process you mentioned also not whether, but when. You feel confident on certifying in '18 but help us make sure we're watching the right dates and the right venues to watch that process for what could be a pretty significant opportunity?

Matthew J. Desch - *Iridium Communications Inc. - CEO & Director*

Yes, so it's complicated in the sense that the International Maritime Organization is sort of a UN sanctioned body that operates with many countries coming together in very regular meetings and subcommittee meetings and technical subcommittee meetings, et cetera. We've been at this now for I don't know 4 years or 5 years I think. We've gone through sort of the stages of the process, which included last year's technical analysis to a subcommittee that demonstrated, really without reservations, that we met all the requirements of the service. Now, it's an issue of getting a positive vote from the main body. There's some politics probably involved. There's probably some people who'd like to slow us down as you could expect and we're working through those issues. I'm expecting a positive result but unfortunately there's a lot of people involved in sort of a unique environment. So we're doing everything we can to do it in May, but there are other, there are other meetings following that if that one for some reason wouldn't happen, but I'm pretty optimistic that everything is looking constructive towards completing in May. Just sort of a reminder too about GMDSS, I am -- it's important that we be able to do GMDSS because of the choice it will bring because it's another important service that our network will be able to provide maritime customers and so it's important, but it's not in itself a revenue generating opportunity and I think I mentioned this before, it's kind of an important function that our system be able to provide so that our partners who are increasingly trying to separate themselves from the incumbent and not have them on the ships that they are selling into because of their competitive nature in terms of trying to sell other products to their customers that it have. So it's important we get this completed. I'm confident, optimistic that we'll get this completed this year, but, that said it's not completely within our control.

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

Sure, but it opens up for some opportunity for other sales as you can get onto to the boat for other purposes then?



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Matthew J. Desch - *Iridium Communications Inc. - CEO & Director*

Yes, exactly, I mean it's a very important function that we really look like we're going to be able to complete this year and we'll add to the value of our offerings to our partners through to their customers.

Operator

Our next question comes from Greg Burns with Sidoti & Co.

Gregory John Burns - *Sidoti & Company, LLC - Senior Equity Research Analyst*

Matt, at the top of the call you talked about some of the changes in the competitive environment with some new constellations projected to be launched and a lot of that is not going to be directly competitive with what you're offering, but at the recent satellite conference or show we heard some others like Eutelsat kind of stood out as aiming to launch an LEO constellation in the L-band focusing on IoT applications, so that seems to be more potentially directly competitive with what you're offering. So are there other constellations coming down the pike or do you see anything else that might be more directly competitive to you in the next coming years?

Matthew J. Desch - *Iridium Communications Inc. - CEO & Director*

Yes. So I'm glad you brought that up especially because there's confusion a lot of times when people just use the word LEO because they assume that if they're LEO they must be competitive when in fact if you are using Ku or Ka-band spectrum in LEO, you're really competing against GEO-based broadband systems not really against what we're doing, but the other confusing word is IoT because some people everyone loves to use the word IoT because that's a hot space and if they say that they are going to serve it then they must be valuable, but what they're really talking about typically when they say IoT is very different than the IoT market that we're really addressing. We're addressing very highly mobile individual applications. I think it's the largest part of the satellite IoT market. What they're typically talking about is broadband aggregation of unlicensed or licensed sort of IoT systems, systems like LoRa and others they can then provide service to. They're not typically talking about highly mobile applications on individual devices. We're going to be able to do that part of the market too, but that's another area where we'll probably complement each other. They can serve that sort of what I would call broadband IoT market and we'll supply the much larger, at least in terms of volume of devices, satellite IoT space. So again, I don't really see that as directly competitive with us. They're not going to be providing devices that Garmin is going to deploy to their consumer customers or even I think that will be valuable for an individual Caterpillar device, or an oil and gas pipeline, or some of the things that we're doing today, or a Walmart container et cetera. I really would be surprised if that is the focal point of many of their networks.

Gregory John Burns - *Sidoti & Company, LLC - Senior Equity Research Analyst*

Okay thanks and Tom in terms of thinking about maybe a broader refinancing with the new notes being callable in 2 years, is that kind of the time frame we'd be looking at or would you look to maybe take out the BPI facility prior to that?

Thomas J. Fitzpatrick - *Iridium Communications Inc. - Chief Administrative Officer, CFO & Director*

No, I mean we were very focused on the non-call 2, so that it will depend on the state of credit markets at that point in time, but we wanted the optionality and that's why we were focused on the non-call 2.

Gregory John Burns - *Sidoti & Company, LLC - Senior Equity Research Analyst*

Okay and then lastly, you mentioned D&A will be going up as you are launching more satellites, could you maybe put a number on what you expect depreciation and amortization to be this year and the same with interest expense?



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Thomas J. Fitzpatrick - *Iridium Communications Inc. - Chief Administrative Officer, CFO & Director*

So, it makes its way, depreciation and amortization makes its way to between 75 and 80 [dollars per quarter] call it in 2020. So just draw a line from where we are now to there that's kind of the steady state.

Gregory John Burns - *Sidoti & Company, LLC - Senior Equity Research Analyst*

Okay and then interest expense, cash interest expenses here. I know you were capitalizing some of those costs, does that in addition to the new notes begin to flow through to the P&L more fully this year?

Thomas J. Fitzpatrick - *Iridium Communications Inc. - Chief Administrative Officer, CFO & Director*

It does, so as all the satellites get launched, the interest expense will go from being capitalized to making its way onto the P&L and the cash interest is calculable, it's the interest on the [\$1.8 billion] BPI facility and then 10.25% on the \$360 million, there's your cash interest. There'll literally be a switch thrown once all the birds are in the air and it will all become expensed.

Operator

Our next question comes from Louie DiPalma with William Blair.

Louie DiPalma

Matt, on the competitive environment topic, maritime seems to be the biggest opportunity for Certus and it's not a secret that Inmarsat has a dominant market share of the L-band maritime market. So I was wondering in comparing Inmarsat's FleetBroadband versus the new Iridium Certus, will Certus have certain advantages in terms of throughput, equipment cost and service cost in order to potentially unseat Inmarsat's L-band services?

Matthew J. Desch - *Iridium Communications Inc. - CEO & Director*

Yes, we've really kind of designed Certus to be very extremely competitive to FleetBroadband and to SwiftBroadband and to other current L-band services out there. It will obviously have the best coverage. It will have faster speeds very quickly. In 2019, it will exceed those speeds, it will be in the 700 kilobit per second range where FleetBroadband is in the 432 kilobit per second range today, but importantly it has, it's got some pricing advantages, size of the terminals is smaller because we're LEO so the physics are better. The price of the terminals is going to be a little bit less. The price of the airtime is typically a little bit less because we know we're getting into an established market. So really on just about every category I can envision I think we'll have advantages certainly for the next few years, I know Inmarsat has talked about possibly coming back and eventually delivering an improved version of their service that could be faster and they're welcome to do that. I think what won't be really able to be improved very easily is sort of the competitive dynamic that we're going into, where as I said I think we're being celebrated and encouraged and supported because the distribution channels, the non-Inmarsat distribution channel, really are looking forward to having a supplier that doesn't compete with them - deliver them a superior service. So I think that's going to continue on to the future. They know they can make money and they know that they have a rational competitive market with us. So I think that they're going to be enthusiastically taking us to market. You can see that by the many Certus distributors we've already signed up and the many that we're lined up to announce here in the future.

Louie DiPalma

Okay and Matt was there anything in the recently signed U.S. Department of Defense budget that makes you less confident that you can negotiate a favorable renewal of the EMSS contract.



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Matthew J. Desch - *Iridium Communications Inc. - CEO & Director*

No, I don't know what you might be referring to, but I would say that if anything the budget is a positive in the sense that sort of the DoD, I think is getting everything they're looking for and more. So they're not in quite the constrained environment perhaps that they've been in the past. Notwithstanding that, we believe we're adding better and better value every year, particularly as they expand their usage of our network and we expand the services and the quality and capabilities that we're delivering to them. So I think we're in a probably a more positive environment frankly right now to complete a contract than we were 5 years ago when we were negotiating the last one.

Operator

Our next question comes from Paul Penney with Northland Securities.

Greg Gibas

This is Greg on for Paul. Thanks for taking my questions. I appreciate the commentary on the regarding Aireon and FAA efforts, but was wondering if you could give an update on any other developments with new ANSPs?

Matthew J. Desch - *Iridium Communications Inc. - CEO & Director*

You mean, new customers?

Greg Gibas

Yes.

Matthew J. Desch - *Iridium Communications Inc. - CEO & Director*

I mean they have, they're still signing up customers. I know they I think announced one here in the last quarter. They have a long list of ones that I think will be closed here in the next few months. I can't get out ahead of them because that's really their thing to call, but it looks like a strong lift. I see nothing, just to step back, I see absolutely nothing on the horizon in any kind of form that doesn't say that Aireon isn't the global surveillance technology for ANSPs going out in the future. There only seems to be growing interest, not in any way declining. The list gets longer in terms of closing. I think that there is a little bit of a waiting for the network to be complete and commercial service to be turned on, after the initial number of ANSPs we signed up , but I don't see enthusiasm doing anything but growing for the service. So I still think it's a very positive environment they're working in.

Greg Gibas

Got it. And then secondly, can you give more color on your go-to-market strategy with service. I guess in particular, how are you going be expanding your sales channels with both partners and value-added retailers?

Matthew J. Desch - *Iridium Communications Inc. - CEO & Director*

So we still are using in general the established distribution channels that have been very successful over the last 20 years at taking L-band products to the market in each of the 3 different main market segments, maritime, aviation and land mobile. We're being selective in the sense that it requires some additional efforts to sell broadband than it does to sell some other services, so not every one of our 300-plus partners is going to become a



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distributor, it's only going to become the ones that really are investing in making us successful in the market, and you can see by the people we've announced so far and you'll see in the announcements we make in the coming months that we're really talking about the larger successful ones in the broadband space. So they are going to take us to market, they're investing, they are connecting through our gateway. They are adapting their current provisioning and billing systems to accommodate Certus. They are going to be in trials here in the coming literally weeks as they prepare for their launch this summer, at least in the maritime and land mobile segments and the aviation ones will be kind of working on that later this year. So everybody is kind of getting prepared to take us to market and I think we're not going to see big numbers this year because it just takes time, this is a very sophisticated product, it's usually wrapped up with lots of other services on the ships and it's part of a bigger offering, but I think you'll see it ramp in 2019 and 2020 to the goals that we've set ourselves out in 2020.

Operator

Our next question comes from Chris Quilty with Quilty Analytics.

Chris Quilty

I guess recently, Inmarsat got their SwiftBroadband safety certification for the aviation market. That was a process that I think took them a couple of years. Can you give us a sense of how you expect that process to progress for you with the Certus product?

Matthew J. Desch - Iridium Communications Inc. - CEO & Director

Yes, we've been really in the same environment and process and have been at it really some time as well. We right now expect that we would get certification for Certus aviation products pretty shortly after their introduced in say mid-2019. So it might be later in 2019 or early 2020, but we would fully expect to be safety certified in Iridium Certus products, aviation products as well. And again, there's a lot interest and demand for them because the speeds and capabilities and the coverage of them is superior because we can really serve aircraft more broadly and we're an established player in this space. So aviation safety is a little different than maritime safety where we haven't been certified before, but we are safety certified today and on many, many aircraft today with our narrowband offering. So it's a little different environment getting safety certified for Certus.

Chris Quilty

Great and on the commercial IoT market, I think you mentioned both Garmin, Caterpillar, OEM market, can you talk about first of all the consumer market applications a la of what you're doing with Garmin, how that's going and potential for ramp there with either Garmin or other customers?

Matthew J. Desch - Iridium Communications Inc. - CEO & Director

As I said, Garmin seems to be -- has been really successful with their offering. They've expanded their product line and I won't get ahead of them on that but there is some exciting things coming I think in the future from Garmin on products. They have expanded their distribution, carefully and methodically, but they seem to really be very effective when they do that and as a result, they've been really successful expanding and it looks like they've been very happy with the success they're getting in the connectivity space that we helped bring them in their broad base and I still believe we'll see integration of Iridium and other product lines at Garmin as they bring kind of connectivity to other successful SKUs that they have that they offer their customers. So I couldn't be happier with Garmin as a consumer sort of flagship brand taking us to market. I think they've been very, very effective and I think they're only going to grow really in the coming years as they seem to be very happy with the success they're getting out of satellite connectivity to their products.



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Chris Quilty

Good, Tom, question for you, I think you broke out \$25 million of hosted payload fees and gave the portion of that associated with Aireon. Is there anything in the balance of the bucket beyond Satelles that constitutes the balance?

Thomas J. Fitzpatrick - *Iridium Communications Inc. - Chief Administrative Officer, CFO & Director*

No, no, Satelles is different. \$25 million is hosting. So the breakdown of that is \$14 million from Aireon hosting of which we've recognized nothing yet through the first quarter, but that's \$14 million and then there's remaining \$11 million breaks out \$8 million which is Aireon data and \$3 million, which is Harris hosting and data.

Chris Quilty

Great and Satelles can you give us a sense of the size of that?

Thomas J. Fitzpatrick - *Iridium Communications Inc. - Chief Administrative Officer, CFO & Director*

It was a \$1 million in the quarter, it was \$3 million last year. We think that it's up materially from the \$3 million we did last year this year.

Operator

Our next question comes from Anthony Klarman with Deutsche Bank.

Anthony Klarman

Hi thanks. Just to go back on the U.S. government, I guess I just wanted to confirm your views on what your thoughts are on the new contract that you're trying to put in place and I guess my assumption is that really what we're talking about is just the scope of what's covered in the existing contracts being put into a new contract and my question I guess is really does Certus represent an incremental opportunity for you at some point in government given that the existing contract really doesn't cover that today?

Matthew J. Desch - *Iridium Communications Inc. - CEO & Director*

Yes, so I think your assumptions about the scope of the contract is correct. I think we're still expecting sort of the same structure and possibly the same timeline -- those are still things to be discussed, but Certus is definitely a new revenue stream. Excited about our partner there, Comsat, well established partner to the U.S. government on broadband and already starting to work actually very actively with the government now in terms of installing the necessary equipment to be able to utilize Iridium Certus and to take advantage of it across multiple market segments probably initially in the land mobile segments, but eventually in aviation and maritime as well. So we think the U.S. government's going to be a great customer for Iridium Certus.

Anthony Klarman

And does your longer-range guidance assume anything from the government outside of what the scope of the current contract is, in other words does the longer range guidance assume that there is some penetration of the Certus product in the government segment?



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Thomas J. Fitzpatrick - Iridium Communications Inc. - Chief Administrative Officer, CFO & Director

Yes, it does. Anthony, so the numbers we're out there with our existing broadband product is OpenPort. It's sort of a \$25 million business. We've sized Certus as a \$100 million business as we exit 2021 and the government is included in that sizing. So we have no broadband business today with the government but we do expect that we will penetrate them and that's included in our \$100 million sizing in 2021 exit rate.

Anthony Klarman

Thanks for that and then on, Tom, on you mentioned Aireon and the financing triggering a payment obviously assuming that is successful at some point later this year. Can you remind us what the other milestones are, if there are other milestones that trigger successive hosted payload and other payments from Aireon?

Thomas J. Fitzpatrick - Iridium Communications Inc. - Chief Administrative Officer, CFO & Director

Right. So the Aireon -- the credit facility that's been arranged anticipates 3 basically installment payments. The first of which is upon the closing of the facility. The second occurs upon the successful completion of the Iridium launch campaign, so that money is funded. It will be funded in the Aireon credit facility, but think of it as a holdback in the unlikely event of a launch anomaly that money stays within Aireon for their own account because they will become operational later as a result of an unexpected launch delay, but once the launch campaign completes, the second installment is sprung and the third installment is sprung when Aireon is operational in early 2020.

Anthony Klarman

Great so the first 2 payments actually could wind up being very close together if the timing that Matt described kind of plays out with the financing being completed sort of maybe sometime around the summer or 3Q that would actually trigger - and that's around the time I think that you sort of guided to being substantially complete with the launch campaign the first 2 Aireon payments might wind up being almost on top of each other from that perspective.

Thomas J. Fitzpatrick - Iridium Communications Inc. - Chief Administrative Officer, CFO & Director

That's right, but for revenue recognition, our analysis we have visibility into the Aireon model and the second payment is really not that significant or important as to revenue recognition. The first payment is the one that we have our eyes on for revenue recognition because it flips the switch to being probable of collection. The second payment as does the first goes both those payments will go to the BPI lenders as a pay-down of the debt. So it's really not impactful liquidity-wise -- also just pays down debt. The first payment is important because it gets us over the hump in terms that collectability is assured.

Anthony Klarman

Yes, understood. And on that second payment is that triggered by satellites in service or is that triggered by successful launches, what is the actual trigger for that payment, in terms of being complete with the fleet?

Thomas J. Fitzpatrick - Iridium Communications Inc. - Chief Administrative Officer, CFO & Director

I think it's satellite checkout, which is which shortly after launch.

Matthew J. Desch - Iridium Communications Inc. - CEO & Director

It's only about 30 to 40 days really after the final launch. So it's really almost the same thing.



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Operator

(Operator Instructions) And our next question comes from Andrew Spinola with Wells Fargo.

Andrew Carl Spinola - *Wells Fargo Securities, LLC, Research Division - Senior Analyst*

The growth in the voice and data segment, commercial voice data in Q1 was stronger than it has been for some time and you referenced prepaid voice as well as OpenPort and I'm just wondering if you could sort of expand on that sort of what of those 2 is maybe sustainable. Is there anything sort of one-time? Why was this quarter so strong and how should we think about modeling as to quarters going forward off of this first quarter result?

Thomas J. Fitzpatrick - *Iridium Communications Inc. - Chief Administrative Officer, CFO & Director*

So in the commercial voice and data, kind of the trend in ARPU has been declining as we said before, that was because there was a subset of our installed base, which were heavy data users, which for some time have been migrating into broadband solutions, creating a headwind in terms of ARPU. As we said previously that trend has run its course and we've indicated that we thought there was stability in commercial voice and data ARPU sort of going as we went into '18 and beyond. So that's the kind of the foundation of the relative strength year-over-year, but then we got a bonus if you will in terms of 2 areas -- in prepaid, so we were the beneficiary of stronger prepaid sales. We think that's kind of hurricane-related and then we also adopted a new accounting standard, which causes under the previous standard the unused minutes on a prepaid voucher could not be recognized into revenue until the expiration of the card. Under the new standard, based on history that usage comes in over the expected life of the card. So the combination of just stronger sales as a result of the hurricane and the adoption of the new standard benefited us in the quarter. Similarly, OpenPort usage was just stronger in the quarter and so we're keeping our eyes on that. Right. I mean, both of them are good developments. It's going to depend on how much of the prepaid sales were hurricane-related and how much does that dissipate in terms of what the run rate is going to be, but we characterize voice and data ARPU as quite firm as we look forward.

Andrew Carl Spinola - *Wells Fargo Securities, LLC, Research Division - Senior Analyst*

Makes sense. What was the impact of the accounting change in Q1?

Thomas J. Fitzpatrick - *Iridium Communications Inc. - Chief Administrative Officer, CFO & Director*

Sub-\$1 million.

Andrew Carl Spinola - *Wells Fargo Securities, LLC, Research Division - Senior Analyst*

Sub-\$1 million okay. Can you just actually expand on the legacy customers that went from the voice solution to broadband, what we talk about, have spoken a lot on this call about alternative options not being competitive, but what sort of solutions are these guys migrating to that you're losing these subs to broadband solutions?

Matthew J. Desch - *Iridium Communications Inc. - CEO & Director*

So what we are talking about there is a specific product we have, which we call the L-Band transceiver. Think of it as the circuit switch of voice and data components that were in a satellite phone sort of packaged into a device that was put on an airplane, that was put in the early days on corporate aircraft for a voice and a low speed fax and data solution, was put on ships for sort of the pay phone on the ships, but also provided a data connection. It was used for some specific data applications for telemetry and kind of SCADA kind of things where you needed more than just a quick packet transmission, you needed to send a picture of something across, but at 2.4 kilobits per second, it wasn't and the pricing for which

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we cost that it wasn't the optimal solution for a lot of people. So, the people I think a number of those customers saw -- it was installed it was working well, but they were solutions that would provide them data at a lower cost including our own solutions like OpenPort gave them a better experience and a better capability in terms of pricing and so they would move off to that or other solutions. The kind of the numbers that were high ARPU customers in that category really have now transitioned for the most part, not that many left really to transition and we're providing new solutions not just in terms of OpenPort and Certus, we're going to have a whole, we don't talk about it as much but one of the developments are underway is sort of think of it the new LBT that provides at a very low cost basis what we call Certus 100 or Certus 20 service, which are sub 100 kilobits per second, but a very high quality experience that would be good for a lot of those data applications that don't need a broadband connection and are highly mobile and that sort of thing. That's coming next year. So, that's sort of a technical description of --

Thomas J. Fitzpatrick - *Iridium Communications Inc. - Chief Administrative Officer, CFO & Director*

Yes and what I would say is that we have as many L-Band transceiver customers today as we had 3 years ago, what has changed is the very heavy users of data have kind of been prudent men and say, look if I need this much data an L-Band transceiver is not the solution, I either need a FleetBroadband or an OpenPort. I'll pay up for the higher equipment cost because the cost of the data is much less and so those heavy users of data have made that migration. If you went back 3 years ago, the ARPU in the L-band transceiver was probably \$70 versus our \$45 kind of ARPU. Today, the L-band transceiver ARPU is right on top of that \$45 number, so the heavy users of self-selected out and that trend has now run its course and the headwind which it created for the last 3 years has abated.

Andrew Carl Spinola - *Wells Fargo Securities, LLC, Research Division - Senior Analyst*

That's very helpful color. Just one last question for me. Clearly very strong equipment revenue results this quarter. I think you were downplaying it saying you feel like it's probably hurricane driven, but why do you conclude that, is it just very heavy on the handset side or why does at least my sense from your comments is that its maybe one-time, why isn't it potentially more than that.

Thomas J. Fitzpatrick - *Iridium Communications Inc. - Chief Administrative Officer, CFO & Director*

It's heavy handset for sure and so as we looked at our prospects in 2018, we saw the strength in 2017 In the third and fourth quarters that was hurricane-related and that's why in our initial '18 guidance, we called equipment revenues down because we said, look, we're not going to predict hurricanes in the third and fourth quarter. What we didn't expect was basically the channel refill, if you will of handsets in the first quarter and the strength of that. So we continue to think that in the third and the fourth quarter, we have tough comps from '17 and we don't see ourselves beating them, but the first quarter has been so strong that we, notwithstanding the fact that we see down quarters in the third and fourth, we think we wind up in '18 kind of in line with '17 which was not our expectation and we have our eye on our EBITDA guide kind of in the next couple of quarters with that in mind.

Operator

Thank you and our final question comes from Chris Quilty with Quilty Analytics.

Chris Quilty

Actually just a follow-up on that equipment question, was it your sense that the strength in Q4 was customers buying hardware for things that they need it in real time and Q4 was sort of the follow-on of them realizing oh crap, we need to position toward the future or was there any additional new products that filtered into that mix?



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Matthew J. Desch - Iridium Communications Inc. - CEO & Director

Well, there wasn't, I don't think too many new products per se there. I think it was a broad based, that was led by hurricane, not just the hurricane happened sort of third quarter and into the 4th quarter there has to be sort of a refilling of channels and that sort of thing the way in the fourth quarter. Pleased to see that it's sort of continued in the first quarter not only go beyond handsets were obviously strong but so is IoT and really frankly across the board, we had I'd say it was a good quarter across almost all equipment types, but it was, but I think Tom's right we have tough comps in the second half. So we're, we can call it as flat today, we'll see how it goes in the next quarter or 2 as to where it'll end up in the year, but I think calling it flat to the year is prudent and appropriate for now. [Probably give us] anything special beyond I think overall, we're in a stronger position we've been in the last couple of years and the business is sort of hitting on all cylinders and equipment is tracking that as well.

Operator

Thank you, this concludes the question-and-answer session. I would now like to turn the call back over to management for final comments.

Matthew J. Desch - Iridium Communications Inc. - CEO & Director

Yes, thanks. I hope you'll join us online on May 19 for another I think very interesting launch. It's another flight proven rocket and will be a particularly interesting launch given its a rideshare and then watch for the Certus roll out as well, but we will see you all in the second quarter call soon. Thank you.

Operator

Ladies and gentlemen, this concludes today's conference. Thanks for your participation, have a wonderful day.

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