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EDITED TRANSCRIPT

GOGO - Gogo Inc to Discuss its New Integrated Business Plan

EVENT DATE/TIME: JULY 13, 2018 / 1:00PM GMT

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to Gogo Inc.'s conference call to discuss the results of the Integrated Business Plan known as Gogo 2020. As a reminder, this conference call may be recorded.

I would now like to introduce your host for today's conference, Mr. Will Davis, Vice President of Investor Relations. Sir, you may begin.

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

Good morning. Thank you for joining our call this morning to discuss the results of our Integrated Business Plan known as Gogo 2020. Joining me today to discuss these results are Oakleigh Thorne, President and CEO; John Wade, President of our Commercial Aviation division; and Barry Rowan, executive Vice President and CFO.

Before we get started, I would like to take this opportunity to remind you that during the course of this call, we may make forward-looking statements regarding future events and the future financial performance of the company. We caution you to consider the risk factors that could cause actual results to differ materially from those in the forward-looking statements on this call. These risk factors are described in our press release filed last night and are more fully detailed under the caption Risk Factors in our annual report on Form 10-K and other documents that we file with the SEC.

In addition, please note that the date of this conference call is July 13, 2018. Any forward-looking statements that we make today are based on assumptions as of this date. We undertake no obligation to update these statements as a result of new information or future events. During this call we'll present both GAAP and non-GAAP financial measures. This call is being broadcast on the internet and is available on the Investor Relations section of Gogo's website at ir.gogoair.com. Our press release, filed last night, is also available on the website. After management remarks, we'll host a Q&A session.

And now it's my great pleasure to turn the call over to Oakleigh.

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

Good morning, everyone. Thank you for joining us today to discuss the results of our Integrated Business Plan or IBP.

I'll start by discussing our IBP, then Barry will discuss our financing implications and cash planning projections and then I'll conclude with a few strategic comments and we'll move to Q&A.

As most of you are aware, Gogo is the leading player in in-flight connectivity for both the Business Aviation and Commercial Aviation markets. And as I'm sure you also know, we face major challenges in our CA business units. To get our arms fully around those challenges and develop an efficient set of solutions, we initiated a bottoms-up review and planning exercise, we call the Integrated Business Plan. Today, I'm pleased to report that the IBP process confirmed our belief that we have a compelling business with significant inherent strategic value and that our challenges are manageable. The outputs of our IBP planning process are a new business model, we call Gogo 2020, and an operating plan that implements that model consisting of 102 separate projects to be implemented over the next 10 quarters. Those projects are aimed at implementing mature business processes, improving quality, ensuring that we allocate capital to the areas that will generate the most benefit to our shareholders and realizing efficiencies.

From a financial perspective, we have been very conservative modeling Gogo 2020. We have made modest revenue growth assumptions and we've estimated future Satcom cost, using pricing that we have under contract today. Even with these conservative assumptions, the plan shows significant benefits, including significant growth in annual adjusted EBITDA through 2022, a materially reduced CapEx burden, large reductions in our OpEx cost structure and significant improvements in free cash flow.

Before I jump into the details of the IBP, let me provide some context for the challenges we face for the overall company and more specifically in our CA division. After I joined Gogo in March, we did a reforecast for 2018 and determined that Gogo would not be able to achieve its 2018 financial guidance nor its 3-year plan. So we suspended EBITDA and cash flow guidance on our first quarter earnings call in early May. On that call, I outlined 4 priorities: quality, focus, profitability and driving shareholder value. And those are underpinned by a 3-prong process to achieve them: one, the Integrated Business Plan; two, a financing plan; three, a longer-term strategic planning process. As it relates to CA specifically, our challenges were: first, American Airlines has begun deinstalling our legacy ATG system on several fleets of high-value aircraft. And is replacing them with a competitor's second-generation Satcom product. Without the American deinstalls, our projected CA service revenue growth would be more than 15% for 2019, with them it will be roughly flat. This decision occurred in 2016 when unfortunately our 2Ku product was not ready for prime time. We continue to believe that these deinstallations, which are expected to be completed in the second quarter of 2019, are an anomaly as the number of mainline aircraft flying with ATG that can convert to a competitor's satellite product is shrinking quickly as we upgrade our ATG main line plans to 2Ku.

Second, the launch of our 2Ku product did not go as planned. Last winter, deicing fluid and filtrated 2Ku antennas degraded our service, causing our airline partners to delay marketing support for our product, delaying negotiations with potential third-party payers and requiring significant OpEx and CapEx to repair the 2Ku systems. The good news is we have made strong progress recently in the performance of 2Ku, which I'll detail shortly. And third, we have an increasingly challenged CA business model that, in certain instances, is not delivering sufficient revenue to justify our upfront capital and inflation cost.

Going forward, we'll target being on the right planes with a clear path towards producing a satisfactory return on capital versus being on every plane. Solving this capital allocation problem is a key feature of our IBP. Given that 2Ku is such an important part of the Gogo growth plan, I'd like to highlight some significant performance improvements we've made over the last few months. This past winter, our system availability, which measures the average percentage of time the system is available by plane across the fleet, sank as well as 84%. However, our performance reached 96% in May, 97% in June and for 5 airline partners achieved 98% for the first week of July. This stark improvement results from software implementations, replacing antennas that were defective during the manufacturing process and of course warmer weather. However, much of the improvement occurred during periods when we still had cold weather.

We also have a series of improvements rolling out with our airline partners before winter hits us again, some of which were used by one of our airline partners very successfully last winter. Against the backdrop of the improved performance, our 2Ku customer satisfaction scores have increased and we expect them to get even better. Our 2Ku installations continue to show -- to also show rapid momentum as airlines regain confidence in the product. As of last week, we had installed 259 aircraft in 2018 and we've cumulative 2Ku installs of 809. Given that the Gogo 2020 model significantly changes how we price for 2Ku, it's important to remember some of the inherent benefits of the product. First, it's twice as spectrally efficient as traditional gimbal antennas. And second, it has a relatively cheap upgrade path to being compatible with the new lower cost, Low Earth Orbit satellite constellations that are planned to be launched in the near future. While IBP focus more on our CA division, I would be remiss to not mention the continued good performance of our BA division. Our recently launched AVANCE L5 product is the fastest selling new product launch in our history. We expect to see compounded annual revenue growth of more than 10% in BA for the next several years and sustained adjusted EBITDA margins in the 40% to 45% range through 2022. It's important to remember we have a 90% market share in broadband connected aircraft in BA and have very healthy free cash flow. And though we may face new competitors in the future, Business Aviation is a very underpenetrated market with only 23% of our all BA aircraft carrying a broadband product today leaving plenty of room for growth even with competition.

Now let's turn to the specifics of our Integrated Business Plan. Our first job is to prove we have a business that could be profitable. We did that -- we proved that by doing a zero-based budget that assumed we signed no new customers and only honored existing customer contracts. We also incorporated a net projection, a sale of roughly 80 continuous improvement projects to lower cost and improve quality. The upside of that model was that we started having cash flow positive quarters in 2019. We were cash flow positive for the year 2020 and we never ran a negative cash balance despite no further financing.

The downside of that model was that we would have forgone future revenue growth and reduced our ultimate shareholder value. That analysis conclude that we needed to dramatically change our business model, hence Gogo 2020. On the customer side, the big change in business model are: first, we are going to eliminate or materially reduce subsidies that we offer airlines in all future deals. The subsidy model has led to our entire industry suffering significant losses and it was started by us back when we got -- when we first got into the CA market in the mid-2000s. But let's remember back then, our 3 current-day largest airline partners were actually 6 airlines and their balance sheet were messes, not ours. In conversations with several customers, quality airlines now care enough about connectivity for their passengers that they want the quality IFC players to survive and are willing to consider new business models to make sure they have adequate supply in the future.

Second, we want to focus on user experience not just network availability as our measure of success. And we've already started developing products that will enable user -- enable sign on, faster page loads and in the not-too-distant future seamless sign-ons all which drive take rate in revenue.

Third, we're going to begin charging for the engineering and certification services that we often perform free for airlines today. But which airlines are used to paying for with other vendors for other types of avionic equipment.

Fourth, we are going to focus on growing our relationships with third-party payers by building improved tools and services that enable them to realize a strong ROI on the business they do with us. And fifth, we're going to develop more data and analytics tools for our airline partners so that they have better visibility in the system performance. Gogo will focus on tool creation, training and facilitation, which will save both us and our airline partners money and reduce out-of-service time for airlines.

Turning from the customer side of the Gogo 2020 model to the operational side. Our new plan contemplates the massive change in how we run our business. Change that drives quality, enables ongoing focus on investing what is important to drive value at Gogo and dramatically lowers cost.

During IBP, we refined our objectives to 7 main operating objectives that are enabled by 102 projects that we expect to complete in the next 10 quarters. 25 of those projects have launched or are launching this quarter. The following is a sampling of our operational plans. With 8 projects aiming at fixing quality issues like deicing, antenna reliability, user experience and deploying faster motives. We have 52 projects aimed at achieving operational excellence like improving on-time delivery of airline programs, creating more self-service tools for airlines and on-time kit deliveries. We have 14 projects aimed at improving customer management, targeting the right customers, simplifying our sales process and retooling to sell our new business proposition. We have 9 projects aimed at improving products -- our product management focus here to drive revenue and measure product profitability, focusing on features that drive usage and revenue and launching our safe agile framework product development process which has been very successful in its first iteration, which is just wrapping up here in a few weeks. We have one project aimed at streamlining and enhancing our Satcom capacity planning. We have 15 projects aimed at enablement or streamlining of our overhead functions. And we have three projects that are improving financial accountability within the company.

As a part of these initiatives, we made the difficult decision to eliminate approximately 55 positions this week and sadly said goodbye to many talented individuals. This represents a little more than 5% reduction of our total full time CA headcount. Through the end of 2020, we expect to reduce personnel resources by about 30% with about 50% of that reduction coming from the elimination of contractors and outside vendors. To reach that goal, we aim to backfill only about half of our normal annual attrition rate of 16%.

I want to emphasize that IBP has not been a headcount reduction exercise. It's been a resource allocation exercise. And we plan to continue to invest in those areas we think create Gogo's unique competitive advantage such as aviation mobility engineering, systems integration, Satcom network design and management, ATG network design and management, and global aviation and communication regulatory compliance. We also plan continue to invest in an OEM line-fit, enhancing our data analytic capabilities, enhancing our production capabilities, enhancing our quality processes and very importantly continuing our rollout of the safe agile development process. Given that we have a very solid and mature business in our BA segment, our focus there has been preserving the strong overall BA financial performance with the goal of doing no harm in terms of future revenue and cash flow growth. In order to maintain our significant market share and performance lead, our current plan has funded the migration of our ATG network from EVDO to LTE between 2019 and 2023. While we have not funded BA's further development of our ATG NexGen system. First, we need to see if our major equipment supplier on that project, ZTE, will be allowed to continue to do business in the United States. And that decision is really in the hands of the congressional conference committee under defense authorization bill. Secondly, we're revisiting the business case around NexGen ATG to make sure there's still a wise allocation of capital.

Now let's turn to the financial implications of Gogo 2020. When it comes to modeling, our primary concerns were: a, ensuring that we had a plan we knew we could hit from a cash management perspective; and b, rightsizing our cost structure to a very conservative view of our revenue growth, especially given the Americans Airlines deinstalls.

Our revenue assumptions are: one, a very low 3% annual growth in take rate, which would mean that we grew from about 11% today to 12.6% in 2022; second, we assume today's average revenue per session of slightly less than $6; third, we assume we sign 300 new aircraft a year starting in 2021, of which 200 would be line-fit and 100 will be retrofit; and finally, we assumed a 10% CAGR growth in our third-party payer revenue. While most of our cost model is under our direct control, Satcom cost are not. So we have assumed their Satcom cost stay even with the pricing of our latest Satcom contracts. We already have substantial evidence that may not be the case and the Satcom cost will continue to come down dramatically. But to be conservative, we have not built that into the plan yet.

Before I turn the call over to Barry, I'd like to sum up my view on IBP. As industries evolve and technologies change, the winners are the companies that are ahead of the curve and escape to the (inaudible) faster than the competition. We believe that this significant pivot in our model, the increased focus on quality and the substantial reduction of both OpEx and CapEx all of which have the tacit endorsement of several of our key airline customers will allow us to achieve our goals.

I'll now turn the call over to Barry to discuss finances.

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

Good morning, everyone, and thank you, Oak. Following Oak's summary of the structural and operational framework for Gogo 2020, I'd like to provide some context for how this shapes our views for financing the business.

From the offset of the IBP process, we had 2 overarching objectives in forming our financing needs. First was to determine our worst-case capital requirement under our very conservative set of operating assumptions. And secondly, it was to impose a high level of internal discipline and personal accountability to drive the operational improvements necessary to properly size our cost structure.

Let me summarize the 2018 guidance and longer-term financial targets resulting from this process, which was reflected in our press release issued last night. For 2018, total revenue of $865 million to $935 million in line with prior guidance. 2Ku incremental aircraft online to be at the low end of the prior guidance range of 550 to 650.

Gross CapEx of $150 million to $170 million and cash CapEx of $110 million to $130 million in line with prior guidance. Adjusted EBITDA guidance of $35 million to $45 million. Our longer-term targets include reducing total operating spend in Gogo's Commercial Aviation business, excluding satellite cost, by nearly 20% by the end of 2020, reducing total cash burn in 2019 from the expected 2018 levels by over $100 million and by an additional $100 million in 2020, targeting free cash flow breakeven for the full year 2020. And finally, targeting significant annual EBITDA growth in each year reaching over $200 million in 2022.

Following are some high-level implications for revenue and cash flow that emerge from the IBP. We expect total Gogo consolidated service revenue to decline slightly in 2018 versus 2017 and then return to mid-single-digit growth in 2019 and 2020 before accelerating to double-digit growth in 2021 and 2022. In CA, excluding the American deinstalls, revenue growth is estimated to be more than 15% in 2019. So once the deinstalls are completed, we're set up well to return to solid CA revenue growth beginning in 2021. Even with the projected deinstalls, we expect total aircraft online to grow each year from the end of 2017 onwards.

Due to our cost-saving measures and our significantly reduced CapEx going forward, we're targeting to achieve breakeven free cash flow for the full year 2020. On an unlevered basis, we expect preairborne cash flow to be positive beginning in 2019. Having completed the IBP, we're now setting out to improve on these numbers. There are 3 main areas which we believe offer opportunities for meaningful improvement over this baseline: increased revenue, reduced expenses with counter parties and lower Satcom cost. To illustrate, our average take rate grew by over 4 percentage points during the 2-year period from 2016 to 2018 in an environment of limited 2Ku aircraft and constrained bandwidth. The assumptions included in our IBP assume less than a 2 percentage point growth in take rate over the 4 years ending in 2022. We believe that to be a highly conservative assumption based on the objectives of our airline partners and the expected performance of our satellite-based solutions. An increase in take rate to 15% from the 12.6%, we have modeled in 2022 for example, would, all else being equal, have a tremendously positive impact on EBITDA with our high-margin flow through rates. The second operational lever we are focused on is reducing our expenses with counterparties. We believe this benefit could run into the tens of millions of dollars. Finally, with the continuing growth of satellite capacity we believe our Satcom cost, which is the single largest cost category, could be meaningfully lower than we estimate. Assuming we could refinance our converts before their maturity as planned but with an assumption of no additional financing and assuming we get no benefit from the 3 operational levers I just described, we maintain a positive cash balance through 2019.

Our low cash point would be a negative $50 million to $75 million, which occurs in early 2021. We believe it is a very reasonable assumption but we'll achieve some operational improvements and that we could access the capital markets to raise these levels of capital. We therefore want to pass along our confidence about our ability to meet our liquidity needs. Should we ultimately need additional liquidity, it's important to underscore the point that no one is more concerned about equity dilution than Oak and is investing affiliates who collectively control about 30% of the outstanding shares. It's also worth noting that Oak and other insiders have recently purchased additional shares. He, along with multiple other current shareholders, have also expressed interest in purchasing additional shares should they become available. In the context of these relatively modest additional cash needs, our near-term balance sheet objectives are twofold. First is to provide an ample cash cushion based on our business requirement and second is to address the $352 million of converts due in March of 2020. We are committed to addressing these maturities prior to them going current in March of 2019 and we will certainly keep you apprized as these plans crystallize.

We believe that the combination of the support of our current shareholder base and a wide array of financing and strategic options will enable us to address our balance sheet. Our confidence is bolstered by the objective of achieving or -- excuse me, of reducing our cash burn by over $100 million in 2019 versus 2018 and another approximately $100 million in 2020 as anticipated CapEx and OpEx reductions take hold. We believe this cash flow improvement in combination with the targeted adjusted EBITDA of over $200 million in 2022 contributes to the financeability of our business.

I'll now turn the call back over to Oak to discuss the current thinking of our board as it relates to our strategic options.

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

Thanks, Barry. As Barry said, I'm going to finish by discussing developments on the strategic options front, which I originally brought up during our first quarter call in May.

In sum, strategic discussions across both the IFC and the broader avionics industry appear to be heating up. Competitors are thinking about consolidation, large strategic players are thinking about how to enter the business and private equity firms are thinking about how to act as consolidators and take advantage of the huge IFC opportunity. In our case, those opportunities come up either in the context of being a platform for industry consolidation or as a centerpiece to connected aircraft strategies. It's worth considering our potential role in connected aircraft strategies for one moment. As I'm sure most of you are aware, a number of studies were recently published highlighting the opportunities in the connected aircraft space. A recent report by the London School of Economics found that airline operational savings from aircraft connectivity estimated at $5.5 billion to $7.5 billion annually today and expected to grow to $11 billion to $15 billion by 2035. And a recent Honeywell report notes that the importance of connectivity will ultimately move from focus on the cabin to preventive maintenance. In reference to survey indicating that 82% of respondents ranked connectivity important or extremely important in handling maintenance issues.

Realistically, Gogo is probably not well equipped to drive innovation on the predictive analytics and maintenance side of that industry. But our advanced connectivity and real estate on the aircraft puts us in an enviable position as a conduit for larger technology providers to access these planes. Further, our current aircraft equipment allows for virtual machines within our servers to host applications for third parties to store, process and transmit information in a secure environment. This technical expertise should be of true strategic value as the ecosystem around our IoT begins to coalesce. And I should note that this capability exists in both our CA and our BA platforms.

Despite all of our issues, it's important to remember that we're the market leader in both of our markets. Though we have the leading products in both and in the case of our BA business we have a very strong cash flow. It's probably not surprising then that Gogo has received a number of strategic inquiries from financial and strategic acquirers in the last few weeks and our board has considered those inquiries and asked management to assess them and asked us to relay the following statement and I quote, "Since our first quarter 2018 earnings call, a number of parties have contacted management to suggest various strategic and/or financial relationships and transactions, some of which would involve splitting the company into BA and CA. The board has asked management to assess whether shareholder value would be increased by the company engaging in any of the suggested relationships or transactions or others suggested by third-parties or conceived by management and its advisers. The board has not made any decision to pursue any such transaction or relationship at this time. Please note that Gogo has no obligation to provide further disclosure in respect of any of these matters and will decide in a discretion if and when to provide any further comment."

On a personal note, I think I speak for the management team when I say that we're not going to let strategic options distract us from building a great company capable of delivering reliable value creation for its customers, employees and owners, whether that's in a public context, private context or as part of some larger entity. And that is the goal of Gogo 2020.

Thank you for joining our call today. I'd like to thank the following constituencies: our employees for their hard work in these challenging times, our shareholder base, and our airlines, and BA customers and suppliers.

With that, Barry, John and I are now available for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Robert Gutman of Guggenheim Partners.

Robert Ari Gutman - *Guggenheim Securities, LLC, Research Division - Senior Analyst*

Thanks for all the updated information. Can you at this point flesh out a little bit how the numbers filter through the segments in terms of margins in NA -- in North America and Rest of World? And also the ARPA assumptions that correspond to some of the input that you've given us today?

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

Yes, Rob, it's Barry. We are not breaking it out between NA and ROW at this stage. I mean this obviously is not a quarterly earnings call as well. So as we move forward, we will decide how -- what kind of business metrics to disclose. we increasingly, for example, run the CA business as a combined entity under John Wade since the reorganization. So at this point we're not planning on disclosing any additional information on this call regarding that split. As a regard to ARPA, yes, as we tried to illustrate in the call, we do believe we're taking very conservative assumptions around ARPA. I know you saw the take rate, for example, grow as I described 4 percentage points over the last 2 years and we've modeled it very conservatively from 11% to 12.6%. One of the reasons that historically the ARPA objective has been a different one going forward is a shift in our business model that as we shift to the airline-directed model, there are 2 -- you need to look at growth ARPA versus net ARPA so as you -- when the rev share reduces the comparability there. And secondly is the impact of 606 as you all know. So because of those 2 differences, it actually makes it more difficult to provide comparability for ARPA across period. So as we go forward, as I mentioned, we will be looking at what are the best ways to -- what are the best business metrics to provide for you to work on their models and understand the need for doing that.

Robert Ari Gutman - *Guggenheim Securities, LLC, Research Division - Senior Analyst*

And one other question, if I may. The 2Ku manufacturing issue that you are resolving this year. Are you able to tell us what the cost isolated to that is? And it was identified on a certain number of planes, but there are a lot of planes that have already been installed this -- why isn't the problem more widespread? Why is it contained to a certain number of planes?

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

Yes, Rob, regarding the numbers. As we mentioned in our last call, we expected the cost of deicing issue to be in excess of $25 million. It's right in that ZIP Code, so it's about $25 million this year as expected, a little less than $20 million of that is OpEx, the balance is CapEx related, so that's the impact for this year. And then John can speak to the overall situation.

John Wade - *Gogo Inc. - President of Commercial Aviation Division*

Yes, there were 2 issues really related to the antennas, one was our manufacturing one and the other was deicing related. Manufacturing issue had been identified prior to the deicing season. So a lot of the aircraft that were installed starting late last year didn't have that defect. So that's why they are more distributed, if you will, because it wasn't fazed across the entire fleet. And then deicing, it clearly impacted the airlines that have deicing more than others. And that's again why that was distributed across the fleets.

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

And, Rob, I should add on the financial impact that I responded directly to your question about cost but one of the things that's not comprehended in there is the lost revenue associated with that. Because as you know, we had planned to have 2Ku performing at those higher levels earlier in the year which would have enabled our airline partners to market it more aggressively earlier in the year. So that marketing impact and the financial results are delayed as a result.

Operator

Our next question comes from the line of Philip Cusick of JP Morgan.

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

What are some of the considerations to keep in mind when deciding whether or not to split the business into CA and BA? How would the ground network be managed in that situation? And how do you think about the dis-synergies of separation?

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

Yes, there are some dis-synergies of separation. Operationally, we have some shared data centers. We share some backhaul, not that much backhaul, some. We share a common routing and billing platform. And then there are some shared-technology resources. But relative to other splits I've seen, they are relatively minor and could easily be managed with service contracts for some period of time. And then, ultimately, one of the other divisions migrating to another data center, and other backhaul and building their own billing and routing systems so...

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

Okay. So splitting the radio layers could just be managed with service contracts as well?

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

Yes, that's right. I mean, I think that the ATG network would be in BA, the satellite network would be in CA. And there would be contracts between the 2 to serve each other.

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

Okay. And speaking of the ATG network, what's the timing of the decision on the Next Gen ATG availability and rollout? Are there alternatives to ZTE as a supplier? And if we don't do the Next Gen ATG, what do you do to upgrade those planes over time instead?

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

Yes, so first of all, the really important investment to us, I mean, looking at capital allocation is to move from EVDO to LTE on our existing ATG network. We have over 4,000 planes lying on that are very -- producing good revenue and are very profitable. And EVDO goes end of life, let's call it 2024, 2025. So -- and we don't believe -- I'm still looking at the business case here. A lot of the BA market may not -- probably won't migrate to the NexGen product. So it's a high BA product in the regional jet market. So we are looking at a couple of things. First of all, we need to know if ZTE is going to be allowed to do business in the United States or not, which is really up to Congress at this point. If not, we've got a lot of other options in terms of electronically steerable antennas, potentially hybrid ground satellite solutions that might be better for the regional market than Next Gen ATG. So I think the -- that the answer is we're evaluating the business case, and we'll make an investment when we see that it's appropriate. And I guess one other thing I'd add, Phil, I mean, there is this -- a question of competitive pressure and we don't really see much right now. So we'll see how that goes as well.

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

Well, I think assuming that there won't be any other alternatives for RJs over time seems a little naive, doesn't it?

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

Yes, over time, I agree with that. So we'll need some form of solutions down the road, I agree with that. Remember this though, Phil, the other thing just to point out is that moving to LTE will give us significant performance improvement in the current ATG system and that as planes move over to 2Ku, we're unloading that ATG network and further improving performance. And we actually see customer satisfaction scores climb now on the ATG network as well as on the 2Ku network because of that offload.

Operator

Our next question comes from the line of Simon Flannery of Morgan Stanley.

Simon William Flannery - *Morgan Stanley, Research Division - MD*

Barry, I wonder if you could just talk a little bit more about the EBITDA guidance. You gave us the new guidance for the year. Can you talk about the shape of that EBITDA through 2018? I know before you've talked about a kind of a breakeven number in Q2 and then ramping. So I just want to get an update on that. And also, getting to that 2022 number of $200 million, is it a fairly linear improvement in EBITDA through the intervening years or is it sort of back-end loaded? And then you gave a lot of revenue guidance numbers. I think there's just some clarification around whether that's service revenue, whether that's equipment revenue. If you could just maybe -- just make sure we've got those numbers right?

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

Sure, Simon. So let me take them in those 3 parts. First, with regard to 2018. Yes, as we said we expected it to be certainly low in the second quarter. As it plays out now, some of those are onetime or some of those expenses primarily related to deicing, for example, are shifting into the third quarter. So we actually expect the second quarter to be meaningfully better than we had planned and the third quarter is going to be worse and decline we expect from the second quarter to third quarter and then would expect it to ramp-up somewhat in the fourth. So the profile during the course of the year, we expect to follow that line. Looking longer term, we do expect EBITDA to ramp meaningfully starting next year. And then it's a reasonably linear progression from there going forward. So you get the benefit of the deinstalls kind of not impacting the performance beginning around 2021 or so. So -- but it's a relatively linear growth. It's not a highly back-end loaded if that's really the basis of your question. And then thirdly, with regard to revenue. We primarily focused on the total revenue, and of course, that is impacted so the -- and the guidance that we reiterated was for the total revenue and is impacted meaningfully by the 606 accounting, which includes meaningfully more equipment revenue, particularly over the next couple of years. And as I've mentioned, we've set pretty low expectations for new aircraft coming online to 300 a year in the out-years, which is meaningfully below what we had -- have seen historically, so you'd see some decline in that percentage of revenue comprised from equipment versus service in the out-years.

Simon William Flannery - *Morgan Stanley, Research Division - MD*

So when you say CA revenue is flattish next year versus underlying up 15%, that's a total revenue number?

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

That was service revenue.

Simon William Flannery - *Morgan Stanley, Research Division - MD*

That was service revenue, okay. If the American deinstall is that, are you seeing that mostly impacting through '18 into '19 or what has the pacing of that today versus your prior expectations?

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

Yes, those deinstalls we expect to be done by about mid-2019. So the impact of that hits really pretty substantially in 2018 and in 2019. So by mid-'19, we've really seen the primary impact of that and then is done by mid-'19. And there are about a -- from what we -- about 112 year-to-date deinstalls to give you an example.

Operator

Our next question is from the line of Louie Dipalma of William Blair.

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

In the scripted remarks, you referred to your guidance as conservative and for the 2020 free cash flow breakeven target, I was wondering if you're currently assuming the existing $100 million in cash interest expense? And I was also wondering if you're currently assuming something in the ballpark of maintenance CapEx of around $70 million?

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

Yes, so regarding the overall cash flow, and it is a target Louie, I'd point out, it's not guidance, I mean, so -- and it also, as I just would also point out that part does assume that we make some progress on some of the operational levers that we think we can pull. But we're giving ourselves that as an internal target to hit that because we're kind of within spinning distance practical term of that but that's the objective. So it does reflect the current planned interest payments, so we have not assumed that, that changes in the planning horizon. And then, remind me the second part of your question.

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

For -- in the past, Gogo has said maintenance CapEx is generally around $70 million. And so basically I'm asking if that maintenance CapEx number has changed at all?

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

Yes, we see maintenance CapEx being more in the $30-ish type million range. So lower than what we -- lower than the $70 million that you had in mind.

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

Okay. And secondly, Oakleigh, you discussed the eliminating subsidies for future deals. And I was wondering if Gogo has any ability to renegotiate or like amend some of the subsidies for its current backlog considering that -- it seems as though the current backlog is going to dominate the installations for the next 3 years. And so I was wondering if Gogo has been able to go to its airline partners and has any negotiating or wiggle room for those current installations?

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

Yes, Louie, I think we're planning to have some conversations with our airline partners around that. We believe in honoring our commitments but at the same time. I think it's interest to the airlines that they have a viable partner. So we're going to be having some conversations and we can update those for you as we make progress.

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

Okay. Great. And lastly, in the press release, you mentioned a 20% reduction in commercial division OpEx. And when I do the math, I calculate something in the $50 million ballpark. And I was wondering if that's consistent with how you are looking at it?

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

Well, it's a bit more than that, Louie. And the reason for that is, we put all of the -- (inaudible) the OpEx together, excluding Satcom, because certainly Satcom is projected to go up because of the significant increase in the numbers of 2Ku planes and usage. So that translates into more than the $50 million closer in the $70 kind of million range between -- that being the difference between the 2018 and 2020.

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

Okay. And maybe I'll sneak one last one in there. For your strategic alternatives, you've discussed implementing these cost cuts for the commercial division that should go in place by the end of 2020. And do you get the sense that potential strategic and financial partners can see the appropriate long-term value in Gogo's commercial division right now, even though the commercial division hasn't been optimized and you only have like 400 out of, I'd say, 1,100 international planes online generating revenue. Do you get the sense from your discussions that these partners actually see the value in Gogo's commercial division?

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

Absolutely. The difference in view of strategic -- potential strategic partners of our value and Wall Street sense of our value is striking as I have ever seen.

Operator

Our next question comes from the line of Paul Penney of Northland Capital.

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

Can you give more color on where the 20% operating cost reductions will come from in CA business? And aren't satellite costs still a major increase in expense as you need to materially spend as you upgrade the satellites to 2Ku and deliver bandwidth to your customer base?

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

Well, Paul, we make about a 45% margin on our Satcom revenue. And we expect that kicks in next year and it kind of continues at that rate going forward. So yes, the cost goes up but the revenue is going up as fast as the cost, if you will. So it ends up being a profitable product line for us. Your other question was around what again?

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

Sources of the reduction. Let me address that one, Paul...

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

Yes. Sources of reduction, yes...

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

The sources of the reduction and that so they begin in 2018, as Oak mentioned, starting with the reduction force that we had this week. The primary areas where we see those are in technology and operations. And the reason for that is there is a -- there are a number of programs that we're still working our way through that will have less cost in the out-years, things like line-fit and STCs, for example, as those were lost, but the primary driver of that is also continued operational improvement. So as we deploy the business model, as Oak described, it results in significant operational improvement and reflected in the expectation for headcount reduction which translates into that expense. And then in the early part of the years, it's also the assumptions around ATG-NG, but we do have the cost in there for deploying the longer-term LTE network that Oak described.

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

I'd add one other thing, which is we -- one of the issues of this company in the past was lack of focus and we took on a lot of one-off customization projects for airlines. We started the year with 500 -- roughly 500, what we call, capability in airline projects. We have now simplified that down to 91 or so through a consolidation of some projects, realizing there were better ways to address some of them in terms of platform solutions and other things. So we need to -- we are working our way through that backlog. And we are not making -- we're not doing a lot of one-off customization deals anymore. So that will bring down the amount of work, for instance, in our product development area substantially starting next year sometime. So it's all very operationally driven, Paul.

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

And one last piece as we complete the shift from B2C to B2B and really focus on airline partners, our needs for marketing are also reduced. So that's reflected in the numbers.

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

Yes, that's right.

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

That's a good color. When you look across your CA customer base, which airline customer to do you believe you do the best job for today? In other words, if you're talking to a new perspective IFC customer and they ask for a customer referral, which airline contact info would you give them?

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

So, Paul, you want me to piss off all the other airline customers by telling you that?

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

I just want 1 or 2 that you do a good job for.

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

We try to do a good job for all our airline customers. So I'm not going to get into that any further.

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

Okay. Last question. Could you just give more color on -- Barry, on how you maintain revenue guidance against the backdrop of explicitly slowing down your new IFC installs and in an environment of increasing level of airline director wholesale price remodels? Just give us more comfort how you can maintain your revenue guidance as before?

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

Yes, for 2018, the things are on track because of the installs that we're doing. So as we've talked about it, there will be a mix of equipment cost and service revenue cost, so the total expected to be online, expect that the equipment cost will probably be a little bit higher. As we go forward, the drivers of the revenue are, we have install base or we have the backlog to be installed, which of course, is really providing the revenue in the upcoming years. Beyond that, we will add some more airlines but there is also additional revenue from third-party payers, for example, that we see coming online. We've had a lot of success with wireless carriers in the form of T-Mobile, for example, and we see the opportunity to do more of that. So that gives us the confidence around the revenues, and as we mentioned, what's not in there is we think probably a pretty likely increase in the take rate over what we have in the plan but that's not reflected as we talked about it, 12.6% take rate in 2022.

Operator

Our next question is from the line of Lance Vitanza of Cowen.

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

On the Business Aviation side, I'm wondering and I know this has been discussed to some extent, but aside from your financial situation, what has changed to make you less certain about the need to rollout Next Gen ATG? And I'm wondering, in particular, if there's been any change in your view on SmartSky and the progress that they are or perhaps are not making to get into the Business Aviation market?

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

Yes, that's a good question. I mean, frankly, we don't see that much progress and we watch them quite carefully. There are questions around 2.4 spectrum and whether -- in densely populated areas whether these products are going to be effective or not. So that's just a question. We haven't been able to test now since the Denial Order came out. So we've been -- we have 10 powers up and running and -- but haven't been able to fly them as a result of the Department of Commerce Denial Order. Frankly, I think that the answer to your question is where you have the new capital allocation rigor here. And we're requiring good business cases for investments. The LTE case is a very good business case. And NexGen is a little less clear in terms of what the addressable market is. So we'll continue to work that. And I'm not saying that we're not going to do it. I'm just saying that we need to develop the business case before we agree to fund going forward.

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

Just one last one on the Commercial Aviation side. The participation rates that you're projecting, I guess 12-and-change percent in 2022. Can you possibly break that out or at least provide some color around how that would look if we were to isolate 2Ku planes versus the rest of the fleet?

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

Lance, we're not breaking that out. But I would just say that the -- it is higher on the planes that have the higher bandwidth capability. So that's what we'd expect and we expect that to continue to grow.

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

Is that guidance I mean or is the thinking there that you want to be conservative or is the participation rate a reflection of a bound based on the amount of capacity that 2Ku can provide to the plane? I would think that half of the people in the cabin are going to want to use the product if it works sufficiently well. So what's the thought process there?

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

No, it has absolutely nothing to do lack of bandwidth, in fact, just the opposite as you pointed out. So that really does increase our ability to drive take rate. The reason for this, Lance, and again, let me just provide a little bit more context around the IBP itself. This was meant to, as we talked about, help us understand our capital requirements and to drive the rigor internally to size the customer to where it needed to be and to drive all the kinds of operational improvements and then it led to this change in the business model. Frankly, Gogo historically has overpromised on revenue when you look at it in the long term. And we want to make sure that we're not doing that. So this IBP has the 3 levels of conservatism built in that we talked about around counterparties, around revenues, around Satcom cost very consciously so we -- our airline partners also feel very strongly about the opportunity to increase take rates substantially above these levels as do we. So we're -- but it's a little early to see exactly where the need in that curve is going to be. And there's -- we think there will be an inflection point as we get more 2Ku planes installed. There is more bandwidth. Our larger operators, in particular, are able to market it aggressively. But that's not yet embedded in the plan to any degree for the reasons I outlined.

Operator

Our next question is from the line of Ric Prentiss of Raymond James.

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

A couple of questions to follow up on. It also seems like obviously third-party pay is pretty important. Barry, I think you just mentioned wireless carriers. Talk to us a little bit about the status of getting those folks back onboard now that the 2Ku may be issues are getting behind you?

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

Well, we have a number of discussions underway. And I wouldn't want to speculate on where they'll end up. But we're working hard with some other providers. And we're building sets of tools and services to make sure that we serve those markets effectively. But it's an exciting opportunity because you can see a very seamless experience or something you can walk on the plane and essentially roam on to their wireless service. I think that would drive usage quite well for us and would lower the cost for the airline, of course, providing the service also. We're excited about it. And we're going to work hard at making it happen.

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

And when you talked about you wanting to address the converts before they become current in March of '19. What couple of items would you want to see happen in your business and the market's reaction to your business between now and March '19 -- or March of 2019, sorry?

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

So, Ric, we're certainly letting the plans to do that. So would be in a position to execute on that. I mean, obviously, the trade-off is -- you think about what the dilution would look like. So I think the things that would be in our mind is, we begin to execute on the IBP. We will have to see what kind of impact that has. There are alternatives besides just the like-for-like exchange, for example, that could make that more attractive. Don't have to do it all at once depending on where the stock price is and what that dilution impact would be. And then the strategic options that we had talked about are certainly an overlay to this. So I think the things that we would want to see are where we will -- we have a whole range of opportunities, financial and strategic. As you saw from the board's direction, we are going to be assessing those. And we'll view the refinancing of the converts in that context as well.

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

And since the Gogo 2020 is kind of a long-term view also. If we were to step back further and just say, how do you guys view what is the competitive advantages? If you want to break it out CA versus BA, that's fine. What are the competitive advantages you guys think are core to your offering of why a customer chooses you and stays with you?

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

Versus -- well, in CA, I think, the 2Ku argument is compelling. We have the best coverage around the globe. We have the fastest network. And we have the most reliable network because of our leasing model, where we can access dozens and dozens of satellites around the world. We also are future-proof and that you can migrate from 2Ku to using LEO systems as they come up in a multi-constellation mode to make sure that you're getting the best price and best latency performance from the satellites that we're utilizing for your airline. So I think that's the compelling argument there. We also provide, I think, a lot of great services around that offering. And I know people question our quality, et cetera. And we are very focused on improving our quality. But I will say this, generally speaking, our quality is much better than our competitors. So those are the reasons people pick us in that space. In the BA space, the only other solutions are much more expensive than ours, kind of at the high end of the market or have very low bandwidth at the low end of the market. And we have -- again, we have the best products on the market. AVANCE L5 is rolling out at a blistering pace. And we have a very, very reliable network in the ATG system. So those would be mine. John, am I missing anything you would add to that?

John Wade - *Gogo Inc. - President of Commercial Aviation Division*

No, I'll certainly say in the Business Aviation space, I think the legacy of the company is still and the reputation for incredible levels of customer support and technical support really kind of sets us apart in terms of the way customers view the aviation side. Gogo really is market leading, so that's another important aspect. It's not just the technology is superior, but it is the service and support that goes with it as well.

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

And so as you look at those cost cuts of nearing 20%. Barry, I think you said it might be more in the $70 million, $75 million range or $70 million range. Is those -- are those areas kind of protected? And you're going to cut the cost in other areas?

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

Well, if you've listened to the script, as I said, a whole bunch of areas where we're investing more money. Our aviation mobility experience is, I think, unparallel. We are very good at building and running Satcom and ATG networks. And I could go on down the list. So we are investing in the areas which we consider Gogo's secret sauce and lean the organization out where our cost add less value.

Operator

Our next question is from the line John Hodulik of UBS.

Lisa Levenson Friedman - *UBS Investment Bank, Research Division - Associate Director and Analyst*

It's Lisa for John. I just have two questions kind of building on what Ric was asking about. As far as the convert, I believe Moody's had said that they would look at another downgrade if that was not refinanced by the end of the third quarter. So I just wanted to ask about your level of confidence that, that is something that you might be able to accomplish? And then as far as the strategic and financial alternatives, can you give us a sense of sort of your thought process, what you need to know or what you need to determine to decide if that's the most compelling way forward?

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

Yes, let me start on the first piece of that, Lisa. And we have active conversations with the rating agencies. So I think they are -- and we are keeping them well apprised of what we're doing. I think they -- the Moody's perspective is our view that not that it would have to be done by the end of September but if they look at maturities 18 months out and want to make sure that the companies are addressing and have plans to (inaudible) we have shared our all financing alternatives at a high level and have committed to stay in touch with the rating agencies as we go through this process. And I think they've been constructive based on what we are -- what we've laid out here today. With regard to how are we going to look at the financing and strategic alternatives going forward? I can start on that and then can have Oak comment as well. We have a wide array of alternatives that have been presented to us and that we're considering. So capital markets transactions to do things like refinance of convert to degree that we need to add additional buffer capital. And then to look at that in the context of the overall strategic options as well. So we can't comment further on what those strategic options are, but we with our board will be evaluating all of those together over the coming weeks and a month or 2.

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

Yes, I mean I'll leave you with a simple thought, which is may be a little provocative. If people worry about our refinancing and all of that, either one of our business divisions would be worth more than our entire debt to strategic acquires in my humble opinion. So I'll leave it at that.

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

Thanks, Lisa, and thank you, everyone, for joining our call today. This concludes our call. Thank you for your support of Gogo. Bye-bye.

Operator

Ladies and gentlemen, thank you for your participation in today's conference. This does conclude the program. You may now disconnect. Everyone, have a great day.
