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GOGO.OQ - Q4 2023 Gogo Inc Earnings Call

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PRESENTATION

Operator

Good day, and thank you for standing by, and welcome to Gogo Inc. Fourth quarter 2023 earnings conference call. (Operator Instructions) Please note that today's conference is being recorded and will now hand the conference over to your speaker. Howard Will Davis, Vice President of Investor Relations.

Will Davis - *Gogo Inc - VP of IR*

Please thank you, Olivia, and good morning, everyone. Welcome to Gogo's fourth quarter of 2023 earnings conference call. Joining me today to talk about our results are Oakleigh Thorne, Chairman and CEO; Jesse Benjamin, 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 performance of the Company. We caution you to consider the risk factors that could cause actual results to differ materially from those in the forward-looking statements on this conference call.

Those risk factors are described in our earnings release filed this morning and are more fully detailed under Risk Factors in our annual report on 10K and 10Q and other documents that we have filed with the SEC. In addition, please note that the date of this conference call is February 28th, 2024 Any forward-looking statements that we make today are based on assumptions as of this date, and we undertake no obligation to update these statements as a result of more information or future events. During the call, we'll present both GAAP and non-GAAP financial measures. We have included a reconciliation and explanation of adjustments and other considerations of our non-GAAP measures to the most comparable GAAP measures in our fourth quarter earnings release.

The call is being broadcast on the Internet and available on the Investor Relations website at ir dot Gogo air.com. The earnings press release is also available on the website. After management comments, we'll host a Q&A session with the financial community only. It is now my great pleasure to turn the call over to Oakleigh.

Oakleigh Thorne - *Gogo Inc - Chairman of the Board & CEO*

Thanks, Will, and good morning, everybody. 2023 was a busy year for Gogo. We continued to grow our high margin service revenue and to drive Gogo's strong cash flows propelled by accelerating adoption of Gogo's advanced platform and fueled by strong business aviation demand for connectivity. At the same time, we're making great strides in our investments to future-proof our business by extending the technology, Frontier and aviation with Gogo 5G and our low earth orbit satellite products, Gogo Galileo.

We believe these new technologies will deliver order of magnitude improvements in the speed of Gogo's service. It will increase our total addressable market by about 60% and the Dell extend customer lifetimes by providing easy upgrade path for existing events, customer with the addition of Gogo 5G and Galileo, Gogo will have the most complete product portfolio in the business aviation, IFC industry with products that offer the right performance, the right coverage at the right total cost have great customer support for every segment of the highly unpenetrated 39,000 aircraft global business aviation market.

We also navigated temporary aviation industry headwinds related to parts, labor shortages and busy maintenance schedules. No, those continue to impact our OEM and dealer partners. We are seeing suspension intervals starting to shorten and reactivation rate starting to pick up which will hopefully help boost aircraft online this year.

Despite the delay in the development of our Gogo 5G chip, the market continues to respond enthusiastically to the 5G value proposition with ongoing pre-provisioning programs and a flood of STC programs that we believe position us for a highly successful launch late this year. And on top of that, we're executing the SEC secured networks program support from the US government to enhance the security of our nation's infrastructure and at the same time, deliver meaningful benefits to Gogo's network and growth.

Yes, as Jeff will describe in a moment based on our new long-term forecasts were bullish on Gogo's opportunity for significant growth and long-term value creation. Today, we serve a highly unpenetrated market with 76% of the world, 39,000 business aircraft flying with our broadband solution in demand for connectivity in those aircraft growing dramatically from both passengers and operators as a result of these trends, we expect global broadband connectivity penetration across all business aircraft to grow from 24% today to the mid 30% range by the end of our five year planning horizon.

Over that horizon, we expect Gogo's share of global installed aircraft to remain at roughly 75% with our North American share remaining in the low 80s and Gogo's Rest of World share, growing from 0% today to the high 20% range by 2028, which equates roughly to 600 aircraft to be conservative in our Gogo projections. We've assumed that StarLink achieves its currently published STC. schedule and launches of smaller tenants in the next two years. And for planning purposes, we projected as Galileo installing come online share will shift away from today's geostationary satellite of incumbents, and then Gogo and startling will benefit from that shift.

And now we have now and that we have to muscle through a tough investment year to deliver 5G and Galileo. Our long-term projections are driven by strong recurring service revenue that drives strong cash flow and a strong balance sheet, which acts as a flywheel to drive investment and further enhancing our products and further securing our competitive advantage in the future.

Now I'll highlight some demand trends and provide an overview of our Q4 results before I dive more deeply into progress in our strategic initiatives, demand for WiFi and aircraft continues to grow. Data consumption per flight hour in Q4 was once again, up 50% compared to prior year and up 74% from Q4 2019, demonstrating a step change in passenger expectations for in-flight connectivity. Demographic trends bode very well for connectivity.

Penetration of all ages wanted better in-flight connectivity demand for connectivity increases as the age of the flyer deep Coca-Cola could be a 2023 flight counts were down 2% versus 2022 of the gap narrowed to a 0.5% in Q4 and actually turn the corner and after a 2% increase in January over prior year, which certainly signals demand for in-flight connectivity remains strong, on-site for flight remained strong.

More importantly, flights are significantly elevated from pre-COVID levels for Q4 are up 28% from Q4 2019, signaling to many industry observers that stronger private aviation demand is here to stay, which is further supported by strong OE of order books and very strong fractional sales, which we expect will drive Gogo shipment growth over the next few years.

Now let me turn to our Q4 performance. Revenue was down roughly 10% from our record Q4 2022 performance, which was driven by a 2022 post-COVID surge in equipment orders. On the positive side, we achieved record service revenue in the quarter, driven by record total advanced activations, which were up 20% from prior quarter and 15% from prior year, driven by accelerating reactivations and record of upgrades from classic to the advanced platform.

At the end of Q4, we reached 7,205 ATG aircraft online, representing 55 incremental ATG units in the quarter and reached 3,976 advanced aircraft Ahmar representing 192 incremental advanced units in the quarter, up 21% from prior year and now representing 55% of our installed base. We view every addition of an advanced unit, whether a new customer or an upgrade can be a strategic win for Gogo because it extends the lifetime value of that customer.

That's because once an advanced platform product is installed, it is far easier and cheaper for a customer to upgrade to new technologies such as 5G and LEO satellite connectivity with Gogo than moving to a competitor's product to upgrade that technology. The reason for that is generally the only work inside the aircraft to upgrade to a new technology with Advance is to add or replace an antenna on the outside of the aircraft. The rest of the upgrade can be achieved on the events, but inside the aircraft with a simple software upgrade this gives us a huge advantage in our distribution channels because advances already line-fit on every currently produce make a model of aircraft OEMs have lower engineering and line-fit covenant expense.

When they adopt 5G or Galileo than a new product from one of our competitors because they've already engineered into their production for the Gogo equipment that goes inside the aircraft on the dealer side because they're already STC. for events and all makes and models of business aircraft, they can upgrade their STC.s or field approvals far more quickly than doing whole new design for competitive products. And on the fleet front, if they have advanced installed, they can invest in one of one set of advanced hardware inside the aircraft and then upgrade incrementally by adding antennas at far lower cost than replacing full systems.

To give an example of where we think this will work to our advantage today. There are more than 2,100 heavy jets flying with Gogo ATG connectivity in North America, many of which also utilize geostationary satellite products when flight magnify outside North America, today, 61% of those have advanced installed, providing an easy path to upgrade from GEO LEO connectivity when they so desire.

We believe this advantage will only grow as we migrate the 3,200 customers still in our classic ATG products to the advanced platform as part of our FCC C Secure Networks program, customer conversion campaign moving from service revenue to equipment those shipments paled compared to our blockbuster year last year. 2023 was our second highest advanced shipment year app, which we believe portends more good things for the strategic customer reasons I mentioned a moment ago. And finally, given the strong activations last year, Gogo inventory in the field normalized, and we're now down to roughly 100 units in the field that are not committed to a particular buyer of which only 37 are dealers. It do not regularly move large amounts of it.

On the earnings side for the quarter, despite our revenue headwinds. EBITDA came in higher than plan, and free cash flow set a new record. This demonstrates the durability of our business model. I'm proud of the Gogo team and wanted to thank them for their commitment to our strategy and strong execution throughout 2020.

Now for our progress on our strategic initiatives, Gogo will focus on accelerating growth with a three pronged strategy. First, we want to expand our addressable market globally by expanding outside North America and developing products and pricing that fit every segment. Of the 39,000 aircraft global market. Second, we want to drive customer loyalty by continually improving our networks and leveraging the advanced platform to provide an easy upgrade path as new technologies emerge. And third, we're focused on offering the best product and customer support to each segment of the market at the lowest total cost of ownership. And we're making great strides on our strategic initiatives to achieve these goals.

Let me start with 5G. I'll begin with a little bit of bad news, which is that due to a non-technical contractual issue between sub suppliers, we've had a slip in our 5G deliveries from Q3 to Q4 of this year. However, we believe that issue has been resolved and we're back in fabrication node on the chip despite the shift in timing. We're really encouraged by the commercial certification progress we're making, bringing this product to market, and we've already shipped 198 5G proved pre-provision kits will then be 13 5G antennas, 59 of which have already been installed and are flying today on our 4G network with an L5 4G box.

Once our chip is ready, we will start shipping the LX. five box to those customers because the LX. five and L5 has the same form factor, they can make a quick swap and begin five service and 5G service immediately saving downtime and expense. We have orders from five OEMs, one of which is already line-fit installing their B thirteen's three of stock orders for 46 systems from our dealer network. On the certification front, we have 31

SDC.s and work representing 41 aircraft models and more than 9,700 North American jets of those 10 SDC.s have already been completed for the 13 and tenants.

And because the Alex slide is the same form factor as the L5 will be quickly upgraded once we ship them the LX five boxes with the 5G chip inside the other 21 programs are waiting the LX. five before completing work, which again, because they are the same form factor is a relatively modest sector. We also had an exciting milestone earlier this month when we received our first FPGA version of the five G. chip and began testing the 5G chip software in our Chicago lab. We're excited to bring Gogo 5G in a market in which means speeds around 25 megabits per second peak of 75 to 80 megabits per second, we believe is the perfect product for midsize and smaller business aircraft are flying North American missions and won't break it into connectivity at a better value than competitive satellite product.

Now let me turn to our LEO based global broadband initiative. Galileo comes in two versions, a smaller HDX terminal and a larger FD. extra Galileo HDS HDX terminals a small antenna that sits on almost all business aircraft and target a the almost 12,000 midsized and smaller jets domiciled outside North America and have absolutely no broadband solution today and being those jets out of the 11,000 mid-size and smaller jets that domicile inside North America that often fly international missions, Galileo FDX terminal is a larger antenna that delivers significantly higher bandwidth and targets.

The roughly 7,000 global super mid-size and larger heavy jets fly transcontinental missions for Galileo peak speeds. It means speeds will be in close proximity with HDX delivering speeds to the aircraft in the high 50 megabit per second range and FDX delivering speeds close to 200 megabits per second, which is comparable to the speeds Darling publishes for his 39 years. As I mentioned earlier, a huge advantage for us is the Galileo is a simple upgrade from any advanced installed plane. One only needs to add our HDX reg FDS. in Canada on the fuselage and then run data and power cabling into the aircraft.

As I also mentioned earlier, given that advances already aligned fit option that every OEM has STC.s on every currently produce model of aircraft will be relatively easy from an engineering and certification perspective for OEMs and dealers to offer Galileo as an option to their cars. We've already signed one line credit agreement and have discussions underway with several others.

And six Gogo dealers have already either verbally committed or already under MOU for 10 SDC.s, representing 28 different aircraft models and a global TAM of 8,000 aircraft. We remain on track to start shipping HDX terminals in Q4 and if the externals in the first half of 20, we hit an exciting milestone this month and we received the first fully constructed prototype of the Gogo HTS antenna, which marks a significant step in design validation preparing for flight test this summer that we're one step closer to our goal of offering a global broadband connectivity solution for every business aircraft everywhere.

Now let me turn to the SEC secured networks program. You'll recall that two years ago, Gobi Gogo was awarded a $334 million grant under this program to reimburse it for expenses associated with accelerating the removal of Chinese telecom technology from our 4G network because, there were more qualified grants than originally planned. Funding for all brands were cut back to 39% of the original award, which in Gogo's case was a cut back to $132 million.

As I mentioned last quarter, the White House included full funding for the program and at some supplemental funding request to Congress last year. Given that full funding has broad bipartisan support in Congress, we feel that it has a chance of passage this year, partial funding will cover about 70% of our reimbursable cost of replacing all EVDO ground equipment and moving Gogo classical customers to advanced equipment that is compatible with the replacement ground requests.

And that is why what we are projecting in the long-term guidance we shared today based on changes we've made to our evolution program. We no longer believe we will need nor would we receive $334 million. However, if full funding is approved, we would be able to accelerate our program and cover all reimbursable on the customer side of this transition, our goal is to convert all 3,200 tails still flying with our classic product today to new LRU.s with LTE. AirCards over the next two years. And we are finding very attractive conversion. We made plans to encourage them to do so.

We've been in conversations with more than 95% of these customers. So far, 55% of indicated a preference, but the overwhelming majority leaning towards an advanced upgrade, almost half of those choosing L. fives everywhere else raise. This program has considerable benefits for Gogo and its customers, including a 40% improvement in connectivity performance for our events. Our three customers, a doubling of the number of aircraft, the ATG. four G. network and simultaneously manage and an acceleration of Gogo Classic customers upgrading to advance, which has the strategic benefit of extending Gogo customer lifetimes due to the ease of upgrade to 5G and Galileo and other new technologies I described a few moments ago. Perhaps the biggest news in the quarter was announced after the quarter was over and that is the 10-year extension of our 20-year relationship with Netjets.

Netjets is by far the largest operator of business jets in the world with roughly 600 aircraft in North America, which they plan to go to a hub 1,000 over the next five years and another 85 aircraft operating in that just Europe of the North American aircraft, roughly 40% are on advanced today and 60% are classic Gogo ETG. product. There are plenty upgrades to advance for all their North American aircraft. And then future upgrades, either 5G and or HD-X, depending on mix.

NetJets Europe by 70 aircraft that are equipped with Gogo equipment today, largely to provide in-flight entertainment, but 40% of those are already on the advanced platform and they plan to upgrade all of those 72 events with HDS, Galileo. And most importantly, net debt is the bellwether of the business aviation industry in order to carry business and that just OEMs and dealers make sure that they can provide the products and services net jets wants to install, and that should create great pull through demand for Gogo.

So I mentioned at the outset of 2024 is an exciting year for Gogo as we deliver Gogo 5G and Galileo and continue to execute on our strategy, we are more in-demand, more innovative and more poised for value creation than ever.

Now I'll turn it over to Jesse for the.

Jessi Betjemann - *Gogo Inc - Executive VP & CFO*

Thanks, Oak, and good morning, everyone. Because we'll continue to demonstrate strong demand for our products and services in the fourth quarter, setting new records operationally and financially, despite the unfortunate delays of our 5G program, we discussed on our Q2 earnings call, the industry headwinds, we've endured significant strategic investments we've undertaken and Gogo 5G and Galileo. We delivered solid bottom line financial performance and record free cash flow in 2023.

Our ability to achieve these results is a testament to the strength of our business model, financial position and investment strategy. And with the bulk of our strategic investments coming to completion at the end of 2024, we expect our free cash flow to accelerate substantially in 2025.

In my Morocco, my remarks today, I'll start by walking through Gogo's fourth quarter and full year financial performance. Then I will turn to our balance sheet and capital allocation priorities. Next, I will provide an overview of the financial impact of the SEC program. And finally, I will provide additional context on our 2024 financial guidance and the long-term targets we announced this morning.

For the fourth quarter, Gogo's total revenue was $97.8 million, down 10% year over year and remained relatively flat sequentially because of top line was driven by record service revenue of $80.9 million, up 5% year over year and 2% sequentially in the fourth quarter. Our ATG aircraft online reached $7,205, up 4% year over year and 1% sequentially. Total advanced aircraft online grew to $3,976, an increase of 21% year over year and 5% sequentially.

Driven by a record number of total activations. As Oak described. We expect another strong year of advanced activations in 2024 as we plan to aggressively upgrade our classic Gogo Biz ATG customers as part of the STC program while maintaining a reasonably conservative view on improvements in the maintenance cycle times that have slowed installations over the past year, upgrading our customers to advance is a critical part of our strategy as it extends customer lifetimes due to the easy upgrade path to Gogo 5G and Galileo. However, it will mute the ATG aircraft online book growth rate. Total APG. RPU grew 1% year over year to $3,387, driven by a shift in product mix the launch of Gogo 5G Galileo to further expand our RPU growth opportunity over time.

Turning now to equipment revenue. Gogo delivered $16.9 million in equipment revenue in the fourth quarter, a 45% decrease year over year. We had a tough comparison to our record prior-year quarter, compounded by the parts and labor dynamics, an order slowdown in anticipation of our new product launches. Equipment revenue decreased by 8% sequentially as the 5% increase. We had 202 advanced units sold in the fourth quarter with offset by a $4 million reserve, primarily driven by specific customer circumstance.

Now onto profitability. Gogo delivered service margins of 78% in the fourth quarter, remaining relatively flat compared to the prior year quarter and 1% point higher sequentially. We expect service margins to be in the 75% range this year with a slight decrease in future years as Google Galileos concentration and product mix increases. Overtime, service revenue and margin continues to be the primary lever for free cash flow generation and long-term value creation equipment margin for 9% in the fourth quarter 23% points lower than the prior period prior-year period.

The decrease was primarily due to an increase in production costs as a percentage of revenue due to lower equipment revenue in the quarter and also by increased inventory reserves, which negatively impacted equipment margin by [nine] points. Equipment margins were 24% points lower sequentially, driven largely by the $2 million accrual taken in the third quarter for the expected FTC. reimbursement of costs incurred in prior periods for aircraft replacements, along with the increased inventory reserves I just mentioned, we expect equipment margins in the 20% range in the near term and to decrease slightly in the long term as the mix of lower-margin Gallo units sold increases over time.

Moving on to operating expenses, fourth quarter combined engineering design and development, sales and marketing and general and administrative expenses increased 20% year over year and 19% sequentially to $35 million. The increase in the fourth quarter is primarily due to approximately $3 million in legal expenses related to the SmartBuy patent litigation and global constant efforts to support Galileo cargo expects 2020 forward to be a significant investment year as we continue to invest in our Gogo 5G and Galileo program. We expect that these new products will accelerate revenue and free cash flow growth over the long term and are the key foundation for our long-term financial targets that I will discuss shortly.

In terms of the 5G in the fourth quarter, our $2 million of 5G spending was comprised of $0.4 million in OpEx and $1.6 million in CapEx for 5G delay has pushed approximately $10 million of CapEx and approximately $7 million of OpEx from our original plan in 2023 into this year. The delay also dampens revenue, EBITDA and free cash flow in the coming quarters, we expect 2024 will include approximately $8 million of 5G OpEx and approximately $12 million in CapEx. We continue to maintain our estimate of $100 million in total external development and deployment costs for our 5G program and anticipate no negative impact on the overall program cost from the delay. All of these impacts are reflected in our 2024 financial guidance.

Now on to Gogo Galileo initiative in the fourth quarter at Gogo recorded $2.5 million in operating expenses related to Galileo. We continue to expect external development costs for both the HD-X and FDX solutions to be less than $50 million in total, of which $9 million was incurred in 2023, approximately $25 million is projected in 2024 and the remainder in 2025, we anticipate approximately 90% of global Galileos external development costs will be and are back.

Moving on to our bottom line because our recorded $35.1 million in adjusted EBITDA in the fourth quarter, a 24% decrease year over year and 19% decrease sequentially, driven by lower equipment profit and an increase in legal expenses as previously described, as delivered net income of $14.5 million in the fourth quarter, down 48% year-over-year, translating to $0.11 in basic and diluted earnings per share. As a reminder, our financial statements reflect non-cash income tax expense as we continue to generate positive pretax income based on our substantial NOL position at the end of 2023, including $446 million in federal net operating losses and $377 million in state net operating losses.

This results in a net deferred income tax asset of $217 million. We do not expect to pay meaningful cash taxes through our five-year planning horizon. As a reminder, our shareholder rights plan that was designed to preserve NOLs expired in September 2023. Thus, there are no limitations to shareholders buying over 5% of our equity in the fourth quarter, we generated record free cash flow of $28.4 million, an increase from $25 million in the year-ago period and $21 million last quarter. Year-over-year increase was primarily driven by lower CapEx associated with 5G and lower net working capital.

I will now turn to a discussion on our balance sheet. Gogo ended the quarter with $139 million in cash and short-term investments and $606.9 million in outstanding principal on our term loan. With our $100 million revolver revolver remaining undrawn Gogo's net leverage remains at 2.9x, in line with our target range of 2.5x to 3.5x. As previously mentioned, we have a hedge agreement in place and we currently have 87% of our loans hedged the next step down in the hedge to $350 million occurs in July 2024, with an increasing strike rate from 0.75% to 1.25%.

Our cash interest paid for 2023 net of hedge cash flows was $41.5 million, which includes approximately $10 million for two months of interest expense related to 2022, assuming no further debt paydown, the cash interest paid for 2024 net of hedge cash flow is expected to be approximately$ 33 million.

Now I'll provide a recap of our 2023 full year results. Covid generated total revenue of $397.6 million, down 2% from 2022 at the top, but at the top end of our guidance range, we delivered record service revenue of $318 million, up 7% from 2022, driven by a record number of total advance activations, including profit to advance upgrades. Service Equipment revenue was $79.6 million, down 26% from 2022. We reached adjusted EBITDA of $162.1 million, down 7% from 2022, but above our 2023 guidance range by lower revenue throughout the year.

Net income increased 58% year over year to $145.7 million, primarily driven by a $48.1 million tax benefit due to the partial release of the valuation allowance on our deferred tax assets. In the second quarter, we delivered record free cash flow of $82.7 million, up 43% from $57.8 million in 2022 due to lower CapEx and lower networking capital. While revenue was well below our expectations due to the industry dynamics, we have discussed the 5G delay and the resulting wait and see situation. Our bottom line and free cash flow were better than expected, increasing demand from customers for connectivity and Gogo's route robust business model as a testament to the strategy we are employing for long-term financial growth and success.

Now let me turn provide a recap of the capital allocation priorities, which are in service of our current strategic goals, we are focused on, first, maintaining adequate liquidity, second, investing in strategic opportunities to drive competitive positioning and financial value, including global 5G and Galileo third, maintaining an appropriate level of leverage for the economic environment with a target net leverage ratio of 2.5x to 3.5x.

And finally, returning capital to shareholders as appropriate in the future. As we mentioned last quarter, we were comfortable moving to priority for in returning capital to shareholders as our Board of Directors approved a share repurchase program in September with no set expiration date that grants authority to repurchase up to $50 million of shares of common stock in the fourth quarter go to repurchase approximately 480,000 shares for a total cost of approximately $4.8 million and an additional 566,000 shares for a total cost of approximately $5.2 million in January, abruptly our confidence in the long-term value of Gogo and in the strength of our balance sheet.

Looking ahead, we need to continue to balance the use of cash over the next year. Across our capital allocation priorities, I believe we are well positioned to execute our investment schedule, continuing to evaluate further debt paydowns, especially in consideration of the upcoming hedge step-down I previously mentioned and expect to have more opportunities to return capital to our shareholders in the future.

I will now provide an update on the expected financial impact of the FCC and reimbursement program. Gogo expects to receive $132 million from the program as it is partially funded. However, we are awaiting Congress's decision on full funding, which could substantially increase our reimbursement up to the approved [$334 million]. As a reminder, we submitted our first claim in July 2023, which triggered the start of the one-year clock to complete the program by July 21st, 2024. In our application, we stated that we will need to have multiple extensions to complete the program and are planning to request an extension in the near term because we have incurred and will continue to incur costs for this program in three main areas.

First, network equipment for sulfates and data centers. Second, airborne equipment for the swaps of LT AirCards to replace EV-DO AirCard and partial rebates for customer installation costs to enable existing customer aircraft to communicate to the new network and third operating expenses. We expect that this spend will be partially offset by the FCC reimbursed.

As of December 31st, 2023, we recorded an $18.3 million receivable from the FCC as we spent approximately $20 million of reimbursable expenses and recouped approximately $2 million in cash reimbursements. This receivable is included in prepaid expenses and other current assets in our balance sheet with corresponding reductions to property and equipment inventory and contract assets. And with the pickup in the income statement since the program is currently partially funded. We have some optionality on what we request reimbursement for which the impact to grant money received will be recorded between the income statement and balance sheet as we mentioned last quarter, we are currently seeing reimbursements coming in quicker than expected, potentially changing a single effect on free cash flow over the years. However, with partial funding, we are forecasting that we will run out of reimbursement funds in late 2025, and we'll need to continue to spend money in support of the program through 2026, which will negatively impact 2026 free cash flow.

Now I'll turn to the guidance, our long-term targets we announced this morning, starting with some additional color on our 2024 projections. So the 2024 projections reflect our anticipated increase in Galileo spend and the impact of the pushout of 5G spend from 2023. These investments, coupled with lower shipments and the aviation industry dynamics changing aircraft online in 2023. And the delay of Gogo 5G will constrain our 2024 2024 performance. As we stated previously below, expects 2024 revenue to be in the range of $410 to $425 million. This implies 5% overall growth with equipment revenue expected to grow faster than service revenue.

Service revenue growth will be slower than the growth rate in 2023 as we project a significant number of upgrades from profit to advance driven by the FCC program. And while strategically important and will dampen aircraft online growth, we anticipate 2024 adjusted EBITDA in the range of $110 to $125 million. This guidance reflects approximate operating expenses of approximately $40 million strategic and operational initiatives, including approximately $8 million in expected Gogo 5G spend approximately $20 million of Google Galileo development spend approximately $9 million in the LTE. spend that is not reimbursable by the FCC and approximately $3 million in additional operational initiatives.

Our adjusted EBITDA guidance also includes approximately $4 million related to legal expenses tied to the Smart Sky patent litigation. We expect 2024 CapEx to be approximately $45 million, which includes approximately $25 million for the following strategic initiatives, approximately $12 million for Gogo 5G and $5 million for Galileo and approximately $8 million for the LTE. network build-out related to the SEC's reimbursement program. We also expect free cash flow of $20 million to $40 million, which includes approximately $56 million of expected SEC spend, including non-reimbursable development spend and approximately $45 million in SEC reimbursed.

Now turning to our long-term targets. We recently updated our long-term model, which reflects the launch of Gogo 5G and Galileo in the fourth quarter of 2024 and the build-out of the LTE network and associated customer conversion related to the FCC reimbursement program by 2026 our long-term targets are as follows. We expect revenue growth at a compound annual growth rate of approximately 15% to 17% from 2023 through 2028 at Galileo contributing to revenue beginning in 2025. We expect to continue to expect free cash flow in the range of $150 to $200 million in 2025.

This does not take into account the effect of the FCC program. A projected significant increase of free cash flow in 2025 is due to increased EBITDA driven by revenue, both the launch of Gogo 5G and Galileo, reduced engineering design and development OpEx and lower CapEx as investment in these strategic programs are completed and positive net working capital driven by inventory purchases and prepayments planned in 2024 or 2025 equipment shipped.

We expect annual adjusted EBITDA margin to be reaching 40% by 2028 while still projecting healthy margin, it is lower than our prior expectation of mid 40%, driven by the delay in 5G launch, an increased share of Galileo revenue with lower incremental margins compared to ATG. These updates reflect our expectations to perform strongly and drive further value creation for our customers and shareholders as we execute our strategy. So this business continues to perform well. Our outlook underscores the value creation potential for our customers and shareholders that we expect to unlock as we execute our strategy and invest in this strategic initiatives that are anticipated to extend and enhance our long-term growth.

Before we open the call up for questions, I would like to join Oak in thanking the entire global team for their hard work and dedication to our business and to providing unparalleled service to our guests. Operator, this concludes our prepared remarks. We're now ready for our first question in Kim.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Simon Flannery, Morgan Stanley.

Simon Flannery - *Morgan Stanley - Analyst*

Great. Thank you very much. Good morning and thanks for all the detail. If I could turn to Galileo. So there's been a concern about some delays on the OneWeb constellation, particularly around ground stations. You didn't really reference any delay concerns around that? I wonder if you could just help us understand what's the status of your your understanding with OneWeb, any risk of some further delays because they could continue to delay commercial launch.

And then on StarLink, you talked about small antennas. Can you just help us understand what you're assuming in terms of Sterling's ability to address your own existing fleet, is that small antenna going to be competitive with the HDX antenna? And just on the content cost about both have install and service that you're seeing from the these satellites and services versus your existing ATG.?

Oakleigh Thorne - *Gogo Inc - Chairman of the Board & CEO*

Yes. So and we believe StarLink, I mean, I'm sorry, OneWeb will have the Ground network complete to our satisfaction by the time we launch, we don't anticipate operating in the Soviet Union or China or North Korea, places like that. So people and always need because it totally global while now not really you're not going to be able to fly over places you might get shut down. But but generally, we think that they will be they'll be they'll be done in time for us. So we're pleased about that.

And your second question was about, I believe, the StarLink small antenna that has now been underway, but the pricing around StarLink versus your air to ground? Yes. So we don't they haven't announced a small antenna. So just for planning purposes and we've assumed that they well, we don't know that they will. That's that's their decision not ours. So we don't we don't know what it is.

They've got in various applications at the SEC for a wide variety of antennas of various different sizes, mostly for consumer market, but then they could repackage one of the smaller versions of those four for aviation, it's difficult to do. We're not sure that those really are going to be aviation grade in the long run and have the reliability and durability of our equipment designed from the ground up for aviation but death.

So you have to ask Darling that question about what they might launch in terms of the small data for us, it was just a planning assumption.

Okay. And Understood. And then I think your last your last question was about install costs all in.

Simon Flannery - *Morgan Stanley - Analyst*

Yes, just when you're talking about people looking at GEO versus LEO or you're going to have a dual system where people use Galileo over water and use a TG. domestically? And how do those are you dramatically cheaper than a satellite solution?

Oakleigh Thorne - *Gogo Inc - Chairman of the Board & CEO*

Yes. I mean, today it costs about $700,000 to install a GEO satellite solution and we're much cheaper today than that. I think you know, we will be less than half that cost us in terms of both equipment sales plus installation, and that's for a new installation. Of course, if you have advanced, that will be a lot cheaper because you don't have to do anything really inside the aircraft, deceptive ads, the antenna and the and then two cables power in and power out and the data in. So we're considerably cheaper will be considerably cheaper on service as well as will StarLink.

And will you just use their recently announced $10,000 a month unlimited plan. As you know, today, you pay $30, $40,000 a month to a geostationary satellite provider for an unlimited global plan. So they're either going to have to cut their pricing a lot to compete or which will be a big hit to them in terms of their cash flow or our you know or lose business, it's a pretty tough choice. I think that the superiority of LEO over geo is substantial and use both. I mean, it's just a it's an order of magnitude improvement. When you go to Leo, the latency is obviously much faster and then the other capacity is also greater. So it's a it's a much better experience.

So when you combine the fact that it's going to be much cheaper to install, it's going to be much cheaper to operate and the performance is much better. And we think that if StarLink keeps coming into the market that they will impact of the other big impact on the geo players. And our Gala Galileo product will do the same. And we think we have a few advantages. Are you getting in some parts of that heavy jet market, which are that we do have 1,300 jets on advance already for them. It's a very easy upgrade at our product. So as I said in my script, I think we see Sterling have banner and us both having a pretty significant impact on the GEO satellite players.

Simon Flannery - *Morgan Stanley - Analyst*

Great. Time. Just one last one on from smart Sky. You referenced some of the litigation expense. Any updates there on there kind of presence in the marketplace?

Oakleigh Thorne - *Gogo Inc - Chairman of the Board & CEO*

No, not really a we don't see any progress by them in terms of installing aircraft.

Simon Flannery - *Morgan Stanley - Analyst*

Thanks a lot of friction.

Oakleigh Thorne - *Gogo Inc - Chairman of the Board & CEO*

Thank you.

Operator

Ric Prentiss, Raymond James.

Ric Prentiss - *Raymond James - Analyst*

A couple of questions follow on Simon's questions there, too. So as you think about the addressable market, how are you taking a shot at what you think your market share will be as we look over, say, the next decade? And then could you share that market with? Is it space like StarLink, is it other LEO operators that you're starting to keep an eye on as well, but just help us understand kind of your base assumptions that hit those free cash flow targets and the revenues category targets about what the addressable market split up share might be?

Oakleigh Thorne - *Gogo Inc - Chairman of the Board & CEO*

Yes. So I can't give you 10 years because we didn't do that. We just did five of them will do, okay. So yes, this is all part of our annual long-term model update that creates the guidance and everything else. So yes, we build it from the bottom up. We go both North America, we buy the World and North America and rest of world, and we divide it into different segments of jets. And then we we look at everybody's value proposition and where we think they're going to be going in terms of pricing, products, et cetera.

And then I'm going to build the numbers up from there so obviously, we've got big head start over everybody in the small mid size jet market. We actually have the largest share of the heavy jet market today. A lot of people don't realize we've got 2,200 heavies. I think the next biggest player has about 1,800. So you know, we we have our we add our product rollout plans to that in terms of what we think we're going to be getting in terms of upgrades, as you know, new wins, et cetera, we look at our OEM positions and what the OEMs are going to be producing and what our attachment rate is at those OEMs.

We go through the dealer channel and we look at everything that's being sold there and estimate what our share is going to be. So we build it really it's very granular, bottom-up approach, I think showed the numbers in there in my script today. If you look at the global market, and we include turboprops in our markets.

Okay. And we have of the installed planes were in the low 70% of the global market where those sort of low 80s in the US market, which is by far the largest. And even though there's going to be a shift over the next five years, we kind of just maintain those market share levels of the overall market penetration globally today, only about 24%. I think of aircraft business aircraft have in-flight connectivity installed. And I think we see that going up almost 50%, 60% over the next five years to the mid 30s. So the reason we can kind of maintain share, while others are also winning planes, is that of course that the overall market's growing quite a bit in terms of installed aircraft and we StarLink in our for planning purposes.

And we don't know what StarLink is going to do or if they're going to succeed. But we we take sort of a worst case view of the world. And so we we plan on they're succeeding on their STC. schedule as they published it. And then we make this a bold assumption that they'll probably want to add a second antenna at some point. And so based on that day and we have about an equal penetration of the heavy jets outside the US on Android, I think we get to 20% of that market.

So I think they would get to something similar and in our projections. And we think that given those assumptions, they have a relatively strong start. And I'm not going to give out the exact numbers where we think they are five years, but it would be a very, very successful program compared to the launch of GEO satellite products, for instance, in the middle around 25 to 15, 16 they got up to, you know, 1,500 something like that, JETS in about five or six years, and I think you'd see something similar for style.

Ric Prentiss - *Raymond James - Analyst*

It's very helpful, very granular like you said, thank you. We'll come back to the '24 free cash flow guidance. Can you walk us through how we get from EBITDA taking into account? No cash taxes you talked about cash as you sort of help us walk through the sort of the EBITDA of about $110 to $125 million. How do we end up at (inaudible) on free cash flow? Obviously, there's a lot FCC. stuff going on there. There's working cap, but just kind of help us bridge that EBITDA all the way down to free cash flow in '24?

Jessi Betjemann - *Gogo Inc - Executive VP & CFO*

Yes. So yes, so exactly the our adjusted EBITDA range is $110 to $125 and our CapEx is projected to be at [45]. And then we do have and negative net working capital. So I'm just kind of the main part of the difference. And there is a lot of buildup of inventory that we're doing in 2024 in anticipation of '24 and '25 shipments. And then, of course, we also have the net interest that we have as well included in there, too.

Ric Prentiss - *Raymond James - Analyst*

Okay. So it really is the working capital and the inventory build out there probably is the bigger swings or any of the net working capital?

Jessi Betjemann - *Gogo Inc - Executive VP & CFO*

Net working capital and interest.

Ric Prentiss - *Raymond James - Analyst*

Yes. Okay. And then just Eric, you mentioned that And under the current funding for as we call it, rip and replace their spending will continue, but reimbursement would be played out in the same increase that you mentioned that there could be a 26 free cash flow hit. Can you put a kind of a fence post around that, let us know kind of what the current program funding and your current thoughts would be as far as the hit in 26 free cash flow from the program.

Jessi Betjemann - *Gogo Inc - Executive VP & CFO*

And so as Oak mentioned, we we don't anticipate needing the entire $334 million on and are the reimbursement will end around the towards late 2025. So there'll be some impact in 2025, but a greater impact in 2026. And it's probably going to be somewhere in the range of $30 to $40 million in 2026.

Ric Prentiss - *Raymond James - Analyst*

And the 25 long-term guidance of [150] to [200] excludes any effect from FCC would that be a negative effect in 25 number as well from the FCC program? I know it's pretty complicated and a lot of moving pieces in DC, but just wondering is that a negative hit that would hit [25] from that time versus that one [150] to [200]?

Jessi Betjemann - *Gogo Inc - Executive VP & CFO*

So we I mean the reason why we've been saying it excludes our guidance excludes that is to be able to do the comparison to when we originally provided that target. So that's why we want to make an apples-to-apples comparison. There is going to be a small impact in 2025. It's not as big as 2026, but yes.

Oakleigh Thorne - *Gogo Inc - Chairman of the Board & CEO*

Okay. So we believe we still end up in the range? Yes, we do believe that the range even with the FCC in 2025,

Jessi Betjemann - *Gogo Inc - Executive VP & CFO*

Obviously, depending upon timing. But as we've seen and what we're seeing now and the timing of the reimbursements we expect that we will be in the range both with and without it.

Ric Prentiss - *Raymond James - Analyst*

Okay. That's helpful. And then last one for me. I think you mentioned you're getting your first fuse antenna company and start trying the summer. What's the first Did I hear that correctly? And second, what is kind of thoughts then available to ramp that up falling behind? Simon's question about waiting for OneWeb, obviously to hit the ground already there before launch, but we don't use and Western kind of a ramp as far as getting antennas from this.

Oakleigh Thorne - *Gogo Inc - Chairman of the Board & CEO*

And now we're right on schedule to launch this product in mid mid fourth quarter. So and that's the update in this shoes has performed exceptionally well so far in this intended arrived, right on time as as called for in the project plan and is testing well. So we're very pleased with the progress there and remain on track for that.

Ric Prentiss - *Raymond James - Analyst*

Thanks, everyone.

Operator

Louie DiPalma, William Blair.

Louie DiPalma - *William Blair - Analyst*

And Louis, I hope that Good morning, Justin And well, I have a general question on hardware equipment cost. I'm one of the main and the value propositions of Avon is inexpensive and is here upgrade to 5G and the Galileo networks. And I was wondering in general, what would you estimate is the difference in equipment costs for a customer to to upgrade to hypothetically five G. versus if they order rip and replace and tried to go to a competitor's like LEO satellite solution.

Oakleigh Thorne - *Gogo Inc - Chairman of the Board & CEO*

And it all depends where you start, right? So if you've got no L5 installed than the DDA. and tenants and yes, it's going to be yes, it's going to probably be about that. That's going to be probably two thirds of the cost for equipment and installation that going to a competitor's satellite product with the.

Louie DiPalma - *William Blair - Analyst*

Okay, that makes sense. Thanks for that. And secondly, on Oak, you referenced the the FPGA 5G testing. When should we know if and when the new 5G chip is ready for production?

Oakleigh Thorne - *Gogo Inc - Chairman of the Board & CEO*

Well, right now it's actually a bit to it. These are very technical term. So production in chip world means you're in mass production and they're not there yet, obviously, but they are in production and that's in our sense there. And then the pattern mass generation phase right now, and that's what happens right before you start your allocation of the feel that the chip silicon layer by layer. So that's that's where we are.

Louie DiPalma - *William Blair - Analyst*

Okay. When when should we know if the new chip works in terms of the 5G components and the non G Suite, the non 5G components in order to clear the hurdles there that weren't clear last year.

Oakleigh Thorne - *Gogo Inc - Chairman of the Board & CEO*

So the FPGA will let us test whether the software side of the chip works because that's what it is. It's sort of a a big, a very big box. I would spend some time with it yesterday, but it emulates the physical structure of the FPGA. And you can run the I mean, a piece of the 5G chip and you can run the actual 5G chip software on it so you get all the software testing out of the way in the FPGA stage, which is novel and is giving us the ability to really accelerate the program.

So I would say we'll know whether that is all going well in April, May the April-May timeframe, there's a lot of tests. It's very complicated. We've got 14 layers of the chip that have are they are unique to us and run our software and it's all about. So yes, accommodating things like how fast radio waves move at the speed of like, hey, a Doppler effect and signal strength. And it's massively complicated, but we got lab here in the US in Chicago that emulates all that. And that's what we're doing now doing that testing. So you'll know, and we think April May, if that software is all doing well. And then it probably be we don't have the fabrication masking just started.

And, you know, we'll probably discuss several weeks before we understand exactly how long it will take to lay each layer of silicon. And then once we know that pace, we'll know when the chip will come out of the fab and then and then you have to go to bring up. We actually test it to make sure it's all working. So we'll probably update people on that on the second quarter call or if we have any milestones between now and then that we can announce publicly.

Louie DiPalma - *William Blair - Analyst*

Great. Thanks and for on for Jesse. And as it relates to the the 2025 free cash flow guidance, you you mentioned how it does not include the SEC reimbursement program. And you also discussed, I think how for this year you have in $18 million receivables such that like the cash inflows seem to lag on your your cash outflows. And so is on the STC. program expected to be negative for free cash flow in 2025? And is there any way to frame?

Jessi Betjemann - *Gogo Inc - Executive VP & CFO*

As I was answering Rick, before that we there is going to be a small negative impact in 2025 for two reasons. One is the continue to get a little bit of that lag, but then the funds do went out in late 2025. But as mentioned in terms of the guidance we provided, we feel that even with that, of course, if the timing of things change with the SEC reimbursement cycle, then that potentially could change things. But regardless, we do feel that we will still be within that range with FCC petition, but it is slightly negative in 2025.

Louie DiPalma - *William Blair - Analyst*

Great. And my final one on you referenced on the potential for for debt paydown on. Is there any framing in terms of how much like debt paydown would you'll be looking for like potentially to keep like the cash interest expense at that same $33 million annual run rate? And is that what you're looking to do?

Jessi Betjemann - *Gogo Inc - Executive VP & CFO*

No. I mean, I think that when we look at this, we want to make sure that we kind of balance the use of our cash between debt paydown and on potential additional returning returning capital to shareholders. So we'll look at book and kind of assess we alternate to see where interest rates going to be going. And but with all of this, we do need to consider the hedge stepping down. So we haven't necessarily identified an exact target of $1 billion of share but done, but we'll keep all these different factors in mind.

Oakleigh Thorne - *Gogo Inc - Chairman of the Board & CEO*

And at the other major factors, share price, the share price down where it is now returning capital to shareholders becomes more attractive relative to paying down debt. And then if the share price were higher now, so Board of know we're in active conversations with our board on our plan. And as you know, we spent $10 million on share buybacks in Q4 and Q1 so far, and we can't trade today set up QuickBooks. It was the conversation with the board tonight about what we're going to do.

Louie DiPalma - *William Blair - Analyst*

Excellent. I think you're implying something. Okay, thanks. Thanks a lot, everyone.

Oakleigh Thorne - *Gogo Inc - Chairman of the Board & CEO*

Thank you.

[pesky], Camco investors.

Unidentified Participant

Good morning. Thank you for taking the questions. My first question is on Galileo. As you launch that product, what markets or market segments would you prioritize in your push to sell global broadband over the next two or three years?

Oakleigh Thorne - *Gogo Inc - Chairman of the Board & CEO*

And well, I think you're asking about markets we would prioritize on our geography of geography. Yes, as well. And look, yes, I start with the most attractive markets. So do that does it from the Europe Middle East. India will be early in the list and that, you know, South America is very attractive markets as well. So we will be paying attention down there and then probably Asia after that, it's rough order of events.

Unidentified Participant

Yes. And my second question, given where the company is today and significant organic growth opportunity, how do you guys think about M&A? Maybe if you could remind us your M&A philosophy and what makes sense for Gogo over medium term that could accelerate realization of your current strategy or just and hence overall shareholder value?

Oakleigh Thorne - *Gogo Inc - Chairman of the Board & CEO*

Yes, I think our view is that our organic, what is the right place for us to invest capital to grow the company because we see really nice returns on that. And we also feel that that is less risky than M&A. So we don't have an active M&A program right now.

Unidentified Participant

Got it. Thank you.

Oakleigh Thorne - *Gogo Inc - Chairman of the Board & CEO*

Thank you.

Operator

Thank you, and I will now turn the call back over to Will.

Will Davis - *Gogo Inc - VP of IR*

Hello. This concludes our fourth quarter earnings call. Thank you for your participation. You may now disconnect.

Operator

Ladies and gentlemen, that does conclude our conference for today. Thank you for your participation. You may now disconnect.
