

Iridium Communications
Q2 Earnings Conference Call
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CORPORATE PARTICIPANTS

Kenneth Levy - *Vice President, Investor Relations*

Matthew Desch - *Chief Executive Officer*

Thomas Fitzpatrick - *Chief Financial Officer*

PRESENTATION

Operator

Hello and welcome to the Iridium Communications 2019 Second Quarter Earnings Conference Call. You will be in listen-only during the presentation, but there will be an opportunity afterwards to ask questions. Instructions will follow at that time. If you should you need assistance during the call, you may signal to an operator by pressing star, then zero on your touchtone phone. This conference is being recorded.

I now would like to turn over the call to Ken Levy. Please go ahead.

Ken Levy

Thanks, Ben. Good morning, and welcome to Iridium's second quarter 2019 Earnings Call. Joining me on today's call are our CEO, Matt Desch and our CFO, Tom Fitzpatrick.

Today's call will begin with a discussion of our Q2 results followed by Q&A. I trust you've had an opportunity to review this morning's earnings release which is available on the Investor Relations section of Iridium's website.

Before I turn things over to Matt, I'd like to caution all participants that our call may contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements are statements that are not historical fact and include statements about our future expectations, plans, and prospects. Such forward-looking statements are based upon our current beliefs and expectations and are subject to risks, which could cause actual results to differ from the forward-looking statements. Such risks are more fully discussed in our filings with the Securities and Exchange Commission. Our remarks today should be considered in light of such risks.

Any forward-looking statements represent our views only as of today and, while we may elect to update our forward-looking statements at some point in the future, we specifically disclaim any obligation to do so, even if our views or expectations change.

During the call, we'll also be referring to certain non-GAAP financial measures. These non-GAAP financial measures are not prepared in accordance with Generally Accepted Accounting Principles. Please refer to today's release and the Investor Relation section of our website for a reconciliation of these non-GAAP financial measures to the most directly comparable GAAP measures.

With that, let me turn things over to Matt.

Matt Desch

Thanks, Ken. Good morning, everyone. As you saw in our press release this morning, we continued to enjoy good momentum through the first half of the year, which sets us up nicely to achieve our full year guidance for service revenue and operational EBITDA.

As I highlighted during our Investor Day earlier this year, Iridium is well-positioned for continued growth, market share gains, and free cash flow generation. With the Iridium NEXT program now behind us, we're in a unique phase in our corporate life cycle. Capital spending has fallen off dramatically and our upgraded constellation is now generating new revenue streams.

Now while it was a lot of fun to create and launch, I'm glad to say that we won't have to embark on another satellite replacement campaign for at least a decade. This position is a luxury that most satellite companies don't enjoy, and with it, our focus can shift to a new set of priorities.

First, we need to keep the growth going. We'll do this by doubling down on exploiting our wholesale model and unique network to sign-up new partners, drive new subscriber growth, and capture market opportunities.

Second, we will leverage our upgraded constellation to support new applications that were previously not possible with our first-generation network. Our network is ideal for truly mobile applications, small form factor devices often running on battery power, and providing mission-critical functions. While some describe us as a niche service, we embrace that role as we've developed a wide competitive moat that cannot easily be duplicated and it provides us significant room to grow.

Finally, we are committed to taking advantage of our financial transformation. After ten years of investing in Iridium NEXT, we are now positioned to harvest returns. Subscriber growth is robust and cash flows are expected to be considerable in the coming years, which we expect will create significant value for our shareholders. I'll let Tom speak further on the topic, but know that we both feel that our financial transformation creates a lot of opportunities for the company.

As I step back and think about the market in which we play, I expect the most immediate opportunities for revenue and subscriber expansion will come from new broadband services we've branded as Iridium Certus.

As I've said before, Certus is a technology platform that scales very efficiently both up in speed and down in antenna size and cost, which means that it has broad utility for a wide variety of exciting new applications.

In the near-term, Iridium Certus broadband will fuel our revenue growth. However, I'm really excited about the significant opportunity for mid-band and narrowband applications, which we will capture by extending Iridium Certus functionality down to speeds below 100 kilobits per second utilizing lower power and smaller antennas.

We think this will be a real sweet spot for us and we see a long runway of opportunity, including new revenue from higher ARPU applications than we currently see from IoT or voice and data services today.

We have a lot of commercial partners developing new products for Iridium Certus, both in broadband as well as in the lower band areas. In fact, in June we just enabled our first beta partners with operational Iridium 9770 transceivers. This device is small and highly mobile with a low-cost antenna, but with 88 kilobits per second of data speed – which is more than 35 times faster than our current modem – it's fast enough to send pictures and other rich data sources cost effectively, and also supports two dedicated voice lines as well. Our partners have begun developing products based on the beta version of the transceiver in advance of its commercial launch next year.

On a competitive note, we are singularly focused on the L-band market, where we enjoy strong brand recognition and an improving competitive position. L-band spectrum has unique and very attractive physical properties that make it complementary to Ku- and Ka-bands.

As such we are watching with interest all the plans for the new Ku and Ka-band LEO mega constellations. Given that they all have very different business plans and competitive focus than us,

we're cheering them on and already see opportunities for collaboration when they eventually come to market.

I know there's some confusion about the competitive threat posed by these players. Some investors and media don't seem to understand that LEO is just a neighborhood in space and a type of orbit rather than a business model on which we compete. The new mega constellations use Ku- and Ka-band spectrum and are seeking to compete with existing Ku- and Ka-band operators on price and speeds.

We do not view them as competitors and they are more likely to be partners in the same way that our L-band terminal is paired today with VSAT in maritime. The overlap between us and these potential new networks is small and a bit of due diligence on their business plans should make this apparent to investors and journalists covering these entities.

Closer to home, in our segment of the satellite industry that does utilize L-band spectrum, we've actually become sustainably stronger in the past few years relative to our traditional competitors. Aging constellations, challenging business models, and capital needs are all taking their toll on most of them. Some have been acquired, while others find themselves financially challenged or have channeled their limited capital resources to try to move beyond L-band services.

Today, Iridium is the only company that is exclusively focused on L-band mobile satellite services with a long-term financed plan for success in this market space. As a result, we see growing interest from new partners in new and existing market spaces who want to utilize our network and services for their customers.

Iridium Certus 350, our initial broadband offering, launched this year in January. Partners are really excited about the product and have been actively promoting it to their customers.

To date, more than 2,000 Certus terminals have shipped to our partners, even as some are still integrating their proprietary service offerings and training their sales teams. We're really pleased with this progress.

Our partners have also been excited to see the first GMDSS terminal introduced from Lars Thrane, which was launched last month at a major maritime industry trade show. They're also pleased that Iridium's GMDSS offering coming next year isn't just a clone of Inmarsat's legacy service, but will be more feature-rich with integrated voice communications and better coverage.

Another big introduction in the second quarter was the first dedicated PTT handset unveiled by the Japanese manufacturer Icom. It's a fantastic unit and our partners are telling us it really improves our already unique global PTT service for business continuity and security capabilities, especially where interoperability with existing land/mobile radio systems is required. We believe that this device will allow Iridium to finally fully realize our long-held vision of delivering the best satellite PTT offering for global, commercial, and military users.

I know that many of you are interested in the status of our EMSS contract with the U.S. government, especially in light of our signing a fourth one-month extension last week. Don't read too much into how long this process is taking. Our government contract is shifting from DISA, where it's been for many years, over to the Air Force, and that seems to have slowed the process down.

As you can see from the filings, the government has agreed to pay more each month with each extension and we hope, as a result, to have a new contract wrapped up soon. From my perspective, discussions continue to be productive and while we have little ability to expedite this process, we

continue to secure step-ups in revenue to compensate us for the delay.

The federal government is an important and valued customer. We continue to expect an EMSS contract renewal to be long-term and at a rate greater than the \$88 million in annual revenue in the last full year of the contract. This contract only covers voice and legacy narrowband services, meaning that Iridium Certus broadband and mid-band capabilities and other new services will be incremental and procured by the government outside of the EMSS contract. And those services are really growing right now with the U.S. government. They've added 12,000 subscribers in the first half, which is 70% greater than last year's first half and that's a really strong pace. We're on track to have the biggest year of subscriber growth with the USG in our history.

You'll also notice this quarter a rise in engineering and support revenues. We're seeing increased activity with government customers, including our new Gateway maintenance contracts signed with the DoD earlier this year. Engineering and support revenues remain episodic, but the heightened activity is a clear indication that despite the time it's taken to close a new EMSS contract, business with the DoD is quite robust and ongoing activities position Iridium services to be utilized even more in the next decade and beyond.

Finally, on Aireon, the company has made great strides since launching its service in April and is quickly becoming the global standard for aircraft surveillance in remote and oceanic areas. Aireon's technology is allowing air traffic control over the oceans and remote areas to advance from the traditional procedural approach where aircraft report their position about every 14 minutes, to one which is real-time, providing position updates automatically to controllers every few seconds. This is why Aireon is already a game changer over the busy North Atlantic corridor, where it's helping NAV CANADA and UK NATS better control over 1,200 flights per day. They seem quite pleased with the capability and are reporting enhancements to safety through real-time monitoring of adherence to cleared flight paths, as well as improved efficiency through tighter spacing and better altitude assignments that also allow aircraft to travel at their optimum speeds.

Last month, the European Aviation Safety Agency, or EASA, certified Aireon to provide space-based ADS-B surveillance. This was a major milestone for Aireon and was the first time a certification has ever been issued by this regulator for a commercial surveillance provider. This certification and the positive impact that Aireon service has had on service over the North Atlantic is helping them accelerate sales and close new contracts.

On that front, Aireon should be announcing some new customers very soon, and will continue to roll out live services to their existing customers beyond the North Atlantic over the rest of this year now that they're certified and operational. We anticipate that the FAA will begin using Aireon services starting in the Caribbean later this year and continue with its phased rollout thereafter.

We're very proud of the progress Aireon is making and continue to believe that maintaining our equity stake in this company will yield significant cash flow for us in the coming years. Though only six months removed from the final launch of Iridium NEXT satellites, I can comfortably say that Iridium's financial transformation is progressing as expected, which bodes well for continued strong growth in the years ahead. This was another strong quarter and sets us up well as we enter the second half of the year.

With that, I'll turn it over to Tom. Tom?

Tom Fitzpatrick

Thanks, Matt, and good morning everyone. I'll get started by summarizing our key financial metrics for

the quarter, and provide some color on the trends we're seeing in our business lines, then I'll recap the 2019 guidance we affirmed this morning, and close with a review of our capital structure and liquidity position.

Iridium generated total revenue of \$143.1 million in the second quarter, which was a 6% increase to last year's comparable quarter. This improvement was attributable to growth in total service revenue, as well as an increase in engineering and support revenue during the quarter. Operational EBITDA was \$85.1 million, which was up 8% from the prior year's quarter.

On the commercial side of our business, we reported service revenue of \$86.3 million in the second quarter, which was 5% higher than a year ago. This increase reflected growth in both IoT revenues and voice and data services, partially offset by decline in hosted payload revenue. The decline in hosted payload revenue was entirely due to a one-time \$4.2 million revenue recognition catch-up in the prior year quarter.

During the quarter, voice and data revenue rose 3%. This increase was driven by an increase in ARPU to \$46 that primarily reflected price changes in our handset programs implemented in April of 2018. Commercial IoT revenue grew 15% during the quarter to \$23.9 million on a 25% increase in billable subscribers.

Demand for consumer-oriented devices like Garmin's inReach continues to provide us with momentum. These personal messaging services are particularly attractive to Iridium in terms of revenue generation relative to network resources used. This new class of devices has driven more than 240,000 new subscribers to our network, and these consumer-oriented services remain a welcome and growing source of revenue for Iridium.

During the second quarter, we added 52,000 net new commercial subscribers with the increase weighted toward IoT. Commercial IoT data subscribers now represent 66% of billable commercial subscribers, up from 61% in the year-ago period.

Turning to our government service business, we reported revenue of \$24.5 million in the second quarter, which reflected short-term extensions to the EMSS contract. Since April, DISA has extended the EMSS contract four times at progressively higher rates to allow additional time to complete negotiations on the EMSS contract renewal. As Matt noted, we continue to expect that a new EMSS contract will be long-term in nature and at a rate greater than the \$88 million in annual revenue in the last full year of our current contract.

In the second quarter government subscribers grew 17% year-over-year and total U.S. government customers reached a record 125,000. Revenue from equipment sales was \$23.4 million in the second quarter and continues to reflect our outlook for moderation from a record pace last year.

Equipment margin was 43% in the latest quarter. Engineering and support revenue was \$8.9 million in the second quarter compared to \$5.1 million in the prior year's quarter and was driven by an increase in activity with the U.S. government.

The first half of the year has come in much as we would have expected, which gives us comfort in reaffirming our full year guidance. We continue to forecast total service revenue of approximately \$440 million this year and operational EBITDA in a range between \$325 [million] and \$335 million.

In the second half of the year we anticipate a step-up in data service revenue corresponding with a customer contract milestone that Aireon is on track to reach. We expect Aireon data revenues will rise

from about \$1.1 million a month currently to approximately \$1.9 million a month, when this milestone is satisfied.

Depreciation and amortization expense in the most recent quarter reflects the completion of the Iridium NEXT project and the operation of our upgraded constellation. Quarterly depreciation and amortization should continue close to this level for the foreseeable future.

Iridium had a cash and cash equivalents balance of \$175.8 million as of June 30, 2019. During the quarter we incurred approximately \$49 million in Iridium NEXT-related capital expenditures. Moving forward, we anticipate maintenance CapEx cost to average approximately \$35 million a year for the next 10 years.

I know many of you have been closely tracking our timeline for refinancing the BPI facility and are interested in our long-term capital plans. As Matt noted, our business is positioned to generate strong cash flow moving forward and we plan to deploy excess cash as part of our capital plan to refinance existing corporate debt, reduce leverage, and execute on shareholder friendly activities or compelling strategic opportunities.

We're taking a methodical approach in executing this plan. So, let me share some of the tenants that will govern our actions. First, assuming attractive dynamics continue in the debt markets, we anticipate moving forward with the refinancing of our credit facility in the months ahead. We also anticipate being able to retire our high-yield notes in the first half of 2020, if market conditions hold.

Second, we want to de-lever our balance sheet and are targeting net leverage between 2.5 [times] and 3.5 times OEBITDA. We expect to exit 2019 with net leverage of approximately 4.5 times OEBITDA. This compares to leverage of 5.1 times as of June 30, which was down half a turn from our peak of 5.6 times in 2018.

Finally, we continue to encourage investors to look at Iridium's levered free cash flow to evaluate the strength of our business and assess the relative value of our common shares, especially with the completion of the Iridium NEXT program.

When considering measures like levered free cash flow yield and conversion, we believe that Iridium stacks up quite well against the tower sector, which enjoys trading multiples in excess of 20 times EBITDA. This information should be helpful as you update your models and consider our timeline for executing on our financial priorities.

Most of you are aware that on May 15, Iridium converted all outstanding shares of our Series B cumulative perpetual convertible preferred stock into common. This action added approximately 16.6 million shares to Iridium's basic share count and is reflected in our 10-Q issued this morning. With the retirement of this security, no further dividend payments will be required.

In closing, Iridium's business continued to grow nicely in the first half of the year and we are positioned well to generate meaningful free cash flow in the balance of the year. We look forward to keeping you abreast of our activities and delivering on the financial transformation that the completion of the Iridium NEXT mission kicked off.

With that, I'll turn things back to the operator for the Q&A.

QUESTIONS AND ANSWERS

Operator

Thank you very much. At this time if you would like to ask a question you may do so by pressing star, then one on your touchtone phone. Press star, then two to remove your name from the list. Again, pressing star then one allows you to ask a question. Star then two removes your name from the list. We will pause momentarily to gather our roster.

Our first question comes from Ric Prentiss with Raymond James. Please go ahead.

Ric Prentiss

Thanks. Good morning, guys.

Matt Desch

Hi, Ric.

Ric Prentiss

Couple of questions. Obviously the government contract with the fourth extension gets a lot of focus. When you say long-term contract, are we thinking three, five, ten years because we're almost a year extension from when it was originally expiring back in October and had the 6-month extension. So what are you thinking as far as what does long-term kind of mean?

Tom Fitzpatrick

Well the long-term will commence upon the execution of the contract. So, the time that is past is past. So, it will be a contract that commences when it's signed.

Matt Desch

Yes, and our expectation is that, it will at least basically be as long as the last contract, which was five years.

Ric Prentiss

Okay. Yes, there was a big step-up here on the fourth extension, if I remember right it was kind of 8.3, 8.45, 8.58 now up to 8.8. How should we think about how that's reflected into your guidance and what we should be looking at as far as expectation of what the second half of the year might mean as we look at modeling of the government contract?

Tom Fitzpatrick

Well I would say, as you can see the rate of increase increased this month and that just reflects the fact that it's taken longer than we would like. In any type of a short-term month-to-month arrangement there's a premium exacted and that's what you see reflected here.

You should consider our guidance that says that the long-term contract will be higher than the \$88 million. So the month-to-month and the long-term contract are not related and you shouldn't relate them. You should just look at our guidance on what the long-term expectation is, that's what we would suggest.

Ric Prentiss

Okay. And one of the other interesting things in the quarter to us was SG&A dropped from year-over-year and quarter-over-quarter from what had been about \$24 million down to \$21 million. Is there any one-timers there and how should think about what the run rate of SG&A is particularly as you start ramping up the Certus sales?

Tom Fitzpatrick

Yes. So, our foreign consultants that work for us around the world are on stock appreciation right plans. And those plans, when the stock goes up, it causes SG&A to go up. The stock came in this quarter and so you saw that take-back of that accrual in the quarter. That accounted for a lot of the sequential decrease from kind of the 24 area back to 21 or so in the current quarter.

Ric Prentiss

Because obviously as you ramp sales, we're going to see some more upward movement on SG&A, I guess as the revenues come in.

Matt Desch

I don't know. Well, we have a fairly fixed cost structure. So I don't really know that I would make that as an expectation. As Tom said, as far as mark-to-market happens to be sort of a volatile thing that goes quarter-to-quarter based upon the stock price that's obviously difficult for you to model overall. But overall, our number of resources is growing quite slowly in terms of what we expect. So obviously, that's why we expect operating leverage to continue to grow over time as revenues increase.

Tom Fitzpatrick

Yes, I mean, I think SG&A was 97.8 on the full year of 2018 and we don't see it higher than that. It will be around that or maybe—we don't see it up materially from that in '19.

Ric Prentiss

And last one from me. Obviously interest rates have stayed pretty attractive, the environment looks good out there. What kind of rates are you seeing at the different types of that you might look at? Is there any kind of illustrative examples of how you see the rate environment out there right now or what bankers are telling you that the market might be interested in?

Tom Fitzpatrick

I would just say that they're attractive, Ric, and we are ready to move as soon as we get this DoD contract signed up.

Ric Prentiss

Okay, great. Thanks guys.

Operator

Our next question is from Greg Burns of Sidoti & Company. Please go ahead.

Greg Burns

Hi. Just a question on your outlook for the new PTT product. I know you've talked about PTT a lot in the past and maybe you haven't had as much success as you thought you would have maybe historically, getting market adoption for that type of service on your network. But what's different this time around with this new product and why do you think that you're going to have a little more success this time?

Matt Desch

I wouldn't counter that we had poor success or anything else like that. Certainly in terms of the total numbers, the number of PTT units is relatively small compared to our satellite phone-type services. But I would say that, when we introduced the service a couple of years ago, while it was quite unique that you could have a handheld device work in a talk-group environment with a number of others around the world, the one thing, kind of the weak spot in our offering, was the fact that we had to sort of repurpose our 9575 Extreme phone, which didn't have a very loud speaker in it. I mean, we're really kind of using it in a way that it wasn't ever expected to operate.

And while some other devices have been created, this new Icom device is really outstanding. It was built as a Push-to-Talk radio, it's sort of military grade. It will really work in consumer environments and interwork with existing land/mobile radio systems. So, our partners who were selling PTT were saying that was the one thing we are missing, because the service operated really well, but their customers weren't terribly impressed with the handset devices.

So, we're expecting this new device and the interoperability will help increase sales. It will still won't be massive numbers, but these are good ARPU customers, they're long-term in scope. And they'll help continue to support sort of a slow growth kind of environment in that voice and data environment, which is what we've been driving to underpin our IoT, broadband, and other businesses.

Greg Burns

Okay. And on the IoT side of the businesses, is Garmin your only consumer-based product or customer? And do you have a pipeline of opportunity in that personal communication space beyond Garmin, and within Garmin are you seeing them looking to expand your service into more products as we move throughout the year? Thanks.

Matt Desch

Garmin is our largest consumer product, but they're not the only one. There are other consumer companies, but none of them are nearly the scale and scope that Garmin is. There are a number of new very attractive-looking consumer-like products coming out and actually have been out there of different form factors and different types. Some of them are operating in the consumer space; some crossover in the enterprise and government spaces. But it demonstrates just really how good Iridium is in the personal communications environment, and I think that will continue to expand in the future as we add more devices, which add more speed, which add higher other service like faster messaging platforms and everything, which are coming.

So as far as Garmin, I think you really should talk to them. I can tell you they're expanding their view. They've been quite successful in not just expanding into new markets, but into new product types. But I really think that they should more speak to their future than we should, but certainly it's quite interesting market.

Greg Burns

Okay. Thank you.

Operator

As a reminder, you can press star, then one on your handsets to enter the queue.

Our next question is from Hamed Khorstan with BWS Financial. Please go ahead.

Hamed Khorstan

Hi. Good morning. Two-pronged question here. First, could you just talk about the subscriber increase this quarter versus last year? If those are just old customers coming back online because the ships are being put in use and if they're upgrading any services, or just paying those actual increase in subs, just trying to figure out the quality here. And also with the equipment that's being sold in the quarter, is that NEXT-related equipment? Or is that the old network equipment? Could you just provide a little bit more insight into this?

Matt Desch

Well, in terms of subscribers, it's very difficult to exactly tell what a net new subscriber is. Subscribers

and the growth in subscribers this quarter are related to lots of new subscribers, and then some subscribers stop, and then the net is really what you see – and obviously you see it's quite strong. Most of those subscribers are in the IoT space, I mean, the majority of them are. And I would describe those probably as mostly new subscribers, a lot of them, new personal communication-type subscribers like we were talking about with Garmin, but many across our over 200 other partners are also growing in all kinds of applications from buoys to oil and gas pipeline monitoring, to heavy equipment sales with companies like Caterpillar and many others. It's really a broad-base and they're typically net new subscribers in those cases. So, I would call them high quality from that perspective.

And in terms of equipment sales, that's a lumpy-type thing. We never know exactly how much as we said it's not quite as much as last year, which was a record year. It's broad-based, lots of IoT devices, handsets, it's PTT devices. It's not old equipment with the old network, because all equipment works with both the old and the new network, so we don't really differ. A handset really operates today on the new network as well or better than it did on the old network.

There is new NEXT equipment that is related to this new Iridium Certus. In our case, we sell the core device called the BCX. It's sent to companies like Cobham and Thales who turn it into terminals and that's what's made those 2,000 terminals we talked about that have already gone out to partners to sell to their customers. So, that's in the mix there as well and those are being sold in the quarter, though they probably are really being dominated by IoT devices and handsets and other type of equipment that goes out.

Hamed Khorstan

Okay. So, what I'm trying to also understand is, given that you're seeing the strong increase in revenue and subscribers and so forth, what's leading you to be a little bit apprehensive as far as the service guidance goes, now that we are halfway through the year?

Tom Fitzpatrick

We're not apprehensive. We affirmed it, right? So, we affirmed the \$440 [million] that, as you know Hamed, that has been our long-term guide, it's a couple of years old that guide. We affirmed it here. We feel quite good about. We feel like it's a number we won't miss, and we'll see how the year progresses in terms of the third and fourth quarter, whether it'd be appropriate to take that guide up, but I would not characterize this as apprehensive.

Matt Desch

Yes.

Hamed Khorstan

Well, I used that word because you're almost suggesting Q3 and Q4 will be flat at \$111 million to hit that number and you're growing subscribers and you're in a growth mode with IoT increasing. It still seems like you're reluctant to increase guidance. I'm trying to understand what loss you're thinking you might lose?

Matt Desch

Yes. I don't know what your model looks like, Hamed. But summer is always a strong time of the year. We have a little bit of a seasonal business that is the strongest in the second and third quarters and a little bit less in the fourth and first quarter. So, I mean, based upon that, obviously we're looking ahead.

It is really a good year, but as Tom said, we'll see how the third and the fourth quarter play out and make sure that we continue this kind of growth. We don't like missing guidance at all. And so, we want to make sure that we stay within what we said before.

Hamed Khorstan

Okay. Thank you.

Operator

Our next question is from Louie DiPalma with William Blair. Go ahead.

Louie DiPalma

Good morning, Matt, Tom and Ken.

Matt Desch

Hi, Louie.

Tom Fitzpatrick

Hi, Louie.

Louie DiPalma

Tom, annual cash interest expense at the Analyst Day was guided to \$120 million for 2019. Based on your current discussions with investment banks in today's low interest rate environment, can you provide a ballpark range for Iridium's long-term annual cash interest expense, and should we assume something in the range of 350 to 450 basis points above LIBOR for a new term loan, or am I way off there?

Tom Fitzpatrick

I wouldn't say way off, but let's see how things progress here, Louie. What we have said is we expect the interest rate on the new instrument to go up. Our current rate is around 5%. And so, it will go up slightly. But then, as you think about the long-term interest rates, where we settle out, we'll take the high yield out. That's an expensive coupon--that's 10.25%. And so the blend probably shouldn't be far off of where we are currently is where we're thinking on a steady-state pro forma for the removal of the high yield.

Louie DiPalma

Okay. Sounds good. And for Matt, is there any way to quantify the improved battery efficiency on the new 9770 devices that are in beta right now?

Matt Desch

No. I don't think so. I mean, relative to what. It's relative to other devices that would be produced that could still perform that kind of power using that small of an antenna and deliver those kind of data rates. So, it's a little hard to compare it to something. The device has been made to be very battery efficient, very power efficient. It has sort of a new sleep mode that our partners can kind of take advantage of, which will help applications using battery, a lot of it will be used in line powered applications as well, so that doesn't really help in that case.

I will say the 9770 is only the first of a number of devices that we plan to make that will offer data ranges, various power profiles, various size and various antenna configurations. It's why I said that I really think that this is sort of the lead device in sort of a whole new segment for us that bodes well for our voice and data and IoT services, because it really provides a lot more capability in terms of just efficiency on our network, in terms of data rates for customers, in terms of the kinds of applications you can envision putting across our network.

Louie DiPalma

Okay. And a final one. Europe's GNSS service experienced an outage last week. Can you go over the value proposition of Satelles and provide any update on when Satelles could launch commercial services, or that you can monetize that investment?

Matt Desch

Yes. I think you said Satelles, yes?

Louie DiPalma

Yes.

Matt Desch

Satelles is our partner for this service called Satellite Time and Location. That's the service we've had the last couple of years and it's been actually deployed number of places around the world already with a number of customers, both commercial and civil and government.

You're referring to the Galileo system, which was launched a few years ago and I think experienced almost a six-day or seven-day outage, I don't know exactly how long it was. I know it's been recovered. You could imagine if there was a six- or seven-day outage of the GPS system in the U.S. we'd all be running into things in our cars. We'd have no idea where to go. Actually, all the digital systems that we come to depend upon, like our mobile phones would cease operating, because they're all digital-based and use time reference signals, the New York Stock Exchange would have challenges and NASDAQ and others would all have significant problems. So, it is viewed as a big concern.

GNSS is the sort of the general terms for those kind of systems, their viability, their ability to be spoofed or jammed is a big concern. Satellite Time and Location is a technology that has been proven to really offer a backup to those systems. It would offer kind of the reference system to check the viability and quality of the signals that go on. And as such, it has a lot of promise, we think. We're really quite excited about it. It's one of the reasons why we made an investment into Satelles. So, we're a small owner of that right now.

It's not really competitive to any of our other partners, in fact it's synergistic. And I would expect to see things like the Galileo outage of last week as almost just as an advertisement for a why a service like that is so important around the world. So, we're quite excited about the potential for Satellite Time and Location. It's providing revenues this year, but we see growth in that and we see growth and the potential for Satelles as a partner and an investment.

Louie DiPalma

Thank you very much.

Matt Desch

Thanks, Louie.

Operator

As a final reminder, you may press star, then one to enter the question queue.

Our next question comes from Chris Quilty of Quilty Analytics. Go ahead.

Chris Quilty

Tom, just want to start with a quick clarification on those hosted payloads revenues. I mean, you gave us where it will kick in up to \$1.9 million a month. Does that feather or is there a discrete step-up when you meet the milestone?

Tom Fitzpatrick

It is a discrete step-up. It will occur in a month and it will step-up from whatever I said, from \$1.1 million to \$1.9 million.

Chris Quilty

And this is probably fourth quarter?

Tom Fitzpatrick

We've said second half, well let's see.

Chris Quilty

Okay. And Matt, I just wanted to circle back a little bit on the maritime market. You're about six months into the service launch. Two questions for you. Number one, where are you now in terms of partner terminals that are available now versus beginning of the year and do you expect to see additional terminals available, let's say a year from now? And the second part of the question is: What are you seeing in terms of ARPU trend relative to the old open port service?

Matt Desch

Yes. As you know, we announced Certus service in the maritime industry with two terminals, one from Cobham and one from Thales and there is one terminal right now in the land/mobile area from Thales called Thales MissionLINK, a great terminal. And there is a whole bunch of them really right now under development for aviation. So those aren't announced and in the market yet, but we are working with partners as they develop those and are watching them work through their development and certification processes for putting them on airplanes, which we expect to happen more next year.

As far as will there be more terminals next year at this time, potentially like in maritime? Yes, there will be potentially more terminals. Haven't been public about that, but that's certainly likely. And we also will see other terminals, not just built for this 700 kilobit per second service that's available at the end of the year, but also for as I said, these mid-narrowband terminals there'll be a lot of those next year as well. So yes, I think the terminals are going to expand to provide service for broader-based Certus applications and we're quite excited about the potential for that.

Chris Quilty

Got you, and on the ARPU side?

Matt Desch

Oh, yes, thanks. Sorry, on the ARPU side. Yes, we had expected ARPUs to be significantly above our OpenPort ARPUs, which were in the low- to mid-\$200 range. And they are kind of coming out quite a bit above that, not quite double that, but they are really significantly higher. We haven't really announced that number yet. But as you would expect with higher speeds, we are getting higher ARPUs out of those devices. And I think they'll bode well, especially as the firmware upgrade goes in late this year to allow all those existing terminals that are going out right now to kind of double their speed that will only probably help even bolster those ARPUs more.

But I'd say, we're kind of more in what you would call Inmarsat-type ARPU ranges as opposed to the traditional for similar kinds of terminals than we had with our previous 128-kilobit per second OpenPort terminal.

Chris Quilty

Understand. And to the degree you have visibility, is it basically, your same traditional customer buying

the product or are you seeing entry into new market niches where you hadn't previously seen adoption?

Matt Desch

Well a number of the terminals are Inmarsat replacements. So I would say, that's a new market in a sense of these are people who would have selected an Inmarsat L-band product and in this case selected an Iridium product. So we are seeing some fleets move over and that sort of expected since that's the target market for us. I would say, we've always been in the VSAT companion market the last couple of years. I think we're even more firmly into that right now because our partners really wanted to deploy Iridium as a companion to their Ku-band services, since they're in competition with Inmarsat for their Ka-band Global Xpress service. So I am only seeing even more kind of commitment to that companion application.

And then, I would say that there were some stand-alone ships that 128 kilobit per second OpenPort or Pilot just wasn't fast enough for them, but a product that can do 700 kilobits per second on a pay-as-you-go kind of basis is what they were looking for. So we are seeing those start to come on too. It is still early. As you even saw, I think another one of our partners announced their interconnection was complete this morning.

Our partners are still interconnecting with us. They're still integrating their proprietary products into it. They're still training their sales forces. We're still working on lots of seminars around the world. So we're still in sort of the early ramp of that. I'm pleased to see that we're ramping up and the excitement is high. And we'll talk numbers and stuff maybe more as we exit this year on exactly how many we have as we start thinking about 2020, but still early days, but a lot of excitement out there.

Chris Quilty

Okay. Also wanted to circle back on the Satelles question. I think you mentioned the Galileo, which I think was more of a ground network issue. But I think more importantly, there were some news stories about Israel experiencing spoofing and jamming of aircraft. Is that a problem that Satelles or Satellite Time and Location can address and part two of the question, within the DoD, they have now created an assured PNT office. Is that an organization that you're engaged with at this time?

Matt Desch

On both questions, yes. So there's a number of applications that Satellite Time and Location (STL) solves. One of them is spoofing, what you can do since it is such a powerful signal coming from the Iridium signal. You can compare another Galileo or GPS signal to ours to see if the two are different, because it's very difficult to say spoof or jam both. Certainly, helps with jamming, because it would have to be a very, very big jamming system to jam an Iridium Satellite Time and Location signal. It helps with in-building applications, because it can penetrate well into a building, so instead of having to put say a GPS or other type GNSS thing on the roof of your building to bring a timing signal in to synchronize your digital signals, you can just directly have the STL signal right in your building and a number of applications are using that today in commercial applications.

So it really solves a number of things. And yes, both the U.S. and other governments are looking at this technology to support their applications. I think that would just only make sense. They're looking at a number of different technologies, but STL is available today and it's very robust and it's in operation and we expect it to be used many places.

Chris Quilty

Great. Thank you very much.

Operator

Our next question is from Ric Prentiss with Raymond James. Go ahead.

Ric Prentiss

Hi, guys. Appreciate the follow-up. I wanted to follow-up on some of Chris' questions there. You mentioned what you are seeing as far as sales with Inmarsat replacements in the companion market as well. What has been the response that you've seen from Inmarsat in the marketplace to you guys coming in and you anticipate as they look to go private any changes to that response?

Matt Desch

Oh, they've welcomed us with open arms everywhere I can tell, and we really appreciate that. No. They obviously are working hard to compete, and especially at this sort of low end, they have made a number of offers to try to stem the tide. I don't see any major movement that really affect our excitement and confidence in our ability to continue to grow and meet our overall long-term objectives, which are to take a sizable piece of that business. But we're not looking to completely replace them.

They're going to continue to have an L-band business. We'll share it much more equally going forward, if not, maybe unequally is our goal. But they can take some pricing actions, but they probably have to be very careful not to re-price their base and basically kill their existing maritime business, which is quite a large piece of their business, where it's really almost all new ground for us. It's all sort of open for our taking right now. So, I like our prospects very well. I think you asked a second follow-up there—

Ric Prentiss

Just as far as, when they go private, any thoughts on what they—

Matt Desch

Private. Yes. Thanks. I don't see any changes to that. I mean, I think they still have business objectives that they have to do. It will be more difficult to see exactly probably publicly what they're doing, and how they're doing. But I really don't see any changes to their strategy as a result of this. They certainly haven't announced any or do we see any movement that are coming from that in the marketplace, nor our partners telling us they're hearing anything different.

So I do think that they're really focused on growing their Global Xpress business and that's understandable, with the strong focus on aviation, again, that's not really where we compete directly. And I think that's a good focus area for them, but I don't really see any changes with their going private.

Ric Prentiss

Matt, you also mentioned your long-term goals. Anecdotally, is there any update to how that broadband revenue number has been starting to move probably not much movement yet? But I think previously you've been doing maybe \$25 million a year and you want to head towards at least \$100 million, if not more? Any anecdotal update on how that broadband revenue line is doing?

Matt Desch

No. I think you saw in my opening comments about I think that's a pretty big number, you know 2,000 terminals already out in the marketplace given that our previous business, which has taken well over ten years to create maybe achieved almost 10,000 or so net terminals in the market. I think that's pretty good right out of the gate for the first six months. But I don't want to give too much information right now on this, it's something I would really rather wait until sort of the end of the year to start providing more detailed breakouts on our Certus revenue.

We know we have to do that and want to do that really in the marketplace, it's appropriate for us to do

that, but it's just a little early and I don't want to create any kinds of unexpected expectations, or anything based upon that. But I think you got enough from my overall comments to probably get a sense that we're still very excited about our strategy and our approach, and what we are trying to accomplish here.

Ric Prentiss

That one sounds very good. Okay. Thanks for the follow-up.

Matt Desch

Sure.

CONCLUSION

Operator

This now concludes our question-and-answer session. I would like to turn the call back over to management for any closing comments.

Matt Desch

Yes. Thanks for joining us all. We'll certainly keep you abreast of any progress that we expect to be making with the U.S. government. I'm sure, I'll see some of you in Paris in the September timeframe, and I think you also probably should stay tuned for good news from Aireon as well here in the near term. But beyond that, we will see you next quarter. Thanks.

Operator

The conference is now concluded. You may now disconnect.