Iridium Communications Inc.

Q4 2019 Earnings Conference Call

Tuesday, February 25, 2020, 08:30 A.M. Eastern

CORPORATE PARTICIPANTS

Matt Desch – *Chief Executive Officer*

Tom Fitzpatrick – *Chief Financial Officer and Chief Administrative Officer*

Ken Levy – *Vice President of Investor Relations*

PRESENTATION

Operator
Good morning, and welcome to the Iridium Communications Fourth Quarter 2019 Earnings Conference Call. All participants will be in listen-only mode. Should you need operator assistance, please signal the operator by pressing the star (*) and then zero (0) on your touchtone phone. After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press star (*), then one (1) on your telephone keypad. To withdraw your question, please press star (*), then two (2). Please note, this event is being recorded.

I would now like to turn the conference over to your host today, Ken Levy. Please go ahead, sir.

Ken Levy
Thank you, Keith. Good morning, and welcome to Iridium's fourth quarter 2019 earnings call. Joining me on this morning's call are our CEO, Matt Desch; and our CFO, Tom Fitzpatrick.

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

Before I turn things over to Matt, I would 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 facts and include statements about our future expectations, plans, and prospects. Such forward-looking statements are based upon our current beliefs and expectations and are subject to risks, which could cause actual results to differ from forward-looking statements. Such risks are more fully discussed in our filings with the Securities and Exchange Commission. Our remarks today should be considered in light of such risks. Any forward-looking statements represent our views only as of today and, while we may elect to update forward-looking statements at some point in the future, we specifically disclaim any obligation to do so even if our views and expectations have changed.

During the call, we will also be referring to certain non-GAAP financial measures, including operational EBITDA and pro forma free cash flow, free cash flow yield, and free cash flow conversion. These non-GAAP financial measures are not prepared in accordance with generally accepted accounting principles. Please refer to today's earnings release and the Investor Relations' Website for further explanation and cover non-GAAP financial measures and reconciliation of the most directly comparable GAAP measures.

With that, let me turn things over to Matt.

Matt Desch
Thanks, Ken. Good morning, everyone. So, it was only a bit more than a year ago that we were toasting the 8th and final launch of our Iridium NEXT satellites and celebrating the completion of our new Constellation, and of course that was just the start of a milestone year filled with many accomplishments. As far as those satellites go, we continue to be very happy with our new network and all its new capabilities. Tom will go into detail on 2019's numbers and our 2020 outlook, but a few trends really stood out to me particularly in context of our recent performance. Obviously beating 2019 guidance on operational EBITDA was noteworthy, as was achieving another year of strong subscriber and service revenue growth.

In 2019, Iridium delivered a 16% increase in net billable subscribers as well as double-digit revenue growth in IoT, government and hosted payload. Not bad for a transition year. To put this in context, even as we were building our new satellite network over the last five years, we grew our operational EBITDA at a 9% CAGR, which is really outstanding for the satellite industry and we are excited about our opportunities for growth in the future.

Perhaps a more meaningful stat for our investors was that we generated $168 million in pro forma free cash flow in 2019. This is a dramatic flip from prior years, when we were spending significant capital on our network build. As you know, we believe investors should increasingly be focused on our cash flow going forward--metrics like free cash flow, cash conversion, cash flow yield and the like and evaluating us on it.

We think we stack up particularly well on these measures versus other firms in the communications infrastructure space, many of whom enjoy higher valuation multiples than Iridium. These new metrics we're focusing on are important as they should drive real shareholder returns.

After lots of effort and investment, we've finally reached what I've been calling financial maturity. What I mean by this is that Iridium has become self-sustaining, especially as we look to the future. In contrast, throughout Iridium's 30-year history, we've been beholden to the financial markets to supply debt and equity needed to build and upgrade our network. At times since I've been here, obtaining needed capital was a very challenging proposition given our level of revenue, the state of the capital markets, and the operational risk we faced in launching a new network. Today, we are in a much different place.

In light of our market position, revenue growth and expectations for significant cash generation for years into the future we now believe that our destiny is in our own hands, particularly so as we've chosen a unique and differentiated path compared to all other satellite players, including existing competitors as well as the new LEO systems being launched today.

We have an exciting open lane in front of us for continued growth in areas like specialty broadband services with our new Iridium Certus platform, best-in-class satellite IoT services, and consumer-oriented personal communications services. These and unique new services like Aireon and satellite time and location are all showing great potential.

Our new broadband offering has really thrust Iridium into the mainstream in maritime. 2019 was our first year with this new offering and I think we did very well. Iridium Certus launched in the first quarter and was recently upgraded in speed, making it the fastest L-Band service available.

It is also more affordable, provides better coverage, and has other benefits compared to the incumbent offering. Plus, our partners love selling it. This is why it is both great as a standalone service and increasingly being paired with VSAT as a companion product.

Today, we have more than 1,200 active subscribers using Iridium Certus and believe that the pace of activations will continue to ramp as new distribution partners and products come online. With several new terminals scheduled for introduction this year, we have a very competitive offering to grow our footprint.

It also helps that we've just been formally authorized for GMDSS service, which will roll out in the coming months. Adding Iridium Certus aviation and U.S. government customers to this mix in the coming years as well as partnerships supporting the new LEO mega constellations and we think the runway for growth in Iridium Certus broadband is quite exciting.

To help you better track this growth, we will begin breaking out service revenues from our broadband services starting in the first quarter.

IoT has become a core market for Iridium with its compounded annual subscriber growth topping 25% over the last 10 years. IoT posted another great year of growth in 2019 and now generates 27% of our commercial revenue today. We expect this figure to increase on the continued strong momentum we see moving forward. Our network is perfect for consumer and enterprise-oriented personal communication devices and that’s been driving a lot of our subscriber growth in recent years.

With expanding offerings from Garmin and quite a few other partners, we still think our brightest days are ahead. We also benefit from being network of choice for industrial IoT solutions, where reliability and coverage are critical. You’ve seen this in the heavy equipment OEM space where we’ve been adopted by the largest manufacturers over the last few years.

Our partner ecosystem remains one of the key reasons for our IoT success. We added over 20 new partners alone in 2019, and I do not see that pace slowing. With over 450 partners today, we touch a lot of diverse IoT opportunities. However, we’re really only scratching the surface. In particular, we see growth in areas like agriculture, transportation, and the emergence of autonomous shipping and unmanned aerial vehicles. As our new Iridium Certus midband devices become commercially available later this year, the ability to expand the types of IoT datasets, including things like pictures, will only expand our market potential further.

At the same time, our strategy is to make it as easy as possible for these industries to utilize Iridium IoT in their applications, and that has become much easier with the launch of Iridium CloudConnect through our relationship with Amazon Web Services. That service went live last month.

Another avenue that will facilitate and accelerate our growth is to provide partners with innovative new integrated devices that make it easier and faster for them to get services on our network, which expedites time to revenue and improves their margins. We have had good success on that front with the introduction of Iridium Edge in 2017 that integrated our IoT transceiver with an L-Band antenna for plug-and-play simplicity to extend existing cellular-based applications to satellite. Since its introduction, our partners have purchased over 10,000 of these devices for their customers.

In the next few months, we’e introducing two more products in this category to integrate additional components for ease and speed. The Iridium Edge Solar will integrate solar power to offer a very low-cost and long-lasting tracking device to support asset tracking right out of the box. And the new Iridium Edge Pro device will incorporate a processor and GPS so that partners have an all-in-one integrated package to develop their applications more easily. We see interest from our partners for these devices and together with Iridium CloudConnect, we believe 2020 will bring new momentum and keep our IoT business on a roll.

Finally, 2019 was a great year for our relationship with the U.S. government, which continues to evolve and grow stronger. The highlight was obviously the new long-term fixed price contract for our existing narrowband services, but you should also take note of the other two long-term government contracts we signed. They contributed to the jump in engineering services we're seeing as we support the government's diverse uses of Iridium for another decade.

This new investment on infrastructure and R&D is an indication of the close collaborative relationship we have with the DoD. While the EMSS contract establishes a base for their Iridium services, we anticipate building on this foundation with new incremental pay-per-use services like Iridium Certus broadband. I still think investors may not fully appreciate the range of our business potential with the U.S. government.

Beyond the contracts we signed with the DoD in 2019, we have significant opportunities to grow our relationship. This is because Iridium can fill large gaps in capabilities and coverage that exist in the government's relationship with other satellite operators.

With 14% compound annual subscriber growth over the last decade and 135,000 active government subscribers today, we continue to view our relationship with the U.S. government as a source of innovation and mutual collaboration for many years to come. Another relationship that is creating significant upside for us is Aireon. I'm really proud of the progress Aireon made in 2019 as they commercialized their service. The rate of customer additions remains strong and this is evidenced by our step-up in data revenues, which we announced earlier this year.

Over the past six months, air traffic controllers around the world have begun managing air traffic using Aireon data and this is providing real safety and efficiency benefits to airlines and the traveling public. While we have always expected that Aireon would become a mainstream service, our optimism about their potential has only strengthened with the success of their commercial introduction.

I'm particularly excited that Aireon is now going into initial use by the FAA in their Miami airspace, and Aireon's pipeline for other new customers remains strong. Aireon expects to generate positive operating cash flow this year and to pay us significant dividends in the years to come. This gives us confidence in our long-term view that Iridium's equity stake in Aireon will be a meaningful source of value creation for our shareholders.

Reflecting on all this, Iridium has created a very powerful business platform, built on a new network, delivering unique and differentiated services, generating strong growth, and as a result is poised to generate a significant amount of cash in the coming years. I can't help looking back proudly over how far we've come, but I'm really more focused on the tremendous opportunities we see going forward.

We are positioned as a long-term leader in L-Band satellite mobility services and our competitive position has actually improved over the last few years, even as others in the sector have struggled. I'm excited for 2020 as all the plans we have set into motion for continued growth and innovation with our expanding ecosystem of partners. For Iridium, the best is yet to come.

With that, I'll turn it over to Tom for a review of our financials. Tom?

Tom Fitzpatrick
Thanks, Matt, and good morning, everyone. Having just wrapped up another great year for Iridium, I would like to start with a recap of our 2019 financial results and provide some color on our fourth quarter performance. I'll then walk through the key components supporting our 2020

outlook, discuss the refinancing activities we have executed in recent months, and conclude with a review of Iridium's free cash flow and valuation metrics, which we believe are compelling.

We made steady progress executing on Iridium's financial transformation in 2019. As Matt noted, we achieved another year of strong growth in billable subscribers, service revenue and operational EBITDA. Beyond these metrics, Iridium also generated $168 million in pro forma free cash flow, which marked our return to positive free cash flow in 2019 and drove additional balance sheet deleveraging.

In fiscal 2019, total service revenue and operational EBITDA both grew 10%. This strong performance was driven by continued momentum in our commercial business, highlighted by a meaningful ramp in hosted payload revenue and IoT. In the fourth quarter, Iridium reported total revenue of $138.9 million, which was up 5% from last year's comparable period. This growth was attributable to strong trends in commercial voice and commercial IoT and new long-term contracts with the U.S. government, which drove incremental service revenue and engineering and support work this quarter. Operational EBITDA rose 6% from the prior year's quarter to $80.1 million.

The commercial side of our business remains strong and generated revenue of $88.6 million in the fourth quarter. Revenue from commercial voice and data increased 5% from the prior year period, reflecting demand for Iridium's new broadband offering and increased access in roaming revenue.

In commercial IoT, personal communications devices continued to fuel new subscriber and revenue growth. IoT subs rose 24% from the prior year's quarter while revenue grew 13%. While these consumer-oriented plans have lower ARPUs, they are particularly attractive in terms of revenue generation relative to network resources used, making them an ideal source of incremental revenue.

For the year, personal communication services and consumer IoT were responsible for over 100,000 new subscribers on our network. In all, commercial subscribers grew 16% year-over-year and IoT subscribers now represent 69% of billable commercial subs, up from 64% in the year ago period.

Revenue from hosted payload and other data service was $12.1 million in the fourth quarter, down 15% from the year ago period. You will recall that in the fourth quarter of 2018, Iridium recognized a $4.5 million catch-up revenue adjustment from satellite time and location services. Government service revenue grew 14% in the fourth quarter to $25 million, reflecting the terms of our new EMSS contract with the U.S. government. During this same period, government subscribers grew a robust 19%, underscoring the utility of Iridium connectivity for the Department of Defense. Total government subscribers ended the year at a record 135,000.

Revenue from subscriber equipment continued to reflect our outlook for moderation from 2018's record pace. Equipment revenue fell 15% to $17.1 million in the fourth quarter. We believe 2019's equipment revenue is more in line with the long-term trends we have experienced in handset sales.

In 2020, we forecast operational EBITDA in a range of between $355 million and $365 million, predicated on total service revenue growth between 6% and 8% over 2019's level of $447.2 million.

The key elements supporting this outlook are as follows. First, we expect service revenue to benefit from continued strength in IoT, growth in hosting revenue, Iridium Certus broadband activations, and the contractual step up in our government contract.

In IoT, we have good visibility into our partners' business plans and expect the demand for reliable, low latency personal communication devices to continue, which makes us comfortable forecasting double-digit subscriber growth for IoT in 2020. We also anticipate approximately $47 million in revenue from hosted payloads in 2020. This increase reflects the full run rate of our data, power, and hosting contracts with Aireon and L3Harris, including the $800,000 step up in monthly data service fees we announced for Aireon earlier this year.

On our new EMSS contract with the U.S. government, this contract started on September 15th at a $100 million annual rate and will reach a contractual step up on its anniversary to $103 million. We also expect equipment revenue to increase in 2020 from 2019. This outlook is predicated on expectations for relatively flat handset sales in 2020, but an increase to other products due to technology migration and resulting last-time buys.

Finally, we continue to expect negligible cash taxes in 2020, and consistent with our previous guidance, we currently estimate negligible cash taxes through 2023. Thereafter, our outlook calls for an estimated cash tax rate at mid-to-high single digits until 2028.

As you can surmise from our 2020 outlook, Iridium is a completely different company today than when we began the Iridium NEXT program 10 years ago. We have a much stronger earnings profile, lower capital needs and the ability to generate significant free cash flow at a growth rate that exceeds our growth in OEBITDA. Moving forward, we expect total CapEx to average about $35 million per year.

Now focusing on our balance sheet. As of December 31, 2019, Iridium had a cash and cash equivalents balance of $223.6 million. At the end of the first quarter, with the retirement of our high-yield notes, we expect our cash balance to be around $50 million and grow from there. We closed 2019 with leverage at 4.8 times of OEBITDA. This was down from 5.2x a year earlier and in line with our forecast, which reflects the impact of refinancing our credit facility with BPIAE in November. We continue to expect that net leverage will fall in 2022 to approximately 4 times of OEBITDA as we exit the year.

Earlier this month, we retired $360 million of 10.25 high-yield notes using excess cash and the proceeds from a $200 million tack on to our existing term loan facility, which is priced at LIBOR+ 375 basis points. This refinancing, together with the retirement of our BPIAE facility in November, materially reduces our annual interest expense moving forward.

In 2019, our pro forma net interest expense was approximately $112 million. Pro forma net interest for 2020, based on our new $1.65 billion term loan, is approximately $90 million, a $22 million or 20% reduction. This has a beneficial impact on our pro forma free cash flow.

If we use the midpoint of our 2020 OEBITDA guidance at $360 million and back off $90 million in net interest pro forma for our new debt structure, $35 million in CapEx, and $26 million in working capital, inclusive of the appropriate hosted payload adjustment, we are left with pro forma free cash flow of approximately $208 million, up 20% from 2019. This is the conversion rate in excess of 55% and suggests that our pro forma free cash flow will grow by more than double the rate of growth of OEBITDA in 2020, representing a yield of approximately 5%.

I know I shared a lot of numbers here, but we've posted a more detailed description and reconciliation of these cash flow metrics as a supplement on our Web site. It's important to note that our $200 million tack-on facility was multiple times oversubscribed and priced at 101. This suggests that LIBOR+ 375 basis points is above market pricing. We can re-price the entire $1.65 billion facility on its six-month anniversary in May and intend to do so, assuming market conditions hold.

To illustrate, a 50-basis point reduction in our spread would yield $8.25 million in additional annual interest savings, or about a 9% reduction. We believe this is an important consideration in evaluating our free cash flow growth prospects, particularly given Iridium's deleveraging profile and the ability to re-price our term loan periodically, if market conditions allow.

We continue to believe that Iridium's free cash flow statistics compare quite favorably to companies in the communications infrastructure space that trade at much higher multiples than Iridium. For example, certain fiber companies trade in the high teens and certain data center companies enjoy a multiple of 20x, while the tower sector trades around 25x EBITDA. We think this is an important investment consideration in evaluating Iridium.

In closing, 2019 was another strong year for Iridium. I continue to feel very good about the underlying strength of our business. We continued to enjoy strong top line growth and the deployment of our upgraded satellites unlocks new revenue streams that kickoff a new era of growth characterized by strong free cash flow and declining leverage. Now that we have enhanced our financial structure, I'm very excited about the prospects of unlocking additional value for our shareholders.

With that, I'd like to turn the call over to the operator for the Q&A.

QUESTIONS AND ANSWERS

Operator
Yes. Thank you. We will now begin the question-and-answer session. To ask a question, you may press star (*), then one (1) on your touchtone phone. If you are using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question, please press star (*), then two (2). At this time, we will pause momentarily to assemble the roster.

And the first question comes from Ric Prentiss with Raymond James.

Ric Prentiss
Thanks. Good morning, guys.

Matt Desch
Good morning, Ric.

Ric Prentiss
Hi. Tom, I appreciate that color on the guidance. I did have a couple of extra questions there. First, on the hosted payload, the $47 million full run rate, there is also hosted payload in Other. Are you still expecting that other's going to run maybe in that $14 million a year that we saw in 2019 as we go into 2020?

Thomas Fitzpatrick

Yes. So, hold on. Let me look into that, Ric.

Ric Prentiss
Okay. Because I think total hosted and payload in the quarter was just over $12 million, but now you are up to a better run rate. You guys can look at that. While you are looking up that number, you had also previously thought that the exit of 21 for the new revenue from the broadband service would be $75 million. Is that still the thoughts? And I appreciate you guys are going to start providing actually financial breaking out that in 1Q '20.

Matt Desch
Yes, I mean, on that one, we just provided that guidance pretty recently ago and there is nothing really changed much in terms of our optimism about the service, and it is way too early to even think about making that higher or lower. It was fairly backend loaded anyway.

We are now introducing the full speed of 704 kilobits per second this quarter and GMDSS just got approved, and new terminals are coming online, and I think we are finally at full strength in terms of all the partners like fully selling it. So, full speed ahead right now and I would say we are still optimistic. Those are good numbers really, but overall, we are still excited about sort of the market position of the service.

Ric Prentiss
Okay, and you mentioned the new LEOs. We get a lot of questions from investors about the Billionaire Space Club going on out there with SpaceX Starlink and Amazon potentially and OneWeb and Boeing, lots of questions about the new LEOs. Can you talk a little bit about how you see those? They are in your same neighborhood I think you have used in the past but not the same source. What markets do you see these new LEOs attacking and entering? Is it aeronautical; is it maritime; is it consumer broadband? And how does their spectrum or equipment cost kind of compare to what you are trying to deliver?

Matt Desch
Those are good questions that whole conferences are right now addressing. I have talked to all of those guys here in the last 6 to 12 months and so every one of them is a little bit different. I say there is a same neighborhood, but I mean the same neighborhood in space. They are low Earth orbit, but they are really completely different business models and frequencies and approaches much closer to what the existing fixed satellite services market is offering today versus what any kind of highly mobile personal communication kind of services that we offer today, or IoT.

They are all Ka and Ku-band. I would say that they are mostly focused on what I would call the commodity broadband space, trying to provide services that compete almost more with existing VSAT and fixed satellite services space, but even going beyond that to someone like Starlink or maybe someday Amazon Web Services, I would say that they are even going after what I could call the core fixed market, particularly consumer markets that maybe are served by Hughes and Viasat today or even by fiber and other kinds of solutions. Those are completely different markets than what Iridium is interested in or has been addressing. We have stayed away from those. Those are extremely competitive markets with very complex distribution issues. Some of them, by the way, are going direct, some of them are going through existing market channels it appears. It is quite interesting to watch them all develop, particularly from our historical vantage point of 30 years in satellite and knowing all the challenges they have to go through. I am rooting them on overall, because I think it is interesting and good for the industry. I think there is a lot of challenges ahead in building a lot of those businesses, you well know, and everyone is sort of still waiting and watching.

On our front, we see a lot of what they are doing is complementary to what we do. So, you have seen, for example, the MoU we put out with OneWeb. We are certainly talking to everybody else, because we think our services are complementary to theirs as well and perhaps at the right time all of them are very busy just even building their systems and I think they will be in that mode for quite a few years to come.

So, I do not know if that covered–it is a broad question, an interesting one. I know there is a lot of interest, but I will say only a final note, I hope they all can achieve the financial maturity I talked about faster than the 30 years it took us. I think many of them probably dream about doing it in four or five. That may be a lot of challenge and maybe it is a good thing that they have patient equity in terms of billionaires and others who are supporting them, because that is what it takes in the satellite industry given the high CapEx and recurring nature of the CapEx requirements to just get to the state that Iridium has gotten to today.

Ric Prentiss
Makes sense, and then ….

Tom Fitzpatrick
Hey Ric, just coming back here to answer your question. The other's around 10 [million]. It was 10 [million] in '19 and we see it around 10 [million] in 2020.

Ric Prentiss
Okay, great, and then just a bigger picture, obviously coronavirus is grabbing a lot of attention in the marketplace and the news cycle. How are you feeling about the heavy equipment market, any other global economy items, any early indications that coronavirus is affecting supply or demand?

Matt Desch
Yes, obviously I am watching it with as much interest as you are. It is capturing everybody, and it is going to clearly have sort of a global economic effect. I have seen like the early projections from airlines and others about less travel and that sort of thing. So, it is certainly of interest and concern to every company. We are not I am sure totally immune to it, but I can you I have not really seen a lot of action from any partners. Certainly, our supply chains are in good shape. We do not have a lot of exposure, for example, to China. Our inventories are good.

We are not really seeing a big change in any kind of demand today and I think it is helpful that our business is so diverse in so many businesses and areas, some of which by the way are related to emergency and would be on the other side of say supporting a coronavirus. So, I won't say that I do not think it will have any impact. Certainly, it must have an impact for every company at some point if it gets bad enough, but we are not really seeing any impact or projecting any impact right now on what we are talking about for 2020.

Ric Prentiss
Great. Thanks. See you in a couple of weeks in DC for the Satellite Show where those conversations will probably all continue.

Matt Desch
Keep your mask on when you come, okay.

Ric Prentiss
Thanks. Have a good day.

Matt Desch
Thanks.

Operator
Thank you, and the next question comes from Greg Burns with Sidoti & Company.

Gregory Burns
Good morning.

Matt Desch
Good morning, Greg.

Gregory Burns
I am just wondering if maybe you could give us a little bit of an update on the activity around Certus adoption. I know at the onset it was maybe a little bit slower than you were expecting, but can you just talk about the pace of activations? Have you seen that pick up? Maybe if we just start there. Thanks.

Matt Desch
We have, but it has only been a few months really since we even provided that update. So, it is really still too early to say it is faster or slower than expectations. I would say with so many positive things sort of happening around the product: with partners; with new terminals; with GMDSS certification; with the faster speed, which is a firmware upgrade to existing terminals, all those things are coming and sort of affecting it and are coming into the channel and going out there. So, it is going to take I think a few months before we can start looking and saying, I can see that we are on track, ahead of track, or behind track. So, I would say we are feeling pretty good about where we are right now, certainly good about the product and the channels and the interest in it and all the things that we have seen so far, but it is really too early to kind of call out any changes to 2021 or anything here.

Gregory Burns
Okay, and I guess there is a little bit of uptick in your ARPU, and I know you are going to start breaking it out next quarter with Certus specifically, but can you just help us frame what your typical ARPU was maybe with OpenPort and what we can expect from Certus terminal going forward?

Matt Desch
Yes, I think you will end up seeing that–at roughly on the order of 10,000 subscribers kind of with our first generation service and I have already given you some idea about how we have done in the last year by adding more than 10% to that number, and I think the ARPUs were in the 200s kind of range with the OpenPort service. They have gone up 150% to 200% depending… It is kind of a wide range, but you will see the average will step up quite a bit with the higher speeds and the higher functionality of the Certus services. So we are seeing both new builds both on new ships, but also on sort of new installations of standalone Certus, but we are also seeing a lot of companion applications and of course those ARPUs vary between whether they are companion application or – a little lower-versus a standalone application, which can be quite a bit higher.

So that all still averages considerably above where we were before and bodes well for the future in terms of how much each of those incremental terminals will add to our bottom line.

Gregory Burns
Okay. Thanks, and then lastly, the equipment cost, the gross margin on the equipment this quarter was a little bit lower than I guess what it has typically been. Is that what we can expect for next year? And then lastly on the engineering and support revenue, is this a good level to kind of model out or do you expect it to moderate in 2020? Thanks.

Tom Fitzpatrick
On the engineering and support, I think it is going to be about this level. It is going to be about this level in 2020.

Matt Desch
Yes, this feels like sort of the new run rate for a while. We really have stepped up the activity with our government partner. There is an awful lot of activity around–almost in some ways we are resource constrained in terms of being able to handle sort of all the things that we are doing around new activities. So, this seems like a good level for us right now, and I know equipment, it was an issue of mix more than anything else. It all depends on exactly what we are selling in the year.

Tom Fitzpatrick
The margin was light in the fourth quarter, but on the full year we are flirting with 40 and that is where we see ourselves in 2020.

Gregory Burns
Okay, perfect. Thanks.

Operator
Thank you, and the next question comes from Anthony Klarman with Deutsche Bank.

Anthony Klarman
Hi. Thanks. Earlier in the month you put out an 8-K that indicated that Aireon had met some milestones in its operating agreement that it has with you that was going to trigger some additional increases in the data billing that would you collect. I am wondering if the timing of that is that you are recognizing that immediately or if there is some ramp to that that happens throughout 2020. I think you indicated that the annualized impact was about $10 million. I guess, I am just trying to capture if that entire $10 million is baked into the guidance. And then as an add-on to that, maybe Tom or Matt if you could remind us are there any other important milestones in the agreement you have with Aireon such that if they continue to scale relatively quickly could accelerate the timing of either cash payments or the buyback that I think is out there at some point in the future?

Tom Fitzpatrick
Aireon's ability to pay off the hosting fee is going to be driven by their contracts that they sign. And we have said that we see that in late 2021 or 2022, depending on their rate of adoption. They have been doing very well this year in terms of signing up new customers and we expect them to continue to do that. So that is the driver on when we get the hosting payment and then buyback of the shares comes after that, I think 2023. And yes, Anthony, the step up in 800 [thousand dollars] a month, so there is your $10 million a year. So, it is out of the gate.

Matt Desch
And that happened right off the bat… really in the beginning of the year, so you would expect that to be that level through the year and that was all put into our guidance now. So, we have good visibility to exactly what Aireon is going to deliver this year.

Anthony Klarman
Yes, got it. Thank you, and then maybe Tom, now that the recapitalization is complete, and you have taken out the high-yield notes and you have an all-term loan structure, I guess could you just remind us a little bit about your financial policy. I think you had previously indicated a long-term leverage target of 2.5x to 3.5x over the long term. Your guidance has you only a half a turn above that at 4x net leverage at the end of '20. How do you think about uses of free cash flow here? And do you have any sort of update to your financial policy about how you prioritize cash here?

Tom Fitzpatrick
We still think leverage between 2.5x and 3.5x is right and we see ourselves–obviously we would delever below that in 2021, and so we delever into that range in 2021. And so, shareholder friendly actions are on the table once we get in that range.

Anthony Klarman
But we should assume that for 2020 you are sort of sticking to the core of kind of the operating business and that, as we think about other uses for the free cash flow, I guess your expectation is that the cash would just sort of build to the balance sheet as you get towards that leverage target?

Tom Fitzpatrick
Yes, as we see the world today, yes, that is our expectation.

Anthony Klarman
Okay. Thank you.

Operator
Thank you, and the next question comes from Hamed Khorsand with BWS Financial.

Vahid Khorsand
Good morning. This is Vahid for Hamed. Just a few questions. Have you been able to address your manufacturing needs for Certus equipment? And do you need more partners or just the ability to make more equipment?

Matt Desch
Yes. So, we have–just to understand how our Certus product works, we build the core transceiver module, which is at least for most terminals, though we will even license that technology if desired to some to make it themselves. We have made those, shipped many more out in our terminals in the market. Those then get turned into terminals by our terminal VAMs, which we have announced a number and have some more potentially coming.

They then create the terminals. People like Cobham and Thales in particular are the primary ones in the maritime market today. And we have given some guidance in the past about sort of the additional terminals that they have made then even or have been activated. So, the channel seems to have a good supply of terminals right now to support the growth in 2020. They will be augmented by, I think we have discussed it. Intellian is coming onboard, a really strong Asian manufacturer. They should be delivering their product in the first half of this year and I am sure they will also address, particularly they have a fan base kind of core in Asia, but really all of the world as well and that will add product as well.

In addition, we see some other–even lower cost terminals coming on the market in 2020 that provide different levels of service. We also see aviation terminals, which are under test right now that will hit more later in the year, and there is some other visibility to other things that are coming in the market as we license additional people to make terminals. So, supply of terminals is good. The diversity of applications that they can support is growing. And competitive nature seems healthy in terms of sort of the kinds and price points of the terminals that are out there. So, we feel good about the supply of Certus terminals for the market.

Vahid Khorsand
Thank you, and then one more question with regards to IoT, is Garmin still your main source of subscriber growth or are you seeing any new customer trends develop?

Matt Desch
Well, Garmin certainly is putting some big numbers up because–being a consumer player and having such a broad first of all global scope in terms of who they support, but also a growing number of products that they are delivering to the market and expanding the base of the applications that they are supporting. That is certainly I think going to continue to be a driver of just raw subscriber numbers in the future.

It is kind of hard to expect others will match them, though we are having discussions with others who certainly have the potential long term of being able to add good numbers too that are also in broader segments.

We are seeing some new consumer products coming online. We are really pleased to see others entering the market as well. There is only more than a handful right now of really nice looking products and different market segments going from consumer to enterprise, to governments and others that are also addressing this personal communication space. Plus, we are seeing that midband technology that we are deploying this year. We are in trials with a number of our partners on new applications using higher speed services and we see that entering into the consumer and enterprise space, especially into 2021 and '22. And I think those will also add some interesting numbers as well. But yes, definitely Garmin is --definitely the winner in terms of subscriber growth short to medium term.

Vahid Khorsand
Thank you.

Matt Desch
Thanks.

Operator
Thank you, and the next question comes from Louie DiPalma with William Blair.

Louie DiPalma
Matt, Tom and Ken, good morning.

Matt Desch
Good morning, Louie.

Tom Fitzpatrick
Good morning, Louie.

Louie DiPalma
Matt, Iridium shares are near their all-time high and it seems as though you have a lot of new products in the pipeline, particularly in IoT. Meanwhile your closest IoT competitor, Orbcomm, has seen its shares near their all-time low. At a high level, can you discuss the competitive dynamics in the IoT market from the various sources of competition, whether it is Orbcomm, cellular, and even future LEO IoT services, and the differences in system architecture that has thus far allowed your team to prevail?

Matt Desch
Yes. Our competitive position on the IoT space has only sort of improved as we develop more unique devices, made it easier to get into service, provided more competitive pricing plans, and brought on more partners who put us into more applications. And all of that has been sort of an engine of growth as I said that has delivered consistently high-performing subscriber growth.

And it all is due to the unique nature of our global… no one has to have reservations about where the coverage is on any device, the latency is consistent to everywhere in the world. It is just a very high-performing, reliable application. So, partners have been drawn to really our service versus others over time. And really in some ways anybody knew who really wants to go into market around sort of the applications we support are really being drawn to us.

I have said in the past, I still agree. We have never lost a partner to any other satellite player. Once they come to us, they stay. We have taken a lot of share from others who were in the market earlier. You mentioned one, but there have been others as well. And we seem to be migrating their applications over to our network as well, especially with the new Iridium NEXT network that we have built, everyone sees the long-term future and potential of the capabilities we can provide versus anybody else.

So, when it comes to what I call one-to-one premium satellite IoT, I do not think we have a lot of competition compared to the past. And you are right. It is more about doing nothing would be a competitor or cellular being good enough in the 10% of the world if it works. But we are making it easier and easier for cellular IoT customers to move over into satellite as well with things like Iridium CloudConnect and new devices that are attractive to those who built their networks on cellular.

So, it really feels like we have a strong engine of growth going well into the future. We continue to bring in new products, new devices, new partners. I do not really see anybody challenging us in the traditional MSS space in the way we have maybe 10, 15 years ago. And these new mega constellations, these new LEO bands all are focused on a completely different segment of IoT. It is a niche segment called broadband IoT, where they deliver sort of a broadband node to a regional area and then distribute the signal to make it cost effective to lots of devices in a very limited area. And that is an area that is a smaller part of the market. We serve it with Certus, more than anything else. But I do not really see that as an area of – that is just an area that is complementary to what we really provide as our core IoT space.

So, very different IoT. I have talked to all by the way the mega constellations, and I say when you say IoT, do you mean what I mean? And they all agree that what we are talking about is very, very different and complementary.

Louie DiPalma
Got you, and Tom, I think you provided an unofficial pro forma free cash flow guidance of $208 million and that amount of free cash flow generation is fairly unique in this industry. I was also wondering, related to that, can you provide a little color in terms of the difference between that pro forma $208 million number and the change in net debt that is implied by your deleveraging forecast?

Tom Fitzpatrick
Well, so the pro forma for 2020 is pro forma for our new capital structure, which was implemented in February this year. So, we think that what's important here is what's the run rate of cash flow, right? And so that is why we provide that pro forma statistic, because we think that the growth rate, which is more than double the rate of growth in EBITDA, is unique and that is why we highlight it. We have a detailed calculation, Louie, for you to kind of have at. It is on our webpage and we have footnoted every calculation there, and so rather than take the time here, I would just direct you to the Web site and then we can have a follow-up as appropriate.

Louie DiPalma
Okay, and do you expect–I know you said you expect to average $35 million for CapEx per year I think for roughly the next 10 years. Do you expect to already hit that mark for 2020?

Tom Fitzpatrick
Yes. 35 [million] is our guide for 2020.

Louie DiPalma
Great. Thanks.

Tom Fitzpatrick
And you will see in the Web site, that is evident on the exhibit we posted to our Web site. There is a $35 million deduct in arriving at the $208 million.

Operator
Thank you, and again please press star (*), and then one (1) if you would like to ask a question.

And the next question comes from Chris Quilty with Quilty Analytics.

Chris Quilty
Hi, guys. Congratulations on finally, finally getting the GMDSS certification. Can you answer two questions? Number one, do you have any other terminal manufacturers besides Lars Thrane at this point? And I guess, how large would all this Certus providers eventually be certified for GMDSS? And the second of all, maybe this is more qualitative, can you give us a sense of how you think that is going to impact the market and competition going forward, now that you finally have that in pocket?

Matt Desch
Yes. So, Lars Thrane got that terminal, which is a great terminal by the way. It is the first terminal, but there are others that are under development and we expect to see those coming later in the year, or into '21. I will let them announce them when they are available, but there will

be multiple choices. And the Certus suppliers are also going to be certifying their terminals for GMDSS as well. Again, you are right, it was a long process to get there. Getting full authorization is a big deal, because we broke a monopoly of 30 plus years.

I would say too, I should tell you our GMDSS service is truly going to be the best in just about every front – coverage to start with, but really the fact that that Lars Thrane terminal can do all services, including voice and data as well as all the information services. And it is a really attractive package. I think we are going to get equally great new terminals when they are available going forward.

The most important aspect about it is not the revenues necessarily that it will generate. Technically, GMDSS services are free, certainly in the early term. Though those terminals can generate revenue-generating services, that Lars Thrane service can be used for ship more data and that sort of thing, which will generate revenues on top of it. But I think the most important thing is that the distribution chain not only has an alternative to offer, but they do not have to offer a mixed solution. They can offer a completely non-competitive solution to what they offer, and they have obviously been looking for an Iridium solution to be able to offer their customers, so that they do not have to mix it with their primary competitor on the VSAT market onto a new ship or new service.

So, our goal is not to replace all the existing GMDSS terminals out there. There will probably be a lot more new devices going forward, because I do not know if there is a business case for necessary changing out the GMDSS terminal, but certainly if you are going to put a new system on our ship, I think we are going to be an extremely attractive offering, not just because it is lower cost and provides more services, and works in places the other solution does not, but because it is really much more friendly from a competitive perspective.

Chris Quilty
Got you, and on Aireon, obviously you or Aireon tripped the recognition, due to their rollout of that service with the FAA, but what is the next step and expected timing of the next step for Aireon in terms of brokering a broader, more global agreement with the FAA?

Matt Desch
Yes. So, they are starting now with a small straightforward step to be able to serve the surveillance needs in the Caribbean where–it is a fairly straightforward step for them to implement Aireon and I think it will be a great confidence booster as they get comfortable. It is easy to integrate into their existing back office software systems that they use to control traffic. So, it was the obvious first step.

I mean, the big growth is in the oceanic space where the airlines really want them to deploy it, where there is a lot of value to be added. The software systems that they have that will ingest that data are being updated now and I think that they will be available to use later in the year in 2021. I think there is an awful lot of discussions right now at the FAA about their phased plan and exactly how fast do they go, and I think we will leave that to Aireon and FAA to work that out. But I am encouraged that I think that they see the benefits of space-based ADS-B. I think they are seeing the value of the efficiency, but also the safety improvements it has had. There has been some really high profile saves that have been underway in the last few months as the FAA and others have called Aireon to find out where downed aircraft are.

I think you are going to see more stories about that. That is certainly just the visibility to a lot of areas that they have never had visibility to is really attractive to controllers, the pilots, the airlines, to everybody who was involved in the aviation system. So, our hope is it moves faster. Obviously, the faster they move, the better it is for Aireon, the better it is for the travelling public. I think there is a lot of good reasons for that.

Obviously financially Aireon–not just the FAA, but they have a pretty long pipeline and I think you are going to see a lot of new customers come onboard in 2020 and 2021 as they adopt it beyond the existing 35 countries or so that have adopted it initially, and I think that is going to continue to drive revenues. It will allow them to refinance their debt. That will allow them to pay their hosting and dividends and all kinds of other financial benefits that happen out, as Tom said, when they happen in the next few years.

Tom Fitzpatrick
I mean, it is really just–the model is just add customers of which the FAA is a big one, and the more they add, then the sequencing is hosting first, then buyback of certain of our interest for $120 million, then dividends. And we have laid that out in our Investor Day and that is how we saw it this time last year and it is how we continue to see it. They just continue to prosecute and add new customers.

Chris Quilty
Well, maybe let me ask this in a more direct way. Are there–the issues that are throttling a final agreement, are they technical in nature or is it budget related? They have not yet been allocated the money they need to sign a broader agreement?

Matt Desch
I do not think I can characterize it as one thing. Obviously, the other countries and people have moved along faster than the U.S. has in terms of deploying space-based ADS-B. I am just happy they are moving forward right now and starting to see some progress. For a long time, there they had been acting as if, maybe it was not even part of the solution or something that they may only consider for long into the future. Now they seem to be moving on a phased introduction plan that is going to move forward. I think you know agencies where the size and scope and the traffic that they have to support have to move at certain rates for lots of different reasons. And I am sure that Aireon and they will move through that. I just like the momentum I am seeing right now.

Chris Quilty
Shifting gears with Certus and your government customer, are you engaged currently in negotiations to provide that service and any sort of update on timing of when there might be a contract in place?

Matt Desch
Actually, we have contracted already to COMSAT with a take-or-pay contract–and they the primary supplier of L-Band services to the U.S. government. And so, they have already kind of committed to a revenue stream for us from the U.S. government. In addition, the U.S. government has already committed and is spending money and working through the process of implementing the Certus equipment at the government gateway. They have already spent money and are working on implementing a secure Iridium Certus capability. That is moving along well and takes longer than I always think it will, but it should be available I think probably at 2021. In the meantime, they have procured services via the commercial gateway. So particularly on the land-based side, already have a number of terminals activated and are liking what they are seeing from the service and are having discussions around a number of areas from aviation, maritime and land to deploy it.

So, I do not think you are going to see a direct contract per se from us. It will be more through their procurement through COMSAT. So, the channel's all set up, the revenues will flow, they will just accelerate more, when they have a secured capability that is implemented fully at their gateway and can deploy it more rapidly.

Chris Quilty
So, Tom, where would COMSAT–to the degree they were successful with the government, where would those revenues flow? Would they still come through your government reported line or would they show up as commercial?

Tom Fitzpatrick
We see–and there is not much of them now, but we see that being reported in our broadband segment. When we introduced that broadband target–if you remember the slide, there is a slice for government on that slide. So, we see that as part of our broadband target. So, it would not be on the government line. The government line, we see that as the contract with DISA.

Matt Desch
Yes. Primarily the narrowband existing fixed-price services and then we will move sort of the government line into the broadband section--for the broadband area.

Chris Quilty
Okay, and final question, commercial IoT net adds were sort of flat year-over-year at 35,000. I would have expected that might have been up, given you have got more products and Garmin's been at this longer. Was there anything about the fourth quarter that you saw as one-time in nature either that benefitted last year or might have created a headwind for you this year on the commercial side?

Matt Desch
No, there were no headwinds. There are some puts and takes. I remember there was a cleanup from one partner from some nonproductive customers and there were not that much ARPU associated with them, and I do not remember how many there were, but it was a significant kind of number that was unexpected. That happens occasionally. Some people seem to do that and yet we do not really know when it is going to happen. So, it depends on what quarter it hits. I would not read anything into the nature of it being flat, that it has been running ahead for quite a while from expectations, and then I think there was a bit of clean up in the fourth quarter from some people, but really the ARPU stayed strong, the momentum stayed strong, and nothing really happened around any business changes or anything. I do not think it had anything to do with economics or anything else right now. I do not see any issues with our IoT.

Tom Fitzpatrick
No. As we said in our prepared remarks, we had visibility into the personal communication partners and feel real good about our prospects in 2020. So, we are not fussed about the fourth quarter net adds, Chris.

Chris Quilty
Perfect. Congrats and good luck on 2020.

Matt Desch
Thanks, Chris.

Operator
Thank you, and this concludes the question-and-answer session.

I would now like to turn the conference back over to management for any closing comments.

CONCLUSION

Matt Desch
Well, obviously this was a good year. We are off and running. We are going to see very soon in the first quarter, but there is also a number of conferences I think we would probably see some of you at here, the big Satellite Show is in a couple of weeks here in Washington and I know some of you will be here then. There will be a lot to talk about I think in 2020. We look forward to seeing all of you each quarter going forward. Thanks.

Operator
Thank you. The conference is now concluded. Thank you for attending today's presentation. You may now disconnect your lines.