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IRDM - Q3 2017 Iridium Communications Inc Earnings Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Iridium Communications' Third Quarter 2017 Earnings Conference Call. (Operator Instructions) I would now like to hand the floor over to Ken Levy, Vice President of Investor Relations. Please go ahead, sir.

Kenneth Levy

Thanks, Karen. Good morning, and welcome to Iridium's Third Quarter 2017 Earnings Call. Joining me on today's call are CEO, Matt Desch; and our CFO, Tom Fitzpatrick.

Today's call will begin with a discussion of our third quarter 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 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 like to update forward-looking statements at some point in the future, we specifically disclaim any obligation to do so even if our views or expectations change.

During the call, we'll also be referring to certain non-GAAP financial measures. These non-GAAP financial measures are not prepared in accordance with generally accepted accounting principles. Please refer to today's release and the Investor Relations section of our website for reconciliation of these non-GAAP financial measures to the most directly comparable GAAP measures.

With that, let me turn things over to Matt.



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

Thanks, Ken, and good morning, everyone. As you saw this morning we delivered another good quarter with both revenue and operational EBITDA growth. We've had excellent subscriber momentum this year with continued strength in the third quarter. Operational EBITDA is also tracking well to our full year outlook, which gives us confidence in tightening our guidance with 2 months to go in the fiscal year.

As you know, we've completed 3 successful launches this year with the latest batch of 10 Iridium NEXT satellites going into orbit 2 weeks ago. We now have close to half of our 66 new operational satellites in orbit and expect this figure to reach about 60% by the end of the year with our NEXT launch just 8 weeks away. The satellites from launch 3 are currently being tested by our operations team and will soon be inserted into our constellation. So everything's going according to plan on that front. Within the next 2 to 3 weeks, these new satellites will be inserted into their respective slots in plane 4 and will begin carrying live traffic to improve our network and improve our new -- and support our new services.

As we announced last week, our fourth launch is scheduled for Friday, December 22, and will carry another 10 Iridium NEXT satellites to orbit, this time to plane #2. Nine of these satellites are slated for immediate operation while one will drift to plane #1. Every launch really bolsters the quality and robustness of our network as we replace 20 year old satellites with brand-new Iridium NEXT birds. We're seeing the benefit of these new satellites already, and overall, we're on track to complete our launch program by mid-2018.

As you know, SpaceX is having a great year. They've now completed 15 total launches in 2017 and are on pace to launch more rockets than any other company or country, for that matter, this year.

The Falcon 9 has demonstrated excellent reliability, which led to the decision we announced last week to use previously flown or what SpaceX calls flight-proven rockets in our next 2 launches. We've studied the SpaceX refurbishment program and are comfortable that the risks are the same or perhaps even lower for using a flight-proven booster. Our insurance carriers have told us that our insurance premiums will not change as a result of this plan, which supports our conclusion, and this decision will help to guarantee our launch schedule.

So we're in really good shape with the launch plans and feel great about the steady progress our team is making with the Iridium NEXT deployment. The performance of the new satellites has been exceptional, and they're improving the capabilities and robustness of our network. Thales Alenia and Orbital ATK continue to produce and maintain a sufficient inventory of Iridium NEXT satellite to meet our launch schedule. They've both been great partners to work with to see this project through to fruition.

Moving to our third quarter results and outlook. We delivered strong subscriber growth with the addition of 36,000 net new subscribers. 2017 is turning out to be a record-breaking year for subscriber additions and significantly above last year. Continued revenue momentum this year gives us confidence that operational EBITDA will come in closer to the high end of our previously guided range. Tom will provide more detail on this shortly.

Commercial service revenue grew 4% year-over-year, owed largely to continued expansion in our IoT business, which was up an impressive 14%. In the third quarter, total commercial subscribers reached 854,000 with IoT or M2M users accounting for 57% to this total. Our IoT business continues to expand with heavy equipment partners, like Caterpillar and Komatsu, ramping up production and consumer partners, like Garmin, expanding distribution of their popular inReach products. Our subscriber base and M2M has grown at a double-digit pace every year over the past decade, and new IoT partnerships are adding momentum for continued growth going forward.

We've improved the quality of our partner base and align with businesses that are expanding their distribution networks and telematics capabilities. We're also now licensing our core technology, which we refer to as chipsets, to several partners in addition to selling transceivers, which allows Iridium to be integrated into more products at lower cost than ever before. 3 of our partners recently completed their first IoT products utilizing our chipsets.

The momentum we're now enjoying in our IoT business was seeded with contracts signed 2 to 3 years ago. Today, Iridium is sitting on a very strong pipeline, and we believe that the addition of new IoT partners, steady growth in fleet management and personal communicators and improving conditions in the oil and gas markets provide good visibility into the Iridium Certus era of growth.



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Recently, we announced another win in the heavy equipment sector with the signing of a long-term agreement with Hitachi Construction Machinery. Hitachi is a top 5 OEM with annual sales north of \$7 billion. They're adopting Iridium satellite-based IoT solution to improve performance and enable reliable worldwide delivery of their global e-service platform. This service monitors telematics information, like equipment utilization, fuel level, temperatures, pressures, and is used to enhance operating efficiency, control emissions and, importantly, will expand Hitachi's capabilities into regions and markets it could not reach with other satellite operators' offerings. To date, Iridium's IoT services are used by 8 of the top 20 heavy equipment OEM, including 5 of the top 10. Look for us to continue to add to this customer account.

Our strategy is to be the leader in satellite IoT. With our sustained growth in this area, I don't see how anyone could doubt the importance of our superior coverage and differentiated offerings. Our subscriber growth is clear evidence that the industry agrees, and we're achieving this goal.

While our IoT business is expanding nicely, we're excited about the higher speeds in new technologies that are coming with Iridium NEXT. I know we've spent a lot of time talking about how new Iridium Certus broadband offerings will soon be the best L-band service in the market, but it's also important to understand that Iridium Certus technology will also be scaled down to devices that enhance our position in the IoT space as well.

Development is already underway to create a small new transceiver that reduces the size and cost of Iridium Certus technology for lower-speed, highly mobile applications. The technology will deliver a number of data rates below 100 kilobits per second, using low-cost passive antennas, which are perfect for a wide variety of new IoT applications. This new transceiver, which we call the SFX, will be available to our partners late next year, and we think the SFX will be a game changer.

Three weeks ago, the Iridium Certus program achieved a big milestone as new software was uploaded and activated to our Iridium NEXT satellites in space to enable our partners to start on-orbit testing of their new broadband terminals. This moves our broadband offering out of the lab and into the real world, and it's only adding more excitement for our distribution channels and end customers.

Iridium Certus terminals have now been introduced by Cobham and Thales and are being developed by L-3 Communications and Rockwell Collins and will ultimately offer the fastest and most wide-reaching L-band broadband solutions available through small cost-effective terminals and antennas. Initial commercial service is scheduled for the second quarter of 2018.

Iridium Certus will deliver very competitive data rates for L-band to target the sweet spot of the market and address the growing demand for streaming video and Internet services. It will complement high-speed KU and K-band offerings on ships and aircraft, and we're confident that our broadband offering will set a new performance standard for industry in L-band, doing so with global coverage at a competitive price.

In recent months, hurricane activity and storm relief efforts have been in focus. And with many news outlets reporting on outages in terrestrial and cellular networks and widespread damage to infrastructure, I'm proud to say that Iridium delivered reliable service throughout these storms and provided a critical lifeline for first responders assisting families and facilitating aid to those who desperately needed it. We've been tracking closely our partner activity in Texas, Florida, Puerto Rico and throughout the Caribbean.

Late in the third quarter and into the fourth, we've seen a pronounced spike in network usage and a sharp increase in equipment sales and activations in those areas affected by the hurricanes. In Puerto Rico alone, we've seen more than 4,600 unique Iridium phones active with peak usage there running at several hundred times normal levels. And that's only reflecting commercial use and doesn't even count U.S. DoD activity.

Iridium is often the go-to technology during times of crisis. The recent storms and the wildfires in California are not so much an airtime revenue event for us but more serve as a reminder of the critical role that Iridium satellite technology plays in communication infrastructure, even in well-developed urban areas. New technologies like Push-to-Talk were heavily utilized in a number of places for the first time during hurricane relief efforts and are also being used as critical tools by first responders in the ongoing wildfire and relief efforts in northern California.

Finally, a word about Aireon. Aireon continues to fortify its business with its new aircraft surveillance capabilities rolling out as soon as next year. With 2 more MOUs signed in the latest quarter, that brings the total number of countries that are formally working with Aireon to over 30 in addition to the 10 that have signed long-term data services agreements. So bottom line, we expect the Aireon to continue to develop into a very successful business that will yield significant returns for our shareholders.



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So we have a full schedule in the fourth quarter with the completion of our launch 3 satellite position activities, our fourth launch right before Christmas and the continued live testing of Iridium Certus broadband, along with the selection of specific distributors to sell that service. I look forward to keeping you abreast of our activities and will be sure to provide updates in the meantime.

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

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

Thanks, Matt, and good morning, everyone. Let me start by summarizing our key financial metrics for the third quarter and highlight some trends we're seeing in our business. Then I'll review our balance sheet and liquidity position.

Iridium generated third quarter total revenue of \$116.5 million, which was up 3% from last year's comparable quarter. Iridium's top line continues to benefit from strong growth in commercial M2M. This quarter, we also realized incremental revenue from equipment sales associated with seasonal storm activity. Operational EBITDA was up 3% from last year to \$71.8 million while our operational EBITDA margin remained at 62% this quarter.

On the commercial side of our business, we reported service revenue of \$67.9 million in the third quarter, which was up 4% from the prior year's quarter, driven by continued strength in IoT. During the quarter, we added 33,000 net new commercial customers, driven predominantly by our M2M business. M2M data subscribers now represent 57% of billable commercial subscribers, up from 53% in the year-ago period. In our commercial M2M business, we picked up 25,000 net new subscribers in the third quarter. This was an 80% increase from net subscriber growth a year earlier.

As Matt noted, we've seen improved results from oil and gas partners and are also seeing broader adoption of our IoT solution from fleet and maritime users. Existing customers like Garmin and Caterpillar continue to activate new devices in large quantities, which gives us confidence that the strong IoT subscriber growth we were enjoying this year will continue for some time to come.

ARPU in our M2M business was \$13 this quarter, down from \$15 a year earlier, while commercial M2M revenue grew 14% over the same period, reflecting our expanding portfolio of satellite IoT partners and their growing offering of applications. These incremental partners and their customers value Iridium for the global reach and reliability of our network.

Many new customers are utilizing lower data usage plans that have lower ARPUs, a trend we expect will continue. Regardless, these subscribers are great additions, highly profitable, given their very low usage of our network and have a negligible cost to acquire. Year-over-year, commercial voice and data subscribers increased 3% while voice and data ARPU dropped slightly to approximately \$43.

For the quarter, we realized about \$700,000 in hosting and data services revenue from 13 operational Iridium NEXT satellites. Our recognized GAAP revenue include Aireon data services and Harris data and hosting components, but does not include Aireon hosting revenues. Aireon has not yet made a payment on its hosting obligation, and so we have not yet recognized the earned hosting revenues. Given expectations for the successful closing of Aireon's pending financing and partial payment to Iridium, we would recognize Aireon hosting revenue in 2018. Note that while we recognize hosting and data revenues for GAAP this quarter, we excluded them for purposes of OEBITDA, as we have done in prior quarters. Since they were less than Iridium NEXT expenses, they were also excluded from OEBITDA.

Turning to our government service business. Revenue remained steady at \$22 million this quarter per the terms of the EMSS contract. Government subscribers grew 16% year-over-year, and total U.S. government customers reached a record 95,000 this quarter, driven by balanced growth in voice and M2M data.

In the third quarter, subscriber equipment revenue was \$21.8 million, a bit stronger than we had expected due to hurricane-related activity. Equipment margin was 44%, and we continue to expect 2017 equipment margin will remain in the low 40% range.

Engineering and support revenue was \$4.9 million in the third quarter as compared to \$5.6 million in the prior year's quarter and reflects ongoing episodic work on government projects.



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In light of the strong fundamental trends we continue to see in our business, today we are tightening guidance for operational EBITDA at the high end of our previous 2017 full year outlook, which we expect to come in between \$260 million and \$265 million, based upon total service revenue growth of between 3% and 5%.

Moving to our balance sheet and liquidity position. We had a cash and marketable securities balance of \$350 million and are fully drawn on our \$1.8 billion credit facility, backed by the French export bank, formerly known as COFACE, which has been renamed Bpi. The drawdown in our cash position this quarter reflects milestone payments associated with the Iridium NEXT program.

Aireon continues to make progress in their financing efforts. We continue to expect a partial payment of Aireon's hosting fee in the first quarter of 2018 upon successful completion of their financing. We also continue expect an additional payment upon the successful completion of Iridium's launch campaign. We now expect a third payment will occur in the second half of 2019 or early 2020, tied to success-based milestones that Aireon is negotiating as part of their facility.

Separately, we've been actively evaluating our ability to refinance our credit facility. While it's been an excellent vehicle for the last 7 years, we're looking forward to replacing it with a structure that is more flexible. It is the consensus view of several global investment banks we've been talking to that a refinancing can be readily accomplished upon the completion of our launch campaign in the second half of 2018.

One of the considerations that we're working with is that Aireon's most recent estimate of hosting payment amounts and timing would not enable Iridium to meet the March 31, 2019, maturity of the Thales note and DSRA replenishment if the credit facility is not refinanced prior to that time. In the unlikely event of a significant launch delay, a refinancing might not be possible prior to the March 2019 maturity. We are actively working with our credit facility lenders on ways to deal with this contingency.

So with that, I can summarize by saying that 2017 is shaping up to be another solid year for Iridium, and we continue to see strong momentum in subscriber growth even before the commercialization of new services that Iridium NEXT will bring. Each successful launch reduces overall execution risks, and we remain confident in our ability to capture new business with the deployment of our upgraded constellation. The future for Iridium is very bright and are on way to unlocking significant shareholder value and transforming the cash flow characteristics of this company.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Andrew DeGasperi with Macquarie .

Andrew Lodovico DeGasperi - Macquarie Research - Analyst

First, great quarter. Just wondering the hurricane impact. I mean, it seems that we should see this continue into fourth quarter. But after that, I mean, should we sort of be taking that estimates back down, so sort of a normalized level?

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

Yes, I would think so. I mean, I -- it's clearly a spike. And as I said, it's more an equipment than necessarily service revenue at this point, because a lot of devices sort of had to go in those areas and then, in the fourth quarter, probably more backfilling those inventories for partners who sent theirs on to first responders and to individuals. As I said, I think this is kind of more of an advertising for Iridium service in many ways. I've had many people kind of call me in some of those areas now that everything has passed, like (inaudible) and suddenly be interested in maybe a satellite device for the future. I mean, I think in some ways a lot of communities, who might have thought that they could cut back, realize that this is maybe

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an essential communication tool for the future. So I think it sort of, just overall, generally supports this business, but we certainly aren't forecasting that this is a growth trend or anything like that.

Andrew Lodovico DeGasperi - *Macquarie Research - Analyst*

Right. And then just quickly, there's been an uptick in, I guess, a chatter about non-geostationary orbit projects and constellations. Just curious to know your thoughts on the impact to Iridium from either a business or debris perspective?

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

Yes. I mean, from the business productive, almost exclusively all those are noncompetitive systems. They're all looking to build broadband capabilities, what I would call sort of commodity or general-purpose kind of broadband capabilities in the KU and K-band area or even in higher bands like V. And those are all potential partners for us because our L-band will complement those services nicely, and our, really, approach and network is doing different things than they're forecast to do. So I don't look at any of those from sort of a business impact. I empathize with the efforts that they have to do to build some of those systems because we've been 30 years at this and know what's involved, but I'm sort of more cheering them on. Debris is another matter, we've taken a leading position in the market on what -- in the industry, really, on what we think is necessary in that area, what needs to be happening I urge all my satellite brethren not to cheap out on the core technologies that they're putting in their satellites because they need to be maneuverable and avoid things. But overall, they certainly all seem to be very cognizant to that fact. So I'm expecting that that's not going to be a long-term big issue but one we're always cognizant of.

Andrew Lodovico DeGasperi - *Macquarie Research - Analyst*

Right. And maybe last one for me is, can you maybe update us on what your current maritime mix is? And how's the market trending at this point?

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

Yes. I mean, the market is what the market is. We're just in a pretty good position right now with our current products being sort of value-based and probably competitively more palatable to the distribution markets than our main competitors because of sort of the approach we have to pricing and not competing with our partners. So our core business and our OpenPort products continue to do pretty well and are growing. And so we're sort of net coming from a smaller position and growing into that and then feel really good about the prospects going forward with Iridium Certus because of the advantages that we'll really have in the L-band market for a number of years, we think. And I think from what I see in the partner base, they're quite excited about offering a really competitive offering there, either standalone or in conjunction with VSAT products as we're deployed a lot of times as sort of a backup complement to those products. So we see growth in the maritime space right now. Despite challenges in sort of that market overall, we're kind of coming from the right place, if you will, competitively there.

Operator

And our next question comes from the line of Rick Prentiss with Raymond James.

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

Appreciate the update on the batch 4 launch and how you're going to shoot those into plane 2. Can you update us on the cadence for the next couple? You're going to use the flight-proven, I guess, for the next 5 batch. But how should we think about the cadence going into the rest of '18 then?



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

Yes. It's going to definitely be pretty quick because we still believe we can finish by mid-2018, and that means we have 4 launches in the first half of 2018 to complete that. Had a lot of discussions with SpaceX. They certainly are operating at a much higher rate than they did at this time last year and into the early part of next year. They think they can handle it with both flight-proven and new boosters. We've had -- we got the Vandenberg, seems cooperative in terms of launch schedules, and our satellite production appears able to meet the overall schedule. So it's going to be a busy first half, but everything's lining up right now to keep the pace up to be launching enough satellites to complete it as we hope to in mid-2018.

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

And is kind of the 60 day target still there? Or do you hope to do even better than that?

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

Well, you can kind of do the math and figure out that, in some cases, it'll be even better than 60 days, we'll even be able to tighten up beyond that. We think right now one of the gating items has been the ability to really fly those satellites into position in a timely way. We were worried that it would take almost 60 days to position our satellites. But our team at our network operations center here in Leesburg is just doing such a great job, and our satellites are performing so well. We're not having any hiccups with that, but things are moving a lot faster on that front. So we're really able to launch quite a bit faster than 60 days. So it's just really a matter now of getting rockets, putting the satellites on them and working through all that. So -- and one of those 4 launches is really a rideshare launch with only 5 satellites, and that takes a little bit of heat off of that one in terms of the operations team because they don't have as many to position. But yes, we feel good about the cadence for 2018.

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

Great. And last quarter you had talked a little bit about your thoughts on the FAA coming onboard may be by second half '18. Any update to that process?

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

No, I wouldn't say there's really any change in that. I still feel good about the FAA as a customer. They have their decision processes and timelines. And probably I'd say more the focus right now is continuing to sign up customers around the rest of the world and continue to support the FAA's decision processes, which, as we said, we still believe will happen later in 2018 and with eventual deployment of the service.

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

Okay. And then Tom, you mentioned the credit facility replacement, talking with lenders out there. How should we think about your timeline and what you're focused on and working on and what we should be watching from the outside as far as putting in place alternatives for that principal and interest repayment kind of schedule you have with the existing one?

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

Right, so Rick, I would say we've been very active with the leverage finance organizations of bulge bracket global firms, who have been putting a lot of work into the Iridium refinancing to the extent of sharing our models, et cetera. So I would characterize the belief that we can readily refinance our existing COFACE facility upon the successful launch of our launch campaign as highly vetted and to a high degree of confidence that we can get that done. And so we're just being -- in my prepared remarks, we're just trying to be prepared in the unlikely event of a significant launch delay, that we're not flat footed. So we have a very robust relationship with the French banks, the French treasury, and we're doing scenario planning around that March '19 maturity should it become a consideration. And they're very constructive in -- we're on the same page to have a plan in



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place to deal with that. So that's how you should think about it. I mean, I think probably in our next earnings report, we will probably have that contingency plan in place, and you should expect us to report on what that is.

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

Great. And that's what I was looking for, just kind of when we should think about getting some information out here.

Operator

And our next question comes from the line of Greg Burns with Sidoti.

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

Could you just give us an update on where you stand in signing up partners for Certus? And I was wondering if you can maybe give us some color on the economic model there, how you'll be working with those partners to resell the service. Will those partners be prebuying capacity and reselling it? I just wanted to better understand kind of the Certus model.

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

Yes. So an awful lot of activity. I would say it's been very detailed discussions at the contractual level, even at this point, with pretty much everyone in the maritime, aviation and even somewhat in the terrestrial markets, to sell these new terminals starting in second quarter of next year. We've actually signed a few, probably more in the aviation section. We haven't really talked about who those are, some smaller ones. The maritime ones, there a number of those right now that I think are going to conclude this quarter. I think it's going to be fairly broad-based in terms of the number of people that can distribute Certus. And the general model is not that far off of what we do today, where we provide -- we don't provide just capacity, though that's -- we provide basically broadband capability and then they mark it up and sell it, along with terminals, to their customers for periods of time. There's discounts for larger commitments and that sort of thing that they can get so that they can even increase their margins. And I think there's a fair amount of flexibility that they're going to get, that they like in terms of how they can market our service to their partner base. So we're really in the finalization stage of these partners all over the world, and I'd expect we'll start announcing before long here.

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

Okay. And the change in the outlook for the timing on that last payment from Aireon, was that a function of their outlook on the ability to sign maybe the FAA or some other change in their business that kind of pushed out the timeframe?

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

It has nothing to do -- Greg, it has nothing to do with the FAA. Our expectation is the FAA will make a decision in the second half of '18. That has been a consistent expectation, and so there's no change there. The change in the third payment is more around I would characterize the credit facility as being highly refined, the Aireon credit facility, and the bankers saw the need for sort of an operational milestone that became clear to Aireon they -- that would -- they could pass that milestone in the second half of '19, which then says that the payment needs to kind of -- couldn't happen sort of in the first half of '19. And they advised us of that most recently, and so we're advising you of it. But to reiterate, it has nothing to do with the FAA. We remain very confident in that regard.

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

Okay. So they do have a credit facility lined up here that gives you kind of the visibility on that -- the first payment coming in the first half?



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

I would characterize them as way down the road with their bankers.

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

Okay.

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

They're spending a lot of time on the fine points of their credit facility.

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

Okay. And the reusable Falcon 9 rocket, I mean, it doesn't sound like there's any additional risk from an insurance perspective. Was there any financial benefit to you in using that? Or was it just simply about getting the cadence of the launches to where you needed them to be?

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

Yes. There was a financial benefit. I just haven't really focused as much on talking about that, because not just the size of it, but really the fact that, that wasn't the primary consideration. I mean, if the risk wasn't the same or lower and the cadence wasn't going to be improved, I really wasn't going to -- I really couldn't put a price on that. So yes, it has improved our contract somewhat. There are some apples and oranges in the numbers. So quoting a specific price per rocket doesn't sort of make sense because there's a number of moving parts in that really. But yes, it did have a financial positive impact.

Operator

And our next question comes from the line of James Breen with William Blair.

James Dennis Breen - *William Blair & Company L.L.C., Research Division - Communication Services Analyst*

Tom, I was wondering if you could just talk about -- given that you have a little bit more information now on what's going on with Aireon and funding in general, just talk about how you think about the puts and takes of funding over the next 2 to 3 years and then how you think about delevering the business plan as the constellation gets fully launched in 2018.

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

Right. So how we think about our existing credit facility is while it's -- it was like I said on -- in my remarks. While it was sort of tailor-made for our needs during the construction period, once the construction period is over, it calls for a number of things that we don't think are appropriate in our circumstance, which is significant principal repayments, the inability to do things like share buybacks and consider paying dividends. And so it doesn't suit our circumstance anymore. The work that I talked about that several investment banks are doing, says that we could put in a structure that has sort of 5x through the banks with 1% principal amortization, very attractive in interest rate and have sort of a slug of high-yield in -- behind that. And so that's the capital structure we're focused on. That's the capital structure, we think, is appropriate for our circumstance in the post construction period, Jim.



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James Dennis Breen - *William Blair & Company L.L.C., Research Division - Communication Services Analyst*

And so essentially, in some ways, you're terming out some of the debt. But does the plan, in terms of deleveraging, change much in terms of trending -- be fully delevered from '18 to '22?

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

No. The firm naturally delevers. Just as EBITDA grows, the capital structure is not going to determine the rate of deleveraging, right? So either we'll be sitting on more cash or whatever, but the credit specifics are not going to be changed.

James Dennis Breen - *William Blair & Company L.L.C., Research Division - Communication Services Analyst*

And then just one other question on the GMDSS. Maybe I missed it. But is there any update there on getting that put in place?

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

Yes. I mean, the process, which takes a long time, continued to progress. We've actually had some recent success in terms of testing with the organizations that are involved in it. We haven't really announced this formally or anything. We may do that in the future. But we just had a very successful sort of testing program, both in our labs and out in Europe right now, where they sort of observed that we were able to demonstrate a whole number of things, really, the capability of GMDSS. And really, from what I heard all that testing went flawlessly. So that all goes into a report, and it goes to the whole international maritime organization. And we still believe that, that will successfully conclude in -- with a positive outcome in 2018. And as terminals become available, the service will go into operation. So we're still making great progress towards GMDSS certification, and that's still a core part of our strategy.

James Dennis Breen - *William Blair & Company L.L.C., Research Division - Communication Services Analyst*

And I guess just one more on the government side. It seems like you've seen pretty good growth there, even though it's a fixed price contract in terms of subscribers and usage over the course of the last year. When do you think about the renegotiation of that and the services rendered there?

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

Yes. We have had good subscriber growth, which really kind of bodes well for the future. It's a fixed price from a revenue perspective. But the whole point of that was to really promote subscriber adoption, which lowers the overall cost per subscriber to the customer and even increases the overall value of Iridium to the customer. And in addition to the core services with the new capabilities of Iridium Certus coming along with the sort of excitement about the new service we -- that went commercial last year, satellite time and location and tactical radio services and everything. We feel really good about the future of our relationship with the government and the contract. That being said, the contract doesn't expire till -- well, technically expire until next year in the fall. And even then, there's sort of a -- we're expecting that they'll -- there's a tale that they execute that goes into 2019. So while we've had a lot of discussions with them about the overall structure and price and that sort of thing, it's really not going to come to a head until well into 2018 in my view, probably more out to next year. So we're not into the actual details. But feel good about the process, have a very constructive relationship and a lot of activity around them that obviously makes us feel good about -- that, that relationship is going to continue long term on reasonable terms for both of us.

Operator

And our next question comes from the line of Chris Quilty with Quilty Analytics.



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Chris Quilty - *Quilty Analytics - Analyst*

Just want to follow up on the Aireon. You've got a number of MOUs. When do you expect that those -- or I guess Aireon has a number of MOUs. When do you expect that those would eventually convert over into data service agreements?

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

Yes. I can say they're really, really busy right now. The second half of 2017, they're on the road almost constantly right now because there's a list of about 6 to 10 that I know that they're really kind of focused on right now with a couple of big ones in the near term. So they're really -- the pipeline is pretty well developed. And many of the MOUs have really moved into the data service agreement, negotiations, and we expect that those to convert, really, in the next few months. So it's a busy time for them right now, and really, I expect you'll see a lot of activity around that in the next 6 months.

Chris Quilty - *Quilty Analytics - Analyst*

Okay. And second part of the question, for Tom. I think you mentioned previously that Aireon was out on the road looking to raise capital and something you mentioned about their current debt service agreement seemed to indicate that they accomplished something. Or is that still something yet to be done?

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

They're actively on the road with their financing, Chris.

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

It is not completed yet. It is not completed yet. It's just well-developed and into really sort of execution stage right now. But we don't have a result from that yet and really don't expect to in the next month or 2.

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

No. But the tranching of payments to Iridium are part and parcel of the credit agreement that's being marketed currently. So they have their financial models. They have contracts in hand that are the subject of the collateral. It has nothing to do with the FAA. We will get our first payment even without the FAA coming in, and that's contemplated by a credit facility. And then as additional contracts are signed, they essentially give rise to additional capital and collateral in the credit facility that's being marketed. And that's where the additional payments come from us. So think of it that way.

Chris Quilty - *Quilty Analytics - Analyst*

Got you. And do you expect that their financing will be in place before the end of the year?

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

We wouldn't say that. We've said that we can expect the payment to us by the end of the first quarter of '18.



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

We don't really have a timeline exactly. Obviously, we're showing some optimism only based upon a lot of discussions we've had with their bankers and them. But the market is the market, and they got to get through their activities here. And I don't frankly know exactly how long it will take for them to close, but -- and anything could, I suppose, happen. But we're obviously feeling good about the process overall, from what we've heard.

Chris Quilty - Quilty Analytics - Analyst

Okay. Switching gears, you mentioned that you -- on the M2M IoT side, you've got some customers that are now integrating chipsets. Those are presumably first-generation chipsets that they've been developing for years. Is the fact that the SFX is not available a hold up for other customers, not doing the work to integrate so that they're not making a switchover between current generation and future generation silicon?

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

No. We haven't seen any kind of hold up of where people are waiting for Certus technology to go forward. The current technology -- current chipset technology, which is based upon the 9602, 9603 platform, as you can tell by the subscriber growth, is a very desirable technology. The larger partners like the idea of -- even though it's not that expensive overall, I think, in the big scheme of things. But if they could just take the core chips and integrate them into their technologies, they can even reduce their costs further and develop a platform more in line with what their technical needs are going forward in their sort of product road map. So we're seeing a couple of those happen. It's exciting to see some of the products. More importantly, it's nice to know that you're being embedded in sort of their road maps because they've invested to take your technology and put it into their product road maps going forward, which obviously bodes well for the long-term relationship. But no the SFX has a lot more capabilities. The lower end operate, in say, at 22 kilobits per second with battery power, all the way up to, say, 88 kilobits per second, line-powered with different kind of antennas and a range in between. We have had some discussions with a couple who are excited about that. It's challenging to license. I mean, we will -- we're opening to license that technology, the SFX, potentially as a chipset model. But we really have to complete the development or get a lot further down the road before that would really kind of actively happen anyway. It's too hard to license the technology while you're developing it, and they realize that. But I don't see anybody really waiting. I think, too, that the SFX isn't really sort of so much a replacement. It's probably more of a replacement for what we call our L-band transceiver in 9523 platform. And I think that there'll be a lot of new applications it creates. I think it'll also create new price points and that sort of thing in, say, the aviation markets and some other kind of low-end applications at -- in maritime as well. But that's really kind of a whole new area for us, I think.

Chris Quilty - Quilty Analytics - Analyst

Okay. And is it fair to assume that if somebody is going through all the time and expense of integrating chipsets to drive down costs, that we might see much higher volume applications in the future? And if so, when might we see that?

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

Well, that's always the hope. I know -- particularly, in the consumer space, that's where you can see bigger numbers. But there can also be some in the enterprise government space as well, where people have described plans that could have a lot higher volume. A lot of those are lower ARPU, but that's fine with us because that's all incremental new revenue. So yes, I mean, we're starting to see the volume increase today, and I would expect that to only improve, really, as these chipsets offering come into play as well. But no forecast, going-forward exact numbers, but obviously, that's possible.

Chris Quilty - Quilty Analytics - Analyst

Okay. And any update you can give us on what you're seeing with your time and location business and partnership there?



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

Yes. I mean, it's -- I would say it's only been positive. It's been hard to describe specifics to -- because a lot of that is related to both governmental and enterprise activities that our partner, Satelles, more directly controls. We've been involved in a number of those discussions so I feel very -- I can say I'm excited about the potential for that technology really improving, not just -- really more on the time information. Time's become so important right now, and the reliance upon GPS, for so many industries, has made it aware recently that that's dangerous because GPS can be fragile. It's a single threaded sort of technology. So Iridium, I think, is rapidly becoming sort of a secondary backup to that or something that can complement and augment that technology for doing stuff and lowering the cost in enterprise applications where you need to put a GPS, just even for communication networks and utility networks, et cetera. So for us, it's basically, it's a -- we get payments to turn on the service around the world. So we don't kind of participate in the upside but feel very good about the potential for even getting those payments as we -- for lighting up sections of the world in the next couple of years, based upon everything we've heard.

Chris Quilty - Quilty Analytics - Analyst

Got you. And final question. I don't think you've publicly commented on the MOU with Magnitude Space since that was announced a month ago or so. Can you give us your thoughts on that agreement?

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

Yes. I'd say the IoT opportunity is huge in the coming years. We think we're -- we said very well-positioned with -- on the real time high-end premium satellite IoT space. And you can see by our subscriber numbers and our technology plans, we think that's going to continue to grow. We think that there's kind of a market at both the high end of that, where they're sort of broadband distribution to things, and we think we're going to play with that in the Certus market. But we also think there's a kind of a low end as well in the future, where Space can deliver to very, very low cost, very high latency applications. Think of like soil sensors. You might only want to spend \$0.25 a month to get what the -- this field's soil moisture rate is. That's not really something our current network is well-positioned for. We wouldn't really want to go after that business, but someone like Magnitude Space is perfect for that. You don't care when you get that information. They plan for 24 satellites that will be sort of a store and forward network for that -- for low-cost sensors just like that. That could be very complementary to our base. So when we met Magnitude Space about a year ago, and they're one of a couple of companies looking to do this, we thought that was a nice complement, and that's why we signed the MOU. We -- they still need to get their funding in place. They need to launch satellites and that sort of thing. So we're not participating on that basis with them. We're more focused on our own network for that. But we like the idea of working with them on joint products, maybe be a one-stop shop to our partner base towards our multiple technologies, and I think that could be very complementary.

Operator

(Operator Instructions) Our next question comes from the line of Greg Mesniaeff with Drexel Hamilton.

Gregory Mesniaeff - Drexel Hamilton, LLC, Research Division - Senior Equity Research Analyst

When you look at your recent acceleration in subscriber growth relative to your revenue growth, is it fair to say -- well, let me phrase it this way, what percentage of that roughly is greenfield opportunities versus gains in market share from competitors?

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

Yes. We don't have a -- really, a breakdown exactly that way. There are -- as I mentioned, the partners that we added 2 or 3 years ago are starting to come online. So you might see some new growth from a Komatsu, for example, soon, and you'll see other partners that we added a couple of years ago. And those are adding nicely. You've seen new products that Garmin might've introduced a year or 2 ago starting to really kind of take



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hold. You're certainly seeing Caterpillar growth. But we don't kind of categorize that in one way or the other. And we also see our base really continuing to do pretty well in a number of different market sectors. We're certainly seen oil and gas, the headwinds kind of abate there a little bit on that. That isn't declining. Potentially, maybe there's growth, transportation, et cetera. So it's pretty broad-based across an awful lot of partners right now. And it is true that some of the big growth areas are maybe lower-ARPU kind of devices. And as Tom mentioned, since there is no incremental cost to those, that all just drops to the bottom line. Our ARPU kind of falls a little bit, but that's incremental revenue. So we like to get that. And those are good customers as well. They don't use that much of the network resources and end up adding to the base and driving equipment sales and other sensors.

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

Yes. I would just add, the growth in Garmin is particularly strong. And if you think about the history there, right, that Garmin acquired a company called DeLorme that had -- I would characterize it as limited distribution, when you compare it to Garmin's global distribution, and we're definitely seeing the benefit of that. And you would characterize that as greenfield, they're taking a product that wasn't distributed in certain geographies, and now it's a global consumer offering that, we think, are going to fuel our subscriber additions for quite some time.

Gregory Mesniaeff - *Drexel Hamilton, LLC, Research Division - Senior Equity Research Analyst*

If you could just also give us a quick update on your relationship with Harris and any color there.

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

Yes. And you're talking specifically about the ship tracking service? Well...

Gregory Mesniaeff - *Drexel Hamilton, LLC, Research Division - Senior Equity Research Analyst*

Yes.

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

[I can address] the most public part of that. Yes, that, we formed a number of years ago as a result of the Aireon payload. They won that contract to do the Aireon payload, have done, by the way, I think, a fantastic job of developing that payload. It seems -- from what I understand from the Aireon team, is working really, really well. They had some extra room in that and asked for the ability to kind of market some additional capabilities. And we negotiated a hosting and data services arrangement a couple of years ago, and that's now sort of coming into play. The primary payload that they have been public about is this AIS ship tracking service that is on most of the new satellites, and they have been telling us that the testing of that has gone very, very well. They market that, I think, to the U.S. government and exactEarth of Canada kind of markets it to the rest of the world, and both of them are very excited about the potential for it. We don't participate in the direct revenues of their business growth in that area, to the extent that they sell that service. But we do get hosting and data service payments, and those are things we're reflecting in our financials right now.

Operator

And our next question comes from the line of Jim McIlree with Chardan Capital.



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James Patrick McIlree - Chardan Capital Markets, LLC, Research Division - Senior Research Analyst of Industrial and Consumer Technology

In the Q that was released this morning as well as the Q for the June quarter, you cited about a \$5 million year-over-year increase for insurance payments. And the question is, how big do those go? When you have the entire next constellation up, how large will those insurance payments be? Or in -- alternatively, how much more of an increase is there?

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

So Jim, I think the insurance you're referring to is the in-orbit insurance. So on our launch insurance, part of that is capitalized. But the in-orbit piece of the insurance, under GAAP, needs to be expensed. From the way we look at it, both -- those elements of the insurance are part of our construction costs of Iridium NEXT, but the cost that you're referring to, which are in-orbit, hit the P&L. And so they'll be sort of 5. They were actually \$4.4 million in the third quarter. It will be \$5-ish million next quarter and between \$4 million and \$7 million in '18, and then they'll tail off in the first and second quarters of '19. It'll be \$3.5 million the first quarter of '19, and then we'll be done with it, done with the amortization in the second quarter of '19.

James Patrick McIlree - Chardan Capital Markets, LLC, Research Division - Senior Research Analyst of Industrial and Consumer Technology

Great. And you are correct, I was referring to the in-orbit insurance. And then secondly, on the Aireon payments that you're expecting, can you put a range or a size on what you think those 3 tranches will be?

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

Not at this point. Let's let Aireon get through their process that they're literally right in the middle of it. It'd be premature. We do know that there will be those 3 tranches, and we want to see exactly how they sort out that as a result of their marketing efforts.

Operator

And our final question will come from the line of Paul Penney with Northland Securities.

Greg Gibas - Northland Capital - Analyst

This is Greg on for Paul. Even though most, I think, have been answered, first, as Certus broadband speeds begin to slowly ramp after testing is complete, how should we expect gross margins on both the service and equipment side to change there? Will probably be new price points and antenna options?

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

Well, of course, we have no revenues and service revenues for that sort of line. That'll all be brand new revenue for us. And if you're comparing it to, say, OpenPort or you're comparing it to its main competitor in the market, Fleet and SwiftBroadband, that's a whole another question here. The reason we speak so positively about it is we know that our partners are telling us the terminal costs that they plan to sell the products -- we sell them an underlying card called the BCX and then they turn that into a terminal and that the cost that they have in the market are going to be very competitive with things out there in the market. It should be less expensive, smaller, they obviously, operate on a wider scale of planet than the competitors' products do. And the data rates that we are -- that we talked about in the previous questions, not just data rate, but the cost for the data, really, are very competitive in terms of what they currently see in the market. So all that leads to believe that we believe it's going to be a successful product. But it's -- I don't know what to really compare it to since it's new revenues for us really. And OpenPort continues on for a while anyway, too, and that's a separate product line.



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

Yes. But just to differentiate. The access and air time in Certus has the same gross margin characteristics as they access and air time generally, which is there's minimal variable costs. It's almost very high-growth margins. As to the equipment margins, we're not selling that gear. That's -- our partners are selling that. So there -- it's not going to be either be accretive nor dilutive to us because we're not selling it, and the equipment that we do sell in maritime is not one of our higher-margin product lines anyway. So we just look at it as the incremental service revenue and very high gross margin opportunity that Certus brings us.

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

Good point.

Greg Gibas - Northland Capital - Analyst

Got it, very helpful. And just one more. I know you touched on this in the past, but just to get a clear a picture of the CapEx expectations. Is it safe to assume that approximately half of 2017's guidance range of \$500 million to \$600 million would be reasonable for 2018? And just wondering if you could provide a little more color on what would drive that, either higher or lower, in 2018.

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

So the CapEx is finite. So I would say in the area roughly half, maybe a little more than that in 2018.

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

And those are all fixed price contracts and everything, and so there's really not a lot of variability up or down. It's more just about when the timing of it is and when payments are due and when milestones are met. That's really been the only kind of variability.

Greg Gibas - Northland Capital - Analyst

Got it. So it's safe to assume that some could be recognized in early 2019, too.

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

Well, that would only be if the program really got delayed in some way. That's really certainly not our expectations, but -- so we certainly -- our whole goal is to spend it all in 2018.

Operator

And that concludes our question-and-answer session. I'd like to turn the floor back over to Iridium for any closing remarks.

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

Thanks for joining us on the call. I look forward to updating you, and I'm sure you'll be watching us on December 22 on our next launch. So thanks for joining us. Take care.



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Operator

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

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