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IRDM - Q1 2017 Iridium Communications Inc Earnings Call

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## PRESENTATION

### Operator

Good day, ladies and gentlemen, and welcome to Iridium's First Quarter 2017 Earnings Conference Call. (Operator Instructions) As a reminder, this conference is being recorded. I would now like to hand the floor over to Ken Levy, Vice President, Investor Relations.

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### **Kenneth Levy** - *Iridium Communications Inc. - VP Investor Relations*

Thanks, Karen. Good morning, and welcome to Iridium's first quarter 2017 earnings call. Joining me on today's call are our CEO, Matt Desch; and our CFO, Tom Fitzpatrick. Today's call will begin with a discussion of our first 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 on Iridium's website.

Before I turn things over to Matt, I would like to caution all participants that our call today 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 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 disclosed 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 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 earnings release and the Investor Relations section of our website for a reconciliation of these non-GAAP financial measures to the most directly comparable GAAP measures.

With that, let me turn things over to Matt.



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

Thanks, Ken. Good morning, everyone. So you can see, 2017 is off to good start. The business is running well. We made significant progress with the deployment of our first Iridium NEXT satellites, and we're now planning for our second launch in June. I want to use today's call to provide an update on Iridium NEXT and then touch on some of the first quarter business highlights before turning things over to Tom.

First off, I'm happy to report that our initial batch of Iridium NEXT satellites are now fully operational and working very well. We went through an extensive checkout process before putting these into the constellation. Each satellite was tested thoroughly, both individually and in conjunction with all our other satellites. Primary and hosted payload functions have also been tested extensively to ensure these and future satellites will work as designed once launched.

We completed the commissioning of these Iridium NEXT satellites about a week ahead of schedule, which is a real testament to the planning and preparation of our satellite operations team. What's important is that our experience with in-orbit testing, slot swaps and the new satellite performance gives us confidence that we'll be able to manage the roughly 60-day launch cycle that SpaceX is targeting following the second launch. In all, I am very pleased with the execution of Thales Alenia and our operations team, and I congratulate them both on all the good progress so far.

Of the 10 satellites we launched in January, 8 were placed into service in plane 6, while 2 satellites have begun a 10-month journey to an adjacent plane as part of a highly choreographed process that will eventually get all the satellites into their proper positions at the earliest possible time. We continue to expect that the Iridium NEXT constellation will be fully operational in mid-2018. This outlook is predicated upon our second launch in June, and SpaceX's execution of Iridium NEXT launches about every 60 days thereafter. Based upon the launch success and turnaround SpaceX has demonstrated this year, they should be able to keep to this cadence.

Each of the 8 Iridium NEXT satellites we put in service so far are not just working well, they're providing our customers better service. The satellites' faster processors, larger memory and modern engineering design are delivering better voice quality as well as faster data throughput for our maritime, aviation and IoT customers.

While our current network is performing amazingly well for its age, the statistics for our newest satellites are even better. I can't wait for the coming launches and the impact that additional NEXT satellites will have on the overall work performance, and that's even before we introduce new services.

The offshoot of our successful launch campaign is that we must also plan for and execute the deorbit of legacy satellites being removed from the constellation. I thought you might find it interesting the methodology we're taking for decommissioning our Block I satellites, now that we've started that process to give you insight into the effort and care we're taking to execute on this part of the mission.

As I've described before, the process of replacing a legacy satellite with an Iridium NEXT satellite is called a slot swap, and it follows a precise sequence of steps to ensure service continuity. As a new Iridium NEXT is cross-linked into the constellation and L-band services are engaged, the new and the old satellites remain co-located for a short period. Based on the health and operational capabilities of the legacy satellite, we'll either start an immediate deorbit or move it into a temporary storage orbit, approximately 20 kilometers below the operational constellation. Those legacy satellites lowered to the storage orbit will be maintained as a contingency measure until all 75 Iridium NEXT satellites are placed into service. As a practice, we're keeping the best of the legacy satellites in orbit as either operational satellites or as temporary spares, and then we'll deorbit the rest pretty quickly.

For example, of the 11 satellites in plane 6, 8 are the new Iridium NEXT satellites from the first launch, and 3 satellites are the best-performing legacy satellites that were operating in this plane. Of the 7 remaining legacy satellites we remove from service, we plan to put the 2 best in the temporary storage orbit as backups. For the rest of the old satellites, our operation team follows a methodical decommissioning process to deorbit and safely retire them from lower orbit. Each of the satellites we deorbit will follow NASA recommendations with a scripted series of thruster burns to utilize all their fuel to put them in the lowest orbit possible, where they will then automatically deplete or passivate their batteries, open their electrical relays and propellant lines and position their solar arrays for maximum drag, so that the satellites will burn up in the atmosphere. We're expecting most satellites will burn up within a year or less after completing this process.

A few weeks ago, the first of our Block I satellites, SV40, was decommissioned this way, and we are planning for the second and third to occur in the next few weeks. We will continue this process for all legacy satellites that we aren't using as temporary spares, and we'll eventually deorbit all the Block I spares after Iridium NEXT is completed next year.

So moving back to building and launching the new satellites. To date, Thales Alenia has manufactured over 40 Iridium NEXT satellites, and production continues on track to complete all satellites around year end. Thales and their partner, Orbital ATK, are doing a good job on production, and we should have plenty of satellites ready for each launch. As far as the second launch goes, SpaceX has informed us that they have scheduled our launch for Thursday, June 29, just a few minutes after 1:00 p.m. Pacific Time. That launch will be into plane 3. Vandenberg has also confirmed the 29th, so satellites will start shipping to the base in about 2 to 3 weeks to begin processing as the dispenser and the payload adapters are ready and on-site.

With SpaceX's increasing cadence on production and launch, they've also provided us launch dates for 3 more launches in 2017, in August, October and December. So we're hoping they stay on track as we're ready to deploy satellites as soon as they can launch them.

Moving on to our business results. The first quarter came in on plan and in line with our expectations. IoT subscriber growth remained strong and at a much faster pace than last year, led by several of our larger and newer customers. Year-over-year, M2M subs grew 67,000 or 18%. This continued impressive growth reflects strength from new business partners and growth from existing partners like Caterpillar and Garmin. We continue to have the best satellite IoT product in the industry, and with Iridium NEXT now deploying, we're starting to win new business with global partners, which can diversify our existing subscriber base further.

Last month, Honeywell announced that it adopted Iridium satellite solutions to help its government and commercial customers monitor remote assets and human capital. Honeywell Workflow Solutions will roll out a line of connected worker products to monitor the location and safety of workers in remote locations.

This new partner is another example of bigger IoT players who may have worked with other satellite IoT networks in the past and are now moving to Iridium for our reliability and enhanced quality as we launch our next-generation constellation.

Last week, we announced another new partner like this with Lindsey Manufacturing, who provides smart grid solutions to the energy sector. They will combine Iridium's global connectivity with their transmission line analytics solutions, which is a unique satellite IoT application. In fact, we're not aware of another partnership of this type. This will allow for a dynamic electricity routing and power management in time-sensitive markets. Lindsey has identified global opportunities for their products using Iridium that extend and improve the efficiency of the electrical power grid, particularly where cellular doesn't work.

In the first quarter, we maintained our strong momentum with the U.S. government, as subscribers grew 15% from the year-over-year period to a record 86,000 users. We have also had a number of important business development and engineering projects underway with the DoD. With our EMSS contract with DISA slated for renewal next year, we anticipate that our negotiations with the U.S. government will take shape later in 2017 and pave the way for another win-win contract.

Development of Iridium Certus terminals and equipment continues to progress well. In the past, Iridium has only played at the low end of the broadband space, but the rollout of new equipment from world-class partners will harness the full capabilities of our Iridium NEXT satellites and allow Iridium to really set a new standard in L-band satellite broadband for maritime, aviation and land applications.

Last month, we visited with many partners and new business relationships at the SATELLITE 2017 trade show. At this show, Thales announced and showcased some of their new Iridium Certus products, which they've branded MissionLINK, FlytLINK and VesseLINK for the land, aviation and maritime markets, respectively. Other trade show participants also voiced their excitement about Iridium NEXT and the impact that reliable L-band broadband service will have on their businesses and the markets they serve. As we move through the year, you'll hear more about Iridium Certus from our other VAMs like Cobham, L3 and Rockwell Collins as they publicly announce the Iridium Certus products they are developing. The first Certus products are slated for customer trials later this year as we all prepare for commercial launch early in 2018.



We're also moving quickly to finalize selection of service partners who have committed to sell Iridium Certus to their customers. We look forward to converting on their interest in selling Iridium Certus over the next few months.

And finally, Aireon continues to make nice progress with its business development and certification. With a handoff of payload control from Iridium in early March, Aireon completed initial flight testing with the FAA, NAV Canada and company-sponsored inspection aircraft to validate the performance of its space-based tracking and surveillance services. Everyone has been very pleased with the results. In fact, you may have seen yesterday's release on Aireon's testing with the FAA. They reported that their testing in the Washington and New York Flight Information Regions last month was a success. And that's good news as it's a particularly high-density and challenging environment. And of course, it's good news that the FAA continues to make progress in their evaluation of the Aireon service.

In February, Aireon agreed with Airways New Zealand to explore operational validation in the South Pacific. And in March, they signed new agreements with the ANSPs of Spain and France to evaluate satellite-based ADS-B surveillance services. Together, Spain and France surveil more than 5 million flights per year and manage several million square kilometers of airspace, both inside and outside of Europe. Overall, Aireon has an impressive list of MOAs and data service agreements with customers who represent a big share of the world's global airspace.

I thought it was kind of poignant when last week Malaysia Airlines became the first airline customer to sign up for SITA's real-time tracking service for airlines, powered by Aireon data through FlightAware. Malaysia Airlines will get minute-by-minute positioning updates of its global fleet so they can know the real-time position of every aircraft and customer. The tragic event of 2014 was a wake-up call to the whole airline industry. Malaysia Airlines continues to look for technology that will improve safety, and its adoption of this flight tracking service is a testament to Aireon's one-of-a-kind solution and how it is revolutionizing the aviation industry.

On the funding side of its business, Aireon has been active with advisers and bankers. We expect Aireon to commence its formal capital-raising activities this summer, setting the stage for a possible hosting payment to Iridium later this year. They are already starting to pay data fees as new satellites go into service.

So continued execution on the Iridium NEXT mission remains our central focus this year, and we feel very good about the momentum we have with the new development partners and business opportunities.

Before I pass things over to Tom, I just think it's important to note how much progress Iridium has made since we became a public company in 2009. At that time, I was hearing from investors a host of concerns about the potential decline in the health of our constellation network, our ability to grow in the face of competition, the likelihood that Iridium NEXT would overrun its \$3 billion budget and whether our selected launch provider, SpaceX, would ever fly.

Fast forward 7 years, and we have largely addressed all of these concerns while growing our subscriber base by 2.5x and nearly doubling our operational EBITDA. Our team has shown the ability to effectively retire risks and address any issue that comes our way. We will continue to do so as we get ever closer to our coming financial transformation next year.

I appreciate the ongoing support of our longtime shareholders and look forward to our next call in July to report out on our second launch and share further details on how we're progressing towards our financial goals. So with that, I'll turn it over to Tom. Tom?

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**Thomas J. Fitzpatrick** - Iridium Communications Inc. - CFO, Chief Administrative Officer and Director

Thanks, Matt, and good morning, everyone. I'll get started by summarizing our key financial metrics for the first quarter and provide some color on the trends we're seeing in our major business lines. Then I'll recap the 2017 guidance we affirmed this morning and close with a review of our capital structure and liquidity deals we have previously discussed.

Iridium generated first quarter total revenue of \$104.4 million, which was flat to last year's comparable quarter. Revenue was in line with our internal forecast and was fueled by strength in commercial M2M, which offset declines in equipment sales and engineering and support. Operational EBITDA was strong at \$64.3 million, an increase of 6% from the prior year period. Our operational EBITDA margin also strengthened this quarter to



62% from 58% a year earlier. You'll note that we recognize a \$14.2 million gain from the Boeing in-sourcing agreement. Of this amount, only \$3.2 million benefited EBITDA as it pertained to a cash credit received as part of the renegotiated Boeing arrangement in 2010. The remaining \$11 million was excluded from EBITDA as it pertained to a noncash purchase accounting adjustment dating back to 2009. The treatment of each is consistent with our historical practice, as each was being amortized over the operational lives of our satellites.

On the commercial side of our business, we reported service revenue of \$59.8 million in the first quarter, which was 3% higher than in prior year's quarter. This reflects continued growth in IoT from accelerating revenues from M2M contracts previously announced. During the quarter, we added 17,000 net new commercial customers, with the gain coming entirely from our M2M business. Commercial M2M data subscribers now represent 55% of billable commercial subscribers, up from 51% in the year-ago period.

For the first time this quarter, we are realizing revenue from hosting and data services on our first batch of Iridium NEXT satellites. This revenue flows through the commercial voice and data line and will eventually be broken out into its own line item in our MD&A discussion. In Q1, we realized less than \$100,000 in revenue from Aireon and Harris Corporation based upon several Iridium NEXT satellites being put into service during the quarter. With 8 next-generation satellites now operational, we anticipate the revenue from hosting and data services will continue to ramp with each successful launch and incremental Iridium NEXT satellites placed into service in 2017.

In our commercial M2M business, net subscriber activations more than tripled from those in the first quarter of 2016. We continue to see significantly less headwind from oil and gas related deactivations, while at the same time experiencing broad-based growth elsewhere, including from Garmin and Caterpillar.

Year-over-year, commercial voice and data subscribers increased about 1%, while voice and data ARPU ticked lower to approximately \$39. Our voice business felt the effect of subscribers using fewer minutes despite the year-over-year rise in subscribers.

Turning to our government service business, we recorded revenue of \$22 million this quarter. This quarterly rate was flat to last year's comparable period and will remain fixed through the end of our EMSS contract with DISA, which runs through October 2018. Government subscribers again grew at a rapid clip, rising 15% year-over-year. Total U.S. government customers reached a record 86,000 this quarter, driven in part by M2M growth of 21% from the prior year quarter.

We continue to believe that these subscriber trends reflect well on the value that Iridium technology provides to the U.S. government. The DoD's effective average cost per subscriber has continued to fall each year under the fixed-price EMSS contract, and the current cost per subscriber is approximately 12% lower than at the start of the contract in 2013. This fact is notable as we commence contract renewal discussions.

Moving to subscriber equipment, we reported revenue of \$17.1 million in the first quarter, which was down 3% from the prior year quarter and in line with our expectations. Gross margin was 41% for the quarter, modestly higher than the year-ago period. Overall, we have continued to reduce our manufacturing cost and expect that full year 2017 equipment margin will remain in the low 40% range, though mix shifts in individual quarters will cause some variability.

Engineering and support revenue, which is largely episodic and primarily relates to work done in the government gateway, was \$5.5 million in first quarter as compared to \$6.8 million in the prior year's quarter.

Moving now to our financial Outlook, we affirmed our 2017 full-year guidance this morning as well as our long-range financial outlook. Our first quarter results were largely in line with our forecast. Commercial service, inclusive of revenue from hosting and data services, provides incremental growth as 2017 unfolds. We continue to anticipate revenue from hosting and data services in the mid-single digit million range this fiscal year.

M2M data should benefit from continued growth in subscribers in 2017 as we expect Iridium IoT services to be increasingly integrated into solutions offered by heavy equipment manufacturers. Over the longer term, growth should be accentuated from new contracts like the one signed with Honeywell, and we expect further unit growth from Garmin as it expands its distribution of the inReach product through its global sales channel.



Finally, revenue from the government business will remain steady this year, keeping with the terms of the EMSS airtime contract. We anticipate continued robust growth in government subscribers using Iridium's voice and data as well as IoT services.

This year, we continue to forecast total service revenue growth of 3% to 5% and OEBITDA between \$255 million to \$265 million.

Moving to our balance sheet and liquidity position. As of the end of the first quarter, our Coface Facility was fully drawn, and we had a cash and marketable securities balance of \$419 million. All remaining milestone and interest payments associated with the Iridium NEXT mission are anticipated to be made in cash.

I am happy to tell you that we are nearing completion of our financing with Thales and modification to the payment schedule of the debt service reserve account with the Coface lenders. The agreements will be subject to the formal approval of the French Treasury, which is targeted for late May.

In addition, these deals will provide over \$200 million of liquidity to Iridium. Components of these deals, which are also described in this morning's 10-Q filing are as follows: First, Thales has agreed to defer \$100 million of individual milestone payments on Iridium NEXT through the first quarter of 2019. This arrangement will be financed at a rate of LIBOR plus approximately 250 basis points and require Iridium to pay a \$1 million up front cash fee. Second, lenders to the Coface credit facility have agreed to delay \$98 million in payments into the debt service reserve account until March 31, 2019. This figure is a combination of delayed payments and access to some funds that Iridium has previously paid into DSRA as restricted cash.

The arrangement also places restrictions on our use of funds received from Aireon with respect to the \$200 million in hosting fees. Any such payments in excess of \$50 million will be used to proportionately repay Thales the deferred amounts and replenish the DSRA.

The final component of these deals is a suspension of Iridium's preferred dividends on its Series A and Series B preferred stock. This action will provide almost \$20 million in liquidity over 5 quarters, after which, we intend to resume making preferred payments.

In total, this arrangement will provide the cushion we need to absorb an Aireon delay of payment well into 2018. We will need to have collected the Aireon hosting fee by the end of the first quarter of 2019 or made other financing arrangements to repay Thales and fund the DSRA at that time. However, based upon the terms and expected timing of these liquidity deals and the state of credit markets generally, I am quite confident that our funding plans for Iridium NEXT are in good shape. As a result, we do not anticipate any liquidity issues in 2017 and anticipate that the deals with Thales and Coface will provide Iridium sufficient liquidity well into 2018, even without the Aireon hosting payment.

I want to thank Thales and the Coface lender banks, who have been very supportive of the Iridium NEXT program and great partners in getting this bridge. We feel very good about Iridium's business transformation and look forward to our next launch in June.

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

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## Operator

(Operator Instructions) Our first question comes from the line of James Breen from William Blair.

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

Just a couple of questions. One, Matt, can you just talk about the process you've gone through so far with getting the data from the satellites that are up and providing that for Aireon to help them get their funding in place? And then just for Tom, you just talked about some of the relief you gotten on the debt side to provide some liquidity. It seems like it's more than what you would need over that time frame. Just wondering what your thoughts were on the total package.



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

In terms of the 8 payloads that are active, after we checked out all the satellites, we really turned over complete control of those -- of that Aireon payload to Aireon and their partner, Harris, for their use. They can configure it. They can manage it. And it very quickly started providing lots and lots of data, because every aircraft essentially underneath that payload is visible to it. And they've been just storing away since that time tons and tons of aircraft tracks. And of course, as I said, they've been testing those against actual aircraft on the ground, including the FAA's flight test that we announced as well. Like I said, they're really, really pleased with the performance of the payloads. They're telling me that they've kind of exceeded the specification that they originally set up. They're demonstrating really being able to see aircraft, in some cases, over the horizon, which means it's a much bigger coverage zone, which means that the overlap will be even greater, which means even faster pickup and better real-time performance. So all in all, it's meeting all their objectives, and I think that's really helping them both with their sales plans, because they can now go to a customer and show them all the areas of their flight regions that they could never see before, which makes it very real, which is going to, I think, accelerate their MOAs and DSAs for future customers. But in addition, it's obviously been a big confidence builder for all those that they've signed up so far. All that said, they have now been, as I said, engaging bankers and have been out doing due diligence. They're -- that process seems to be going along smoothly, very well. And they're reporting kind of a positive approach that should be sometime this summer that they engage investors in that. So hopefully that will go very well, and that will be good for all us.

**Thomas J. Fitzpatrick** - Iridium Communications Inc. - CFO, Chief Administrative Officer and Director

Jim, this is Tom. So as to the amount of the bridge financing, we worked very closely with the Coface lenders and representatives from the French Treasury. And I would characterize their interest as being very interested in ensuring the sufficiency of Iridium's liquidity, as that was our interest. So we settled on this amount and this arrangement as the amount that does that comfortably. And we look at the all-in cost of this bridge financing. It's inside of 250 bps, so it's -- which is very attractive, very friendly kind of financing in terms of the interest rate that's being extracted. And so if it's a little bit more than what we need, that's only goodness, from our perspective.

**Operator**

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

**Gregory Burns** - Sidoti & Company, LLC - Analyst

When we look at the service revenue growth this quarter, a little bit below what you're looking for the full year, can you just give us a little bit more color on where you expect that incremental growth to come from throughout the year?

**Thomas J. Fitzpatrick** - Iridium Communications Inc. - CFO, Chief Administrative Officer and Director

Yes, Greg. So as we said, hosting revenues come in back-ended as the satellites launch. So if you're just looking at run rate growth in the first quarter of 2, how does it get to 3 to 5? The hosting revenues are more back ended, as is our relationship with Thales. So those are those the 2 kind of elements that bridge you from the 2 into the 3 to 5%.

**Gregory Burns** - Sidoti & Company, LLC - Analyst

Okay. And do you have an estimate on how much hosted and data service revenue you expect to recognize this year?

**Thomas J. Fitzpatrick** - Iridium Communications Inc. - CFO, Chief Administrative Officer and Director

Yes. We've quoted mid-single digit millions.





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**Gregory Burns** - *Sidoti & Company, LLC - Analyst*

Okay. And I don't think we've talked about this in a while, but in the maritime space, GMDSS certification, is that progressing? Do you have any line of sight on that?

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

Yes. It's a long process, because it's never really been done for, I think, 30 years, since the last time it's been done. So we're kind of having to write the rules and work through the process. It's going on track. Our Certus suppliers particularly are interested in that, so they are feeling comfortable that we'll be getting a GMDSS certification as the new Certus terminals come on line in 2018, '19. We're going to be demonstrating this year the service through the terminals to the emergency centers, and really showing how we will do the service. But it's a long sort of political -- well, that's probably not the right word. It's a bureaucratic process that sort of takes to go through as meetings are only scheduled at these international bodies periodically, and you kind of have to just line up with each one and then submit the paperwork and go through reports and all that sort of thing. But really, we're pleased with how it's performing. There've been no surprises, really, in the last year, 1.5 years. Hard as a CEO to see things not go faster, but I can't really push an international process any faster. So I think it's going really well.

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**Operator**

And our next question comes from the line of Andrew DeGasperi from Macquarie.

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**Andrew DeGasperi** - *Macquarie Research - Analyst*

First, Matt, can you maybe comment on the partnership you have with SITAONAIR and Malaysia Air. Is this something that you foresee expanding to other airlines? And then maybe secondly, Tom, could you maybe let us know what -- sort of the ARPUs were down on both voice and IoT business. I was just wondering what was impacting that.

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

So it's not our relationship. It's Aireon's relationship with SITAONAIR, but obviously it's a demonstration of the value of the Aireon service, so that's why it's very relevant to us. What -- that was part of the previous announced relationship with FlightAware, which is sort of a -- this is not the core part of Aireon's service, where they provide air traffic control services, real-time air traffic control services, but they're taking the data and they're providing other uses of it. So this is the first, and I think there's going to be others, of the way that they sort of exploit this real-time flight-tracking data, and in this case, it's a private service to allow airlines to monitor and manage their fleets more effectively. And FlightAware, of course, has been -- already has had a long-standing relationship with -- well, longstanding being they're a fairly new company, but they provide information to airlines today. With their relationship now with Aireon, they're providing this whole new service that enhances that and gives global service, so they're not having to just sort of estimate where airplanes are when they're outside of coverage. They actually know where every airplane is. And then SITA will then supply that through their relationship, in this case to Malaysia [Airlines], but I think a number of airlines are going to be picking up that service, because they just want to know where their airplanes and customers are at all times. It'll help them manage arrival information. It will help them manage catering and maintenance and that sort of thing. So it's just a nice add-on business, if you will, to the Aireon core business.

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**Thomas J. Fitzpatrick** - *Iridium Communications Inc. - CFO, Chief Administrative Officer and Director*

So as to the ARPU, let's separate the voice and data ARPU from M2M, because what's going on in those 2 areas are completely different. In the voice and data, what you had was about \$1 of erosion \$40 to \$39 in the first quarter. And that trend has been a chronic trend. If you go back 5 years, that is a downward sloping line. \$1 is, frankly, less than we've run in previous years. The issue in commercial voice and data is sort of an acute issue in respect of, I don't know, 25% of our installed base in that segment, which are so-called LBT or L-band transceiver customers, who are very



heavy data users. And the long-term trend has been that they have disconnected or used less, because it was more economical to use other solutions. The good news is that -- our base of that kind of revenue is a fraction of what it was sort of 5 years ago, and we're down to levels now where its ability to put that much pressure on our ARPU has been greatly diminished, just because it's so much smaller of a piece of our business. So I would -- I think about commercial voice and data revenues as sort of down \$1 [year-over-year] in each of the next 3 quarters this year. I see them down less than that, if down at all, as we go into 2018, just because that kind of trend has run its course, in our view. Now M2M is a completely different story. We have said for some time that M2M ARPU is a downward sloping line. And that, frankly, we're fine with that. We care about M2M revenue growth. There's no cost to acquire in that business. Partners like Garmin, who are adding significant amounts of subscribers, albeit at a lower ARPU than our installed base, we take all the business like that we can get because it's very profitable, recurring revenue. And so we think about the M2M or IoT ARPU as -- you're going to see a continuation of that trend sort of at the run rate that you're seeing it. I think we were down \$1 year-over-year in the quarter in M2M from \$14 to \$13. And I would model it similarly as you look out sort of into '18.

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**Operator**

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

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

I just want to make sure I understand the EMSS contract. That expires in October of 2018. Is there -- is that the last of the option here? Is that right?

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

That is the end of the fifth year, and then they have the right to sort of extend that, if there wasn't a contract, for another 6 months at the same final pricing if they choose to do it, though our goal will be to replace that contract with a new multiyear contract at the time.

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

Right. And so is it reasonable to expect that the new contract will be similar to the old in that it's fixed price with unlimited subscribers, or is that under discussion as well?

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

Everything is negotiable, I suppose. But I can tell you from every discussion that I've had, and I've had many, including very recently, there's no interest in changing the structure of the contract by the government. They really liked the fixed-price approach. It really provides them a lower cost per customer and the ability to kind of look at using Iridium more broadly in many more things, so they like the approach to be more about just what the price is, really, overall and how long a term it is. It would be fixed. It is still also being discussed, some of the same services, voice, secure voice, tactical radio services, low-speed machine-to-machine. The discussions will be around services like higher-speed services, higher-speed IoT, satellite time and location services, other things that they would like to perhaps add as to whether those go in the EMSS contract or those are separate contracts. But we've already both agreed that Iridium Certus services, and there's a lot of opportunity for higher-speed L-band broadband in the government in areas we've never played before, so we're really optimistic about that. That will really be a separate contract to the EMSS. Of course, we don't just make those kind of service fixed-price. So that's the overall sort of thinking going forward on the EMSS.

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

And Tom, you mentioned this gateway revenue under the engineering and support. How long does that last?

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

It's actually a separate parallel contract with the same period. It's also 5 years. So it also gets renegotiated at the same time and would be also viewed as a multiyear going forward, new contract for support services.

**Thomas J. Fitzpatrick** - *Iridium Communications Inc. - CFO, Chief Administrative Officer and Director*

So let me just break that apart, Jim. There is that, which is included in our engineering and support revenues, which is kind of fixed and contractual. That which is episodic is when we get hired for, call it, kind of -- sort of one-off improvements to the gateway. And so there's kind of a fixed component, which is the regular support of the agreement, and I think we quoted that as \$34 million over 5 years or something like that, so 1/5 of that. And then you'll see it spike around when they just sort of put up a work order for some certain defined functionality that they want us to build, if that makes sense to you.

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

No, that's perfect. It's very helpful.

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

In fact, one of the key kind of episodic things has been, this last year and this year, is the work being done on a new secure handset. We've sold the same handset to the U.S. government for 15 years. It was getting long in the tooth, and they really wanted to take advantage of the advances that we've made with our commercial customers with a platform like the 9575 Extreme. So it's more an asset that provides for a secure sleeve, and that's coming to fruition here really in the next few months, and it will be new equipment into the government as they take up those new secure handsets and utilize them around the world.

**Operator**

Our next question comes from the line of Rick Prentiss from Raymond James.

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

Two, if I could. You mentioned the Certus product, and that wouldn't be, obviously a fixed price with the government. Can you update us on the Certus product, more maybe along the lines of the products themselves? When do you expect to have devices and handsets be able to be put into the marketplace as you roll out the next constellation? And then a second question, speaking of the constellation, CapEx seemed a little late in the quarter. Can you update us as kind of how we should think about the timing of CapEx as we go through '17, '18, the pacing?

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

Yes, Rick, to your first question on Certus products, as I mentioned, we've actually -- some of our partners have been demonstrating, they've been showing their products, the prototypes of the products, to their customers at industry shows. Thales was the one I mentioned. Those products, at least -- I know at least 2 products in the second half of this year will be out and in demonstration and Beta trials. They'll be on ships, in particular. Maybe some terrestrial applications this year, because the satellite software is ready on the new satellites and will be available this year. All the gateway upgrades have gone forward, and so Certus is really coming together right now in the second half of this year to go to completion. So we really want to make sure that gets a lot of time with customers before it gets declared commercially ready. But we believe in the very early part of 2018, first month or 2, really, it should be all ready, assuming there's no issues with our customers or any of those products. And we would expect products will be sold and being put on ships that will provide the initial speeds of say 350 kilobits per second, which you could upgrade to 700 kilobits per second after the network is completed. And there'll be other products that will be coming about as well. That's from at least half of

those customers. The aviation products will be coming out more in 2018 and '19 as they get certified on specific airplanes. And they'll be being tried, and so I'm expecting that 2018 will be the first almost full year of the start of the ramp of our Certus revenues.

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

And then the CapEx...

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**Thomas J. Fitzpatrick** - *Iridium Communications Inc. - CFO, Chief Administrative Officer and Director*

Sure. And Rick, as to CapEx, our guide is \$500 million to \$600 million this year. And I would call investors' attention to the -- to our 10-Q. We've included our financial obligations table in there, because we know that's top of mind to everybody in terms of how the money gets spent. And so you'll see we're going to spend a bunch of it here this year and into next year. I should note that the spend on Thales up till this point has been, I would call it, kind of, sort of in lockstep with launch delays. The degree to which Thales has completed satellites now, they kind of get unhooked. They've kind of done their work, and they get payments notwithstanding launch delays, and so investors should know that. We've -- and that's why we've included that additional kind of disclosure in our 10-Q. And this, obviously, was top of mind as we thought about our liquidity position as we think about 2017 and 2018.

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

Can you give us just a high level? Today's a busy day with 4 companies all reporting at the same time. So just kind of -- can you lay out what that CapEx pacing might be, and then we'll go grab the Q?

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**Thomas J. Fitzpatrick** - *Iridium Communications Inc. - CFO, Chief Administrative Officer and Director*

So we've said \$500 million to \$600 million this year in 2017.

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

Okay. And then '18, any updated thoughts on what '18 CapEx would be like?

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

Well, the remainder, isn't it? So it -- because the program...

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**Thomas J. Fitzpatrick** - *Iridium Communications Inc. - CFO, Chief Administrative Officer and Director*

There's a very small -- it's the remainder, and there's a very, very small amount that leaks into '19, Rick.

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**Operator**

(Operator Instructions) And that concludes our question-and-answer session for today. I would like to turn the conference back over to Iridium management for any closing comments.



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

Well, thanks. Good start to the year. Look forward to seeing some of you, I hope, in California here in June for the launch. And certainly, we'll be following that, and we'll be back and talking to you about the second quarter shortly thereafter. So thanks for joining us.

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**Operator**

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

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