

Iridium Communications Inc.
Q4 Earnings Conference Call
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CORPORATE PARTICIPANTS

Ken Levy - *Vice President, Investor Relations*

Matt Desch - *Chief Executive Officer*

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

PRESENTATION

Operator

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

I would now like to turn the conference over to Mr. Ken Levy, Vice President, Investor Relations. Please go ahead, sir.

Ken Levy

Thanks, Cole. Good morning, and welcome to Iridium's Fourth Quarter 2018 Earnings Call. Joining me on this morning's call are our CEO, Matt Desch; and our CFO, Tom Fitzpatrick. Today's call will begin with a discussion of our fourth quarter results, followed by Q&A. I trust you'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 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 in 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.

Matt Desch

Thanks, Ken, and good morning, everyone. So by my count, this is the 37th quarterly earnings call we've held since going public in 2009, and it's certainly one of our most satisfying in terms of results and achieving our long-term goals.

As I'm sure you saw in our press release, 2018 was an outstanding year for Iridium in terms of subscriber growth, financial performance, and business execution. Our subscriber base rose 16% to over 1.1 million active users; top-line revenue grew 17%, our highest rate of growth as a public company; and operational EBITDA rose 14%, our best in seven years.

And of course, shortly into the new year we realized our crowning achievement, the completion of Iridium NEXT. As a result, we enter 2019 with tremendous business momentum, we enjoy our best competitive position in corporate history, and are now able to fully leverage our brand new powerful network platform.

On February 5, the final Iridium NEXT satellites went operational, completing our network of 66 new satellites. This historic event completes a decade-long design, construction, and launch program, retires a lot of execution risk, and allows Iridium to move from a period of capital investment to a new, exciting era of free cash flow.

As I reflect on this milestone, I'm reminded that nothing in space comes easily, and this journey has not been without its fair share of challenges. In completing the Iridium NEXT, we had to react to changes in technical plans, schedules, and financial events along the way, always keeping in mind our objective.

Some would say we also caught a few breaks along the way, like the incredible resiliency of our original network. I would respond, however, that we made most of our own breaks, thanks in large part to the immensely capable and highly performing team we've assembled over the years. I am proud of the roughly 470 Iridium employees who brought the Iridium NEXT mission to fruition. Many of them have supported the Iridium network since its inception, and there isn't a better group of hard-working, committed people.

Though the final satellites only arrived to their operational orbit positions earlier this month, we have been managing, controlling, and living with these new Iridium NEXT satellites for over two years now. The satellites are operating extremely well, delivering better statistical performance than we'd even hoped for. We've had very few issues with the new satellites, given the complexity of the whole project, and that gives us tremendous confidence in the long-term resilience of the network.

With the completion of the constellation upgrade, we have also now launched our first new service, Iridium Certus, and are already hearing a lot of good feedback. The service formally launched in mid-January for the maritime and land mobile sectors.

More than half of the 38 partners that signed up so far to offer this service globally have completed their interconnects and launched their sales activities, and the rest are being quickly on-boarded. You can expect a few more new partner announcements this year, as everyone we've talked to is excited about offering this service to their customers.

Early feedback on their sales pipelines and the first month of activations have been encouraging, although 2019 remains an introductory year and we've kept our expectations appropriately measured. We see Iridium Certus ramping in subscriber additions and revenue over the next three years, and as we've said before, we forecast an incremental \$75 million in broadband revenue, leading to a \$100 million run rate for Iridium's broadband revenue as we exit 2021.

This year, a number of aviation antenna suppliers, like Collins Aerospace and Thales, are working to bring their Iridium Certus offerings to market as well. Given the regulatory work involved in aviation products, I expect that will take most of this year to occur. So we remain excited about the revenue stream that Iridium Certus Aviation will add to today's existing mix of maritime, terrestrial, and government customers.

We positioned Iridium Certus to be a best-in-class solution for broadband users. One of the benefits of our offering is that it scales very efficiently, both up and down. This means that it has broad utility for a wide variety of current and emerging applications.

Iridium Certus is being developed as a multi-product platform, which can be used for broadband applications but is agile enough to fit into more optimized packaging that's focused on low-cost and small-size rather than throughput. Examples of these uses might include new consumer devices supporting feature-rich chat applications with pictures, fully featured email, or even low resolution video for security

applications.

Our network is optimized for and we see a tremendous market in highly mobile, low cost, industrial-grade applications, frankly, not a market that other satellite network operators are designed to address. Our users prioritize size, weight or power over throughput. Iridium Certus has been designed this way to get the most data possible through low-cost, smaller antenna. As a result, we believe our network will continue to appeal to an expanding base of developers and users.

You may have heard that we're working on a lower speed, smaller device this year called the Iridium Certus 9770. This transceiver really targets the highly mobile enterprise and IoT space, hitting the sweet spot for low-cost, highly mobile applications in a variety of speed ranges between 22 and about 100 kilobits per second.

While we've been quite successful over the years with a product that uses only 2.4 kilobits per second of data, a lot of user applications around the world are looking for a little more speed, but still want small, low-cost and low power antenna and devices. We think our network and the Iridium Certus technology platform are the perfect solution for expanding into these opportunities.

Our new 9770 transceiver is actually the first of a new family of devices we will be introducing for partners, optimized for high-volume consumer and enterprise applications, which is a growing segment that should be a significant source of revenue in the future. Think of them as ways to expand our current voice and data business, as well as our IoT revenue line, well into the future.

Another big priority for us this year is the renewal of our enhanced mobile satellite services contract with the U.S. government. I don't have a lot of specifics to report on this effort today, except to say we remain very engaged and continue to have positive discussions towards making this new contract a win-win.

Given that government subscribers grew 13%, to a record 113,000 subs in 2018, the cost per user continues to fall under the EMSS contract. We think we should be able to reach an agreement on a contract that continues to drive down cost per user for the government, while supporting overall revenue growth for Iridium.

The management of Iridium's EMSS contract officially transitioned from the Defense Information Services Agency, or DISA, to the Air Force at the end of last year. This move does not change anything regarding our negotiations, but seems so far to be a positive step for centralizing the management of commercial satellite with military satellite operations, and that should be a good thing for the industry.

Aireon continues to make good progress, and in 2018 made some significant payments on its hosting fee obligations as it continued to pay its data services fees. We believe that Iridium's equity stake in Aireon, as well as its contributions to our cash flow, will provide long-term benefits to our shareholders. As you know, Aireon is creating a unique and powerful global air traffic surveillance service that we believe will revolutionize air traffic management.

With the FAA's and Europe's mandates requiring all aircraft to be equipped with ADS-B transmitters by the end of this year, we expect Aireon to increasingly be very busy this year with new customers and turning on commercial services for their initial customers this spring, especially now that they have a 100% complete network. I would also expect the company will continue to be a fixture in the media as these deadlines approach.

As I reflect on the completion of the Iridium NEXT constellation, I am reminded that we considered several dozen hosted payload opportunities for Iridium NEXT. Aireon rose to become our top choice for the primary hosted payload due to its game-changing potential and strategic fit with Iridium. Clearly, we hit

a home run.

It's not often that you get to turn a good idea into a revolutionary service with global impact on an industry the size of aviation with such significant potential for value creation. So it will be exciting to see Aireon go live this year. Following the final testing and certifications of the system, Aireon will begin operational use of the service with their first customers over the North Atlantic.

I don't think investors really appreciate how successful Aireon should become. Aireon provides an essential air traffic surveillance service that is useful to every air navigation service provider in the world, in addition to utility in commercial aviation. Together, this is a \$750 million annual addressable opportunity.

Given forecast for Aireon's growth and margins, we believe that the company will ultimately generate substantial earnings that should generate significant dividends for Iridium in just a few years. So I'm very excited about the record performance and strong progress we made in 2018. I continue to feel very good about the underlying strength of our business and the growth that our new broadband services will deliver.

We enter the era of Iridium NEXT as a technology leader with a strong track record of successful execution. 2018 was truly an historic year for Iridium, and it's safe to say that 2019 will be equally exciting now that Iridium NEXT is fully operational.

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

Tom Fitzpatrick

Thanks, Matt, and good morning, everyone. For nine years, Matt and I have been predicting a financial transformation for Iridium at the completion of the Iridium NEXT capital campaign. That day has now come, and the transformation is underway. From this quarterly conference call forward, we expect to continue to talk about Iridium's OEBITDA growth, but we'll also add new commentary on Iridium's levered free cash flow.

With the completion of Iridium NEXT, Iridium has become a rare company, one that is characterized by robust OEBITDA growth and material-levered free cash flow. In a few minutes, I'll introduce some measures of Iridium's levered free cash flow we think investors should consider moving forward. Let me start, however, by summarizing Iridium's key financial metrics for the full year and provide some color on our fourth quarter results. I'll then walk through the 2019 financial targets we updated this morning and review our leverage, liquidity position, and suggested levered free cash flow metrics.

2018 was a record year for Iridium. Total service revenue grew 16%, our best rate as a public company, and full year operational EBITDA totaled \$302 million. This strong performance was driven by continued momentum in our commercial business and a meaningful ramp in hosted payload revenue associated with the deployment of Iridium NEXT.

In the fourth quarter, Iridium reported total revenue of \$132.2 million, which was up 14% from last year's comparable period. This growth was attributable to incremental hosting fee and data service revenue in conjunction with strong trends in commercial voice and continued growth in commercial IoT. In the fourth quarter, operational EBITDA rose 19% from the prior year's quarter to \$75.5 million.

The commercial side of our business remained strong in the fourth quarter, generating record revenue of \$85.3 million. This was a 23% increase from the prior year's quarter and almost double the growth we enjoyed a year earlier. Strength was evident across every segment of the commercial business. Revenue from commercial voice and data increased 9% from the prior year period, reflecting an increase in ARPU related to price changes adopted early in the year. That said, subscriber growth in Iridium

OpenPort was also strong, as we continue to see Iridium's services and brand attract more maritime customers with the recent launch of Iridium Certus.

In Commercial IoT, revenue increased 12% to \$21.8 million, driven by a 27% increase in billable subscribers, which benefited from continued strong growth in consumer IoT, in particular, personal communication services sold by Garmin.

In all, Commercial subscribers grew 16% year-over-year, and IoT subscribers now represent 64% of billable commercial subs, up from 59% in the year-ago period. Revenue from hosted payload and other data service was up \$9.7 million year-over-year to \$14.2 million in the fourth quarter; \$7.7 million of this amount reflected hosting and data service fees paid to Iridium by its hosted payload partners. This steady advance in payload revenue has continued, as more Iridium NEXT satellites have been put into service.

Also of note in the fourth quarter, Aireon closed its financing and remitted a cash payment of \$35 million for our hosting fees. Of the total payments of approximately \$43 million in 2018, we recognized \$14 million as hosting fee income this year. The balance of this payment is deferred revenue on our balance sheet.

In the fourth quarter we also recognized a \$4.5 million non-recurring item from satellite time and location services. Favorable developments at our partner, Satelles, caused us to recognize revenue earned in prior periods.

With the U.S. government exercising its option to extend the EMSS contract for an additional six months at the prevailing rate, revenue from our government service business remained at \$22 million in the fourth quarter.

Government subscribers grew a robust 13% in 2018, ending the year at a record 113,000 subscribers. We continue to make positive headway on a new EMSS contract, and expect to update you in the second quarter of this year.

Revenue from subscriber equipment grew by 4% from the prior year quarter to \$20.1 million, driven by demand for IoT equipment. 2018 was a record year for equipment sales, driven by higher-than expected demand for satellite handsets, which have now returned to more normalized levels.

Moving to our 2019 financial guidance. In 2019, we forecast operational EBITDA in a range of \$325 million to \$335 million, predicated on total service revenue of approximately \$440 million for the fiscal year. The key elements supporting this outlook are as follows.

First, we expect continued strength in IoT from heavy equipment manufacturers and customers providing reliable, low-latency telematics. We also expect continued strength in personal communication services. These factors make us quite confident in forecasting double-digit subscriber growth from this business line in 2019 and well beyond.

Second, we anticipate approximately \$35 million to \$40 million in revenue from hosted payloads in 2019. This revenue includes hosting fees and data service fees from Aireon and Harris Corporation, which are tied in part directly to the successful deployment of Iridium NEXT satellites and, therefore, will reach a steady state run rate given network completion. Aireon's annual data service fee further steps up from \$13 million to \$23 million, when they reach a customer contract milestone. We expect this milestone to be met sometime in the second half of 2019.

Third, we expect an increase in revenue from our fixed price contract with the U.S. government from 2018. Ongoing subscriber growth within the U.S. government bodes well for our negotiation, and should

lead to a new contract that will be a win-win for both parties.

Fourth, we expect equipment revenues in 2019 to decrease from 2018 on lower handset sales.

Fifth, we continue to expect negligible cash taxes in 2019. Based upon our most recent estimates, we now expect negligible cash taxes through 2023. This is a change from our prior long-term guidance of negligible cash taxes through 2020. We expect to exit 2019 with a net operating loss carry-forward of approximately \$1.3 billion.

Finally, as Matt mentioned, Iridium Certus launched commercially last month. We expect a relatively small amount of revenue from Iridium Certus in 2019 as the service launches, but continue to believe this new broadband service will be the major contributor to a \$100 million revenue run rate for broadband services as we exit 2021, up from \$25 million currently.

After the successful execution of eight launches and the flawless deployment of 75 brand new satellites, Iridium NEXT is complete, and the associated capital spending will cease. Investors can clearly see this transformation in our 2019 guidance. We expect total CapEx of approximately \$95 million this year, comprised of about \$35 million in non-Iridium NEXT capital expenditures and the final Iridium NEXT invoice payments of approximately \$60 million in the first and second quarters.

With our newly issued OEBITDA guidance, investors can calculate the financial metrics that should be additional consideration for our valuation going forward. Today, Iridium is a completely different company than the one you have known for the last nine years. Today, we have a very different risk profile, with material free cash flow generation capability.

I'd expect that investors will increasingly consider metrics like levered free cash flow, levered free cash flow growth, levered free cash flow yield, levered free cash flow conversion, and CapEx intensity in assessing the fair market valuation. Investors who calculate and track these statistics will see that we are unlike any other satellite player, and given our growth rate and competitive position traditional satellite peers are not appropriate comparables.

We'd encourage investors to benchmark Iridium against the tower sector and fiber companies, both industries that enjoy strong recurring cash flow, low revenue risk and low maintenance capital expenditures. We think that you'll find that we stack up quite well. We've also been clear that we intend to undertake debt refinancings in the short-term that will facilitate the payment of dividends and share repurchases.

Given successful execution of our business plan, we estimate that Iridium's capacity for returns of capital through 2025 to be approximately \$2 billion. Compare that to our current market capitalization, and you can see why we have such a unique financial profile.

As of December 31, 2018, Iridium had a cash and marketable securities balance of approximately \$273.4 million. Late in 2018, Aireon closed its financing and remitted a cash payment of \$35 million for Iridium's hosting fees. As Aireon has disclosed, the facility totaled \$200 million, quite impressive for a pre-revenue company. This is indicative of a robust operating model with firm contracts with high-quality customers aggregating to hundreds of millions of dollars.

You'll note that Iridium's deleveraging has already begun. We closed the year with leverage at 5.2 times OEBITDA, down from a peak of 5.6 times in the first quarter. We continue to expect that net leverage will fall to approximately 4.5 times as we exit 2019. This leverage would be impacted slightly should Iridium effect refinancing. We expect this impact to be approximately a quarter turn of leverage, should

it occur.

In closing, I feel very good about the progress we made this past year and the clear path we have shown for Iridium's financial transformation. We appreciate the support that our investors have provided during the capital-intensive Iridium NEXT mission and look forward to rewarding this patronage and confidence in our company.

With that, I'd like to turn things back over to the operator.

QUESTIONS AND ANSWERS

Operator

Thank you. We will now begin the question-and-answer session. To ask a question you may press star, then one on your telephone keypad. If you're using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question, please press star, then two. At this time, we will pause momentarily to assemble the roster.

Operator

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

Ric Prentiss

Thanks. Good morning, guys.

Matt Desch

Hi, Ric.

Tom Fitzpatrick

Hi, Ric.

Ric Prentiss

Obviously exciting times with the operational fully functional, so that's good news. A couple questions on the guidance side. Previously, the operational EBITDA excluded the revenues and recurring cost associated with NEXT. Can you also update us like in your 2019 guidance, are you expecting that that adjustment will go away starting 1/1, or does it go away starting in 2Q? Just what should we think about what's baked into the guidance as far as that NEXT adjustment?

Tom Fitzpatrick

Sure, Ric. Substantially, all of the NEXT expenses in 2019 relate to the in-orbit piece of our launch insurance under GAAP. That needs to be amortized over the 12 months following launch, because that's the coverage period. So, our launches from 2018, the insurance associated with the in-orbit coverage get amortized into 2019, and since our last launch took place in January of 2019, we'll have about less than \$0.5 million that will also leak into 2020. That's substantially all of the NEXT expenses, and that's about around \$10 million that will be excluded.

Ric Prentiss

Okay. We also appreciate the update on the government contract. Has there been any impact from the government shutdown? And I guess you said it's moved to where the Air Force is the one doing the negotiations. I'm just wondering, should we expect the April date is going to hold?

Matt Desch

Yes, the April date is a firm ending. There's a date in April it has to be completed by. It's unlikely there

would be an extension, I'm assuming they could ask for one, but it would have to be an appropriate new contract or some sort that would be appropriate for that sort of thing.

But as far as like did the shutdown effect for Iridium, I would say, generally not, especially since most of our interactions were with agencies that really weren't affected by that. I didn't really see any kind of necessarily business slowdown or anything from that perspective. So, we were sort of immune to that, I guess.

Ric Prentiss

That's good. And the final one from me. Tom, you kind of touched on it obviously, the balance sheet, you mentioned debt refinancing in the short-term, are there any provisions, call provisions, any penalty points, and how soon should we think that you might be able to go into the marketplace? Obviously the pricing looks more attractive than maybe it would have been a couple of quarters ago.

Tom Fitzpatrick

So, we are paying close attention to the market, Ric. The market backed up in December and it appears to be coming back. So I would just characterize those as looking very closely at it, and couldn't rule out something happened as early as mid-year.

Matt Desch

And, by the way, Ric, that will be the topic obviously for March 7 as well, I mean, and hopefully we'll be able to discuss that a bit more fully then too.

Ric Prentiss

Great. Thanks a lot, guys.

Matt Desch

Thanks, Ric.

Operator

And our next question comes from Greg Burns with Sidoti and Company. Please go ahead with your question.

Greg Burns

Yes. Hi. Just a question about Aireon, the market opportunity there. You've been talking about a \$750 million TAM. I was just wondering, based on the contracts that you have in hand, how penetrated are they? I guess we could start there. How penetrated are they into that opportunity, based on the contracts they've already signed?

Tom Fitzpatrick

They have contracts in hand valued in the hundreds of millions of dollars, Greg. They're well down the road.

Matt Desch

It's still early days, though, I would say. It's certainly probably less than a quarter or the opportunity so far yet even though it's substantial. That \$750 million is computed by sort of taking the way that they price their service by flight region and sort of multiplying it based upon each of those flight regions. If it was 100% covered in the world, and might not even include completely all the commercial opportunities that are a spin-out of having all this data available, things like what they do with Flight Aware and other kinds of services.

So, it's not an unreasonable expectation to see that the whole world someday will be using it, but it won't happen for quite a few years. But given their fairly low costs in general, that's very, very high margin revenues, so very high profit overall in terms of what it's able to support.

Tom Fitzpatrick

I think that the implications of them closing a \$200 million dollar credit facility—investors should reflect on that in terms of that this is a pre-revenue company that was able to close a loan like that, and use of proceeds to pay Iridium \$35 million, that is a very strong indication of a robust operating model that was able to secure that type of a financing.

Greg Burns

Okay. And in terms of the \$2 billion in capital you expect to return to shareholders through 2025, is that a reflection of your outlook for operational cash flow, or does that also include maybe some dividends from Aireon? How do you get to that \$2 billion number?

Tom Fitzpatrick

Sure. So, the building blocks are new disclosure around taxes. No cash taxes through 2023, and let me say the statutory rate is probably 24%, 25%. It takes us years to get to that level, so cash taxes after 2023 feather in very gradually, and think of 2024 and 2025 as being low-single-digit kind of rates. So the tax is an important component.

We see leverage between 2.5 and 3.5 times in terms of the amount of leverage we have on the company. And yes, we do expect a lot of things from Aireon. We expect the remainder of our hosting fees to be paid. We expect interest on that hosting fee. We expect dividends and we expect them to buy back the stock for \$120 million. Those are all components to our \$2 billion expectation of capacity, shall we say, for shareholder returns. Obviously, should a strategic opportunity present itself that we think would be more beneficial to our shareholders, we would proceed accordingly.

But that \$2 billion is a capacity number and the operating assumptions around that are—if you reflect on this business, since we came public we've got a CAGR in OEBITDA of about 9.5%. We've got some significant new revenue opportunities in the area of Certus, that if Certus is what we think it is, we think we're on a path to putting up those same kind of results through 2025.

I would say, though, one doesn't have to believe in a 9.5% CAGR in OEBITDA to get to \$2 billion, when you consider things like Aireon dividends and that sort of thing. So, that's why we feel comfortable with the \$2 billion number as the capacity.

Greg Burns

Okay, great. Thanks.

Operator

And our next question comes from Hamed Khorsand with BWS Financial. Please go ahead.

Hamed Khorsand

Hi, good morning. First off, could you just talk about the inventory of equipment at the retail channel and how much of that is old stock versus new stock? And how are you going about as far as commercializing the Certus service to minimize the amount of people on the old legacy service as you go forward?

Matt Desch

Yes, I mean, if you just specifically talk about the maritime opportunity that we have now, first we've had a product in the market called OpenPort for a number of years here and it still continues to do well, even

as we move into this year. It hasn't suddenly fallen off, it's actually still being put on ships because it works so well and it's reliable and a lot of people are comfortable with it.

There is probably still quite a bit of inventory out there of OpenPort. It's hard to tell exactly how much. But we get the impression that there is still a fair amount of inventory, and I expect that that will continue to be deployed, even going on through this year and perhaps into next year as well.

At the same time, you have these new Certus terminals are also now shipping from our primary suppliers of Cobham and Thales, and we can kind of get visibility through the number of transceivers we've sent to them and how many they tell us that they've been shipping – a fair amount of those are now going into the roughly 38 partners that are out there distributing them to their distributors. And those are starting to get into the channels now. And so, again, we've seen some pretty good activations, even over the first month, as that product starts to ramp into the market.

So, I think we're going to see both products continue to go for a while. But in the long run I think Certus, given its performance value and everything else, is going to be the predominant product.

I assume you were mostly talking about broadband as opposed to handsets and IoT services, because that's all new stock out there in the market, if you will.

Hamed Khorsand

Yes. Are you doing like a mandatory push to Certus service? How are you going about as far as managing the conversion and just getting people to convert the new service?

Matt Desch

I would say that this isn't about conversion. Well, it is about conversion, it's conversion of our competitors' products into our service, because they've been the one for the last 20 years that have been the sole one to offer a service. And so, there is a lot of interest in our regard of converting those customers to our customers with a better product that has a higher value and longer-term dynamics.

We're not managing a conversion per se. Our partners naturally want to deploy that product because it's competitively superior. They like the idea that we're not a competitor to them. They see its performance and that it operates more globally than other products. The antennas are smaller and lighter and easier to operate, etc. So, it naturally is going to go into the market. As we said, we are trying to measure our own expectations about how fast that is. But, based upon everything we've seen and talked about, it makes us comfortable with sort of the guidance we've given on the next three years of deployment for it.

But we're really not trying to convert our existing 9,000 to 10,000 OpenPort subscribers. I'm expecting that over time that those will be upgraded, and given the fact that the speed and other things are faster, I would expect that ARPU's might even increase on the ships when those get converted. But I'd really rather more focus on converting my competitors' products than our own.

Hamed Khorsand

Okay. Thank you.

Matt Desch

Thanks, Hamed.

Operator

And our next question comes from Chris Quilty with Quilty Analytics. Please go ahead with your question.

Chris Quilty

Thanks. Tom, just a clarification on the guidance. The service revenue number you provided includes or excludes any hosting fees? And can you also give us a breakdown of how the hosting fees would look in 2019 with the component pieces?

Tom Fitzpatrick

Sure. So, yes, the service revenue guide has always included the hosting fees. And the hosting fees, think of them in this way, Chris, they ramp to a steady state, a full ramp of \$47 million. This year, we think we'll be somewhere in the \$35 million to \$40 million range. Giving effect to all the hosting revenues, the only component that bridges from the \$35 million to \$40 million to the \$47 million at full ramp is – as to the Aireon data fee, there is a customer contract concentration milestone that takes that from \$13 million annually up to \$23 million, and we're expecting that that will occur in the second half of 2019. Such that, 2020, if you will, would be a full \$47 million, up from the \$35 million to \$40 million we expect this year.

Chris Quilty

Got you. And the other component of that, if I remember correctly, the Aireon hosting fee is around \$16 million.

Tom Fitzpatrick

That's right. So think of Aireon at (\$16 million, \$23 million), \$23 million in data, \$16 million in hosting at full ramp, and Harris about \$8 million--so that's how you get the \$47 million.

Chris Quilty

Okay. Good. With the equipment, you mentioned also, equipment down. Is that down a little or down hard? I mean, as you begin to shift to more of an outsourced model on pushing those equipment revenues out to your partners, how quickly does that come down, and is it driven primarily by the adopting of Certus, or are there other factors at play?

Tom Fitzpatrick

No, it's nothing to do with that, Chris. It's just handsets were very strong this year. If you looked at a three-year trend, the 2018 handset shipments and sales jumps off the page. We've seen that softening to more historical levels, and our guide of down reflects what we're seeing. I would say it's going to be down. We wouldn't bring it up. It would be down, not immaterially. But the degree of decline is fully anticipated in our OEBITDA guidance.

Chris Quilty

And there seem to be a step-down in the government voice business in Q4. Was that just kind of end of year house cleaning on their part?

Tom Fitzpatrick

No, no, you mean, the service revenue? It's \$22 million. I mean, that's contractual.

Chris Quilty

No, no. Number of subs.

Tom Fitzpatrick

Oh, number of subs.

Matt Desch

There was a clean-up. Actually, there was good growth in the quarter, but there was one service that sort of had an optimization thing that was going on, and they, over a period of just a week or two, sort of cleaned out a number of subs that they didn't think were really active or were in the field or anything like that just to optimize their service number. So, it was just a one-time clean-up from one place that I guess affected and made it look like it's flat even though there were still growth in other areas.

Chris Quilty

And actually, now that I think about it, are we still dealing mostly with the old 9055 handset, or has the new encrypted, certified handset been approved and shipping out to the market?

Matt Desch

Yes, what we would call the 9575A, which is the secure device, I think went into service early in the year. It actually was shipping quite well and quite a few of them went out in 2018. It's proven, it looks like a very popular device. We actually had a gap for a while, I think going back in 2017, when we almost ran out of the old 9505s that they used to use secure devices. But now it's back into full operation with the 9575A, which continues to be a popular service.

But remember, they're also now doing tactical radios, a lot of IoT business. And we're already starting to see some Certus revenues from the government, particularly in the Land Mobile side, they're are driving a lot of the initial sales, as they put things on certain vehicles and that sort of thing to provide broadband service.

Chris Quilty

So, how are they paying for Certus? Because you haven't, if I recall, that contract for Certus service is going to be separate from the EMSS contract that you're negotiating, and obviously neither of those are in place, so I'm assuming this is more special operations using their funny money?

Matt Desch

Well, it is true that variable rate services, particularly with higher speed data, is always going to be a separate contract and revenue stream from our fixed costs narrow-band services. So Certus is new revenues. Today, those are, I think, flowing really primarily through our commercial business as opposed to the government line until the government gateway gets fully in operation, which they are moving towards right now, and that will give them a complete secure capability.

But because they have so much interest, they have been deploying some initial product going through our commercial gateway and through our commercial revenue lines. But those will be based upon how much service they deploy, what speeds they operate, how much data flows through it, and that will be independent of our EMSS contract.

Chris Quilty

Okay. And sticking with the voice theme, an update on Push-to-Talk, is that starting to gain traction, either government or commercial/industrial?

Matt Desch

We have had nice pick-ups lately. I would say that we're really excited about a new terminal coming in the second quarter. Many of you heard that a partner, Icom, a Japanese supplier that makes very good products, we're really impressed with the initial device that I've seen going through certification right now. It's on track to probably deliver in the next few months, and we think it's going to really, really make our Push-to-Talk service even more attractive.

Our previous handset, which was built on our 9575 handset was good, but it really wasn't built to be a

push-to-talk device, and I think once we have a purpose-built device for that, that's really going to help convert a lot of the opportunities we still see around the world. Still a lot of interest, and we are getting new customers every month for that. I'd say overall it's still small compared to the rest of our business, but we still feel very positive about the future and potential of that business.

Chris Quilty

And one final question, shifting back to the commercial IoT business. Good numbers in Q4, but in terms of subs on the consumer side, presumably, if things were shipping for the Christmas season they really don't show up as subs until the first quarter. Are you getting any good indications of consumer uptake for some of your devices, and notably that would be the Garmin inReach, which seem to get some good coverage from them in their earnings call.

Matt Desch

Yes, I mean, that's a little forward leaning here in terms of sort of not hitting the 2018 results, as you said. But I can tell you, we continue to see really robust IoT subscriber growth and have really good expectations for broad-based growth. Garmin in particular, really continues to execute extremely well, just very impressed with them as a partner as they both expand their product lines and their distribution around the world. We clearly see it in our results. I think you are going to continue to see it in the coming years in our results.

We're continuing to look to diversify even beyond that. But right now, I'm pretty excited about future products that they have as well. Clearly this is, I think they have seen positive results from sort of connected devices in their channels as well, and I think that that's going to be a great partner in the coming years.

Chris Quilty

Great. Thank you.

Matt Desch

Thank you.

Operator

And our next question comes from Anthony Klarman with Deutsche Bank. Please go ahead with your question.

Anthony Klarman

Hi, thanks. Just a couple of questions. First, I apologize if this came out in the text of the commentary and I missed it, but I wanted to just understand on the 2019 outlook what that assumed in terms of the run rate for the government contract. And to the extent it was the government contract at the current rate, would you envision providing us clarity on sort of what the new contract looks like when that is signed by revising guidance or sort of giving us what the incremental run rate might be?

Tom Fitzpatrick

Hi Anthony. Our guide assumes what we expect to be the increase effective April 19th, so it would be a stub period. So that, we've included what we expect the increase to be. We haven't disclosed that, and certainly the government contract would be material and its terms would be disclosed. And if it's materially different than our guidance, we would update accordingly. But we have factored in what we think the increase is going to be in our guide.

Anthony Klarman

Got it. So it essentially winds up being the current run rate for 1Q, the stub period for 2Q, and then the

new run rate for the full period for the back half of the year?

Tom Fitzpatrick

That's right.

Anthony Klarman

And then I guess, if I look at that and then I look at the guidance around the \$75 million in incremental broadband opportunity, can you just talk about what the path of that or what the rhythm of those numbers look like as they pace out? Because if I just pull the current run rate of the business forward and I layer in some incremental broadband opportunity plus some modest presumed step-up in government, the guidance certainly looks like it is on the conservative side. Can you help us just think about maybe if there are other one-timers or puts and takes in there that we should consider, or how the ramp of the EBITDA progresses throughout the year?

Tom Fitzpatrick

Yes, so there is a one-timer there that I did talk about it in my commentary, which is on our satellite time and location, we had a \$4.5 million true-up there. So Satelles is a start-up operation, we have a contract with them that GAAP says should come into revenue at \$5.1 million a year, notwithstanding the fact that the payments are not leveled, they're back-ended as you'd expect with a start-up.

And so in the early years, we could have recognized \$5.1 million, but given the fact that the collection of that was not probable, we only collected what we've got in cash. There were developments there this year that caused the certainty of the collection to cross the probable line and so we basically brought in the revenues that we chose not to recognize in prior periods.

And that was a benefit to 2018 that implicitly decrements the year-over-year growth in 2019. So, pro forma for that, the 2018 revenue growth looks like 16% would come down to 15%, and the 2019 growth would not be 8%, it would be more like 9.4%. So that's as to answer your question in terms of the one-timers.

As we think about the growth, if you take the kind of pro forma 9% growth into 2019, there is very little Certus in there. And so, if you model a ramp to \$100 million, you see the Certus revenues into 2020 and 2021 to get to a \$100 million exit rate, there is material growth there that takes that 9.4%, 2019 pro forma growth well into the double-digits.

Anthony Klarman

Understood. Thanks. And then, I know we've covered this previously, but I was wondering if you could maybe remind us, you mentioned Aireon's remaining hosting fee account payable to Iridium. Can you just remind us if there are any milestones that still need to be achieved that would trigger additional payments from Aireon to Iridium, or whether it's just sort of the commencement of commercial operations on their end and that will change the revenue rec? And then a reminder on what the timing is on the equity repurchase agreement?

Tom Fitzpatrick

Sure so the facility that they just closed contemplates an additional payment to Iridium of \$15 million, pending them signing up some contracts that they are looking to do. What we have said is that, we expect there is that payment and still it could be expended, but we expect it to be fully paid by 2021, as to the hosting fee. And then the buyback of the stock would be subsequent to that hosting fee payment in 2021.

Anthony Klarman

Got it. Okay. And then, Tom, just finally on the refinancing comment you made, I was wondering if, when you talk about the refinancing, you're talking about just the BPI piece or if you are all talking about more of a holistic refinancing? In light of I think you've sort of mentioned that the refinancing could cost you about a quarter turn with respect to the net leverage target that you have.

Tom Fitzpatrick

Right. So, we think about as a two-step process. The first step would be to refinance the BPI facility, and then we have our eyes on the high-yield bond, when it becomes economical, in the April/May timeframe of 2020.

Anthony Klarman

Got it. So, you would imagine that the high-yield bond probably stretches out somewhere close to the first call date?

Tom Fitzpatrick

Yes, we have our eye on the first call date. Yes, we have our eye on the first call date there.

Anthony Klarman

So, then in mentioning the quarter turn impact to net leverage, I guess, other than just sort of normal fees and expenses, I'm wondering what the breakage costs are on the BPI? Is there call protection on that facility or is it pre-payable, and what would lead to that quarter turn of incremental leverage?

Tom Fitzpatrick

It's not that. We've assumed that there are things going both ways. There is money that's due back to us and there are swap fees that they can lay claim to. In our quarter of a turn, we're just purely dealing with the fees to arrange a \$1.5 billion credit facility.

So, we model the exit cost, if you will, from the BPI facility as kind of neutral, and we think we're being conservative there. And so our quarter turn of leverage is just because we have a formal guide out there of 4.5 times, and we would be remiss if we didn't say, hey look, we are also thinking about refinancing that could make that go wide by about a quarter of turn, should we do it.

Anthony Klarman

Got it. And when you say exit cost, I guess, my presumption was that you could probably refinance BPI into a normal way, first lien credit facility at an all-in rate that's below PPI. But are you assuming for modeling purposes that you should think about it as maybe flat?

Tom Fitzpatrick

No, it's not. The cost will be up, because that's 5% money. So we fully anticipate that our interest costs will go up. But it's the right thing to do for the business. We need the flexibility of a regular way financing to run our business. The BPI facility was a wonderful instrument to use during the construction period, but we need to run a business at this point, and are focused on paying dividends and buying back shares, none of which we can do with that facility.

Anthony Klarman

Yes, understood. Thank you.

Operator

And once again, if you would like to ask a question, please press star and then one.

And our next question comes from Louie DiPalma with William Blair. Please go ahead.

Louie DiPalma

Good morning, Matt, Tom, and Ken.

Tom Fitzpatrick

Good morning, Louie.

Louie DiPalma

For the EMSS contract, do you expect it to gradually increase from year one to year five, similar to the existing contract?

Matt Desch

It's a little too early to give that kind of guidance, to be honest with you. We're still in discussions. I think that's the most likely approach, but we want as much flexibility as possible here. Overall, the total value should go up, because the usage. And, cost per user have come down so dramatically and the expectations of future usage are really strong right now, given all the different projects that the government is going to deploy the technology on. But exactly how that will be profiled over the next number of years, I can only say broadly that's probably just a general expectation. But we'll know in a month or two.

Louie DiPalma

Okay. And also on the defense side, you mentioned, or I think you mentioned a new Department of Defense Certus Gateway. Is that a separate gateway from their voice gateway in Hawaii?

Matt Desch

No, it's additional equipment that would be built and installed at that location so that they can take and deliver basically Certus service through the same sort of approach, a secure global service. But that's actually been under development now for a while. They committed to deploying it, and there is a plan right now to do that over the next year or two, to deploy that technology.

Louie DiPalma

Okay. And I'm assuming it's necessary for that gateway to be completed before they establish a Certus contract with your partner, Comsat?

Matt Desch

No. I mean, they could have that. The revenues would maybe flow through Comsat through our commercial broadband lines, if you will, and we'll account for it through the commercial service. So they can deploy service and Comsat can be involved. It just won't go through our government line, if you will, and through that government gate.

Louie DiPalma

Got you. And lastly, your competitor, Inmarsat, they're beginning to announce vendor contracts for their new sixth generation I-6 L-band constellation. Are you confident that your Certus services with Iridium NEXT will be able to achieve similar levels of performance relative to their future constellations?

Matt Desch

I believe very confidently in our business projections around what Certus will do for many years. Inmarsat, or anyone else here deploying a service, it's not about speed. To add another megabit per second might be interesting, but again it's more about cost, size, coverage, competitive dynamics, etc. By any measure, we should never been able to sell an OpenPort device over the last 10 years, because

it was a fraction of the headline speed of what Inmarsat did, and of course we did quite well with that.

I think Certus is going to carve out—and by the way, not just exactly identical services to what they do, but I think it's going to expand the market. For example, they really can't do effectively what we can do with our MissionLINK Land Mobile business right now, because we're providing a highly mobile service, broadband-on-the-move, instead of what you could call broadband-on-the-pause, where you really have to kind of set up or have an extremely expensive antenna to do that. Those kind of advantages are going to remain well into the future. And someone might come up with a higher headline rate than their megabit or so that we are doing, but just having a 2 megabit terminal or a megabit-and-a-half, or whatever they want to call it, isn't really what it's completely about, because it's not just speed. That really is going to be I think the competitive dynamic for the coming years.

So, I am really confident with really the potential that we have for Iridium Certus well into the future, and you can also see how excited we are at an area that I don't know that anyone can compete against this, which I call the 100 kilobit per second and below using low-cost model antennas. That's going to be a whole brand new market that I don't think anyone can touch us on, and no one looks like they're even designing anything to go after that market.

Louie DiPalma

Sounds good. I look forward to hearing more about the 9770 on March 7th.

Matt Desch

And it will be good to see you, Louie, and I think that will be a great chance for us to really expand and tell our story a bit more broadly. So, I hope everybody tunes in for that too, if you're not with us.

CONCLUSION

Operator

And this will conclude our question-and-answer session. I would like to turn the conference back over to management for any closing remarks.

Matt Desch

Well, obviously it was a great year, and it's exciting to have a brand new network in service. I know you've been following us. As I said for a number of times, I think March 7th is going to give us an opportunity to really flesh out the story, our strategy going forward, and how people should be looking at us, and it's going to be an exciting year. So, thanks, everybody for joining us again.

Operator

The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.