

Iridium Communications, Inc.

Iridium Communications, Inc. Second
Quarter Earnings Call

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CORPORATE PARTICIPANTS

Matt Desch – *Chief Executive Officer*

Tom Fitzpatrick – *Chief Financial Officer*

Kenneth Levy – *Vice President, Investor Relations*

PRESENTATION

Operator

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

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

Kenneth Levy

Thank you. Good morning and welcome to Iridium's second quarter 2018 earnings call. Joining me on the call this morning are our CEO, Matt Desch; and our CFO, Tom Fitzpatrick. Today's call will begin with a discussion of our second 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 Web site.

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 facts and include statements about our future expectations, plans and prospects.

Such forward-looking statements are based upon our current beliefs and expectations and 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 Web site for a reconciliation of these non-GAAP financial measures to the most directly comparable GAAP measures.

With that, let me turn things over to Matt.

Matt Desch

Thanks, Ken. Good morning, everyone. As you saw in our press release this morning, sales momentum continued into the second quarter and its helping to drive another strong year of performance for Iridium. I'm particularly pleased that we pushed comfortably above 1 million subscribers this quarter, with subscriber growth continuing to accelerate as customers and partners flock to our nearly complete next-generation network.

Our first half performance gives us the confidence to raise our full-year outlook for service revenue and operational EBITDA. Our business is really firing on all cylinders and we're capitalizing on the inherent benefits of our unique global LEO constellation. We are also excited that this is

happening at the same time as we approach the imminent commercial launch of Iridium Certus, our new L-band broadband offering out later this year.

As many of you know from your long affiliation with our story, our path to success has not always been as clear as it appears today. It's required vision, strong conviction and a tremendous amount of planning and operational execution. We've come a long way since our first launch early in 2017, and now about 80% of the traffic on our network is connecting to Iridium NEXT satellites. This upgrade has improved the performance of our core services and the quality is noticeable to our customers.

The market has clearly noticed our progress in executing our business plan and completing the Iridium NEXT constellation. It's apparent to longtime shareholders and even the casual investors who track our stock that Iridium is executing well and rapidly retiring risks. It is also obvious to our current partners who continue to generate strong subscriber growth and develop Iridium powered solutions.

Most importantly, however, it is evident to many technology and distribution companies who want to join in our success and utilize our new network. Continued progress on Iridium NEXT deployment is attracting new companies to our partner ecosystem which bodes well for our future growth.

With last week's successful launch, the 7th of 8 total, 65 Iridium NEXT satellites are now in orbit. These 10 newest satellites will go into operation over the next five weeks or so and the team will then prepare for our 8th and final launch. We're finalizing our plans now for the final launch and will announce it in due course. But as we've often promised, we're on track and confident, we will complete our Iridium NEXT program this year.

So what does this milestone mean for our company? With the completion of the final launch, Iridium will enter a well-deserved CapEx holiday, which we anticipate lasting for at least 10 years. With a powerful new network and lots of new ideas about how to use it, we're confident with our business outlook and how the new constellation will benefit our cash flows. So, it's a huge milestone for us and I'm sure you can understand why the celebration after the final launch may go on a bit.

I know the history of other satellite operators regarding CapEx holidays isn't so good, but our motivations are very different. Our network is very flexible, and our new satellites have been designed to support the growth and market opportunities we see in the future.

Remember, this is our second CapEx holiday. The first lasted about 12 years after our first-generation network was completed. I'm also confident that the \$35 million CapEx we expect, on average, each year for the next 10 years, along with the continued robust R&D program will be sufficient to continue to bring many innovative new products to our partners and their customers. With over 400 companies taking us to the market – and that list continuously growing in number and quality – I think it would be hard for others to replicate this important engine of growth.

The completion of Iridium NEXT also unlocks several new revenue streams for our company. The two most immediate include hosted payload revenue from Aireon and Harris, which you've already seen enter our numbers, will grow to \$47 million in annual revenue post-NEXT deployment. Second, new revenue from the rollout of Iridium Certus, which we'll commercially launch this year.

We've guided to our expectations of \$100 million in Iridium Certus revenue as we exit 2021, though we believe the annual market opportunity for L-band broadband service is north of \$700 million today. Iridium Certus technology will also turbo-charge our IoT business, which is already doing quite well. We don't see anyone even approaching the flexibility and portability of our existing service and expect that new IoT capabilities powered by Iridium Certus will continue to drive meaningful subscriber and service revenue growth.

As you know, we were excited to be recognized by the International Maritime Organization, in May, to provide services for the Global Maritime Distress and Safety System. GMDSS has significant strategic relevance to our company. Our many new Iridium Certus maritime distribution partners are excited by our recognition, as it gives them additional flexibility to deploy Iridium broadband solutions. Of course, it's also a testament to the dependability and global coverage of our satellite network.

As you've seen this year, we're selling a lot of equipment to our partners. We hadn't expected the sales momentum from 2017 to continue this late into 2018, but sales have remained strong. This is now causing us to revise upward our full-year equipment forecast. That's good news and it bodes well for continued subscriber growth. But overall, we primarily see higher equipment sales as a means to generate additional recurring service revenues.

Longer term, our strategy is to encourage more partners to embed Iridium's core IP directly into their solutions. We've been working over the last few years to attract larger companies to license our core chipsets and reference designs to build their own customized transceivers and integrate Iridium more deeply into their product portfolios.

We've already seen success with this strategy with several sizable companies and are working with others, primarily in the IoT and Iridium Certus broadband area, but in commercial push to talk as well, both for commercial as well as government solutions. These companies are able to make solutions using the Iridium Network that are to smaller and less expensive for their customers and more elegant to use.

Licensing of Iridium chipsets and IP can lower their hardware costs and be leveraged across other product lines. Year-to-date, we have shipped more than 55,000 chipsets to our partners we've attracted to our licensing program. This figure is already more than the aggregate number of chipsets we've shipped over the last five years. So, our IP strategy is really starting to take hold.

Not only it is exciting to see this early progress, but this embedding of technology is likely to help drive the next large wave of service revenue growth for our IoT business after the Iridium Certus launch.

I know that many of you are focused on our business with the U.S. government. In this segment, we've continued to see strong subscriber growth and feel very comfortable about the continuity of our relationship.

As you know, the current EMSS contract with DISA runs through October and we anticipate that they will exercise their option to extend this contract for an additional six months as we work together to sign a new contract. We are working closely with the government's procurement team to support this process and expect to enter into a new EMSS contract by April of 2019; one which is beneficial to both parties.

And finally, on Aireon, the company continues to make progress towards commercial introduction of their service early in 2019. While we await the completion of their credit facility, we welcomed the equity investment they received from the third largest ANSP in the world. On May 15, U.K. NATS purchased a stake equivalent to about 10% of Aireon and announced their intention to begin using Aireon space-based ADS-B solutions to manage traffic in U.K. airspace in early 2019.

This \$69 million investment in Aireon is a new source of operational capital, fortifies Aireon's balance sheet and improves their strategic position. By the way, U.K. NATS is no stranger to Aireon. They signed a long-term data service agreement with the company in 2014. However, this equity stake signals an additional level of confidence in Aireon's future and helps assure Aireon becomes the global standard for aircraft surveillance.

Last week, Aireon announced that it had signed an agreement for data services with Airbus Defense and Space. This contract validates the intrinsic value of a comprehensive global data set of aircraft movements and will allow Airbus to begin to develop solutions around Aireon's unique real-time information. We expect Aireon will find more opportunities like this to monetize the unique and incredibly rich data set they're accumulating as they follow every global aircraft.

So, this has been an outstanding quarter and we're carrying strong momentum as we enter the second half of the year. With one more launch to go, we're getting close to arriving at what some of you have heard me call the land of milk and honey. That valley beyond the mountain we've been scaling which will reward all our hard work.

We are not taking victory laps yet, but our business is very strong, and our prospects have never looked better. I eagerly await our third-quarter call so that we can update you on our progress and usher in this new era for Iridium.

So with that, I will turn it over to Tom.

Tom Fitzpatrick

Thanks, Matt, and good morning, everyone. We are proud to have delivered another strong quarter with 20% growth in both revenue and operational EBITDA. The first half of the year has been solid with sales and OEBITDA running ahead of plan and record net subscriber additions in our commercial business segment.

Today I'd like to review our key financial metrics and provide some color on the trends supporting this quarter's strong performance. Then, I will discuss the details of some favorable developments in our arrangement with Aireon and close with a review of the upwardly revised full-year guidance we released this morning.

Iridium generated second quarter total revenue of \$134.9 million, which was up 21% from last year's comparable quarter. This was the best quarterly revenue growth in company history, fueled by double-digit revenue growth across all commercial revenue lines. Operational EBITDA increased by 20% from the prior year period to \$78.7 million and our operational EBITDA margin was 58% this quarter.

On the commercial side of our business, we reported record service revenue of \$82 million in the second quarter, which was 27% higher than the prior year's quarter. This increase reflects the recording of \$6.9 million in hosted payload revenue, a rise in voice revenue, and the effects of accelerating growth in IoT subscribers.

Voice and data revenue increased 10% in the most recent quarter principally reflecting targeted price changes adopted in April. With recent constellation upgrades, improving voice quality across our network and evolving competitive dynamics in the industry, we thought it appropriate to adjust some of our pricing plans. We've been pleased with how this has been received by the market.

Importantly, it has not meaningfully affected net subscriber additions. In fact, we actually saw a rise in the pace of equipment sales during the quarter, which is a positive indication of the value that subscribers place in our service offerings. As a result, voice and data ARPU increased to \$45 in the second quarter from \$41 in the year-ago period. We expect ARPU to remain at approximately \$45 through the first half of 2019 and increase thereafter as a result of Iridium Certus adoption.

During the quarter, we added a record 48,000 net new commercial subscribers, driven by growth in IoT and seasonal activity. Commercial IoT data subscribers now represent 61% of billable commercial subscribers, up from 56% in the year-ago period.

Existing partners continue to drive new IoT activations with accelerating growth from Garmin, who's been actively extending global distribution and introduced the inReach Mini in the second quarter as well as industry-leading heavy equipment manufacturer Caterpillar. We're also seeing steady subscriber growth from the transportation and logistics industry, as well as in maritime. As a result, net subscriber activations rose 26% from the year-ago period in our Commercial segment.

Revenue from Hosted Payload and Other Data Service was \$12.4 million in the second quarter, compared to \$1.9 million a year earlier. With 50 Iridium NEXT satellites operational through the second quarter, hosting and data services revenue contributed \$9.7 million this quarter – this figure included \$2.7 million in Aireon hosting revenue earned in the second quarter of 2018 and a catch-up adjustment of \$4.2 million for Aireon hosting fees in 2017 and the first quarter of 2018.

You'll recall from previous quarterly calls that we were not recognizing Aireon hosting revenues until Aireon clears certain expected milestones supporting probability of collection. Developments in the quarter have caused the receivable's collection to become probable and, accordingly, we've recorded all amounts earned to date under GAAP in the quarter.

This quarter, Aireon made an initial cash payment of \$8 million to Iridium for hosting fees, and has contractually agreed to pay Iridium an additional \$6 million by year-end 2018, regardless of the state of their financing efforts. Aireon has further agreed to pay Iridium a minimum of \$16 million in hosting fees in 2019 and subsequent years until all hosting fee commitments are fully paid. Again, regardless of whether they're able to raise outside debt.

When Aireon does close its credit facility, additional payments allowable under the facility will be paid to Iridium over and above these newly implemented contractual minimums. Aireon continues to work to close their financing and continues to believe that this will occur in 2018. But this closing now has no impact on Iridium's revenue recognition of hosting fees, nor does it impact Iridium's liquidity.

All hosting fee payments received from Aireon are used to make early payments on the BPI facility. And the interest rate charged to Aireon on its receivable is not materially different from the rate on the BPI facility. So, in summary, this is a very good outcome for Iridium and reflects the outstanding relationship we have with our partners in the Aireon venture.

Turning to our government service business. Revenue remained steady at \$22 million this quarter under the terms of the EMSS contract. Government subscribers grew at a healthy 16% pace from a year-ago and total U.S government subscribers numbered 107,000 at quarter end. Revenue from subscriber equipment was higher than we expected, growing 37% to \$25.9 million in the second quarter.

An increase in handset sales this quarter, even in the face of an access price increase, is a strong indication of our competitive position in the satellite voice market and demonstrates the strength of our brand and network, which we believe also extends to growth segments like IoT and broadband.

In light of continued robust growth, we now expect 2018 equipment sales to exceed 2017 levels.

Engineering and support was \$5.1 million in the second quarter as compared to \$6.1 million in the prior year's quarter. This change reflects the episodic nature of work on commercial and government projects.

In light of our record revenue performance during the first half of the year and continued strength in subscriber additions, today we are updating our full-year 2018 outlook. We now forecast service revenue growth between 12% and 14%, which is up from previous guidance of 10% to 12%. This growth in projected service revenue is based upon accelerating strength in IoT and better-than-expected net additions in the face of our service price increase.

Our revenue outlook continues to assume \$25 million in hosted payload revenues in 2018, including \$14 million from Aireon hosting fees, \$7 million of which will be recorded in the second half of the year. Today we are also raising our operational EBITDA guidance for the full year to a range of \$290 [million] to \$300 million, up from a range of \$280 [million] to \$290 million, previously. This increase reflects our expectations for higher service revenue in 2018 and a higher equipment margin from the sale of more satellite phones than initially forecast.

We continue to expect capital expenditures of approximately \$500 million this year. The majority of this spending is tied to launch related activities and acceptance testing, which will be completed with the deployment of the remaining Iridium NEXT satellites this fall.

Iridium enjoys a strong liquidity position today and we now expect our net leverage position to peak at around 6x OEBITDA later this year. Our cash and marketable securities balance as of June 30 was \$375.9 million and we anticipate future interest and principal payments, as well as invoices and milestone payments associated with the Iridium NEXT program will be made in cash.

Before I close, I do want to highlight two items that impacted our financial results this quarter, which were largely responsible for the GAAP net loss we reported. The first was a \$30.3 million change in depreciation and amortization expense, which reflects an increased number of Iridium NEXT satellites in service from the prior year period. We expect depreciation in amortization to continue to increase as additional satellites are placed into service.

The second item related to a state tax law change enacted during the second quarter, which resulted in an \$8.7 million nonrecurring charge to our deferred taxes. This caused income taxes in the second quarter to be disproportionately large relative to our income before taxes.

I continue to feel very good about the underlying strength of our business. We are making strong progress completing Iridium NEXT constellation. Its deployment should unlock new revenue streams to our company and with it significant value for our financial stakeholders.

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

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 are using a speakerphone please pick up your handset before pressing the keys. To withdraw your question please press star then two.

Our first question comes from Greg Burns of Sidoti and Company. Please go ahead.

Greg Burns

Good morning.

Matt Desch

Hey, Greg.

Greg Burns

Hi. Could you just talk about the dynamics in the handset market that gives you confidence to raise prices? What are you seeing from the competition, where you feel comfortable now raising your prices?

Matt Desch

Well, I don't know if that was completely in competition. We've never really gone for the value end of the market. We thought that was really not the way the satellite market works.

When people need a satellite phone they really are looking for the best, the most global solution, the one that they can rely on the most, and that's been borne out over time. Our success in this space isn't brand new, but as our new network was coming online, really heard good things from our customers and partners about the quality of the service. As we saw an opportunity, we hadn't really raised prices in the number of years, I think five.

Since it's primarily a device that is an access device usually more of an insurance product for most people, a modest increase and the access price was warranted, and I've been really pleased with the reception in the sense that really hasn't affected our pace very much.

It is true, some of our competitors aren't really as active as they had been. Some of our competitors don't have new phones anymore, one in particular. Others seem to be in sort of a different state of their business right now, perhaps, not emphasizing this quite as much as they have in the past. So I'd say, overall, I think we've often said to you that we feel confidence in sort of the baseline of our voice business. We didn't think it was a where we were going to get a lot of our future growth from, but we thought it was stable and that it was the foundation of our business, and I think this quarter proves that in spades.

Tom Fitzpatrick

Right. I would just amplify that to say, we've always characterize that voice businesses is highly defensible and slow-growing. And it -- the fact that it's defensible is what enables us to increase prices modestly in the face of a \$3 billion investment in a brand-new network.

Greg Burns

Okay, great. Thanks. And then, looking at the government, How do they currently sourced their L-band broadband services and do you have a sense of how much revenues progress there once Certus is launched? Thanks.

Matt Desch

Yes, they have sourced their L-band broadband from Inmarsat for the last number of years. I think the amount of business that's been done has been between \$100 [million] and \$300 million depending upon the year over the last number of years. That was the only really choice they had for L-band broadband services.

Now with Iridium Certus and they're already by the way deploying the infrastructure right now to be able to use Iridium Certus and are starting to consider the acquisition. I've heard they're particularly excited about the fact that our network really doesn't touch other countries, given the security and reliability of our network, we cover more the world, including the poles. It goes directly into U.S. government facilities once it's completed. We're excited about the potential for taking a significant part of that business.

Our partner in that space is Comsat, which has a long-standing relationship with the U.S. government. They understand how to build applications and support them, and support their customers. So, we believe that that's a great vehicle for us to service and support U.S. government customers. So, I'm very optimistic, particularly, about the long-term potential for the U.S. government as a customer for Iridium Certus.

Greg Burns

Great. Thank you.

Operator

Our next question come from Ric Prentiss of Raymond James. Please go ahead.

Ric Prentiss

Yes. Good morning, guys.

Matt Desch

Good morning, Ric.

Ric Prentiss

It certainly nice to have a debriefing of the launches in the Aireon booking come into place. Couple of questions. Tom, you mentioned on the voice side, the \$45 ARPU we'd expect to run through first half '19 and Certus can help the growth. How about on the IoT side? Obviously, a lot of success there, adding a lot of subs, how should we think about the pricing dynamics in that space?

Tom Fitzpatrick

The pricing dynamic is holding up just fine. The subs that we're adding are lower usage, so they are just as profitable as higher ARPU subs. It's just the fact that they are on lower data bundles, if you will. Most notably, Garmin is our fastest growing. And those ARPUs are less than the average, and so we've said for some time that we see the ARPU in the IoT business is a

downward sloping line and that's what you've seen in the current results and we'd expect that to continue with the outsize growth coming in the lower ARPU, lower data usage devices.

Ric Prentiss

Okay. And then can you give us an update on the FAA side of things, as far as their review of the Aireon product?

Matt Desch

Yes, everything I've heard has been positive. They're going through their process and still are on track to make decisions later this year and still high expectations they will be deploying that. I do know we've been answering an update on the FAA for the last several years. As you can tell with Tom's comments, we've worked hard over the last couple of years to disconnect ourselves to Aireon. I know that FAA was very heavily connected to the hosting payments and all that sort of thing. Really, we've largely unconnected that now with the arrangements that have been made with Aireon. While that will possibly trigger even more hosting fees to pay down our credit facility and that sort of thing, it's really not a liquidity issue anymore or a revenue recognition issue anymore.

Overall, I would say, I still think things continue to be very positive on the FAA front. They've recognized the value of having surveillance in their airspace. I've heard them speak positively about the potential for it. It's just they've got to still continue to go through their process at their speeds.

Ric Prentiss

Then the derisking has been very significant; I appreciate all that work. Really filters it down into the operations and so as you think about second half '18, going into '19 and the ramping of the Certus service, what should be monitoring, particularly, from the outside to watch the progress you guys are making?

Matt Desch

Well, you've certainly seen a lot of our announcements on partner announcements. It's been a lot of enthusiasm and a pretty broad range group of distributors. You'll see us declare that to be commercially ready here in the next few months at most. Frankly, the product is very robust and it appears to us to be ready for commercial launch from the satellite and network perspective, we're just really waiting for our partners to be completely ready on their side.

Broadband is an end-to-end product and you really want a great service all the way down to the ship or the airplane or the terrestrial device and it's in commercial beta testing and that seems to be going very well, but we're just waiting for a few of them to really declare it to be bullet proof before we declare commercial service. You will see that and then I expect you'll see some revenue growth from it.

Beyond that, I'd expect you will see continued IoT partner announcements, IoT growth. You'll start to see the technology being introduced from Certus into IoT in 2019. Our small form factor device, I'm pretty excited about – the potential for that in IoT and in other markets like aviation. You'll see the aviation segment come on in Certus next year. You'll see the DoD contract we sign.

There is still a lot to be done early right here. It's not like the final launch is done and then we really have nothing to do for it any time. I think there's certainly a lot of activity across the board.

Ric Prentiss

Great. Look forward to launching the ramping of the operations in the sales cycles. Good luck, guys.

Matt Desch

Thanks, Ric.

Tom Fitzpatrick

Thanks, Ric.

Operator

Our next question comes from Hamed Khorsand of BWS Financial. Please go ahead.

Hamed Khorsand

Hi. Good morning. About the IoT and the growth you're seeing, is that related to your Certus ramp or is there something else driving that growth?

Matt Desch

Yes, so IoT right now is completely unconnected from the new Certus introduction, though Certus technology will eventually come into it next year and year beyond to provide new products for IoT. The current growth we're seeing is really based around the hundreds of partners that we have in that space who are really doing very well in deploying lots of subscribers and growing service revenues.

By the way, it's across the number of our partners; obviously we're achieving good growth and success in the heavy equipment segment. That was one of our more recent ones. Garmin is a good example of the personal communication segment of IoT, where there's a number of partners who are deploying products that individuals would want, going from commercial to enterprise to government tracking and locations, but transportation logistics, it's been a recovery in oil and gas. A broad-based area of our partners are achieving success.

Our model for IoT is primarily to bring the partner on and a year or two later they start to deliver and we're seeing the growth of partners delivered in previous years hitting this year and we're expecting the partners we're signing up this year to come on next year and continue to add to that growth.

Hamed Khorsand

You were just touching on my next question, which was trying to gauge with your voice subscriber increase, is that related because of oil and gas? How sustainable is that? Are you taking market share?

Matt Desch

Are you talking about in satellite phones?

Hamed Khorsand

Yes, in the subscriber adds that you had.

Matt Desch

Well, we've always had the largest share of that space right now. I wouldn't know that we're necessarily taking share or anything. We are really holding our own and increasing the value of the segment that we have.

There are a couple of products in that market line, commercial voice and data. It's not just satellite phones. It's also circuit-switched data devices that have been on ships and in certain applications that's also OpenPort Pilots, which are maritime high-speed broadband devices. There's a couple segments in there. Clearly, ARPU growth this quarter has primarily been about the access fee increase and its adoption this year.

Overall, I just think right now the global economy is pretty strong. I think our brand is very strong. I think the quality of the product is recognized by our partners is good. I think our partner distribution is healthy. They see that they can make money with an Iridium satellite phone where they may not be able to make as much money with some of our competitors' devices, so they want to sell us and they promote us.

There's just a lot of different reasons, I think, for why we've always held up very well in this segment. Of course, it really is the fact that it works everywhere on the planet versus other solutions that only work on certain terrestrial regions, for example, or in certain parts of the world or the fact that there's a lot of quality reasons why people, I think, prefer our devices.

Hamed Khorsand

Yes. What I was trying to understand was, there was no one-time benefit because we're seeing a ramp in oil and gas. That wasn't the real reason why your subscriber numbers increased in voice and data, correct?

Matt Desch

No. no, there's not one specific reason. It's really the whole segment is holding up very nicely.

Hamed Khorsand

Okay. Thank you.

Matt Desch

Thank you.

Operator

Our next question comes from Louie DiPalma of William Blair. Please go ahead.

Louie DiPalma

Hi. Good morning, Matt, Tom, and Ken.

Tom Fitzpatrick

Hello, Louie.

Louie DiPalma

Good morning. GMDSS was obviously positive for your maritime competitive positioning. For aviation, Iridium has announced that they've partnered with all of the major players. I was wondering what is necessary from a regulatory perspective and a technology perspective for Iridium to gain more share in aviation and cockpit connectivity? And I was wondering if there are any specific milestones that we should be looking for.

Matt Desch

Yes. So, aviation is actually even more natural segment for us than maritime. Airplanes really appreciate 100% global coverage, even more than ships do, in the sense that airplanes can cover anything, and they also like the lower cost, typically, of an Iridium solution. We've always done

very, very well in aviation. There's, probably over 40,000 aircraft, are already installed with Iridium systems on board.

The parallel for GMDSS is in aviation safety services, goes by many names, FANS 1a, future navigation services, controller pilot datalink, ADS-C, these are all technologies and Iridium has been approved for all those things unlike GMDSS where we haven't been approved in the past for maritime. Our current generation of systems have been approved for all those and they are the reasons why we're now being line fit on more and more aircraft, we are an OEM option for any aircraft.

Our safety voice, which is something that we got approved for just a couple of years ago, is now in over a 1,000 commercial aircraft. So, we're really been doing very, very well. Perhaps we are certainly getting at least our share of the market, maybe even exceeding the shares of others for cockpit communication today even using the existing technology and existing network.

Now, I think the excitement in Iridium Certus is only adding to that – the fact that we can add higher speeds, hundreds of kilobits per second, instead of tens of kilobits per second is exciting. And there's already been a lot of activity on the fact that that would be just as natural upgrade for safety services for our Certus product. When those become available in 2019, it's expected that those will all be also approved to do the same sort of things that our existing technology is able to provide.

I'm not sure there's a specific milestone to look at. There's not a formal approval there that I'm aware of. I'll look into that to see if there is sort of a specific ICAO approval to say, a Certus device or something, but I don't think that that would be what would drive, particularly anything specifically anyway because we're already getting a lot of momentum on the aviation side right now.

Louie DiPalma

Sounds good. And for IoT subscriber net adds were solid this quarter. For your short first data, the 9603 modem, you have frequently discussed the demand from the heavy-duty machine vertical for asset tracking. I was wondering if any other industry verticals have started to contribute in a material way.

Matt Desch

Yes, we make a few different devices and 9603 is the smallest. There's also the 9602 and we use the 9523. All of them contribute to that segment and it's broad-based. Heavy equipment has been a driver, but as Tom said, so is the personal communication segment. A lot of times we call out Garmin, but actually, broad-based using Iridium to connect people in small messaging devices that allow people to know where they are and for them to send messages back and forth, and to send information to loved ones, and to track where they are and that sort of thing is a broad-based segment which we're really uniquely suited for, and frankly, I think we're the only one in satellite that can do that. We're also seeing transportation, we're seeing in logistics, we're seeing oil and gas, we're seeing -- just a broad number of our segments are doing pretty well right now. I think it's broad-based. I don't know if there's a specific market segment I'd call out necessarily.

Louie DiPalma

Okay. And lastly for Tom, I believe you mentioned that Aireon is obligated to pay \$30 million between 2018 and 2019 out of the \$200 million that they owe you. I was wondering in terms of the 2019 leverage guidance of 4.5x, what are you assuming in terms of how much money Aireon pays you over the next 20 months or so?

Tom Fitzpatrick

The '19 guidance assumes that we get the majority of the posting.

Louie DiPalma

Okay, thanks.

Tom Fitzpatrick

Not the full \$200 [million], but the majority.

Louie DiPalma

Great. Thank you very much.

Operator

Our next question comes from Paul Penney of Northland Securities. Please go ahead.

Greg Gibas

Good morning, Matt. This is Greg on for Paul. Thanks for taking my questions. First, regarding the new government contract that would begin in April 2019, what kind of changes in pricing should we expect here?

Matt Desch

Yes, I always have a little challenged talking out loud in the middle of a negotiation to provide too much guidance there. I've obviously coded my response to "beneficial for both parties" and hopefully you can get what that means.

The one thing I can say and I've said this in the past, there are what I would call core services that we've traditionally offer the government – voice, secure voice, IoT, push to talk capabilities et cetera. That's really how you value the last 5-year contract.

Obviously, my comments about "beneficial to both parties" apply to those core services. What it doesn't apply to is new things, and particularly, Iridium Certus. It's not going to be part of that core EMSS renewal contract because . . . that contract is still anticipated to be an unlimited all-you-can-eat kind of service and that will only make sense for narrowband type of services. So the upside really in our business and I think significant business for the government is going to be Iridium Certus and broadband. There's some other additional services that come with things like satellite time and location, etcetera. That's really our upside and significant upside, even though I think we'll do fine in the core business as well, primarily because the subscribers are growing so well, and the government has seen so much more value out of it.

Greg Gibas

It makes sense. I understand. Then, second, in terms of commercial billable subscribers, you were just saying that the disparity and growth into IoT and in voice and data, which is a function of demand you're seeing from those customers, but would it also be a function of the pricing at all?

Matt Desch

No, not really. Our pricing hasn't really changed that much, if you would take the price per kilobyte or some other sort of form that way or access and everything. It has been pretty stable really over the last couple of years. It's really all about usage in the case of IoT. And in that case it's not that anyone is using it less. Each different partner comes along with a brand-new -- say a new solution

that have an ARPU with it, and we're bringing on more people who don't need to use the network much. They still value it, but it uses less ARPU. And that's fine with us, because the incremental cost of each of those dollars is extremely small. So it all adds positively to our bottom line.

Tom Fitzpatrick

Just fundamentally our commercial voice and data businesses is our legacy business. We've characterized it as slow-growing. It's niche, highly defensible, and we evidence that with the pricing action that we've taken. IoT we're riding a bow wave of the Internet of people becoming the Internet of Things and we are the premier satellite solution playing to that fundamental trend. That's why we're putting up subscriber gains at 25%, and we don't think there's an end in sight, at least if you read reports about the Internet of Things and its proliferation.

Greg Gibas

Got it. Got it. Then one last thing, regarding the hosted payload revenues that drove the beat, are these cash or non-cash?

Tom Fitzpatrick

Well, all of the data is cash. They pay it as we bill it. The hosting, they've made an \$8 million payment and contractually agreed to pay another \$6 [million], so the rev rec will all be cash in 2018.

Greg Gibas

Got it. Thanks. Congrats on the quarter.

Matt Desch

Thanks, Greg.

Tom Fitzpatrick

Thanks.

Operator

Our next question comes from Fernando Lopez-Ona of Silver Rock Financial. Please go ahead.

Fernando Lopez-Ona

Good morning. Congratulations on your numbers. Most of my questions have been answered. Thank you.

Matt Desch

Great.

Tom Fitzpatrick

Thank you.

Operator

Our next question comes from Doug Thomas of Gabelli. Please go ahead.

Doug Thomas

Hey, good morning. Congratulations on the financials and the launch last week. I know it's not directly relevant, Matt, but the FCC C-band 5G discussion and all that stuff – All that a positive in the sense that it just drives enthusiasm and interest in adoption in using satellites in general for a lot of this traffic possibly. Is all this an additional tailwind for you?

Matt Desch

I don't think so. It certainly is good thing for the operators who are able to participate in that, who have spectrum that will possibly be valued higher and you can see that. I think it does draw attention, if you will, to satellite operators who are experiencing big equity growth that people look around and say, "What's this mean?"

I don't think there's a direct comparison because that's really spectrum arbitrage, which we haven't ever participated in or ever alluded to. We apologize, because it has great value, if you can do it. But we've built our success on just the performance of our network and subscriber growth in building the business. It is not really directly relatable to us, but it certainly isn't a bad thing for them and we applaud them for it.

Doug Thomas

It's just good for the industry, in general, from a financial point of view and from an investor sentiment point of view, it can't be a bad thing.

Matt Desch

Yes, that's how I look at it too.

Doug Thomas

I had a question on Aireon. I'm just wondering, given the recent investments in the company and obviously the schedule for them paying you, how are we best led to understand what ultimately evaluation of that is. If things fall into place the way you think they will, and I don't know where the FAA is going to come down in all of this, but what do you think this potentially could be worth and how does this get monetized down the road? IPO or what do you think the true value of this business is as it relates to Iridium couple of years down the road?

Matt Desch

Just in general – Tom, I appreciate his view too – but we own a piece of a company that has a yearly revenue potential really of more than \$0.5 billion a year and without lots and lots of cost. It's a high margin business that we own a nice piece of. It won't be generating dividends for a couple of years, but I think it's going to get to cash flow positive pretty quickly and, therefore, start throwing off dividends down few years from now, which could potentially be quite substantial, which is why I think the current investors are enthusiastic about it.

The nice thing, it too has a long, long track record. There's not many other ways you can do this. It could become the global standard. On all that basis, this is a very valuable company now. I don't know exactly how Aireon will chose to monetize that. I'd be glad to take the cash dividends down the road, if that's all it is. I'd say there are other things that can be done with it at that time, but I think given that a lot of its customers own it, they want to at most maintain and ensure the success on long-term viability of the entity more than anything and will be working to protect that. I think there's a lot of long-term value in Aireon to Iridium and we're excited to be part of it.

Tom Fitzpatrick

Right. We've laid out the flows that we expect from them relative to our ownership interest. They'll pay us \$120 million for half of our interest and what we'll be left with is 22% of a company that is exclusively going after \$750 million per year TAM. As Matt said, they're very profitable. So, that's how we think about it in terms of bringing value to Iridium.

I think the same thing is if you think about what ADS-B is, it's replacing radar, which is technology that dates to the Second World War. Its sure feels like a very durable kind of generational type of an enterprise, and we already know who our hosted payload is going to be on our next NEXT – our next generation constellation – it's going to be Aireon. There's a lot of value flow into Iridium from Aireon for a very long time to come.

Doug Thomas

Thanks, Tom. I appreciate it.

Tom Fitzpatrick

Thanks, Doug.

Operator

Our next question comes from Chris Quilty of Quilty Analytics. Please go ahead.

Chris Quilty

Hey, Matt, two-part question on Certus. Number one, have your partners yet announced the pricing plans? Generically how are they positioning those either relative to other services or competition? Part two of that is, do you have a sense of what end markets, what verticals, is it aviation, land or maritime really become the leading piece?

Matt Desch

Okay. So, the first one, we have started to see some pricing in the market, in fact some aggressive promotions and that sort of thing to get people to try, which is exciting, because we see our partners are really even savoring this product, which I think will bode well for it.

The first market that it's going to be applied to is maritime, and I think it's still heavily oriented as the backup to VSAT, which is fine with us. That's a nice market segment for it. And I get the impression that they're pricing it very competitively against previous L-band solutions. So, it is marketed to sell, but I would say it's not heavily discounted.

It's going to be a better product at a reasonably improved competitive price. It seems to be positioned that certainly the way we designed it to be positioned. So, all good in terms of that.

As far as the other ones, as I said we're seeing good interest across all those three market segments. We've always expected that maritime would be the largest market segment just by history. It's going to get there first. That's going to be the product that we'll be starting to sell this year and maritime has a large distribution model that's well established, for which Certus is going to go into operation pretty quickly.

Terrestrial will be the next product. It's the smallest of the three right now for us, but I have to say I'm really pleased with how it's been positioned. We are going to be like the only really truly on the move terrestrial broadband solution. A lot of things today are move and stop and you have to put a lot of expense to have it be a truly efficient device on the move – where our terrestrial Certus service product is going to be a much more efficient terrestrial product. There will be a little bit of a new market segments in there that we will see how that evolves.

As I said, aviation is a natural market segment for Certus. We see a lot of potential there, a lot of excitement across our partners, but that just starts later. It starts more in 2019 when the products get certified. So, I don't really expect that market to start growing much in 2019, that will be more

of a 2021 market segment. It'll be probably about a little larger than terrestrial, but still smaller than maritime.

Chris Quilty

Great. And one follow-up question for Tom. You gave several numbers on the hosted payload and other data service fees. There's at least one part time thing thrown in there with the Satelles. I haven't had time to calculate numbers, can you just perhaps spoon-feed a bracket of what we should expect for full-year this year? Then, perhaps, what the run rate might look like going into '19?

Tom Fitzpatrick

So, let's take hosted payload. We've said that's \$25 million, our guidance assumes \$25 million this year for hosted payload. The full run rate is \$47 million for hosted payloads – and that's both Aireon and Harris. And the one thing that needs to happen is, is there is a customer contract milestone that affects the data and power piece, so full run rate data and power is \$23 million in 2019. We've assumed that, that contractual milestone in our long-term guidance is met early in the year, so we're saying that its very close to \$23 million is what we're assuming, but there is a milestone that needs to be made to hit that. I think data in 2018 is about \$8 million bucks, Aireon data.

Chris Quilty

Okay. And the Satelles piece?

Tom Fitzpatrick

Satelles, we think it'll be 5-ish [million dollars].

Chris Quilty

In '18?

Tom Fitzpatrick

Yes and pretty close to that in '19.

Chris Quilty

Okay, great. Thank you.

Operator

Our next question comes Jim McIlree of Chardan Capital. Please go ahead.

James McIlree

Thank you. Good morning. What needs to happen in order for the government to be a service customer? Did they have to build out gateways or you have to get a GSA contract or do you have to build new handsets for them? What still needs to happen in order for that government usage of Certus?

Matt Desch

Yes, the primary thing is that they need, the government, the Certus technology to be deployed as a government gateway, but they've already started that process. They have contracted to do that work and they are actually working on plans to install that equipment now. That milestone already is passing right now and we see that that will be happening in 2019, at least, that we would see them able to deploy Certus technology.

Beyond that, they have to just contract with our primary partner. They have vehicles to do that. I think it's not going to be a win of a contract, per se, in a sense that they can deploy it. I think they're already terminal providers, starting to work on solutions specifically for them and platforms that are considering using it. It's really on the path right now without any specific big milestones that I think you're looking for to be deployed at the government gateway.

James McIlree

Just to be clear, it's not like you need an EMSS-like contract in order for this to happen. There's already contract vehicles out there that can be utilized?

Matt Desch

Yes, and unlike the EMSS contract where they would buy it directly from us, in this case that they would buy it from our partners who sell it to them. The specific one that we've selected is COMSAT, which is part of Satcom Direct. COMSAT has been supplying them a lot of L-band broadband data in the past. They have a long-standing relationship. They know how to service and support that and that would be where they would procure it from and then COMSAT has made commitments to us in terms of their deploying that and selling it and we would see that revenue would start flowing, maybe 2019, but definitely 2020, 2021 we'd see revenue flowing from that.

James McIlree

It's a new handsets or a new terminal device required or recommended?

Matt Desch

No, it's the same technology really that is being deployed in commercial fronts. It's Thales or Cobham, Rockwell Collins, L-3, those kinds of companies would be supplying technology. The U.S government would buy that either directly or through COMSAT and they would deploy it on to aircrafts, ships, deployed vehicles. We've already seen them actually test technology which was exciting. They tested our terrestrial technology and said it worked very well. So that was good for one of our partners, but no new technology. There may be a solution, there may be security that needs to be deployed – that a commercial customer wouldn't deploy – or it needs to be tied into specific systems, but that's true if anything the government does. That's not something we'd be involved in. It would be just the natural deployment of technology like they deploy IoT or other solutions today.

James McIlree

Right, right. The government would need to deploy a new terminal not necessarily from you, but they would need a new terminal to access and service?

Matt Desch

Right, for Certus. The terminals that we've licensed companies to make and they're currently making them. A good example would be the Thales Mission Link terminal. That's a terrestrial-based service that would be perfect for the U.S. government and the one that they could deploy very quickly on, say, a Humvee or a Striker or something like that on terrestrial basis. That's available today and they could buy it today. They're not limited today by the fact of needing some new device that is still years away from development.

James McIlree

Got it. Okay, great. Thank you very much.

Matt Desch

Thanks.

Operator

Our final question today comes from Louie DiPalma of William Blair. Please go ahead.

Louie DiPalma

Hi. One last question. Last year AT&T awarded a contract to Inmarsat for FirstNet. And I was wondering with your new Certus services, if there's opportunity for Iridium to gain First Responder related revenue, particularly with AT&T competitors that are also rolling out First Responder networks?

Matt Desch

Louie, I think Iridium is a great choice for FirstNet and someday when they deploy that network and buy satellite equipment from anybody, I think that we'll be in the mix for both Certus and other technologies and I think by the way push-to-talk is a great technology for that as well. I think that will be in the mix for that, but that's not a real near-term big revenue opportunity for anybody. As far as the overall First Responders at work, yes, we're a big player all over the world right now in that space. Certus, there's a lot of enthusiasm about terrestrial solutions for bringing quick broadband to first responders using Certus. I think that's probably even a more real-time near-term opportunity for us.

Louie DiPalma

Sounds good. Thanks.

Matt Desch

Thanks, Louie.

Operator

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

CONCLUSION

Matt Desch

Well, a lot of good questions. Thanks. It was a good quarter and I look forward to seeing you all relatively soon with the third quarter and to share with you our eighth launch here pretty soon. Thanks. Take care.

Operator

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