

Iridium Communications, Inc.

Third Quarter Earnings

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CORPORATE PARTICIPANTS

Kenneth Levy - *VP, IR*

Matt Desch - *CEO*

Tom Fitzpatrick - *CFO*

PRESENTATION

Operator

Good morning. Welcome to Iridium Communications' Third Quarter 2020 Earnings Conference Call. All participants will be in listen-only mode. Should you need assistance please signal the conference specialist by pressing the star key followed by zero. After today's presentation, there'll be an opportunity to ask questions. Please note this event is being recorded.

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

Kenneth Levy

Thanks Kate. Good morning, and welcome to our Iridium's Q3 2020 earnings call. Joining me on the call this morning are CEO, Matt Desch; and our CFO, Tom Fitzpatrick.

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

Before I turn things over to Matt, I'd like to caution all participants that our call may contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements are statements that are not historical fact and include statements about our future expectations, plans and prospects. Such forward-looking statements are based upon our current beliefs and expectations, and are subject to risks which could cause actual results to differ from the 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, including operational EBITDA and pro forma free cash flow, free cash flow yield and free cash flow conversion. These non-GAAP financial measures are not prepared in accordance with Generally Accepted Accounting Principles. Please refer to today's earnings release in the Investor Relations section of our website for further explanation of these non-GAAP financial measures and a reconciliation of the most directly comparable GAAP measures.

With that, let me turn things over to Matt.

Matt Desch

Thanks Ken. Good morning, everyone.

As I'm sure you saw in our release this morning, we had a strong third quarter. As many of you know, we started the year on a record setting pace in January and February, and then were hit abruptly by the global lockdown in mid-March and April. With little visibility to understand how the industries we serve would respond we were comfortable with the steady month-on-month improvement that the second quarter delivered. Now, with the results of the third quarter in hand, it's clear that we've trended back to the fast pace that kicked-off the year.

In light of our strong subscriber growth during the past quarter, and the momentum we're carrying into the final months of the year, we have greater visibility as to how we'll finish out 2020.

This year, our business has once again demonstrated its resiliency perhaps most evident by the surge in net subscriber additions, which reached a record 67,000 this quarter, more than doubling growth from the last quarter. With an ongoing thaw in the global business environment, Iridium's financial prospects have continued to improve and we're now on a glide path to end the year with better top and bottom line growth than we expected when we updated guidance on our second quarter call.

Our prospects for free cash flow have also improved to approximately \$200 million for the full-year as a result of these improved operating results.

So what's driving our recovery from the effects of the coronavirus? First, the service we provide is both important and unique and our satellite applications are often essential to the mission critical functions of our customers. Second, I think our offering, particularly with our new constellation in place is second to none. We do mobile and remote connectivity better than anyone else in the industry. Third, and maybe most importantly, we have a very diverse and effective partner ecosystem covering every important market segment and almost all are telling us they are open for business again and bullish about their futures.

Our more than 450 partners and their businesses are very diverse in terms of geography, industry and application. With the exception of our partners in aviation and to a more limited extent maritime, both of which may take a few years to fully rebound, the majority of our ecosystem partners are back at work generating new business and activating new customers. We've worked for decades to develop and cultivate our distribution network and I credit this one of a kind wholesale ecosystem for Iridium's ability to endure economic recessions and keep growing even during a global pandemic.

Based on our performance through the first three quarters of the year, we are raising our full-year guidance for service revenue growth and operational EBITDA. This move reflects the underlying strength of our business and the greater pace of subscriber additions than we originally expected during our peak summer selling season.

Demand for Iridium services also spurred robust hardware sales in the third quarter and drove engineering revenues.

Despite the strong business trends in the third quarter, there are still some parts of our business that have yet to fully recover. I'll speak to Broadband and Aviation in a minute, but want to start with our Voice business. It's been running softer than a year-ago even though net subscriber additions have been quite a bit better than we initially expected after the pandemic surfaced. Consistent summer improvement spurred incremental demand for handsets and that has benefitted overall equipment sales. This firming in our legacy voice business is a good indication that this part of our business is returning to its more normal cadence.

In IoT, the consumer bounce back we talked about last quarter has continued and while most of our IoT applications are adding subscribers again, in particular, retail demand for consumer personal communications devices really accelerated in the quarter. Iridium added 61,000 net new subscribers in IoT. This shatters the previous quarterly record set last year by almost 30% or an additional 14,000 net new users. With an increasing number of consumer oriented SKUs and a growing number of partners going after these personal communications services, as well as having the ideal network to support them, this should be an important and growing market for us for a long time to come.

In terms of new products late last month, we launched our latest IoT turnkey end-user device called Iridium Edge Pro, and it's already generating a lot of interest with current and potential partners. The Edge Pro is a programmable device with built-in sensors for asset tracking and performance monitoring that lets a partner reduce their development costs and expedites their time to revenue. This hardware offering will continue to make Iridium relevant for a growing number of global IoT applications.

We'll add the Iridium Edge Solar device to the mix with its launch later this quarter and that will represent another low maintenance turnkey device that will drive incremental IoT partner solutions.

An area we don't have full recovery from yet is Maritime. While we added 300 net new broadband customers during the quarter, the pandemic has continued to cause operational and logistical headwinds for the Maritime market. We've talked previously about these issues and while we are seeing growth in subscribers each month, global travel restrictions and installation issues are still creating headwinds.

For example, some of our partners have centralized installation crews and they have often been unable to travel to meet ships in ports. Those with distributed installation teams are having an easier time of it. So it's going to take longer for this market to fully recover and we believe that installation challenges are likely to persist into 2021.

On a positive note, we continue to see good demand and interest in Iridium Certus. Our partners are excited about selling the product and are very pleased with its performance in the field and ARPUs from our broadband service continue to rise reflecting the propensity for larger data service plans from subscribers. During the third quarter, we saw a 12% increase in year-over-year broadband revenue and an increase in ARPU. Overall, Iridium Certus remains an important vehicle of our growth and we look forward to seeing it hit its stride in the coming years.

I haven't talked much about aviation this year, though you've probably started to see some press highlighting a few of our equipment suppliers like Collins and SKYTRAC in recent months. We currently have six partners working on new aviation hardware with these terminals targeting the commercial transport, corporate rotorcraft, and general aviation markets. This equipment will be available for retrofit as well as new builds and there's a lot of activity taking place today by these partners to develop and certify these terminals for commercial availability in 2021. Iridium is also very involved in obtaining safety certification for Iridium Certus to match the safety services we provide today on legacy aviation terminals.

From what we see, the global aviation market, particularly the commercial side, may take about two to three years to fully recover. Given the progress of being made, we think our partners will be ready with Iridium Certus aviation products well within that timeframe to take advantage of it.

As far as the US government goes, we continue to work with them on upgrades to their dedicated Iridium Gateway. These engineering upgrades and maintenance services support the government's use of our services, and also provide for their ability to utilize Iridium Certus services globally.

On September 15, the Government's EMSS contract also reached its first of four revenue step-ups. This resets the contract's base rate at \$103 million for the next 12 months.

Lastly, Aireon continues to develop their business despite the global aviation downturn. They signed another high profile customer, the Civil Aviation Department of Hong Kong, that is the latest ANSP planning to deploy Aireon's space-based ADS-B system. The region manages more than 400,000 aircraft each year and supports a critical corridor in the South China Sea. Including Hong Kong, Aireon's data services are now being deployed by ANSPs covering 38 countries globally.

I am also happy to announce today that the FAA has expanded its relationship with Aireon after the progress of their initial trials in the Miami flight information region. The FAA signed a significant contract in September to access Aireon's global data set to support test and integration into their air traffic controller automation platforms, as well as to support the FAA evaluation of a variety of applications, including Airspace Safety Analysis, accident investigation data analysis, search and rescue, and commercial space. This is an important milestone for Aireon as well as for the FAA and I think signals that their longstanding relationship is progressing to the next level, which will assist in increasing safety and efficiency even further for US passengers and operators. We congratulate the FAA and the Aireon team for getting this done. It's a big deal for the US airspace and US's leadership in aviation.

Before I pass things over to Tom, I'd like to provide an update on our capital investment plans. Since completing Iridium NEXT, we've guided and kept our capital spending to about \$35 million per year. Given the strong subscriber growth during this period and the potential we see for growth with our new network's added capabilities, particularly in personal communications and the higher speeds and efficiencies we can create for IoT services, I'd like to step on the gas a bit and invest more right now for the next couple of years.

Our partners are telling us they see opportunities with our system that they'd like to see us develop sooner rather than down the road. Additionally, like many companies COVID has caused us to rethink the work-from-home model, which we expect to persist in a hybrid mode even after the pandemic has passed. This presents a timely opportunity for us to consolidate some facilities and save on overhead.

To address these initiatives, Iridium plans to increase capex for the next three years, 2021 through 2023. As such, our capex will rise to about \$45 million as we move quickly on product development and a real estate refresh. We expect to be back to a \$35 million run rate in 2024. I think this plan is the prudent course to ensure we take full advantage of our competitive position, technical leadership, and the opportunities we see today.

To close let me reiterate that Iridium has remained disciplined this year, and continues to execute well. Our focus on mission critical services, global connectivity, and reliable communications has allowed us to manage through this challenging year and deliver both subscriber and revenue growth. Our business is performing well and we continue to have strong visibility across our partner channel that underscores our confidence. In addition to top and bottom line growth, the health of our partner network will also help us to improve net leverage and free cash flow this year.

So with that, turn it over to Tom for a more detailed review of our financials. Tom?

Tom Fitzpatrick

Thanks, Matt, and good morning everyone.

I'll get started by summarizing our key financial metrics for the quarter and providing some color on the trends we're seeing in our business lines, which give us confidence in raising our full-year guidance. I'll then close with a review of our liquidity position, and capital structure.

Iridium generated total revenue of \$151.5 million in the third quarter, which was 5% higher than last year's comparable quarter. This increase was primarily attributable to strength in subscriber equipment sales and a contractual step-up in hosted payload.

Operational EBITDA was \$93.4 million, which was up 6% from the prior year's quarter. Our OEBITDA margin was 62%.

On the commercial side of our business, we reported service revenue of \$91.8 million in the third quarter, which was up 2% from a year ago. This increase primarily reflected growth in hosted payload revenue, which more than offset a decline in revenue in our legacy voice business.

During the quarter, voice and data revenue fell 4%. This decrease was predominantly driven by a fall in seasonal activations attributable to the ongoing pandemic, though not as severe as we initially feared back in April. While billable subscribers were down year-over-year, we actually saw an improvement in net subscriber additions on a sequential quarter basis. These trends continue to be better than our early expectations, when the impact of the pandemic was largely unknown. We continue to expect full-year voice and data revenues to be down from 2019.

Commercial IoT has largely rebounded from the initial drop caused by the pandemic in March and April. Many markets that had slowed at that time seem to have rebounded and many retail outlets offering consumer-oriented IoT that closed temporarily have now re-opened. The notable exceptions are the aviation, and oil and gas industries where usage has remained under pressure, as the frequency of flights has slowed and demand for oil production has waned.

Offsetting these pandemic related declines however has been a resilient retail consumer, whose appetite for personal communications devices continues to rise. In the third quarter, commercial IoT revenue was flat to the year-ago period. This is a marked improvement from the 5% decline we reported in the second quarter, and another sign of the mass appeal of satellite IoT devices in the consumer market. Summer drove a meaningful increase in activations of personal communications devices. It's clear that even as consumers have sought to socially distance during the pandemic, keeping in communication with others remains a priority.

In our Commercial Broadband segment, we reported revenue of \$9.1 million in the third quarter, up 12% from the year-ago period. While positive, as previously noted, the pace of broadband growth is slower than we had originally expected, and reflects the ongoing disruption that the coronavirus is having on the Maritime industry. As Matt noted, ship accessibility remains a headwind to new installations though Iridium Certus continues to receive strong reviews from the channel and existing broadband subscribers.

During the third quarter, Iridium added a record 64,000 net new commercial subscribers with the bulk of this increase driven by commercial IoT and unprecedented demand for personal communications devices. Commercial IoT data subscribers now represent 72% of billable commercial subscribers up from 67% in the year-ago period.

Hosting and other data services revenues increased to \$14.5 million this quarter, up 21% from the comparable quarter in 2019. The majority of this increase was due to higher data service revenues associated with a step-up in Aireon's Data Service agreement that we noted earlier this year. We continue to forecast normalized revenue from hosted payloads of about \$47 million per year.

Turning to our Government Service business, we reported revenue of \$25.1 million in the third quarter, including the impact of the contractual step-up in the EMSS contract on September 15. Year-over-year revenue was down fractionally reflecting the 2019 benefit of increasing rates on monthly contract extensions prior to the finalization of the seven-year contract under which we are operating today. In the third quarter, government subscribers grew 8% year-over-year to 142,000 users.

Equipment sales continued to trend better than our April forecast, aided by a rebound in store openings and strengthening partner business trends. We also have enjoyed the benefit of currency tailwinds, where weakness in the US dollar results in lower equipment pricing for foreign purchasers. Through the

first nine months of the year, equipment sales are up 2% compared to last year. This is a noteworthy turn from last quarter, when first half revenue was trailing the prior-year period by 5%. In light of recent trends, we now anticipate full-year equipment sales will be equal to or greater than 2019 levels.

Engineering and support revenue was \$9.4 million in the third quarter, compared to \$7.6 million in the prior year's quarter. The change reflects increased work on commercial and government contracts, both of which are episodic.

All told, Iridium's revenue has remained resilient this year, especially in the face of the global pandemic. This is not to say that we have been immune to the effects of COVID-19 however. Improvement in our commercial business and equipment sales through the third quarter heightens our confidence in revenue growth and operational EBITDA for the full-year.

Accordingly, we are raising our full-year guidance for 2020 to reflect the health of our business partners and the momentum that we continue to see in subscriber additions. We now expect full-year OEBITDA of approximately \$355 million in 2020 based upon total service revenue growth of approximately 3%. This full-year outlook reflects a stabilization in our voice business and renewed momentum in IoT following the initial shock of the coronavirus pandemic on channel partners.

We continue to expect capital expenditures of approximately \$35 million this year. As Matt described, a couple of initiatives will cause our capital expenditures to run a bit higher in the next couple of years. But we expect them to return back to around \$35 million in 2024 and stay at that level for several years.

If you consider the 10-year capex holiday period we have previously described, the increase during the next few years would take our average capex up closer to \$40 million from the \$35 million we had previously guided to. We view this as a modest increase that will not change our stated goals of deleveraging and returning capital to shareholders. Moreover, the increases are warranted as they will yield expense efficiencies from the consolidation of facilities and increased revenues from the delivery of additional functionality to our already popular line-up of devices, as evidenced by our record setting gain in subscribers this quarter.

Specifically on facilities, we anticipate consolidating our real estate footprint in Arizona, which will save us about \$1 million a year in overhead starting in 2022. We'll need to refurbish the remaining facilities and expect to spend about \$6 million on this over the next two years.

Moving to our capital position, Iridium had a cash and cash equivalents balance of \$182.7 million as of September 30, 2020. This is up \$63.6 million from June 30. We believe that free cash flow provides a useful benchmark for the health and earnings power of our company, particularly in the current climate. Based on the quarterly results we announced today and our updated outlook for OEBITDA in 2020, we believe Iridium will generate pro forma free cash flow of approximately \$200 million for the full-year 2020 compared to pro forma free cash flow of \$168 million in 2019.

For illustrative purposes, consider the following. We start with OEBITDA of \$355 million and subtract \$90 million in pro forma net interest to reflect our new debt structure, \$35 million for capex, and \$30 million in working capital inclusive of the appropriate hosted payload adjustment. 2020's pro forma free cash flow supports a conversion rate in excess of 55% and a cash flow yield of approximately 6%. This is indicative of the underlying strength of our core business, and compares well to companies in the communications infrastructure space, which enjoy higher trading multiples than Iridium. As in the past, we have provided supplemental information on the Investor Relations section of our website, laying out these pro forma free cash flow calculations.

Iridium closed the third quarter with leverage at 4.2 times OEBITDA and based upon guidance revisions expects to exit 2020 with net leverage of approximately four times OEBITDA. As we've discussed previously, our goal is to reduce net leverage to a range between 2.5 times and 3.5 times OEBITDA to provide ample flexibility to support shareholder friendly activities.

The business environment in 2020 has been unique. Even as the pandemic has continued to create uncertainty in certain sectors, Iridium's business has shown great resilience. We see meaningful business opportunities for Iridium moving forward and have confidence that we can capitalize on these to grow our earnings and bolster our free cash flow.

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

QUESTIONS AND ANSWERS

Operator

We'll now begin the question-and-answer session. To ask a question you must press star then one on your touchtone phone. If you are using a speaker phone please pick up your handset before pressing the key. To withdraw your question please press star then two. At this time we will pause momentarily to assemble our roster.

Our first question is from Ric Prentiss from Raymond James. Go ahead.

Ric Prentiss

Thanks. Good morning.

Matt Desch

Hi Ric.

Ric Prentiss

Hey, obviously good to see the beat and raise on the actuals and the guidance. Question on COVID-19 and the visibility you mentioned, obviously, you're seeing some nice signs out there. Any concerns on second wave or lockdowns that we're seeing in Europe and some signs in the US of what that might mean to the business?

Matt Desch

Probably not for 2020, I mean because we're pretty well on a path, I think for this year. I'm concerned that it will kind of continue well into next year. So areas like aviation and maritime will still stay at the same levels. I don't know about what you think, but I don't think there's a lot of tolerance for completely locking down businesses anymore. It seems like the global environment has learned to live in sort of a new normal right now. And the economy is as it is. But it means we're all not going to go to restaurants and have much fun at sporting events for a lot longer somehow. But I think we're kind of in the environment we're going to be in for a while here. And I'm sort of expecting that's going to last well into 2021.

Ric Prentiss

Sure. Okay. And then, obviously some nice improvement also on margins. Tom, as you think about the business and growing the revenues, and the cost basis of the business, where could aspirationally margins go over time, when you look at your competitive universe out there?

Tom Fitzpatrick

Hi, Ric. So we've said for a long-time that there's inherent operating leverage in this model. It's a network

after all and so the variable cost to produce the incremental minute of usage is very small. And so, when we started our capital cycle, we had margins in the high-40s and had said that when we exited, we saw 60%. And so we're now there. So there's really nothing stopping us. If you look at mature satellite companies that have been around longer than us, their kind of model is the same. They enjoy operating leverage, and they have EBITDA margins in the 80s. So as we grow our service revenues, we think it's accretive to the margins over time.

Ric Prentiss

Understand. And I like to focus on free cash flow; we really like looking at that as well. One of the items when you kind of called out the EBITDA – good to see margin improvement continue there – interest expense, how are you thinking about the debt markets right now? Is there the ability? Are they open? What kind of rates are you seeing? Is it something you could actually improve free cash flow as you look at the interest expense?

Tom Fitzpatrick

Yes, I mean, our term loan B is trading very well. I mean, as you know, we can reprice the term loan B, if the market is there and we're keeping a close eye on that. A 50 bps reduction in the margin is 8 million bucks to us, so that directly benefits free cash flow.

Ric Prentiss

And with the market stabilizing now sort of the debt market maybe being up and what would cause the trigger to enter the market then?

Tom Fitzpatrick

The appetite is just that it, that it would be a market clearing transaction for us to reprice and we and our bankers are keeping a close tab on that.

Ric Prentiss

Okay. And last one for me, I appreciate the questions. You called out aviation a couple of times; I know that's obviously going to take a couple of years to recover. Walk us through and remind us again what that effect is on the ARPU side, is it on the IoT that we mostly see it right?

Tom Fitzpatrick

Yes. We've said it's the usage on commercial airliners for safety services, Ric. And we said that's about a \$1.5 million a quarter headwind from our prior run rate, just because planes aren't flying. So, we're not seeing the usage.

Ric Prentiss

Right, and that when we do see usage come up that was just something that would come back, but that's all we have to look, as Matt pointed out going to watch where aviation and maritime come back.

Tom Fitzpatrick

Yes, that's right.

Matt Desch

Yes, they would both come back. And plus, we'd also see potentially new installations for more higher speed terminals, which potentially also could drive additional ARPU on aircraft, if they take advantage of the higher speeds and more functionality as those products become ready in the next year or two.

Ric Prentiss

Yes, and that's what you're talking earlier about the six new hardware [partners] and also getting into the

safety side.

Matt Desch

Right, yes and we're a big player in aviation today. And obviously, we're on a lot of long haul commercial aircraft right now. And those are the ones most affected right now because nobody wants to fly long distance. Domestic is coming back a little faster. And I think over the next two or three years, we'll see a recovery, our existing systems will then go back to normal, or growth, and we'll possibly see new additional installations then at that time too of the higher speed stuff.

Ric Prentiss

It's not so much the in-flight connectivity, it's more the cockpit and the safety and other broadband services; you're not going to in-flight connectivity business per se.

Matt Desch

That's right, we're really focused on cockpit communication and safety services and that's where our sweet spot is, and where we don't see as much competition either, because we have a truly global product versus anyone else.

Ric Prentiss

Makes sense. Glad to see the results guys. Glad to hear you're doing well. We'll talk to you later. Thanks.

Matt Desch

Thanks, Ric.

Tom Fitzpatrick

Thanks, Ric.

Operator

Our next question is from Greg Burns from Sidoti & Company. Go ahead.

Greg Burns

Good morning. The update on the FAA with Aireon, has that in any way changed the calculus of them raising capital, paying the remaining hosting fees that they owe you? Can just maybe just update us on the status there in terms of their financing? Thanks.

Tom Fitzpatrick

Hi, Greg, we view the developments with the FAA as constructive to Aireon's financing obviously, but the slowdown in air traffic that's resulted from COVID is going to delay their ability to pay us the lump sum hosting fee and the buyback of the shares. So we don't think that that happens before the end of 2022, when we're going to see how fast traffic comes back. As you understand, we view those payments as highly likely and the developments with the FAA only bolster that opinion of ours.

But that, as you know, has no effect on our revenue, annual revenue, which is \$39 million from them per year between hosting and data. They're going to pay us that – cash pay – based on their updated financing outlook. So the downside case is that there'll be a delay in the lump sum payments of the hosting and the share buyback probably beyond the end of 2022. But as I say, let me reiterate, we're highly confident that we will receive those payments eventually.

Greg Burns

Great, thanks. And then in terms of the US government consuming like Certus broadband services on

top of their EMSS contract, do you have any visibility on when maybe they might start to do that or when there might be maybe some upsides to the contractual numbers you're seeing quarterly?

Matt Desch

They're already starting to use some Certus using our commercial gateway, especially our terrestrial [land-mobile] services and they are planning to, we're expecting to see more in 2021. So as we're seeing growth in terms of the potential kind of backlog and opportunities are increasing. Again, we'll primarily come through the commercial gateway, though we'll describe them as government revenues. As their gateway gets completed sometime either later next year or early in 2022, then I think that will also spur incremental additional growth beyond that. But there is already usage today and we're seeing progress, and it's going to be part of our Certus broadband revenues going forward.

Greg Burns

Okay. So that'll be reported as Certus and not [in] the government line item that you report?

Matt Desch

Yes, that's right. We're putting all that in our broadband revenues, [whether] government or commercial.

Greg Burns

Okay, great. And then lastly the 300 net activations on the broadband side, is that kind of the pace that you're still expecting for the foreseeable future?

Matt Desch

Well, I'd like it to go up from there. You know I had a meeting last week with one of our larger service partners and I was asking them what kind of level of business did they see out there, and they said that they were – particularly in VSAT installations, which was sort of a proxy to me of our L-band installations that often go with them – roughly about 70%, of where they normally would have thought that they would have been. And I asked them how much of that was a slowdown due to some of those issues I just described and how much of that was due to the overall economy and that sort of thing. And they said they had record backlog. So it was almost all due to installation. And they have a global installation teams. So they weren't really limited by some of the problems that I told you about.

So I think it's mostly these challenges that sort of COVID creates in terms of getting installers on ships and that sort of thing. I think as that starts recovering here and I don't know that that will happen in the fourth quarter or first quarter, even in next year. But I believe they're getting better and better at figuring out ways of getting terminals onto ship. And then we'll see the numbers grow. It's just it's hard to forecast at this point, how fast that they will.

Greg Burns

Thank you.

Matt Desch

Thanks. Take care.

Operator

Excuse me. Our next question is from Louie DiPalma from William Blair. Go ahead.

Louie DiPalma

Matt, Tom, and Ken, good morning.

Matt Desch

Hi Louie.

Louie DiPalma

Congrats to you, Don Thoma and the Aireon, Iridium teams on the FAA contract announcement.

Matt Desch

It's been longtime coming; I think for Don, I'm happy for him and happy for the FAA.

Louie DiPalma

And on that note, can you provide a higher-level more details in terms of what that expanded relationship entails for the debate of ADS-B versus ADS-C and know how the FAA may be viewing those two technologies long-term. I know that you also provide ADS-C. But can you just at a high-level discuss that debate and what it might mean with the FAA?

Matt Desch

Yes, well, that debate, ADS-C is a traditional every 15 minutes sending a position report through a satellite connection like our safety service terminals that are on long haul airplanes. That has been sort of—that is the baseline. And that is what's been done for a number of years.

ADS-B is the sending not through a satellite network, but through a standalone transponder from every airplane, a position report twice a second, and that being picked up in the past by ground transmitters but now by Aireon space-based ADS-B. ADS-B is ubiquitous, and it provides position information, but it's actually complementary to ADS-C, which is more of a communications technology and goes along with a number of other things that you can send through the satellite network.

So we've always felt, as has Aireon, that the two technologies were complementary and would grow together. You're right, there was a debate with one other company that thought ADS-C was the way that you should go and that you should only install Satellite Systems onto airplanes, etc. So I think that debate is over. I think it's been over for a year. I think the view of not just the FAA, but of all the ANSPs around the world is that they're complementary and both will be utilized for both surveillance and communication and taken together, they will provide higher safety, more efficiency, more accuracy, better travel times, fuel savings, and the like. So I hope that answers your question.

Louie DiPalma

Yes, that was great. And in terms of the expanded relationship, is the expanding relationship more of, like an IT systems relationship in order for the FAA to enhance its systems in order to be integrated with Aireon or is it something different from that?

Matt Desch

Look, it's use of Aireon's data set in many more ways than had previously been quite limited. They have expanded the use of the data to use in a number of applications. It's hard for me to go much beyond that. I'd really rather frankly that the FAA and Aireon told you more about that. We're just pleased to report that there's been a step-up. It's certainly not the complete potential of that relationship and where it ultimately can go in terms of size and revenue and that sort of thing for Aireon and the scope of use of the data with the FAA, but it's significantly greater than it had been before and felt it was worth calling out because we've had this discussion for years about when and if the FAA would get more involved with Aireon and take advantage of it. And I think it's important to say we see that happening now.

Louie DiPalma

Yes, definitely. You guys have been talking about the FAA catalysts for at least eight years. So it's definitely great to see. One last question in terms of the increase in broadband ARPU, are you seeing a

lot of your OpenPort subscribers upgrading to Certus or more of the broadband activations completely new subscribers?

Matt Desch

There is both going on. I will say, based upon our expectations several years ago, OpenPort has actually been holding up better, if you will -- less replacements than we were expecting or you could say potentially feared, because if it's a one-for-one [replacement], we aren't really gaining market share. I'd say that it probably goes along with the fact that it's difficult to get these new broadband terminals onto ships, it also means it's harder to get older technology off the ships as well.

So, while the transition has not been happening, OpenPort customers, subscribers have been not been declining that fast. And so I would say it's—I don't know two-thirds, probably new sales and one-third, maybe something like that, replacements. That's a really rough number and maybe even more sometimes 50/50, it's hard to tell exactly what that is. But those are new sales, they're at higher ARPUs of course, because of the higher speeds and higher usage. And that's why the mix is still heavily oriented towards OpenPort terminals in our broadband revenues. So the ARPUs are going up, but I expect would continue as the mix favors more and more higher speed Certus terminals.

Louie DiPalma

Thanks Matt.

Matt Desch

Thanks Louie. Take care.

Operator

Our next question is from Anthony Klarman from Deutsche Bank. Go ahead.

Anthony Klarman

Hi, thanks. Two questions. First on the capex revision or the modest increase in capex? I certainly think it makes sense in the context of the \$200 million run rate free cash flow you're producing; I guess maybe Tom, what should we think about in terms of returns or payback on that incremental capex spend? How do you—how should we think about it in terms of future margin improvement or other kinds of benefits that you'll see from that incremental \$30 million investment?

Tom Fitzpatrick

Well, I mean, if you just look at how we're growing in personal communications, adding functionality to that could really accelerate that rate of growth and so the returns could be very attractive, we think there's the shot in the arm that growth could get there.

Anthony Klarman

Got it. Thank you. And then all right, go ahead, Matt. Sorry.

Matt Desch

I think Tom covered it pretty well. I mean we have a long roadmap of things that our partners would like to see us do to fully exploit our network with a number of different transceivers and new products and incremental things. We could continue to spend the same level and deliver those things over an extended period of time, but what we're doing is accelerating those earlier than they would otherwise be developed if we maintained that \$35 million run rate. So it's generating revenues earlier for us in some ways, which obviously has a positive overall rate of return.

Anthony Klarman

Yes, maybe you just answered my follow-up, but I'll ask it in case there's any additional clarifying details. Is it that the capex will be \$45 million for call it three years, but then maybe, rather than the subsequent years being \$35 million, maybe they are \$30 million to \$32 million? Are you literally just pulling future capex forward that would have been in that \$35 million run rate and then also pulling forward the incremental revenue recognition or operational expense benefits?

Tom Fitzpatrick

No, we've said, Anthony that it's going to go to \$45 million based on projects that we see. It's going to bump to \$45 million for three years, and we think it settles back down to \$35 million. So the 10-year average, if you will, which we had thought about as \$35 million is going to be \$40-ish million and the only proviso there -- what we don't include -- is any launch of our ground spares because we've not made a decision to do that. We don't know whether we're going to do that. So that wouldn't be enough. But it feels to us like we got three [years of] \$45 million and then the balance of \$35 million to average \$40 million for the capex holiday period, which we had previously thought of as a \$35 million average; think of it as a bump.

Anthony Klarman

Okay, understood.

Tom Fitzpatrick

The takeaway here is we just put up record subscribers right, we think we got to play to this trend, most notably this personal communications trend. Investors should consider what could be the penetration of Iridium -- consider the number of smart phones in the world and this personal communication turning out to be accessory to a smart phone. And so additional functionality playing into that market, we think could be very meaningful returns.

Anthony Klarman

Yes, thank you and maybe a question on guidance. If I look at the \$355 million, you're actually back to the original low end of guidance that you provided in February, obviously pre-COVID, which is exceptional, I think when you think about what the impact is to the business and the leverage guidance is now back to the original leverage target of four times. But the service revenue guidance is still only about half of what the original guidance was. I was hoping you could maybe give us some additional color on the other benefits that you've seen maybe come back a little faster. Clearly, some of it is expense reductions, which you've talked about before. But could you maybe talk about what some of the other catalysts were there kind of getting you back to the original low end of the guidance range, despite all the impacts the business has seen?

Tom Fitzpatrick

So its expense reductions. It's travel, it's sadly incentives are down, right because we're not quite where we needed to be. And we're pay for performance kind of a company, so that's less. So we're getting natural expense reductions from the slightly lower level of OEBITDA production. And that's what's resulted in us getting to the very low end of our previous range.

Anthony Klarman

And would you think, Tom, on those comments that if the world starts to normalize, maybe we'll use the timeframe Matt talked about in his comments of maybe it's not '21 but maybe it's '22 when we're a bit more normalized. Do some of those expenses have to creep back into the business, such that you're sort of more in a normalized state at some point in the future, and we shouldn't necessarily just run rate exit levels of operational expense here?

Tom Fitzpatrick

Yes, you shouldn't run rate exit levels because for one, incentives will come back. So we'll pay at 100% for a level of performance in '21. So you'll see a year-over-year expense increase as to that.

As to SG&A, it's a new world. Let's see what travel winds up being. Are we going to travel the same way we used to, and so we'll have to establish what the new run rate is in post-COVID how do we all work, how do we travel. It feels like it ought to be down from what it was pre-COVID but probably up from where we see 2020. We'll just have to figure that out.

Anthony Klarman

All right. Thank you guys very much.

Matt Desch

Thanks Anthony.

Operator

Our next question is from Hamed Khorsand from BWS Financial. Go ahead.

Hamed Khorsand

Good morning. So on the last call; you mentioned you were running promos. Did that generate the return you were looking for? Or was that just harmful to gross margins this quarter?

Matt Desch

Well, we're always running promotions. You can see we had really strong subscriber growth. I don't think it was related really to specific promotions. I would say it was positive in that it continues to help encourage our positive activations and performance. Yes, I'd say it was definitely still continuing to be positive.

Hamed Khorsand

And then on the retail side, do you think the growth that you saw this quarter as far as the demand; do you think that was a pull in from the holiday season? Or do you think it's going to be resilient again, for the holiday shopping season?

Matt Desch

From what I can tell I don't think anything's a pull in. I think people—you might have seen, we announced a week or two ago, just a study we had done, where we had looked at state parks, we looked at like the 10 top state parks in the US and looked at the usage of our network, and it was up something like 26% or something over last year. I think people are using these personal communications devices as they increasingly get off the grid during social distancing. So I think it was the strong summer usage of those devices, as people got out and they couldn't travel to exotic locations, they were certainly at least getting off grid. And it's also representing the fact that there's just more and more devices out there, both the existing partners like Garmin have more and more devices that are satellite connected, and we see a number of new partners that are showing some success, particularly there's one called ZOLEO. But there's a number of others as well that are offering consumer devices that people are finding attractive - they want to stay connected while they're away from cell phone coverage, which is still spotty in many places, and still only covers less than 15% of the planet. So I believe that was a complete summer activity and doesn't really forecast anything as to what will happen for Christmas season or any other period.

Hamed Khorsand

And lastly on the equipment revenue, can you help us to decipher how much of that bump in equipment was related to retail versus Certus equipment of the new installs?

Matt Desch

Well, equipment is broad-based. I'd say especially as it relates to margins, and that sort of thing, handsets is obviously is a high margin area for us. And the fact that we saw a recovery based upon previous expectations of what handset sales would be because our voice business strengthened during the summer, it was a better summer season than I think we were worried about back in the second quarter, when everything locked down. So we saw more handsets.

IoT continues to be very strong across the board in terms of sending modems out, sending the devices out that go into all kinds of IoT devices. I don't think a lot of it is related to broadband because I don't think there is—

Tom Fitzpatrick

Because our vendor sells Certus equipment.

Matt Desch

That is really—we just sell a radio and it doesn't add tons of margin when we sell the radio to our value-added manufacturers and then they turn that into terminals and sell those to fleets and ship owners and that sort of thing.

Hamed Khorsand

All right. Thank you.

Matt Desch

Thanks Hamed.

Operator

Again, if you have a question please press star then one.

Our next question is from Matthew Robilliard from Barclays. Go ahead.

Matthew Robilliard

Hey, good morning and thank you for taking the questions. I had a follow-up question on the equipment side. So obviously, you pointed to very strong IoT devices during the quarter. And in terms of the contribution to equipment and I was wondering if all of that is already reflected in IoT subscribers that are activated generating service revenue that creates a tailwind for good growth in IoT into Q4. So that was the first question really.

Matt Desch

Yes, equipment sales are more of a harbinger of the future, as opposed to current because it takes anywhere from 3 to 12 months for equipment to kind of get into service. So I think it's fair to say, when you see equipment firming up and improving, it's really a sign that our partners are bullish about the future and have orders that they need to fulfill in future quarters as opposed to current quarters. The equipment that was used in the third quarter was equipment sold, several quarters ago probably in most cases for IoT.

Matthew Robilliard

Thanks, great. And then I have a question on Certus product on aviation and maybe I didn't get everything you said in your prepared remarks. But in terms of the Certus product, when can we expect it to be ready to be marketed in aviation?

Matt Desch

Yes, it's taken longer than I had hoped due to a variety of factors. I'm sure as it relates to the licensed terminal manufacturers whose licenses I've said -- there're six who are working on terminals. We've started to see as you could see in the last couple of months, some of them are starting to announce successful demonstrations and trials of their technology. I mentioned two who've been pretty public in this last quarter being Collins and SKYTRAC, but there're four others that are also at various stages, and starting to see some progress as we're seeing them come into the lab to test their designs with our systems.

And so we're starting to get visibility that some of them are telling us that they believe that they'll be ready and certified -- at least one or two -- in 2021. And that's encouraging. And there could be more, but I think that they'll be coming online in 2021 and 2022 for the most part. Which as I said, while it's taken longer to see the aviation side of the business, which we think we have a lot of advantages for given our global network and the smaller size of our antennas and the fit for the cockpit use etc., in corporate and general aviation, in rotorcraft and other market segments.

Frankly, the aviation downturn kind of gave our partners a little bit more time to get their products ready. And I think as we start to see those markets recover, they'll all be ready with very competitive and exciting new products to offer that space.

Matthew Robilliard

Thanks. That's very clear and congratulations on a great quarter.

Matt Desch

Thanks Matthew.

Operator

Our next question is from Chris Quilty from Quilty Analytics. Go ahead.

Chris Quilty

Hi, guys. A follow-up question on the capex which by the way, I mean nobody's happy when you spend more money. But I think it's a good decision in the context to get those products to market. And the question I had for you was, first of all, Tom, can you break that down into how much is going to facility consolidation versus new products? And the second part is on the new products, as you just mentioned recently, you've typically been moving towards a strategy of building modules that you then feed to your VAMs. Are you allocating any of this development for actual finished product? Or is it a continuation of that previous strategy?

Tom Fitzpatrick

So I'll take the first part, Chris, the facilities is about three [million dollars] a year in 2021 and 2022.

Matt Desch

So that covers that, quickly. As far as the second question is broad-based effect, you could say, why are we doing this now in the third quarter part of is because we're budgeting right now for 2021. And we have so many things that our technology team wants to develop and for which our product management and partner management team has been requesting and it covers a wide range. Some of it has to do with even satellite developments, and strong network efficiencies that would get a lot of performance, capacity efficiency out of our network, and a big part of it still goes towards accelerating this roadmap of devices that are the foundation for more and more applications in all the different market segments that we are in. And I will say we have some ideas for some additional finished products as well, that may or may not be in that category as well. But that's not really our strategic focus.

For the most part, what we're really trying to do is continue to deliver more and more products, because that is our growth model. We put more modules and devices and capabilities in the hands of more and more partners and more and more market segments. And that drives growth. And as the market recovers in 2021 and 2022, we want to be there with the best portfolio and the broadest portfolio covering all those additional market segments.

So, like I said, I just looked at next year and thought I have about at least \$45 million, actually more than \$45 million worth of demand for what we could be delivering right now. And while we could have probably slowed things down and done \$35 million, it just seems to make sense at this time to really step on the gas a bit.

Chris Quilty

Understand. And a specific question, you mentioned that the US government is buying Certus services off the commercial gateway, are they using commercial off the shelf devices?

Matt Desch

Yes, at this time their revenues are using either Thales or Cobham Certus terminals. And primarily, I think we've even talked about some applications that have used Thales MissionLINK terminals in the terrestrial environment, but there's some sales in the maritime environment as well. That will continue to expand into 2021.

And then we're starting to see a lot of interest in what we call SFX or the new Iridium 9770 modem. There's a number of different applications that they like -- the portability and not just them, but other many other applications on both the commercial and international side as well that will take advantage of that that new modem and ideas of other devices as well.

Chris Quilty

Okay. And is there an effort or a possibility of securing government funding for government specific product development?

Matt Desch

Yes, we've been very good at doing that over the years. That goes into our engineering revenues, you saw this is obviously a good quarter in terms of fulfilling contracts. Our number of contracts we have doing special development, whether it's developing things like the distributed task communication system or new IoT applications or other specialized devices and modems that just, I think is expanding in some ways. I mean, it's not obviously, the area of revenue that's the most strategic orientation for us, but it's all good margin revenue, because it develops more capabilities as many times can be used in commercial applications as well. But yes, that continues.

Chris Quilty

Got you. One question on maritime, what's the status of GMDSS?

Matt Desch

Very, very soon. Actually the beta trials are now completed, we're in a final cleanup mode of the final, final areas because that service has to be absolutely bulletproof. And I believe it will be commercial literally within weeks at this point. And we're excited to see that day. It's a very comprehensive and end-to-end service product with lots of connections. We're completing all those connections with all the different safety service organizations around the world for navigational information and meteorological information, and testing all those links and finalizing the absolute final bugs being cleaned up in the terminals and end-to-end systems, but it's very robust at this point, and literally is within a few weeks of

going commercial.

Chris Quilty

And you do expect to have some of your other partner products certified, because I think right now you just got one standalone terminal with Lars [Thrane]?

Matt Desch

Yes, that is going to be the primary vehicle for definitely the next few quarters. We're starting to work on the process of getting Certus terminals, a Certus service completed and certified that will still be a lot of effort, but there is activity around that front as well. And that will be the primary next phase, we won't see any other standalone terminal installed; it will be Certus based terminals after this.

Chris Quilty

Okay. And final question back to Aireon. What's the next step with the FAA like what would be the next announcement or the next milestone that the guys at Aireon will be targeting?

Matt Desch

I think this is a major step. I mean, obviously the use of the data for broader, I mean it's still continued additional applications they could use in terms of the data in oceanic regions, and for domestic regions, and there's lots of other applications that they can work with on Aireon. And I think that will be a focus for 2021 for the two of them to continue working on it. They're still in, I would say the development stage, they're doing a lot of development of the automation systems and that sort of thing and integrating them. So it will be really the usage of that to control traffic which is still to come yet.

Chris Quilty

Okay. And so, is there is still an expectation that at some point, perhaps in '21, that there's just a big long-term fixed price contract that the FAA signs?

Matt Desch

Yes, I think that's a fair assumption. Again our focus is trying to actually defocus a little bit away from this. I mean, this is great news for Aireon and continues to be, but it really doesn't make that much difference in terms of our business. We're not waiting for anything like that in terms of our expectations of timing for getting hosting fees or dividends. I don't think it will really affect that time timeline. I think what Tom described in terms of our timeline is what we're going to see no matter what other announcements you see between Aireon and FAA. So it's probably not as important to focus on that anymore from an Iridium perspective. And I think the focus should be on really what Aireon and the FAA announce in the future going forward.

Chris Quilty

Thank you very much and great quarter guys.

Matt Desch

Yes. Thanks Chris. Appreciate it.

CONCLUSION

Operator

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

Matt Desch

Well, thanks, everybody for joining us. It was a good quarter. And I think we now have visibility to the rest of the year. And we'll look forward to seeing you -- maybe sometime I guess in February -- as we talk about the full-year and talk about 2021 at that time. So thanks all for joining us. Take care.

Operator

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