

THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

IRDM - Q4 2016 Iridium Communications Inc Earnings Call

EVENT DATE/TIME: FEBRUARY 23, 2017 / 1:30PM GMT



CORPORATE PARTICIPANTS

Ken Levy *Iridium Communications, Inc - VP, IR*

Matt Desch *Iridium Communications, Inc - CEO*

Tom Fitzpatrick *Iridium Communications, Inc - CFO & CAO*

CONFERENCE CALL PARTICIPANTS

James Breen *William Blair - Analyst*

Ric Prentiss *Raymond James - Analyst*

Andrew Degasperi *Macquarie - Analyst*

Jim McIlree *Chardan Capital - Analyst*

Chris Quilty *Quilty Analytics - Analyst*

Andrew Spinola *Wells Fargo Securities - Analyst*

Paul Penney *Northland Capital*

PRESENTATION

Operator

Good day, ladies and gentlemen and welcome to the Iridium fourth-quarter 2016 earnings conference call. (Operator Instructions). As a reminder, this conference is being recorded. I would now like to hand the floor over to Ken Levy, Vice President, Investor Relations. Please go ahead.

Ken Levy - *Iridium Communications, Inc - VP, IR*

Thanks, Karen. Good morning and welcome to Iridium's fourth-quarter 2016 earnings call. Joining me on today's call are our CEO, Matt Desch and our CFO, Tom Fitzpatrick.

Today's call will begin with a discussion of our fourth-quarter results followed by Q&A. I trust you have 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 today may contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements are statements that are not historical fact and include statements about 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 disclosed in our filings with the Securities and Exchange Commission. Our remarks today should be considered in light of such risks.

Any forward-looking statements represent our views only as of today and while we may elect to update forward-looking statements at some point in the future, we specifically disclaim any obligation to do so, even if our views or expectations change.

During the call, we will also be referring to certain non-GAAP financial measures. These non-GAAP financial measures are not prepared in accordance with generally accepted accounting principles. Please refer to today's earnings release and the Investor Relations section of our website for a reconciliation of these non-GAAP financial measures to the most directly comparable GAAP measures. With that, let me turn things over to Matt.



Matt Desch - *Iridium Communications, Inc - CEO*

Thanks, Ken and good morning, everyone. So we have a lot of good news to report on today. As you know, we started out the year with a successful launch of our first 10 Iridium NEXT satellites on January 14 and have made great progress since then in validating these new satellites.

The launch was truly picture-perfect. We had a clear day with moderate winds and I was happy to bear witness to this milestone event after so many years of planning. As SpaceX's return to flight, this launch received global media coverage and was a dramatic way to start our launch campaign. The launch was a success on every measure and SpaceX placed our first batch of Iridium NEXT satellites right where we needed them.

I also want to acknowledge the good work of our prime satellite contractor, Thales Alenia Space. We have a great relationship with the team there and I know they were just as excited as we were given all their work in the design, test and manufacture of these Iridium NEXT satellites.

They've continued to stay on track with production and have already assembled more than enough satellites for our next two launches. With ongoing satellite production at approximately one per week, Thales has a comfortable margin to meet our launch schedule.

Speaking of schedule, as we announced last week, SpaceX is now targeting our next launch date for mid-June. That's later than we expected and a function of their manufacturing backlog and availability of our rocket. Based on SpaceX's production schedule, June is the earliest they could provide us with our Falcon 9. They have assured me that once they get through the first half of this year, it should get a lot easier to get back on track to our needs. Their timeline still puts us on track to complete the Iridium NEXT program in mid-2018.

So now that we are in the launch phase of the Iridium NEXT program and starting to transition our constellation, I want to provide a status of the work being conducted to ensure that our satellites are performing as designed. Our operations team, along with Thales Alenia, is actually running ahead of schedule on their extensive in-orbit testing plan for each of the satellites ahead of their insertion into our constellation.

The 10 satellites from our first launch have completed their platform and functional testing and eight have been raised into a temporary storage orbit about 80 kilometers below their operational satellites in our constellation. These are ready to be moved one by one into their orbital slots to replace existing satellites. The remaining two satellites will soon start adrift to an adjacent plane for use there in about 11 months.

This is the start of a very coordinated sequencing of inserting and drifting satellites from each launch, which will result in 11 operational Iridium NEXT satellites and at least one in-orbit spare being placed into each of our six orbital planes surrounding the Earth.

I'm also really excited to report today that our first satellite, SV106, has been placed into commercial operation and importantly now fills one of the two holes in our constellation. This is the first Iridium NEXT satellite to be serving customers and that's a really big deal. This also means that all the hard work by our team and of course, Thales Alenia has been validated and that there won't be a gap in capability between our satellite generations.

So while our legacy constellation continues to perform with high-availability, the first replacement is validating the full capabilities of our payload. The remaining single hole in our constellation will be filled with our second launch, which will bring us back to full strength.

By the way, the next satellite to be moved into our network is SV109 and that will be our first slot swap. A slot swap is what we call the process of moving legacy satellites out of the constellation and replacing them with Iridium NEXT satellites. This requires a new satellite to be placed near an existing satellite, which near in this case is something like 50 kilometers apart. SV109 is in that position now ready for its slot swap in about a week.

When they are ready, our engineers then simultaneously move the communication cross-links to the new satellite and drop the old links on the legacy satellite. This process is designed to maintain continuity of subscriber traffic as we complete each satellite upgrade. The legacy satellite is then physically lowered into a temporary storage orbit for eventual de-orbit. The slot swap process will be repeated over and over between now and mid-year next year, so our operations team is going to be kept very busy.



By now, you've probably heard that the hosted payload for global aircraft tracking from Aireon had some early success as well. Though Aireon's early testing has been limited while we have checked out other functions of the spacecraft, they've been very pleased with what they are seeing. They have already received thousands of tracking messages from aircraft through the payload and into their operations center. We are planning to officially turn over control of the payload to Aireon this weekend and that's when they will start an extensive flight testing program with partners to validate their space-based ADS-B data.

Our other payload customer, Harris, also has their AIS ship tracking payload on four of the new satellites and are planning to deploy their separate VHF antenna from the aft side of each Iridium NEXT satellite in March to start testing and tracking ships in real-time.

So the testing and deployment of the new satellites from launch one is going about as well as anyone could have imagined and I am really pleased with the progress so far.

Last month, we announced the addition of an eighth launch with SpaceX. This launch is a rideshare with a scientific civil space mission. The launch will carry five Iridium NEXT satellites on the lower wing of the dispenser and two satellites from our rideshare partner will ride above that for delivery into a separate low-Earth orbit. This launch is expected to occur in early 2018 and will be feathered into our launch program as we are both ready.

This rideshare is both a smart and cost-effective way to get an additional five Iridium NEXT satellites into orbit. We will share the SpaceX launch costs with our rideshare partner allowing us to launch a total of 75 satellites for about the same cost during the construction period as we had previously planned for 72 with a Dnepr launch.

This eighth launch has the added benefit of allowing us to complete the entire operational constellation faster than if we only employed seven launches and importantly will bring our in-orbit spares to nine providing us with additional network resiliency. By completing the Iridium NEXT constellation faster, our new satellite services like Iridium Certus can be made available to customers earlier.

So to complete the Iridium NEXT update, our launch campaign is off to a great start and the satellites are working well. SpaceX plans to get as many of our launches into 2017 as they can with the remainder in the first half of 2018 to complete our constellation.

Moving onto our business results, our team executed well in 2016 and delivered solid financial performance. We reached the high end of the full-year guidance we laid out early in 2016 and posted 6% total service revenue growth and 9% growth in operational EBITDA. Most notably, we grew our total subscriber base by 9% for the full year. I feel very good about the state of our business and particularly the growth that Iridium NEXT will bring as our constellation is completed in 2018.

Our commercial business recovered somewhat in 2016 from the headwinds we experienced in 2015, particularly in maritime broadband and M2M. Our satellite handset business continues to be challenged by a strong dollar, but we are doing about as well as anyone in this area as no other competitor can match the quality of our service and our global reach.

In maritime and aviation, we continue to enjoy solid subscriber growth and maintain a strong position as a trusted supplier of L-Band services. We believe that new functionality and faster data speeds associated with Iridium NEXT will allow us to extend into new addressable markets and build marketshare in the L-band/broadband segment that we've only played at the low end to date.

It will also make us the perfect partner for Ku- and Ka-band VSAT players as well, both those operating in GEO and LEO, as distributors pair our Iridium Certus with those technologies for safety and reliability.

Finally, our leadership in satellite M2M or IoT, as many are calling the space now, is noteworthy. This leading position is a function of our network architecture and low-Earth orbit and is very difficult to duplicate by others helping us to add new partners for continued growth each year. Technology coming with the new Iridium NEXT satellites will only further our growth in this area.

Our relationship with the US government remains strong and we feel very good about the new services we are bringing to this partner ahead of the new contract expected in 2018 or early 2019.



Subscribers grew 17% in 2016 to a record level and steady demand for all our services is fueling our innovation and collaboration with this important customer.

Aireon continues to gather momentum in signing new customers and advancing their unique and powerful global air traffic surveillance service. They recently signed Isavia, the Icelandic ANSP, which serves the Reykjavik oceanic control area and pretty much completes an end-to-end service to be offered to airlines in the busy North Atlantic.

As part of the deployment to Isavia, for the first time ever, they will be able to provide real-time surveillance and tracking in the region extending from 70 degrees north to the North Pole. Isavia controls more than 5.4 million square kilometers of airspace and this agreement will help to improve safety and facilitate aircraft efficiency to reduce separations of operations in one of the world's largest flight regions.

So as I wrap up my comments, I want to formally welcome the 148 new employees that joined Iridium on January 3 through the transaction with Boeing. This deal allows us to finally manage a wealth of human capital directly rather than through an external contract. These employees have a lifetime of knowledge about the Iridium network and experience in operating the world's largest commercial LEO constellation.

The deal was strategic for us given us a lot more flexibility as we move forward into the Iridium NEXT phase of our operations and will help us manage our satellite operations cost more effectively. The onboarding process has gone well and we thank our friends at Boeing for a smooth transition in completing the transaction. Boeing will remain a partner of ours for years to come as part of the new development contract that we struck with them at the same time.

So 2017 is off to a great start with a successful first launch. I'm excited to keep our momentum going and keep driving for network completion in mid-2018. Iridium NEXT will bring exciting new services and the completion of this \$3 billion capital program will enable a long-awaited financial transformation that will benefit us all. So with that, I will turn it over to Tom for a more detailed financial review. Tom.

Tom Fitzpatrick - *Iridium Communications, Inc - CFO & CAO*

Thanks, Matt and good morning, everyone. I want to start my remarks today by summarizing Iridium's key financial metrics for the fourth quarter and provide some color on the trends we are seeing in our major business lines. Then I'll walk through the 2017 guidance we issued today, review the long-range outlook we affirmed this morning and wrap up with a discussion of our balance sheet and liquidity position.

For the full year, we were pleased to deliver top and bottom-line growth that exceeded our strong performance for 2015. In 2016, total service revenue growth was 6% and operational EBITDA was \$254.2 million. As Matt noted, this year's results came in at the upper end of our guided range.

In the fourth quarter, Iridium reported total revenue of \$107.4 million, which was up modestly from last year's comparable period. This quarter's performance was balanced with both commercial and government business lines contributing to our results.

Government revenue and strength in commercial M2M drove Iridium's growth this quarter. Operational EBITDA remained strong at \$61.3 million in the fourth quarter, an 8% increase from the prior year's quarter. Our operational EBITDA margin also strengthened this quarter at 57%, up about 400 basis points from the year-ago period. This improvement primarily resulted from higher M2M and government service revenue and decrease in non-income taxes.

On the commercial side of our business, we reported service revenue of \$62.2 million in the fourth quarter. This was slightly ahead of the prior year's quarter and reflected continued strength in our M2M business.

Our voice business continues to feel the effect of subscribers using fewer minutes, as well as lower-than-usual subscriber gains on reduced handset sales.

On a positive note, we were pleased with the performance of our Iridium OpenPort service where subscribers were up 15% year-over-year. Our continuing momentum here sets the table for accelerated growth as we roll out Iridium Certus.



Overall, commercial subscribers grew 8% year-over-year. This was driven by a 15% increase in commercial M2M subscribers while our subs in the commercial voice business were up 1%.

Commercial M2M added 15,000 net data subscribers during the fourth quarter. This was more than double the pace from a year earlier helping our M2M mix grow to 54% of billable commercial subscribers, up from 51% in the year-ago period.

Turning to our government service business, we recorded revenue of \$22 million this quarter representing 4% year-over-year growth. Driving this increase was the final rate step-up in our EMSS contract with DISA, which occurred early into the prior year's period.

This contract structure has been beneficial for both parties. US government has continued to enjoy broader use of Iridium services as its subscriber base grew 17% from the year-ago period to a record 84,000 total users while the average cost per subscriber under the fixed-price contract has become a better value for DISA.

In equipment, we realized revenue of \$16.4 million, which was in line with our expectations, though below the prior year's quarter. Equipment margins were down in the fourth quarter to 36% compared to 46% in the fourth quarter of 2015. This decline was principally associated with product mix and the sale of fewer high-margin handsets.

Recall that a year ago Iridium enjoyed a tailwind from product mix. Also, this quarter, we did not have the warranty benefit from Iridium OpenPort, which occurred in the year-ago period. Overall, we have continued to reduce our manufacturing costs and expect that full-year 2017 equipment margin will remain in the low 40% range, though mix shifts in individual quarters will cause some variability.

Moving now to our financial outlook, we issued 2017 full-year guidance this morning. We forecast operational EBITDA in a range of between \$255 million and \$265 million and total service revenue growth of approximately 3% to 5% this fiscal year.

Our service revenue guidance for 2017 includes the impact of hosting and data fees from hosted payloads for those satellites that are expected to be operational in 2017. The key elements supporting this outlook are as follows. First, we anticipate revenue from hosted payloads in the mid-single digit million range in 2017. This is a new revenue stream for Iridium and our forecast is based only on operational satellites.

Note that we will not recognize revenue from satellites while they are drifting and no revenue will be recognized for spare satellites until they are subsequently put in service.

Second, revenue in our government business will remain steady at \$88 million. As I noted earlier, the final step-up in our fixed-price EMSS contract occurred in October 2015; therefore, 2017 contract revenue will remain at 2016 levels. We feel very good about our enduring partnership with the US government and continue to believe that the number of government subscribers accessing Iridium's voice and data IoT services will grow.

Third, we expect continued strength in M2M and see solid double-digit subscriber growth continuing from this business line in 2017. Not only did we win a number of high-profile contracts this past year, including one with heavy equipment manufacturer, Komatsu, but we also expect that these new partners will ramp up equipment purchases and activations to take full advantage of the low latency global reach of the Iridium network.

We anticipate lower equipment sales in 2017 due in part to continued strength in the US dollar. The handset market in which our product commands a premium is mature. While we have a defensible position, we expect macro forces will weigh on unit sales.

Today, we are also affirming our long-range outlook. Looking forward, we continue to expect total service revenue of between \$440 million and \$465 million for the full-year 2017. There are a number of factors that support this revenue forecast.

First, we expect continued growth in commercial services. Second, we anticipate a renewal of the EMSS contract with the US government. We expect the new contract will provide significant benefit to DISA and incremental revenue to Iridium. While it is still early in the discussions with this customer, we believe that ongoing subscriber growth within the US government bodes well for our negotiations this year and will lead to mutually beneficial terms.

Third, we forecast \$47 million in hosted payload revenue in 2019 based upon terms of our contracts with business partners, Aireon and Harris. Beginning in 2017, we will start to recognize revenue from hosting and data fees based on each operational satellite in the Iridium NEXT constellation.

Finally, new products remain an important component of our long-term revenue growth. We remain excited about the rollout of Iridium Certus and the demand we are seeing for satellite time and location, as well as our commercial push-to-talk offering.

Iridium Certus will begin beta testing in 2017 and we expect this to contribute to revenue in 2018. With significant industry growth in maritime and aviation tied to broadband services by the end of 2020, Iridium Certus is poised to generate annual revenue up to \$100 million.

As Matt noted, Iridium NEXT is scheduled to be operational in mid-2018. Our revenue outlook would only be significantly impacted in the event of a material delay beyond our current deployment schedule. I should also add that the rideshare agreement we recently announced will have an immaterial impact to the total capital cost of the Iridium NEXT mission during the construction period while allowing us to utilize additional ground spares, which we have always planned to do.

The other components of our long-range outlook, which we are also affirming today, include expectations for operational EBITDA margin of approximately 60% in 2019, negligible cash taxes through approximately 2020, peak net leverage of between 6 times and 6.5 times in the 2017 fiscal year and finally, net leverage of below 4 times in 2019.

Moving to our capital structure and liquidity position, as of December 31, 2016, we had drawn \$1.78 billion from the Coface facility and had a cash and marketable securities balance of approximately \$410 million. As of today, our Coface facility is fully drawn.

In 2017, we anticipate total capital spending of approximately \$500 million to \$600 million, including approximately \$86 million of capitalized interest. This reflects continued work on Iridium NEXT and the underrun of payments to Thales Alenia and SpaceX in 2016, which pushes spending into the 2017 and 2018 fiscal years.

Aireon continues to work on its financing to get us a cash payment in 2017. They are making good progress with their planning with advisers and have identified strategies for funding.

I would like to update you on our credit facility amendment negotiations. As we have said previously, our goal was to wrap this up by the end of 2016, which we were unable to do. The delay primarily merely had to do with an inter-creditor issue between Thales and Coface that frankly didn't involve Iridium but had to be dealt with nonetheless.

We've been advised that this issue has been satisfactorily resolved and we are now in the process of documenting the arrangement. The arrangement entails a payment delay to Thales, a delay in payments into the debt service reserve account and a suspension of our preferred dividends for a few quarters.

To be clear, this arrangement provides the cushion we need to absorb an Aireon delay of payment well into 2018. We will need to have collected the Aireon hosting fee by the end of the first quarter of 2019 or made other financing arrangements to repay Thales and fund the DSRA at that time.

In wrapping up my thoughts, I want to reiterate my excitement about the status of the Iridium NEXT program and the progress our team is making to solidify new partnerships and roll out new services. The successful launch of our first batch of satellites confirms their functionality and puts us on track for Iridium's financial transformation.

With that, I will turn things back to the operator and the Q&A portion of this morning's call.



QUESTIONS AND ANSWERS

Operator

(Operator Instructions). James Breen, William Blair.

James Breen - *William Blair - Analyst*

Tom, can you just talk a little bit about the potential for funding? I think you just said you need Aireon to raise capital by the beginning of 2018. What are your thoughts around that in terms of how you could potentially fill the gap over the long term? Thanks.

Tom Fitzpatrick - *Iridium Communications, Inc - CFO & CAO*

Right. So what we said, Jim, is Aireon is working hard to get us money in 2017 and 2018. We said long ago we're not going to bet on that. We hope they do and they are making progress along those lines. What folks should know is Aireon has contracts with air navigation service providers, government agencies or quasi-government agencies denominated in multiples of the \$200 million hosting fee they owe us.

The financing that is envisioned is essentially a collateralization of those contracts and they are making progress down that road. So to the extent that they accomplish that in 2017, they will be able to pay us.

Our financing plan assumes that that does not happen and what we are saying here this morning is, with this arrangement with our credit facility lenders, even if Aireon doesn't get us money at all in 2017 and well into 2018, this financing arrangement ensures our liquidity through that period.

It isn't until the first quarter of 2019 when these deferred payments become due that we either need the Aireon money in or we need to consider other financing arrangements. So that is a long way off, Jim.

James Breen - *William Blair - Analyst*

Okay. Do you think that the funding for Aireon is dependent upon the FAA coming in sometime this year?

Tom Fitzpatrick - *Iridium Communications, Inc - CFO & CAO*

Dependent upon, no. Is the FAA contract relevant to it? Yes. But I wouldn't say it's strictly dependent on it or conditioned on it.

Matt Desch - *Iridium Communications, Inc - CEO*

We can absolutely say that they are focused with their advisors and what Tom just mentioned was not really related to a specific timeline on the FAA. And of course, it will affect how much and rates and things like that, but that isn't really -- they are making a broad-based set of plans there.

James Breen - *William Blair - Analyst*

Okay. And then just one follow-up around the CapEx side. Obviously, as launches have gotten delayed, CapEx has shifted. Can you talk about is 2017 going to be the peak CapEx year with a significant portion coming off in 2018 and then back and then down to that \$30 million to \$50 million level in 2019?



Tom Fitzpatrick - *Iridium Communications, Inc - CFO & CAO*

That's exactly how we see it, Jim.

James Breen - *William Blair - Analyst*

And can you remind us how much you have left from a funding perspective to get the full constellation launched?

Tom Fitzpatrick - *Iridium Communications, Inc - CFO & CAO*

So I would just direct you to our financial commitment table in the 10-K, Jim. We lay that out.

James Breen - *William Blair - Analyst*

Okay. Thanks.

Operator

Ric Prentiss, Raymond James.

Ric Prentiss - *Raymond James - Analyst*

Congrats obviously on getting the first one up there. Definitely was an important event. I just wanted to walk through the pacing also and just make sure we understand it. So mid-June for the next two, the second NEXT satellite launch. How long after that is the expected to be drifting into planes for that next 10?

Matt Desch - *Iridium Communications, Inc - CEO*

So our second launch goes, I think, into plane three and I think we put a few of them into operation. We drift a number of them. Launch three is say -- let's say it's in an about the August timeframe or so. That also has drifters as well. Drifters take about 11 months or so -- I can't remember the exact number of days -- and those will come in -- the ones from probably the launch three are the ones that will come in the last really in terms of the operational side, but some of those could be spares as well.

Remember that launch eight that we added to puts five more in there and they are direct insertions into the network too, so that also speeds delivery and is why we look at a plan right now that shows everything should be done mid-2018. Does that kind of answer your question?

I know it's a complicated -- as I said, I could almost take you through a video that we've made that shows you exactly how many launch and drift -- it's a very detailed plan. It's locked in really right now with our operations team and suppliers in terms of which satellites go where, but it really does create a plan. And about the only thing that throws that off really is if for some reason launches get really delayed.

Particularly these next two are important to us, which is why we have really been driving to make sure we get this next launch in June and another launch in say two months or so after that.

Ric Prentiss - *Raymond James - Analyst*

Okay. And then from a revenue collection standpoint, Tom, you mentioned you've gotten 2017 guidance revenue in the mid-single digit from hosted. Would that just be book revenue versus cash revenue then?



Tom Fitzpatrick - *Iridium Communications, Inc - CFO & CAO*

It depends. It could be both. It depends. We think that the credit analysis on the revenue recognition looks to the enterprise of Aireon, which has significant invested capital, equity capital, significant contracts, etc. And so the credit analysis looks very good for that revenue recognition. That's why we are including it in our guidance.

Ric Prentiss - *Raymond James - Analyst*

Okay. And then the Thales payment delay well into 2018, is that -- I must admit I haven't read the 10-K, although it just came out, but is that in the financial commitment table as well as far as the timing?

Tom Fitzpatrick - *Iridium Communications, Inc - CFO & CAO*

No, the arrangement with Thales and the lenders has not been reflected in our 10-K because it is not done. So what is reflected in our 10-K is our commitments sans this arrangement.

Ric Prentiss - *Raymond James - Analyst*

Okay. And then when you say that you've addressed the debt service reserve, can you help us remember what that involves?

Tom Fitzpatrick - *Iridium Communications, Inc - CFO & CAO*

The debt service reserve is a -- think of it almost like a sinking fund where contractually we were supposed to build it up to \$189 million and there is still some, in the area of \$80 million of payments, that are due to go into that in 2017. The arrangement that is contemplated suspends that contribution of that DSRA thus creating liquidity and then that would need to be replenished by the end of the first quarter of 2019, similar to the repayment of the Thales deferral.

So you think about those as creating a bridge, if you will, for an Aireon delay in payment, which we are not expecting. We are thinking Aireon is going to work hard and get their financing done. We just didn't want to bet on that and so we long ago made these arrangements, started talking about these arrangements for essentially a bridge in the event of an Aireon payment delay. And so we now have visibility with this arrangement that our liquidity is fine absent an Aireon payment well into 2018.

Ric Prentiss - *Raymond James - Analyst*

Okay. And then the final question just on the financial flexibility, you mentioned suspending the preferred dividend for a few quarters. Is that going to become a PIK payment and does a few quarters mean 2017 or is it slipping into 2018?

Tom Fitzpatrick - *Iridium Communications, Inc - CFO & CAO*

So all I can say is a few quarters now, but that accumulates, that suspended -- so it will ultimately be paid, but it will be suspended for a few quarters.

Ric Prentiss - *Raymond James - Analyst*

Okay. Thanks.



Operator

Andrew Degasperi, Macquarie.

Andrew Degasperi - *Macquarie - Analyst*

First, congrats on the first launch. I just wanted to maybe -- I might have missed this in the beginning of the call, but how many satellites have you manufactured to date?

Matt Desch - *Iridium Communications, Inc - CEO*

Yes, we are right now -- I think we have -- I think we've done almost 34 or something like that as of today, 35. I don't know exactly what the numbers are. We have roughly almost 25 in storage right now and they are continuing to grow here through the June launch.

So I know we have started manufacturing of over half of them right now, so I think we are probably working on number 45 or so right now. So really a big part of the program is well underway. We haven't found really many issues in the first satellites on orbit. Everything has really been software fixable in terms of small things that we found and now that we have the first satellite commercial, that's a huge, I guess, risk retired from my mind anyway. And by the way, I had a few great calls here in the last couple days on satellite phones that probably were the best calls I think I have ever had, both emotionally because it's satellite and it completes an important milestone, but they were really, really great quality calls.

And data is flowing and M2M calls are going through that satellite and really all the services are working. So that's a big step. So I think that also helps to really feel confident that our production is really not an issue really anymore. That probably is not going to be in any way a gating item to the completion of our network.

Andrew Degasperi - *Macquarie - Analyst*

Great. And as a follow-up to that, would you think there is a potential point in time where you might decide to change the way you market your plans today as more NEXT satellites get into orbit and the performance improves in both voice and data?

Matt Desch - *Iridium Communications, Inc - CEO*

Yes, I don't want to give anything away, but we have had some good discussions about that. The most important thing, of course, for the new services that the satellites entail. So while I didn't talk about it as much just because I think we've talked about it in previous quarters, our Iridium Certus plans are extensive. As terminals are being created, as the testing is going to be underway very shortly really of beta units here this summer of devices leading up to commercial introduction of our new broadband service toward the end of this year I think is really kind of the target here.

So that's the really primary focus. Yes, it also, by the way, this new technology, Certus technology, kind of turbocharges our machine-to-machine offerings as well, or IoT offerings, in the coming years as we build new devices and we put other new capabilities that the satellites entail.

Voice isn't really where it's at necessarily as you can tell in the results, but with higher quality and new products, I'm sure we will continue to maintain that business. I think the more emphasis is going to be around machine-to-machine, Certus, Aireon and other new services that really the satellites entail.

Andrew Degasperi - *Macquarie - Analyst*

Great. Thank you.



Operator

Jim McIlree, Chardan Capital.

Jim McIlree - Chardan Capital - Analyst

Can you talk a little bit about the Boeing transition? Any incremental expense reductions or increases because of that?

Tom Fitzpatrick - Iridium Communications, Inc - CFO & CAO

We see the Boeing transition as accretive over the long term as operational efficiencies can be garnered. I would say it's immaterially so in 2017.

Jim McIlree - Chardan Capital - Analyst

Okay, great. Thank you.

Matt Desch - Iridium Communications, Inc - CEO

Just to add to that, it really is about more -- we have a lot more control really than we did before and there is some efficiency as we think about how to run our network long term. We really now have the combined operations team all under one head that we can think more creatively about how we deploy people and resources and manage that and move people around. I think it's going to be positive as it goes over forward, but didn't do it primarily for I would say financial reasons directly.

Jim McIlree - Chardan Capital - Analyst

Got it. Thank you. And so as the new constellation comes in, what happens to the old satellites? Is there a financial obligation that you will face in order to retire those? Mechanically what happens to the old satellites?

Matt Desch - Iridium Communications, Inc - CEO

Well, mechanically, it doesn't cost anything to eliminate the satellites. It's really sending commands to the satellites to deploy all the rest of their fuel, which most of them have a lot of fuel still to de-boost themselves and de-orbit over coming months or about a year or so and so we have a plan. We are going to keep them in orbit below our current constellation, some of them. In fact, the best ones will probably be kept up there and I would expect that we will even start the de-orbit process maybe later on this year for the first groups of satellites. And over time, we will remove all the satellites from orbit say in the -- by about the 2019 timeframe.

I know I am getting a lot of Twitter responses about our Iridium flares that won't be -- won't happen any longer after that, which I am sorry, but we really don't want them in space any longer than necessary.

But there is not really financial aspects to that. There is no -- we have commitments in terms of a de-orbit policy that when we de-orbit them that we will take them out of space quickly, really -- most of them really within a one-year period and that's just good housekeeping practices really for space in our orbit.



Jim McIlree - *Chardan Capital - Analyst*

Okay. That's great. Thanks a lot.

Operator

Chris Quilty, Quilty Analytics.

Chris Quilty - *Quilty Analytics - Analyst*

Thanks. Tom, a couple quick follow-ups just on the Boeing. I can't remember the time that you guys actually brought them in and I'm just thinking in terms of SG&A. When we look at the Q4 SG&A, is that a good indication as the run rate on a go-forward basis or were there other items in Q4?

Tom Fitzpatrick - *Iridium Communications, Inc - CFO & CAO*

So Boeing would have been in cost of service. That's where its geography is. So you will see not much change, as I said to Jim. Immaterially accretive in 2017. The geography is going to change a little bit in that Boeing was and will continue to show in cost of service. The overhead will move out of SG&A into cost of service and so you are not going to -- I would think 2017 SG&A will be up. Translation, if that, over 2016.

Where you are going to see a big change year-over-year between 2016 and 2017 is in cost of service really not owing to Boeing, but owing to the fact that we will start expensing the orbit insurance associated with NEXT, which is part of our \$3 billion plan for NEXT. But under GAAP that portion of the insurance is expensed. So you will see that in cost of service and we will carve it out for EBITDA.

Chris Quilty - *Quilty Analytics - Analyst*

Okay. Speaking of carving out, the hosted payload revenues, are you going to give us a separate line item on that so we can track it?

Tom Fitzpatrick - *Iridium Communications, Inc - CFO & CAO*

It will certainly be easy to follow. Yes.

Chris Quilty - *Quilty Analytics - Analyst*

Okay. And you mentioned a forecast for capitalized interest -- I just missed it -- for 2017.

Tom Fitzpatrick - *Iridium Communications, Inc - CFO & CAO*

I think we quoted 85 or 86.

Chris Quilty - *Quilty Analytics - Analyst*

Okay. That's what I thought. And when you mentioned for 2017 solid double-digit growth in M2M, was that subs or revenue?

Tom Fitzpatrick - *Iridium Communications, Inc - CFO & CAO*

Subs.



Chris Quilty - *Quilty Analytics - Analyst*

Subs. Got you. And so the other question on the EMSS contract discussions, typically, a lot of that bid and proposal work is pretty expensive stuff. You don't expect that to have a substantial impact on SG&A this year with those negotiations ongoing?

Tom Fitzpatrick - *Iridium Communications, Inc - CFO & CAO*

No, we do not.

Chris Quilty - *Quilty Analytics - Analyst*

Okay. And can you remind us, I know it is pretty hard to handicap what the next five-year contract might be, but perhaps what services you expect to have available for the new five-year contract that were not included in the old one?

Matt Desch - *Iridium Communications, Inc - CEO*

So I think our primary focus is going to be on the -- since the subscribers have grown dramatically across the number of services that are in the contract, M2M continues to grow well. One that is going to I think grow a lot faster starting next year is DTCS as they complete the global services improvements that they wanted to make and I think that they are going to start deploying that more effectively starting next year.

So all the same basic services. There's brand-new secure voice devices that will be utilized. So that's going to be I think the core of the contract and it will be more of a comparison between the last five years and the forward-going five years.

Where I think things may be outside that contract, Iridium Certus is likely going to be a separate vehicle. We have never really had any broadband business with the US government, but Iridium Certus has a whole lot of advantages for the government in terms of being a secure private, almost broadband, L-band service that has higher speeds than things that they are currently deploying today. And discussions are very positive in terms of it being a valuable new capability, but we would not include that in part of the EMSS contract because we can't make it a fixed cost. It has to be a pay-as-you-go kind of service because that's the way broadband works.

Other things like STL, which they are quite interested in, satellite time and location, also will probably be outside the core EMSS contract, but that's part of the discussions that are underway with them right now.

Chris Quilty - *Quilty Analytics - Analyst*

Got you. And you mentioned Satelles. Do you have any updates there on the commercial aspect of that business and how they are progressing?

Matt Desch - *Iridium Communications, Inc - CEO*

Yes, they recently got some additional investment from a company called Orolia, which is a pretty good sized company and I think their partnership I think will bear fruit as they put their products together and supply services to the in-building microcell market that wants to eliminate having to run GPS antennas and pay for that sort of expense.

That sounds like a really smart commercial business, but there are a lot of other commercial applications in cyber security, protecting assets and a number of other things that they are talking about.



So I have heard good things. I'm not as close to that because that is really Satelles and Orolia working through that right now, but that seems positive. Most of our support with them is more around the government applications and those are encouraging, as well as I think that they are able to do some things that governments really need done right now as it relates to protecting GPS infrastructure and time and that sort of thing.

Chris Quilty - *Quilty Analytics - Analyst*

Okay. And final question here. The inReach product, which tends to be one of your higher volume M2M products, can you give us any update on either what your partner there may be doing with it, line extensions, geographic expansion and whether you are looking at other potential customers that might want to integrate that capability?

Matt Desch - *Iridium Communications, Inc - CEO*

Yes, I can tell you -- first of all, Garmin, which acquired the inReach product, is I think really pleased with what they have got there. I know that they have just been starting to announce a whole new set of products that are coming out. I've had a chance to look at the pipeline of products coming out from the technology they have planned and it's quite exciting in terms of where they are going with it. Much smaller products that offer a different level of services.

So I think first of all the product set is great and it looks super going forward. You are right, they are really one of our highest volume machine-to-machine partners in 2016 and I expect that to continue in 2017 and 2018.

I do know that we've had some discussions with them about expanding into specific regions, but I think you really should get that information from them. I don't still believe that, in 2016, so our results that we reported, almost have any of that expanded distribution in them. I think that's more of a 2017, 2018 event as they seem very professional about how they roll this thing out into their expanded distribution around the world. So I expect between new products and expanded distribution that that will continue to be one of our largest subscriber partners really.

Chris Quilty - *Quilty Analytics - Analyst*

And I guess an extension of that, so it's not the same question, but you've talked about the automotive OEM?

Matt Desch - *Iridium Communications, Inc - CEO*

Yes, the concept of a connected car from a satellite is interesting and I know some people are talking about showing what they can connect to a car. That is not going to be I think a big market for satellite companies for the next couple years just because it takes so long to embed things into cars. We have several partners, one in particular I know that is going after that market segment and may have some success there down the road, but I don't think it's going to affect our near-term revenues just because it takes so long to embed technologies. And I've always been pretty public about I really think the bigger market there is more in safety services to automobiles, things like airbag deployments on a global basis, software-over-the-air, firmware-over-the-air updates for warranty improvements, the kind of view that we are going to replace T-Mobile in your Lexus isn't going to happen anytime soon with satellite.

So I think it's going to be specialty applications evolving from right now today where we have connected trucks. That's a big market for us in the transportation sector as many, many trucks have Iridium connections on them right now for driver efficiencies and for information about the location and making sure that they are not speeding and all that sort of thing.

But it's really more of an extension at the higher value applications of vehicles where I know some people want to talk about the sexy nature of a mass market to vehicles, but I just don't think that's going to happen with any technology really for the next couple years.

Chris Quilty - *Quilty Analytics - Analyst*

Got you. Thank you.

Operator

(Operator Instructions). Andrew Spinola, Wells Fargo.

Andrew Spinola - *Wells Fargo Securities - Analyst*

Tom, I was hoping you could clarify a couple of comments you made earlier. I think you said that in 2016 commercial voice subs grew by 1% year-over-year. Is that correct?

Tom Fitzpatrick - *Iridium Communications, Inc - CFO & CAO*

That sounds right to me.

Andrew Spinola - *Wells Fargo Securities - Analyst*

Okay. So voice and data subs total were up about 0.5% and I think you said that OpenPort subs grew 15%. So I was just trying to figure out what was the offset to that (multiple speakers)?

Tom Fitzpatrick - *Iridium Communications, Inc - CFO & CAO*

No, I think that voice and data is our external reporting, so that is the combination of -- think of it as handset and OpenPort and the reason the OpenPort 15% doesn't move the needle that much is because there's not that many subs. It's only like 7000 subs versus 350,000 subs in (technical difficulty).

Andrew Spinola - *Wells Fargo Securities - Analyst*

Right.

Matt Desch - *Iridium Communications, Inc - CEO*

And we should clarify that. There's actually three things in there. I really think you should remember that we also have our data modems, our circuit switch data modems, which are used in aircraft and ships and have been declining as people move to OpenPort and other broadband technologies. That was a narrowband circuit switch service that has really been a trend for a number of years as people move away from those early maritime systems into higher-speed services too. And so you've got a lot of moving effects in that voice and data line on our sheet here.

Tom Fitzpatrick - *Iridium Communications, Inc - CFO & CAO*

But the way to think about it and why we call the OpenPort 15% growth is, even though in that product and maritime, we had a couple of years where we had some quality issues, they are well behind us and that product is really resonating. That's important not because it nets down to a 1% growth in the overall external category, but that is going to be our entree. As we are selling Certus, we are going in with a lot of credibility in maritime that we can make a product that really resonates as a VSAT backup. And so that's setting the table, if you will, for our entree into maritime applications.



That was the point of why we are pleased with that rate of growth here and that represents a nice turnaround from what we had, but also it should portend good things as we think about rolling out Certus, Andrew.

Andrew Spinola - *Wells Fargo Securities - Analyst*

Yes, it makes sense. Could you just expand a little bit on the revenue result in the voice and data segment in the quarter? What were some of the pressures that led to the decline?

Tom Fitzpatrick - *Iridium Communications, Inc - CFO & CAO*

So what I would say is it's not atypical of what we have seen historically. We have a profile of L-band transceivers wherein there is a migration away from that technology to fleet broadband or OpenPort just because it's much more economical. And so we have seen pressure on voice usage or usage that is I would say acute in these L-band transceivers, which is 25% of our installed base. But also just usage by handheld users has declined over time. So we, for some time, have experienced and have talked about a declining slope of the usage line.

What we've seen the last couple of years compounding that downward pressure is that our subscriber net activations in our legacy telephony product have been less than they have been historically and we trace that right back to the low rate of sales and handsets that we think has, at its origins, largely the strength of the US dollar.

So I don't see in the quarter any kind of acceleration of that trend or it's kind of consistent though. The year-over-year numbers might be off a bit. We don't see that as a marked change in what we view as somewhat of a long-term trend.

Matt Desch - *Iridium Communications, Inc - CEO*

I agree with Tom. I think you'd agree. I just don't think fourth quarter really meant a lot. In fact, we always have a little bit of a decline in subs for example in the fourth quarter. We had less decline in the fourth quarter than we did the previous year-over-year quarter from a year ago, so it's our winter season. It's a slowdown. It's a little lumpy and I wouldn't take much into the fourth-quarter numbers.

Tom Fitzpatrick - *Iridium Communications, Inc - CFO & CAO*

If you look at the ARPU decline, it's like \$1 year-over-year. If you go back a few years ago, we were experiencing \$2, \$3 year-over-year declines there as the usage was declining at a faster rate. So if anything, I think I'm encouraged by the year-over-year performance in ARPU and voice and data.

Andrew Spinola - *Wells Fargo Securities - Analyst*

Got it. Last question for me. Just from a higher level, I think you mentioned that you expect some revenue contribution from Certus in 2018. And I'm wondering if we can get more granular and you can explain to me how many satellites you need to have in service to be able to offer Certus. I guess part of my thinking was that maybe it would be all of the satellites, so if the last launch was the middle of 2018, there would probably be a couple months until everything was in service and then maybe even some testing beyond that with the new hardware, etc., as everything gets put together. So maybe you can help me understand when revenue could start to be -- when we can start to see revenue. What milestones have to be hit?

Matt Desch - *Iridium Communications, Inc - CEO*

Yes. So, there's not a specific number, but I think our plans are a little more aggressive than what you are describing there. Our plans with our VAMs, for VAMs that have been selected to build products, there's going to be products available this year, which include dual-mode products that allow



them to operate on the new speeds with new satellites over them and existing speeds, say OpenPort speeds when you have an older satellite under them.

So there's a lot of value that new product will bring into it and really given that you put that on a ship in January of 2018, it's bringing value to the ship owner either standalone or combined with a VSAT and it only gets better literally month by month as the network continues to evolve.

I'm expecting with the kind of launch plan we have this year that there will be -- almost half the satellites are up there, maybe a little less than that, so it will be a pretty robust Certus service even at the end of this year. And then it will evolve very quickly.

And by the way, since these terminals that are being built will be upgradable to double their speed really as soon as the -- through firmware really without hardware changes after the network is complete in middle of 2018 or when that capability is completed in 2018, they are just going to get better and better over time.

So the VAMs that we've had are pretty excited about the opportunity that Certus brings already in 2018 and there will be a lot of testing here in 2017 throughout this year of Certus on existing satellites with these terminals to make that happen.

The other thing then is we are going to be signing up new service providers to deliver those services and we've had very good discussions with them. Those contracts are going to start rolling in here over the next couple months, so SPs will also be selected this year to be selling that in 2018. So I'm expecting that we will have revenues in 2018 starting very early on and ramping up through the year.

Andrew Spinola - Wells Fargo Securities - Analyst

Okay, great. Thank you very much.

Operator

Paul Penney, Northland Capital.

Paul Penney - Northland Capital

Just a couple quick questions. On the FAA, has the tone or the pace of interaction with them changed given the Trump administration's vocal criticism of the current quote/unquote inferior technology?

Matt Desch - Iridium Communications, Inc - CEO

Yes, what you referring to is that the airline executive meeting a couple weeks ago where he was mentioning -- and there was a lot of discussion about improving the air traffic control network. Look, I think that a change in administration is probably a positive thing overall in terms of the -- for space-based ADS-B, not just in the FAA, but in the Department of Transportation and in the administration.

I think the two bigger things that are really affecting the FAA's view, the first one is the fact that it's now part of what they call their Next-Gen Advisory Council process. The NAC, as they call it, is where all their customers come in and provide them specific guidance about what they want out of the next-gen system. And right now, Aireon's space-based ADS-B is deep in that process right now and indications are positive that the airlines have done all their own modeling, really do see the benefits and they are driving that and that FAA is seeing the benefits as well through that NAC process.



The other thing I think that's going to really affect the FAA is when they start testing starting this weekend. Maybe they might not be involved this weekend, but over the coming weeks as live data is presented not just for the FAA, but for customers all around the world, it makes it real when they see airplanes that they've never seen before in places they've never seen before. And I think that will also be a driver for adoption by the US.

With that said, I think the international business is going extremely well. The FAA is on their own timeline and are doing well. The Trump thing doesn't hurt, but I think it's a number of other activities that are probably more important.

Paul Penney - *Northland Capital*

Okay, great. Last question. On margins, you are at 59% margins now. In 2019, in a world where you have all the satellites up and you should have a string of new business coming in, what's to prevent margins from growing above and beyond your 60% target?

Tom Fitzpatrick - *Iridium Communications, Inc - CFO & CAO*

So Paul, our 60% in 2019, we have said for a long time, there is nothing to prevent year-on-year margin growth, a la the mature satellite players that have 70%, 80% margins. It's just operating leverage and you're right to observe that that should continue over time.

Paul Penney - *Northland Capital*

Okay, great. Thank you.

Matt Desch - *Iridium Communications, Inc - CEO*

Are there any other questions?

Operator

That concludes our question-and-answer session. I would like to turn things back over to you for any closing comments.

Matt Desch - *Iridium Communications, Inc - CEO*

Great. Well, I appreciate all of you being on. It won't be long before we are talking about first quarter, so I will see you very soon. Thanks.

Operator

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



DISCLAIMER

Thomson Reuters reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES THOMSON REUTERS OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2017, Thomson Reuters. All Rights Reserved.