Iridium Communications, Inc.

Third Quarter 2023 Earnings Conference Call

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CORPORATE PARTICIPANTS

Ken Levy – *Vice President of Investor Relations*

Matt Desch – *Chief Executive Officer*

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

Operator
Good morning, everyone. Welcome to the Iridium Communications' Third Quarter 2023 Earnings Conference Call.

All participants will be in a listen-only mode. Should you need assistance, please signal a conference specialist by pressing the "*" key, followed by "0". After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press "*" and then "1" using your touchtone telephone. To withdraw your questions, you may press "*" and "2".

Please also note that this event is being recorded.

And at this I like to turn the floor over to Ken Levy, Vice President of Investor Relations. Sir, please go ahead.

PRESENTATION

Ken Levy
Thanks, Jamie. Good morning, and welcome to Iridium's third quarter 2023 earnings call. Joining me on this morning's call 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, 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 facts and include statements about our future expectations, plans, and prospects.

Such forward-looking statements are based upon our current beliefs and expectations and are subject to risks, which could cause actual results to differ from forward-looking statements. Such risks are more fully discussed in our filings with the Securities and Exchange Commission. Our remarks today should be considered in light of such risks.

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

During the call, we'll also be referring to non-GAAP financial measures, including operational EBITDA, 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 and the Investor Relations section of our website for further explanation of these non-GAAP financial measures, as well as a reconciliation to the most directly comparable GAAP measures.

With that, let me turn things over to Matt.

Matt Desch
Thanks, Ken. Good morning, everyone. I know that many of you joined us for our Investor Day less than a month ago, where we laid out our strategic growth objectives, through 2030. We

remain very excited about our business opportunities and bullish about our ability to grow revenues and generate meaningful free cash flow for our business and investors.

For those who may not have had the opportunity to listen to our Investor Day remarks, I would highlight our expectations that Iridium will generate about $1 billion in annual service revenue by 2030 and have the capacity to generate approximately $3 billion in shareholder returns during this seven-year period.

During the program, we talked about our confidence in Iridium's strong business position and ability to grow revenues and subscribers. You certainly saw that in our results, today. This outlook is based upon the ongoing strength of our core business lines and a number of growth vectors we will leverage through the end of the decade to support business expansion, while maintaining our CapEx holiday.

Despite market uncertainty about broader economic growth, Iridium's financial stability continues to strengthen. Just before Investor Day, we completed the refinancing of our Term Loan B, which lowered our interest rate and extended the maturity of our credit facility by four years to September 2030.

In light of all the competitive challenges in the satellite industry this year, Iridium continues to be a standout, not only for our ability to grow revenues and subscribers, but also for the health of our network and ability to grow organically, without the need to buy a new platform or merge with competitors.

We do understand that investors would like more information about forecasting new direct-to-device revenues from our partnership with Qualcomm. Adoption of this service by manufacturers is slower than Qualcomm originally projected, but we continue to believe that Iridium will be a player over the coming years in smartphones, automobiles, and other consumer products.

In the meantime, as you can see from today's financial results, we are growing well in all our commercial business lines and continue to expect to do so. One area of business momentum has been in engineering revenue, particularly with our growing business with the Space Development Agency and the U.S. government.

I'm sure you also saw news last month, of Iridium's involvement in the Space Force's Proliferated LEO program. This program supports DoD's rapid response efforts and positions Iridium's broadband services to be a core capability for the war fighter, even as new government-funded satellites deploy, for which Iridium will provide the ground operation support, as well.

I should also point out that we made another quarterly dividend payment on September 29th as we continue to return significant capital to shareholders. The Board's confidence in our business prospects and commitment to capital returns is visible in their expansion of our Share Repurchase Program, where they added a $400 million authorization earlier this summer and extended the program through 2025.

So, given that you've heard a lot from me and my team with the Investor Day a few weeks ago, I'll keep my prepared remarks short today to allow more focus on your questions.

We take great pride in the way our business is performing, adding new partners and their new applications that drive growth and support our free cash flow. Like our past, our future will be based on continued strong execution and capitalizing on what we do best.

So let me turn the call over to Tom now for a 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. Then I'll recap the 2023 guidance we updated this morning and close with a review of our liquidity position and capital structure.

Iridium continued to execute well in the third quarter, generating total revenue of $197.6 million, up 7% from the prior year's quarter. The improvement reflects ongoing growth in our commercial business lines and strength in engineering and support revenues.

Operational EBITDA hit a record $121.3 million in the third quarter. This was up 12% from the prior year's quarter, driven by strength across all commercial business lines and engineering and support revenue.

On the commercial side of our business, service revenue was up 12% this quarter to $125.5 million. Growth was broad based and reflected continued momentum.

Commercial voice and data revenue grew $5.9 million, or 12%, in the third quarter, to $56.2 million. The increase was largely driven by the price changes we implemented earlier this year. To date, we've been pleased with how the new pricing has been received and expect that voice ARPU this year will remain in the mid-40s.

In commercial IoT, we continue to benefit from demand for personal satellite communications. Revenue rose 14% from the prior year quarter to $38.5 million, with a shifting mix of subscribers resulting in IoT ARPU of $7.90 during the quarter. As I've discussed before, we like this growing business and the service revenue it generates relative to the network resources it consumes.

Commercial IoT subs grew 18% from last year's third quarter, fueled by 89,000 net new additions. This was one of the biggest increases in our history. IoT data subscribers now represent 80% of billable commercial subscribers, up from 77% in the year-ago period. We estimate that consumer-oriented plans account for about 900,000 of our 1.7 million commercial IoT users.

Commercial broadband revenue grew 16% from the year-ago period to $15.8 million. Similar to last quarter, we continue to benefit from Iridium Certus being adopted as the de facto standard companion to VSAT services in maritime, though we are seeing lower usage on certain vessels where Iridium Certus had been used as a primary.

Hosting and other data service revenue was $15 million this quarter, in line with last year's comparable quarter and consistent with our hosting contracts.

Government service revenue was also steady in the third quarter at $26.5 million, reflecting the terms of our EMSS Contract with the U.S. government.

Subscriber equipment revenue was $20.4 million in the third quarter, down by 27% from the comparable quarter, last year. Based on trends and input from our channel partners, we had been expecting equipment sales for the full year to be in line with 2022.

But with supply chain issues now resolved and partners not fighting for inventory, we have updated our outlook. We now expect equipment sales to be down in the fourth quarter and down for the full year.

2022 was a record year for equipment sales at $135 million, representing 150% of the prior three-year average. Our updated estimate for equipment sales is fully reflected in our latest estimate for 2023 OEBITDA. While down from 2022, we expect 2023 equipment sales to remain above normalized historical levels and now expect this year to be the second highest on record.

Going forward, we expect equipment sales to moderate to be more in line with historical averages. This is consistent with our comments at our recent Investor Day.

Engineering and support revenue was $25.2 million in the third quarter, as compared to $17.1 million in the prior year period. The increase reflects ongoing work for the U.S. government related to the Space Development Agency contract that we won last year.

We continue to expect engineering revenue will be up significantly this year but will fluctuate from quarter to quarter based upon execution and milestone achievements.

Based upon our results through the third quarter and trends we're seeing into October, we're updating our full-year guidance for service revenue growth to approximately 10% in 2023 and operational EBIDTA to between $460 million and $465 million.

You'll note that SG&A was up 4% this quarter versus 48% in the first quarter. This was consistent with our expectation for moderation in year-over-year growth rates throughout the year, and we continue to expect SG&A to be up 20% for the full year.

Moving to our capital position as of September 30, 2023, Iridium had a cash and cash equivalents balance of $67.9 million. Iridium's growing cash flow has been a source of liquidity and continues to support our board's confidence in quarterly dividend payments and an active share repurchase program. With their incremental authorization in July, our board now has authorized a total of $1 billion in buybacks since the program started in early 2021.

Iridium paid a third quarter dividend of $0.13 per common share on September 29 and expects this program will return approximately $65 million of cash to common holders in 2023. In the third quarter, we also purchased approximately 1.4 million shares of common stock at an average price of about $51.71 for about $75 million. We had approximately $385.7 million of capacity outstanding on our share repurchase program at the end of the quarter and will continue to execute on these buybacks.

Iridium's net leverage was 3.1 times OEBITDA at the end of the third quarter. This was down from 3.4 times a year earlier, even when factoring in our share repurchase and dividend activity. Our current expectation is for net leverage to be about 3.0 times OEBITDA at the end of 2023, inclusive of quarterly dividends and expected share buybacks.

As we said on our Investor Day, we expect net leverage to decline to below 2.0 times OEBITDA as we exit 2030. Capital expenditures in the third quarter were $12 million. We expect annual capital expenditures to average between $50 million and $60 million through 2030. Excluding launch-related costs, 2023's capital expenditures should fall in line with this long-term forecast.

Turning to our pro forma free cash flow, if we use the midpoint of our updated 2023 OEBITDA guidance and back off $76 million in net interest, approximately $75 million in CapEx for this year, and $16 million in working capital, which considers the increase in inventory we announced this year and a declining balance over the next few years, as well as the appropriate hosting payload adjustment, we're projecting pro forma free cash flow of almost $300 million.

These metrics represent a conversion rate to EBITDA to free cash flow of 64% in 2023, and a yield of more than 5%. A more detailed description of these cash flow metrics, along with the reconciliation of GAAP measures, is available in a supplemental presentation under 'Events' on our investor relations website.

In closing, we remain very excited about Iridium's ongoing strength and its many partnerships and prospects for growth. Demand for our L-Band services and equipment remains strong, and our business continues to perform well. We are incredibly excited about our future and are in a good position to continue to return capital to our shareholders as we fund new projects and make strategic investments.

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

QUESTION AND ANSWER

Operator
Ladies and gentlemen, at this time, we will begin the question-and-answer session. If you'd like to ask a question, please press "*", then "1" using a touchtone telephone. To withdraw your questions, you may press "*" and "2". If you are using a speaker phone, we do ask that you pick up the handset, prior to pressing the keys to ensure the best sound quality. Once again, that is "*" and then "1" to join the question queue.

We'll pause, momentarily, to assemble the roster.

Our first question today comes from Ric Prentiss from Raymond James. Please go ahead with your question.

Ric Prentiss
Great. Thanks. Good morning, everybody.

Matt Desch
Good morning, Rick.

Ric Prentiss
Hey. A couple questions. Matt, I know you said, obviously, we all are very interested in direct to device info. And you mentioned maybe it's been slower than Qualcomm predicted, but can you help us understand--I think you said previously that you expect $5 million to $10 million of direct to device to come in this year. Can you update us as far as how much has come in so far in the quarter and year-to-date this year?

Matt Desch
Tom, you want to take this? We're just assembling that.

Tom Fitzpatrick
Yes, it's $5 to $10 (million) in the full year. I don't have the quarter information, Ric. We'll have to double back with you on that.

Ric Prentiss
Okay, that's fine.

Tom Fitzpatrick
We continue to expect $5 to $10 (million) in its development revenues.

Ric Prentiss
Right. And as we think of moving towards royalties coming to you from the chip side, what's the timing of your ability to recognize that revenue? Is it when the chip goes into the phone? Is it when the phone ships to the OEM? Is it when the customer buys the phone and then enables it? Just trying to understand the logistical timing as we try and model this in the dark.

Tom Fitzpatrick
So, the development revenues are what is the $5 to $10 (million), and that is milestone-related for development work that we've done, okay. So, that's that tranche. Then we get paid per the chip when Qualcomm orders a chip. That's royalty revenue. And then, finally, when we entitle, when we entitle a device on our network, that's the other element of revenue. And then when it's used, there's usage revenue.

Ric Prentiss
Okay. Is the entitlement going to be part of the E&S revenue, or is that rolling to services?

Tom Fitzpatrick
That's services. Think of that as access, Ric.

Ric Prentiss
Sure, right. Monthly access type thing, and then when you use it, you get charged for usage. Okay. Yes. That helps. And then your cash balance came down a little bit this quarter. You did the, obviously, the debt refi in there. How much money should we think you want to keep on the balance sheet to kind of run the business as we look at what your free cash flow production would be and your ability to kind of hit the stock buyback?

Tom Fitzpatrick
So, we were $67 million at the end of this quarter. We're quite comfortable there. We took the cash balance down from year end by $100 million; $75 million of it was share buybacks.

Ric Prentiss
Okay. And then the last one for me is the competition in the legacy voice and data business in the past, and I think at the Investor Day, you also kind of mentioned, it seems like you've got still some good runway there, competitively, versus the competition's ability to get handsets and provide service.

How are you feeling on that legacy voice and data business as far as able to grow revenues? Obviously, it's going to be a tough comp next year because you raised prices this year. It sounds like you're not looking to raise prices, though.

Matt Desch
Yeah, I think it continues to be. We're very well positioned there. The business continues to perform really well, better than we certainly expected with a price increase this year, which certainly demonstrates the strength of our offering over anyone else's. And given that we've added new offerings in there, like with the Go products and Push-to-Talk and that sort of thing, those are all growth vectors for us, as well. So you're right, it'll be a tough comp next year in terms of year-over-year growth, but I think you're going to see continued absolute growth out in the future.

Ric Prentiss
Okay. Thanks, everyone. Stay well.

Matt Desch
Thank you.

Tom Fitzpatrick
Thanks, Ric.

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

Hamed Khorsand
Hey, good morning. Could you just talk about the IoT customer composition? Did that change in Q3? Are you expecting that to change anytime soon?

Matt Desch
Given our extensive history in IoT over a long period of time and the literally hundreds of partners and I mean, could be thousands of solutions there, it doesn't change that much, quarter over quarter. There might be some partners have contracts perhaps in specific industries or something that are doing slightly better in one quarter over another, but it really doesn't manifest itself into a single quarter driver to anything we do.

I've talked in the past about some potential new growth vectors with things like autonomous systems and drones and that sort of thing, and we've certainly seen lots of experimentation in that area. But really, on the whole, it's a very broad-based base from energy to transportation to oil and gas to heavy equipment and beyond.

And it's very consistent quarter to quarter. There's just a little stronger summer activity perhaps while in the northern hemisphere it's a little more outdoor, particularly in the consumer segment to that space. But otherwise, it's pretty consistent.

Hamed Khorsand
Okay. And then on the equipment revenue side, obviously it shrank this quarter. Is this your expectation that there's enough supply out there or is this shrinkage just because demand isn't as strong as your resellers thought it would be?

Matt Desch
The latter. Yeah, I think Tom provided a lot of detail there. This is going to be our second highest year ever, and while it's slightly lower than last year--I mean, it's going to be lower than last year--our long-term--a lot of that reason was because of both the stock out of handsets and also just

our partners really needing equipment as they were struggling in their own supply chains and saw that we were not able to deliver them on time.

So, I think you're going to see more of a normalized demand over time. And as we talked in the investor day a couple weeks ago, that's what we were assuming was more of a normalized equipment demand rate as we gave you our forecast out through 2030.

Hamed Khorsand
Okay. Thank you.

Operator
And our next question comes from Caleb Henry from Quality Space. Please go ahead with your question.

Caleb Henry
Hi, guys. Just one question because I think most of mine have been answered, already. Just on the Qualcomm rollout, you mentioned that it was going a little bit slower than they had anticipated. I'm wondering if they gave you any clarity as to why it was moving a little bit slower and if you have kind of an updated timeline for adoption.

Matt Desch
No, not really. I mean, we don't have the visibility into the discussions with the handset suppliers and their specific timelines and what their expectations are. So not a lot of information. And as we've said pretty consistently over time, the information will come out when phone manufacturers decide to deploy it and when that plans to be.

Caleb Henry
All right. Thanks. That's all for me.

Operator
And our next question comes from Edison Yu from Deutsche Bank. Please go ahead with your question.

Edison Yu
Hey, good morning. Thanks for taking our questions. First, it seems the IoT ARPU has been on the uptick the last couple quarters. I know it's certainly lumpy, but do you think that's something that can continue or is this kind of flattish going forward or any thoughts there?

Tom Fitzpatrick
So, the fundamental trend is it's just a function of mixed. So our personal communications subscribers, which is in IoT, are growing faster than the rest of the base. And so, they have a lower ARPU in the $4 range, whereas the rest of the base is higher. And as those grow faster, it's going to naturally cause the overall ARPU to reduce, over time.

Increases in this quarter probably relate to seasonality. Summer months, our usage tends to be higher. So you have the fundamental trend of we expect personal communications to continue to grow faster than the rest of the IoT base. And so you have that factor, which would be dilutive to the ARPU.

Countering that is we have new functionality that's being rolled out within IoT with higher data speeds. Think of the ability to push pictures through a personal communications device. That will be accretive to the ARPU. And so what you have is these two kind of fundamental trends will fight each other, and we'll see where ARPU settles out in IoT, over time.

Edison Yu
Understood. And then just a second question on the E&S (Engineering and Support) side. There's a nice, I think, sequential move as well. Is that all driven by the SDA? And is this a good level to use, going forward?

Matt Desch
Yeah, you're talking engineering and support revenue. Yes, primarily, the biggest driver there is SDA. That's a really large contract that we're ramping up towards in terms of delivering equipment and software and support with our partner. General Dynamics for this first tranche of the Space Development Agency's new network that we expect to continue for many years to come and expand into further work, as well.

So, I think you're going to see that continue to grow. But some of the core R&D work we do with the government is also growing around that as well, as we are embedded in more programs that the government has. And so overall, I think that's kind of a longer term trend.

Edison Yu
Great. Thank you.

Matt Desch
Thanks.

Operator
And our next question comes from Greg Mesniaeff from WestPark Capital. Please go ahead with your question.

Greg Mesniaeff
Yes, thank you for taking my question. I'd like to drill down just a little bit more into the increase in SG&A in the third quarter. You said it was up 4% and you guided to like a 20% increase, going forward. What's driving that? What are the key drivers of the SG&A increase?

Tom Fitzpatrick
Right. So if you look at our results, the first quarter was actually up 48%. And we said at the time we grew our headcount last year and we also incurred additional stock-based comp expenses in 2022 and they increased throughout 2022 such that the comparable quarters reflect kind of the increased run rate, through 2022. So, we knew that the comps in the third and the fourth quarter would show a lot lower rate of growth. And that's exactly what you're saying.

So whereas we grew 48% in the first quarter, we only grew by 4% in the third. And we reiterated that we expect SG&A to be up 20% on the full year. And again, the drivers were headcount increases in 2022 that occurred sequentially through the year, as well as higher stock-based comp.

Greg Mesniaeff
Thank you for that clarification. Do you expect headcount to continue to trend up?

Matt Desch

Well, certainly, a lot of our direct charge headcount is growing. That's probably the fastest part that is charged to the government and for which we get profit for. So our total workforce is growing, but it's mostly in the direct charge areas at this time.

Greg Mesniaeff
Thank you.

Operator
Once again, if you would like to ask a question, please press “*” and then “1”. To withdraw your question, you may press “*” and “2”.

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

Louie DiPalma
Matt, Tom and Ken, good morning.

Tom Fitzpatrick
Morning, Louie.

Louie DiPalma
I was wondering, how should investors think about opportunities with the Proliferated LEO contract that you announced earlier in the quarter? I think SpaceX was awarded one of the first task orders. And what type of services could this involve for Iridium? Thanks.

Matt Desch
Yeah, thanks. So the government, specifically the Space Force, has a lot of opportunities to buy commercial broadband from LEO operators. And it's complicated if they had to do that with every specific service provider and operator. And so, they've decided to create this kind of envelope called the PLEO, assign $900 million over, say, the next five years and ask all the industry to apply, to be qualified, to basically be awarded task orders off of that. And there were like 20 different awardees, I think, or potentials for that.

And we've been one of them, along with some of our partners. For Certus L-band, we're the only L-band supplier in this. The rest of it is mostly KA- and KU-band suppliers like Starlink and others. And so we expect as broadband needs are needed, whether in places like Ukraine and other places, they can just draw off of this ID/IQ, indefinite delivery, indefinite quantity contract against that.

And it will make it easier for them, in our case, to purchase Iridium Certus for government uses. So, it's an upside. It's just not specific about exactly what it will be and where it will be, but it will make it easier for them to buy broadband from us.

Louie DiPalma
Great. And for Tom, how should we think about CapEx and SG&A for 2024 relative to 2023, given how there likely won't be any satellite launches next year? And in the previous answer, you were discussing how you ramped up hiring in 2022. How should we think about those relative levels? I know it's not 2024 yet, but any color there would be helpful.

Tom Fitzpatrick

So CapEx, there's not going to be any launch year, right? So our guide is 50 to 60 (million dollars), I think. That will be in that area in 2024. I think it's premature to give 2024 guidance on SG&A. We'll do that when we unveil our 2024 guidance in February.

Louie DiPalma
Great. And one final one. How should we think about the leverage ratio? The prior guidance for this year was between 2.5 times and 3.5 times. With interest rates continuing to tick up, are you leaning more towards three times versus the high end of that prior range?

Tom Fitzpatrick
Yes, so we're saying we see ourselves right around 3.0 as we exit this year, Louie. That's an all in. That's taking into account everything we know.

Louie DiPalma
Okay, great. Thanks, everyone.

Matt Desch
Thanks, Louie.

CONCLUSION

Operator
And ladies and gentlemen, at this time and showing no additional questions, I'd like to turn the floor back over to the management team for any closing remarks.

Matt Desch
Well, obviously, a little shorter call than usual because of all the information we provided at Investor Day and all the great conversations that we all had. If anybody hasn't seen the Investor Day, there is a replay available on our website, and I encourage you to see that. But you'll see us at conferences and around, and we look forward to seeing you at the fourth quarter results in a couple months. Take care, all.

Operator
Ladies and gentlemen, with that, we'll conclude today's conference call and presentation. We thank you for joining. You may now disconnect your lines.