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# EDITED TRANSCRIPT

IRDM - Q2 2015 Iridium Communications Inc Earnings Call

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## PRESENTATION

### Operator

Good day, ladies and gentlemen. Welcome to the Iridium second-quarter 2015 earnings conference call. (Operator Instructions) As a reminder, this conference call is being recorded.

I would now like to introduce your host for today's conference, Mr. Ken Levy. Sir, you may begin.

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### Ken Levy - Iridium Communications Inc. - IR

Good morning and thanks for joining us. I would like to welcome you to our second-quarter 2015 earnings call. Joining me on this morning's call is our CEO, Matt Desch, and our CFO, Tom Fitzpatrick.

Today's call will begin with a discussion of our 2015 second-quarter results followed by Q&A. I trust you have had the opportunity to review our morning release on our website in the investor relations section.

Before I turn things over to Matt, I would like to caution all participants that our call this morning may contain forward-looking statements with 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 our 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 like to update our forward-looking statements at some point in the future, we specifically disclaim any obligation to do so, even if our expectations or views change.

During the call, we will also be referring to certain non-GAAP financial disclosures. Our 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. Good morning, everyone. I will begin by highlighting that based on our results through the first half of the year we've updated our full-year guidance for service revenue and operational EBITDA.

2015 has shaped up to be a more challenging year than we expected with a number of largely macroeconomic headwinds impacting our results. Handset sales and related usage in our voice market remain pressured by a strong dollar and weakness in the energy sector. We are also now seeing reduced oil and gas activity curb near-term growth in the M2M sector.

Now while we have to manage through these hurdles, let me be clear, the foundation of our long-term growth trajectory remains intact. Tom will have more on these trends during his remarks. For my part, I will focus on the dimensions of our growth profile, the status of our network, developments in our Iridium NEXT program, recent news from our Aireon joint venture, and an update on our major lines of business.

Before I jump to these key strategic initiatives, it is important underscore that our investment case is long-term. We expect to see a financial transformation build through 2018 with great potential for the Company in the years ahead. Simply, we see much higher operational EBITDA and much lower CapEx combining to generate significant free cash flow and ultimately meaningful value to our stakeholders.

The first topic which is usually the case is the performance and the resilience of our current network. Good news once again on that front, as it's been about one year since the satellite failure and our constellation continues to perform very well. Our operations team does a great job of getting the absolute best out of our current first-generation system. We expect more of the same as we soon move into the Iridium NEXT era.

In regard to Iridium NEXT, we've spent just over half of the approximately \$3 billion total cost through the second quarter of 2015. There also continues to be a surge in the pace of development and production activity as we get ready for our first planned launch, which has moved out several weeks to December of this year. I will discuss those details more in a minute.

Just a few highlights to illustrate our progress there. The platform software testing is now 100% complete and we continue to hit key milestones in testing the payload, like the recently announced compact antenna test range testing of Iridium NEXT satellites, where the main mission antenna cross-links and down-links were successfully compatibility tested and operated simultaneously at full power.

We have now completed voice and data calls through the flight hardware, validating the compatibility and performance of the new network architecture. The first Aireon payload has been successfully integrated with a satellite platform and comprehensive ground testing is ongoing to confirm the operation of hosted payloads in rigorous environmental conditions. And the first five satellites continue to move through production and we continue to take major steps in qualifying the manufacturing process with high rate production expected later this year.

As I noted, while the overall schedule remains on track for network completion in 2017, we are now targeting the initial launch to occur in December instead of October. The reason for this is that one of the subsystem suppliers for the Iridium NEXT program is reworking an important hardware component related to the Ka band transmit receive modules, which are used by the satellites to communicate with our gateway and with each other in our mesh network. The rework and retesting of that is now on the critical path ahead of the previous payload software testing in order to get to satellite readiness.

As you may remember, we will put up the first two satellites on a Dnepr rocket and will run them through a very comprehensive series of checks on orbit for about four months before we begin our primary launch services campaign with SpaceX. Regarding Dnepr, the Dnepr space head module, which is the customized rocket component that holds the two satellites during launch and releases them at the appropriate time, is manufactured and completing qualification testing. Kosmotras assures us they will be ready for our launch from Yasny later this year.

After SpaceX, we continue to have great confidence in their ability to get back on track and meet our launch schedule from Vandenberg Air Force Base next year. Our confidence is bolstered by the pulmonary findings SpaceX announced last week and their expectations that they will catch up on their manifest in a way that does not impact Iridium's launch schedule.

Our team has been monitoring the failure review process closely and Space X has been very transparent, thorough, and systematic in their review and is fully capable of getting back to success quickly.

Our Aireon joint venture is doing great and continues to build momentum. We recently signed agreements to collaborate on the potential deployment of space-based global aviation monitoring with the air traffic management agencies of Iceland and New Zealand. These agreements add to those previously signed and expand the potential deployment of Aireon service around the world.

Ultimately, Aireon is working to secure all the strategic flight corridors around the globe that will drive significant operational benefits and fuel savings for the airlines.

As Aireon continues to refine its business model, the use cases for this very unique aircraft tracking technology continue to expand. Additionally, revenue streams capitalizing on the value of the aircraft tracking data set are becoming increasingly evident. As a result, we are more confident than ever that our interest in Aireon will be a meaningful source of value creation for Iridium equity holders.

On a go-forward basis, our annual service revenue contribution from hosted payloads will also now increase from an expanded hosting contract with Aireon and an expanded secondary payload agreement we have executed with Harris related to their recent deal with exactEarth.

Moving now to a quick update on our major lines of business. In our legacy telephony market, a difficult foreign exchange environment and reduced activity in the energy sector on lower oil prices is still weighting on our results. While we added 8,000 subscribers during the second quarter, ARPU fell 7% year-over-year, reflecting usage headwinds and currency effects. Still, with a superior network and expanding product portfolio, our competitive position remains highly defensible and we remain confident in our prospects over the long-term.

Aiding that growth profile will be new products, including our new commercial push-to-talk solution. This product became fully commercially available late in the second quarter and we have seen great interest from foreign governments, public safety agencies, and industrial customers. As the first portable satellite PTT product on the market, we see a lot of attractive use cases for this solution. Overall, we expect it will add to our commercial service and equipment revenue in 2015 and beyond.

In M2M, results were mixed and caused us to ball below our historic double-digit run rate for service revenue growth. However, we continue to penetrate the heavy equivalent OEM sector and feel very good about our progress.

Earlier this year we announced that Iridium had signed a construction agreement and engine manufacturer and we are now at liberty to share the name of that company. Doosan, based in Korea, is an important multinational manufacturer and we are working closely with them on their next-generation M2M services that will roll out later this year. Our funnel remains robust and you should still expect to hear about additional important wins in the coming quarters.

The M2M competitive environment is dynamic, with new challenges and opportunities. We have observed our satellite competitors, reacting to our success in the M2M sector, working together to try to unify their efforts in their respective M2M markets. They've realigned their sales channels to sell each other's products and services, in part I think to make up for deficiencies in their networks and coverage.

While we don't believe this changes the competitive landscape in any meaningful way, we are taking note as they more aggressively target certain customer segments. We haven't lost any customers as a result of this activity, but we do expect we will need to protect some of our more mature customers operating in the more cost-sensitive niches. Ultimately, we believe any attrition will be limited as transition costs are high and our customers really appreciate the clear advantage that comes with low latency, a uniform global service, and small form factor antenna and devices.

We still feel very good about our growth prospects in M2M and the overall growth of the satellite segment of the IoT market. In fact, there are significant new growth opportunities coming out of a legacy M2M service being sunset by a competitor. We believe Iridium is in a strong position to provide an immediate alternative for Inmarsat's legacy M2M services that are going to end-of-life. We are confident that this technology transition provides Iridium with a new opportunity to leverage our global capabilities, low latency, and small form factors to pick up some of their legacy customer base.

As for our broadband platform in maritime, we continue to be pleased with the quality and performance of Iridium pilot units in the field. Our partners have reengaged after seeing solid product performance and low failure rates over an extended period time and the competitive landscape remains favorable for us to build market share as the value player.

Despite outstanding progress and double-digit growth rates during the last six quarters, we think 2015's service revenue will be pressured somewhat by a renegotiation of a take-or-pay contract with one of our service providers. This particular service provider had seen decreased usage from 2014 levels and found itself with excess capacity. We agreed to assist them, as a long-term and important partner, by deferring some 2015 payments in future years while they seek to penetrate new fleets with Iridium OpenPort.

Overall the value of this contract remains the same. Our negotiation only impacts the timing of revenue. As a result, however, we expect this will cause our revenue growth from Iridium OpenPort to dip this year below the 12% mark we achieved in 2014 before bouncing back in 2016.

Finally, we're excited about our expanding broadband footprint with the ongoing works of Iridium service broadband. As you know, we have partnered with Iridium Certus Broadband. As you know, we've partnered with five world-class manufacturers to develop faster user terminals for the aviation, maritime, and land sectors that will take advantage of Iridium NEXT's enhanced capabilities, which we expect to turn on late in 2016 even before all satellites are up.

We think the industry is hungry for the reliable low-latency and high-speed L band service that Iridium NEXT will provide, both as a standalone solution and as a service sold alongside other technologies like Ku-band VSAT. While we're making great progress in developing the faster service and reached an important milestone this quarter, -- excuse me, we are making great progress and we have just completed the development of our prototype transceiver. We are now supplying our partners with this core technology of Iridium Certus to support them as they continue developing their new high-speed Certus terminals for maritime aviation, terrestrial, and government users.

In closing, while we are facing a few unexpected challenges this year, our investment thesis and our view to the financial transformation that should occur in 2018 are solidly intact. The US government relationship remains the foundation of our service revenue growth and Aireon is achieving its key targets. We expect to launch our first Iridium NEXT satellites before the end of the year and I'm confident that we will clear the hurdles that have surfaced in our commercial business.

Although there have been some bumps along the way, we're driving forward to a period of significant free cash flow generation and value creation, and I look forward to updating you on our progress in October. So with that, I will turn it over to Tom for a more detailed financial review.

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**Tom Fitzpatrick** - *Iridium Communications Inc. - CFO & Chief Administrative Officer*

Thanks, Matt. Good morning, everyone. I'll get started by recapping our key financial metrics for the second quarter and will then outline the changes to our 2015 and long-range outlook. I will close by taking you through the elements of our long-term growth profile and briefly reviewing our liquidity position and balance sheet.

Iridium reported second-quarter total revenue of \$101.9 million, which was down 1% from last year's comparable quarter. Service revenue grew 2%. This was offset by an 8% decline in equipment revenue.

Operational EBITDA came in at \$61 million, an increase of 12% from the prior-year period. Operational EBITDA benefited from higher government service revenue and lower product warranty costs. Product warranty costs were down materially from the year-ago quarter as our Iridium pilot

maritime product continues to perform very well. Our operational EBITDA margin was 60% for the second quarter, up from 53% in the year-ago period.

From an operating viewpoint, we generated commercial service revenue of \$60 million in the second quarter, which was unchanged versus last year. We added 16,000 net commercial customers during the quarter, with the gain even we split between commercial voice and M2M customers. Commercial M2M data subscribers now represent 49% billable commercial subscribers, an increase from 46% during the year-ago period.

I'm going to dig deeper on our M2M business as there are now additional headwinds in 2015 beyond the NATO customer usage profile change we discussed earlier in the year. First, one of our key service providers has significant exposure to the oil and gas market and has absorbed increased subscriber cancellations as activity has been reduced in the energy space. We now expect revenue from this partner will decline by about \$1.5 million in 2015.

We've also proactively adjusted pricing for this service provider to support affordability in this distressed sector, which will further reduce our revenue from them by another \$1.5 million in 2016. Second, our network provides the connectivity to remotely command and control the assets of the large and unique project by a major company who doesn't let us reference their involvement in the program.

We saw significant airtime usage in last year's third quarter during the testing phase for this project. We now understand from our customer that this high level of activity will decline in the second half of 2015 as the service moves into another, more mature development phase, which will culminate in commercialization in 2016. We expect a full-year decline of \$500,000 in M2M service revenue from this customer as a result of this evolution, with much of that coming in the third quarter.

Taking all this together, we continue to project double-digit subscriber growth this year in our M2M line of business, but expect that M2M service revenue growth will be limited to the single-digit range.

Turning now to the government service business, which recorded revenue of \$18 million, representing 13% year-over-year growth, driven by our fixed-price airtime services contract [with the] Department of Defense. Government subscribers again grew at a rapid clip, posting 18% year-over-year growth. In addition, we reached a record 65,000 total US government customers during the second quarter. This heightened activity bodes well for future contract renewals and clearly showcases the value of our relationship with this important customer.

I will focus next on equipment revenue, which was \$18.8 million for the second quarter. It declined 8% year-over-year primarily due to lower commercial handset sales. As we've shared throughout the first half of the year, the pronounced increase in the strength of US dollar continues to impact demand for our handset products and services. This effect will be partially offset by shipments of new products, specifically commercial push-to-talk.

While we still don't expect equipment revenue to grow in 2015, we are seeing the material improvement we forecasted versus what was the low point in the first quarter, and we project that the second half of 2015 will be even better than this quarter.

Moving now to our 2015 and long-range financial outlook, which we updated this morning, we now forecast total service revenue growth between 1% and 3%. This revised estimate considers all the developments I've just enumerated.

On the same basis, for the full year 2015, we expect operational EBITDA of approximately \$230 million, which compares to \$216.5 million in 2014. By moving to the low end of our guidance range, we are reflecting both the headwinds to our service revenue profile this year and the benefit of lower product warranty costs and lower other operating expenses.

As for our long-range outlook, we expect total service revenue of between \$420 million and \$465 million for the full year 2018, which trims the high end of our previous range by \$20 million in consideration of our anticipated 2015 results. With the exception of post 2018 capital expenditures, which I will update in a minute, the other elements of our long-term guidance remain unchanged.



As we bridge to our growth profile for future years, there are a number of factors at play that continue to give us confidence in our forecast. We have a known \$22 million increase in government service revenue when comparing 2018 to 2014, as outlined by our airtime services deal with the Department of Defense. 2015 will be 15% higher than 2014 and 2016 will be up 17% from there.

Given the developments in our Aireon business over the last year, I also think it's pretty safe to say that this venture is well capitalized and on track to launch the world's first space-based, global aviation monitoring system once Iridium NEXT is completed in 2017.

And as Matt noted, we have expanded our hosted payload agreements with both Aireon and Harris. When combining the revenue we expect to book from hosting fees and customer data contracts, we now expect total annual service revenue from our hosted payload business to ramp to roughly \$47 million in 2018, up from the \$40 million we previously forecast. We've already received \$19 million in cash from the Harris contract and expect to receive the balance in the coming years. We expect meaningful contributions from new products, including commercial push-to-talk during this timeframe.

Our anticipated 2016 certification for the provision of mobile satellite communications and the Global Maritime Distress and Safety System, or GMDSS, represents a new source of growth in our maritime business. This initiative would not only expand our addressable market to all of the 60,000 vessels that are required to have the safety service, but would also enhance our relevance for both safety and operational communications.

And the final element of growth will be the launch of enhanced broadband services, or Iridium Certus Broadband, as Iridium NEXT is deployed. I also want to comment on our plans for launch insurance. Due to the state of the current space insurance market, we have had to change original strategy about placing insurance on the launches and satellite.

Originally, we expected to place 100% of the insurance prior to the first launch, but the capacity isn't there today and we've now changed our strategy to a hybrid approach where we place as much as the market allows for the full complement of launches and satellites and then ensure the remainder launch by launch.

To date we have bound over 60% of our insurance coverage for all eight launches up front. The economics of these bindings are consistent with our overall cost estimate of between \$100 million and \$125 million for insurance. We continue to bind insurance and expect that our first launch in December will be fully bound prior to its launch date and will bind subsequent launches as we go.

Finally, I want to close with a review our balance sheet and liquidity position. As of the end of the second quarter, we had drawn approximately \$1.4 billion from COFACE facility and had a cash and marketable securities balance of \$476.8 million.

During the second quarter we had detailed technical development meetings with our Iridium Certus partners to define the specific elements of our offering. These meetings have served to further support our expectations of our market opportunity. In light of this, we now believe that additional investments are appropriate in this area and are raising our estimate of average capital expenditures in the post 2018 timeframe from \$30 million to \$35 million.

Wrapping up my thoughts, we are working through the short-term challenges on our path to the financial transformation we believe will occur for Iridium in 2018. We are on the cusp of Iridium NEXT era and Aireon continues to add potential customers to its roster.

Our commercial business is having a down year, largely due to macroeconomic factors, but the foundation is in place to achieve our long-range service revenue forecast. We look forward to updating you again in late October.

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

## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) Andrew DeGasperi, Macquarie Capital.

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### Andrew DeGasperi - Macquarie Research - Analyst

Thanks, good morning. I wanted to first know if you were seeing any other weakness in other sectors outside of oil. And do you see some kind of trends stabilizing at this point or should we wait a few more quarters before that turns around?

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### Matt Desch - Iridium Communications Inc. - CEO

That's a good question. Of course, our business model is indirect, so we work through our many partners who address the M2M market segments and voice and maritime segments in those space.

The real significant standout has been oil and gas. It's really clear -- and some of our earliest and largest partners had been in that sector and so, of course, that has sort of a very high -- over a majority it seems like of the overall effect that we have been seeing.

There does seem to be some weakness in other sectors as well, but it's sort of hard to pin them down as exactly what those might be. They are in specific market areas. Some of our partners continue to grow and do very, very well; it's just the net-net seems to be more the oil and gas sector than anything else right now.

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### Andrew DeGasperi - Macquarie Research - Analyst

Got it. Secondly, can you (multiple speakers)?

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### Matt Desch - Iridium Communications Inc. - CEO

I'm sorry, Andrew. Andrew, you mentioned in terms of -- look, nobody knows for sure. It is a headwind. I think we fully accounted for it this year in terms of sort of the change in our expectations and what we are doing. What it does next year we're really not sure exactly how long it happens.

I don't know what the market expectations are for that sector, but I think probably most of our partners have fully accounted for the downturn in terms of what they are telling us they think will happen. Certainly our hopes, like anything else, is that these headwinds will ultimately turn into tailwinds somewhere down the road. Don't know exactly when, but I think we've accounted for it this year for the most part.

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### Andrew DeGasperi - Macquarie Research - Analyst

Got it. Secondly, can you comment on OneWeb securing funding a few weeks ago? Just want to know what are your thoughts about it and do you think there is any chance that they might interfere with your network? Thanks.

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### Matt Desch - Iridium Communications Inc. - CEO

So OneWeb, for those who don't know it, is a new startup in the I'd say the broadband, global broadband space. It's a very interesting venture.

Andrew is talking about a \$500 million equity investment that really kind of kicks off the venture. It is a Ku-band system, so it's not L-band, and it's meant to operate with an awful lot of small satellites in lower orbit.



I think it's a very interesting venture. It is hard to really tell much about the business or the business model right now, so I can't really speculate about its potential success. I know I feel for them; they have a lot of challenges. We have been through all that before and I wish them well, but I think it's going to probably take them a long time to really get up there.

I look at them, frankly, more as a potential future partner because what they plan to do is not what we really plan to do with Iridium Certus Broadband. We are focused on very specific market segments, very highly oriented towards safety applications in aviation, maritime, and land.

We plan to be more of a complementary technology as opposed to always being the primary technology, so when they get into operation in the early 2020s as a real player, there is a real potential that you could see complementary kind of systems. Kind of hard to have those discussions with them now because I think they are really still in building mode, but it's certainly an interesting development.

I keep saying and we were Leo before Leo was cool. And I think we kind of demonstrate really the value sort of a low latency, close to the Earth kind of system in terms of what it can perform. I think they are inspired by that and will build a potentially complementary system in the long run for that if they are successful.

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**Andrew DeGasperi** - *Macquarie Research - Analyst*

Great, thank you.

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**Operator**

James Breen, William Blair.

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**James Breen** - *William Blair & Company - Analyst*

Thanks, just a couple questions. One, Matt, you talked about take-or-pay contracts and more around timing. Can you just give us a little color on that? Is it basically implying that you get the revenue; you just might get it further down the road?

And then within the M2M space, can you just talk about the competition there and any progress you've made with Caterpillar? Thanks.

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**Matt Desch** - *Iridium Communications Inc. - CEO*

Competition you said in the M2M sector, the heavy equipment? Okay. So the first one, yes, there was -- one of our service providers had a take-or-pay contract going after specific fleet. As I said, they found themselves in a difficult position.

We probably could have forced the take-or-pay on them, but I think that's really not the right thing to do from a partnership perspective long-term, particularly since we both plan to be in this industry a long time in participation going after new business. So we did renegotiate that and just stretched the revenue out and so the revenue moves out a year or two down the road from what we had expected.

We had planned for it more this year. Some of that is coming out of this year. That affects our short-term results, but long term it is still the contract, the take-or-pay nature of it, and the overall value of that contract has remained intact.

On the second part, in terms of the heavy equipment space, there's not a lot of change in that space. Pleased to see Caterpillar starting to roll the early customers. It takes time for them to build it into their systems, so these are longer than sometimes desired buildups. But the payoff long term in terms of all the systems that will be out there using Iridium machine to machine are exciting.

We continue to expand the number of companies we are talking to. It's all moving in the right direction. I still feel like we're going to be closing some more contracts this year. Doosan is a great example. As they move to their next-generation system; they are going to be moving with us and we're excited about that.

I still think the dynamics are very much the same as they have always been, and that still kind of underpins really some of our growth in the machine to machine sector over the next couple years.

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**James Breen** - *William Blair & Company - Analyst*

Great, thanks. And then just one last one just on the launch schedule. So with the initial launch moving to December and the four-month testing, will that push the first SpaceX launch into the second quarter or are you still hoping for the end of the first quarter?

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**Matt Desch** - *Iridium Communications Inc. - CEO*

No, it does push it to the second quarter, and as I said, I think they are going to be well ready for us. As I said, I think SpaceX is being very thorough. I think we agree with their initial assessment of what happened in terms of the strut that failed and we are starting to get a sense of why that might be.

I think they are not moving too fast on that. They are being extremely thorough about what they are doing and what I really like about SpaceX as a supplier, they have a lot of control over the development and manufacturing processes. So when they want to fix something they can do it quite quickly, because they don't have to rely upon real extensive development change.

They are feeling like they're going to get back to launching this fall and there will still be a number of launches before we go in sort of the middle of the second quarter. And we will be able to get back on track quickly really to our launch schedule that completes our network in 2017.

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**James Breen** - *William Blair & Company - Analyst*

Great, thank you.

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**Operator**

Jim McIlree, Chardan Capital.

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**Jim McIlree** - *Chardan Capital Markets - Analyst*

Thank you and good morning. Can you talk a little bit about OpEx? Specifically SG&A was down quarter to quarter; is that a seasonal thing or is that a new level of SG&A or is that expected to rise again as the revenue growth accelerates?

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**Tom Fitzpatrick** - *Iridium Communications Inc. - CFO & Chief Administrative Officer*

Well, sequentially I think it's down largely on the back of lower planned incentives is what you are seeing in the current quarter. And as we said, our guidance on the full year expects lower level of operating expenses just as we trim in given lower service revenues.

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**Jim McIlree** - *Chardan Capital Markets - Analyst*

Okay, great. Matt, can you refresh our memories on what it is you're exactly doing for Doosan?

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**Matt Desch** - *Iridium Communications Inc. - CEO*

I think we had talked about having won an equipment supplier a while ago. We are just announcing their name this quarter. But, yes, Doosan is a major global player in the heavy equipment space with a very broad portfolio of systems that they produce every year.

They had been operating with both terrestrial and satellite components in some way in their current generation, but have planned a next generation sort of evolution of that system that is more comprehensive and all encompassing. They have selected us as the supplier for that system and are building us now into their platforms. And as they get built into platforms they will roll out and provide tracking, engine monitoring, engine services, maintenance, and warranty monitoring, all the types of things that really the heavy equipment space wants to use IoT for.

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**Jim McIlree** - *Chardan Capital Markets - Analyst*

Are you aware if you are exclusive globally or regionally or in other -- in any other sense for this next generation?

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**Matt Desch** - *Iridium Communications Inc. - CEO*

I know that has certain connotations to a few of those words and I would rather not try to use those at this point. That is not to take away from the fact that you really can't -- it's very difficult to be multivendor on these things, but I do believe we will have an extremely strong position in the next generation.

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**Jim McIlree** - *Chardan Capital Markets - Analyst*

Great, that's very helpful. Thank you.

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**Operator**

Greg Burns, Sidoti.

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**Greg Burns** - *Sidoti & Company - Analyst*

Good morning. What is the timeframe that you expect Aireon to make their hosted payload fees payments to you? Do you think they have the necessary contracts in place to obtain funding or do you think they're going to require the FAA signing on to be able to make those payments?

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**Tom Fitzpatrick** - *Iridium Communications Inc. - CFO & Chief Administrative Officer*

Greg, the Aireon payments are expected in the second half of 2016 and 2017 and with those payments anticipate the FAA signing up a contract, which we believe they are on schedule to do in 2016.

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**Greg Burns** - *Sidoti & Company - Analyst*

Okay. And the component issue that's causing the delay was that a design issue on the manufacturer's part or was there an issue with Iridium's design?



**Matt Desch** - *Iridium Communications Inc. - CEO*

No, the design is really our manufacturer's design, if you will. We validate and assure and accept it, but no, it's in the design.

A subsystem component, which is testing fine; we are getting the testing results, some yield challenges to it, but really it's in our initial satellites that are on the floor and, as you can tell from our testing, it's working. The problem is after testing and qualification we found, or they found really, some rework required for long-term robustness of those components.

And then, of course, you have turn that back around, get them back into the test vehicles, retest them to make sure that they meet all requirements, etc. And all that is now planned, but it really does affect the critical path again and move the path out in the weeks it took to get that work redone.

So there's still a lot of other things going in parallel with that, but that really is now the critical path item versus what had previously been the payload software testing, which is progressing very well and will be done on time. It's just this Ka-band component is really sort of the gating item now.

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**Greg Burns** - *Sidoti & Company - Analyst*

Okay. And Tom, on the insurance, the \$100 million to \$125 million, is that the full expense you expect or is that for the 60% you have already contracted?

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**Tom Fitzpatrick** - *Iridium Communications Inc. - CFO & Chief Administrative Officer*

So the \$100 million to \$125 million was our estimate of what insurance would cost and the 60% that we bound is in line with that estimate.

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**Greg Burns** - *Sidoti & Company - Analyst*

Okay, okay. Thank you.

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**Operator**

Chris Quilty, Raymond James.

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**Chris Quilty** - *Raymond James & Associates - Analyst*

Thanks. Just wanted to follow-up on the component testing. Is it fair to assume that you have done vacuum chamber and that was the only piece of hardware that showed up any issues?

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**Matt Desch** - *Iridium Communications Inc. - CEO*

I don't know if I can make that definitive statement. There could have been issues in the past that were issues, but they have been resolved and any rework that was necessary to -- if something failed in qualification, it has been fixed. So it is the one issue we have right now. It is the big -- the issue that's on the critical path.

And, frankly, much of the qualification is done. It's almost complete, but there's a few still things to be done. We really have put the satellites through thermal, thermal vac, acoustic, RF range testing, all kinds of other things, and this is the component.



Little disappointed it's not -- this is not a sophisticated component, but this isn't something that real invention would be required to do Ka-band. And I'm sure the subsystem component vendor, which you can figure out who it is, is fully capable of fixing this and meeting the rework schedules that they have.

But these sort of things happen in a very complicated satellite design process, and despite everyone's efforts, including the time that was budgeted to find these things, things happened and it has delayed our schedule somewhat. But really I'm pleased it's delaying our schedules weeks, not longer period of time.

There's still a lot to be done before December, but we do have a solid plan to launch in December now and feel good about the potential for that now. And have a plan that closes on that at this point. We're going to keep monitoring it very closely and ensure that the rework happens and that we get launched.

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**Chris Quilty** - *Raymond James & Associates - Analyst*

Great. The current difficult environment for heavy equipment manufacturers, how does that impact your discussions with existing or potential customers? Does that benefit you because they are focusing more on efficiency or does it slow things down because of availability of capital?

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**Matt Desch** - *Iridium Communications Inc. - CEO*

I don't think it has a lot of affect personally, from my personal experiences with it, because all -- the heavy equipment sector is very long-term in their thinking. They have to make planning cycles over many, many years and so they don't -- while it may impact sort of short-term decisions in terms of their production, in terms of [hertz] things.

But when you are talking about factors like moving to the Internet of Things and efficiency and providing more things to their customers, they kind of seem to keep moving forward on that basis as opposed to just stopping activities. These are big companies with a lot of resources and I haven't sensed sort of that the near-term, sector-by-sector impacts necessarily affect their long-term thinking about how we interact with them.

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**Chris Quilty** - *Raymond James & Associates - Analyst*

Okay. And you announced the push-to-talk rollout last month. Can you give us a sense of what kind of impact you might expect in 2015 and how these deals will be structured? I think you indicated in the past that these tend to be large system rollouts. Does that stagger the rollout impact with new customers?

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**Matt Desch** - *Iridium Communications Inc. - CEO*

Yes, I think the impact in 2015, our expectation of it is fairly modest right now. Really is more of a 2016/2017 opportunity for us, but we do have a significant funnel of opportunities around the world. There are opportunities here in North America, but there's a number of opportunities with both public safety, militaries, and others.

The funnel is with a number of our distribution partners who have all been trained on how to sell the system. It's certainly a longer-term sale than -- you don't just provide a phone or two to somebody and it happens. It really is a sale into, say, a public safety agency or a friendly military or whatever it might be, and they really have a lot of training and testing and administration kind of stuff that they go through to deploy it.

Good news is when they do it they normally are tens or hundreds of devices and they're long-term contracts in which they -- the value is really in that work group, in the communication amongst those devices. So you really expect to see those to be very sticky, long-term contracts. It's still early days, starting to ramp. I am starting to see devices and customers sort of declare and come on board, but I really don't think it's going to be a real rapid revenue impact for us.

**Chris Quilty** - *Raymond James & Associates - Analyst*

At any update on Iridium GO! and how that's selling after the initial channel fill?

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**Matt Desch** - *Iridium Communications Inc. - CEO*

It's slow; I will have to be honest. Iridium GO! has -- customers really like it. It's been well received in the market by our partners and our customers. It seems to be an issue of -- I'm pleased that it is very different than a satellite phone and so it sort of is a different market segment for us. So it's additive as opposed to in any way competitive what we are doing.

It is a more complicated product in some way and I would say that the experience that an end-user has with the device that is still fairly low speed, as are all devices in these kind of cases right now, if their expectations are wrong they won't be as pleased. And I think when you hear a Wi-Fi hotspot you immediately think you have a seamless experience with your smartphone.

We have never said that's what it was, but I think we're repositioning it now with our partners a little bit more so that they understand really what the value equation is. Because when people do use it and have their expectations set appropriately, they tell us they like it. In fact, they use it a lot. They use it more than, say, a satellite phone would be used.

So I think it's a great, great product to add to our portfolio. It is additive, but it's not -- I think it will be a great product for us in the coming years. I think it's a great first effort and I'm really looking forward to the Iridium Certus version of it, which will come in the coming years. I think because more speed will give us a more seamless end-customer experience with their smartphone, which what they want.

The only other thing I would add is one thing that kind of mitigates all that is when an app developer designs for the data system and that partner list is growing. There's over 55 now I think -- 55 now app developers who have developed applications in the maritime, aviation, weather, and other segments. And those, of course, experiences are excellent because they've been designed into it and I think as more and more of those come on, that will also drive GO! sales.

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**Chris Quilty** - *Raymond James & Associates - Analyst*

Speaking of voice sales, do you expect any impact from the Inmarsat product recall that was announced recently?

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**Matt Desch** - *Iridium Communications Inc. - CEO*

We are aware of that. Apparently, Inmarsat had to withdraw their satellite phones from the market for some technical issue. It's too early to tell in terms of what that means to us. I'm expecting that that will have a positive impact on us a bit, but it's hard to tell what that impact will be right now.

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**Chris Quilty** - *Raymond James & Associates - Analyst*

And a question for Tom. The equipment margins were very strong in the quarter. Obviously that's the lack of warranty effect. Are those margins sustainable at that level or should we expect them to fall back a little bit more to the longer-term trend?

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**Tom Fitzpatrick** - *Iridium Communications Inc. - CFO & Chief Administrative Officer*

Right, the answer is, no, they are not sustainable. There's about a \$2 million benefit. In the prior-year quarter there was a warranty expense and, in fact, this quarter there was a reversal of a reserve because the units are just not failing. And so you should think about normalizing that to take that \$2 million benefit out.

Similarly, the 60% EBITDA margin is on top of our long-term guidance for 2018 and so we don't think about that as being sort of run rate. We think kind of the steady-state where we are right now is 56%, 57%. Really strong year over year. It's up 300 basis points from the comparable quarter last year, but you shouldn't think about 60% as steady-state either.

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**Chris Quilty** - *Raymond James & Associates - Analyst*

Final question. Russia, where do you stand in terms of building out the gateway? And just general comments on the demand environment in Russia.

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**Matt Desch** - *Iridium Communications Inc. - CEO*

In terms of the gateway, it's progressing. We have made -- in fact, I think we have installed a lot of the pedestals and earth terminals right now. We're still waiting on some equipment in the gateway, but there's a plan that completes the gateway either late this year or early next. It really depends on an awful lot of factors of course that aren't completely within our control, but it's moving along well now.

And as far as demand, I would say it continues there. There was certainly the effects of the ruble. We've seen that in terms of repricing prepaid and that sort of thing, but that is a growth market and we do still see activations, good activations out of the Russian market right now.

I don't know if you've any more color on that, Tom, in terms of specifics there, but it has been -- hasn't made a real big change actually overall in terms of the trajectory. I think of it as a new growth market for us.

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**Tom Fitzpatrick** - *Iridium Communications Inc. - CFO & Chief Administrative Officer*

I think you characterized it right, Matt. Our timing wasn't great going into Russia, but that's going to be -- it's a perfect market for us. And that is the perfect example of headwinds will become tailwinds and you're going to see it in Russia.

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**Chris Quilty** - *Raymond James & Associates - Analyst*

Great. Thank you, gentlemen.

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**Operator**

(Operator Instructions) Andrew Spinola, Wells Fargo.

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**Andrew Spinola** - *Wells Fargo Securities - Analyst*

Thanks. Was wondering if you could explain a little bit more your decision to proactively adjust the pricing for the energy customer that you have. Just wondering; it would seem that your end-to-end product is a fairly small percentage of the cost of an energy installation. So is this a price reduction for a need to stay competitive or is this a situation where your customer is billing in local currency and paying in dollars and so their profitability has been squeezed?



**Tom Fitzpatrick** - *Iridium Communications Inc. - CFO & Chief Administrative Officer*

It's really not a currency issue. It's -- they are oil and gas. You saw our M2M subscriber adds were very weak in the quarter. This SPE, I think we had about 5,000 net deactivations here, so it's an acute issue.

They basically came to us and said it's going to be more than that if we can't adjust our contract. So we had a contract with them at a certain price and they came and said give us a lower price. As we think about market -- we don't price the same for every SP. It's going to depend on volumes, etc., and so we just looked at their circumstance and adjusted their pricing because we thought that, in fact, they would deinstall given their situation.

We just made a proactive decision to say we want to retain this business and don't want to run the risk of a cancellation. That's just how it went.

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**Matt Desch** - *Iridium Communications Inc. - CEO*

You are generally right, Andrew. We are fairly small part of the overall cost, certainly in terms of installation. But on an ongoing basis, if you are out there after a period of time, the communications costs essentially are the one thing that they see after installation over a period of time.

And that is really what I think the pressure is right now is to -- when assets are going inactive or dormant and the ability to turn those things off or maybe still keep them and track where they are and keep their monitoring, the value of that sort of asset to the Company is going way down and so the communication cost does become a bigger part of it.

So I just think it's a, hopefully, cyclical issue in that sector, one which we have to continue to trim. We do have that kind of pressure in the M2M space, but as I said, I think it's somewhat balanced by the new opportunities we're seeing in this space, not just with M2M but with competitive potential takeaways and other sectors. And so long term we really don't see this changing our optimism for our machine-to-machine sector. It's still sort of a short-term headwind I think. Near-term mix.

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**Andrew Spinola** - *Wells Fargo Securities - Analyst*

That makes sense. The reference in the press release to the power increase required by the Aireon payload, is that the driver of -- the biggest driver of your increase, so your 2018 estimate of hosted payload revenue? And how does that impact your ability to sell other hosted payloads if Aireon requires more power?

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**Tom Fitzpatrick** - *Iridium Communications Inc. - CFO & Chief Administrative Officer*

So Aireon is way down the path on their equipment and the usage of their equipment. They concluded that they needed more power than they contracted with us when we signed up the deal. And so we had the power to give them and there was a willingness on their part to pay, so they are going to pay us something like \$40,000 a satellite, which aggregates to \$2.8 million a year for the life of the constellation.

Over a 12.5 year life, which is the latest estimate of what our depreciable life will be, that's \$35 million of incremental value from Aireon. That is a new, positive development.

Similarly, we signed up a new payload with Harris and that is worth \$15 million. And so the two of them are -- were up \$6 million or \$7 million in our guidance of \$18 million. The two of them account for a little over \$4 million of that increase.

And the other impact is we've finalized our accounting estimate of what our depreciable life is going to be. It's going to be 12.5 years, which is -- that is the accounting estimate. Obviously, we think it's going to be longer than that if history is any guide, but accounting being conservative it's going to be 12.5 years. And previously we have been using a 14-year estimate for purposes of calculating how the hosted payload revenue would come in. And so that gives us a \$2 million pop.



Two new significant economic value that aggregate at least \$50 million are driving it and then an accounting true-up drives the balance.

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**Matt Desch** - *Iridium Communications Inc. - CEO*

Let me just cover the technical piece a little bit more. Power is a fungible thing on a satellite. As the satellite design matures, actually power budgets somehow increase as people give up power, so we had a bit more to offer.

But really it more reflects not even as much as a technical issue on the Aireon payload because they always -- I think they've done a great job designing that -- but that the opportunity for Aireon has increased. As they saw terrestrial uses for it, their customer base expanded around the world and their original expectations about where they would be using the service expanded and how much they really wanted to keep the receiver operating and where they wanted to operate it.

So it's good news on all fronts. And since they needed some more power and really in some ways our contract with them was based on sort of what resources they were using on the satellite, it made sense to expand that contract commensurately.

It doesn't affect anything else. Of course, the payload space is fully allocated right now. There isn't anything else in there at this point. Harris's AIS receivers are in there and they use that, but all this power budget was done in conjunction with knowledge about what they needed in terms of their payload. So it doesn't really affect anything else.

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**Andrew Spinola** - *Wells Fargo Securities - Analyst*

Got it. So the \$47 million is likely as high as that number is going to go. Is that what you're saying, the capacity is mostly sold out?

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**Tom Fitzpatrick** - *Iridium Communications Inc. - CFO & Chief Administrative Officer*

That's it, and the \$47 million represents contracted revenue. That's how you should think about that.

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**Andrew Spinola** - *Wells Fargo Securities - Analyst*

Got it.

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**Matt Desch** - *Iridium Communications Inc. - CEO*

I think that's absolutely correct. It's great to see it's expanding, but there isn't more -- we're too late to put anything else on our systems right now.

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**Andrew Spinola** - *Wells Fargo Securities - Analyst*

Makes sense. Just last one, Tom, you mentioned that the -- 60% of the insurance is bound. Just want to -- does the cash go out prior to the launch or has that already been paid for?

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**Tom Fitzpatrick** - *Iridium Communications Inc. - CFO & Chief Administrative Officer*

No, it goes out prior to the launch.

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**Andrew Spinola** - Wells Fargo Securities - Analyst

Got it. All right, thank you very much.

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**Operator**

I'm showing no further questions in the queue at this time. I would like to turn the call back to Iridium for closing remarks.

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**Matt Desch** - Iridium Communications Inc. - CEO

Thank you all for spending the time with us. Look forward to following up with you and talking to you in our next quarter. Thanks a lot.

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**Operator**

Ladies and gentlemen, thank you for participating in today's conference. This does conclude our program for today and you may all disconnect. Everyone, have a wonderful day.

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