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IRDM - Q3 2015 Iridium Communications Inc Earnings Call General
Investor Q&A

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Operator

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Chris Quilty *Raymond James & Associates - Analyst*

Jim McIlree *Chardan Capital Markets - Analyst*

James Breen *William Blair - Analyst*

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PRESENTATION

Operator

Welcome to the Iridium third quarter 2015 call with management. My name is Hilda and I will be your operator for today. At this time, all participants are in a listen-only mode. Later we will conduct a question-and-answer session. Please note that this conference is being recorded. I would now like to turn the call over to Mr. Kenneth Levy, Vice President of Investor Relations. Mr. Levy, you may begin.

Kenneth Levy - *Iridium Communications Inc. - VP, IR*

Thanks, Hilda, and thanks everyone for joining us this afternoon. In light of the systemic failure that caused our third quarter earnings call to prematurely disconnect this morning, we thought it was appropriate to schedule some time with investors to address any questions that you have. We've scheduled about 30 minutes this afternoon with Iridium's CEO, Matt Desch and Iridium's CFO, Tom Fitzpatrick; who are both on line with me. I hope you've had the opportunity to review this morning's earnings release and management's prepared remarks, which were posted to our IR website shortly after noon today.

Before I turn things over to the operator to queue up Q&A, let me remind you that we may make forward-looking statements during this session about 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 SEC. 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 obligations to do so or if our expectations in these change.

During the session, we may also refer to non-GAAP financial measures. Please refer to today's earnings release in 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, Hilda, let me turn it back to you so you can provide instructions for the Q&A session.

QUESTIONS AND ANSWERS

Operator

Thank you. (Operator Instructions)



Kenneth Levy - *Iridium Communications Inc. - VP, IR*

So Hilda, if you will announce our first question, please.

Operator

Andrew Degasperi, Macquarie.

Andrew Degasperi - *Macquarie Capital (USA) Inc. - Analyst*

First, I guess the comments from the transcript on the credit facility, can you maybe give us little more color basically on was there anything financially that you had to do with them or was this strictly just an insurance issue that you resolved?

Tom Fitzpatrick - *Iridium Communications Inc. - CFO*

It was strictly just an insurance issue that was resolved as we described in Matt's commentary, in mine, and in the press release.

Operator

Chris Quilty, Raymond James.

Chris Quilty - *Raymond James & Associates - Analyst*

I was hoping you could give us a little bit more color on the product side, specifically what you see happening in the maritime market and secondarily the push-to-talk, that product launch and what you're seeing in terms of uptake, pricing, deal size, and impact?

Matt Desch - *Iridium Communications Inc. - CEO*

So Chris, in the maritime space as I said, we can see that it's an overall kind of challenging market out there, but OpenPort is back in business and we see activations there. We also have had in terms of net activations, I think it's roughly about flat or so. I mean it's not because we've kind of cleaned out a lot of very low subscriber customers as we moved to the new plans. It's still viewed very positively. There's a lot of activity around it and I believe over time that will still continue to be a solid part of our business. But the focus right now I would say in the market for us is more around the development of the new Iridium Certus products that will come to market later next year and into 2017.

As Iridium Certus goes online and as GMDSS is certified, that we think will be the real uptake in our business in the maritime business. In terms of push-to-talk, it's still early days, a lot of interest. Our partners who specialize in that are telling us that it is a unique product, that there is interest from many different government agencies and industrial agents. The activations are a bit slow right off the bat because these are big system sales, you've kind of got to sell them all at once. So, this is not a matter of buying a few handsets. These are usually larger kind of handset orders with government agencies, but we feel good about the long-term prospects for that business.

Chris Quilty - *Raymond James & Associates - Analyst*

And just circling back on the maritime side, did you experience any other discrete losses in the maritime in the oil and gas sector like you did in the prior quarter?



Matt Desch - *Iridium Communications Inc. - CEO*

No. I mean we can't really call out any specific new big changes in the market. It's really a bit more steady state at this point more than anything else kind of as we transition and see opportunity there, but haven't really realized it quite yet.

Chris Quilty - *Raymond James & Associates - Analyst*

And in a broader voice market, have the foreign exchange issues that you pointed out, have they gotten worse, ameliorated? What's the outlook in terms of customer demand?

Matt Desch - *Iridium Communications Inc. - CEO*

It feels sort of steady state to me right now. I don't think it's really changed that much. Certainly the dollar pressure and issues overall in terms of the cost of our devices versus others is sort of as it has been all year long. That's sort of the way we see it.

Tom Fitzpatrick - *Iridium Communications Inc. - CFO*

I would just say in commercial voice as to ARPU, Chris, I tried to call out in my script, which I would direct you to. You saw sort of a \$4 year-over-year decline from \$47 to \$43. We don't see that as run rate at all. There were a couple of reasons for that. There was a prepaid voucher kind of benefit in the prior year's quarter and M2M was particularly strong because of some one-off usage. So, we don't see commercial voice and data kind of eroding at a \$4 year-over-year rate. Half of that would be about the rate. So, that's the only thing I would call out in the quarter that's atypical.

Chris Quilty - *Raymond James & Associates - Analyst*

Okay. And speaking of M2M, can you give us an update of what you're seeing on the OEM side both in terms of existing customers and the rate of role given what's happened to their customers and their markets as well as the pipeline?

Matt Desch - *Iridium Communications Inc. - CEO*

I called out in the script about the Top 20, we have five in service and at more than five I think actually that are close, if you will, I would say of doing trials, talking to us about contracts, looking to move forward; but we haven't been able to land them and announce them yet. There's more in the pipeline in terms of people that we're talking to right now and I think I'd say that anybody who sort of is really moving and making big decisions around telematics is talking to us right now in the heavy equipment OEM space. Notwithstanding of course, a lot of them are under a lot of pressure right now including the largest, I saw their results. But I would say that almost in every case that I've seen, all C telematics is maybe a way through the issues, the headwinds that they are perceiving right now due to oil and gas and that sort of thing.

So, we haven't seen any programs necessarily change or anything that we're talking about with people stop. It probably slows decisions down slightly and maybe lowers the absolute numbers that we would be expecting. But given that this is all a pretty brand new area for us and this is all growth, I don't know that that would be necessarily something you'd see in our results. So nothing's changed in a big way, it's pretty much the same as it's been. It's just a matter of converting these from the pipeline into contracts and then from contracts into service and growth and we're starting to see that come online this year. I think that will continue into next year and beyond.

Chris Quilty - *Raymond James & Associates - Analyst*

And are there any higher SG&A costs associated with these because if I recall, a lot of these deals are more direct in nature?



Matt Desch - Iridium Communications Inc. - CEO

No, I wouldn't say so. Our staff has grown slightly in terms of supporting and going after the market, but I don't believe it really changes anything as far as we're going. You don't see anything?

Tom Fitzpatrick - Iridium Communications Inc. - CFO

No. What I would say is there is not a discrete leadership associated with this. Our thinking around how we go to market in respect of M2M has changed in that you need more corporate development and we've been adding SG&A resource and marketing resource to kind of go after this opportunity, but it's not a discrete higher cost per se, Chris.

Matt Desch - Iridium Communications Inc. - CEO

It's really around the margins I would say.

Chris Quilty - Raymond James & Associates - Analyst

Okay. Ken hasn't figured out how to shut me down yet so I'll gracefully back out and jump into the queue.

Operator

Jim McIlree, Chardan Capital.

Jim McIlree - Chardan Capital Markets - Analyst

Kind of following up on Chris' question on M2M. The growth rate has come down sharply this year and I'm wondering in order to get that back up to the double-digit levels, is that something you can do like products or increase marketing or are we just going to need a better environment that is a better economy or a weaker dollar or something like that. Can you kind of nose around that issue about what you can do to accelerate M2M revenues?

Tom Fitzpatrick - Iridium Communications Inc. - CFO

So, we are as convinced as ever that M2M is a solid double-digit grower for us kind of over the long term as we look out and look at the opportunities we're bringing in in heavy equipment and just generally. We think our network lines up very well with the Internet of Things, the kind of fundamental trend. We talked last quarter, Jim, about some headwinds that we're going experience into 2016 relative to a relatively large oil and gas partner of ours that we gave a price concession to. We sized that headwind at about \$1.5 million. So, 2016 is going to see some headwinds that are kind of a carryover from what we saw this year. Having said that, we see 2016 growth higher than 2015, not quite at the levels we experienced in 2013 and 2014 as we work our way through this headwind, but we feel great about M2M long term.

Jim McIlree - Chardan Capital Markets - Analyst

And do you need NEXT to be launched in order to get it back up to let's call it the 15% plus or are those growth days over?



Matt Desch - *Iridium Communications Inc. - CEO*

No, it's really not a technology issue for us. I mean NEXT brings new technologies that will be very attractive to the NEXT industry as we're able to provide even more speed or more bites cost effectively at the very low package size area, but that isn't really a driver of the growth rates that Tom is talking about. It's more the continued diversification into new segments. The heavy equipment OEM space, it's going after as I talked last quarter in some competitive areas where there seems to be some interest in some people who already are in the satellite telematics maybe diversifying into Iridium and it's into other areas like fleet management as you saw the announcement about MiX from South Africa and I think we're going to see more of that. We have to kind of work through it because there's these couple of oil and gas players who were quite large in our portfolio suddenly sort of deflated all at once and the natural growth around it is going to overwhelm that over time. It's just going to take a little time to work through that.

Jim McIlree - *Chardan Capital Markets - Analyst*

Okay. On the equipment revenue was up substantially quarter-to-quarter, was that seasonal or product driven? And then the margins looked higher than usual, is that sustainable? And that'll be the end of my questions. Thank you.

Tom Fitzpatrick - *Iridium Communications Inc. - CFO*

So yes, we saw greater handset sales in the quarter, I think that it was seasonal. We are still staying we don't see growth in equipment revenues for the full year, Jim. You're right on margins, I would direct you to my prepared remarks, we were up from sort of 26% in the prior year quarter to 45% and there were three drivers of that. The first is we've continued to see much lower failure rates in our OpenPort product so accordingly, our warranty expenses are down again this quarter. We size that about \$1.6 million. On top of that, we introduced a new chip technology that is saving us money as are some other product modifications. And finally, we just had a favorable mix in the quarter, we were handset heavy and handsets have the highest margins. But having said all of that, as we look into 2016, we think equipment margins in the low-to-mid 40% range are achievable.

Jim McIlree - *Chardan Capital Markets - Analyst*

Great. Thank you.

Kenneth Levy - *Iridium Communications Inc. - VP, IR*

Hilda, next question please.

Operator

James Breen, William Blair.

James Breen - *William Blair - Analyst*

One, Matt, if you could just talk about the FAA and seems like they're sort of the last piece in the puzzle with respect to the ANSPs signing up for Aireon. And then Tom, this quarter was a strong EBITDA margin quarter, EBITDA margins continue to pick up a bit here. Just talk about the trends there as you move through this year into next year. Thanks.

Matt Desch - *Iridium Communications Inc. - CEO*

In terms of the FAA, they are a very important potential customer on the Aireon side. You see that Aireon continues to sort of surround the FAA with either MLAs or contracts in the case of Curacao that we talked about on the call. The FAA is very active right now. They're actually updating



the software in their systems to accommodate the Aireon data. They're sort of doing all the preparation work to be able to ingest the data and supply the service in 2018. They're doing everything short frankly of having a contract which as we said, we expect more like after they make this what they call final investment decision that is scheduled out in 2016 sometime.

So, everything is moving in the right direction I believe, but you can't forecast the FAA as you know in terms of their speed and timing. I think they appreciate the value of the system, I think they understand what it could bring, I think they know that there's going to be an awful lot of airplanes being sent into US airspace on very tighter spacing than they would be able to handle without global surveillance for their flight information region. So all things moving in that direction, but until they make that decision in 2016, we are not going to see a contract with them.

James Breen - *William Blair - Analyst*

And Tom, can you just talk about margin progression?

Tom Fitzpatrick - *Iridium Communications Inc. - CFO*

You're right to observe very healthy EBITDA margins at 60%, which is on top of our guidance for 2018 so we're pleased with that. We don't think about that 60% as our sort of run rate. As we think about sequentially into the fourth quarter, we know that SG&A expenses typically kick up and that's because our trade shows and related travel tends to be heavy in the fourth quarter as are some legal expenses. So, we see SG&A moving up sequentially and R&D was low in the third quarter and that will move up as well into the fourth. And so the fourth is a seasonally softer quarter revenue wise and so you're going to have higher expenses and lower revenues so we're not going to sustain the 60% margin into the fourth quarter. A margin in the 57% range feels about right to us and so we feel really good about that guide to approximately 60% in 2018. That's looking like we can see it from here.

James Breen - *William Blair - Analyst*

And given the sort of progression in the business, any sort of changes in terms of thinking about the long-term leverage ratios, what they would be and where they peak?

Tom Fitzpatrick - *Iridium Communications Inc. - CFO*

No, we affirmed them today, Jim.

James Breen - *William Blair - Analyst*

Great. Thank you.

Operator

Phil Dumas, Citadel.

Phil Dumas - *Citadel LLC - Analyst*

What are the costs associated with the credit facility amendment?



Tom Fitzpatrick - *Iridium Communications Inc. - CFO*

There are none.

Matt Desch - *Iridium Communications Inc. - CEO*

They aren't any, Phil.

Phil Dumas - *Citadel LLC - Analyst*

Okay. So unlike the past few amendments, there's no issue or there's no stipulation to issue equity or pay fees or anything like that?

Tom Fitzpatrick - *Iridium Communications Inc. - CFO*

There's no fees and absolutely no requirement to issue equity.

Phil Dumas - *Citadel LLC - Analyst*

Okay, great. Thank you, guys.

Operator

Chris Quilty, Raymond James.

Chris Quilty - *Raymond James & Associates - Analyst*

No costs so you got Tom to fly coach instead of first over to France.

Matt Desch - *Iridium Communications Inc. - CEO*

No, I can't do that yet.

Chris Quilty - *Raymond James & Associates - Analyst*

Just a follow-up on the M2M, some of the future stuff out there. You've talked in the past about some of the larger market applications; automotive, telematics, consumer, working at chipset level solutions, and software defined. Any developments to report there?

Matt Desch - *Iridium Communications Inc. - CEO*

In the M2M area and chipsets and that sort of thing, I really don't have anything I don't think new to report. We haven't announced anything specifically in that area. We are in a lot of discussions right now not just in M2M, but the space is blur with Iridium Certus broadband and Iridium Certus I would call it narrowband, which is sort of not the official name for it, but the areas up to about 88 kilobit per second that would be very helpful to the M2M world. We're primarily supplying the technology in a transceiver form, but we've made it available really to provide it in a core technology form to be packaged in other ways and there is some movement in that area.



There's some interest to do that, but not so much new chipset customers say for a 9603 device because I think most people look at that and see the cost of that, especially with the latest silicon technology that we put into that, is really quite cost effective and it's kind of hard to do that much less expensively. There is some work in what I would call the government tactical radio area primarily using our 9523 in an adjunct form and interest quite possibly in taking that technology and integrating it even further, but it isn't really in a way that I could sort of announce something with a specific customer today. Just a lot of interest right now.

Chris Quilty - *Raymond James & Associates - Analyst*

Can you talk about the staging of products to market relative to service launch and what your expectations are relative to customer uptake? I mean are there risks that customers hold back on buying current generation hardware while they await new stuff coming out or do you plan on launching forward-backward compatible hardware to smooth the transition?

Matt Desch - *Iridium Communications Inc. - CEO*

Good question, it's a big question. I would say that first of all as it relates to Iridium Certus broadband, as I mentioned in the call, there's an awful lot of activity happening there. The development itself is going well and on schedule towards sort of a satellite upload later next year and service introduction shortly thereafter. That's before the whole satellite network is complete, whole Iridium NEXT is complete. So, the only way that that would really add revenues in 2017 is if there's dual mode terminals. Of the value-added manufacturers that we've announced that we've licensed to develop products, a few are developing dual-mode products that have both what we would call an OpenPort level service or 128 as well as the higher level service speed so depending upon what kind of satellite was overhead, they would offer that kind of speed.

Now that they have developer kits and in fact we're having technical interchange meetings on a really regular basis with all of them, we're seeing a lot of activity in maritime aviation and [threshold] in terms of building products. Each are giving us sort of road maps for the kinds of products they will deliver and what their markets will be. I can say there's from what I see a great enthusiasm. For example, we just had an aviation workshop this last week with something like 60, 70 kind of people at it, all our partners were represented and there was a lot of enthusiasm for what Iridium Certus kind of speeds would do in the aviation markets and across the board. And I think we see the same sort of thing in maritime and threshold as well from these partners.

So is there sort of a wait for it, I would say I think we've accommodated that in everything that we've talked about in terms of guidance. I think that's one of the reasons for example why OpenPort despite being used as a high quality product right now is not growing as fast as its speeds are okay and its value is quite good, but the real interest is in the 350 kilobit or 700 kilobit per second product that could be coming out in a year or two and a lot of enthusiasm for the NEXT generation product. So, I think we'll continue to sell that product. It's not exactly a wait for yet, but there is a lot of interest in sort of our higher speed versions of the products that are coming. Did I cover that well for you?

Chris Quilty - *Raymond James & Associates - Analyst*

And if I can just have you touch one more. The aviation market, any developments going on there?

Matt Desch - *Iridium Communications Inc. - CEO*

Well, there's a lot of activity I would say. I mean it's still a fairly robust area for us as all of our partners, for the most part many of our partners now have fans Aviation Safety certified Datalink products and are adding voice certified or soon to be certified, if you want to use that terminology, products that would allow them to use Iridium voice products to replace HF boxes in aircraft and there is a lot of interest in a number of airlines in putting that on. I've talked in the past about what I would call significant near-term activity in China where a number of airlines are now putting satellite voice on their airlines and we are very well positioned for that. There is growing interest in the rotorcraft space for solutions that offer higher speeds since Iridium works very well under rotors and we've always been the big player in narrowband for that. Now with a product out of



Thales that's also giving us 128-K and we think that that will be a great market for Certus as well. So, I'd say it's still robust. I don't have any big quarterly announcements or anything for any big particular wins there, but I'd say it's a robust area of activity.

Chris Quilty - *Raymond James & Associates - Analyst*

Perfect. Thank you very much.

Operator

We have no further questions. I would like to turn the call back over to Iridium for any final remarks.

Matt Desch - *Iridium Communications Inc. - CEO*

We didn't get any questions obviously about, I must have covered very well in the prepared statements, my unhappiness with the schedule and the fact that we're in April and still believe in 2017. I would point you to a statement made by Thales this morning as well. I saw that it's on their website, it's under www.thalesgroup.com. If you go into the space tab, you'll see the Thales Alenia CEO's sort of statement about the schedule, which obviously supports what I talked about and is really their view of the schedule, which lines up with ours. So I mean we're going to be launching satellites before long not as fast as I thought, but we'll be getting up there and I think we'll get back on track and get Iridium NEXT up there next year and in the following year. The only other one I would just suggest, the insurance was very important and obviously the waiver was important. But placing insurance, I do know that I think the call cut off for most of you probably before you heard Tom's prepared statement on the status of our insurance placement. I pointed that out to Tom, do you want to just quickly summarize that sort of where we are with the insurance placement? I mentioned that we're wholly placed on the first Dnepr launch.

Tom Fitzpatrick - *Iridium Communications Inc. - CFO*

I'll just go into a little bit more detail. We've agreed on material terms to our credit facility that we expect to execute shortly terms to provide Iridium to secure the required insurance on a launch by launch basis for the first three launches rather than having insurance for all eight launches in place prior to the first launch. The amendment will give us the flexibility to complete the placement after the launch campaign commences. As Matt said, we're off to a good start. We have 100% of the insurance required for the first launch in Dnepr. Additionally, we have secured over 85% of the required insurance for the first two SpaceX launches and over two-thirds of the insurance required for the remaining five SpaceX launches. Given our progress to date, we expect that we'll be able to buy each of remaining SpaceX launches comfortably as required by the terms we've agreed to with our lenders. And in terms of economics, we've done insurance on approximately 75% of the aggregate risk involved and done so at a proportionate cost in line with our overall budget of between \$100 million and \$125 million until we continue to work this placement.

Matt Desch - *Iridium Communications Inc. - CEO*

So, that was just important to bring up because it was obviously a key area of focus for us this early part of the year and obviously with that success we've been having, I don't think it's going to be as big an issue going forward. Without any more calls, I know this was a very strange call, don't usually split it up. I don't think we'll do this in the future quite this way, at least I hope not if we get NASDAQ working right. But I look forward to seeing you on a flawless call I guess in about four months or so. Thanks, everybody.

Operator

Thank you. Ladies and gentlemen, this concludes today's conference, we thank you for participating. You may now disconnect.



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