

Gogo Inc.  
Form 10-Q  
August 07, 2017  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**

**FORM 10-Q**

**(Mark One):**

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934.**

**For the quarterly period ended June 30, 2017**

**OR**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934.**

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission File Number: 001-35975**

**Gogo Inc.**



(Exact name of registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction of  
Incorporation or Organization)

**27-1650905**  
(I.R.S. Employer  
Identification No.)

**111 North Canal St., Suite 1500**

**Chicago, IL 60606**

(Address of principal executive offices)

**Telephone Number (312) 517-5000**

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of large accelerated filer, accelerated filer, smaller reporting company and emerging growth company in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if smaller reporting company)

Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the



Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of July 31, 2017, 86,714,196 shares of \$0.0001 par value common stock were outstanding.



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**Gogo Inc.**

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[Table of Contents](#)**PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****Gogo Inc. and Subsidiaries****Unaudited Condensed Consolidated Balance Sheets***(in thousands, except share and per share data)*

	<b>June 30, 2017</b>	<b>December 31, 2016</b>
<b>Assets</b>		
<b>Current assets:</b>		
Cash and cash equivalents	\$ 96,416	\$ 117,302
Short-term investments	283,241	338,477
Total cash, cash equivalents and short-term investments	379,657	455,779
Accounts receivable, net of allowances of \$657 and \$499, respectively	87,097	73,743
Inventories	52,041	50,266
Prepaid expenses and other current assets	20,870	24,942
<b>Total current assets</b>	<b>539,665</b>	<b>604,730</b>
<b>Non-current assets:</b>		
Property and equipment, net	583,245	519,810
Intangible assets, net	90,296	85,175
Goodwill	620	620
Long-term restricted cash	6,873	7,773
Other non-current assets	56,557	28,088
<b>Total non-current assets</b>	<b>737,591</b>	<b>641,466</b>
<b>Total assets</b>	<b>\$ 1,277,256</b>	<b>\$ 1,246,196</b>
<b>Liabilities and Stockholders' deficit</b>		
<b>Current liabilities:</b>		
Accounts payable	\$ 29,471	\$ 31,689
Accrued liabilities	148,569	132,055
Accrued airline revenue share	15,504	15,521
Deferred revenue	36,817	32,722
Deferred airborne lease incentives	35,342	36,277
Current portion of capital leases	2,613	2,799
<b>Total current liabilities</b>	<b>268,316</b>	<b>251,063</b>



<b>Non-current liabilities:</b>		
Long-term debt	880,371	800,715
Deferred airborne lease incentives	117,459	135,879
Deferred tax liabilities	8,791	8,264
Other non-current liabilities	118,833	90,668
<b>Total non-current liabilities</b>	<b>1,125,454</b>	<b>1,035,526</b>
<b>Total liabilities</b>	<b>1,393,770</b>	<b>1,286,589</b>
<b>Commitments and contingencies (Note 11)</b>		
<b>Stockholders' deficit</b>		
Common stock, par value \$0.0001 per share; 500,000,000 shares authorized at June 30, 2017 and December 31, 2016; 86,944,391 and 86,529,907 shares issued at June 30, 2017 and December 31, 2016, respectively; and 86,714,037 and 86,295,870 shares outstanding at June 30, 2017 and December 31, 2016, respectively		
	9	9
Additional paid-in-capital	888,100	879,135
Accumulated other comprehensive loss	(1,673)	(2,163)
Accumulated deficit	(1,002,950)	(917,374)
<b>Total stockholders' deficit</b>	<b>(116,514)</b>	<b>(40,393)</b>
<b>Total liabilities and stockholders' deficit</b>	<b>\$ 1,277,256</b>	<b>\$ 1,246,196</b>

*See the Notes to Unaudited Condensed Consolidated Financial Statements*



**Table of Contents****Gogo Inc. and Subsidiaries****Unaudited Condensed Consolidated Statements of Operations***(in thousands, except per share amounts)*

	<b>For the Three Months Ended June 30,</b>		<b>For the Six Months Ended June 30,</b>	
	<b>2017</b>	<b>2016</b>	<b>2017</b>	<b>2016</b>
<b>Revenue:</b>				
Service revenue	\$ 154,076	\$ 127,587	\$ 300,571	\$ 246,307
Equipment revenue	18,724	19,952	37,635	42,978
<b>Total revenue</b>	<b>172,800</b>	<b>147,539</b>	<b>338,206</b>	<b>289,285</b>
<b>Operating expenses:</b>				
Cost of service revenue (exclusive of items shown below)	69,127	53,396	133,940	108,250
Cost of equipment revenue (exclusive of items shown below)	14,649	12,477	26,297	26,225
Engineering, design and development	35,685	24,718	71,949	46,366
Sales and marketing	16,564	16,750	30,959	31,492
General and administrative	23,549	22,388	46,098	43,377
Depreciation and amortization	30,562	24,906	60,997	49,263
<b>Total operating expenses</b>	<b>190,136</b>	<b>154,635</b>	<b>370,240</b>	<b>304,973</b>
<b>Operating loss</b>	<b>(17,336)</b>	<b>(7,096)</b>	<b>(32,034)</b>	<b>(15,688)</b>
<b>Other (income) expense:</b>				
Interest income	(771)	(166)	(1,316)	(212)
Interest expense	27,226	17,557	54,169	33,853
Loss on extinguishment of debt		15,406		15,406
Adjustment of deferred financing costs		77		(792)
Other (income) expense	56	3	94	(171)
<b>Total other expense</b>	<b>26,511</b>	<b>32,877</b>	<b>52,947</b>	<b>48,084</b>
<b>Loss before income taxes</b>	<b>(43,847)</b>	<b>(39,973)</b>	<b>(84,981)</b>	<b>(63,772)</b>
Income tax provision	362	221	595	528
<b>Net loss</b>	<b>\$ (44,209)</b>	<b>\$ (40,194)</b>	<b>\$ (85,576)</b>	<b>\$ (64,300)</b>
<b>Net loss attributable to common stock per share basic and diluted</b>	<b>\$ (0.56)</b>	<b>\$ (0.51)</b>	<b>\$ (1.08)</b>	<b>\$ (0.82)</b>
<b>Weighted average number of shares basic and diluted</b>	<b>79,334</b>	<b>78,849</b>	<b>79,237</b>	<b>78,793</b>



*See the Notes to Unaudited Condensed Consolidated Financial Statements*



**Table of Contents****Gogo Inc. and Subsidiaries****Unaudited Condensed Consolidated Statements of Comprehensive Loss***(in thousands)*

	<b>For the Three Months Ended June 30,</b>		<b>For the Six Months Ended June 30,</b>	
	<b>2017</b>	<b>2016</b>	<b>2017</b>	<b>2016</b>
<b>Net loss</b>	\$ (44,209)	\$ (40,194)	\$ (85,576)	\$ (64,300)
Currency translation adjustments	264	64	490	476
<b>Comprehensive loss</b>	\$ (43,945)	\$ (40,130)	\$ (85,086)	\$ (63,824)

*See the Notes to Unaudited Condensed Consolidated Financial Statements*



**Table of Contents****Gogo Inc. and Subsidiaries****Unaudited Condensed Consolidated Statements of Cash Flows***(in thousands)*

	<b>For the Six Months Ended June 30,</b>	
	<b>2017</b>	<b>2016</b>
<b>Operating activities:</b>		
<b>Net loss</b>	\$ (85,576)	\$ (64,300)
Adjustments to reconcile net loss to cash provided by operating activities:		
Depreciation and amortization	60,997	49,263
Loss on asset disposals/abandonments	3,477	924
Deferred income taxes	527	420
Stock-based compensation expense	9,724	7,986
Loss of extinguishment of debt		15,406
Amortization of deferred financing costs	1,799	2,163
Accretion and amortization of debt discount and premium	9,142	8,508
Adjustment of deferred financing costs		(792)
Changes in operating assets and liabilities:		
Accounts receivable	(13,316)	4,409
Inventories	(1,775)	(4,155)
Prepaid expenses and other current assets	4,468	(12,428)
Accounts payable	1,444	(1,598)
Accrued liabilities	2,830	(2,873)
Deferred airborne lease incentives	6,374	8,374
Deferred revenue	5,024	14,235
Deferred rent	103	443
Accrued airline revenue share	(27)	1,005
Accrued interest	963	3,012
Other non-current assets and liabilities	(3,790)	(5,641)
<b>Net cash provided by operating activities</b>	<b>2,388</b>	<b>24,361</b>
<b>Investing activities:</b>		
Proceeds from the sale of property and equipment		1
Purchases of property and equipment	(128,892)	(71,048)
Acquisition of intangible assets capitalized software	(16,851)	(13,993)
Purchases of short-term investments	(193,845)	(259,068)
Redemptions of short-term investments	249,081	99,886
(Decrease) increase in restricted cash	500	(14)
<b>Net cash used in investing activities</b>	<b>(90,007)</b>	<b>(244,236)</b>
<b>Financing activities:</b>		



Proceeds from the issuance of senior secured notes	70,200	525,000
Payments on amended and restated credit agreement		(310,132)
Payment of issuance costs	(1,485)	(10,610)
Payments on capital leases	(1,540)	(1,218)
Stock-based compensation activity	(759)	(346)
<b>Net cash provided by financing activities</b>	<b>66,416</b>	<b>202,694</b>
Effect of exchange rate changes on cash	317	(233)
<b>Decrease in cash and cash equivalents</b>	<b>(20,886)</b>	<b>(17,414)</b>
Cash and cash equivalents at beginning of period	117,302	147,342
<b>Cash and cash equivalents at end of period</b>	<b>\$ 96,416</b>	<b>\$ 129,928</b>

**Supplemental Cash Flow Information:**

Cash paid for interest	\$ 42,698	\$ 20,748
Cash paid for taxes	24	273

**Noncash Investing and Financing Activities:**

Purchases of property and equipment in current liabilities	\$ 48,721	\$ 22,051
Purchases of property and equipment paid by commercial airlines	5,917	8,728
Purchases of property and equipment under capital leases	1,174	1,318
Acquisition of intangible assets in current liabilities	1,532	1,201
Asset retirement obligation incurred and adjustments	745	372

*See the Notes to Unaudited Condensed Consolidated Financial Statements*



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**Gogo Inc. and Subsidiaries**

**Notes to Unaudited Condensed Consolidated Financial Statements**

**1. Basis of Presentation**

**The Business** - Gogo Inc. ( we , us , our ) is a holding company, which through its operating subsidiaries is a provider of in-flight connectivity and wireless in-cabin digital entertainment solutions. We operate through the following three segments: Commercial Aviation North America or CA-NA , Commercial Aviation Rest of World or CA-ROW and Business Aviation or BA . Services provided by our CA-NA and CA-ROW businesses include Passenger Connectivity, which allows passengers to connect to the Internet from their personal Wi-Fi-enabled devices; Passenger Entertainment, which offers passengers the opportunity to enjoy a broad selection of in-flight entertainment options on their personal Wi-Fi-enabled devices; and Connected Aircraft Services ( CAS ), which offers airlines connectivity for various operations and currently include, among others, real-time credit card transaction processing, electronic flight bags and real-time weather information. Services are provided by CA-NA on commercial aircraft flying routes that generally begin and end within North America, which for this purpose includes the United States, Canada and Mexico. CA-ROW provides service on commercial aircraft operated by foreign-based commercial airlines and flights outside of North America for North American-based commercial airlines. The routes included in our CA-ROW segment are those that begin and/or end outside of North America (as defined above) on which our international service is provided. BA provides in-flight Internet connectivity and other voice and data communications products and services and sells equipment for in-flight telecommunications to the business aviation market. BA services include Gogo Biz, our in-flight broadband service, Passenger Entertainment, our in-flight entertainment service, and satellite-based voice and data services through our strategic alliances with satellite companies.

**Basis of Presentation** - The accompanying unaudited condensed consolidated financial statements and notes have been prepared in accordance with accounting principles generally accepted in the United States of America ( GAAP ) and in conformity with Article 10 of Regulation S-X promulgated under the Securities Act of 1933, as amended (the Securities Act ). Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements and should be read in conjunction with our annual audited consolidated financial statements and the notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2016 as filed with the Securities and Exchange Commission ( SEC ) on February 27, 2017 (the 2016 10-K ). These unaudited condensed consolidated financial statements reflect, in the opinion of management, all material adjustments (which include normal recurring adjustments) necessary to fairly state, in all material respects, our financial position, results of operations and cash flows for the periods presented.

The results of operations and cash flows for the six month period ended June 30, 2017 are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2017.

We have one class of common stock outstanding as of June 30, 2017 and December 31, 2016.

**Use of Estimates** - The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosures of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. On an ongoing basis, management evaluates the significant estimates and bases such estimates on historical experience and on various other assumptions believed to be reasonable under the circumstances. However, actual results could differ materially from those estimates.



## **2. Recent Accounting Pronouncements**

In May 2014, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update ( ASU ) 2014-09, *Revenue From Contracts With Customers* ( ASU 2014-09 ). This pronouncement outlines a single comprehensive model to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance. The core principle of ASU 2014-09 is that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Additionally, the FASB issued several amendments to the standard, including clarification on accounting for licenses of intellectual property and identifying performance obligations. This guidance is effective for annual reporting periods beginning after December 15, 2017, including interim periods within the annual reporting periods. We will adopt this guidance as of January 1, 2018 and we expect to apply this standard using the full retrospective method. During 2016, we established a project team responsible for assessment and implementation of this guidance. While we are continuing to evaluate the impact of the adoption of this guidance on our consolidated financial statements, we currently believe



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**Gogo Inc. and Subsidiaries**

**Notes to Unaudited Condensed Consolidated Financial Statements (Continued)**

that the measurement and timing of recognition of revenue from certain of our CA-NA, CA-ROW and BA customers will be impacted in the following ways (however cash and cash equivalents will not be impacted):

Under the current standard, the sale of CA-NA and CA-ROW airborne connectivity equipment does not meet all of the requirements for being recognized as a separate unit of accounting, resulting in the deferral of the related revenue (and cost) over the life of the contract. Under the new standard, we believe airborne connectivity equipment represents a standalone performance obligation as it is both distinct and distinct within the context of the arrangement. As such, the recognition of all airborne equipment revenue will be accelerated and recognized upon installation.

Certain of our CA-NA, CA-ROW and BA contracts provide service revenue that varies based on usage by passengers and our airline customers. The adoption of this guidance will require consideration of whether service revenue under such contracts is considered an optional purchase of goods or services or variable consideration.

We are continuing to assess the treatment of costs to obtain or fulfill a contract with a customer, including costs to obtain Supplemental Type Certificates issued by the FAA that are required to install our equipment on aircraft ( STCs ), which may require capitalization and amortization over the anticipated service period.

Recognition of up-front activation fees may be accelerated as the incurrence of such fees does not contain a future material right or otherwise significantly influence whether a customer would renew its service contract.

Penalties will be accounted for as a reduction of revenue that will be recognized at the time the related performance obligation is satisfied.

In March 2016, the FASB issued ASU 2016-02, *Leases* ( ASU 2016-02 ), which introduces a lessee model that records most leases on the balance sheet. ASU 2016-02 also aligns certain underlying principles of the new lessor model with those in Accounting Standards Codification ( ASC ) 606, *Revenue from Contracts with Customers* ( ASC 606 ), the FASB's new revenue recognition standard. Furthermore, ASU 2016-02 eliminates the required use of bright-line tests used in current GAAP for determining lease classification. It also requires lessors to provide additional transparency into their exposure to the changes in value of their residual assets and how they manage that exposure. ASU 2016-02 is effective for annual reporting periods beginning after December 15, 2018, including interim periods within those annual reporting periods. We will adopt this as guidance as of January 1, 2019 and we are currently evaluating the impact of the adoption of this guidance on our consolidated financial statements.



In March 2016, the FASB issued ASU 2016-04, *Recognition of Breakage for Certain Prepaid Stored-Value Products* ( ASU 2016-04 ), which amends the guidance on extinguishing financial liabilities for certain prepaid stored-value products by requiring that entities that sell prepaid stored-value products recognize breakage proportionally as the prepaid stored-value product is being redeemed rather than immediately upon sale of the product. If an entity is unable to estimate breakage, the amount would be recognized when the likelihood becomes remote that the holder will exercise the remaining rights. Entities are required to reassess their estimates of breakage each reporting period. Any change in this estimate would be accounted for as a change in an accounting estimate. An entity that recognizes breakage is required to disclose the methodology used to recognize breakage and significant judgments made in applying the breakage methodology. ASU 2016-04 is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years, and early adoption is permitted. We can apply ASU 2016-04 by using either a modified retrospective transition approach or a full retrospective transition approach. We will adopt this as guidance as of January 1, 2018 and we are currently evaluating the impact of the adoption of this guidance on our consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, *Classification of Certain Cash Receipts and Cash Payments* ( ASU 2016-15 ), which amends ASC 230, *Statement of Cash Flows*, the FASB's standards for reporting cash flows in general-purpose financial statements. The amendments address the diversity in practice related to the classification of certain cash receipts and payments including debt prepayment or debt extinguishment costs. ASU 2016-15 is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years, and early adoption is permitted. We will adopt this guidance as of January 1, 2018 and we expect to apply this standard using the full retrospective method. We do not believe adoption of this guidance will have a material effect on our cash flows as we have historically reported debt prepayment and debt extinguishment costs in a manner consistent with ASU 2016-15.



**Table of Contents****Gogo Inc. and Subsidiaries****Notes to Unaudited Condensed Consolidated Financial Statements (Continued)**

In October 2016, the FASB issued ASU 2016-16, *Intra-Entity Transfers of Assets Other Than Inventory* ( ASU 2016-16 ), which removes the prohibition in ASC 740, *Income Taxes*, against the immediate recognition of the current and deferred income tax effects of intra-entity transfers of assets other than inventory. This is intended to reduce the complexity of GAAP and diversity in practice related to the tax consequences of certain types of intra-entity asset transfers, particularly those involving intellectual property. ASU 2016-16 is effective for annual reporting periods beginning after December 15, 2017, including interim periods within those annual reporting periods. We will adopt this guidance as of January 1, 2018 and we are currently evaluating the impact of the adoption of this guidance on our consolidated financial statements.

In November 2016, the FASB issued ASU 2016-18, *Restricted Cash – A Consensus of the FASB Emerging Issues Task Force*, ( ASU 2016-18 ), which amends ASC 230, *Statement of Cash Flows*, to clarify guidance on the classification and presentation of restricted cash in the statement of cash flows. ASU 2016-18 is effective for annual reporting periods beginning after December 15, 2017, including interim periods within those annual reporting periods. We will adopt this guidance as of January 1, 2018 and do not believe the adoption of this guidance will have a material impact on our consolidated financial statements.

In January 2017, the FASB issued ASU 2017-04, *Simplifying the Test for Goodwill Impairment* ( ASU 2017-04 ), which simplifies the accounting for goodwill impairments by eliminating Step-2 from the goodwill impairment test. ASU 2017-04 is effective for annual reporting periods beginning after December 15, 2019 and early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. We will adopt this guidance as part of our annual goodwill impairment test in October 2017 and do not believe the adoption of this guidance will have a material impact on our consolidated financial statements.

In May 2017, the FASB issued ASU 2017-09, *Scope of Modification Accounting* ( ASU 2017-09 ), which amends the scope of modification accounting for share-based payment arrangements. The ASU provides guidance on the types of changes to the terms or conditions of share-based payment awards to which an entity would be required to apply modification accounting under ASC 718, *Compensation – Stock Compensation*. Specifically, an entity would not apply modification accounting if the fair value, vesting conditions, and classification of the awards are the same immediately before and after the modification. ASU 2017-09 is effective for annual reporting periods beginning after December 15, 2017 and early adoption is permitted. We will adopt this guidance as of January 1, 2018 and do not believe the adoption of this guidance will have a material impact on our consolidated financial statements.

**3. Net Loss Per Share**

Basic and diluted net loss per share have been calculated using the weighted average number of common shares outstanding for the period. The shares of common stock effectively repurchased in connection with the Forward Transactions (as defined and described in Note 8, *Long-Term Debt and Other Liabilities* ) are considered participating securities requiring the two-class method to calculate basic and diluted earnings per share. Net earnings in future periods will be allocated between common shares and participating securities. In periods of a net loss, the shares associated with the Forward Transactions will not receive an allocation of losses, as the counterparties to the Forward Transactions are not required to fund losses. Accordingly, the calculation of weighted average shares outstanding as of



June 30, 2017 and 2016 excludes approximately 7.2 million shares that will be repurchased as a result of the Forward Transactions.

As a result of the net loss for the three and six month periods ended June 30, 2017 and 2016, all of the outstanding shares of common stock underlying stock options, deferred stock units and restricted stock units were excluded from the computation of diluted shares outstanding because they were anti-dilutive.



**Table of Contents****Gogo Inc. and Subsidiaries****Notes to Unaudited Condensed Consolidated Financial Statements (Continued)**

The following table sets forth the computation of basic and diluted earnings per share for the three and six month periods ended June 30, 2017 and 2016; however, because of the undistributed losses, the shares of common stock associated with the Forward Transactions are excluded from the computation of basic earnings per share in 2017 and 2016 as undistributed losses are not allocated to these shares (*in thousands, except per share amounts*):

	<b>For the Three Months Ended June 30,</b>		<b>For the Six Months Ended June 30,</b>	
	<b>2017</b>	<b>2016</b>	<b>2017</b>	<b>2016</b>
Net loss	\$ (44,209)	\$ (40,194)	\$ (85,576)	\$ (64,300)
Less: Participation rights of the Forward Transactions				
Undistributed losses	\$ (44,209)	\$ (40,194)	\$ (85,576)	\$ (64,300)
Weighted-average common shares outstanding-basic and diluted	79,334	78,849	79,237	78,793
Net loss attributable to common stock per share-basic and diluted	\$ (0.56)	\$ (0.51)	\$ (1.08)	\$ (0.82)

**4. Inventories**

Inventories consist primarily of telecommunications systems and parts, and are recorded at the lower of cost (average cost) or market. We evaluate the need for write-downs associated with obsolete, slow-moving, and nonsalable inventory by reviewing net realizable inventory values on a periodic basis.

Inventories as of June 30, 2017 and December 31, 2016, all of which were included within the BA segment, were as follows (*in thousands*):

	<b>June 30, 2017</b>	<b>December 31, 2016</b>
Work-in-process component parts	\$ 43,446	\$ 39,150
Finished goods	8,595	11,116
Total inventory	\$ 52,041	\$ 50,266



**5. Composition of Certain Balance Sheet Accounts**

Property and equipment as of June 30, 2017 and December 31, 2016 were as follows (*in thousands*):

	<b>June 30, 2017</b>	<b>December 31, 2016</b>
Office equipment, furniture, fixtures and other	\$ 53,009	\$ 49,529
Leasehold improvements	42,402	42,143
Airborne equipment	639,958	557,196
Network equipment	184,440	168,121
	919,809	816,989
Accumulated depreciation	(336,564)	(297,179)
Property and equipment, net	\$ 583,245	\$ 519,810

Other non-current assets as of June 30, 2017 and December 31, 2016 were as follows (*in thousands*):

	<b>June 30, 2017</b>	<b>December 31, 2016</b>
Deferred cost of equipment revenue	\$ 39,496	\$ 14,159
Deposits on satellite and airborne equipment	13,914	10,800
Other	3,147	3,129
Total other non-current assets	\$ 56,557	\$ 28,088



**Table of Contents****Gogo Inc. and Subsidiaries****Notes to Unaudited Condensed Consolidated Financial Statements (Continued)**

Accrued liabilities as of June 30, 2017 and December 31, 2016 were as follows (*in thousands*):

	<b>June 30, 2017</b>	<b>December 31, 2016</b>
Employee compensation and benefits	\$ 17,299	\$ 21,008
Airborne equipment and installation costs	36,012	22,442
Airborne partner related accrued liabilities	18,188	14,307
Accrued interest	41,399	40,436
Other	35,671	33,862
<b>Total accrued liabilities</b>	<b>\$ 148,569</b>	<b>\$ 132,055</b>

Other non-current liabilities as of June 30, 2017 and December 31, 2016 were as follows (*in thousands*):

	<b>June 30, 2017</b>	<b>December 31, 2016</b>
Deferred revenue	\$ 62,965	\$ 38,976
Deferred rent	36,831	36,538
Asset retirement obligations	9,684	8,527
Other	9,353	6,627
<b>Total other non-current liabilities</b>	<b>\$ 118,833</b>	<b>\$ 90,668</b>

**6. Intangible Assets**

Our intangible assets are comprised of both indefinite-lived and finite-lived intangible assets. Intangible assets with indefinite lives and goodwill are not amortized, but are reviewed for impairment at least annually or whenever events or circumstances indicate the carrying value of the asset may not be recoverable. We perform our annual impairment tests of our indefinite-lived intangible assets and goodwill during the fourth quarter of each fiscal year. We also reevaluate the useful life of the indefinite-lived intangible assets each reporting period to determine whether events and circumstances continue to support an indefinite useful life. The results of our annual indefinite-lived intangible assets and goodwill impairment assessments in the fourth quarter of 2016 indicated no impairment.

As of June 30, 2017 and December 31, 2016, our goodwill balance, all of which related to our BA segment, was \$0.6 million.



Our intangible assets, other than goodwill, as of June 30, 2017 and December 31, 2016 were as follows (*in thousands, except for weighted average remaining useful life*):

	Weighted						
	Average	As of June 30, 2017			As of December 31, 2016		
	Remaining	Gross		Net	Gross		Net
	Useful Life	Carrying	Accumulated	Carrying	Carrying	Accumulated	Carrying
	(in	Amount	Amortization	Amount	Amount	Amortization	Amount
	years)						
Amortized intangible assets:							
Software	2.3	\$ 135,596	\$ (80,992)	\$ 54,604	\$ 118,836	\$ (70,127)	\$ 48,709
Service customer relationship	2.8	8,081	(5,280)	2,801	8,081	(4,773)	3,308
Other intangible assets	1.5	1,500	(892)	608	1,500	(682)	818
OEM and dealer relationships		6,724	(6,724)		6,724	(6,667)	57
Total amortized intangible assets		151,901	(93,888)	58,013	135,141	(82,249)	52,892
Unamortized intangible assets:							
FCC Licenses		32,283		32,283	32,283		32,283
Total intangible assets		\$ 184,184	\$ (93,888)	\$ 90,296	\$ 167,424	\$ (82,249)	\$ 85,175

Amortization expense was \$5.8 million and \$11.6 million, respectively, for the three and six month periods ended June 30, 2017, and \$5.1 million and \$9.7 million, respectively, for the prior year periods.



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Amortization expense for each of the next five years and thereafter is estimated to be as follows (*in thousands*):

<b>Years ending December 31,</b>	<b>Amortization Expense</b>
2017 (period from July 1 to December 31)	\$ 13,151
2018	\$ 21,843
2019	\$ 12,837
2020	\$ 6,252
2021	\$ 2,277
Thereafter	\$ 1,653

Actual future amortization expense could differ from the estimated amount as a result of future investments and other factors.

**7. Warranties**

We provide warranties on parts and labor related to our products. Our warranty terms range from two to five years. Warranty reserves are established for costs that are estimated to be incurred after the sale, delivery and installation of the products under warranty. The warranty reserves are determined based on known product failures, historical experience and other available evidence, and are included in accrued liabilities in our unaudited condensed consolidated balance sheets. Our warranty reserve balance was \$2.6 million as of both June 30, 2017 and December 31, 2016.

**8. Long-Term Debt and Other Liabilities**

Long-term debt as of June 30, 2017 and December 31, 2016 was as follows (*in thousands*):

	<b>June 30, 2017</b>	<b>December 31, 2016</b>
Senior Secured Notes	\$ 594,849	\$ 525,000
Convertible Notes	301,517	292,024
<b>Total debt</b>	<b>896,366</b>	<b>817,024</b>
Less deferred financing costs	(15,995)	(16,309)
<b>Total long-term debt</b>	<b>\$ 880,371</b>	<b>\$ 800,715</b>



**Senior Secured Notes** On June 14, 2016 (the **Issue Date** ), Gogo Intermediate Holdings LLC ( **GIH** ) (a wholly owned subsidiary of Gogo Inc.) and Gogo Finance Co. Inc. (a wholly owned subsidiary of GIH) (the **Co-Issuer** and, together with GIH, the **Issuers** ), issued \$525 million aggregate principal amount of 12.500% senior secured notes due 2022 (the **Original Senior Secured Notes** ) under an Indenture, dated as of June 14, 2016 (the **Indenture** ), among the Issuers, us, as guarantor, certain subsidiaries of GIH, as guarantors (the **Subsidiary Guarantors** and, together with us, the **Guarantors** ), and U.S. Bank National Association, as trustee (in such capacity, the **Trustee** ) and as collateral agent (in such capacity, the **Collateral Agent** ). On January 3, 2017, the Issuers issued \$65 million aggregate principal amount of additional senior secured notes due 2022 (the **Additional Notes** ). The Additional Notes were issued at a price equal to 108% of their face value resulting in gross proceeds of \$70.2 million. We refer to the Original Senior Secured Notes and the Additional Notes collectively as the **Senior Secured Notes**.

As of June 30, 2017 and December 31, 2016 the outstanding principal balance of the Senior Secured Notes was \$590.0 million and \$525.0 million, respectively. The unamortized debt premium was \$4.8 million as of June 30, 2017 and the net carrying amount was \$594.8 million as of June 30, 2017. The net carrying amount was \$525.0 million as of December 31, 2016.

Interest on the Senior Secured Notes accrues at the rate of 12.500% per annum and is payable semi-annually in arrears on July 1 and January 1, commencing on January 1, 2017 (other than the Additional Notes, for which interest payments commenced on July 1, 2017). The Senior Secured Notes mature on July 1, 2022. The Additional Notes have the same terms as the Original Senior Secured Notes, except with respect to the issue date and issue price, and are treated as a single series for all purposes under the Indenture and the security documents that govern the Additional Notes and the Original Senior Secured Notes.

We paid approximately \$11.4 million and \$2.0 million, respectively, of Senior Secured Notes origination fees and financing costs related to the issuance of the Original Senior Secured Notes and the Additional Notes, which have been accounted for as deferred financing costs. The deferred financing costs on our unaudited condensed



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**Gogo Inc. and Subsidiaries**

**Notes to Unaudited Condensed Consolidated Financial Statements (Continued)**

consolidated balance sheet are being amortized over the contractual term of the Senior Secured Notes using the effective interest method. Total amortization expense was \$0.6 million and \$1.1 million, respectively, for the three and six month periods ended June 30, 2017, and \$0.1 million and \$0.1 million, respectively, for the prior year periods. As of June 30, 2017 and December 31, 2016, the balance of unamortized deferred financing costs related to the Senior Secured Notes was \$11.3 million and \$11.2 million, respectively, and is included as a reduction to long-term debt in our unaudited condensed consolidated balance sheet. See Note 9, Interest Costs for additional information.

The Senior Secured Notes are the senior secured indebtedness of the Issuers and are:

effectively senior to all of the Issuers' existing and future senior unsecured indebtedness and the Issuers' indebtedness secured on a junior priority basis by the same collateral securing the Senior Secured Notes, if any, in each case to the extent of the value of the collateral securing the Senior Secured Notes;

effectively senior in right of payment to all of the Issuers' future indebtedness that is subordinated in right of payment to the Senior Secured Notes;

effectively equal in right of payment with the Issuers' existing and future (i) unsecured indebtedness that is not subordinated in right of payment to the Senior Secured Notes and (ii) indebtedness secured on a junior priority basis by the same collateral securing the Senior Secured Notes, if any, in each case to the extent of any insufficiency in the collateral securing the Senior Secured Notes;

structurally senior to all of our existing and future indebtedness, including our Convertible Notes (as defined below); and

structurally subordinated to all of the indebtedness and other liabilities of any non-Guarantors (other than the Issuers).

The Senior Secured Notes are guaranteed, on a senior secured basis, by us and all of GIH's existing and future domestic restricted subsidiaries (other than the Co-Issuer), subject to certain exceptions. The Issuers' obligations under the Senior Secured Notes are not guaranteed by Gogo International Holdings, LLC, a subsidiary of ours that holds no material assets other than equity interests in our foreign subsidiaries. Each guarantee is a senior secured obligation of such Guarantor and is:



effectively senior to all of such Guarantor's existing and future senior unsecured indebtedness and such Guarantor's indebtedness secured on a junior priority basis by the same collateral, if any, securing the guarantee of such Guarantor, in each case to the extent of the value of the collateral securing such guarantee;

effectively senior in right of payment to all of such Guarantor's future indebtedness that is subordinated in right of payment to such Guarantor's guarantee;

effectively equal in right of payment with all of such Guarantor's existing and future (i) unsecured indebtedness that is not subordinated in right of payment to such Guarantor's guarantee, and (ii) indebtedness secured on a junior priority basis by the same collateral, if any, securing the guarantee of such Guarantor, in each case to the extent of any insufficiency in the collateral securing such guarantee; and

structurally subordinated to all indebtedness and other liabilities of any non-Guarantor subsidiary of such Guarantor (excluding, in the case of our guarantee, the Issuers).

The Senior Secured Notes and the related guarantees are secured by first-priority liens, subject to permitted liens, on substantially all of the Issuers' and the Guarantors' assets, except for certain excluded assets, including pledged equity interests of the Issuers and all of our existing and future domestic restricted subsidiaries guaranteeing the Senior Secured Notes.

The security interests in certain collateral may be released without the consent of holders of the Senior Secured Notes if such collateral is disposed of in a transaction that complies with the Indenture and related security agreements. In addition, under certain circumstances, we and the Guarantors have the right to transfer certain intellectual property assets that on the Issue Date constitute collateral securing the Senior Secured Notes or the guarantees to a restricted subsidiary organized under the laws of Switzerland, resulting in the release of such collateral without consent of the holders of the Senior Secured Notes.



**Table of Contents****Gogo Inc. and Subsidiaries****Notes to Unaudited Condensed Consolidated Financial Statements (Continued)**

On or after July 1, 2019, the Issuers may, at their option, at any time or from time to time, redeem any of the Senior Secured Notes in whole or in part. The Senior Secured Notes will be redeemable at the following redemption prices (expressed in percentages of principal amount), plus accrued and unpaid interest, if any, to (but not including) the redemption date (subject to the right of holders of record on the relevant regular record date on or prior to the redemption date to receive interest due on an interest payment date), if redeemed during the twelve-month period commencing on July 1 of the following years:

<b>Year</b>	<b>Redemption Price</b>
2019	106.250%
2020	103.125%
2021 and thereafter	100.000%

In addition, at any time prior to July 1, 2019, the Issuers may redeem up to 35% of the aggregate principal amount of the Senior Secured Notes with the proceeds of certain equity offerings at a redemption price of 112.500% of the principal amount redeemed, plus accrued and unpaid interest, if any, to (but not including) the date of redemption; provided, however, that Senior Secured Notes representing at least 65% of the principal amount of the Senior Secured Notes remain outstanding immediately after each such redemption.

The Issuers may redeem the Senior Secured Notes, in whole or in part, at any time prior to July 1, 2019, at a redemption price equal to 100% of the principal amount of the Senior Secured Notes redeemed plus the make-whole premium set forth in the Indenture as of, and accrued and unpaid interest, if any, to (but not including) the applicable redemption date.

The Indenture contains covenants that, among other things, limit the ability of the Issuers and the Subsidiary Guarantors and, in certain circumstances, our ability, to: incur additional indebtedness; pay dividends, redeem stock or make other distributions; make investments; create restrictions on the ability of our restricted subsidiaries to pay dividends to the Issuers or make other intercompany transfers; create liens; transfer or sell assets; merge or consolidate; and enter into certain transactions with the Issuers' affiliates, including us. Most of these covenants will cease to apply if, and for as long as, the Senior Secured Notes have investment grade ratings from both Moody's Investment Services, Inc. and Standard & Poor's.

If we or the Issuers undergo specific types of change of control prior to July 1, 2022, GIH is required to make an offer to repurchase for cash all of the Senior Secured Notes at a repurchase price equal to 101% of the principal amount thereof, plus accrued and unpaid interest, if any, to (but not including) the payment date.

The Indenture provides for events of default, which, if any of them occur, would permit or require the principal, premium, if any, and interest on all of the then outstanding Senior Secured Notes issued under the Indenture to be due and payable immediately. As of June 30, 2017, no event of default had occurred.



**Convertible Notes** On March 3, 2015, we issued \$340.0 million aggregate principal amount of 3.75% Convertible Senior Notes due 2020 (the "Convertible Notes") in a private offering to qualified institutional buyers, pursuant to Rule 144A under the Securities Act. We granted an option to the initial purchasers to purchase up to an additional \$60.0 million aggregate principal amount of Convertible Notes to cover over-allotments, of which \$21.9 million was subsequently exercised during March 2015, resulting in a total issuance of \$361.9 million aggregate principal amount of Convertible Notes. The Convertible Notes mature on March 1, 2020, unless earlier repurchased or converted into shares of our common stock under certain circumstances described below. Upon maturity, we have the option to settle our obligation through cash, shares of common stock, or a combination of cash and shares of common stock. We pay interest on the Convertible Notes semi-annually in arrears on March 1 and September 1 of each year. Interest payments began on September 1, 2015.

The \$361.9 million of proceeds received from the issuance of the Convertible Notes was initially allocated between long-term debt (the liability component) at \$261.9 million and additional paid-in-capital (the equity component) at \$100.0 million, within the consolidated balance sheet. The fair value of the liability component was measured using rates determined for similar debt instruments without a conversion feature. The carrying amount of the equity component, representing the conversion option, was determined by deducting the fair value of the liability component from the aggregate face value of the Convertible Notes. If we or the note holders elect not to settle the debt through conversion, we must settle the Convertible Notes at face value. Therefore, the liability component will



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**Gogo Inc. and Subsidiaries**

**Notes to Unaudited Condensed Consolidated Financial Statements (Continued)**

be accreted up to the face value of the Convertible Notes, which will result in additional non-cash interest expense being recognized in the unaudited condensed consolidated statements of operations through the Convertible Notes maturity date (see Note 9, *Interest Costs* for additional information). The effective interest rate on the Convertible Notes, including accretion of the notes to par and debt issuance cost amortization, was approximately 11.5%. The equity component will not be remeasured as long as it continues to meet the conditions for equity classification.

As of June 30, 2017 and December 31, 2016, the outstanding principal on the Convertible Notes was \$361.9 million, the unamortized debt discount was \$60.4 million and \$69.9 million, respectively, and the net carrying amount of the liability component was \$301.5 million and \$292.0 million, respectively.

We incurred approximately \$10.4 million of issuance costs related to the issuance of the Convertible Notes of which \$7.5 million and \$2.9 million were recorded to deferred financing costs and additional paid-in capital, respectively, in proportion to the allocation of the proceeds of the Convertible Notes. The \$7.5 million recorded as deferred financing costs on our unaudited condensed consolidated balance sheet is being amortized over the term of the Convertible Notes using the effective interest method. Total amortization expense of the deferred financing costs was \$0.3 million and \$0.7 million, respectively, for the three and six months periods ended June 30, 2017, and \$0.3 million and \$0.7 million, respectively, for the prior year periods. Amortization expense is included in interest expense in the unaudited condensed consolidated statements of operations. As of June 30, 2017 and December 31, 2016, the balance of unamortized deferred financing costs related to the Convertible Notes was \$4.7 million and \$5.1 million, respectively, and is included as a reduction to long-term debt in our unaudited condensed consolidated balance sheets. See Note 9, *Interest Costs* for additional information.

The Convertible Notes had an initial conversion rate of 41.9274 common shares per \$1,000 principal amount of Convertible Notes, which is equivalent to an initial conversion price of approximately \$23.85 per share of our common stock. Upon conversion, we currently expect to deliver cash up to the principal amount of the Convertible Notes then outstanding. With respect to any conversion value in excess of the principal amount, we currently expect to deliver shares of our common stock. We may elect to deliver cash in lieu of all or a portion of such shares. The shares of common stock subject to conversion are excluded from diluted earnings per share calculations under the if-converted method as their impact is anti-dilutive.

Holders may convert the Convertible Notes, at their option, in multiples of \$1,000 principal amount at any time prior to December 1, 2019, but only in the following circumstances:

during any fiscal quarter beginning after the fiscal quarter ended June 30, 2015, if the last reported sale price of our common stock for at least 20 trading days (whether or not consecutive) during the last 30 consecutive trading days of the immediately preceding fiscal quarter is greater than or equal to 130% of the conversion price of the Convertible Notes on each applicable trading day;



during the five business day period following any five consecutive trading day period in which the trading price for the Convertible Notes is less than 98% of the product of the last reported sale price of our common stock and the conversion rate for the Convertible Notes on each such trading day; or

upon the occurrence of specified corporate events.

None of the above events allowing for conversion prior to December 1, 2019 occurred during the three and six month periods ended June 30, 2017. Regardless of whether any of the foregoing circumstances occurs, a holder may convert its Convertible Notes, in multiples of \$1,000 principal amount, at any time on or after December 1, 2019 until maturity.

In addition, if we undergo a fundamental change (as defined in the indenture governing the Convertible Notes), holders may, subject to certain conditions, require us to repurchase their Convertible Notes for cash at a price equal to 100% of the principal amount of the Convertible Notes to be purchased, plus any accrued and unpaid interest. In addition, if specific corporate events occur prior to the maturity date, we will increase the conversion rate for a holder who elects to convert its Convertible Notes in connection with such a corporate event in certain circumstances.

In connection with the issuance of the Convertible Notes, we paid approximately \$140 million to enter into prepaid forward stock repurchase transactions (the "Forward Transactions") with certain financial institutions (the "Forward Counterparties"), pursuant to which we purchased approximately 7.2 million shares of common stock for settlement on or around the March 1, 2020 maturity date for the Convertible Notes, subject to the ability of each



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Forward Counterparty to elect to settle all or a portion of its Forward Transactions early. As a result of the Forward Transactions, total shareholders' equity within our unaudited condensed consolidated balance sheet was reduced by approximately \$140 million. Approximately 7.2 million shares of common stock that will be effectively repurchased through the Forward Transactions are treated as retired shares for basic and diluted EPS purposes although they remain legally outstanding.

**Amended and Restated Senior Term Facility** On July 30, 2014, GIH, Gogo Business Aviation LLC, f/k/a Aircell Business Aviation Services LLC ( "GBA" ), and Gogo LLC, as borrowers (collectively, the "Borrowers" ), entered into an Amendment and Restatement Agreement (the "Amendment" ) to the Credit Agreement dated as of June 21, 2012 and amended on April 4, 2013 (the "Amended Senior Term Facility" ) among the Borrowers, the lenders named therein, and Morgan Stanley Senior Funding, Inc., as Administrative Agent and Collateral Agent. We refer to the Amendment and the Amended Senior Term Facility collectively as the "Amended and Restated Senior Term Facility."

On June 14, 2016, the outstanding principal balance of \$287.7 million, together with accrued and unpaid interest, was paid in full, and the Amended and Restated Senior Term Facility was terminated in accordance with its terms on such date (subject to the survival of provisions expressly stated therein to survive the termination thereof). Additionally, we paid the voluntary prepayment premium of 3.0%, or \$8.6 million, and wrote off all of the remaining unamortized deferred financing costs of \$6.8 million. Both of these items are included in loss on extinguishment of debt in our unaudited condensed consolidated financial statements. See Note 6, "Long-Term Debt and Other Liabilities," in our 2016 10-K for additional information on the Amended and Restated Senior Term Facility.

We paid \$22.2 million of loan origination fees and financing costs related to the Amended and Restated Senior Term Facility, all but \$4.1 million of which were accounted for as deferred financing costs. Total amortization expense of the deferred financing costs was \$0.6 million and \$1.4 million, respectively, for the three and six month periods ended June 30, 2016. Amortization expense is included in interest expense in the unaudited condensed consolidated statements of operations. As noted above, deferred financing costs related to the Amended and Restated Senior Term Facility were written off as of June 14, 2016.

**Restricted Cash** - Our restricted cash balances were \$7.4 million and \$7.9 million, respectively, as of June 30, 2017 and December 31, 2016 and primarily consist of letters of credit. Certain of the letters of credit require us to maintain restricted cash accounts in a similar amount, and are issued for the benefit of the landlords at our current office locations in Chicago, IL, Bensenville, IL and Broomfield, CO.

**9. Interest Costs**

We capitalize a portion of our interest on funds borrowed during the active construction period of major capital projects. Capitalized interest is added to the cost of the underlying assets and amortized over the useful lives of the assets.

The following is a summary of our interest costs for the three and six month periods ended June 30, 2017 and 2016 (*in thousands*):



	<b>For the Three Months Ended June 30,</b>		<b>For the Six Months Ended June 30,</b>	
	<b>2017</b>	<b>2016</b>	<b>2017</b>	<b>2016</b>
Interest costs charged to expense	\$ 21,689	\$ 12,250	\$ 43,228	\$ 23,182
Amortization of deferred financing costs	903	995	1,799	2,163
Accretion of debt discount on Convertible Notes	4,812	4,312	9,493	8,508
Amortization of debt premium on Senior Secured Notes	(178)		(351)	
Interest expense	27,226	17,557	54,169	33,853
Interest costs capitalized to property and equipment	2	82	6	153
Interest costs capitalized to software	253	400	611	682
Total interest costs	\$ 27,481	\$ 18,039	\$ 54,786	\$ 34,688



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**Gogo Inc. and Subsidiaries**

**Notes to Unaudited Condensed Consolidated Financial Statements (Continued)**

**10. Leases**

**Arrangements with Commercial Airlines** Pursuant to contractual agreements with our airline partners, we place our equipment on commercial aircraft operated by the airlines for the purpose of delivering the Gogo service to passengers on the aircraft. There are currently two types of commercial airline arrangements: Turnkey and Airline Directed.

Under the Turnkey model, we account for equipment transactions as operating leases of space for our equipment on the aircraft. We may be responsible for the costs of installing and/or deinstalling the equipment. The majority of the equipment transactions involve the transfer of legal title but do not meet sales recognition for accounting purposes because the risks and rewards of ownership are not fully transferred due to our continuing involvement with the equipment, the length of the term of our agreements with the airlines, and restrictions in the agreements regarding the airlines' use of the equipment.

Under the Airline Directed model, which we have historically used on a limited basis, equipment transactions qualify for sale treatment due to the specific provisions of the agreement. When all the recognition conditions are met for the equipment, the sale is recognized as equipment revenue. When equipment and services are not separable, equipment revenue is deferred and recognized over the service period. For more information see Note 2, Summary of Significant Accounting Policies in our 10-K.

Under the Turnkey model, the assets are recorded as airborne equipment on our unaudited condensed consolidated balance sheets, as noted in Note 5, Composition of Certain Balance Sheet Accounts. Any upfront equipment payments are accounted for as lease incentives and recorded as deferred airborne lease incentives on our unaudited condensed consolidated balance sheets and are recognized as a reduction of the cost of service revenue on a straight-line basis over the term of the agreement with the airline. We recognized \$8.6 million and \$18.0 million, respectively, for the three and six month periods ended June 30, 2017, and \$7.2 million and \$12.9 million, respectively, for the prior year periods as a reduction to our cost of service revenue in our unaudited condensed consolidated statements of operations. As of June 30, 2017, deferred airborne lease incentives of \$35.3 million and \$117.5 million, respectively, are included in current and non-current liabilities in our unaudited condensed consolidated balance sheet. As of December 31, 2016, deferred airborne lease incentives of \$36.3 million and \$135.9 million, respectively, are included in current and non-current liabilities in our unaudited condensed consolidated balance sheet. The decrease in our deferred airborne lease incentives is due primarily to the transition in the accounting treatment for one of our airline agreements from a Turnkey model in the prior year period to an Airline Directed model in the first quarter of 2017 due to specific provisions elected by the airline.

Under the Turnkey model, the revenue share paid to our airline partners represents operating lease payments. They are deemed to be contingent rental payments, as the payments due to each airline are based on a percentage of our CA-NA and CA-ROW service revenue generated from that airline's passengers, which is unknown until realized. Therefore, we cannot estimate the lease payments due to an airline at the commencement of our contract with such airline. This rental expense is included in cost of service revenue and is partially offset by the amortization of the deferred airborne lease incentives discussed above. Such rental expenses totaled a net charge of \$10.2 million and \$19.1 million, respectively, for the three and six month periods ended June 30, 2017, and \$10.8 million and \$22.2 million, respectively, for the prior year periods.



A contract with one of our airline partners requires us to provide the airline partner with cash rebates of \$1.8 million in June 2017 and June 2018. We paid the 2017 rebate on June 13, 2017.

**Leases and Cell Site Contracts** We have lease agreements relating to certain facilities and equipment, which are considered operating leases. Rent expense for such operating leases was \$3.0 million and \$6.0 million, respectively, for the three and six month periods ended June 30, 2017, and \$2.9 million and \$6.0 million, respectively, for the prior year periods. Additionally, we have operating leases with wireless service providers for tower space and base station capacity on a volume usage basis ( cell site leases ), some of which provide for minimum annual payments. Our cell site leases generally provide for an initial noncancelable term with various renewal options. Total cell site rental expense was \$2.4 and \$4.7 million, respectively, for the three and six month periods ended June 30, 2017, and \$2.4 million and \$4.7 million, respectively, for the prior year periods.



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Annual future minimum obligations for operating leases for each of the next five years and thereafter, other than the arrangements we have with our commercial airline partners, as of June 30, 2017, are as follows (*in thousands*):

<b>Years ending December 31,</b>	<b>Operating Leases</b>
2017 (period from July 1 to December 31)	\$ 9,790
2018	\$ 17,836
2019	\$ 16,747
2020	\$ 14,662
2021	\$ 14,423
Thereafter	\$ 95,061

**Equipment Leases** We lease certain computer and network equipment under capital leases, for which interest has been imputed with annual interest rates in an approximate range of 8% to 14%. As of June 30, 2017 and December 31, 2016 the computer equipment leases were classified as part of office equipment, furniture, and fixtures and other in our unaudited condensed consolidated balance sheet at a gross cost of \$5.1 million and \$3.9 million, respectively. As of June 30, 2017 and December 31, 2016, the network equipment leases were classified as part of network equipment in our unaudited condensed consolidated balance sheet at a gross cost of \$7.5 million and \$7.5 million, respectively. Annual future minimum obligations under capital leases for each of the next five years and thereafter, as of June 30, 2017, are as follows (*in thousands*):

<b>Years ending December 31,</b>	<b>Capital Leases</b>
2017 (period from July 1 to December 31)	\$ 1,851
2018	2,030
2019	1,016
2020	39
Thereafter	
Total minimum lease payments	4,936
Less: Amount representing interest	(509)
Present value of net minimum lease payments	\$ 4,427

The \$4.4 million present value of net minimum lease payments as of June 30, 2017 has a current portion of \$2.6 million included in the current portion of long-term debt and capital leases and a non-current portion of \$1.8 million included in other non-current liabilities.



## **11. Commitments and Contingencies**

**Contractual Commitments** - We have agreements with vendors to provide us with transponder and teleport satellite services. These agreements vary in length and amount and as of June 30, 2017 commit us to purchase transponder and teleport satellite services totaling approximately \$41.7 million in 2017 (July 1 through December 31), \$72.9 million in 2018, \$79.1 million in 2019, \$85.4 million in 2020, \$75.9 million in 2021 and \$303.0 million thereafter.

We have agreements with various vendors under which we have remaining commitments to purchase satellite-based systems, certifications and development services. Such commitments will become payable as we receive the equipment or certifications, or as development services are provided.

**Damages and Penalties** - We have entered into a number of agreements with our airline partners that require us to provide a credit or pay penalties or liquidated damages to our airline partners if we are unable to install our equipment on aircraft by specified timelines or fail to comply with service level commitments. The maximum amount of future credits or payments we could be required to make under these agreements is uncertain because the amount of future credits or payments is based on certain variable inputs.

**Indemnifications and Guarantees** - In accordance with Delaware law, we indemnify our officers and directors for certain events or occurrences while the officer or director is, or was, serving at our request in such capacity. The maximum potential amount of future payments we could be required to make under this indemnification is uncertain and may be unlimited, depending upon circumstances. However, our Directors and Officers insurance does provide coverage for certain of these losses.



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**Gogo Inc. and Subsidiaries**

**Notes to Unaudited Condensed Consolidated Financial Statements (Continued)**

In the ordinary course of business we may occasionally enter into agreements pursuant to which we may be obligated to pay for the failure of performance of others, such as the use of corporate credit cards issued to employees. Based on historical experience, we believe that the risk of sustaining any material loss related to such guarantees is remote.

We have entered into a number of agreements, including our agreements with commercial airlines, pursuant to which we indemnify the other party for losses and expenses suffered or incurred in connection with any patent, copyright, or trademark infringement or misappropriation claim asserted by a third party with respect to our equipment or services. The maximum potential amount of future payments we could be required to make under these indemnification agreements is uncertain and is typically not limited by the terms of the agreements.

**12. Fair Value of Financial Assets and Liabilities**

A three-tier fair value hierarchy has been established which prioritizes the inputs used in measuring fair value. These tiers include:

*Level 1* - defined as observable inputs such as quoted prices in active markets;

*Level 2* - defined as observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, or inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities; and

*Level 3* - defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions.

*Long-Term Debt:*

Our financial assets and liabilities that are disclosed but not measured at fair value include the Senior Secured Notes and the Convertible Notes, which are reflected on the unaudited condensed consolidated balance sheet at cost. The fair value measurements are classified as Level 2 within the fair value hierarchy since they are based on quoted market prices of our instruments in markets that are not active. We estimated the fair value of the Senior Secured Notes and Convertible Notes by calculating the upfront cash payment a market participant would require to assume these obligations. The upfront cash payment used in the calculations of fair value on our June 30, 2017 unaudited condensed consolidated balance sheet, excluding any issuance costs, is the amount that a market participant would be willing to lend at June 30, 2017 to an entity with a credit rating similar to ours and achieve sufficient cash inflows to cover the scheduled cash outflows under the Senior Secured Notes and the Convertible Notes. The calculated fair value of our Convertible Notes is highly correlated to our stock price and as a result significant changes to our stock price could have a significant impact on the calculated fair value of our Convertible Notes.



The fair value and carrying value of long-term debt as of June 30, 2017 and December 31, 2016 were as follows (*in thousands*):

	<b>June 30, 2017</b>		<b>December 31, 2016</b>	
	<b>Fair Value <sup>(1)</sup></b>	<b>Carrying Value</b>	<b>Fair Value <sup>(1)</sup></b>	<b>Carrying Value</b>
Senior Secured Notes	\$ 673,000	\$ 594,849 <sup>(2)</sup>	\$ 572,000	\$ 525,000
Convertible Notes	330,000	301,517 <sup>(3)</sup>	275,000	292,024 <sup>(3)</sup>

- (1) Fair value amounts are rounded to the nearest million.
- (2) Carrying value of the Senior Secured Notes includes unamortized debt premium of \$4.8 million as of June 30, 2017. See Note 8, Long-Term Debt and Other Liabilities, for further information.
- (3) Carrying value of the Convertible Notes excludes unamortized debt discount of \$60.4 million and \$69.9 million, respectively, as of June 30, 2017 and December 31, 2016. See Note 8, Long-Term Debt and Other Liabilities, for further information.

We have held-to-maturity financial instruments where carrying value approximates fair value. There were no fair value adjustments to these financial instruments during 2017 and 2016.

### 13. Income Tax

The effective income tax rates for the three and six month periods ended June 30, 2017 was (0.8%) and (0.7%), respectively, and (0.6%) and (0.8%), respectively, for the prior year periods. Income tax expense recorded in each



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**Gogo Inc. and Subsidiaries**

**Notes to Unaudited Condensed Consolidated Financial Statements (Continued)**

period was similar, with differences in pre-tax income causing the change in the effective tax rate. The difference between our effective tax rates and the U.S. federal statutory rate of 35% for the three and six month periods ended June 30, 2017 and 2016 was primarily due to the recording of a valuation allowance against our net deferred tax assets.

We are subject to income taxation in the United States, various states within the United States, Canada, Switzerland, Japan, Mexico, Brazil, Singapore, the United Kingdom, Hong Kong and Australia. With few exceptions, as of June 30, 2017, we are no longer subject to U.S. federal, state, local or foreign examinations by tax authorities for years before 2013.

We record penalties and interest relating to uncertain tax positions in the income tax provision line item in the unaudited condensed consolidated statement of operations. No penalties or interest related to uncertain tax positions were recorded for the three and six month periods ended June 30, 2017 and 2016. As of June 30, 2017 and December 31, 2016, we did not have a liability recorded for interest or potential penalties.

We do not expect a change in the unrecognized tax benefits within the next 12 months.

**14. Business Segments and Major Customers**

We operate our business through three operating segments: Commercial Aviation North America, or CA-NA, Commercial Aviation Rest of World, or CA-ROW and Business Aviation, or BA. See Note 1, Basis of Presentation, for further information regarding our segments.

The accounting policies of the operating segments are the same as those described in Note 2, Summary of Significant Accounting Policies, in our 2016 10-K. Intercompany transactions between segments are excluded as they are not included in management's performance review of the segments. We currently do not generate a material amount of foreign revenue. We do not segregate assets between segments for internal reporting. Therefore, asset-related information has not been presented. We do not disclose assets outside of the United States as these assets are not material as of June 30, 2017 and December 31, 2016. For our airborne assets, we consider only those assets installed in aircraft associated with international commercial airline partners to be owned outside of the United States.

Management evaluates performance and allocates resources to each segment based on segment profit (loss), which is calculated internally as net income (loss) attributable to common stock before interest expense, interest income, income taxes, depreciation and amortization, certain non-cash charges (including amortization of deferred airborne lease incentives, stock-based compensation expense and adjustment to deferred financing costs) and other income (expense). Segment profit (loss) is a measure of performance reported to the chief operating decision maker for purposes of making decisions about allocating resources to the segments and evaluating segment performance. In addition, segment profit (loss) is included herein in conformity with ASC 280-10, *Segment Reporting*. Management believes that segment profit (loss) provides useful information for analyzing and evaluating the underlying operating results of each segment. However, segment profit (loss) should not be considered in isolation or as a substitute for net income (loss) attributable to common stock or other measures of financial performance prepared in accordance with



GAAP. Additionally, our computation of segment profit (loss) may not be comparable to other similarly titled measures computed by other companies.

Information regarding our reportable segments is as follows (*in thousands*):

	<b>For the Three Months Ended June 30, 2017</b>			
	<b>CA-NA</b>	<b>CA-ROW</b>	<b>BA</b>	<b>Total</b>
Service revenue	\$ 98,679	\$ 13,188	\$ 42,209	\$ 154,076
Equipment revenue	2,272	885	15,567	18,724
<b>Total revenue</b>	<b>\$ 100,951</b>	<b>\$ 14,073</b>	<b>\$ 57,776</b>	<b>\$ 172,800</b>
Segment profit (loss)	\$ 16,191	\$ (31,403)	\$ 25,202	\$ 9,990



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	<b>For the Three Months Ended June 30, 2016</b>			
	<b>CA-NA</b>	<b>CA-ROW</b>	<b>BA</b>	<b>Total</b>
Service revenue	\$ 89,808	\$ 5,376	\$ 32,403	\$ 127,587
Equipment revenue	2,879	368	16,705	19,952
<b>Total revenue</b>	<b>\$ 92,687</b>	<b>\$ 5,744</b>	<b>\$ 49,108</b>	<b>\$ 147,539</b>
Segment profit (loss)	\$ 18,641	\$ (23,300)	\$ 19,016	\$ 14,357

	<b>For the Six Months Ended June 30, 2017</b>			
	<b>CA-NA</b>	<b>CA-ROW</b>	<b>BA</b>	<b>Total</b>
Service revenue	\$ 195,824	\$ 22,556	\$ 82,191	\$ 300,571
Equipment revenue	3,943	1,803	31,889	37,635
<b>Total revenue</b>	<b>\$ 199,767</b>	<b>\$ 24,359</b>	<b>\$ 114,080</b>	<b>\$ 338,206</b>
Segment profit (loss)	\$ 27,350	\$ (57,958)	\$ 51,317	\$ 20,709

	<b>For the Six Months Ended June 30, 2016</b>			
	<b>CA-NA</b>	<b>CA-ROW</b>	<b>BA</b>	<b>Total</b>
Service revenue	\$ 173,217	\$ 9,978	\$ 63,112	\$ 246,307
Equipment revenue	6,517	371	36,090	42,978
<b>Total revenue</b>	<b>\$ 179,734</b>	<b>\$ 10,349</b>	<b>\$ 99,202</b>	<b>\$ 289,285</b>
Segment profit (loss)	\$ 32,457	\$ (43,021)	\$ 39,240	\$ 28,676

A reconciliation of segment profit (loss) to the relevant consolidated amounts is as follows (*in thousands*):

	<b>For the Three Months Ended June 30,</b>		<b>For the Six Months Ended June 30,</b>	
	<b>2017</b>	<b>2016</b>	<b>2017</b>	<b>2016</b>
CA-NA segment profit	\$ 16,191	\$ 18,641	\$ 27,350	\$ 32,457
CA-ROW segment loss	(31,403)	(23,300)	(57,958)	(43,021)
BA segment profit	25,202	19,016	51,317	39,240



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Total segment profit	9,990	14,357	20,709	28,676
Interest income	771	166	1,316	212
Interest expense	(27,226)	(17,557)	(54,169)	(33,853)
Depreciation and amortization	(30,562)	(24,906)	(60,997)	(49,263)
Amortization of deferred airborne lease incentives <sup>(1)</sup>	8,630	7,241	17,978	12,885
Stock-based compensation expense	(5,394)	(3,788)	(9,724)	(7,986)
Adjustment to deferred financing costs		(77)		792
Loss of extinguishment of debt		(15,406)		(15,406)
Other income (expense)	(56)	(3)	(94)	171
Loss before income taxes	\$ (43,847)	\$ (39,973)	\$ (84,981)	\$ (63,772)