Gogo Inc.
Form 10-Q
August 08, 2018

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, 2018

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	**27-1650905**
(State or other jurisdiction of	**(I.R.S. Employer**
Incorporation or Organization)	**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 August 6, 2018, 87,351,448 shares of $0.0001 par value common stock were outstanding.

Gogo Inc.

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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)

	June 30, 2018	December 31, 2017
Assets		
Current assets:		
Cash and cash equivalents	$ 140,420	$ 196,356
Short-term investments	123,191	212,792
Total cash, cash equivalents and short-term investments	263,611	409,148
Accounts receivable, net of allowances of $664 and $587, respectively	141,134	117,896
Inventories	178,506	45,543
Prepaid expenses and other current assets	35,092	20,310
Total current assets	618,343	592,897
Non-current assets:		
Property and equipment, net	532,148	656,038
Goodwill and intangible assets, net	83,078	87,133
Other non-current assets	70,739	67,107
Total non-current assets	685,965	810,278
Total assets	$ 1,304,308	$ 1,403,175
Liabilities and Stockholders deficit		
Current liabilities:		
Accounts payable	$ 37,257	$ 27,130
Accrued liabilities	205,018	201,815
Deferred revenue	37,275	43,448
Deferred airborne lease incentives	27,207	42,096
Current portion of capital leases	1,442	1,789
Total current liabilities	308,199	316,278
Non-current liabilities:		
Long-term debt	1,012,155	1,000,868
Deferred airborne lease incentives	128,279	142,938
Other non-current liabilities	83,887	134,655

Total non-current liabilities	1,224,321	1,278,461
Total liabilities	1,532,520	1,594,739
Commitments and contingencies (Note 12)		
Stockholders deficit		
Common stock, par value $0.0001 per share; 500,000,000 shares authorized at June 30, 2018 and December 31, 2017; 87,471,813 and 87,062,578 shares issued at June 30, 2018 and December 31, 2017, respectively; and 87,351,300 and 86,843,928 shares outstanding at June 30, 2018 and December 31, 2017, respectively	9	9
Additional paid-in-capital	907,071	898,729
Accumulated other comprehensive loss	(3,146)	(933)
Accumulated deficit	(1,132,146)	(1,089,369)
Total stockholders deficit	(228,212)	(191,564)
Total liabilities and stockholders deficit	$ 1,304,308	$ 1,403,175

See the Notes to Unaudited Condensed Consolidated Financial Statements

Gogo Inc. and Subsidiaries

Unaudited Condensed Consolidated Statements of Operations

(in thousands, except per share amounts)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2018	2017	2018	2017
Revenue:				
Service revenue	$ 159,056	$ 154,076	$ 309,734	$ 300,571
Equipment revenue	68,402	18,724	149,549	37,635
Total revenue	227,458	172,800	459,283	338,206
Operating expenses:				
Cost of service revenue (exclusive of items shown below)	73,650	69,127	148,597	133,940
Cost of equipment revenue (exclusive of items shown below)	64,350	14,649	116,643	26,297
Engineering, design and development	28,409	35,685	58,186	71,949
Sales and marketing	15,427	16,564	31,328	30,959
General and administrative	21,133	23,549	46,292	46,098
Depreciation and amortization	31,938	30,562	67,857	60,997
Total operating expenses	234,907	190,136	468,903	370,240
Operating loss	(7,449)	(17,336)	(9,620)	(32,034)
Other (income) expense:				
Interest income	(1,328)	(771)	(2,404)	(1,316)
Interest expense	30,641	27,226	61,195	54,169
Other (income) expense	374	56	(131)	94
Total other expense	29,687	26,511	58,660	52,947
Loss before income taxes	(37,136)	(43,847)	(68,280)	(84,981)
Income tax provision (benefit)	71	362	(3,654)	595
Net loss	$ (37,207)	$ (44,209)	$ (64,626)	$ (85,576)
Net loss attributable to common stock per share basic and diluted	$ (0.47)	$ (0.56)	$ (0.81)	$ (1.08)
Weighted average number of shares basic and diluted	79,783	79,334	79,718	79,237

See the Notes to Unaudited Condensed Consolidated Financial Statements

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Gogo Inc. and Subsidiaries

Unaudited Condensed Consolidated Statements of Comprehensive Loss

(in thousands)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2018	**2017**	**2018**	**2017**
Net loss	$ (37,207)	$ (44,209)	$ (64,626)	$ (85,576)
Currency translation adjustments	(1,379)	264	(2,213)	490
Comprehensive loss	$ (38,586)	$ (43,945)	$ (66,839)	$ (85,086)

See the Notes to Unaudited Condensed Consolidated Financial Statements

Gogo Inc. and Subsidiaries

Unaudited Condensed Consolidated Statements of Cash Flows

(in thousands)

	For the Six Months Ended June 30, 2018	2017
Operating activities:		
Net loss	$ (64,626)	$ (85,576)
Adjustments to reconcile net loss to cash (used in) provided by operating activities:		
Depreciation and amortization	67,857	60,997
Loss on asset disposals, abandonments and write-downs	6,529	3,477
Gain on transition to airline-directed model	(21,551)	
Deferred income taxes	(3,911)	527
Stock-based compensation expense	8,599	9,724
Amortization of deferred financing costs	2,083	1,799
Accretion and amortization of debt discount and premium	9,204	9,142
Changes in operating assets and liabilities:		
Accounts receivable	(23,522)	(13,316)
Inventories	(6,223)	(1,775)
Prepaid expenses and other current assets	(4,472)	4,468
Contract assets	(14,469)	
Accounts payable	9,263	1,444
Accrued liabilities	6,498	2,565
Deferred airborne lease incentives	(2,986)	6,374
Deferred revenue	1,223	5,024
Accrued interest		963
Warranty reserves	5,355	57
Other non-current assets and liabilities	(3,880)	(3,506)
Net cash (used in) provided by operating activities	(29,029)	2,388
Investing activities:		
Purchases of property and equipment	(103,599)	(128,892)
Acquisition of intangible assets capitalized software	(11,567)	(16,851)
Purchases of short-term investments	(39,323)	(193,845)
Redemptions of short-term investments	128,924	249,081
Net cash used in investing activities	(25,565)	(90,507)
Financing activities:		
Proceeds from the issuance of senior secured notes		70,200
Payment of issuance costs		(1,485)
Payments on capital leases	(1,187)	(1,540)
Stock-based compensation activity	(257)	(759)

Net cash provided by (used in) financing activities	(1,444)	66,416
Effect of exchange rate changes on cash	(373)	317
Decrease in cash, cash equivalents and restricted cash	(56,411)	(21,386)
Cash, cash equivalents and restricted cash at beginning of period	203,729	125,189
Cash, cash equivalents and restricted cash at end of period	$ 147,318	$ 103,803
Cash, cash equivalents and restricted cash at end of period	$ 147,318	$ 103,803
Less: current restricted cash	1,738	514
Less: non-current restricted cash	5,160	6,873
Cash and cash equivalents at end of period	$ 140,420	$ 96,416
Supplemental Cash Flow Information:		
Cash paid for interest	$ 49,911	$ 42,698
Cash paid for taxes	374	24
Noncash Investing and Financing Activities:		
Purchases of property and equipment in current liabilities	$ 19,001	$ 48,721
Purchases of property and equipment paid by commercial airlines	4,816	5,917
Purchases of property and equipment under capital leases	279	1,174
Acquisition of intangible assets in current liabilities	955	1,532
Asset retirement obligation incurred and adjustments	516	745

See the Notes to Unaudited Condensed Consolidated Financial Statements

Gogo Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements

1. Basis of Presentation

The Business - Gogo (we , us , our) is the global leader in providing broadband connectivity solutions and wireless in-flight entertainment to the aviation industry. 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, 2017 as filed with the Securities and Exchange Commission (SEC) on February 22, 2018 (the 2017 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 three and six month periods ended June 30, 2018 are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2018.

We have one class of common stock outstanding as of June 30, 2018 and December 31, 2017.

Reclassifications - To conform with the current year presentation, certain amounts in our unaudited condensed consolidated statement of cash flows for the six month period ended June 30, 2017 have been reclassified. Specifically, accrued airline revenue share of $27 thousand and current deferred rent of $181 thousand have been combined with accrued liabilities and non-current deferred rent of $284 thousand has been combined with other non-current assets and liabilities. Additionally, warranty reserves are now separately stated in its own line, which was included within accrued liabilities previously.

Transition to airline-directed model - The accounting treatment for one of our airline agreements transitioned from our turnkey model to our airline-directed model in January 2018 due to specific provisions elected by the airline that resulted in the transfer of control of the previously installed connectivity equipment. Upon transition to the airline-directed model, the net book value of all previously delivered equipment classified within property and equipment was reclassified to cost of equipment revenue. Additionally, the unamortized proceeds previously received for equipment and classified within current and non-current deferred airborne lease incentives were eliminated and included as part of estimated contract value, which was then allocated amongst the various performance obligations under the agreement. The value allocated to previously delivered equipment was immediately recognized as equipment revenue in our unaudited condensed consolidated financial statements; refer to Note 3, Revenue Recognition, for additional disclosures relating to the allocation of consideration among identified performance obligations. For amounts recognized in equipment revenue that were in excess of the amounts billed, we recorded current and non-current contract assets included within prepaid expenses and other current assets and other non-current assets, respectively; refer to Note 3, Revenue Recognition, for additional details. In connection with the transition of this airline agreement to the airline-directed model, we also established warranty reserves related to previously sold equipment that are still under a warranty period, which is included

Gogo Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

within accrued liabilities. See Note 8, Warranties, for additional information. This transition from the turnkey model to the airline-directed model occurred on January 4, 2018 and the total financial statement effect on our unaudited condensed consolidated balance sheet and unaudited condensed consolidated statement of operations was as follows (*in thousands*):

	Increase (decrease)
Unaudited condensed consolidated balance sheet	
Prepaid expense and other current assets	$ 6,603
Property and equipment, net	(32,716)
Other non-current assets	18,783
Accrued liabilities	2,000
Current deferred airborne lease incentive	(13,592)
Non-current deferred airborne lease incentive	(17,289)
Unaudited condensed consolidated statement of operations	
Equipment revenue	45,396
Cost of equipment revenue	23,845

During the second quarter 2018, we identified an additional $2.2 million of property and equipment, net that should have been included in the transition adjustments as of January 1, 2018. The schedule above reflects the additional adjustment.

Use of Estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (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 revenues 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

Revenue recognition related new pronouncements:

On January 1, 2018, we adopted Accounting Standards Codification Topic 606, *Revenue From Contracts With Customers* (ASC 606) using the modified retrospective method. As a result, we recognized the cumulative effect of initially applying ASC 606 as an adjustment to the opening balance of retained earnings as of January 1, 2018. Our historical financial statements have not been restated and continue to be reported under the revenue accounting standard in effect for those periods.

Prior to the adoption of ASC 606, equipment revenue (and related cost) under some of our CA-NA and CA-ROW segment contracts was deferred and recognized over the life of the contract as the equipment and connectivity services did not meet the requirements to be treated as separate units of accounting. Under ASC 606, these same equipment transactions qualify as standalone performance obligations and, therefore, equipment revenue (and related cost) is recognized upon acceptance by our airline customers. Adoption of the new standard did not materially affect the amount or timing of equipment revenue recognized from our BA segment. Our service revenue across all segments continues to be recognized as the services are provided to customers.

In conjunction with the adoption of ASC 606, we also adopted Accounting Standard Codification Subtopic 340-40, *Other Assets and Deferred Costs Contracts with Customers* (ASC 340-40), which requires the capitalization of costs incurred to obtain or fulfill a contract with a customer. Prior to the adoption of ASC 340-40, we expensed all fulfillment and other costs associated with airline-directed contracts, which were comprised predominantly of costs incurred to obtain supplemental type certificates (STCs); these costs are now required to be capitalized and amortized to expense over the life of the contract (and are included within engineering, design and development in our unaudited condensed consolidated financial statements). Costs associated with our turnkey contracts are not eligible for capitalization under ASC 340-40 and will continue to be expensed as incurred.

Gogo Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

The cumulative effect of the adoption of ASC 606 and ASC 340-40 to our unaudited condensed consolidated balance sheet as of January 1, 2018 was as follows (*in thousands)*:

	Balance at December 31, 2017	Impact of ASC 606	Balances with Adoption of ASC 606
Assets			
Inventories	$ 45,543	$ 974	$ 46,517
Prepaid expenses and other current assets	20,310	603	20,913
Property and equipment, net	656,038	(5,282)	650,756
Other non-current assets	67,107	(30,006)	37,101
Liabilities			
Current deferred revenue	43,448	(7,182)	36,266
Other non-current liabilities	134,655	(48,378)	86,277
Equity			
Accumulated deficit	(1,089,369)	21,849	(1,067,520)

During the second quarter 2018, we identified an additional $2.3 million of property and equipment, net that should have been recorded to accumulated deficit in the transition adjustments as of January 1, 2018. The schedule above reflects the additional adjustment.

See Note 3, Revenue Recognition, for additional information.

On January 1, 2018, we adopted 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. Adoption of this standard did not have a material impact on our consolidated financial statements.

All other new pronouncements:

In March 2016, the Financial Accounting Standards Board (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 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. ASU 2016-02 required entities to adopt the new leases standard using a modified retrospective method and initially apply the related guidance at the beginning of the earliest period presented in the financial statements. During July 2018, the FASB issued ASU 2018-11, which allows for an additional and optional transition method under which an entity would record a cumulative-effect adjustment at the beginning of the period of adoption. The primary impact of ASU 2016-02 relates to our leases with wireless service providers for tower space and base station capacity, and our leases of facilities and equipment. See Note 11, Leases, for further information on our lease arrangements. 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.

On January 1, 2018, we adopted 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 standard for reporting cash flows in general-purpose financial statements. The amendment addresses the diversity in practice related to the classification of certain cash receipts and payments including debt prepayment or debt extinguishment costs. We adopted this guidance using the full retrospective method, which did not have a material impact on our consolidated financial statements as we have historically reported debt prepayment and debt extinguishment costs in a manner consistent with ASU 2016-15.

On January 1, 2018, we adopted 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. Adoption of this standard did not have a material impact on our consolidated financial statements.

Gogo Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

On January 1, 2018, we adopted 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 using the full retrospective method. Adoption of this standard did not have a material impact on our consolidated financial statements. See our unaudited condensed consolidated statements of cash flows for the reconciliation of cash presented in the statements of cash flows to the cash presented on the balance sheet.

On January 1, 2018, we adopted 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. Adoption of this standard did not have a material impact on our consolidated financial statements.

In February 2018, the FASB issued ASU 2018-02, *Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income* (ASU 2018-02), which permits entities to reclassify tax effects stranded in accumulated other comprehensive income as a result of tax reform to retained earnings. Companies that elect to reclassify these amounts must reclassify stranded tax effects for all items accounted for in accumulated other comprehensive income. ASU 2018-02 is effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted. We are currently assessing the impact of ASU 2018-02 on our consolidated financial statements and related disclosures.

In June 2018, the FASB issued ASU 2018-07, *Improvements to Nonemployee Share-Based Payment Accounting* (ASU 2018-07), which expands the scope of ASC 718, *Compensation Stock Compensation*, to include share-based payment transactions for acquiring goods or services from nonemployees. ASU 2018-07 is effective for fiscal years beginning after December 15, 2018 and interim periods within those fiscal years. Early adoption is permitted. We are currently assessing the impact of ASU 2018-07 on our consolidated financial statements and related disclosures.

3. Revenue Recognition

Our revenue is primarily earned from providing connectivity and entertainment services and through sales of equipment. Additionally, to a lesser extent, we earn revenue from providing ancillary services, including installation and Connected Aircraft Services (CAS).

We determine revenue recognition through the following steps:

Identification of the contract, or contracts, with a customer

Identification of the performance obligations in the contract

Determination of the transaction price

Allocation of the transaction price to the performance obligations in the contract

Recognition of revenue as we satisfy the performance obligations

For CA-NA and CA-ROW, pursuant to contractual agreements with our airline partners, we place our equipment on commercial aircraft operated by the airlines in order to deliver our service to passengers on the aircraft. We currently have two types of commercial airline arrangements: turnkey and airline-directed. Under the airline-directed model, we have transferred control of the equipment to the airline and therefore the airline is our customer in these transactions. Under the turnkey model, we have not transferred control of our equipment to our airline partner and, as a result, the airline passenger is deemed to be our customer. Transactions with our airline partners under the turnkey model are accounted for as an operating lease of space on an aircraft. See Note 11, Leases, for additional information on the turnkey model.

Gogo Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

CA-NA and CA-ROW Service Revenue:

CA-NA and CA-ROW revenue consists of service revenue primarily derived from connectivity services, and, to a lesser extent, from entertainment services and CAS. Connectivity is provided to our customers using both our ATG and satellite technologies.

Airline-directed connectivity revenue:

As noted above, under the airline-directed model, the airline is our customer and we earn service revenue as connectivity services are consumed directly by the airline or indirectly by passengers.

Turnkey connectivity revenue (passenger connectivity):

Under the turnkey model, passenger connectivity revenue is generated by services paid for by passengers, airlines and third parties.

Passenger paid revenue represents point-of-sale sessions (which may be flight-based, time-based, multiple individual session packages (multi-pack) and subscriptions). Flight-based, time-based and multi-pack revenue is recognized when the sessions are used. Subscription revenue is recognized evenly throughout the subscription period, regardless of the number of times the customer uses the network.

Third party and airline paid revenue is generated by sales of connectivity services to airlines or third parties in sponsorship, wholesale, enterprise and roaming arrangements. Sponsorship revenue is recognized over the sponsorship term. Revenue from wholesale, enterprise and roaming arrangements is recognized as sessions are used by the passenger.

Entertainment revenue:

Entertainment revenue consists of entertainment services we provide to the airline for use by its passengers. Revenue is recognized as the services are provided to the airline.

CAS:

CAS includes, among other things, real-time credit card transaction processing, electronic flight bags and real-time weather information. Revenue is recognized as the service is provided.

BA Service Revenue:

BA service revenue primarily consists of monthly subscription and usage fees paid by aircraft owners and operators for telecommunication, data, and in-flight entertainment services. Revenue is recognized as the services are provided to the customer.

Equipment Revenue:

Equipment revenue primarily consists of the sale of ATG and satellite connectivity equipment and the sale of entertainment equipment. CA-NA and CA-ROW recognize equipment revenue upon acceptance by our airline customers. BA recognizes equipment revenue when the equipment is shipped to OEMs and dealers.

Equipment revenue also includes revenue generated by the installation of the connectivity or entertainment equipment on commercial aircraft, which is recognized when the installation is complete.

Contract price and allocation considerations:

Our CA-NA and CA-ROW airline-directed contracts contain multiple performance obligations, which primarily include the sale of equipment, installation services, connectivity services and entertainment services. For these contracts, we account for each distinct good or service as a separate performance obligation. We allocate the contract s transaction price to each performance obligation using the relative standalone selling price, which is based on the actual selling price for any good or service sold separately to a similar class of customer, if available. To the extent a good or service is not sold separately, we use our best estimate of the standalone selling price and maximize the use of observable inputs. The primary method we use to estimate the standalone selling price is the expected cost-plus margin approach.

The contractual consideration used for allocation purposes includes connectivity and entertainment services, which may be based on a fixed monthly fee per aircraft or a variable fee based on the volume of connectivity activity, or a combination of both. Examples of variable consideration within our contracts include megabyte overages and pay-per-use sessions. We constrain our estimates to reduce the probability of a significant revenue reversal in future periods, allocate such variable consideration to the identified performance obligations and recognize revenue in the period the services are provided. Our estimates are based on historical experience, anticipated future performance, market conditions and our best judgment at the time.

Gogo Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

A significant change in one or more of these estimates could affect our estimated contract value, and we regularly review and update our estimates and recognize adjustments under the cumulative catch-up method. Any adjustment under this method is recorded as a cumulative adjustment in the period identified and revenue for future periods is recognized using the new adjusted estimate.

As of June 30, 2018, the aggregate amount of the transaction price in our contracts allocated to the remaining unsatisfied performance obligations is approximately $966 million, most of which relates to our commercial aviation contracts. Approximately $187 million represents future equipment revenue that is expected to be recognized within the next one to three years. The remaining $779 million primarily represents connectivity and entertainment service revenues which are recognized as services are provided, which is expected to occur through the remaining term of the contract (approximately 5-10 years). We have excluded from this amount: all variable consideration derived from our connectivity or entertainment services that is allocated entirely to our performance of obligations related to such services; consideration from contracts that have an original duration of one year or less; revenue from passenger service on airlines operating under the turnkey model; and revenue from contracts that have been executed but under which have not yet met the accounting definition of a contract since the airline has not yet determined which products in our portfolio it wishes to select, and, as a result we are unable to determine which products and services will be transferred to the customer.

Disaggregation of revenue

The following table presents our revenue disaggregated by category *(in thousands)*:

	For the Three Months Ended June 30, 2018			
	CA-NA	**CA-ROW**	**BA**	**Total**
Service revenue				
Connectivity	$ 88,833	$ 14,548	$ 47,831	$ 151,212
Entertainment, CAS and other	6,913	637	294	7,844
Total service revenue	$ 95,746	$ 15,185	$ 48,125	$ 159,056
Equipment revenue				
ATG	$ 2,254	$	$ 20,497	$ 22,751
Satellite	21,650	18,460	4,461	44,571
Other			1,080	1,080
Total equipment revenue	$ 23,904	$ 18,460	$ 26,038	$ 68,402
Customer type				
Airline passenger and aircraft owner/operator	$ 54,718	$ 5,097	$ 48,125	$ 107,940
Airline, OEM and aftermarket dealer	49,141	26,311	26,038	101,490
Third party	15,791	2,237		18,028

Total revenue	$ 119,650	$ 33,645	$ 74,163	$ 227,458

	For the Six Months Ended June 30, 2018			
	CA-NA	**CA-ROW**	**BA**	**Total**
Service revenue				
Connectivity	$ 170,873	$ 28,197	$ 95,223	$ 294,293
Entertainment, CAS and other	13,656	1,233	552	15,441
Total service revenue	$ 184,529	$ 29,430	$ 95,775	$ 309,734
Equipment revenue				
ATG *(1)*	$ 47,016	$	$ 35,918	$ 82,934
Satellite *(1)*	31,926	23,384	8,719	64,029
Other			2,586	2,586
Total equipment revenue	$ 78,942	$ 23,384	$ 47,223	$ 149,549

Gogo Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

Customer type				
Airline passenger and aircraft owner/operator	$ 107,642	$ 9,826	$ 95,775	$ 213,243
Airline, OEM and aftermarket dealer *(2)*	126,567	39,005	47,223	212,795
Third party	29,262	3,983		33,245
Total revenue	$ 263,471	$ 52,814	$ 142,998	$ 459,283

1) ATG and satellite equipment revenue for the CA-NA segment includes the $45.4 million related to the accounting impact of the transition of one of our airline partners to the airline-directed model. Approximately $43.4 million was included in ATG equipment revenue and approximately $2.0 million was included in satellite equipment revenue.

2) Airline, OEM and aftermarket dealer revenue includes all equipment revenue for our three segments, including the $45.4 million accounting impact of the transition of one of our airline partners to the airline-directed model.

Contract balances

Our current and non-current deferred revenue balances totaled $62.3 million and $61.1 million as of June 30, 2018, and January 1, 2018, respectively. Deferred revenue includes, among other things, equipment, multi-packs, subscriptions and sponsorships activities.

Our current and non-current contract asset balances totaled $44.4 million and $5.1 million as of June 30, 2018 and January 1, 2018, respectively. Contract assets represents the aggregate amount of revenue recognized in excess of billings for our airline-directed contracts.

Our STC balances were $13.6 million and $7.6 million as of June 30, 2018, and January 1, 2018, respectively. We recognized $0.2 million and $0.4 million, respectively, of deferred STC costs as part of our engineering, design and development costs in our unaudited condensed consolidated statement of operations during the three and six month periods ended June 30, 2018. As noted above, STC costs for our airline-directed contracts are capitalized and expensed on a straight-line basis over the life of the contract.

Impact of adoption of ASC 606

The following table presents the post adoption impact of ASC 606 on our unaudited condensed consolidated balance sheet and the statement of operations *(in thousands)*:

	As of June 30, 2018		
	As Reported	**Impact of ASC 606**	**Balances Without Adoption of ASC 606**

Assets			
Prepaid expenses and other current assets	$ 35,092	$ (907)	$ 34,185
Other non-current assets	70,739	98,567	169,306
Liabilities			
Current deferred revenue	37,275	26,055	63,330
Other non-current liabilities	83,887	106,131	190,018
Equity			
Accumulated deficit	(1,132,146)	(24,165)	(1,156,311)

Gogo Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

	For the Three Months Ended June 30, 2018		
	As Reported	Impact of ASC 606	Balances Without Adoption of ASC 606
Revenue:			
Service revenue	$ 159,056	$ 4,514	$ 163,570
Equipment revenue	68,402	(31,362)	37,040
Operating expenses:			
Cost of equipment revenue	64,350	(25,144)	39,206
Engineering, design and development	28,409	691	29,100
Net loss	(37,207)	(2,395)	(39,602)

	For the Six Months Ended June 30, 2018		
	As Reported	Impact of ASC 606	Balances Without Adoption of ASC 606
Revenue:			
Service revenue	$ 309,734	$ 8,906	$ 318,640
Equipment revenue	149,549	(82,019)	67,530
Operating expenses:			
Cost of equipment revenue	116,643	(64,294)	52,349
Engineering, design and development	58,186	1,542	59,728
Net loss	(64,626)	(10,361)	(74,987)

4. 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 9, 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, 2018 and 2017 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, 2018 and 2017, 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.

The following table sets forth the computation of basic and diluted earnings per share for the three and six month periods ended June 30, 2018 and 2017; 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 2018 and 2017 as undistributed losses are not allocated to these shares (*in thousands, except per share amounts*):

Gogo Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2018	2017	2018	2017
Net loss	$ (37,207)	$ (44,209)	$ (64,626)	$ (85,576)
Less: Participation rights of the Forward Transactions				
Undistributed losses	$ (37,207)	$ (44,209)	$ (64,626)	$ (85,576)
Weighted-average common shares outstanding-basic and diluted	79,783	79,334	79,718	79,237
Net loss attributable to common stock per share-basic and diluted	$ (0.47)	$ (0.56)	$ (0.81)	$ (1.08)

5. 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, 2018 and December 31, 2017 were as follows (*in thousands*):

	June 30, 2018	December 31, 2017
Work-in-process component parts	$ 30,582	$ 35,009
Finished goods *(1)*	147,924	10,534
Total inventory	$ 178,506	$ 45,543

(1) The increase in our inventories is primarily due to the allocation of a portion of our uninstalled airborne equipment (*i.e.*, shipsets designated for installation under an airline-directed contract) within our CA-NA and CA-ROW segments from property and equipment, net, to inventories. Historically, all uninstalled airborne equipment for the CA-NA and CA-ROW segments was classified as property and equipment, net, as the majority of our installations were performed under our turnkey model agreements. See Note 11, Leases for additional information on the turnkey model treatment. As our uninstalled airborne equipment is increasingly being deployed under airline-directed model agreements, we now allocate our uninstalled airborne equipment between property and equipment, net, and inventories, based on our forecasts of estimated future installations by contract type.

6. Composition of Certain Balance Sheet Accounts

Property and equipment as of June 30, 2018 and December 31, 2017 were as follows (*in thousands*):

	June 30, 2018	December 31, 2017
Office equipment, furniture, fixtures and other	$ 50,380	$ 46,445
Leasehold improvements	44,300	42,522
Airborne equipment *(1) (2)*	619,425	765,652
Network equipment	201,522	199,304
	915,627	1,053,923
Accumulated depreciation *(1)*	(383,479)	(397,885)
Property and equipment, net	$ 532,148	$ 656,038

(1) Changes between June 30, 2018 and December 31, 2017 relate to the accounting impact of the transition of one of our airline partner agreements to the airline-directed model (see Note 1, Basis of Presentation, for additional information) and the adoption of ASC 606 (see Note 2, Recent Accounting Pronouncements, for additional information).

(2) Changes between June 30, 2018 and December 31, 2017 also relate to the allocation of uninstalled airborne equipment to inventory (see Note 5, Inventories, for additional information).

Gogo Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

Prepaid expenses and other current assets as of June 30, 2018 and December 31, 2017 were as follows (*in thousands*):

	June 30, 2018	December 31, 2017
Contract assets *(1)*	$ 9,237	$
Prepaid satellite services	6,536	3,360
Restricted cash	1,738	500
Other	17,581	16,450
Total prepaid expenses and other current assets	$ 35,092	$ 20,310

(1) Changes between June 30, 2018 and December 31, 2017 are due to the adoption of ASC 606 and additional activity during the six months ended June 30, 2018. See Note 2, Recent Accounting Pronouncements, for additional information.

Other non-current assets as of June 30, 2018 and December 31, 2017 were as follows (*in thousands*):

	June 30, 2018	December 31, 2017
Contract assets *(1)*	$ 35,144	$
Deferred STC costs *(1)*	13,551	
Deferred cost of equipment revenue *(1)*		40,986
Restricted cash	5,160	6,873
Other	16,884	19,248
Total other non-current assets	$ 70,739	$ 67,107

(1) Changes between June 30, 2018 and December 31, 2017 are primarily due to the adoption of ASC 606 and additional activity during the six months ended June 30, 2018. See Note 2, Recent Accounting Pronouncements, for additional information.

Accrued liabilities as of June 30, 2018 and December 31, 2017 were as follows (*in thousands*):

	June 30, 2018	December 31, 2017
Employee compensation and benefits	$ 14,269	$ 25,621

Airborne equipment and installation costs	26,804	44,059
Airline related accrued liabilities	26,278	13,566
Accrued interest	47,649	47,649
Accrued revenue share	14,458	17,339
Accrued satellite network costs	13,999	12,667
Warranty reserve	9,762	2,424
Other	51,799	38,490
Total accrued liabilities	$ 205,018	$ 201,815

Other non-current liabilities as of June 30, 2018 and December 31, 2017 were as follows (*in thousands*):

	June 30, 2018	**December 31, 2017**
Deferred revenue *(1)*	$ 25,024	$ 73,192
Deferred rent	37,083	37,354
Asset retirement obligations	9,573	9,668
Deferred tax liabilities	2,072	5,983
Other	10,135	8,458
Total other non-current liabilities	$ 83,887	$ 134,655

(1) Changes between June 30, 2018 and December 31, 2017 are primarily due to the adoption of ASC 606. See Note 2, Recent Accounting Pronouncements, for additional information.

Gogo Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

7. 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 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 2017 indicated no impairment.

As of both June 30, 2018 and December 31, 2017, 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, 2018 and December 31, 2017 were as follows (*in thousands, except for weighted average remaining useful life*):

	Weighted Average Remaining Useful Life (in years)	As of June 30, 2018 Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	As of December 31, 2017 Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Amortized intangible assets:							
Software	2.1	$ 153,884	$ (105,701)	$ 48,183	$ 145,063	$ (93,523)	$ 51,540
Service customer relationship	1.8	8,081	(6,296)	1,785	8,081	(5,788)	2,293
Other intangible assets	1.7	1,500	(1,293)	207	1,500	(1,103)	397
OEM and dealer relationships		6,724	(6,724)		6,724	(6,724)	
Total amortized intangible assets		170,189	(120,014)	50,175	161,368	(107,138)	54,230
Unamortized intangible assets:							
FCC Licenses		32,283		32,283	32,283		32,283
Total intangible assets		$ 202,472	$ (120,014)	$ 82,458	$ 193,651	$ (107,138)	$ 86,513

Amortization expense was $7.2 million and $14.8 million, respectively, for the three and six month periods ended June 30, 2018 and $5.8 million and $11.6 million, respectively, for the three and six month periods ended June 30, 2017.

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

Years ending December 31,	Amortization Expense
2018 (period from July 1 to December 31)	$ 12,986
2019	$ 18,811
2020	$ 11,046
2021	$ 4,917
2022	$ 1,890
Thereafter	$ 525

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

8. 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 $9.8 million and $2.4 million, respectively, as of June 30, 2018 and December 31, 2017. Changes between June 30, 2018 and December 31, 2017 relate to the accounting impact of the transition of one of our airline agreements to the airline-directed model, additional activity under airline-directed models and costs associated with remediation of quality issues associated with our 2Ku technology. See Note 1, Basis of Presentation for additional information.

Gogo Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

9. Long-Term Debt and Other Liabilities

Long-term debt as of June 30, 2018 and December 31, 2017 was as follows (*in thousands*):

	June 30, 2018	December 31, 2017
Senior Secured Notes	$ 704,132	$ 705,520
Convertible Notes	322,136	311,544
Total debt	1,026,268	1,017,064
Less deferred financing costs	(14,113)	(16,196)
Total long-term debt	$ 1,012,155	$ 1,000,868

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 Original 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 12.500% senior secured notes due 2022 (the January 2017 Additional Notes). The January 2017 Additional Notes were issued at a price equal to 108% of their face value resulting in gross proceeds of $70.2 million. On September 20, 2017, the Issuers, the Guarantors and the Trustee entered into the first supplemental indenture (the Supplemental Indenture and, together with the Original Indenture, the Indenture) to modify certain covenants, as discussed below. On September 25, 2017, the Issuers issued $100 million aggregate principal amount of additional 12.500% senior secured notes due 2022 (the September 2017 Additional Notes). The September 2017 Additional Notes were issued at a price equal to 113% of their face value resulting in gross proceeds of $113.0 million. Additionally, we received approximately $2.9 million for interest that accrued from July 1, 2017 through September 24, 2017, which was paid in our January 2018 interest payment. We refer to the Original Senior Secured Notes, the January 2017 Additional Notes and the September 2017 Additional Notes collectively as the Senior Secured Notes.

As noted above, on September 20, 2017, the Issuers, the Guarantors and the Trustee entered into the Supplemental Indenture to (i) increase the amount of additional secured indebtedness under Credit Facilities (as defined in the Indenture) that may be incurred by the Issuer and its Restricted Subsidiaries (as defined in the Indenture) under the Indenture by $100 million (from $75 million to $175 million in aggregate principal amount), (ii) permit the Issuer and its Restricted Subsidiaries to incur additional secured indebtedness in connection with vendor financing arrangements not to exceed $50 million in aggregate principal amount at any time outstanding and (iii) permit the Issuer and its Restricted Subsidiaries to make additional dividends or distributions to Gogo in an aggregate amount of up to $15 million during any twelve-month period to pay interest on any indebtedness or preferred stock with a maturity later than July 1, 2022. The Supplemental Indenture became effective immediately upon execution, following our receipt of consents from holders of a majority of the outstanding principal amount of the Existing Notes (excluding Existing Notes held by the Issuers or any affiliates of the Issuers) to the Supplemental Indenture and amendments to the collateral agency agreement governing the Senior Secured Notes (the Consent Solicitation). In connection with the Consent Solicitation, GIH paid $1.4 million in fees (Consent Fees) to holders of Existing Notes who validly tendered (and did not revoke) their consents prior to the expiration of the Consent Solicitation.

As of June 30, 2018 and December 31, 2017, the outstanding principal amount of the Senior Secured Notes was $690.0 million and $690.0 million, respectively, the unamortized debt premium and Consent Fees were $14.1 million and $15.5 million, respectively, and the net carrying amount was $704.1 million and $705.5 million, respectively.

Interest on the Senior Secured Notes accrues at the rate of 12.500% per annum and is payable semi-annually in arrears on January 1 and July 1, interest payments commenced on January 1, 2017 (other than the January 2017 Additional Notes, for which interest payments commenced on July 1, 2017, and the September 2017 Additional Notes, for which interest payments commenced on January 1, 2018). The Senior Secured Notes mature on July 1, 2022. The January 2017 Additional Notes and September 2017 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 Senior Secured Notes.

Gogo Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

We paid approximately $11.4 million, $2.0 million and $2.5 million, respectively, of aggregate origination fees and financing costs related to the issuance of the Original Senior Secured Notes, the January 2017 Additional Notes and the September 2017 Additional Notes, which have been accounted for as deferred financing costs. Additionally, as noted above, we paid approximately $1.4 million of Consent Fees, which partially offset the net carrying value of the Senior Secured Notes. The deferred financing costs on our unaudited condensed consolidated balance sheet are being amortized over the contractual term of the Senior Secured Notes using the effective interest method. Total amortization expense was $0.7 million and $1.3 million, respectively, for the three and six month periods ended June 30, 2018, and $0.6 million and $1.1 million, respectively, for the prior year periods. As of June 30, 2018 and December 31, 2017, the balance of unamortized deferred financing costs related to the Senior Secured Notes was $11.3 million and $12.6 million, respectively, and is included as a reduction to long-term debt in our unaudited condensed consolidated balance sheet. See Note 10, 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.

Gogo Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

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.

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:

Year	Redemption Price
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, 2018, 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.

Gogo Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

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 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 10, 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, 2018 and December 31, 2017, the outstanding principal on the Convertible Notes was $361.9 million, the unamortized debt discount was $39.8 million and $50.4 million, respectively, and the net carrying amount of the liability component was $322.1 million and $311.5 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 as 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 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 $0.4 million and $0.8 million, respectively, for the three and six month periods ended June 30, 2018, 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, 2018 and December 31, 2017, the balance of unamortized deferred financing costs related to the Convertible Notes was $2.8 million and $3.6 million, respectively, and is included as a reduction to long-term debt in our unaudited condensed consolidated balance sheets. See Note 10, 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, 2018 or the year ended December 31, 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.

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Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

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 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.

Restricted Cash - Our restricted cash balances were $6.9 million and $7.4 million, respectively, as of June 30, 2018 and December 31, 2017 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.

10. 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, 2018 and 2017 *(in thousands)*:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2018	2017	2018	2017
Interest costs charged to expense	$ 24,928	$ 21,689	$ 49,908	$ 43,228
Amortization of deferred financing costs	1,048	903	2,083	1,799
Accretion of debt discount on Convertible Notes	5,368	4,812	10,592	9,493
Amortization of debt premium on Senior Secured Notes	(703)	(178)	(1,388)	(351)
Interest expense	30,641	27,226	61,195	54,169
Interest costs capitalized to property and equipment	3	2	15	6
Interest costs capitalized to software	75	253	107	611
Total interest costs	$ 30,719	$ 27,481	$ 61,317	$ 54,786

11. 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 our service to passengers on the aircraft. There are currently two types of commercial airline arrangements: turnkey and airline-directed. See Note 3, Revenue Recognition, for additional information on airline-directed arrangements.

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. Under the turnkey model, 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 turnkey model, we refer to the airline as a partner.

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Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

Under the turnkey model, the assets are recorded as airborne equipment on our unaudited condensed consolidated balance sheets, as noted in Note 6, 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 $7.5 million and $15.1 million, respectively, for the three and six month periods ended June 30, 2018 and $8.6 million and $18.0 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, 2018, deferred airborne lease incentives of $27.2 million and $128.3 million, respectively, are included in current and non-current liabilities in our unaudited condensed consolidated balance sheet. As of December 31, 2017, deferred airborne lease incentives of $42.1 million and $142.9 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 and the amortization of the deferred airborne lease incentives relate to the accounting impact of the transition of one of our airline agreements to the airline-directed model. See Note 1, Basis of Presentation, for additional information.

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 $6.7 million and $13.1 million, respectively, for the three and six month periods ended June 30, 2018 and $10.2 million and $19.1 million, respectively, for the prior year periods. The decrease in rental expense was due to the transition of one of our airline agreements to the airline-directed model. See Note 1, Basis of Presentation, for additional information.

A contract with one of our airline partners requires us to provide the airline partner with a cash rebate of $1.8 million in June 2018. We intend to make the 2018 payment shortly.

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 $6.1 million, respectively, for the three and six month periods ended June 30, 2018 and $3.0 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 $2.6 million and $5.3 million, respectively, during the three and six month periods ended June 30, 2018 and $2.4 million and $4.7 million, respectively, for the prior year periods.

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, 2018, are as follows (*in thousands*):

Years ending December 31,	Operating Leases

2018 (period from July 1 to December 31)	$	11,365
2019	$	21,083
2020	$	19,118
2021	$	18,975
2022	$	17,703
Thereafter	$	92,350

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, 2018 and December 31, 2017 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 $5.3 million and $5.0 million, respectively. As of June 30, 2018 and December 31, 2017, 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, 2018, are as follows (*in thousands*):

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Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

Years ending December 31,	Capital Leases
2018 (period from July 1 to December 31)	$ 851
2019	1,053
2020	211
Thereafter	
Total minimum lease payments	2,115
Less: Amount representing interest	(109)
Present value of net minimum lease payments	$ 2,006

The $2.0 million present value of net minimum lease payments as of June 30, 2018 has a current portion of $1.4 million included in the current portion of long-term debt and capital leases and a non-current portion of $0.6 million included in other non-current liabilities.

12. 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, 2018 commit us to purchase transponder and teleport satellite services totaling approximately $43.8 million in 2018 (July 1 through December 31), $92.7 million in 2019, $90.4 million in 2020, $77.9 million in 2021, $74.4 million in 2022 and $228.1 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.

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.

Linksmart Litigation - On April 20, 2018, Linksmart Wireless Technology, LLC filed suit against us and eight of our airline partners in the U.S. District Court for the Central District of California alleging that our redirection server and login portal infringe a patent owned by the plaintiff. We are required under our contracts with these airlines to indemnify them for defense costs and any liabilities resulting from the suit. Given the very early stage of this litigation, we are unable to assess the merits of the claim, and the outcome of this matter is inherently uncertain.

Pierrelouis Litigation - On June 27, 2018, a purported stockholder of the Company filed a putative class action lawsuit in the United States District Court for the Northern District of Illinois, Eastern Division styled Pierrelouis v. Gogo Inc., naming the Company, its former Chief Executive Officer and Chief Financial Officer and its current Chief Executive Officer, Chief Financial Officer, and President, Commercial Aviation as defendants purportedly on behalf of all purchasers of our securities from February 27, 2017 through May 7, 2018. The complaint asserts claims

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Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, as amended, and Rule 10b-5 promulgated thereunder, alleging misrepresentations or omissions by us purporting to relate to our 2Ku antenna s reliability and installation and remediation costs. The plaintiffs seek to recover from us and the individual defendants an unspecified amount of damages. We believe that the claims are without merit and intend to defend them vigorously. In accordance with Delaware law, we will indemnify the individual named defendants for their defense costs and any damages they incur in connection with the suit. We have filed a claim with the issuer of our Directors and Officers insurance policy with respect to this suit. No amounts have been accrued for any potential losses under this matter, as we cannot reasonably predict the outcome of the litigation or any potential losses.

13. 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, 2018 unaudited condensed consolidated balance sheet, excluding any issuance costs, is the amount that a market participant would be willing to lend at June 30, 2018 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, 2018 and December 31, 2017 were as follows *(in thousands)*:

	June 30, 2018		December 31, 2017	
	Fair Value [1]	Carrying Value	Fair Value [1]	Carrying Value
Senior Secured Notes	$ 742,000	$ 704,132[2]	$ 782,000	$ 705,520[2]
Convertible Notes	316,000	322,136[3]	330,000	311,544[3]

(1) Fair value amounts are rounded to the nearest million.

(2) Carrying value of the Senior Secured Notes includes unamortized debt premium and Consent Fees of $14.1 million and $15.5 million, respectively, as of June 30, 2018 and December 31, 2017. See Note 9, Long-Term Debt and Other Liabilities, for further information.

(3) Carrying value of the Convertible Notes excludes unamortized debt discount of $39.8 million and $50.4 million, respectively, as of June 30, 2018 and December 31, 2017. See Note 9, 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 the three and six month periods ended June 30, 2018 and 2017.

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Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

14. Income Tax

The effective income tax rates for the three and six month periods ended June 30, 2018 were (0.2%) and 5.4%, respectively, as compared with (0.8%) and (0.7%), respectively, for the prior year periods. An income tax benefit was recorded for the six month period ended June 30, 2018 resulting from a reduction in our valuation allowance of approximately $4.0 million due to the application of provisions of H.R. 1, commonly known as the Tax Cuts and Jobs Act, to our evaluation of our deferred tax assets. For the three and six months ended June 30, 2017, our income tax expense was not significant 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, Australia, China, India, France, Germany and the Netherlands. With few exceptions, as of June 30, 2018, we are no longer subject to U.S. federal, state, local or foreign examinations by tax authorities for years before 2014.

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, 2018 and 2017. As of June 30, 2018 and December 31, 2017, 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.

15. 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 2017 10-K. Intercompany transactions between segments are excluded as they are not included in management s performance review of the segments. For the three and six months ended June 30, 2018 and 2017, our foreign revenue accounts for less than 10% of our consolidated 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 they totaled less than 10% of our unaudited condensed consolidated assets as of June 30, 2018 and December 31, 2017. 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 items (including amortization of deferred airborne lease incentives, stock-based compensation expense, amortization of STC costs and the accounting impact of the transition to the airline-directed model) 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.

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

	For the Three Months Ended June 30, 2018			
	CA-NA	**CA-ROW**	**BA**	**Total**
Service revenue	$ 95,746	$ 15,185	$ 48,125	$ 159,056
Equipment revenue	23,904	18,460	26,038	68,402
Total revenue	$ 119,650	$ 33,645	$ 74,163	$ 227,458
Segment profit (loss)	$ 7,041	$ (24,474)	$ 36,679	$ 19,246

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

	For the Six Months Ended June 30, 2018			
	CA-NA	**CA-ROW**	**BA**	**Total**
Service revenue	$ 184,529	$ 29,430	$ 95,775	$ 309,734
Equipment revenue (1)	78,942	23,384	47,223	149,549
Total revenue	$ 263,471	$ 52,814	$ 142,998	$ 459,283
Segment profit (loss)	$ 8,697	$ (47,079)	$ 69,002	$ 30,620

	For the Six Months Ended June 30, 2017			
	CA-NA	**CA-ROW**	**BA**	**Total**
Service revenue	$ 195,824	$ 22,556	$ 82,191	$ 300,571
Equipment revenue	3,943	1,803	31,889	37,635
Total revenue	$ 199,767	$ 24,359	$ 114,080	$ 338,206

Segment profit (loss)	$ 27,350	$ (57,958)	$ 51,317	$ 20,709

(1) CA-NA equipment revenue for the six months ended June 30, 2018 includes the accounting impact of the transition of one of our airline partners to the airline-directed model. See Note 1, Basis of Presentation for additional information.

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Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

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

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2018	2017	2018	2017
CA-NA segment profit	$ 7,041	$ 16,191	$ 8,697	$ 27,350
CA-ROW segment loss	(24,474)	(31,403)	(47,079)	(57,958)
BA segment profit	36,679	25,202	69,002	51,317
Total segment profit	19,246	9,990	30,620	20,709
Interest income	1,328	771	2,404	1,316
Interest expense	(30,641)	(27,226)	(61,195)	(54,169)
Depreciation and amortization	(31,938)	(30,562)	(67,857)	(60,997)
Transition to airline-directed model	2,249		21,551	
Amortization of deferred airborne lease incentives *(1)*	7,462	8,630	15,092	17,978
Amortization of STC costs	(255)		(427)	
Stock-based compensation expense	(4,213)	(5,394)	(8,599)	(9,724)
Other income (expense)	(374)	(56)	131	(94)
Loss before income taxes	$ (37,136)	$ (43,847)	$ (68,280)	$ (84,981)

(1) Amortization of deferred airborne lease incentive relates to our CA-NA and CA-ROW segments. See Note 11, Leases, for further information.

Major Customers and Airline Partnerships Under the turnkey model, we refer to the airline as a partner, and under the airline-directed model, we refer to the airline as a customer.

During the three and six month periods ended June 30, 2018, American Airlines accounted for approximately 22% and 29% of consolidated revenue, respectively, while no other customer accounted for more than 10% of consolidated revenue during the prior year periods. Revenue earned from American Airlines for the six month period ended June 30, 2018 included $45.4 million of equipment revenue recognized due to its transition to the airline-directed model. See Note 1, Basis of Presentation, for additional information. Revenue earned from passengers on aircraft operated by American Airlines, which was under the turnkey model during the three and six month periods ended June 30, 2017, accounted for approximately 22% of consolidated revenue during such periods.

Revenue earned from passengers on aircraft operated by Delta Air Lines, which is under the turnkey model, accounted for approximately 23% and 22% of consolidated revenue, respectively, for the three and six month periods ended June 30, 2018 and 26% during both prior year periods.

One customer accounted for approximately 14% and 15%, respectively, of consolidated accounts receivable as of June 30, 2018 and December 31, 2017. Delta Air Lines, one of our airline partners, accounted for approximately 12% and 21%, respectively, of consolidated accounts receivable as of June 30, 2018 and December 31, 2017.

16. Employee Retirement and Postretirement Benefits

Stock-Based Compensation As of June 30, 2018, we had three stock-based employee compensation plans (Stock Plans). See Note 11, Stock-Based Compensation, in our 2017 10-K for further information regarding these plans. Most of our equity grants are awarded on an annual basis.

For the six month period ended June 30, 2018, options to purchase 2,362,236 shares of common stock (of which 642,462 are options that contain a market condition, in addition to the time-based vesting requirements) were granted, options to purchase 2,500 shares of common stock were exercised, options to purchase 560,347 (of which 286,615 options contain a market condition) shares of common stock were forfeited, and options to purchase 573,478 shares of common stock expired.

For the six month period ended June 30, 2018, 966,599 Restricted Stock Units (RSUs) (of which 213,543 are RSUs that contain a market condition, in addition to the time-based vesting requirements) were granted, 443,284 RSUs vested and 196,160 RSUs (of which 66,137 contained a market condition) were forfeited.

For the six month period ended June 30, 2018, 90,871 restricted shares vested. These shares are deemed issued as of the date of grant, but not outstanding until they vest.

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Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

For the six month period ended June 30, 2018, 66,220 Deferred Stock Units were granted and vested.

For the six month period ended June 30, 2018, 141,000 shares of common stock were issued under the employee stock purchase plan.

The following is a summary of our stock-based compensation expense by operating expense line in the unaudited condensed consolidated statements of operations *(in thousands)*:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2018	**2017**	**2018**	**2017**
Cost of service revenue	$ 447	$ 332	$ 881	$ 790
Cost of equipment revenue	59	50	113	87
Engineering, design and development	783	1,054	1,693	1,904
Sales and marketing	1,226	1,419	2,308	2,168
General and administrative	1,698	2,539	3,604	4,775
Total stock-based compensation expense	$ 4,213	$ 5,394	$ 8,599	$ 9,724

401(k) Plan Under our 401(k) plan, all employees who are eligible to participate, are entitled to make tax-deferred contributions, subject to Internal Revenue Service limitations. We match 100% of the employee s first 4% of contributions made, subject to annual limitations. Our matching contributions were $1.3 million and $2.6 million, respectively, during the three and six month periods ended June 30, 2018, and $1.2 million and $2.8 million, respectively, for the prior year periods.

17. Research and Development Costs

Expenditures for research and development are charged to expense as incurred and totaled $18.0 million and $37.1 million, respectively, during the three and six month periods ended June 30, 2018, and $17.2 million and $39.3 million, respectively, for the prior year periods. Research and development costs are reported as a component of engineering, design and development expenses in our unaudited condensed consolidated statements of operations.