SIENAcollege

Siena Market Line
2nd week of April 2016

# Gogo Inflight Internet

NASDAQ: Gogo

**Analyst:** Mark Gruber
**Sector:** Technology

## Long on Gogo

Price Target: $15.30

## Key Statistics as of 4/10/2016

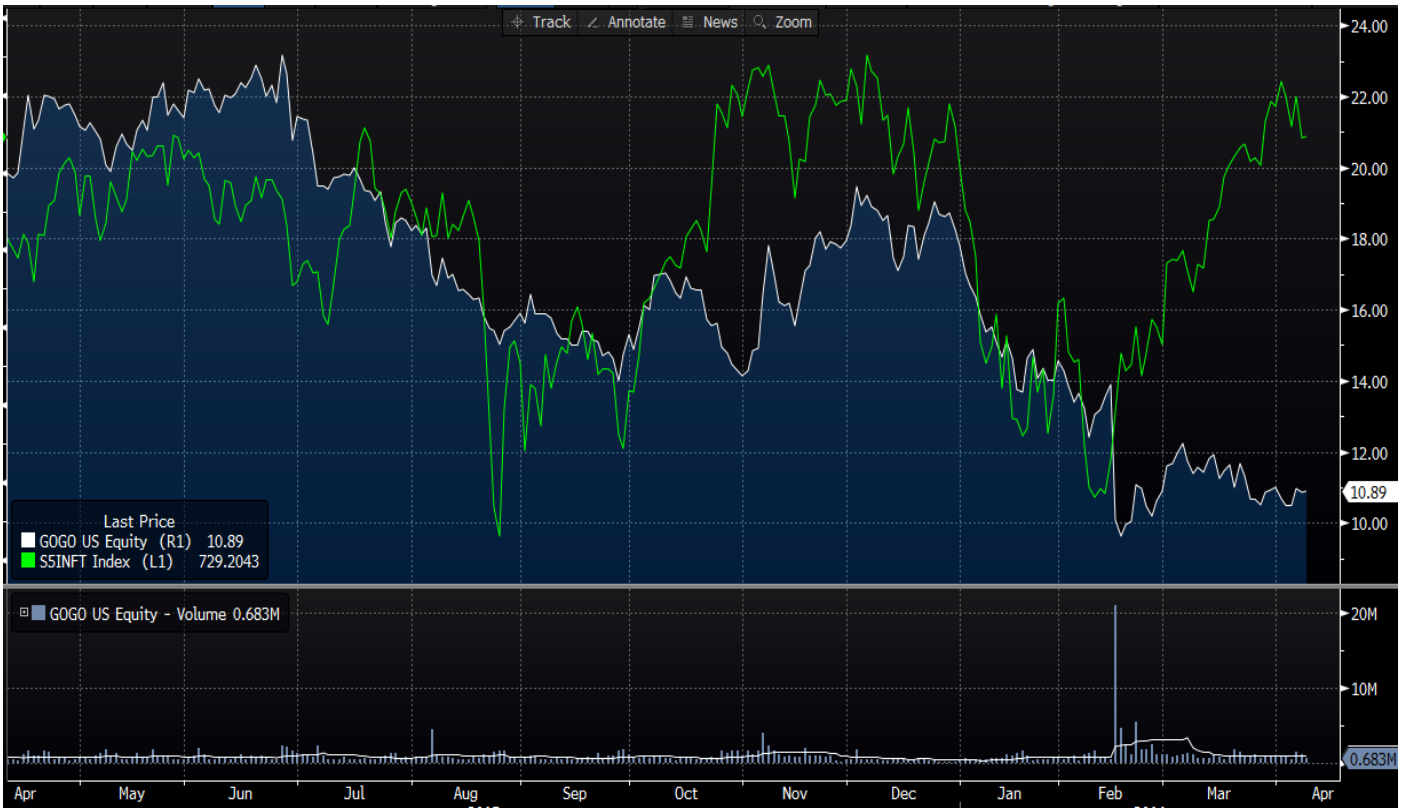
| | |
|---|---|
| Market Price: | $10.89 |
| Industry: | Diversified Communication Services |
| Market Cap: | 935.59M |
| 52-Week Range: | $7.90-23.20 |
| 1 Year Beta: | 2.79 |

## Thesis Points:

- Customers are requesting Wi-Fi, making it essential for airlines to provide it to their customers and leading to more demand in the industry
- American Airlines Lawsuit scared away investors and caused the stock to become undervalued
- New 2KU technology will help generate more revenue

## Company Description:

Gogo is a leading provider of in-flight Wi-Fi. They were founded in 1991 by Jimmy Ray. In 2007, they signed their first two contracts will American Airlines and Virgin America. In 2008, Gogo made their first debut on commercials aircrafts. In 2011, the company underwent a new rebranding effort, changing their name from Aircell to Gogo. The stock went public in 2013, offering 11 million shares. Gogo currently has partnerships will 11 major airlines, spanning over 2,400 commercial airlines and over 6,800 business aircrafts. Some major airlines they do business with include Alaska Airlines, Delta Airlines, and United Airlines



## Thesis

Gogo just recently unveiled their brand new 2ku technology in late 2015.This new technology has been recorded as having double the speed over their old technology, meaning they can accommodate more people than before. In the past, if there were too many people on the Wi-Fi, the internet would become very slow and unusable. With the new technology they can accomate many more people while keeping speeds up. In early 2016, American Airlines filed a lawsuit against Gogo. American Airlines accounted for around 35% of revenues, so it was critical for Gogo to not lose their business. During this time the stock price dropped by about 8%. The reason for the lawsuit was more of a scare tactic rather than actually wanting to terminate its contract with Gogo. In the contract, it states that if another competitor has faster speeds, then the airline can drop the contract and switch to their competitor. In the lawsuit it said that Gogo's older technology was slower than ViaSat's new Ka satellite technology. While this true that Gogo's older technology was slower than ViaSat's new technology, it is because Gogo's technology is over 4 years old, and technology is always changing in this industry. In the lawsuit it never mentions Gogo's latest technology, 2ku which is just as fast if not faster than ViaSat's Ka solution. Since the lawsuit Gogo has signed two more airlines, Air Canada and Beijing Shareco, and the stock price only moderately risen meaning that investors are still most likely reluctant about investing in Gogo due to the American Airlines lawsuit, even though demand in the industry is expected to grow. It was currently reported that 90% of global passengers brought a Wi-Fi enabled device on a plane with them, citing an added need for airlines to provide Wi-Fi to their customers. In the study it also noted that 32% of US & Canada and 55% in other regions said that Wi-Fi is an important factor when deciding which airline to choose. Airlines are already extremely competitive meaning to help them stay on the cutting edge, it is imperative for them to invest in in-flight Wi-Fi to help accommodate their customer's needs. This will lead to increased demand for Gogo in the future.

## How They Operate

The way Gogo operates also takes all the risks away from the airlines. Gogo installs their equipment free of costs to the airlines unlike other competitors in the industry, which charge an installation fee. Then instead of the airlines collecting on fees from consumers, Gogo charges a fee directly to the customers. This helps airlines keep their costs low, and it allows the customers to decide if they want to purchase the Wi-Fi. This will also allow Gogo to continue to increase revenues on an ongoing basis, rather than just getting an installation fee. This is also highly beneficial to the airlines, because they can have the convenience of adding Wi-Fi to their flights, without having to raise costs.

## Industry Outlook

The in-flight Wi-Fi industry is a fast growing industry. It is a relatively new industry that started around 2008. Since than over 10,000 aircrafts have been installed with In-Flight Wi-Fi, and that number is expected to grow over the next few years. With high competition in the airlines industry, airlines have to do whatever they can to try to get a competitive edge over their competitors. This should help lead to consistent demand.

## Financials

Gogo has seen their revenues increase significantly since 2013, and there are no signs of slowing down in the future. In 2014 they reported revenues of 408.5 million compared to 500.9 million in 2015. It is expected than revenues will climb to 586 million by the end of 2016.

| Months Ending | 12/31/2013 | 12/31/2014 | 12/31/2015 | 12/31/2015 | 12/31/2016 |
|---|---|---|---|---|---|
| Revenue | 328.1 | 408.5 | 500.9 | 500.9 | 586.0 |

They have also seen their gross margin increase over the last few years. In 2013 they reported gross margins of 48.80 compared to 2015 where they had gross margins of 54.41

| 12/31/2011 | 12/31/2012 | 12/31/2013 | 12/31/2014 | 12/31/2015 |
|---|---|---|---|---|
| 51.39 | 51.55 | 48.80 | 48.02 | 54.41 |

Their operating margins have also increased from -13.61 in 2013 to -8.95 in 2015.

| 12/31/2011 | 12/31/2012 | 12/31/2013 | 12/31/2014 | 12/31/2015 |
|---|---|---|---|---|
| -21.12 | -11.75 | -13.61 | -12.40 | -8.95 |

Lastly they are creating additional value. Their ROIC/WACC was -.90 in 2014 compared to -.72 in

2015.

| Months Ending | 12/31/2011 | 12/31/2012 | 12/31/2013 | 12/31/2014 | 12/31/2015 |
|---|---|---|---|---|---|
| ROIC/WACC Ratio | -1.93 | -1.02 | -0.72 | -0.90 | -0.72 |

## Management

Gogo is lead by CEO and President, Michael Small. He has been with Gogo since 2010. Prior to coming to Gogo, Small was the CEO of Centennial Communications Corporation from 1999-2009.He was recently named Entrepreneur of the Year by Ernst and Young. He was also named CEO of the Year from the Illinois Technology Association. Gogo is also lead by Executive Vice President and Chief Technology Officer, Anand Chari. Chari has been with Gogo since 2003. Prior to Gogo, Chari held many positions with Fortune 500 companies, along with being the founder and president of Simma Technology. Margee Elias, executive vice president and general counsel for Gogo, is in charge of the company's legal affairs. Prior to Gogo, Elias worked at Ecollege where she held the same position. Lastly, Norman Smagley, CFO and Executive Vice President brings with him 18 years of experience in the industry.

## Porters Five Forces

As with all technology there is great competition in the industry. There are very low barriers in the industry, which means that there is always a chance of new competition. The Bargaining power of suppliers is medium meaning that there are many substitutes. The bargaining power of customers is medium because there aren't many competitors in the industry. The intensity of existing rivalry is also very high in the industry. Lastly the threat of substitutes is medium, because once again there is very low barriers in the industry, so there is always a great chance of new competition.

## Conclusion

Gogo is a market leader in a fast growing industry. They have positioned themselves well in the industry, and their new technology should put them in a good position to continue to gain market share. Based on my proforma I have estimated a target price of $15.30, which is a 40.5%. As more and more airlines try to stay competitive, they will need to provide the option of Wi-Fi to their consumers, which will lead to increased revenues for Gogo.

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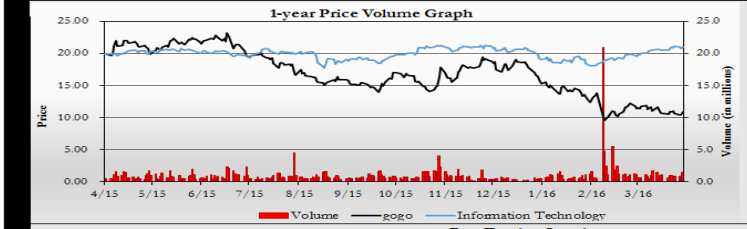
2nd week of April 2016

# Gogo Inc. (gogo) — CENTER FOR GLOBAL FINANCIAL STUDIES — BULLISH

| | | | | | |
|---|---|---|---|---|---|
| Analysis by Mark Gruber | Current Price: | $10.89 | Intrinsic Value | $12.93 | Target 1 year Return: 40.5% |
| 4/9/2016 | Divident Yield: | 0.0% | Target Price | $15.30 | Probability of Price Increase: 92% |




**Description**

Gogo Inc., through its subsidiaries, provides communications services to the commercial and business aviation markets in the United States and internationally.

**General Information**

| | |
|---|---|
| Sector | Information Technology |
| Industry | Internet Software and Services |
| Last Guidance | November 3, 2015 |
| Next earnings date | NM |
| Estimated Country Risk Premium | 5.00% |
| Effective Tax rate | 32% |
| Effective Operating Tax rate | 25% |

**Market Data**

| | |
|---|---|
| Market Capitalization | $935.59 |
| Daily volume (mil) | 0.68 |
| Shares outstanding (mil) | 85.91 |
| Diluted shares outstanding (mil) | 79.70 |
| % shares held by institutions | 55% |
| % shares held by investments Managers | 54% |
| % shares held by hedge funds | 8% |
| % shares held by insiders | 26.93% |
| Short interest | 18.61% |
| Days to cover short interest | 10.88 |
| 52 week high | $23.20 |
| 52-week low | $7.90 |
| Levered Beta | 1.73 |
| Volatility | 0.00% |

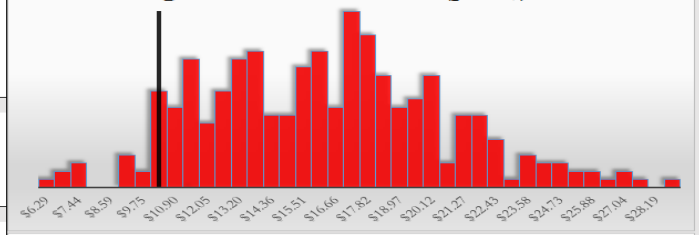
**Past Earning Surprises**

| Quarter ending | Revenue | EBITDA |
|---|---|---|
| 12/31/2014 | 2.73% | 1451.41% |
| 3/31/2015 | 2.39% | 192.84% |
| 6/30/2015 | -0.71% | 129.18% |
| 9/30/2015 | 2.18% | 298.48% |
| 12/31/2015 | 5.07% | 98.81% |
| Mean | 2.33% | 434.14% |
| Standard error | 0.9% | 256.6% |

**Peers**

Global Eagle Entertainment Inc.
Rackspace Hosting, Inc.
Akamai Technologies, Inc.
Phoenix New Media Limited
Time Warner Cable Inc.

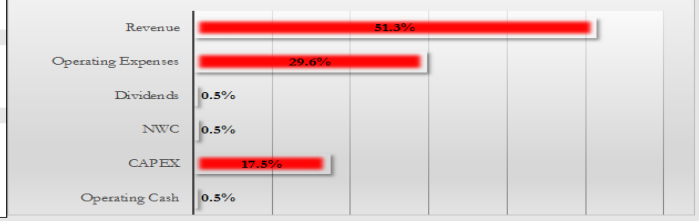
**Target Price Distribution--P(price↑)=92%**



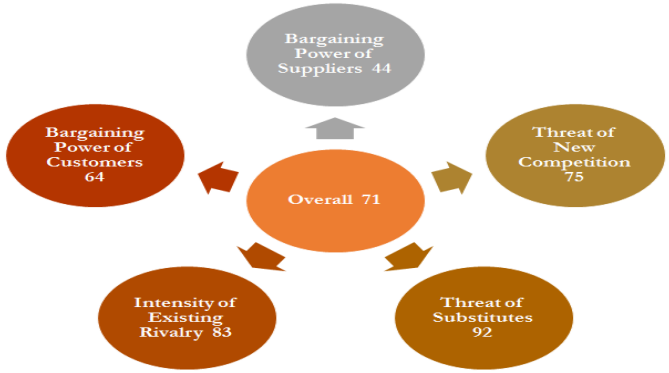

| Management | Position | Total compensations growth | Total return to shareholders |
|---|---|---|---|
| LeMay, Ronald | Executive Chairman | -100% per annum over 2y | N/M |
| Small, Michael | Chief Executive Officer, Pre | 4.68% per annum over 4y | N/M |
| Smagley, Norman | Chief Financial Officer and | 32.45% per annum over 4y | N/M |
| Chari, Anand | Chief Technology Officer and | 25.93% per annum over 3y | N/M |
| ElDifrawi, Ash | Chief Commercial Officer and | 17.99% per annum over 4y | N/M |
| Wade, John | Executive Vice President of | 14.39% per annum over 3y | N/M |

| Profitability | gogo (LTM) | gogo (5 years historical average) | Industry (LTM) |
|---|---|---|---|
| ROIC | 1.2% | 0.00% | 14.96% |
| NOPAT Margin | 2% | -6.63% | 19.4% |
| Revenue/Invested Capital | 0.59 | 0.00 | 0.77 |
| ROE | -3.4% | -0.94% | 15.95% |
| Adjusted net margin | -11% | -12.35% | 17.7% |
| Revenue/Adjusted Book Value | 0.30 | 0.08 | 0.90 |
| **Invested Funds** | **gogo (LTM)** | **gogo (5 years historical average)** | **Industry (LTM)** |
| Total Cash/Total Capital | 32.0% | 35.7% | 68% |
| Estimated Operating Cash/Total Capital | 9.8% | 13.1% | N/A |
| Non-cash working Capital/Total Capital | -6.6% | -7.9% | -13% |
| Invested Capital/Total Capital | 77.8% | 119.4% | 46% |
| **Capital Structure** | **gogo (LTM)** | **gogo (5 years historical average)** | **Industry (LTM)** |
| Total Debt/Common Equity (LTM) | 0.55 | 0.29 | 0.08 |
| Cost of Existing Debt | 18.40% | 14.15% | 4.14% |
| Estimated Cost of new Borrowing | 4.78% | 3.70% | 4.14% |
| CGFS Risk Rating | 18.40% | BB | CC |
| Unlevered Beta (LTM) | 14.37% | 1.58 | 1.08 |
| WACC | 18.40% | 11.49% | 8.33% |

**Sensitivity Attribution Analysis**




**Porter's 5 forces (scores are out of 100)**




**Valuation**

| Period | Revenue growth | NOPAT margin | ROIC/WACC |
|---|---|---|---|
| Base Year | 22.6% | 2.1% | 0.10 |
| 12/31/2016 | 17.0% | 6.4% | 0.42 |
| 12/31/2017 | 16.7% | 8.4% | 0.47 |
| 12/31/2018 | 18.1% | 12.0% | 0.72 |
| 12/31/2019 | 24.4% | 15.9% | 1.04 |
| 12/31/2020 | 15.4% | 17.9% | 1.17 |
| 12/31/2021 | 14.8% | 19.0% | 1.22 |
| 12/31/2022 | 14.3% | 19.9% | 1.31 |
| 12/31/2023 | 12.5% | 20.7% | 1.37 |
| 12/31/2024 | 10.7% | 21.7% | 1.44 |
| 12/31/2025 | 9.0% | 21.7% | 1.44 |
| Continuing Period | 4.0% | 18.4% | 1.19 |

| Period | Invested Capital | Net Claims | Price per share |
|---|---|---|---|
| Base Year | $378.14 | $593.00 | $14.10 |
| 12/31/2016 | $417.33 | $936.86 | $16.09 |
| 12/31/2017 | $486.63 | $1,093.33 | $18.28 |
| 12/31/2018 | $701.35 | $1,271.20 | $20.73 |
| 12/31/2019 | $848.71 | $1,465.78 | $23.48 |
| 12/31/2020 | $890.97 | $1,706.57 | $26.57 |
| 12/31/2021 | $1,259.09 | $1,846.62 | $29.99 |
| 12/31/2022 | $1,432.87 | $1,982.50 | $33.69 |
| 12/31/2023 | $1,662.58 | $2,098.92 | $37.66 |
| 12/31/2024 | $1,964.97 | $2,163.63 | $41.88 |
| 12/31/2025 | $2,358.00 | $2,181.87 | $46.30 |
| Continuing Period | | | |