

Event Type: Q2 2022 Earnings Call (Corrected version)

Date: 2022-08-10

Company: **Blacksky Technology, Inc.**

Ticker: BKSJ-US

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Henry E. Dubois - Blacksky Technology, Inc., Chief Financial Officer

#### OTHER PARTICIPANTS

Jaeson Allen Min Schmidt - Analyst

Colin Canfield - Analyst

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### MANAGEMENT DISCUSSION SECTION

#### Operator

Good morning, ladies and gentlemen, and welcome to BlackSky Technology Second Quarter 2022 Earnings Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. Please note this conference call is being recorded.

I would now like to turn the call over to Aly Bonilla, BlackSky's Vice President of Investor Relations. Please go ahead, Aly.

#### Aly Bonilla

Good morning and thank you for joining us. Today, I'm joined by our Chief Executive Officer, Brian O'Toole; and our Chief Financial Officer, Henry Dubois. On today's call, Brian will provide some highlights on the quarter and give a strategic update on the business. Henry will then review the company's second quarter financial results and outlook for 2022. Following our prepared remarks, we will open the line for your questions.

A replay of this conference call will be available from approximately 12:30 PM Eastern Time today through August 24. Information to access the replay can be found in today's press release. Additionally, a webcast of this earnings call will be available in the Investor Relations section of our website at [www.BlackSky.com](http://www.BlackSky.com). In conjunction with today's call, we have posted a quarterly earnings presentation on the Investor Relations website that you may use to follow along with our prepared remarks.

Before we begin, let me remind you that today's conference call includes forward-looking statements, including financial performance and guidance for the full year 2022, and that actual results may differ from the expectations reflected in these statements due to factors such as long sales cycles, customer demand, and our ability to estimate expense, operational and liquidity needs. We encourage you to review our press release and most recent SEC filings for a full discussion of the risks and uncertainties that pertain to these statements and that may affect future results or the market price of our stock. BlackSky assumes no obligation to update forward-looking statements except as maybe required under applicable securities laws.

In addition, during today's call, we will refer to certain non-GAAP financial measures including adjusted EBITDA. A reconciliation of adjusted EBITDA to net loss, the most comparable GAAP measure, is included in today's earnings press release, which can be viewed and downloaded from our Investor Relations website.

At this point, I'll turn the call over to Brian O'Toole.

#### Brian E. O'Toole

Thanks, Aly, and good morning, everyone. Thank you for joining us on the call today.

Before I begin, I want to take a moment and introduce Henry Dubois. Henry was promoted to Chief Financial Officer in June after having served as the company's Chief Development Officer since August of last year and serving as an advisor to me and the BlackSky Board since 2018. He brings over 30 years of financial experience, including serving

as an executive at two geospatial and commercial remote sensing companies. Henry has been a vital member of our executive team and we are excited to have him lead this role and drive our long-term financial strategy.

Now, let's begin with slide 4. When we started this company many years ago, we believed geospatial intelligence would evolve from static observation and mapping to dynamic, high frequency monitoring. We also believed we needed to develop technology that would allow customers to easily task a satellite constellation from any device and get actionable intelligence on-demand. Today, I can confidently say that we've accomplished that mission and achieved a critical milestone with our first of its kind platform that is delivering reliable and dynamic hourly monitoring of the most important strategic and economic assets in the world. Our strategy and value proposition has been validated as governance and other entities around the world have selected BlackSky for significant contract awards. We are proud to be serving the most important customers as a long-term trusted mission partner, delivering vital intelligence in support of their critical operations.

I'm excited to report that our second quarter was the strongest in the company's history. Specifically, we achieved another quarter of record revenue and continue to see strong customer adoption and demand for our imagery and analytics. We won our company's largest ever contract award, validating that our technology and long-term strategy is the preferred choice by the US government and one that's aligned with their new and expanded requirements for high frequency advanced imaging services. And we've made significant advancements enhancing the functionality of our proven Spectra AI software platform, positioning BlackSky for our next phase of growth.

Turning to slide 5. As many of you know, the war in Ukraine showed the world the vital need for geospatial intelligence and the capabilities that space-based technology can provide. From capturing images of military troops moving toward the border to showing damages inflicted on infrastructure in certain parts of the country, to providing analytics on border crossings and refugee movements, the need for real-time actionable intelligence is now more important than ever. BlackSky has been there since the beginning of the crisis delivering thousands of images and analytic insights to multiple government agencies and allied partners, humanitarian organizations, and news media worldwide. I am proud of the support that BlackSky has provided and continues to provide to the people of Ukraine and their partners, which we believe is making a difference and saving lives.

The war in Ukraine has certainly shined a light on how space-based technology is currently being used and has changed what customers can expect from the timely insights it can deliver. BlackSky is changing the way we use space to deliver vital, actionable intelligence. We're doing this using two key strategic assets. First, our high frequency, high resolution imaging satellite constellation. And second, combined with our fully operational AI-enabled software platform.

Turning to slide 6. We recently achieved a 14-satellite baseline constellation. We are now providing dynamic hourly monitoring of the most important and strategic economic assets in the world. While other companies may claim to have high satellite revisit rates, BlackSky's constellation can truly deliver reliable hourly monitoring and collection of imagery of a specific location up to 15 times a day from dawn to dusk. To achieve this, we've uniquely positioned our satellites in mid-inclination orbits, generally running west to east to optimize high-frequency collection of the most important locations in the world that have the highest economic value to our customers and that can be substantially monetized. This is different from mapping constellations that use polar orbiting satellites traveling from north to south to map the entire earth at six times a day. This difference, combined with a software-first approach, enables us to efficiently capture imagery throughout the day through automated, intelligent tasking software. This operationally efficient approach enables us to right-size and scale the constellation aligned with market demand.

Our on-demand, high frequency monitoring is a new and unique offering in the market and is behind the strong demand we're seeing. Our recent wins, such as EOCL and with new international customers, are evidence and validation of our strategy and is the momentum driving the acceleration of our business.

Our current constellation provides BlackSky with more than enough capacity to meet customer requirements and achieve our revenue growth objectives for the next couple of years. We are scheduled to launch the last of our Gen 2 satellites in Q4 of this year, replacing our first two commercial satellites that went into service back in 2018. We are pleased with the performance of our constellation and are encouraged by the extended mission life we are seeing from our satellites.

Our next generation satellite program remains on track. We expect to begin launching these new Gen 3 satellites in 2023. Let me remind you that our Gen 3 satellites are designed to bring our imaging resolution down to 35 centimeters to 50 centimeters and add a host of other capabilities. We'll provide more details on our Gen 3 deployment plans as the program progresses.

Moving to slide 7. We've also spent the last eight years designing and developing our advanced and now fully operational AI-enabled software platform, which is what really sets us apart from others in the industry. Our Spectra AI platform is a first of its kind, providing users with on-demand satellite tasking capabilities. This is changing the customer experience providing on-demand access to data and analytics to a whole new community of users. For example, we recently demonstrated this capability at the Esri Conference a few weeks ago and surprised many

geospatial professionals with just how easy it is to task a satellite directly from any device, application or through dynamic APIs or in this case, directly from the Esri platform itself. I'll talk more about our integration with Esri and our new partnership in a few minutes.

Right now, customers can task the constellation and receive imagery and analytics delivered directly into their email, in-house ERP systems or cloud environment in under 90 minutes, all fully automated and powered by our Spectra AI software platform. In Q2, we recently expanded our dynamic monitoring capabilities with new data sources such as radar and very high resolution satellite imagery through our new reseller partnership with Airbus. The addition of the Airbus constellation expands BlackSky's product offerings and provides customers with greater flexibility for tasking requests and monitoring all-weather, day and night assets around the world.

I'm pleased with the momentum we've seen in the last several quarters, which continued into Q2 of this year and delivered another strong quarter of revenue performance as shown on slide 8. Second quarter revenues grew to \$15.1 million, a new record for the company and more than doubled last year's Q2 revenue. In fact, we've now reported 10 consecutive quarters of year-over-year revenue growth, demonstrating that more and more customers are choosing BlackSky and seeing the value of our products and services in their day-to-day operations. As a result of this strong first half, we are raising our full year revenue guidance. Henry will provide more details on the second quarter financial results and revised full year outlook later in the call.

Now, I'd like to provide an update on the progress we've made in our US government, international and commercial businesses, starting with the US government business. In Q2, we won several large opportunities, including the historic EOCL contract award, which is shown on slide 9. In May, we announced the Electro Optical Commercial Layer or EOCL contract with the National Reconnaissance Office or NRO. The advanced imagery subscription service contract is valued up to just over \$1 billion over a 10-year period, consisting of a five-year base period and five one-year option periods. The NRO has placed a starting value of \$85 million, of which \$72 million is allocated within the first two years. Thereafter, we anticipate the NRO to provide regular funding updates, typical of many government programs, and expand the level of other imagery services from our current and future constellations. So far, we're off to a great start servicing this contract. Within the first 30 days, we ramped up collections and met contract requirements for delivery of high-volume daily imagery.

This contract is our company's largest award receipt to date, and validates BlackSky's satellite technology and long-term strategy to provide dynamic, high-frequency imagery from both current and future constellations. We're happy to have won all elements of the contract we bid and believe the NRO awarded us such a large opportunity because of our proven capability to address their new and expanding requirements for high frequency and advanced imaging.

Through this contract, BlackSky will provide comprehensive imagery services, including intelligent point and area collection, theater downlink to government remote terminals and other advanced imaging services. I'm pleased that we've been a trusted mission partner to the NRO over the last three years, and look forward to continuing to support their most critical intelligence needs. Keep in mind, this award is only for the delivery of our imagery and does not include analytic products which provide us the opportunity to sell monitoring analytic services to other government agencies such as the National Geospatial-Intelligence Agency and the Space Force.

On that note, turning to slide 10. In addition to EOCL award, we secured several other US and international government customer wins in the quarter with various agencies. We secured three notable agreements that utilize our artificial intelligence-enabled platform and analytic algorithms as additional proof of the relevance of our offering and advanced AI capabilities.

The first is a win with the Joint Artificial Intelligence Center. This award leverages our expertise in space-based dynamic monitoring and our data-rich software platform to provide AI-enabled end-to-end capabilities for the Department of Defense community. The second is a contract award from the Intelligence Advanced Research Projects Activity or IARPA. This award is for the second phase of a multi-year Space-based Machine Automated Recognition Technique or SMART program through which IARPA chose BlackSky's AI framework out of several other competitors to support their entire program moving forward. The SMART program is focused on automating the analysis of space-based imagery and with BlackSky's support, aims to automatically recognize heavy construction projects such as military bases, stadiums, campuses, dams, and airports, all of which are key strategic assets and important indicators of strategic and economic activity. And third, we won a contract with the US Air Force to provide them with advanced AI-enabled monitoring and analytics services for space-based defense and tactical intelligence and reconnaissance applications.

Moving on to slide 11, the Air Force Award continues to expand our portfolio programs with organizations such as the Space Force, US Army and Space Development Agency that are seeking to leverage small satellite constellations for space-based defense, which is a key priority in the US defense budget. US investments in space programs are outpacing broader defense spending and are viewed by those in government as vital to our country's national security and defense strategy. For example, the 2023 budget for the Space Force and the Space Development Agency was increased by 25% over fiscal year 2022 levels.

We're pleased that our architecture and operational capabilities are well aligned with the US government's space-based defense priorities. As we discussed previously, our TACGEO program, for example, with the US Army, is leveraging our Gen 3 satellites to demonstrate tactical space-based operations to inform future architectures.

In addition to winning several large new customer agreements, we continue to see strong demand for our high frequency imagery, monitoring and analytics services from existing customers, such as the National Geospatial-Intelligence Agency or NGA. As part of our five-year economic indicator monitoring contract with NGA, we continue to execute and pursue additional task orders under that program.

We're also seeing robust customer demand for our products and services internationally, which helped drive another solid performance in Q2. We are continuing to see increased demand in Europe beyond just Ukraine and in other regions such as the Middle East, Asia Pacific, and other key areas around the world.

Throughout the quarter, we added and continued to support several major ministries of defense, providing them with mission-critical intelligence of their most important strategic assets and events. With the expansion of our international sales team on track, we are well-poised to capture additional sales opportunities as international demand continues to grow.

Turning now to our commercial business. As we announced last month, we entered into a strategic partnership with Esri as outlined on slide 12. For those who may not know, Esri is the global leader in geospatial intelligence software, used by over 350,000 organizations across 100 countries. Anyone who has ever utilized geospatial mapping or geographic intelligence solutions most likely knows about Esri and uses their software in day-to-day operations.

With our new partnership, BlackSky will provide Esri online users for the first time with access to on-demand satellite tasking services right inside their application. This type of platform integration, similar to our integration with Palantir, is changing how users in any platform can access on-demand geospatial intelligence. Esri users can now task our satellites when and where they want and receive high resolution imagery automatically delivered into Esri's ArcGIS online platform within hours. Thereafter, the imagery can be used in other Esri applications to provide additional analysis for decision making. This partnership was made possible because of our on demand and fully automated software and tasking services, and is another validation that dynamic monitoring and on-demand access to data and insights are what customers are looking for today.

Our proven high frequency constellation, providing hourly dawn to dusk monitoring of the most important strategic and economic assets in the world provides a vital, important capability to a large geospatial community worldwide. We're also continuing to see an increase in commercial opportunities across a number of vertical markets, which we are pursuing through the expansion of our commercial sales team and global reseller network.

In summary, we had a very strong second quarter hitting significant operating milestones with our space and software platform, winning the historic and validating EOCL contract and continuing to grow our customer base.

I'll now turn it over to Henry to go through the quarterly financial results in more detail. Henry?

### **Henry E. Dubois**

Thank you, Brian, and good morning, everyone. I'm happy to be here today and excited to lead the company's financial strategy as the CFO. As Brian mentioned earlier, I've been supporting BlackSky for several years and have worked in the geospatial intelligence industry for quite some time. I believe the company has a unique value proposition providing customers with dynamic hourly monitoring and a proven software platform, delivering actionable intelligence to governments, businesses and organizations around the world. Now that I'm in this new role, I look forward to meeting many of you in the near future. With that, let me address our second quarter financial results.

Starting with slide 14, customer demand for our imagery and analytics solutions continue to grow in Q2, driving another record performance in our revenue. For the second quarter of 2022, revenues reached \$15.1 million or 105% increase over the prior year period and our largest year-over-year growth rate to date. In fact, we've now reported 10 consecutive quarters for year-over-year revenue growth, demonstrating the growing demand from customers for BlackSky's products and services.

Imagery and software analytical services revenue grew to \$13.3 million, a 161% increase over the prior year period, primarily driven by new and existing government contracts. As you know, we were awarded the EOCL contract with the NRO in May with the official start of the program beginning on June 15, resulting in minimal contribution to revenues in Q2. I am pleased with how quickly we ramped up our operations to hit daily imaging volume requirements and look forward to recognizing a full quarter's worth of subscription services revenue starting in Q3. The revenue mix for imagery and software analytical services rose to approximately 88% of total revenues, demonstrating the value customers placed in our high frequency imagery and Spectra AI platform capabilities.

Engineering and systems integration revenue was \$1.8 million, a decrease of \$500,000 from the same quarter last year, primarily due to the way project costs impact the revenue recognition on these manufacturing projects. As a

reminder, our engineering and systems integration revenues include strategic programs with key customers that provide us with funded R&D to offset our capital investments. These programs provide the benefit of building long-term customer relationships and accelerating technology development of future satellites, and in some cases include hardware deliveries.

Turning to slide 15, our cost of sales as a percent of revenue improved dramatically from about 87% in Q2 last year to about 65% in Q2 this year. This improvement was primarily driven by the increase in imagery and analytical services revenue, which grew from \$5.1 million in Q2 2021 to \$13.3 million in Q2 2022. In addition, the revenues from this part of the business grew to 88% of total revenues and generally comprise a low fixed cost structure. As a percent of revenue, cost of sales for imagery and software analytical services was cut in half to about 40% in Q2 this year, compared to 81% in the prior year quarter. This improvement validates the benefit we expect to see as we continue to, one, grow our imagery and analytical services revenue; two, monetize our on-orbit capacity; and three, benefit from the operating leverage provided by our platform.

On the engineering and systems integration side, our cost of sales increased primarily due to the accounting treatment of two projects. These two projects comprise development efforts for our Gen 3 satellite capabilities that are partially funded by customers. Since we generate revenue on these projects, the total costs incurred on these development efforts needs to be expensed rather than capitalized, as they would be if we did not have the benefit of the customer support. In addition, expected future expenses in excess of expected payments from the supporting customers needed to be expensed this quarter also.

We do not expect these excess expenses to continue in the future. Keep in mind, these expenses are costs we would be normally incurring to develop our Gen 3 capabilities but would be capitalized if not for the support from our customers, support, which does improve our cash flow on these activities. We expect to continue working on more of these R&D type projects over time, but want to emphasize that our imagery and software analytical services business is more representative of the long-term direction of our business and the operating leverage we expect from our space and software assets.

Let me briefly touch on operating expenses. For the second quarter of 2022, operating expenses were \$27 million compared to \$30.8 million in Q2 of last year. Keep in mind, there are some onetime charges and non-cash items recognized in both years, including stock-based compensation expense, depreciation and amortization expense and the satellite impairment loss recognized last year in Q2 2021. If we exclude these unique items from both years to make the year-over-year comparison of ongoing operating expenses clearer, then operating expenses increased \$6.6 million from \$8.6 million in Q2 last year to \$15.2 million in Q2 this year. This increase was primarily due to investments in building out our global sales network, our software and engineering teams and public company operating costs. As mentioned earlier, we're already seeing the benefit of those investments in higher imagery and software, analytical services revenue and a growing customer base.

Moving to slide 16. We reported an adjusted EBITDA loss of \$8.8 million in the second quarter of 2022, compared to a loss of \$7.6 million in the prior year period. However, as a percent of revenue, adjusted EBITDA margin has improved significantly between Q2 of this year and Q2 of last year. And it's moving in the right direction, driven by greater volumes of high margin imagery and software analytical services revenue. Based on the strong customer demand for our imagery and analytics, we anticipate revenue growth to outpace our investments in the business which puts us on a path toward positive adjusted EBITDA. Capitalized expenditures in the second quarter were \$12.2 million, with about 70% of this spend attributable to building and launching satellites, of which \$3 million was attributable to our Gen 3 satellites.

We also continue to invest in our software and analytics capability as well as other infrastructure to continue to scale our business. The company ended the second quarter of 2022 with \$111.2 million of cash, restricted cash and short-term investments. You may have noticed in our financials this quarter that we reported about \$44 million of short-term investments as we look to improve our yield on existing cash. Through ongoing cost management and prudent investments in areas where we expect a high return, such as our Gen 3 satellites, we believe we have sufficient cash and liquidity for the foreseeable future.

Now, let's move on to our 2022 outlook as shown on slide 17. Customer utilization and demand for our unique dynamic monitoring, on-demand satellite tasking and analytic insights continues to be strong. We are seeing greater interest for our products and services from both US and international governments, as well as several well-known organizations like Esri who are choosing to partner with us, thereby expanding our customer reach globally. As a result of the increased market demand, combined with several large recently awarded multi-year contracts, we are positioned to have a robust second half of the year.

To that end, we are raising our company's full year revenue outlook for 2022 to between \$62 million and \$66 million. This is an increase from our previous guidance range of between \$58 million to \$62 million. Taking the midpoint of our new guidance range, this represents a strong 88% year-over-year growth. For capital expenditures, we continue to expect spending for the entire year to be between \$52 million and \$56 million as previously guided. As customer

demand continues to fuel higher revenues, combined with our strong focus on cost management, we look forward to further scaling our business.

Finally, we'll be filing our 10-Q for the second quarter later today, post-market close.

With that, I'll now turn it back over to Brian for closing remarks. Brian?

**Brian E. O'Toole**

Thank you, Henry.

In closing, we're very happy with the great execution we've made across the business and momentum we're carrying through the year, resulting in a strong second quarter. Once again, our revenues achieved another record, more than doubling from the prior year period. We achieved our baseline constellation that is delivering reliable and dynamic hourly monitoring of the most important and strategic economic assets in the world, which gives us the on-orbit capacity to achieve our revenue growth objectives for the next few years.

We won several large multi-year contracts, including our company's largest award to date, with the EOCL contract, validating our technology and long-term strategy of providing strong revenue visibility. We established new strategic partnerships with companies like Esri to accelerate our commercial adoption and expand our customer reach. And as a result of all of these accomplishments, we've raised our revenue guidance as we're seeing strong customer demand for our products and services.

We're in a very exciting time in the industry, as BlackSky leads a major shift from static mapping to dynamic monitoring, as we change the way we use space to deliver actionable intelligence. Customer demand for our high frequency imagery, dynamic monitoring, analytic insights has never been higher, and we look forward to carrying this strong momentum into the second half of the year.

This concludes our remarks for the call, and we'll now take your questions.

**QUESTION AND ANSWER SECTION**

**Operator**

Thank you. We will now be conducting a question-and-answer session. Thank you. Our first question is from Jaeson Schmidt with Lake Street Capital Markets. Please proceed with your question.

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**Analyst:** Jaeson Allen Min Schmidt

**Question – Jaeson Allen Min Schmidt:** Hey, guys. Thanks for taking my questions. Brian, I know in the prepared remarks you noted kind of momentum from both existing and new customers, but curious if one or the other is really just driving this update to guidance.

**Answer – Brian E. O'Toole:** Good morning, Jaeson. Thanks for joining today. Yeah, I would say it's a combination of both. We've been establishing a good base of customer revenue from existing US and international government customers, but we've also been adding new customers, particularly internationally where we're seeing a lot of demand in a number of different regions around the world.

**Question – Jaeson Allen Min Schmidt:** Okay. And that's a good segue to my next question on that international traction. I think revenue was about \$2.7 million in Q1. I know the 10-Q is coming out later, but can you just help us think about directionally how it was in Q2?

**Answer – Brian E. O'Toole:** Well, I think, it continues to grow, as we've outlined. We're not getting into the specifics of those different segments. But I would say it's in line with our plans, and there's several aspects that are growing faster than expected.

**Question – Jaeson Allen Min Schmidt:** Okay. Got it. And then, just last one for me and I'll jump back in the queue. I understand sort of the dynamics going on kind of in the engineering and systems gross margin, but when we think about gross margin in aggregate, is it fair to assume that you can build upon that kind of 35.2% you just posted in Q2 here in the second half of the year?

**Answer – Brian E. O'Toole:** Let me have Henry take that one.

**Answer – Henry E. Dubois:** Thank you, Jaeson. And gross margin or cost of sales, the way we're looking at it is that 35.2% is the combination of the – it's the mix between the margin or the cost of sales of the software and analytical support services revenue, which comprises 88% of our revenue and the engineering and services revenue. If you look on the financial statements, you'll see the breakdown of those two revenue and the cost of sales, and we also have

that on the chart where the software and analytical services revenue, our cost of sales for this year, up in the second quarter, I should say, was only about 40%. It was about 40 basis points reduction from where it was last time last year. So, I mean, and as we continue to focus more on the revenue from the software and analytics, I would expect our margins to continue to improve.

**Question – Jaeson Allen Min Schmidt:** Okay. That's helpful. Thanks a lot, guys.

**Answer – Brian E. O'Toole:** Thanks, Jaeson.

**Operator**

Thank you. Our next question is from Colin Canfield with Barclays. Please proceed with your question.

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**Analyst:**Colin Canfield

**Question – Colin Canfield:** Hey, good morning, guys. Can you discuss (00:35:35) for the Army TACGEO architecture from a sales and a cash perspective? And then maybe if you can flush out how BlackSky views the kind of customer funded R&D thesis versus cannibalization of geospatial analytics (00:35:52). Thanks.

**Answer – Brian E. O'Toole:** Yeah. Good morning, Colin. Yeah, the TACGEO program has been going on now for well over a year. It's an R&D type program that the government is using to explore future architectures. And that's a precursor to potential programs of record that may be pursued by the Army or the Space Force.

And then on your second question, we look at these engineering and integration programs as funded R&D. So that offset some of our capital cost. They're extremely beneficial in the sense that we establish very early on strong relationships with strategic customers. We get capital to fund future technology and we get good insight into future customer requirements. So, these are highly strategic in nature, but also have the benefit of offsetting cash investments.

**Question – Colin Canfield:** Got it. And maybe if you can talk a little bit about kind of the adjacent geospatial analytics upside from EOCL and the sort of costs and head count that you need to service that market. Appreciating that integrating AI and your machine learning algorithms is probably a low cost (00:37:21) but at the same time, you have to assume that as you approach kind of more services type work in geospatial analytics, there's still going to require some head count, or is that a wrong way to think about that business?

**Answer – Brian E. O'Toole:** Well, I think, first off, EOCL contract is for imagery only as I outlined in my remarks. So that gives us the opportunity to sell subscription monitoring and analytics services to other elements of the government. And so, we have that opportunity in addition to what we just outlined with tacticalize our solutions for the Space Force.

With respect to kind of the AI and head count, once we develop a particular AI algorithm, those run automatically in the platform. So, these results in high margin upsell analytics services. And relative to head count, the development of those types of things are embedded in our invested software CapEx over that's consistent going forward.

**Question – Colin Canfield:** And then maybe the last one, if you can maybe talk about the customer feedback of Airbus asset integration and how that compares to kind of early WorldView Legion traction that we've seen, maybe more in international markets than domestic, but still kind of something we have (00:38:46) to consider.

**Answer – Brian E. O'Toole:** Yeah. I think the important thing there, Colin, is that our Spectra AI platform was designed from the very beginning to integrate lots of different data. Customers want solutions that include different types of data sources. Those data sources we use to deliver actionable intelligence on demand. And the Airbus partnership enables us to bring in radar and very high resolution imagery that's combined with our high frequency monitoring. So that's what enables us to provide a richer offering to customers going forward.

**Question – Colin Canfield:** Got it. Thanks for the color.

**Operator**

Thank you. Our next question is from Josh Sullivan with Benchmark Company. Please proceed with your question.

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**Analyst:**Josh Sullivan

**Question – Josh Sullivan:** Hey. Good morning.

**Answer – Brian E. O'Toole:** Good morning, Josh.

**Question – Josh Sullivan:** Just now that you have EOCL (00:39:49), what are your thoughts on EBITDA visibility? What do you think you'll be able to give us longer-term outlook here?

**Answer – Brian E. O'Toole:** I'll let Henry take that one.

**Answer – Henry E. Dubois:** Sure. Hey, Josh. How are you doing? When you take a look at kind of our – as we were talking on that prior question from Jaeson, I was looking at our gross margin as we're improving our revenues and becoming more on the software and analytics, I would expect our cost of sales as a percent of revenue to continue to decline. If you could take a look at kind of in the first half of this year, when you take the increase in software and analytical revenue, it went up about \$12 million, and our cost of sales, as you'll see, is – went up probably in the neighborhood of about \$3 million. So, that says you've got about only – on the incremental revenue, got about 25% cost of sales or for the flipside, 75% margin on that. So, I would expect the cost of sales to continue to decline or gross margin to improve.

And then on our operating expenses, as we discussed in the remarks, our kind of period costs, as I would call them, did increase from about \$8.6 million from the second quarter last year to \$15.6 million in the second quarter of this year. That \$6.6 million increase – I'm sorry, \$15.2 million. The \$6.6 million increase is a combination of investments we're making in the sales and marketing team and public company costs and some of the engineering team. Some of those expenses, particularly like public company cost and some of the more back office and kind of the – you get to a floor type expense level, you pretty much have that kind of – on that set. The things that will continue to grow would be things like sales team and the software engineering expenses to support revenue growth. So they won't continue to grow at the same rate.

So over time, we would expect, obviously, our adjusted EBITDA margin to continue improving. We saw a 55 basis point improvement this past year-over-year quarter and we believe that we're on the right trajectory to get to a positive EBITDA and some nice EBITDA margins.

**Question – Josh Sullivan:** Got it. And then just as your customers get more real-time experience in Ukraine and elsewhere, how is the feedback with Gen 3? I mean, are you changing the strategy at all to enhancing that? Just curious on what the real-world environment is suggesting Gen 3 should either include or maybe you guys don't think you need to change what your strategy is.

**Answer – Brian E. O'Toole:** We do not need to change the strategy. The Gen 3 architecture was a result of some customer input over time as it's informing things like resolution and some of the other features we're putting on the spacecraft. So Gen 3 remains on track. As I mentioned, we'll start launching those satellites next year. They'll deliver higher resolution imagery and some other capabilities like shortwave IR, which the key aspect of Gen 3 is that with the higher resolution, the level of analytics that can be extracted from that type of data when you combine it with high frequency monitoring offers an extremely powerful value proposition to our customers.

**Question – Josh Sullivan:** Yeah. Thanks for the time.

**Operator**

Thank you. Our next question is from Scott Deuschle with Credit Suisse. Please proceed with your question.

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**Analyst:** Scott Deuschle

**Question – Scott Deuschle:** Hey, guys. Good morning. Thanks for taking the question.

**Answer – Brian E. O'Toole:** Good morning, Scott.

**Question – Scott Deuschle:** Henry, are you seeing much inflationary pressure on satellite construction? Obviously, to help the (00:43:46) CapEx guide, I'm just curious if you're seeing anything there that's moving in here (00:43:50).

**Answer – Henry E. Dubois:** Sure, Scott. Appreciate the question. That's one – inflation is always one that's top of our mind at the moment in the current economy. But as we're looking at it, we've got the benefit of getting our first batch of satellites under contract. So, we've got to understand what those costs are and we're able to manage that plus our supply chain. So, for the first batch of satellites that we'd expect to start getting up around the end of next year and into 2024, I think we've got those costs pretty well understood. Also, given the fact that we've got a full constellation right now, we've got a little more flexibility on timing if things were to become an issue.

**Question – Scott Deuschle:** Got it. And then, just an accounting question, I guess. Why it's in satellite depreciation and cost of sale?

**Answer – Henry E. Dubois:** Well, the reason we're doing it this way is we're looking at the cost of sales as kind of our operating costs, our current period cash costs. So, we've got the cost of sale of staffing up there. You've got the



cost of data transmission, ground station, operating costs, et cetera. So, we are looking at that as things that we can control, the depreciation we've got as a separate line item, because that is a decision that we're making more based on our overall capital expenditure budget as opposed to the actual operating decisions. And so it really comes down to more of how we go about managing the business.

**Question – Scott Deuschle:** Got it. That makes sense. I guess, just the follow-up would be you need to be talking about incremental gross margins earlier and there's not much incremental cost that the line you were just referencing. But with the CapEx or spending and when you launch Gen 3 and D&A should be going up, I would think. So, I guess the question is how do you think about incremental gross margins within imagery, if you were to allocate some percentage of that D&A to the segment.

**Answer – Henry E. Dubois:** I think, what you would want to look at is kind of what I would call kind of the maintenance CapEx over time. They kind of get into that kind of run rate of the number of satellites you have times the costs associated with those satellites divided by their – the expected life of those satellites and Gen 3 and others we're looking at kind of some improved lifecycles on those. So, when as we're going about doing our analysis, we definitely make sure we look at that. And that also plays into the timing of when we get the satellites up.

**Question – Scott Deuschle:** Okay. What would be a good long-term maintenance CapEx level for this business?

**Answer – Henry E. Dubois:** At the moment, we're not providing guidance on that number.

**Question – Scott Deuschle:** Okay. Thanks so much for your time.

**Operator**

Thank you. Our next question is from Chris Quilty with Quilty Analytics. Please proceed with your question.

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**Analyst:**Chris Quilty

**Question – Chris Quilty:** Thanks. Maybe start by beating a dead horse here on the revenue guide, the increase in the revenue guide. Would it be correct to think about it in one or two ways, either the incremental capacity that's come online or was there some uncertainty around the timing and the size of the EOCL award that gave you more confidence? Were either of those buckets more incremental in terms of the guidance raise?

**Answer – Brian E. O'Toole:** Hey. Good morning, Chris. Yeah, well, first off, EOCL in your term was in line with our expectation. So the size and the timing of that was consistent with our forecast. Of course, now that provides us with greater revenue visibility going forward. As reported in the first quarter, we are seeing strong growth internationally. And then frankly, we're winning more contracts that we have had in our pipeline and are converting into long-term agreement. So I think all of those things combined are what is driving our visibility and our increase in guidance.

**Question – Chris Quilty:** Thanks. That's some good color. This one's probably for Henry, it's a – again, a follow-on on the margin. With the new partnerships, both Airbus integrating and Palantir and Esri, do the revenues generated through those platforms generate a significantly different margin from just the core imagery sales and services on the base platform?

**Answer – Henry E. Dubois:** Chris, yes. As we look at that, those costs, I mean, they are built into our cost of sales models and they do have an impact on that margin. As you might imagine, imagery coming off our satellites when we're looking at from a pure incremental cost-type basis, those are very high margin. So there's a little bit of a drag, but they provide strategic benefits. And quite honestly, the imagery and the revenue that we're generating from our internal capabilities is much higher, and we expect to continue the leverage that.

**Question – Chris Quilty:** Great. And also a follow-up on Esri, I mean, they obviously have a pretty huge user base. Can you talk about the sort of user interface of how people would actually access and purchase the imagery? And I think, I get a news article and I click on the website and I want to see it, but they want me to pay, and (00:49:40) I'm going. Is that built into and automatically build through Esri so it's much more seamless or what would that user interface look like?

**Answer – Brian E. O'Toole:** Across the user interface, actually enables end users to pass for satellites with a BlackSky application running within the ArcGIS online platform. So, it's seamless from a customer experience. And then after they tap, that automatically, that request goes to our platform and then we automatically collect it and deliver it right back into the Esri platform into the user's account. All that is seamless. The business model is essentially reselling through Esri and orders flow through on their platform into ours.

**Question – Chris Quilty:** Got you. And one other follow-up on Airbus with like the SAR imagery coming in right now that you're offering through the platform, are you currently just providing imagery or do you have plans to actually do any of the analytics around that phenomenology?

**Answer – Brian E. O'Toole:** Yeah, Chris. We're planning and we already do support, we've been integrating SAR imagery in our platform now for several years. And there are certain programs that we have, one in particular is the economic indicator monitoring with NGA, where we're fusing high-frequency monitoring SAR to deliver analytical insights through our Spectra AI platform. So, we're doing all of that already. The Airbus agreement enables us to get access to a whole new data source of SAR and very high resolution imagery.

**Question – Chris Quilty:** Great. And one question on, actually, it's a two-part question on the Gen 3 constellation. I think in the deck, you mentioned both onboard processing and space communications. On the first part, how incremental is the on-board processing relative to what you currently have on the Gen 2 platform? And is that driven primarily around reducing ground segment costs or is it more around the latency, decreasing the latency on the data? And the second part of the question, when you talk about space communications, I know recently, Planet with their Pelican added a C-band relay capability with that, what sort of capability are you looking at?

**Answer – Brian E. O'Toole:** Yeah. So of course, on the – starting with the on-board processing, let me just say, generally, the Gen 3 architecture and bus (00:52:42) is very modular. It was designed such that we can have plug-and-play types of processing communications and other and payloads. So, we have a lot of flexibility in the architecture on what we put in there over time. On-board processing does give us the ability to shorten timelines and deliver analytic products directly off the vehicle. And then on space comms, it's a capability that's going to enable us to use space links to shorten tasking timelines and delivery timelines.

**Question – Chris Quilty:** Got you. And if I can, a final question, again, on the investor deck, and you show the sort of today the 2025 growth. And the biggest portion, at least percentage-wise, in growth is on the commercial side. Can you talk about where you're seeing success with commercial customers, either by application or industry?

**Answer – Brian E. O'Toole:** I would say the largest area we're seeing success commercially is the ease in which we're enabling commercial customers to access through platforms like Palantir and Esri. We have a number of other projects that we're working across different vertical markets and things like supply chain analytics and insurance, for example. So, we're seeing interest across a broad number of verticals, but I would think be it the platform integrations that we're demonstrating with Palantir and Esri is a first-time enabling in-app types of tasking and access to on-demand imagery and analytics, which we think is going to be instrumental in driving our commercial growth and our go-to-market strategy.

**Question – Chris Quilty:** Great. Thank you.

**Answer – Brian E. O'Toole:** Thank you, Chris.

**Operator**

Thank you. There are no further questions at this time. I'd like to turn the call back over to Aly Bonilla, BlackSky's Vice President of Investor Relations. Go ahead, Aly.

Well, I want to thank everyone for participating on the call today. And we look forward to speaking to you again soon. Have a great day.

**Operator**

This concludes today's conference. You may disconnect your lines at this time. Thank you for your participation.

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