Q2 2018 Question and Answer Transcript

Operator

Welcome to Tucows' second quarter 2018 and inaugural post-quarter question and answer dialogue with Elliot Noss, President and Chief Executive Officer. Thank you to all those who submitted questions over the past two weeks. For your convenience, this audio file is also available as a written document on our website.

Please note that the following discussion may include forward-looking statements, which, as such, are subject to risks and uncertainties that could cause the actual results to differ materially. These risk factors are described in detail in the company's documents filed with the SEC, specifically the most recent reports on the Form 10-K and Form 10-Q. The company urges you to read its security filings for a full description of the risk factors applicable for its business.

Please go ahead, Mr. Noss.

Opening Remarks

Let me begin with a couple of opening comments before we get to the questions. First, based on early indications, this change in format has been a great success. We are viewing success in two ways. One -- the feedback from investors has been uniformly positive. And two -- the quality of the questions is demonstrably better, which only makes sense when people have time to consume the results and think about those questions. And there are also more of them!

My second comment is prompted by one investor in particular who asked about my health. He was worried for me in a kind way and I realized we haven't provided an update since our Q4 call in February. As many of you know, I had both my hips replaced in January and, I am pleased to note that I am in great health and pain free for the first time in thirty years giving me LOTS of runway to lay fiber across the country!

Finally, I want to remind that our AGM is September 4 and unlike many, it is not a big deal at all. In fact, most years no one attends. I share this as I will not be at the AGM this year and I wouldn't want anyone planning to attend to not know that in advance!

Now, on to your questions.

Q: What is the expected cash burn for Ting Internet for 2018?

The expected cash burn for Ting Internet for 2018 should be about the same as it was for 2017 -- roughly $5.0 million. When we originally provided our forward view on this metric for 2018, we estimated it would be more in the $3.5 million range. The difference is almost entirely due to the delay in launch in both Centennial and Sand Point that we've talked about numerous times. This has simply delayed the onset of revenue. What is missed is months 5-7 in those markets as those months are pushed into 2019. It’s not a concern for the business, just a timing matter.

In terms of looking further forward, it’s certainly too early to talk about 2019 at this time, but we are seeing the right characteristics towards profitability at the city level. And I want to remind everyone that we look at the contribution from or burn for Ting Internet at three levels:
At the city level -- this is basically on a cash flow basis, comparing the revenue or gross margin in a city to the direct operating expenses in the city;
At a business unit level -- in which we add the costs of anyone at head office who is working across all of the different markets;
And then company overheads, which of course we don’t allocate.

Again, we are seeing the right characteristics towards profitability at the city level. And when we are talking about cash burn from a cash EBITDA perspective, we are talking about that at the business unit level.

Q: How do customer acquisition costs and churn profiles on the Ting Mobile acquisitions over the last couple of years compare to your core acquisition efforts and customer base?

The only relevant comparison here is RingPlus, since PlatinumTel, or PTel, was just a special offer to stranded customers, not an acquisition, and Roam just has a wildly different profile of usage, costs and churn. But RingPlus is a great example and it is a great question since we may see more of these.

Of course, each base we acquire will be different. What they will have in common is that these customers did not choose Ting and they will, therefore, almost certainly churn at much higher rates, particularly at the start.

In the case of RingPlus, including customer credits, customer support costs and commissions paid to the seller, we spent about $80 per original migrated customer. That is below what we usually spend for new customers in our marketing program although, again, these customers predictably had a lower lifetime value. The original 20,000 RingPlus customers churned at about 20% for the first few months and then churned a bit less each month since, settling in at churn of about 3.7% this past quarter versus the 2.74% we reported for the rest of our base.

The effort was well worth it on a cash on cash basis.

Q: Will Internet costs ever become a significant cost item for Ting Internet?

The short answer is “no”. They are a real cost at a dollar level as the business grows, but as a percentage of revenue, they start off low, and get lower over time. When we go into a new city, we tend to get a larger circuit than we need in two directions, for redundancy -- redundancy not only of circuit, but also redundancy of route. That tends to serve us for a fair portion of time until, over time, we need to upgrade that circuit. When I talk about gross margins comfortably north of 90% in the Ting Internet business, really the only COGS are those circuit and peering costs -- so, sub-10% of Ting Internet revenue -- that's not a cost we consider significant. That being said, we do everything we can to manage those costs expeditiously.

Q: We had a number of questions on the Ting TV offering:
Will Ting TV be profitable outside of the benefit of higher conversion rates?
Will Ting TV be accretive to Ting Internet margins on a per user basis?/Are the margins on Ting TV better than the margins on Ting Internet?
Are there any plans to offer Ting TV to subscribers other than your Ting Internet subscribers?

I'm going to address those questions together. First, let me remind you that we expect Ting TV to be out in limited beta to some our customers this year. We did have a slight delay with one of our software vendors, but that shouldn't push things out very much. Our current plan is to be out for general availability during first quarter of next year.

We continue to view Ting TV as something that will drive the Ting Internet take rate. We view TV as a part of Ting Internet and not as a business unit. The Ting TV offering itself will generate low percentage gross margin dollars, but we only measure it by estimating what it does to take rate. We consider it an add-on to Ting Internet, as there are not employees, whether it's in customer service, or product or engineering, that are dedicated to the TV product. There are a operations people certainly, but nowhere near the level at which we would think about TV as a business unit level contribution.

We also don't really view TV through the lens of adding ARPU. And, while I think we are going to provide some interesting innovations, particularly around the way set top boxes work, and how you access Ting TV, we have no plans, nor would we have any, to make this available as an "over the top", or OTT, service out of market. And I say that because right now we view the OTT space as very crowded and generally populated by companies for whom that is the most important strategic thing they are doing. We really bring no innovation or native benefit to that other than some clever user experience or look and feel. So, you won't see us offering an OTT app -- we think that would be a poor use of our time and effort.

I also note that Ting TV has much lower margins than Ting Internet and will, in fact, drag down Ting Internet margins. When I've talked about Ting Internet margins being comfortably north of 90%, that's independent of the TV offering.

Q: We had a number of questions around the status of the pipeline for additional Ting Internet towns.

When looking at the Ting Internet pipeline, there are a few things that I want to reiterate up front. First, we are not cash constrained. We are not opportunity constrained. We are resource constrained. There is plenty of opportunity out there. It is important to recognize that the fibre business at the start of 2017, consisted of our purchase in Charlottesville and our public-private partnership in Westminster. We were learning how to stand up the business. We did a nice job of figuring out some of the core elements of being an ISP, billing and provisioning, support, how to build out crew, manage truck rolls, and much much more. At the beginning of 2017, and through 2017, we stood up our first market from scratch in Holly Springs. That was something that was significantly more work, and different work, and all of it needed to be repeatable. Things like network design and sourcing and managing contractors. Through the later part of 2017, we also were starting to get the initial work done for Sandpoint and Centennial. So, for the later part of 2017 and into 2018, we were now, for the first time, in three different markets, and doing those things simultaneously. And there was a lot of learning there. There was significant and skills development around what we needed to be able to do to build and light up in multiple markets at the same time. Later in 2018, we added and are already doing work in Fuquay Varina and we are now, with Centennial and Sand Point both coming onstream, and the rebuild work in Charlottesville, experiencing what it's like to be in four and in five markets at the same time. What investors should watch and track is the steady, consistent, significant progress that we are making in our ability to operate in multiple markets, and you can see that best through the lens of capex. You heard my comments in my prepared remarks for the quarter about that significant ramp. You're going to see those levels of capex continue for the next few quarters and hopefully start to increase as well.

So from our perspective, new Ting towns are not slow in coming. In fact, we were quick out of the gate with Fuquay Varina, and I note that it's a great example of something that's easier to do. It's easier operationally to start work in a city like Fuquay Varina where we came to an agreement with the city quickly where we already have a team in place in Holly Springs. We already have arrangements with existing contractors that we can just slide over to work in Fuquay Varina as they are finishing work in Holly Springs. We see a similar exercise in Charlottesville, where we've added solid numbers of serviceable addresses just outside city limits.

I have now noted a couple times in my remarks that cities are the wrong metric to be watching. Watch capex spend and serviceable addresses. We don't feel like we have any lack of opportunity to sign contracts with cities. We continue to expand what we're doing every quarter and we continue to improve the organizational muscle that allows us to take on more and more and more work.

Q: What have been, or might be, the effect on Tucows of protectionism and new tariffs?

There are two comments I would make here. First, and probably most importantly, all of our business lines are significantly recession proof. Relatively speaking, low price items, whether they are domain names or mobile phone service or home Internet, they are core needs, things that people cannot do without. They are not luxuries. They are, in the context of today's world, necessities. And so we believe our business to be relatively recession-proof.

The second comment I would make is that I do have a personal view that there is a little higher risk than there has been for the last few years of a significant economic correction -- not a market correction, I don't offer opinions on the market -- but in that context, and even with a recession-proof business, it does make us slightly more conservative in terms of how we are looking at our uses of capital. I don't want you to take any alarm away from that comment -- if previously we were at a 6 in terms of worry, now we are at a 7 or a 7.5. And I do tend to be relatively conservative -- I'm probably more prone to fiscal conservatism than most.

Closing

That ends our Q&A. I would like to explicitly note that we also answered a number of questions that we did not believe to be of general interest, directly with the questioners.

We all really appreciate both the positive response and the thoughtful questions. We invite you to share your feedback on the format as we hope to continue to improve our shareholder communication.