

Tucows Q3 2018 Question and Answer Transcript

Operator

Welcome to Tucows' third quarter 2018 post-quarter question and answer dialogue with Elliot Noss, President and Chief Executive Officer. Thank you once again to all those who submitted questions over the five-day period subsequent to the call. 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

Welcome to the Q3 2018 Q&A.

The current approach to the investor call and the follow-up questions has been extremely well received. As noted, it is also a work in progress and we intend to keep trying to improve it.

This quarter the format was a little too successful! By that I mean that we received a LOT of questions and some of you asked a large number of detailed questions. I wish to be clear that those of you that did were very apologetic (and appreciative) so please do not worry. We are all learning together. This quarter we will add two small modifications. First, if your questions reach a certain threshold or volume we may ask you to schedule a call instead. This is not a bad thing at all. It is just a more effective way of dealing with the full body of your questions.

Second, we are grouping similar questions into categories that we feel are addressing your issues. They may not be. So if you feel that the recorded answers and/or any direct email you may receive, did not address the meat of your question, please let us know.

Finally, we have debated for years having a shareholder letter or similar artifact but it has never happened. It is now clear that this process of recorded calls and questions will create a nice living body of information that can serve to fulfill much of the purpose of an annual shareholder letter. Please do not look at our efforts in this light after a quarter or two, but rather after a year or two. In general, we get great feedback on our transparency, accessibility and our clarity as a public company. We feel this body of work will really help take that to the next level.

Q. There was a question about my recent share sale.

As many of you know, I am over 100% invested in TCX. By that I mean that the value of my TCX shares exceeds my net worth. This is primarily due to the fact that in Canada, stock options are taxed when exercised, not when sold. In order for me to be able to afford to hold my shares, I have had to borrow money, secured by some of my shares, in order to pay my tax bill.

You will now see me disposing of shares in two circumstances. Last year I started donating shares representing roughly ⅓ of my taxable income. This is the maximum amount allowed by Revenue Canada as a deduction from taxable income. In addition, this year I initiated a 10 b) 5 program to start to pay down my debt. Presently, I intend to sell a little less than 1% of my holdings, NOT shares outstanding, under this program every year. I will be surprised and disappointed if my total dollars invested does not continue to go up over any appreciable time frame. I hope this was not too personal and I hope it provides clarity.

Q. We received a few questions on the outlook for our domains business, and the industry generally and, unsurprisingly, a few questions on Verisign increasing the price of .com.

There are three points I would emphasise generally. First, there is industry growth. The number of domain names in the world consistently grows in the 4-8% range. That growth is more in the long tail and developing world though, so even though we do well for a big player in those areas, our market growth opportunity is more in the low-single digits.

Second, our price changes on the wholesale platform in the last year were primarily aimed at both aligning historical Open SRS and eNom pricing and at cleaning up a number of historical inefficiencies in pricing for some eNom customers. Over the years eNom was simply less consistent than we were in our pricing and we were not comfortable with some of the inefficiencies. Net net, this cleanup had a positive impact on gross margin dollars. Additionally, that impact is about half of the growth you see in gross margin dollars in this category, with the other half coming from organic growth.

Third, I commented on being more excited about the opportunity for new services than I have been in years. Some of you wanted specifics. I apologize, but as with all that we do, I prefer to tell you about what we have done, not what we will do. I do not expect to even refer to this again for the next few quarters. The reason I did mention it was that it connects with the integration and new platform work and I wanted to make sure that investors understand this as a part of the long term thinking.

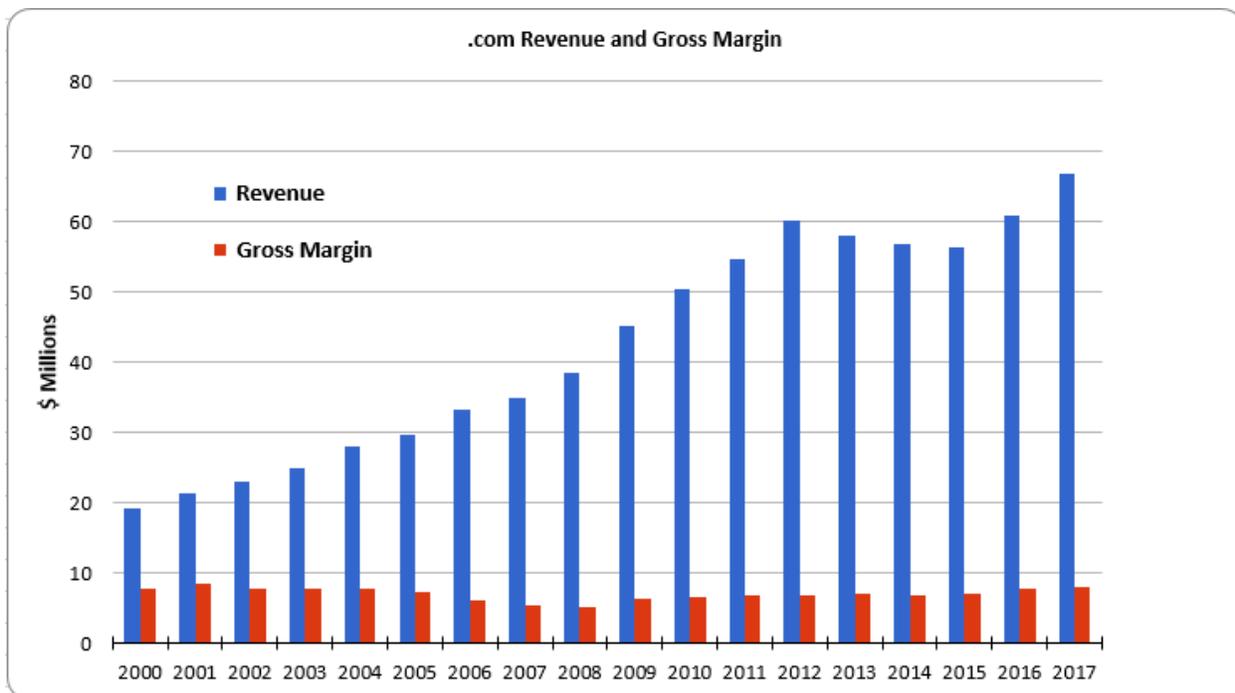
As for the Verisign price increase, the US government, through the NTIA, recently decided to allow Verisign to raise the price for .com. Rather than provide details here, I simply provided a link in the published remarks (below). I apologize that it is from the trade press as what Google yielded was mostly protest or editorial.

<https://domainnamewire.com/2018/11/01/breaking-u-s-gov-grants-verisign-com-price-hikes/>

There are two comments I will make. First, our wholesale pricing is “registry-plus” meaning that we generally pass this price increase along to our wholesale partners. We like it no more or less than they do.

Second, .com has a strange place for us, and I suspect most registrars. It is still by far the largest top level domain. It is still by far the one that end users want as first priority. It still dominates our discussions with resellers. And over time it has become less and less impactful to our gross margin dollars. The data, going back to the launch of OpenSRS in 2000 speaks volumes. The unit volume of .com sold goes up every year. The amount of money we pay to Verisign goes up commensurately. And the amount of money that the competitive registrar market allows us to generate stays flat. Like the prairies. Amazingly flat over now 18 years. And on a % basis it has gone from us making 40% of the .com revenue generated in 2000, all the way down to 12% in 2018. We make a little under \$8 million per year on .com. That was

true in both 2000 and 2018. They made roughly \$19 million from our .com sales in 2000. In 2017 that number was nearly \$67 million. This price increase only exacerbates that trend. And of course we believe that registrars do, by far, the lion's share of the work to generate that revenue.



We expect that a similar story holds for most registrars. Obviously, it makes .com less profitable for us than other tlds. But again, we are insulated from the price increase.

Q. There were a number of questions on Ting Mobile.

I was asked about churn in Q3. Churn was 3.03% in Q3, compared to 2.82% a year ago in Q3 2017 and 2.73% in Q2 2018. The comparison versus year ago is more important since churn is quite seasonal. From our perspective, this was a relatively insignificant increase. We are both proud of our churn and excited about opportunities to improve it. Importantly, I did not intend to omit it on the earnings call. We just had an otherwise long script and accidentally left it out. We will rectify that next quarter.

In response to my comments on the call about Ting Mobile's pay for what you use pricing versus unlimited, some investors, who are also customers, were shrewd enough to flag that we have, in fact, been quietly testing unlimited by offering it to certain customers and wanted to hear more about that.

We have indeed been experimenting with an unlimited plan. With the help of some excess capacity we have on our carrier commitments, we have been using it discreetly to convert some incremental prospects, save some departing customers and, mostly importantly, gather some valuable usage data. As I indicated on the call, I do not believe unlimited represents our best opportunity to differentiate Ting and pry customers away from carriers and I certainly do not believe it can offer us the margins we enjoy on this business. Unlimited may be a small tactic for Ting – it is not necessarily a long-term strategy. I do think we can use it to catch some customers coming and going around the edges and to help us earn some revenue against these carrier commitments. But, of course, anything we do going forward will depend on what we learn from our experimentation and on our carrier negotiations.

Q. On Ting Internet, we were asked to explain why there were so few serviceable addresses added in Q3, particularly relative to the capital expenditure.

I mentioned in our prepared remarks that with three towns - Sandpoint, Centennial and Fuquay-Varina - still in the foundational stages of construction, you will see outsized serviceable addresses added next quarter. I should have been more explicit that those three markets at those stages of construction were also responsible for very few incremental serviceable addresses relative to capex in Q3. The word “foundational” really does explain it best. There is a lot of work and a lot of investment at the beginning of a build that does not produce a lot of serviceable addresses. But the serviceable addresses will inevitably follow.

Q. Finally, relating to both Ting Mobile and Ting Internet, we continue to get a lot of questions about 5G. People want to understand what sort of threats and opportunities it represents for us and how it impacts our current planning and investment.

I actually answered that question quite comprehensively in a five-minute video that you can find in the Investor Videos section of our Tucows Investor website. Please take a look and do feel free to let us know if there are still outstanding questions after reviewing that video.

<https://www.tucows.com/investors/investor-videos/>

Thank you again for all the interest and participation in this question and answer process. Look for individual responses in your inboxes and please feel free to keep asking.