tucows

Q1 2019 Q&A Transcript

Introduction

Welcome to Tucows' Q1 2019 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 period subsequent to the call. For your convenience, this audio file is also available as a written document in the investors section of our website, along with our [Q1 2019 financial results](#).

Please note that the following discussion may include forward-looking statements, which, as such, are subject to risks and uncertainties that could cause 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. Our current approach of a pre-recorded investor call followed by solicitation of follow-up questions and a call responding to those questions has been extremely well received, and has enabled more questions, and more productive discussion with investors. As noted, it is also a work in progress and we intend to keep trying to improve it.

We received detailed questions again this quarter. We are grouping similar questions into categories that we feel are addressing common queries. If your questions reach a certain threshold or volume we may ask you to schedule a call instead, to ensure we can address the full body of your questions. And if you feel that the recorded answers and/or any direct email you may receive, do not address the meat of your questions, please let us know.

Go ahead Mr. Noss.

Remarks [Elliot Noss]

Thank you for listening in on our Q1 2019 Q&A.

ASCIO

With respect to Ascio and 2019 guidance, the original plan was to have Ascio close by January 31st. At the time of the 2018 Q4 call, we believed that the Ascio deal would close in the next week or so. Given that it was less than 5% of the annual cash EBITDA number, we elected to include Ascio in the 2019 guidance, as I did not want to move the number just a week or two later -- and we expected to address it in the communication around the transaction, which we did. Then Mr. Murphy intervened and the vendor changed the deal -- for good reason -- from an asset purchase to a share purchase, delaying the close by just over a month. A good reminder that each deal has a life of its own.

For clarity, Ascio contributes a little under $4 million in cash EBITDA on a run rate basis, and in addition, will provide synergies of a little over $1 million, through the next 12 to 18 months, from replacing overhead costs of the previous owners on a more cost effective basis, and being able to apply some of the talent in the Copenhagen office more broadly over the entire wholesale business.

TING MOBILE

Several respondents asked about the carrier negotiations and the non-product carrier penalties we incurred in Q1. You will find them accounted for in COGS for mobile on our Q1 financial statements.

The extra costs and penalties we incurred in Q1 fell into two or three different contractual and operational buckets. They are indications of relationships that are less productive than we would like, and, particularly at these levels, were a surprise and disappointment to us. These are large, complex commercial relationships that are difficult to negotiate in public, and the tension between clarity and visibility for investors -- which we love to provide -- and being able to conduct the most productive negotiations, is a real challenge. We hope and expect to talk a lot more about these relationships on the Q2 call. We are focused on the long term profitability of this business, and are quite confident that we have a productive path forward. So stay tuned.

There were also a variety of questions about our plans to address the lack of growth on Ting Mobile. Investors know that we have been able to find customers from exiting MVNOs with some regularity over the last few years. These have helped us post margin gains every year since 2012, even as organic growth has become tougher. Thankfully, the same conditions that have made growth tougher for us seem to be nudging less successful MVNOs toward exits. You have heard me say that there is more we can do to improve the business on the carrier side. So I am confident we have levers to deliver growth yet again, in 2019. Meanwhile, we continue to explore and experiment with scalable, sustainable acquisition strategies and tactics, that we will share more as we progress.

Investors have also asked about our intentions to drop our mobile pricing. We note that we have a much greater challenge with awareness than we have with conversion or satisfaction. Indeed, our margins have grown over time with reduced carrier costs, and we are considering investing in customer growth. Lower rates help convert prospects that are aware of the service, but do little to drive awareness, which is still our greatest challenge. Also, lowering rates means paying a significant price on existing customers that are still quite satisfied and still churning at a relatively low rate. Spending that margin on awareness building, and targeted conversion tactics such as trial offers, targeted save tactics, or acquisition offers to other MVNOs, may end up giving us greater returns on our investments.

TING INTERNET

Turning to fiber. Most of the questions about fiber this quarter were in regards to the overall model. I thought it a good time to do another level set.

First, remember that we do all our fiber modeling on a cash-on-cash basis. This means that things like capitalizing labor will impact our GAAP accounting but not our decision-making. We feel this helps everyone in the business better operate like an owner. Of the capex for our fiber build, 70-80% is labor cost. We note that this is true from building the main line to bringing the fiber from the curb to the home.

Next, remember that costs are incurred on three levels: the city level, the national level, and overheads. Overheads include things such as the time Dave Singh and I spend on the fiber business, or the facilities that people in our headquarters use. Those costs are simply efficiencies for us, as they were already fully covered by the other businesses. Next are the national costs. These are the costs of people who work across the markets, performing functions like network design, or providing leadership and management for people working at a city level. These costs also include customer service, which we do not break out at a city level. These costs are more efficient the larger the number of addresses and customers.

Finally, we have costs at a city level. The two largest of these are: construction and installation teams, who do some of the building of the plant and all of the installations; and marketing costs. I note that both of these two larger buckets of costs are spent towards growing either the physical asset, or the number of customers. These are a growth, not maintenance, spend. Then we have the city manager function and other smaller city level costs. And of course, the cost of our Internet circuits -- which is the cost of goods sold, which we encourage investors to think about as sub-10%; probably closer to 5%.

There are two elements of this model that I would like to call out. First, our ability to scale this model depends upon growing our organizational capacity to build. Our continued growth in capex reflects this increasing capacity. I am pleased with how this is progressing. We have no models for this as we build the world's first Internet telecom.

Second, as with all SAAS platforms competing with legacy businesses, our big advantage in fiber long term rests in a much lower cost of acquiring, provisioning, billing and otherwise servicing a customer, while providing a vastly improved customer experience. We have now had enough time in-market to know that we are delivering on this improved service while seeing our costs well within the ranges we had planned for. This is now an exercise in growing this machine with increasing throughput and efficiency.

Lastly on Internet, we are not going to project or break out the impact of non-build models like Westminster or Fullerton yet. We will wait until they have a material impact on our totals. Our goal with things like this is to make the business as simple and understandable as possible for investors, and at this point the non-build models are just not terribly material, and will lead more to confuse than to provide enlightenment.

CAPITAL ALLOCATION DECISIONS
And to wrap things up; we had a few questions on hurdle rates as they relate to capital deployment. As we've stated many times previously, whether it is an acquisition, an internal investment, or buying back stock, we like to look for a cash-on-cash IRR of at least 20%. And from there of course we risk adjust.

I would add that there were a few questions specifically asking whether we will be buying stock at these levels. When we are buying stock in the open market, we are no more likely to telegraph our intentions than our investors are. I consider us lucky to have both capital to deploy, and opportunities that meet our threshold to deploy it. One small note here: We have had more acquisitions in the last few years than was usual in our history. And a fuller M&A pipeline means more time when we are precluded from buying back stock.

Again, thank you for listening in on our Q1 2019 Q&A, and a reminder that if you feel that the recorded answers and/or any direct email you may receive do not address your questions, please follow up with us at ir@tucows.com.
