

Introduction [Michael Goldstein]

Welcome to Tucows' third quarter 2018 investor call. Management has pre-recorded its prepared remarks regarding the quarter and outlook for the Company. In lieu of a live question and answer period following the prepared remarks, shareholders and analysts are invited to submit their questions to Tucows' management via email at ir@tucows.com. Management will then post a recorded audio response to questions, as well as a transcription, to the Tucows website on Friday, November 16 at approximately 4 p.m. eastern time.

Now, on to management's prepared remarks.

On Wednesday, November 7, Tucows issued a news release reporting its financial results for the third quarter ended September 30, 2018. That news release, along with the Company's financial statements and 10-Q are available on the company's website at tucows.com, under the Investors heading.

Please note that the matters the company will be discussing include forward-looking statements and, 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.

I would now like to turn the call over to Tucows' President and Chief Executive Officer, Mr. Elliot Noss.

Management Remarks [Elliot Noss, CEO]

Thanks Michael. I will begin our remarks with a review of the quarter. Dave Singh, our Chief Financial Officer, will then review the third quarter financial results in detail. And I'll return for some concluding comments.

Before I begin, a few notes on the new format. The approach has had an overwhelmingly positive response. That said, as it was our first time last quarter, we asked for your feedback, and many of you requested that we post the responses to questions sooner after the call than we did last quarter. This quarter we will take questions until Monday, November 12 and will post our responses by end of day Friday, November 16.

Now on to the quarter.

Q3 was another solid quarter across the business, once again demonstrating how the consistent performance and cash flow generation of our Domains and Ting Mobile businesses are enabling us to invest in the Ting Internet footprint setting up for our next phase of outsized growth. Total revenue was \$83.5 million, which was down marginally from \$85.0 million in the same period of last year, but in line with our expectations due to the bulk transfer of 2.7 million domain names with essentially no gross margin associated with; as you can see with gross margin dollars increasing 18% in the same period. Net income for the third quarter increased 55% to \$5.3 million from \$3.4 million, while adjusted EBITDA increased 27% to \$11.9 million from \$9.4 million.

I'll now review the performance of the individual businesses.

Our **Domains** business saw another quarter of consistent performance.

In the Wholesale channel, total registrations were approximately 3.8 million, which was essentially unchanged from Q3 of last year, net of the bulk transfer mentioned earlier. Importantly, we are seeing the positive impact of the price increase on Wholesale Domain Services gross margin dollars, which were up 40% year-over-year to their highest level ever. Correcting for some one-time events, the normalized number would still be up over 30%.

The Wholesale renewal rate for Q3 was a very healthy 78% -- right in line with recent performance.

The Retail domains channel also saw consistent performance in Q3 with total registrations of approximately 390,000, down slightly from around 400,000 in Q3 of last year, as continued growth in our legacy Hover registrations was offset by the expected decline in the acquired Enom business registrations, but to a slightly greater degree.

The renewal rate for the Retail channel fell slightly to 75% in Q3 due to a customer event specific to the quarter. Outside of this, the Retail renewal rate was also consistent with recent performance, and, as does our Wholesale renewal rate, continues to track well above the industry average.

There was particularly significant progress in the integration work this quarter. I will be talking more about this later, but this was the quarter where we really started to see the pieces that we have put in place for our future domains platform take shape.

Now on to **Ting Mobile**.

We had another strong quarter financially. Revenue was up 1.5% versus Q2 and 6.5% versus year ago. Margin was up 7.2% versus Q2 and 13.2% versus year ago. This growth was the result of increased usage per subscriber, decreased carrier costs and net subscriber adds from new business accounts.

We finished Q3 with just over 162,000 accounts and about 295,000 subscribers, down about 1,000 accounts from the previous quarter and up about 13,000 subscribers.

That lift in subscribers was largely driven by a small number of Internet of Things, or IoT, customers.

The needs of each of these IoT devices are much different than our typical human subscribers. They need only small amounts of data to exchange bits of information and usually no talk or text at all. The customer needs outstanding support at the enterprise or account management level, but almost none at the user level. The IoT customer will have thousands of active devices at a time and will thus will be extremely price sensitive on the total monthly cost.

Businesses that leverage IoT devices have started to discover Ting for fair, flexible pricing and outstanding account management and I am hopeful we will see more success in this area. But I will offer one qualifier and one warning. The qualifier, an IoT subscriber is worth a lot less than our typical Ting subscriber. We are making just a bit of margin on our monthly line fee and almost nothing on the data usage. The warning, we are servicing early stage ventures here and many will not be around in a year. The IoT space is attracting lots of ideas, innovations and investment. That also means there will be lots of failure. We are thrilled to get the business and careful to support it efficiently. This segment is not big enough to break out on its own which means it will cloud the subscriber numbers occasionally.

I promised an update this quarter on our review of Ting Mobile positioning and pricing.

I reported last quarter that we were validating some potential new concepts with both Ting customers and prospects.

What we heard from Ting customers did not surprise us. They believe wholeheartedly in paying for what they use. They do not want to pay a premium for simplicity or predictability. They are happy to manage their usage and thrilled to have a provider that gives them that control and rewards them for that effort while treating them like an adult.

What we learned from our prospects that had never heard of us did surprise us.

There were plenty of unlimited zealots, although not as many as we expected. They have no interest in managing their usage and no stomach for variability in their bills. We were surprised, however, by the number of prospects from the general population that were quite positive about the current Ting plan and even more surprised that they showed little interest in our attempts to simplify it. They preferred smart, frugal and differentiated to simple, indulgent and familiar.

This attitude might also be representative of a broader cultural trend that Ting would be well positioned to leverage.

Considering our findings and this cultural insight together, we believe Ting may have a targeting or segmentation opportunity more than a pricing opportunity. We already have a smart, differentiated rate plan that allows our customers to take control of their phone bill and save money. We need to work harder, and perhaps spend some more of our healthy margins, to find that portion of the population that would be inclined to embrace smart over simple. We need to do a better job explaining the Ting plan to them and persuading them to give Ting a try.

We will experiment with several offers and promotions. But do not expect a significant price change from Ting in the coming quarters.

I mentioned last quarter that we had agreed to purchase customers from The People's Operator, another MVNO. The migration of those customers has taken longer than expected as TPO has, quite publicly, worked through some financing issues. The base has also shrunk and is now at about 8,000 customers. We are now hoping to migrate those customers in Q4.

Finally, there was a small feature mentioned in the Apple keynote last month that could be a big deal for Ting Mobile and an even bigger deal for the whole mobile phone market. Apple announced that the new iPhone models would be eSIM-enabled, allowing customers to choose from a list of service providers on screen without needing to insert a new SIM card. Anything that eliminates hurdles to switching and puts more power in the hands of mobile users will ultimately help Ting grow. There is engineering that needs to be done between Ting, Apple, our carriers and the eSIM platform providers to get Ting on that list, exposing us to millions of prospective new customers. These are big companies and I do not know when that will happen. But we have two feet in the door, with the eSIM iPad placement we got in our Roam acquisition and with our direct Apple relationship.

To be clear, so much of our planning and work on Ting Mobile, both technical and financial, now hinges on the state of our carrier relationships going forward. We have two contracts that can be renegotiated next year. We have two suppliers that will likely become one. We have other potential suppliers in the pipeline that could transform our cost structure and our offering. We are a valuable customer to these carriers, representing tens of millions of dollars in revenue. I am not concerned at all that we will have carrier partners. But we will need some clarity and then to do some work on our supply before we can focus on demand.

Finally, **Ting Internet**.

This quarter we continued with a fiber capex spend at new, higher levels. As we have talked about, this is the number that investors should be paying most attention to. In Q3 we spent \$6.2m slightly down from \$6.7m in Q2 but significantly up from \$3.7m in Q3 of last year. As long as we continue to deploy capital at these levels and higher, within the operating parameters we have established, the growth will inevitably follow.

This quarter we lit up our first customers in Centennial, Colorado. We now have five fully active towns where we are installing, activating and supporting customers every day. We are also

taking pre-orders in Fuquay-Varina, North Carolina, right next to Holly Springs, and expect to light up the first customers by end of year.

At the end of Q2, we had passed about 20,500 serviceable addresses and had about 5,300 active customers. In Q3 we added about 2,000 addresses and 900 customers to get to totals of 22,500 serviceable addresses and 6,200 active customers.

With three towns - Sandpoint, Centennial and Fuquay-Varina - still in the foundational stages of construction, you will see outsized serviceable addresses added next quarter, and thus we still expect to reach right around 30,000 serviceable addresses by the end of this year. And we continue to be pleased with how these serviceable addresses are translating predictably into subscribers and recurring margin.

We've recently signed a contract for a new Ting town using a partnership model similar to Westminster, but with private ownership rather than municipal ownership. The model separates fiber infrastructure construction, ownership and operation from the provisioning of Internet service and customer support. With our partner taking on the resource-intensive functions involved in engineering, construction and ownership, Ting can scale more quickly and focus on our core business strengths of providing fantastic Internet service with a great customer experience.

Those around longer will remember that we expected more of these types of arrangements when we launched. We are now seeing more of them starting to emerge.

The market itself is desirable in size, density and demographics and should provide an excellent opportunity. We will share more in Q1 2019 when the market is announced to the public.

We have begun testing our new Ting TV product internally and will slowly start rolling it out in discrete phases between this year and early next. Again, think of TV as a tactic to help convert more Internet customers, not as an ARPU driver. As you would expect from Ting, we have found a few opportunities to challenge some agonizing conventions in the cable world and make television service just a bit more honest, a bit more affordable and a bit more usable. More on that soon.

Those of you who follow us in your news feeds may have read that Ting has partnered with University of Virginia athletics in Charlottesville to offer Wifi in Scott Stadium, home to the UVA football team, and, soon, John Paul Jones Arena, home to the nationally ranked UVA basketball team.

This has been a really exciting opportunity for us to flex some new muscles and build the enterprise revenue stream for Ting Internet. As we start to leverage our fiber network and our skills in wireless and other enterprise-level technologies to service college campuses, hospitals, public spaces, large businesses and even national mobile carriers, it should add complimentary products with nice recurring revenues to the business.

Finally, we continue to feel confident about the core business as modeled. Adoption of 20% after one year and 50% after five years. Customers are indeed delivering \$1,000 a year in margin. And our build costs are coming in between \$1,000 to \$1,500 per serviceable address, or \$2,500 to \$3,000 per customer at that projected 50% adoption.

I'd now like to turn the call over to our CFO, Dave Singh, to review our financial results for the quarter in greater detail. Dave?

Financial Results [Dave Singh, CFO]

Thanks, Elliot.

Total revenue for the third quarter of 2018 was \$83.5 million, which was down slightly from \$85.0 million for the same period of last year, primarily due to the bulk transfer out of almost 2.7 million domains in Q1 of this year. These names accounted for approximately \$6 million of revenue in Q3 of last year that generated essentially no gross margin. Also of note, in the third quarter of 2018, there was an additional bulk transfer of domain names of approximately 240,000 names resulting in further acceleration of \$1.7 million of no margin revenue. The Company expects a similar sized acceleration in the fourth quarter of 2018.

Cost of revenues before network costs decreased 10% to \$54.5 million from \$60.4 million for the third quarter last year, with the decrease due to the lower revenue in Q3 of this year.

Gross profit before network costs for Q3 increased 18% to \$29.1 million from \$24.6 million. As a percentage of revenue, gross margin before network costs expanded to 35% from 29% for Q3 last year. The year-over-year increase was primarily the result of growth in both Ting Mobile and Domains gross margin, including the negative impact in Q3 last year from the acquisition of the Enom business, the accounting of which required amortizing into revenue, deferred revenue that was recorded at fair value at the acquisition.

I'll now review gross margin for each of the Domain Services and Network Access areas.

For Domain Services, gross margin for the third quarter increased 15% to \$16.1 million from \$14.0 million for the same period in 2017. As a percentage of revenue, gross margin for Domain Services for Q3 of this year increased to 27% from 23%. The increase on both an absolute and percentage of revenue basis was primarily the result of the impact of the Enom acquisition related deferred revenue fair value adjustment in 2017 I just mentioned. The improvement as percentage of revenue this year also benefited from the transfer of the nearly 2.7 million very low margin names earlier this year.

Looking at the individual components of Domain Services, gross margin for the Wholesale channel increased 27% to \$11.4 million from \$9 million for Q3 last year. As a percentage of

revenue, gross margin for Wholesale increased to 23% from 17%, mainly due to the positive impact of the transfer out of the nearly 2.7 million very low margin names.

Gross margin for Retail Domain Services was essentially unchanged from Q3 of last year on both an absolute basis and as a percentage of revenue at \$4.3 million and 48%, respectively.

Gross margin for Portfolio Services was \$0.5 million compared to \$0.8 million in Q3 of last year. As a percentage of revenue, gross margin was 75% compared with 82%.

Moving now to Network Access, gross margin for the third quarter of this year increased 20% to \$12.3 million from \$10.2 million for the same period last year, driven primarily by lower carrier costs, a larger subscriber base and higher usage per subscriber. As a percentage of revenue, gross margin for Network Access improved to 50% from 44% for Q3 of 2017.

Turning now to costs, network expenses for the third quarter of 2018 increased 10% to \$4.2 million from \$3.8 million for the same period last year. The increase is primarily due to increased amortization associated with the investment in the Ting Fiber network.

Total operating expenses for the third quarter of 2018 increased 14% to \$16.6 million from \$14.5 million for Q3 last year. The increase is due primarily to the following:

- Workforce and third-party work force related expenses, excluding stock-based compensation, increased by \$1.1 million primarily the result of the continued growth in the number of Ting Mobile and Internet subscribers and the Ting Internet footprint, and to a lesser extent unfavourable foreign exchange impacts from a stronger CAD dollar in the third quarter of 2018 as compared to the third quarter of 2017
- Stock-based compensation is up \$0.5 million from the same quarter last year, and;
- \$0.5 million increase in other costs, including tools and technology to support our growing employee base, professional fees and facility costs.

As a percentage of revenue, total operating expenses increased to 20% from 17% for Q3 last year.

Net income for the third quarter of 2018 increased 55% to \$5.3 million, or \$0.50 cents per share, from \$3.4 million, or \$0.33 cents per share, for Q3 last year.

Adjusted EBITDA increased 27% to \$11.9 million from \$10.4 million for the same period last year.

Turning to our balance sheet and cash flows, cash and cash equivalents at the end of the third quarter of this year was \$10.8 million compared with \$11.2 million at the end of the second quarter of this year and \$12.5 million at the end of the third quarter of last year. The decrease in cash from Q2 of this year was the result of the use of \$4.4 million for the net repayments of our loan and the investment of an additional \$7.0 million in continued investment in property

and equipment. These were almost entirely offset by the generation of \$11.2 million in cash flow from operations.

Deferred revenue at the end of the third quarter of 2018 was \$148 million, down from \$152 million at the end of the second quarter of this year and down from \$163 million at the end of Q3 of last year. The decrease on both a year-over-year and sequential basis is due to the domain name revenue accelerations noted earlier.

That concludes my remarks and I'll now turn the call back to Elliot.

Closing Remarks [Elliot Noss, CEO]

Thanks Dave.

When I provided our full year cash EBITDA guidance of \$54m in February, I noted that we expected to spend roughly \$3.5m in the Ting Internet business. In fact that investment has been over \$5.5m. Despite that additional \$2 million spend, I want to reiterate the \$54m number. The business has been resilient enough to be able to make that additional investment.

In the domains section I noted the solid progress we are making on the new domains platform. It has now moved from concepts and plans to something more tangible. So much so that for the first time since the launch of Ting Mobile, we are really looking at growth opportunities in additional services for Domains.

At this point we have also realized about half of the additional synergies that we expected to realize from the Enom acquisition. We have expressly taken this savings and reinvested and redeployed into two areas, investing in our core technology infrastructure and investing in our data practice. A lot of this has taken the form of redeploying quality people from areas of redundancy or less than optimal use into areas that feed the company in more leveraged ways.

At this point I am also ready to declare Ting Internet a business. It is no longer a test or an experiment. It is a working, thriving business. We have now seen that a city-level business can turn cash flow positive in 18-20 months and will be right around breakeven, or start to contribute cash in its second year. By the third year it is a business and by the fourth, a solid business.

We are at the point now where we can model things at a city level with some precision and analyze returns as well as target where to optimize them. We are pleased with the results.

We are still early enough in this business that we can take stock of operations towards the end of the year and take clear lessons that we can apply to the next year and the next launch. And in terms of the cycle, the cycle of fiber replacing old coax and copper infrastructure, last year I talked about this being like 1971 or so and noted for reference that HBO launched in 1975. A

year later, it feels like we are still that early in the cycle, let's call it 1972. The importance is the length of runway and the amount of change that we are likely to see in the coming years.

The machine is working. You put capex in one end and EBITDA comes out the other. The focus now is on having Domains and Ting Mobile create as much free cash flow as possible, increasing the ability of the machine to absorb capex and produce as much EBITDA as possible. The machine is working. We will now continue to optimize for throughput and efficiency.

And with that, we await your questions. Again, please send them to ir@tucows.com.

Thank you.
