Q3 2019 Q&A Transcript

**** Note clarification in Concluding Remarks***

Introduction [Monica Webb]
Welcome to Tucows' Q3 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 Q3 2019 financial results. We've also added lifetime fiber capex to our KPI Summary, which you will likewise find in the investors section.

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-Q and Form 10-K. The company urges you to read its securities filings for a full description of the risk factors applicable for its business.

Our current approach is pre-recorded management remarks followed by solicitation of follow-up questions. 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.

Opening Remarks [President and Chief Executive Officer, Elliot Noss]

Thank you, Monica. And welcome to our Q3 2019 Q&A call.

Most of the questions we received centered on the overall business, with specific questions on our mobile and fiber businesses.

TING MOBILE
First, Ting Mobile. We had questions about our efforts to migrate mobile subscribers off the T-Mobile platform.

As a reminder, we announced in July that we had signed a new agreement with Verizon and terminated our agreement with T-Mobile. At that time, we detailed an eighteen-month phase-out period ending December 2020, during which time we could support existing subscribers on T-Mobile, but, starting December 19th of this year, not add new ones. We also warned there would be significant expense and risk involved in migrating about 160,000 subscribers away from T-Mobile by the end of that phase out period.

I am pleased to report that we have reached a subsequent agreement with T-Mobile and a mobile virtual network enabler (or MVNE), named Prepaid Wireless Group (PWG), that essentially eliminates that expense and risk. Prepaid Wireless Group will now be considered our direct provider of T-Mobile network access. The new deal accomplishes a few important things: It extends our ability to support customers on the T-Mobile network for another three years starting this December, with an option to extend further. It allows us to continue to activate subscribers on the T-Mobile network if we choose. And it maintains our current T-Mobile wholesale rates and gives us very reasonable annual revenue guarantees.

With this deal, we no longer have any urgency to migrate these subscribers away from T-Mobile, and no reason to incur expensive incentives going forward to do so. We will now add Verizon with much less rush. We will think about what is best for both our incoming and existing subscribers, and our business across all three of our networks; Sprint, Verizon and T-Mobile. With very achievable guarantees across all three in the coming years, we also put ourselves in a position to see the outcome of the still unresolved Sprint/T-Mobile situation and be able to watch the landscape evolve.

I will also note that the PWG deal will not impact 2019 results. We were only able to make that arrangement in the last few days, and had already commenced extensive migration work and testing in order to be able to hit the ground running in 2020.

TING INTERNET

On Ting Internet, I first want to reiterate our metrics around cost to pass premises, and expected take rates. Our cost to pass a premise is still in the $1,000 to $1,500 range. And our goals for subscriber take rates remain at 20% after year one, and 50% after year five.

A little more clarity on the reason for the lag in addresses progressing from passed to serviceable, which we discussed in detail on the call. Once an address is passed -- that is, the glass fiber is installed and connected -- it needs to be lit, or have a light sent through the glass fiber in order to be serviceable. The electronics required to light a fiber are housed in a small facility that is essentially like a small data center.

The lag for us has been created by an overload in the number of these small facilities required in multiple markets concurrently, with Centennial and Fuquay-Varina being the most affected. We exacerbated this already stretched resource by adding the data center work, which is essentially just a lot more facilities construction.

We have since recognized this choke point, and we've both restructured some of the work and added capacity. Again, we expect to see this all caught up through 2020.

Concluding Remarks

We were asked, without providing guidance, about the headwinds and tailwinds heading into 2020. This was a great question to allow us to summarize where we are.

In 2020, the biggest financial headwind will be the absence of domain portfolio contribution. The biggest financial tailwind will be the absence of carrier penalties. Those two should roughly cancel each other out.

At the highest level, the rest of both domains and mobile will be challenged for growth in 2020, and Internet will see a continued ramp, at an increased pace. The headwinds for both domains and mobile will be primarily around getting the right pieces in place to create growth in the longer term.

In domains, 2020 will be the year that the new architecture manifests. We will see TLDs moving to the new platform starting early in the year, and continuing throughout 2020. We will also see further rationalization of operations with the collapsing of some of our registrar accreditations, and the rationalization of a number of processes across the business.

In mobile, the integration of Verizon and then the ability to focus on improving the Ting mobile service will be the predominant area of attention in 2020.

For both the domains and mobile businesses, as well as our Internet business, we will be doing a lot of work in 2020 to continue to move to microservices, which will allow for greater flexibility and scalability across the business.

Once this work, and the work noted earlier, is substantially complete, then the domains and mobile businesses can turn to growth. The domains business through the introduction of new services, and the mobile business through growing customers.

The other headwind to note is potential increased competition in mobile, depending upon the outcome of the Sprint/T-Mobile merger. We do not know what DISH as a potential new entrant may do, or alternatively, what becomes of an independant Sprint.

The one huge tailwind is the continued runway available in building fiber in the US. With cable companies worried about fixed 5G and focused on increasing ARPU through mobile penetration, and copper companies focused on everything from data centers to film studios, the greatest opportunity in telecom in a couple of generations continues to have plenty of runway.

Finally, there were a range of general questions about fiber IRR. We are always trying to provide more visibility to allow investors to model the business more easily. A fiber model is really dependant on four variables: cost of build; take rate; net margins in the business; and terminal value. We have spoken in great detail about cost of build and take rates, and we leave terminal value to you.

We have now had a few years in this business and have been able to learn a great deal. We have been pleased, perhaps even beyond expectations, with how take rate and cost of build have tracked to our original assumptions. We have now learned enough in this business to say that we see long-term net margins* comfortably exceeding 60%. We have always had a deep belief, based upon a couple decades of experience, that the ISP business produced incredible net margins at scale, and that it could be done better than it was being done. Now, from putting a shovel in the ground, to providing large, streaming and gaming families with the best Internet in the world, we have visibility to knowing that is the case.

Again, thank you for listening in on our Q3 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.

* *For greater clarity, this refers to net EBITDA margins, not net income margins. We always discuss EBITDA margins in this context but wanted to be sure there was no confusion.*
