tucows

Q4 2018 Q&A Transcript

Introduction

Welcome to Tucows' Q4 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 period subsequent to the call. For your convenience, this audio file is also available as a written document on our website, along with our Q4 2018 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 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.

Remarks [Elliot Noss]

Thank you for listening in on our Q4 2018 Q&A.

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. As noted, it is also a work in progress and we intend to keep trying to improve it.

We received a lot of 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 that 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.

First, we received a question about the investment from Union Square Ventures, whose co-founder, Brad Burnham, is a member of the Tucows Board. Union Square Ventures has invested in Tucows, but not to the 5% holdings minimum that would trigger them to disclose. Brad personally controls 26,000 shares and participates in voting and investment decisions for a further 327,000 shares as a managing member of certain USV funds. This indirect holding has been noted in a recent filing.

Next I'll address some of the questions we received on our domains business.

A few of you asked about the ongoing realization of synergies from the Enom acquisition. Integration is not a financial asset with set terms like a bond, it involves people, so the transition is much subtler. It does not happen on a certain, specific date.

As I have noted previously, a substantial portion of the efficiencies have been realized. Another set of efficiencies has resulted from moving strong resources from the historical Enom business into roles in the rest of the company. And the final portion will result from the data center work that we discussed on the Q4 investor call.

With respect to domain portfolio sales, our portfolio of domains that we hold for resale in the aftermarket is something that we consider tactical, not strategic, as an asset. The bulk portfolio sale in Q4 2018 was generated from our non-surname portfolio of names held.

The bulk sale in each of the last two years in Q4 were tied into, and part of the timing of other related operational changes, including the move of our Tucows expiry stream to a different partner. While a similar sale is possible in any quarter, we currently have no plans in this regard.

We received a couple of questions about historical churn numbers for Ting Mobile and the numbers that we posted in our new KPI Summary. Over the past few years, we have gone to great pains to break out small, acquired customer bases such as PlantinumTel and RingPlus in our reporting of both gross adds and churn. These customers typically have higher churn since they did not choose Ting. So, churn numbers you have heard in the past might have been expressed as, "non-RingPlus," for example. Those would be lower than the historical churn numbers you can view on our 2018 KPI Summary on our website, which are for the entire base, including acquired customer bases. In the KPI Summary we decided not to clutter it with notations or extra columns. These deals have become more common in our total customer acquisition effort. There is also variability in how anomalous each cohort performs. Going forward, we will continue to highlight in our prepared remarks whether unique cohorts impacted net adds and churn as appropriate, but probably less so than in the past.

Some of you asked very specific questions around our take rates for Ting Internet. As you may recall, we have set goals of a 20% take rate for addresses that are one year old, and 50% for addresses that are five years old. Although the precise trajectory between these two benchmarks will vary by town and by neighborhood, so far, on an overall basis, we are tracking where we should be.

Regarding the split between Ting Internet subscribers who take the lower tier versus the gigabit offering, although the vast majority take the gigabit, we view our success in aggregate by using an average ARPU measure for all connections, which we look to be at $1,000 per year. We continue to be around that number.

Also on Ting Internet, there were a couple of questions about serviceable address counts and per address costs.

With respect to costs, on earnings calls I have been saying $2500 to $3000 for some time. This was not updated in the investor presentation until recently. The fact that we do not present at investor conferences, or regularly do marketing days led to us missing that. Our apologies.

Regarding our plans for adding serviceable addresses, as I have mentioned before, we will continue to report addresses as they go live, and you can track them on the Ting Internet Build Scorecard, available on our website. That being said, the best way to track our plans for serviceable addresses currently, is by tracking our capex spend. We are clear about the amounts we are planning to spend and we update this quarterly with commentary. From there it is simply division. There is no shortage of opportunity for us in finding places to build.

And finally on Ting Internet, we have the inevitable series of questions asking about 5G, coax, low-earth-orbit satellites and other alternative means of providing data. We continue to be crystal clear. We believe that fiber, light over glass, is the physical infrastructure that will predominate for the next century. There will be any number of advances dealing with those trying to stretch their existing infrastructure, trying to reach more remote or less dense geography, or trying to spend less money and reach the bottom of the market. That is not our approach. We are laying fiber to the home and providing the fastest Internet service at a fair price, with a great customer experience. We are concerned with the next hundred years, not the next ninety days.

We had a question about data usage in our fiber customer base, as it relates to the potential substitutability of mobile phone service. We found, so far, that our customers were using, on average, more than 650 gigs of data a month. That clearly demonstrates that mobile phone service is not a viable substitute for fixed Internet or home Internet service. Could you imagine a mobile phone plan with 500 gig maximum in their unlimited? Further, when you think about the way that data usage has increased over the last years, it’s also pretty clear that within the next two, or three, or four years, the existing caps that some of our competitors have on home Internet service will become a factor for a larger and larger percentage of their customer base.

There have been a number of questions on Adjusted EBITDA versus Cash EBITDA. Cash EBITDA can be calculated by starting with our disclosed Adjusted EBITDA and adding back the net impact of the change in our deferred revenue and prepaid registry fee balances. Those figures can easily be derived from the Operating section of our Consolidated Statement of Cash flows. The SEC changed it's view on cash EBITDA--and including deferred revenue or not--around the time of the Enom transaction. This made for a material difference between the two. Our goal is to best help our investors understand both the levels and trends in the business. While these differences continue to exist, we will talk about both.

A few of you asked for more detail on our 2018 taxes. There are a number of considerations impacting our taxes, so bear with me on the complexities.

Our effective tax rate for 2018 is approximately 34%; higher than the 21% US Federal tax rate and the 26% Canadian tax rate. Setting aside regular reconciling items such as the impact of US state taxes, and the timing of exercise of stock-option deductions, there are two main drivers for the variance.

First, our legacy domains business--meaning our domains business outside of Enom--is domiciled in Canada, but considered a US taxpayer. The earnings from this legacy business are first taxed in Canada at 26%, which generates a foreign tax credit against our US taxes on that same income. The impact of the Canadian taxes, which are 5% higher than US corporate taxes, is that a portion of the credit cannot be utilized on the legacy domains earnings stream.

Further, due to the new bonus depreciation rules enacted in late 2017 under the US Tax Cuts and Jobs Act, which allow the 100% expense treatment for certain eligible capital expenditures for tax purposes, our taxable income sourced in the US is negative, thus we cannot take the full benefit of the Canadian credits. Although available to be carried forward as tax credits, we don't believe that we will be able to utilize those credits based on the current tax rate differences, and as such, have taken a valuation allowance against those credits. The impact of the valuation allowance increases the effective tax expense. We had a similar phenomenon for the year ended December 31, 2017. A full effective tax rate reconciliation will be provided as part of our upcoming 10-K filing in March.

As the balance between domains and telecom net income changes, and as we are able to more effectively structure our operations, the effective rate will improve. We are providing no additional guidance in this regard as we are also trying to grow our capex, and thus our deductions, as fast as possible.

To clarify the capex spend on our data center strategy, the $13M we referenced in our prepared remarks is the full allocation for our data center build outs. The allocations started in late 2018, and continue in 2019, but may not be fully incurred this year.

The regular capex forecast of $4M for 2019 represents a much larger than regular number. In connection with the data center work, we are taking the opportunity to modernize older equipment. This will return to the regular amount, in the $750,000 to $1.5M range, going forward. In addition, this number includes renovations for our main office in Toronto, which has not had a significant refresh in twenty years. This will allow us to better accommodate more modern working practices among other, more practical, benefits.

I was asked about my comments on a possible recession. I do not profess to be able to predict economic cycles. I look at the macro environment through the lens of general business trends, not market timing. My comments are really the result of two related items. First, the massive expansion in the money supply globally over the last decade and second, the shape of the yield curve. The first is something that always concerns me. And the second measures that concern.

As we have noted on an annual basis, the way that open market programs work, they must be established. They are a formality. If one were to say, “that announcement is no big deal,” I would agree. If one were to say, “it is intended to otherwise misdirect or mislead,” I would strongly disagree.

It is always prudent to have an open market program in place because one does not know what the future holds. In a period where there is a real concern of a material correction in the broader markets, that is even more true. Our investors should assume we will always have a program in place.

Again, thank you for listening in on our Q4 2018 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.