tucows

Q3 2020 Q&A Transcript

Introduction [Monica Webb, Head of Market Development and Strategic Partnerships]

Welcome to Tucows' combined question and answer dialog for Q3 2020. Elliot Noss, President and Chief Executive Officer, will be responding to your questions. For your convenience, this audio file is also available as a transcript in the investors section of our website, along with our Q3 2020 Financial Results and updated reports.

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 Forms 10-Q and 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 [Chief Executive Officer, Elliot Noss]

Thank you, Monica. And welcome to our Q&A for our third quarter 2020 financial results.

Mobile Services

There were a number of questions that when boiled down, were essentially asking for help in modeling the new MSE business. This is a fair ask. As I noted on the call, one of the few downsides of the transaction was complicated disclosure.

The good news is that this is a short term problem. Post-Boost migration this business should become relatively easy to model. The bad news is, that prior to that it will be very choppy as the expenses related to scaling the platform will be rolling in consistently, but the biggest contributor to revenue -- the Boost customers -- will not be present until after the migration.

I am sympathetic to our investor's plight, but the best advice I have in the short term is to refer you back to our view that we expect the contribution from the mobile business in 2021 to exceed that of 2020. And you can infer from the above that the second half of the year will be clearly larger than the first half.

When we were evaluating this transaction, one of the elements we considered was the challenge it would create in 2021 in terms of investor understanding. We chose to prioritize the best cash generating outcomes over simplicity in comprehension. We know this will probably lead to a few more phone calls and a little more confusion, but our investors have demonstrated to us time and again that they have the capacity to sort through things like this.

We had a question around the gross margins for the various revenue streams from our new Mobile Services Enabler business model going forward. For the Mobile business, as I noted previously, this revenue stream consists of a fee per subscriber from DISH paid on a regular basis. As this is essentially a fixed cost business, with very little variable cost, gross margin is very healthy and we expect that to be relatively stable over time. Other Professional services is primarily the revenue stream derived from the Transition Services Agreement, under which, in the near-term, we will continue to service Ting Mobile customers, but on DISH's behalf. The advice from the call was to look at it a bit like device revenue, with a bit more margin. Other professional services revenues will encompass one-off or special projects, and so will have some margin variation over time. And again, the TSA revenue stream doesn't correlate to the real health of the strategic mobile business, which will be driven by the MSE platform revenue in the long term.

There were questions about the size of the contribution of Mobile Services to our Q3 results, one specifically relating it to my comment, "*expecting the impact from the shift to an MSE model to be neutral to slightly negative on financial performance for this year,*" and wondering why the drop looked more precipitous. It didn't. It will take getting used to, but investors need look at both the mobile business *and* the money received for the earn-out on the Ting Mobile customers sold to DISH, which is being recognized under "Other Income," as a "Gain on the Sale of the Ting Customer Assets". This latter number will be relatively close to what the sold customers would have generated on a contribution basis, and will decline over time, roughly with churn.

Specifically with regard to this quarter, as we noted in our disclosure and our remarks, "Gain on Sale of Ting Customer Assets," included a one-time $3.5 million, non-cash write-down of certain assets related to the sale of the Ting Mobile customer relationships to DISH, which was netted from the $4.6 million gross Gain on Sale. Thus, the third quarter Gain on Sale number is not representative of future quarters. The third quarter contribution of Mobile Services was more or less as expected at the time of the announcement of the DISH agreement and transition to the MSE model. At the time, we noted that we expected the transition to be neutral to slightly negative to EBITDA on the year. That continues to be the case, and, as a result, we continue to be comfortable with our 2020 EBITDA guidance of $50 million.

I am also pleased to announce that earlier today we hit the first significant milestone in our work with DISH. We have launched new pricing for Ting Mobile, which our investors know is something we have talked about for a couple of years. We had all the challenges in dealing with carriers and a cost of goods sold that was limiting our ability to be competitive. We went to the extent of pivoting the whole business due to this market element. It is an exciting moment. Ting Mobile has long offered the best customer experience and produced the happiest customers. As of today, it also boasts among the best pricing. We are thrilled that there are plans to satisfy almost any customer -- from the stingiest data users, to the heaviest. It is a strong position in the market for DISH and we are happy to have contributed.

Ting Internet

Turning to Ting Internet, we had questions about growth in capex, and in the number of homes passed for next year in our Internet business. We of course intend to provide guidance on that number for 2021 next quarter, and report the actual numbers at the end of each quarter, so I will not be specific until then. But, I will be directional.

We expect the next five years to be the most important years in the coax-to-fiber transition for a challenger like Ting. We invested $100 million in that transition prior to the pandemic, and COVID has greatly accelerated people's need -- and I mean need, not want -- for fast, reliable, symmetrical Internet.

We've talked a number of times about the amount of capital pouring into the space. That capital is primarily directed into M&A, with a number of mixed assets trading, either copper and fiber, or coax and fiber. There are some fiber pure plays, but not many. The fiber portion of these transactions are trading at extremely high multiples. Meanwhile, focused companies with strong management teams and the capacity to both build and operate fiber assets are able to essentially build EBITDA at significantly lower multiples. This delta will not last long. While it does, we intend to be as aggressive as we can in building.

Accordingly, you can expect our 2021 capex to increase as much as it can. I have noted that we are not capital-constrained, nor opportunity-constrained, but rather the challenge is in scaling the organization. This is the focus of a lot of our attention.

I'd also like to take this opportunity to share an announcement we made this morning, on the expansion of Ting's fiber footprint in California. Culver City is Ting's third town in California; and 12th town in the U.S. Culver City is a growing, vibrant town with a tenured history in film production, as the long-time home to Sony (formerly MGM) Studios, and more recently, the new location of choice for streaming giants, Apple, Amazon and HBO, which has brought an influx of jobs and residents to the City.

For the Ting Internet footprint, Culver City brings 23,000 serviceable addresses, and will be our first market to widely deploy microtrenching, which will enable us to build significantly faster and with less disruption than traditional underground construction. The climate of Culver City also enables us to build year-round, to offset our seasonal construction markets in Colorado and Idaho. Network construction in Culver City is slated to begin early in 2021, and the first customers to be lit with fiber service by the summer.

We're also pleased to report that our Wake Forest, North Carolina market will be officially lit with service over the next week, and our installations will be ramping up there accordingly.

Closing Remarks

We're very focused on scaling our MSE platform to support DISH; migrate Boost customers; and then look for opportunities in the global transition from 4G to 5G.

We are very focused on structuring the Ting Internet business for scale and speed of deployment, which means investing in people, in innovative tools for installing, provisioning and supporting customers, and rolling out new processes like microtrenching.

With our mobile pivot behind us, our strategic questions are answered. 2021 looks like a year of putting our heads down and grinding, which is what we have proven to be able to do for over twenty years.

Again, thank you for listening in on our 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 question, please follow up with us at ir@tucows.com.