



Tucows Q1 2021 Management Remarks Transcript

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

Welcome to Tucows' first quarter 2021 management commentary. We have pre-recorded prepared remarks regarding the quarter and outlook for the Company. A Tucows-generated transcript of these remarks, with relevant links, is also available on the Company's website.

In lieu of a live question and answer period following the remarks, shareholders, analysts and prospective investors are invited to submit their questions to Tucows' management via email at ir@tucows.com, until Tuesday, May 11. Management will address your questions directly, or in a recorded audio response and transcript that will be posted to the Tucows website on Tuesday, May 18 at approximately 4 p.m. eastern time.

We would also like to advise that the updated Tucows Quarterly KPI Summary, which provides key metrics for all of our businesses for the last five quarters, as well as for 2019, 2020 and 2021 year to date, is available in the [Investors section of the website](#), along with the updated Ting Build Scorecard and Investor Presentation. Please note that the KPI Summary has been modified to reflect our transition from a Mobile Virtual Network Operator to a Mobile Services Enabler. This means the mobile metrics that are no longer applicable to our business have been removed.

Now for management's prepared remarks:

On Thursday, May 6, Tucows issued a news release reporting its financial results for the first quarter ended March 31, 2021. That news release, and the Company's financial statements, are available on the Company's website at tucows.com, under 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 Forms 10-K and 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, Elliot Noss. Go ahead Elliot.

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

Q1 Results Summary

Thanks Monica. The first quarter was a very solid start to 2021. In our Domains business, the underlying consistency of that business benefited from the accelerated transition to online, driven by the pandemic. In Mobile Services, the new iteration of our business is moving forward on plan with our legacy customer base performing as expected and DISH's mobile business also progressing nicely. And with Ting Fiber, we set new records across all of our key metrics, most notably, by far our largest quarterly capex investment, as well as our highest ever growth in serviceable addresses.

Turning to our financial results, I will again remind you that for comparative purposes, our reported revenue and gross margin do not include results from our legacy mobile customers, with almost all of that revenue and much of the expenses associated with the Mobile business now subsumed in "Other Income." Those looking for a refresher on the details can refer to our [Q3 2020 management remarks](#).

Net income for the first quarter was \$2.1 million, or \$0.20 per share, compared with \$2.8 million, or \$0.27 per share, driven primarily by higher depreciation through our continued fiber network build and a slightly higher effective tax rate.

Cash flow from operations was essentially unchanged from Q1 last year at \$14.1 million.

And adjusted EBITDA for Q1 was just over \$12.7 million, up very slightly from Q1 of last year.

Total revenue for Q1 was \$70.9 million, versus \$84.0 million for Q1 last year, and total gross margin was \$17.5 million compared with \$25.2 million last year, with the decrease reflecting the shift in our Mobile business to the MSE model.

Excluding the impact of the change in how our Mobile results flow through the P&L, Q1 revenue for just the Domains and Internet operations was up 4% year over year to \$66.6 million, and gross margin was up 13% to \$23.2 million.

Domains

Turning now to our individual businesses, starting with Domain Services. On the heels of a record 2020, and aided by the favorable impact the pandemic has had on the demand for domain names, Q1 was another strong quarter financially.

Adjusted EBITDA was \$13.8 million, up \$2.3 million and 20% from Q1 2020, as the majority of every incremental dollar we are generating in gross margin is flowing to cash EBITDA. Looking at it another way, our net EBITDA margin improved to 23% compared to 19% in Q1 of last year, and we continue to run the business efficiently and to manage expenses prudently. I do want to remind you that Q1 is typically our most profitable quarter due to seasonality -- gross margin tends to be strongest in Q1, while our expenses are consistent across all four quarters.

Overall, Domain Services revenue was up 3% year-on-year, and gross margin was up 14%. As expected, we saw growth in the number of new transactions in both the Wholesale and Retail Channels, and we continue to build on a new high water mark in terms of the quantity and quality of our names and customers. One year into the global pandemic, Q1 is the last quarter that the year-on-year comparison will benefit from the accelerated transition to digital services.

In our Wholesale segment, total registrations were up 2% to 4.4 million, with new registrations up 5%. We believe new registration activity has now settled into a steady state business again. The Wholesale renewal rate for Q1 was 80%, up a point from Q4, and continues to reflect the quality of our base of names. Value-Added Services gross margin increased 26% year on year, positively impacted by strong results from our expiry stream revenue, which highlights the increased demand in both the primary and secondary market for domain names.

In our Retail Channel, Q1 gross margin was down 2% from last year -- consistent with the results we have seen in previous quarters. Total registrations were up 2% year over year, and new registrations up a very healthy 24%. The Retail renewal rate for Q1 was 86%, and the Wholesale and Retail renewal rates are both solidly above the industry average.

Mobile

On the Mobile business, what news there is, is good. The earnout on the Ting Mobile legacy base is performing as expected. Customers that already churned at a relatively low rate have churned even less with the rollout of new Dish-powered pricing. More importantly, the build on our MSE platform is going well and the Dish relationship continues to be strong. This will serve our billing and provisioning work in all three businesses.

The flow of revenue will have some noise over the next couple of quarters as we work with DISH on customer migrations and their 5G launches. The eventual rhythm of the MSE business will be characterized by small, consistent recurring platform fees, as DISH and any other subsequent customers grow their businesses.

I do want to highlight one risk across the Mobile business. T-Mobile has announced that it will be shutting down the Sprint CDMA network by the end of 2021. As we have seen too often with these network events, this small amount of lead time for MVNOs to deal with -- in this case, millions of impacted subscribers -- is too short, and the data needed to deal with these subscribers effectively has been less than adequate. The smaller risk here is on the legacy Ting Mobile subscribers that generate our earnout revenue. Only about 20% of roughly a quarter million Ting Mobile subscribers are on the Sprint network. About two-thirds of those just need to swap out a SIM card. About one-third need a new device. The greater risk is on the millions of Boost subscribers that are entirely on the Sprint network. If this network shutdown proceeds as announced, Tucows and DISH will waste lots of time and money. But the greater risk is to the millions of Boost subscribers, who are generally lower income. If they are not successfully migrated by Jan 1, 2022, they will wake up with no cell phone service. As always, the best information on both the Ting Mobile and Boost bases will come from DISH disclosures. But it does affect both our work and our revenue flow, and I wanted to give you a high-level heads-up here.

With apologies to our friends at DISH, we are really enjoying not having to think as much about minimums, guarantees, and network shutdowns that are beyond our control!

Beyond that, Mobile had a solid first quarter, both in performance and progress.

Ting Internet

Moving on to Ting Internet, the results for the first quarter across all of our KPIs continue to demonstrate early results of our work structuring the business to scale.

In Q1, or as we call it internally, “[Jill's](#) first full quarter”, our investment in capex ramped by 36% from Q4, to \$14 million and up 84% from Q1 2020. As a fundamental indicator of the level of investment we’re making in long-term, revenue-generating assets, this is a good sign that the organization is on track to scale up our construction and operations more aggressively.

We added 9,200 serviceable addresses, an acceleration of address additions of 82% from Q4, bringing our total of serviceable addresses to 64,700, now up 42.5% year over year. Notably though, as an indicator of our accelerated growth trajectory and our more predictable conversions of passed addresses to serviceable, the 9,200 serviceable address additions in Q1 represent the addition of 3.5 times more addresses than in Q1 of 2020.

We also continued increasing our net subscriber numbers in Q1, by a record 1,800 subscribers -- an increase of 9% from Q4 2020, and 48.5% year over year total subscriber

growth -- bringing us to 17,300 subscribers. We continue to ramp up our ability to meet strong and pent-up subscriber demand in newly-lit areas of markets in North Carolina; Centennial, Colorado; and Solana Beach, California.

On the topic of subscribers, as investors know, our assumption is that we will achieve 20% penetration of serviceable addresses that are a year old, and 50% once addresses are five years old. And what we're seeing, is that in Centennial, Colorado, where the average address age is a year, we have a 20% penetration rate. In Sandpoint, Idaho, where the average age of addresses is two years, we're seeing 30%. And in Holly Springs, where the average address age is three years, we're seeing a 40% rate of penetration. All of these numbers reinforce our initial 20% assumption, and also show our penetration rates tracking along the frontier towards 50%.

Something else I'd like to call out is the unique market selection approach we've taken compared to others in our middle-market residential fiber cohort, and how it has benefitted us from an opportunity perspective -- and now from an operational perspective. Because we are an Internet company, our operations are inherently more scalable and efficient than more traditional telecom operations. Because of our roots going back to the mid-90's partnering with ISPs all over the world, in multiple different industries, we have a deep appreciation of the importance of an ISP being local, and how to tease out which operating elements need be local and which are better centralized. Having multiple geographically separate markets has presented us with opportunities to add new contiguous cities, which has also then provided operational efficiencies, within our distributed footprints.

This does mean more opex burn in the short term. As the Holly Springs case study video we published last quarter shows, these businesses simply require patience. That patience is rewarded with fantastic net margins at scale. In California for example, we spent a fair bit of opex spinning up operations in Q1. Those rewards come down the road. And the road is long. And on that note, we have had a fantastic start to our build in Culver City setting a faster pace in that build than in any previous build. Which bodes extremely well.

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, Chief Financial Officer]

Thanks Elliot.

Before I get into the numbers, as a reminder, we have reorganized our reporting structure into three operating and reportable segments: Fiber Internet Services, Mobile Services, and

Domain Services. Although we have discussed these operationally in the past, we previously formally reported in two segments: Network Access Services and Domain Services. The evolution of our business and management structures, especially in light of the transition of Mobile Services to a predominantly MSE model, has been such that the Network Access segment has become increasingly operationally distinct between Mobile and our Fiber Internet Services. As a result, we have broken those out into separate segments for reporting purposes.

We are also now reporting each of our three segments down to the Adjusted EBITDA line. Certain corporate costs are excluded from segment Adjusted EBITDA results, as they are centrally managed, including Finance, Human Resources, Legal, Corporate IT, depreciation and amortization expense or impairments, interest expense, stock-based compensation, and other income and expense items not monitored as part of our segment operations. Our comparative period financial results have also been reclassified to reflect the reorganized segment structure.

I will also remind you here that, as Elliot noted at the outset, our first quarter results once again reflect the impact of the transition of our Mobile business to the MSE model in Q3 of last year. With this transition, gross margin, which now consists of only the legacy Mobile retail customer base that was not sold to DISH, decreases significantly year over year, or, more accurately, Tucows no longer owns the margin on the growing portion of that base. Operating expenses go down because we replace retail spends and a retail staff with a staff intended to build and operate a wholesale business. All of the revenue associated with the customer relationships that were sold to DISH and much of the expenses associated with the previous Mobile retail model are now included as "Other Income." We are, however, including these earnings in our Adjusted EBITDA results, and as such, Adjusted EBITDA may provide a better year-over-year view on the operating performance of the overall Tucows business.

Turning now to the results...

Total revenue for the first quarter of 2021 was \$70.9 million, a 16% decrease from \$84 million for the first quarter of 2020, with the entirety of the decrease attributable to the sale of the Ting Mobile customer relationships during the third quarter of last year. That decrease was partially offset by continued strong growth in Ting Internet revenue generated by expansion of the customer base, which was up just shy of 50% year over year.

As I noted last quarter, when comparing our year-over-year performance of total revenue and gross margin, it's best to look at the combined Domains and Fiber Internet businesses,

excluding Mobile Services. At the revenue line, the aggregate of these two businesses increased 4% year over year to \$66.6 million.

Cost of revenues before network costs decreased 13% to \$46.2 million from \$53.2 million for Q1 of last year, with the decline primarily due to the lower revenue. As a percentage of revenue, cost of revenues before network costs were essentially unchanged from Q1 last year at 62%.

Gross margin before network costs for the first quarter decreased 20% to \$24.7 million from \$30.8 million, with the decrease primarily related to the sale of Ting Mobile customer relationships. As a percentage of revenue, gross margin before network costs decreased to 35% from 37% for Q1 2020.

Excluding the Ting Mobile business, gross margin before network costs for the combined Domains Services and Fiber Internet Services businesses was up 13% year over year to \$23.2 million.

I'll now review gross margin for each of the Domain, Mobile and Fiber Internet Services business.

Starting with Domain Services, gross margin for the first quarter of 2021 increased 14% to \$20.5 million, from \$17.9 million for the first quarter of last year. As a percentage of revenue, gross margin for Domain Services increased year on year to 33% from 30%.

Within the Domain Services business, gross margin for the Wholesale Channel increased 20% to \$15.7 million from \$13.0 million for Q1 last year. The increase is the combined result of year-over-year growth in the number of Domains under management and our success in managing the business for gross margin.

As a percentage of revenue, gross margin for Wholesale increased to 30% from 26%.

Gross margin for Retail Channel of Domain Services decreased 2% to \$4.8 million from \$4.9 million for Q1 2020. As a percentage of revenue, gross margin was 52% compared with 53% in Q1 last year.

For Mobile Services, gross margin was \$1.5 million compared with \$10.3 million in the same period last year with the difference primarily attributable to the transition to the MSE model and the resulting absence in revenue as a result of the sale of the Ting Mobile customers to DISH. As per the accounting treatment of the DISH transaction, we generated a Gain on the

Sale of Ting Customer Assets of \$5.4 million, which represents the earn out on that customer base and is recognized on the income statement as “Other Income”.

For Fiber Internet Services, gross margin increased 6% to \$2.7 million, from \$2.6 million in Q1 last year, mainly due to expansion of the Ting Internet subscriber base. As a percentage of revenue, gross margin for Fiber Internet Services decreased to 51% from 60%. Gross margin is impacted by a number of factors and cost drivers, some of which occur prior to the generation of revenue. A reminder -- Cost of revenues include the following: network access fees paid to third-parties to use their network -- such as our partnerships in Westminster, Fullerton and Solana Beach; leased circuit costs to directly support enterprise customers; the personnel and related expenses (net of capitalization) related to the physical construction and build out of the physical Fiber network; and as well as personnel and related expenses (net of capitalization) related to the installation, repair and overall field service delivery of the Fiber business. Hardware costs include the cost of equipment sold to end customers, including routers, ONTs, and IPTV products, and any inventory adjustments on this inventory. Other costs include field vehicle expenses, and small sundry equipment and supplies consumed in building the Fiber network.

Network expenses for Q1 2021 increased 28% to \$7.2 million from \$5.6 million for the same period the prior year, with the increase being primarily due to higher operational costs associated with; and higher amortization resulting from; the continued buildout of the Fiber network.

Overall, operating expenses for the first quarter of 2021 decreased 7% to \$18.6 million, from \$20 million for the first quarter last year. The decrease is the result of the following:

- People costs increased by \$0.9 million this quarter, impacted by outsized restructuring and severance charges totalling \$0.6 million. Excluding these charges, people costs were up \$0.3 million, primarily from an increased workforce to support business expansion, including Ting Internet growth;
- Marketing costs decreased by \$0.6 million and credit card fees decreased \$0.5 million, mainly driven by the transition of the mobile business, while costs related to travel and other discretionary expenses decreased by \$0.1 million;
- Stock-based compensation increased \$0.2 million while facility costs decreased by \$0.3 million partially related to elimination of some of our office space;
- Amortization of intangible assets decreased by \$0.6 million, due to the write-down of the Ting Mobile assets last year related to sale of the Ting Mobile customers to Dish;
- And lastly, there was a \$0.4 million net decrease in expenses related to foreign exchange impacts. Specifically, we had a gain of \$0.3 million in Q1 2021 related to mark-to-market remeasurements for our forward currency contracts that do not

qualify for hedge accounting, compared to a loss of \$0.4 million in Q1 of last year, resulting in a year-over-year gain of \$0.7 million. In addition, we experienced a loss of \$0.2 million on the revaluation of foreign denominated monetary assets and liabilities this quarter compared to a gain of \$41,000 in the first quarter of 2020, which had the impact of increasing our expenses \$0.3 million on a year-over-year basis.

As a percentage of revenue, operating expenses increased to 26% from 24%, with the increase being mainly due to the lower revenue in Q1 2021 resulting from the sale of the Ting Mobile customer relationships to DISH.

Net income for the first quarter of 2021 was \$2.1 million, or \$0.20 per share, a 24% decrease from \$2.8 million, or \$0.27 per share for Q1 2020. The decrease was driven primarily by higher depreciation from our continued Fiber network build and a slightly higher effective tax rate.

Adjusted EBITDA for the first quarter of 2021 was essentially unchanged from Q1 last year at \$12.7 million. This is net of \$3 million that is related to Corporate Shared services.

Broken out by segment, adjusted EBITDA for Domains Services for Q1 increased 20% year over year to \$13.8 million from \$11.5 million in Q1 last year driven by the elevated volumes in 2020.

Adjusted EBITDA for Mobile Services for Q1 decreased 10% year over year to \$4.5 million from \$5 million in the same period last year. Again, the adjusted EBITDA line is the best indicator of the year-on-year Mobile performance given the change in the model. This result is very encouraging since we have not yet collected any platform fees on Boost, or any other subscribers beyond Ting Mobile. And, as we have said many times, we like our growth potential so much better with MSE than we did with Retail mobile.

Finally, adjusted EBITDA for Fiber Internet Services for Q1 was a loss of \$2.6 million compared to a loss of \$1.1 million in Q1 last year, with the greater loss resulting from the higher costs required to support the accelerated expansion of the Fiber business.

Turning to our balance sheet, cash and cash equivalents at the end of Q1 were \$8.3 million, unchanged from that at the end of the fourth quarter of 2020, and down from \$12.4 million at the end of the first quarter of 2020.

During Q1, we generated \$14.1 million in cash from operations, which was unchanged from the same period last year. This was partially offset by our further investment during Q1 of \$14 million in property and equipment, primarily related to the Ting Internet build out.

Finally, deferred revenue at the end of the first quarter was \$158 million, up 4% from \$152 million at the end of the fourth quarter of 2020 and up 3% from \$153 million at the end of the first quarter of last year.

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

Closing Remarks [Elliot Noss, President and CEO]

I would like to start my closing remarks by tidying up some unfinished business from last quarter: guidance for our mobile segment. Before I do that, let me first note that we are reiterating the guidance we provided on last call for both the Domains and Fiber Internet segments of the business.

In our Mobile segment last year we delivered \$18.8 million in Adjusted EBITDA. In 2021, we expect to increase that Adjusted EBITDA by 20% or so. We have noted some of the risks here, again primarily related to the T-Mobile shutdown of their CDMA network and other T-Mobile deliverables, but we are pleased with where we are in this segment and are happy to see a return to growth here.

As I continue to note, DISH's success is our success and we are excited about their prospects. We have had a clear view on the future of networks for a number of years, and it is a pleasure to have a partner in the mobile space who sees the future the same way we do.

What that Mobile guidance means in total is we have Adjusted EBITDA of \$71 million in the Domains and Mobile segments, and an Adjusted EBITDA burn of roughly \$14 million in Ting Internet, and also spend of about \$14 million in Corporate overheads, for a net of \$43 million in EBITDA in total.

The other important topic for me to cover is the continued acceleration of ALL of the trends in the US transition from coax to fiber as the predominant means of delivering the Internet.

We've talked about the pandemic, the yield-starved world, and the particular history of US telecom as all contributing to a significant acceleration of already strong trends. When I would speak with bankers and large pools of capital just a few months ago, my estimates for the number of homes passed in the next five years were at the very top of the range.

Now, just a few months later, we have AT&T and Frontier with very public commitments to massive new build outs in their copper footprints. In the case of AT&T, this has even been positioned as a shift in focus from mobile to fiber.

We have seen Apollo, KKR, Carlyle and Blackstone -- among others -- take significant positions in this opportunity recently.

We have seen prices for fiber properties in the secondary market naturally increase.

We have seen the Biden administration propose the single largest federal telecom program in the history of the US -- and maybe the world! We have seen the Republicans submit a counter-proposal that would STILL be the largest telecom program in US history. And we have seen these proposals include important considerations, not just to the build out of fiber, but to the affordability of Internet service.

Obviously this is all good news. For those of us who have been talking about and dreaming of this coax-to-fiber transition for many years, these are heady times. And this all bodes well with so much opportunity for everyone!

In many respects all this news and acceleration is simply external noise -- a lovely symphony of noise -- but still noise. We need to keep focused on what is most important -- engaging with the most attractive places to build, accelerating our capex spend, increasing the throughput of orders and installs, and doing all of this while honing the efficiency of our fiber operations at a city level. Remember, this is a local game.

In one respect though, this may suggest some change. This industry momentum and pace of change may change the balance slightly from owned and operated markets towards helping others in their efforts in a number of ways including eventually, with our billing and provisioning platform for fixed Internet.

The macro environment is clear. There will be a huge buildout over the next five years in particular. The micro environment is less clear. The transition from coax to fiber in the US will likely have dozens, even hundreds of participants making the indirect opportunities relatively more interesting. A world with a long tail of service providers suits us. This is how we thrived in the nineties distributing software with ISP partners all over the world. This is how we thrived in the aughts, becoming the largest wholesaler of domain names in the world. This may become an important element of how we thrive in the coming transition.

We always viewed the transition from coax to fiber as inevitable and obvious. It seems conventional wisdom has mostly caught up.

And with that, I look forward to your written questions and exploring areas that interest you in greater detail. Again, please send your questions to ir@tu cows.com by May 11, and look for our recorded Q&A audio response and transcript to this call to be posted to the Tucows website on Tuesday, May 18 at approximately 4 p.m. eastern time. Thank you.
