



## Tucows Q3 2021 Management Remarks Transcript

### **Introduction [Monica Webb, Senior Director, Market Development and Strategic Partnerships]**

Welcome to Tucows' third 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](mailto:ir@tucows.com), until Friday, November 12th. Management will address your questions directly, or in a recorded audio response and transcript that will be posted to the Tucows website on Thursday, November 18th 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 seven 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.

Now for management's prepared remarks:

On Thursday, November 4th, Tucows issued a news release reporting its financial results for the third quarter ended September 30, 2021. That news release, and the Company's financial statements, are available on the Company's website at [tucows.com](http://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]

### Q3 Results Summary

Thanks Monica. The third quarter once again saw solid financial performance across Tucows' businesses. Domains Services continued to deliver consistent performance, benefitting from the higher level of domains under management, driven by the pandemic impact last year, as well as our success in maximizing gross margin. In our Mobile Services business, our Q3 results reflect the growing contribution of our MSE Platform business, which continues to move forward in line with our expectations. And in our Ting Internet business, we continued to make strong, steady progress in the accelerated build out of our network and our customer base.

Turning to our financial results, total revenue for the third quarter was \$75.9 million, up from \$74.3 million for the same period last year, driven by growth in Fiber Internet Services revenue. In addition, for the first time, we are benefitting from the year-over-year growth in revenue generated by the MSE model, as well as the impact of only one month of legacy mobile customer revenue included in last year's number. Gross margin before network costs was \$26.4 million, up 1% from \$26 million from last year.

I note that the DISH deal took place one third of the way through Q3 of last year; thus the year-over-year comparisons, and the currently choppy nature of the MSE revenue, have a positive gross margin effect of roughly \$700,000. Those looking for a refresher on the details can refer to our [Q3 2020 management remarks](#).

Net income for the third quarter was \$1.4 million, or \$0.13 per share, compared with \$700,000, or \$0.07 per share for the same period last year.

Cash flow from operations was \$1.5 million, compared with \$11.4 million in Q3 last year. This primarily results from two things: a short-term accounting impact from our MSE business that Dave will explain in more detail later; and a number of measures that we are taking to protect against supply chain shocks. These include things like larger inventories and fewer days in accounts payable. We expect cash flow from operations to return to normal levels in Q4.

Finally, adjusted EBITDA was \$12.2 million, compared with \$13.3 million in Q3 last year.

### Domains

Turning to our individual businesses, Domain Services delivered another solid quarter, once again highlighting the consistency of this business, which is, as I noted last quarter, operating at a new healthy, steady state level following the growth experienced last year as a result of

the pandemic impact. Q3 revenue, gross margin, and EBITDA were all essentially in line with Q3 last year, as the outsized transaction volumes of last year gradually dissipated to normalized levels from the pandemic peak in Q2 of last year. Notably, gross margin is well above pre-pandemic levels of Q3 2019, as we continue to benefit from our success in focusing on the quality of our customer base.

In our Wholesale Domains Channel, both revenue and gross margin were essentially unchanged from the previous year -- with gross margin well above pre-pandemic levels. In the Domain Services component of the Wholesale Channel, revenue was unchanged year over year, and gross margin was down 5%, with the year-over-year comparison impacted by the outsized quarter last year. When compared to Q3 in 2019, revenue for the Domains Services component of the Wholesale Channel is essentially unchanged, however gross margin is up 12%.

Total registrations for Q3 of this year were 3.8 million, down 6% from the outsized Q3 last year, and essentially in line with Q3 of 2019. Renewals were up 7%, as we continued to see the benefit of high registration activity. The renewal rate for Q3 was 78%, down from our recent historical levels of around 80%, as expected due to the outsized number of first-time renewals. Our Wholesale renewal rate remains above the industry average, and did tick up sequentially as it tracks back toward historical levels, which we expect to see next year. Finally, new registrations were down 32% from last year's outsized transaction levels, as we have settled into normalized post-pandemic activity levels. This is a strong leading indicator of the remaking of our economy, and the settling down of that behavior.

Value-Added Services component of the Wholesale Channel delivered another excellent quarter, with revenue up 11% and gross margin up 13% year over year. This was once again the result of the strong performance from our expiry stream business that I noted on our last several calls.

In our Retail Channel, total registrations were just over 370,000, down 4% from last year's outsized levels, but up 2% from the third quarter of 2019. And when we correct for the transition of retail customers into our Wholesale business that I discussed last quarter, total registrations were up 8% from Q3 last year. New registrations were down 15% year over year -- again, due to the outsized new registration activity in last year's quarter -- and up marginally from Q3 2019. The Retail renewal rate was 85%, unchanged from Q2, and also remains solidly above the industry average.

Gross margin for the Retail Channel for Q3 was down 8% from the same period last year, as we saw normalizing of the trend we have talked about in previous quarters, as well as the

transition of customers from Retail to Wholesale -- the impact of which continues for two more quarters.

Finally on Domains, subsequent to quarter end, on October 1st, we purchased the registry platform service of UNR Corp. We have known UNR's founder, Frank Schilling, for a long time and were excited to learn of this business becoming available. Purchasing the UNR business not only provided the opportunity to add complementary registry platform technology -- but more importantly, enabled us to add an incredibly talented engineering team -- and more -- with specific expertise in our industry, which is somewhat of a rarity, in what is a rather specialized sector. We are already seeing the benefits of their deep experience and expertise.

## **Mobile Services**

In our Mobile Services business, we are now one year into our MSE model. The big development in the recent quarter is that DISH is now live in Boost Mobile stores with AT&T SIM cards. Our MSE platform is at the foundation of enabling this important strategic shift for DISH. With the addition of AT&T, we've now integrated with every major US carrier's network. And for us, this means five networks, not four, as we previously integrated with Sprint. Included in those networks is the world's first native 5G network using O-RAN -- which is what the world's mobile networks will look like over the next decade. That advantage is specific and meaningful. We now have more breadth of experience in the US market than any other vendor -- not just SaaS platform -- but any other software vendor.

I am pleased to note that we completed this network integration faster than any of our previous integrations. This is not because this was easier -- nor is it the benefit of experience. Each of these MNO networks are unique, with their own idiosyncrasies. Both us and DISH were resolved to complete the integration as fast as possible, enabling them to move customers away from T-Mobile faster. Those who are veterans of these calls know well our historical challenges with T-Mobile. And DISH's own challenges with T-Mobile have been quite public. The biggest impact of this work is that we've helped them stop digging a deeper hole by putting more customers on the T-Mobile network. The timeline here exceeded even my lofty expectations. It's rare that a CEO gets to see a massive software project delivered faster than they expected. Both companies deserve real credit here.

We've all heard the 5G hype. That the battle for 5G is the most important technology battle globally. You have all also heard me say that it's vastly overstated. That in fact, what 5G networks actually do -- and this is meaningful -- is to make the operating costs lower and to create business process efficiencies. I do not think, and have never thought, that 5G is a magic wand for bandwidth or throughput. But I have always believed that it would allow for better, more efficient operation. And it would make it easier to create a fantastic customer

experience. Those are the things that play to our strengths. We are truly allowing mobile networks to act like software.

I've talked in the last couple quarters about the revenue in this segment being particularly choppy through this year, and becoming more predictable in 2022. We saw the best example of that to date, in Q3. And I've also talked about how the breadth of the work, the new things that were coming in the door were delaying the originally planned work, including migrations. You are now starting to see the financial benefit of the extra work coming in the door. We expect this to continue for the next quarter or two, before hitting a more consistent stride.

As I intimated last quarter, in 2022 the BSS/OSS platform that we are using for Ting Internet will also be part of this business. We will be providing a lot of detail on this next quarter, but inside the company, a lot of work is already being done in this regard, and starting next quarter we will be talking about a new telecom software business providing services in both mobile and fixed networks with DISH and Ting Internet as fantastic anchor customers.

## **Ting Internet**

Moving on to Ting Internet, we continue to be all hands on deck in order to best take advantage of the coax-to-fiber transition.

In Q3, we had another strong quarter of customer acquisition gains, with 2,800 net additions, taking us to 22,900 subscribers. This tied last quarter for the largest net addition of subscribers to date. We added 3,100 serviceable addresses in Q3, taking us to 81,900 Ting-owned passed addresses and 74,500 serviceable addresses.

Our capex investment was consistent with our 2021 pace, still tracking to roughly double over last year. With capex and other metrics, our current numbers are modest compared to what we are scaling to achieve next year. Again, we would love to double our serviceable addresses and subscribers next year, and investors can look for more detail next quarter about our plans.

On October 18, we announced [Ting's acquisition of Tucson, Arizona's largest fixed wireless company, Simply Bits](#). As part of the deal, Ting will assume all of Simply Bits' existing infrastructure and customers, adding approximately 4,500 customers, 1,100 square miles of established fixed wireless network, and a small fiber-to-the-home footprint. Ting will also retain Simply Bits' employees, including senior management, with guidance from its founders. We view this as a strategic acquisition that will leverage Simply Bits' wireless expertise, and small but growing fiber footprint, to facilitate new market opportunities for Ting in southern Arizona.

I'm sure many of you want to understand our vision for where fixed wireless fits in our network technology strategy. We see it utilized in the following ways: to extend from the edges of a fiber plant to more remote areas; to provide us with additional solutions for MDUs; and to supplement our options for backhaul.

It comes with valuable wireless expertise around spectrum, technologies and deployment that we can leverage across the Ting footprints (and we're already doing that).

The Simply Bits team also has extensive Enterprise experience, which gives us a plug-and-play sales team on the ground in an area we've identified as one of our best regional opportunities, in addition to providing support to our national sales team.

As I've said previously, we're seeing a land rush in the fiber business, and this is a way to give us a bit of an edge -- by acquiring footprints and operations from which there will be both opportunities to expand fixed wireless, as well as potential fiber markets. It's a low risk way for us to create optionality, in Arizona and in other footprints. I do want to note that this is much more about Arizona than a broader fixed-wireless rollup strategy, so if you ask me about other potential fixed-wireless acquisitions, you will hear my standard, and truthful, answer that nothing is planned.

In terms of other new market developments, we're engaged in a couple of really interesting opportunities. Just so everyone can appreciate the cadence of bringing on new markets, one of them is an opportunity we've been discussing for a couple of years, and one just in the last 4 to 5 months. Depending on the readiness and political will in each city, our engagement with them before becoming public can take years, or they can appear suddenly and move forward quickly. We feel optimistic about both of these opportunities being announced in the next few months.

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.

As Elliot noted at the outset, August 1st marked the one-year anniversary of the sale of the majority of our Ting Mobile customers to DISH and the change in our Mobile model from our previous MVNO model to our current MSE model. When comparing our results for Q3 to the same period last year, Q3 last year includes one month of gross margin generated by the customer base sold to DISH, and two months of fees generated under the new MSE model. As

a result, revenue and gross margin reflect the absence of the Mobile customer base sold to DISH, but does reflect the contribution of the MSE model, and once again, Adjusted EBITDA may provide a better year-over-year view on the operating performance of the overall Tucows business. Beginning in Q4, our results will be directly comparable on a quarter-over-quarter basis.

Turning now to the results.

Total revenue for the third quarter of 2021 was \$75.9 million, a 2% increase from \$74.3 million for the third quarter of 2020. The return to positive year-over-year growth is the result of growth in Fiber Internet Services revenue, as well as the diminished impact of the sale of the Ting customers to DISH, as a result of having just one month of revenue from those customers in Q3 last year. Fiber Internet Services revenue was up 43% year-over-year -- as the subscriber base continues to grow, per Elliot's earlier comments. Domains Services revenue was essentially unchanged from Q3 last year. And Mobile Services revenue was down 4%, which reflects the 30-day loss of revenue from the customers sold to DISH, which was substantially offset by the over 200% year-over-year increase in MSE revenue.

Excluding the impact of the shift in the Mobile business to the MSE model, revenue for the combined Domains and Fiber Internet businesses increased 3%.

Cost of revenues before network costs for Q3 increased 3% to \$49.5 million, from \$48.3 million for the same period last year, with the increase primarily due to the increase in revenue. As a percentage of revenue, cost of revenues before network costs was unchanged at 65%.

Gross margin before network costs for the third quarter increased 1% year-over-year to \$26.4 million, from \$26 million. As a percentage of revenue, gross margin before network costs stayed flat at 35%, as compared to the third quarter last year.

Excluding the impact of the Mobile business, gross margin before network costs for the combined Domains Services and Fiber Internet Services businesses was down 2% year-over-year, to \$21.5 million.

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

Domain Services' gross margin for the third quarter of 2021 decreased 2% to \$18.5 million, from \$18.9 million for the third quarter of last year. As a percentage of revenue, gross margin for Domain Services is down slightly from Q3 last year to 30%, from 31%.

Within the Domain Services business, gross margin for the Wholesale Channel was unchanged from Q3 last year at \$14.1 million.

As a percentage of revenue, gross margin for Wholesale was unchanged at 27%.

Gross margin for the Retail Channel of Domain Services decreased 8% to \$4.3 million, from \$4.7 million for the same period last year. As Elliot mentioned earlier, much of this decrease was the result of the transition in Q2 of this year of a significant number of Enom customers and their domains from our Retail business to our Wholesale business. As a percentage of revenue, gross margin was 49%, down slightly from 52% for the same period last year.

For Mobile Services, gross margin increased to \$4.9 million, from \$4.1 million for Q3 last year. The increase is due to a \$3.7 million increase in gross margin generated by the new MSE model and related services to \$4.3 million, which was partially offset by a loss of gross margin resulting from the sale of the Ting Mobile customers to DISH. Of the \$4.3 million in MSE gross margin, \$3.4 million was generated by Platform Services, with the remainder generated under Other Professional Services, which includes transition services and professional services arrangements related to the platform. As Elliot mentioned, the Other Professional Services category will remain lumpy in the quarters to come.

As per the accounting treatment of the DISH transaction, we generated a Gain on the Sale of Ting Customer Assets of \$5.6 million, compared to \$4.6 million in Q3 last year, which represents the earn out on that customer base and is recognized on the income statement as "Other Income". The \$4.6 million in Q3 last year is before taking into account the \$3.5 million non-cash write-down of certain intangible assets from prior MVNO customer relationship acquisitions.

For Fiber Internet Services, gross margin increased 1.5% to just over \$3.0 million, from just under \$3.0 million in Q3 last year. As a reminder again this quarter, gross margin is impacted by a number of factors and cost drivers that are incurred prior to subscriber revenue being generated; hence the relatively modest increase relative to the increase in the subscriber base over the same period. Cost of revenues includes the following: network access fees paid to third-parties to use their network, such as our partnerships in Westminster, Fullerton and Solana Beach; bandwidth costs; the personnel and related expenses, (net of capitalization) related to the physical construction and build out of the Fiber network; and as well, 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 adjustments on the inventory of these items. Other costs include field vehicle expenses, and small sundry equipment and supplies consumed in building the Fiber network. As a percentage of revenue,



gross margin for Fiber Internet decreased to 45%, from 64%. The decrease is primarily a factor of the timing of revenue relative to the incursion of costs.

Network expenses for the third quarter of 2021 increased 38% to \$8.3 million, from \$6.0 million for the same period of last year, mainly driven by the depreciation on our Fiber network assets.

Total operating expenses for the third quarter of 2021 increased 14% to \$21.2 million, from \$18.6 million for the corresponding period last year. The increase is the result of the following:

- People costs were up \$1.0 million this quarter, with increased workforce costs to support business expansion, including Ting Internet growth and MSE platform build offset by certain mobile costs related to the legacy subscriber base being included in Other Income;
- Marketing costs increased by \$0.7 million mainly driven by increased investments in the Ting Internet business;
- Third-party outsourcing services and professional fees increased \$0.4 million to support increased business operations, including MSE platform activities;
- Travel and entertainment increased \$0.1 million reflecting a slight return to travel and in-person meetings, and stock-based compensation and facilities increased \$0.3 million;
- Loss on disposition of property and equipment increased expenses \$0.2 million;
- And lastly, there was a \$0.1 million net decrease in expenses related to foreign exchange impacts. Specifically, we had a gain of \$0.1 million in Q3 2021 related to mark-to-market remeasurements for our forward currency contracts that do not qualify for hedge accounting, compared to a gain of \$0.2 million in Q3 of last year, resulting in a year-over-year loss of \$0.1 million. In addition, we experienced a loss of \$0.1 million on the revaluation of foreign denominated monetary assets and liabilities this quarter, compared to a loss of \$0.3 million in the third quarter of 2020, which had the impact of decreasing our expenses \$0.2 million on a year-over-year basis.

As a percentage of revenue, operating expenses increased to 28%, from 25%.

Net income for the third quarter of 2021 increased to \$1.4 million, or \$0.13 per share, from \$0.7 million, or \$0.07 per share for Q3 last year mainly driven by a lower estimated effective tax rate in Q3 2021.

Adjusted EBITDA for the third quarter of 2021 was \$12.2 million compared to \$13.3 million for Q3 last year. This includes \$3.1 million of expense that is related to Corporate Shared services, which compares to \$2.9 million for the same period last year. The remaining positive \$15.3 million for Q3 this year breaks out amongst our business segments as follows:

Adjusted EBITDA for Domains Services was unchanged from Q3 last year at \$12.0 million.

Adjusted EBITDA for Mobile Services increased 48% year-over-year to \$7.6 million from \$5.2 million. The increase was driven primarily by the increase in Platform Services revenues under the new MSE model that I described earlier.

Finally, adjusted EBITDA for Fiber Internet Services for Q3 was negative \$4.4 million compared with negative \$1.1 million in Q3 last year, the larger loss reflecting higher costs required to support the accelerated expansion of that business.

Turning to our balance sheet, cash and cash equivalents at the end of Q3 were \$5.5 million, down from \$7.3 million at the end of the second quarter of this year, and down from \$10.2 million at the end of the third quarter of last year.

During Q3, we generated \$1.5 million in cash from operations compared with \$11.4 million in Q3 last year, with the change being primarily due to a decrease in adjusted EBITDA -- the impact of the recognition of a contract asset this quarter related to our MSE services where revenue is recognized in advance of invoicing. This had an impact of \$2.8 million. In addition, we had normal fluctuations in operations with respect to timing for inventory purchases and accounts payables. We expect cash flow from operations to return to more normalized levels in Q4.

We also drew down \$10 million on our loan, and generated a net \$1.4 million from the exercise of stock options. These sources of cash inflows were offset by our investment of \$15 million in property and equipment and other Fiber investments, primarily related to the Ting Internet build out, as well the on-going MSE platform build.

Finally, deferred revenue at the end of the third quarter was \$152 million, down 2 percent from \$155 million at the end of the second quarter of this year, and down from \$154 million at the end of the third quarter of last year.

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

#### **Closing Remarks [Elliot Noss, President and CEO]**

Thanks Dave.

First, I would like to reiterate our previous guidance of \$43 million for 2021. In fact there is likely a little upside there.

As I intimated last quarter, for 2022 we will be moving further down the road of separating our three businesses. You are hearing me use the term “businesses,” not business segments, as I think they have now outgrown the term. Next quarter there will be a LOT of detail to share so I felt that this quarter I should provide a high level overview of what we are thinking about.

Over my quarter century at Tucows, we have repeatedly nurtured new business opportunities inside of our existing businesses. The wholesale domains business leveraged our download business. The retail domains business grew up inside of wholesale. The mobile business was nurtured by domains infrastructure. And the fiber business leveraged the mobile business.

As each of those businesses reached a level of scale, they stood up as separate operations. Starting with the DISH deal in August of 2020, we began a process of pushing further into separate businesses. That process had a transitional phase in 2021 allowing investors to understand the simple, yet complicated transaction with DISH in a year-over-year way. In 2022, we will move to a structure that looks much more like three separate businesses with the parent, TCX, acting as more of a holder of a portfolio of assets and a capital allocator.

In terms of why we are doing this, I want to focus on three reasons: operations, capital and investor clarity.

Operationally, there are real efficiency advantages to sharing a number of overheads while nascent, but as the businesses mature it can lead to limitations on growth and focus. Each business has a unique set of needs technically. They also compete for talent -- both in different skills -- and at different levels inside the same skill. And separation will hopefully end what inevitably happens when one business segment has an urgent need and “borrows” from another, as has happened to the slower growing domains business over the last year or two. When leaving the nest, a different level of self-sufficiency naturally arises.

I would also add here that culture has never been more important in business. The need to attract talent has replaced the need to attract capital as the most important differentiator. We have done amazingly well “sharing” a culture to date. And I am comfortable that the roots of the Tucows culture are deep enough in each of the businesses that they will be maintained. But, each business will also benefit from developing a unique mission and vision, while maintaining the core culture.

In terms of capital, the three businesses are quite different. Domains is a consistent cash generator and has no capital needs. The MSE business is attractive to funders who typically invest in SaaS platforms with large total addressable markets. And the Ting Internet business requires lots of capital, and is attractive to lenders like infrastructure funds and pension funds,

who are looking for above-average long-term returns and are comfortable with long payback periods.

And finally, investor clarity. As the two high growth businesses ripen they each require deeper disclosure. This is best exemplified in the Ting Internet business where we need to start doing things like separating mature fiber markets, where cash is being generously contributed, from new markets where we are making investments to stand up the operations. And understanding the increasing spend on the national platform required to sustain increasing levels of construction spend. Each of the businesses has similar nuances investors will benefit from.

It has become clearer and clearer that TCX is a “sum of the parts” company. I have been spending time trying to learn from companies like IAC and Constellation Software. I am a large investor in TCX and this has been the way I have been thinking about the business for the last while. I know I want the rest of our investors to be thinking the same way and we need to help them best do that.

I have noted previously how grateful we are to have the investors we do. Thoughtful, long term investors who appreciate good business as opposed to a particular sector or thesis. We get valuable input from you, and we view you as important stakeholders. I expect we will be having a number of conversations over the coming months as we move to this new structure. I am looking forward to taking your input and working together on how to best provide clarity for these amazing opportunities that we are blessed to have.

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](mailto:ir@tu cows.com) by November 12, and look for our recorded Q&A audio response and transcript to this call to be posted to the Tucows website on Thursday, November 18 at approximately 4 p.m. eastern time. Thank you.

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