



Tucows Q1 2022 Management Remarks Transcript

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

Welcome to Tucows' first quarter 2022 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 these remarks, shareholders, analysts and prospective investors are invited to submit their questions to Tucows management via email at ir@tucows.com until May 13. Management will address your questions directly or in a recorded audio response and transcript that will be posted to the Tucows website on May 25th 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 full years 2020 and 2021 and now also includes summaries of Fiber Internet Services' financial results and historical financial results, 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, May 5th, Tucows issued a news release reporting its financial results for the first quarter ended March 31st, 2022. 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.

Finally, as discussed on our last call, starting this quarter, we will report as separate businesses—Ting, Wavelo and Tucows Domains—in addition to Tucows Corporate. Tucows Domains is unchanged. Ting is also largely unchanged, save for our historical ISP billing solutions, which have been moved under Wavelo. Wavelo no longer includes the tail from the retail mobile customer base sold to DISH or the legacy retail mobile business. Both of these are now included in the Tucows Corporate category, as well as centrally managed

administrative expenses. For those that have not done so, I encourage you to watch the [video](#) we posted in February for additional detail and perspective on the rationale for this change.

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]

Introduction

Thanks, Monica.

With this change in our reporting segments, we are also refreshing the format of these remarks, inviting the heads of each of these businesses to deliver the remarks on their own business to let you hear them and, as investors, start to get to know them better.

Also, in the interests of time, starting with this call, I am going to dispense with my review of the overall financial results. This information is readily available in our disclosures, and our CFO, Dave Singh, will cover it in detail in his remarks. We were essentially repeating each other. We hope our shareholders will appreciate our continuing efforts to be thorough but efficient with these commentaries, and of course we are open to feedback.

We will start with Dave Woroch, Chief Executive Officer, Tucows Domains.

Tucows Domains [Dave Woroch, Chief Executive Officer, Tucows Domain Services]

Thanks Elliot. And for those who don't know me, I've been with the Tucows Domains business since its inception in early 2000, just as the company was preparing to launch its wholesale domain name registration service. Our unique offering completely revolutionized the domain name business for web hosting companies and ISPs. Over the ensuing 22 years, I've been involved in all aspects of our domain business and have been running it for the last five years.

Turning to the most recent quarter, I am pleased to report that Domain Services delivered another quarter of solid performance that once again underscored the consistency of the business.

Revenue for Domain Services for the first quarter was essentially unchanged from the same period of last year, with gross margin down slightly. I will note, however, that gross margin for Q1 last year benefitted from a registry rebate, which happens from time to time, that was not repeated this year. Excluding this rebate, gross margin was in line with that of Q1 last year.

Domain Services' adjusted EBITDA, net of the impact of the rebate, decreased 5%. The vast majority of this decrease was the result of the stronger Canadian dollar, which increases operating expenses, mainly due to Canadian-dollar based compensation costs.

While the overall financial performance of the Domains business was very much in line with Q1 of last year, total transactions for the business, as expected, are now settling back in at pre-pandemic levels after the elevated levels in 2020 and 2021. We are seeing signs that these are industry trends. Verisign, the operator of the .com and .net registry, announced their Q1 results last week, commenting that the component of growth attributed to the pandemic has subsided and that their new registrations, at 10.2 million for the quarter, were down 12% year over year. Importantly, I will note here that Tucows' overall combined renewal rate for Q1, which we view as an indicator of the health of the business, remained well above the industry at 81%, also back to our pre-pandemic levels.

In the Wholesale Channel, revenue for Q1 was up just shy of 1% year over year, with gross margin down just under 2%. Excluding the benefit of the rebate to last year's numbers, gross margin was up 4%.

Within the Wholesale Channel, Domain Services' revenue was unchanged from Q1 last year, while gross margin was down 7%, primarily due to the benefit in last year's quarter of the rebate. Excluding the rebate, gross margin was also unchanged year over year.

The Value-Added Services component of the Wholesale Channel once again generated solid growth, with both revenue and gross margin up 11% compared to Q1 last year. The increases continued to be driven by the performance of our expiry stream business, where the secondary market for domain name sales continues to be strong.

In our Retail Channel, revenue decreased 1% and gross margin decreased 10% from Q1 2021. Once again, Retail gross margin was impacted by the transition in Q2 of last year of a number of Enom customers and their domains from our Retail Channel to our Wholesale Channel.

Along with the realignment of the business segments, we have taken the opportunity within Tucows Domains to more closely connect the Tucows parent and the registrar brands. For more than two decades, Tucows has been synonymous with domain registration. In the coming months, you will see a stronger connection of the Tucows brand with our registrar properties, with each anchored by the rich heritage of the Tucows name. It's something that we are all proud of and reflects our two decades of success in building the world's largest wholesale domain registration business and the second largest domain registration business overall.

Now over to Justin Reilly to report on Wavelo.

Wavelo [Justin Reilly, Chief Executive Officer, Wavelo]

Thanks, Dave, and hello TCX investors. I'm Justin Reilly, the CEO of Wavelo, and I'm excited to be delivering remarks to you for the first time. I joined Tucows in September 2019 following my tenure leading product at one of the world's largest telecoms. The problem Wavelo is solving falls into what is called the startup holy grail: a big, unattended, fragmented, low-NPS market where a solution solves a core issue for humans.

You've heard Elliot address the low customer satisfaction in telecom many times. The customer experience is abysmal, no customer is happy with their telecom, and no telecom is happy with their billing software. The market for telecom software is trending north of \$100 billion, and the move to the cloud is accelerating the last 30% of digital transformation. And I'm thrilled to be at the helm of this audacious effort to use the Wavelo platform to transform telecom and the connected experience for more humans worldwide.

Wavelo is, of course, the brand name we've given to our software platform business, formally launched earlier this year. It is organized as a wholly owned subsidiary of TCX with its own executive team and financials. It was launched not only with the advantages of the funding and resources of Tucows, but also with two formidable anchor customers: DISH and Ting Internet. Don't get me wrong—there is much to work through at this early phase of the business, but launching a new company under these conditions gives us a significant head start and a strong operational base to work from.

After launching in January, we snapped into operating Wavelo right away, developing operating principles and putting a management structure around the formerly named MSE business. And importantly, we brought on new people to round out our leadership team. That now includes Hanno Liem, Chief Technology Officer; Neil Shah, Chief Product Officer; Michael Koenig, Chief Revenue Officer; Tom McGillivray, Vice President of Customer Experience; Joshua Bondi, Director of Finance; and Karaka Leslie, Head of People. The team has hit the ground running, with meaningful progress already being made on subscription management, early sales pipeline work, hiring and core feature development for the two platforms.

Currently the majority of Wavelo's revenues come from the work with DISH and their customers. Q1 2022 Platform Revenue was \$6.1 million, up from \$0.6 million in Q1 of last year, as additional platform fees and subscribers migrated to the platform. Professional services went from nil to \$0.8 million year over year.

As mentioned over the last few quarters, we are completing some one-time, strategic work for DISH. We are at the tail end of that professional services work as we support DISH in their 5G launch. Going forward, we will focus on subscription-based revenue as our growth engine. This revenue is sticky, predictable and, most importantly, aligns our success with our customer's success. Tucows Domains has proven that for many years in a much smaller market.

I understand you are all very interested in what the subscriber base coming from DISH will look like beyond Ting Mobile subscribers and the Boost migration. As always, we recommend consulting DISH's quarterly earnings reports and guidance. However, I will note one item from their Q4 2021 report. DISH's native 5G network—the world's first—is now live in Las Vegas, and, impressively, they are on track to have 20% of the US population covered, in over 25 major metros and 100 smaller cities, in June of this year. We're excited to support DISH in the Las Vegas launch as Wavelo is one of the first platforms to integrate with DISH's new native 5G network. We couldn't ask for a better partner and are bullish about their mission to disrupt the mobile market as we know it.

Having run a venture-backed startup before, I can tell you that the time I save not having to worry about fundraising allows me to operate the business with an obsessive focus on efficiency, growth and value. Both mobile carriers and ISPs are looking for an alternative to the legacy OSS/BSS providers. We are confident that we are the best choice, and we have proved it with the happy customers we created in both Ting Mobile and Ting Internet. There has never been a better time to start a telecom software company, and no better home for it than at TCX.

And lastly, I know many of you are interested in learning more about Wavelo. I would encourage you to visit our website at wavelo.com and read [the white paper](#) we have posted there. I also look forward to any questions you may have from this script.

Thanks for listening, and now over to Elliot.

Ting Fiber Internet Services [Elliot Noss, President and Chief Executive Officer, Tucows]

Thanks, Justin.

Moving on to Ting Fiber. We continued our rapid growth in the first quarter and shared the news of our three largest new markets to date.

In Q1, we had 2,300 net subscriber additions, taking us to 27,800 in total. Our total for both Ting-owned and Ting Partner serviceable address additions were 7,000, taking us to 98,100 total serviceable addresses. Both were impacted by the typical Q1 weather effect.

Our fiber capex moderated due to weather in Q1 to just over \$14 million. We expect to be back to increasing construction pace and capex spend in Q2.

This quarter, we also announced three sizable new markets. In January, we announced that Ting would be the initial anchor tenant on a city-wide fiber network being built and owned by Colorado Springs Utilities. This would be our biggest market yet, with over 200,000 serviceable addresses. We hope for the first addresses from the utility to land in early 2023. In April, we announced that Ting will be expanding into Aurora, Colorado, a community of over 130,000 addresses, that will adjoin our network footprint in Centennial. When combined with our existing network and planned expansion in our southwest Colorado markets, that takes us to 400,000 potential serviceable addresses in our Colorado footprint. We are moving forward quickly in Aurora, with our first permit already filed and crews ready to deploy.

Also earlier this year, investors may have noticed that Ting was one of the finalists in the bid for a broadband franchise in Alexandria, Virginia, and we were undertaking negotiations with the city. Alexandria is a thriving city of 90,000 serviceable addresses and, thanks to regional initiatives like Amazon's HQ2, is experiencing growth and densification. Ting emerged as the final ISP in the process, and we are in the end stages of the negotiation with Alexandria, with the execution of the franchise, a formal announcement and start of construction all expected in Q2.

This is a unique quarter with over 200,000 addresses to be built and another 200,000 partner addresses announced. In a space where competition for opportunities is increasing, this is a fantastic accomplishment.

With this quarter's results, we will have our first look at some of the new disclosure I have been talking about, specifically a view of mature versus growth fiber markets and a look at the operating costs related to building the footprint.

First, the city-level disclosure. Telecom is inherently a local business. With a fiber build in any specific city or town, it will be unprofitable in the first 18 to 30 months and will then generate cash until long after we are all around—even the youngest of us. In the growth period, we engage in the most marketing; we are standing up a workforce to handle installs; we are finding new local facilities among other startup costs. And of course, we have very few customers.

Once we have operated for a couple of years, we pass a threshold into generating cash, and that cash generation grows until roughly the five-year mark, where it roughly plateaus. Beyond that, we will look for growth more from ARPU than from customer growth.

For disclosure purposes, we are defining a mature market as one where the average age of addresses in the market exceeds two years.

In our first quarter looking at this disclosure, I will focus on two things. First, the cash generated from mature markets grew from Q1 2021 to Q1 2022 by over 80% to nearly \$2.6 million in the quarter. This gives investors a small window into the powerful cash generation potential of this business.

Looking at growth markets—those with average address age under two years—we see the EBITDA loss grow by over 40% to over \$1.4 million. For the next three to four years, as we ramp up our build pace and our launches, both these numbers will grow, with the loss from growth markets growing faster than the gains from mature markets. As those newer markets mature, we will see the trend reverse and cash start to powerfully flow.

Second, looking at the expense side, remember that most customer service, marketing and installation costs are covered at a city level. At a national level, we have two buckets of costs—“construction costs” and “national costs.” The latter are costs on a national level for things like finance, HR, product management, and the national components of marketing and customer service. Think of them as the cost to build and the cost to operate. And remember, in each market, we will build for one to two years and operate for decades.

There is positive financial leverage in both of these cost buckets. With construction costs, we see leverage when comparing them to capex. A simple lens is to view the construction costs as overhead required to produce addresses. Thus, efficiency is in construction cost per serviceable address produced. With national costs, we see leverage when comparing it to the number of customers. A simple lens is national costs per customer. Thus, we are able to track the leverage and therefore the efficiency of this spend by looking at it through these lenses.

However, as Ting grows, these two buckets are growing significantly on an absolute basis. We are building a business to scale to much greater levels than it currently is. We are hoping to grow capex aggressively and create a larger footprint. Thus, these buckets are where you will see the overall loss get generated. This disclosure is a work in progress. We hope that this start point lets you see both the absolute growth in various categories, as well as providing some context to allow you to follow and evaluate them on a relative basis. We welcome comments here.

Investors will also note that on the Q1 KPI Summary, we are now reporting only serviceable addresses as our key network footprint metric for Ting and have retired reporting passed addresses. We added the passed address metric at the end of 2019 to provide better visibility into how our capex spend translated into build progress while we were experiencing

significant lags in lighting addresses, primarily due to issues with data center construction. We are now reverting to disclosure more in line with the industry, and that is hopefully less confusing.

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 begin, just a quick note that the results for prior periods have been recast to reflect the changes we made this quarter to the reporting segments to make the periods directly comparable.

Total revenue for the first quarter of 2022 increased 14% to \$81.1 million from \$70.9 million for the first quarter of 2021. The increase was driven by strong growth in both Ting Fiber Internet Services and Platform Services—up 93% and 973%, respectively—which were partially offset by the expected decline in revenue from transition services with DISH, which, as Elliot mentioned, are now part of the Corporate category.

Revenue from Tucows Domains Services was essentially unchanged from Q1 last year.

Cost of revenues before network costs for Q1 increased 7% to \$49.4 million from \$46.2 million for the same period of last year, with the increase being less than the revenue growth due to the increase in high-margin Platform Services revenues. As a percentage of revenue, cost of revenues before network costs decreased to 61% from 65%.

Gross profit before network costs for the first quarter increased 28% year over year to \$31.7 million from \$24.7 million, with the increase due mainly to the higher margin contributions of both Platform Services and Fiber Internet Services. As a percentage of revenue, gross margin before network costs increased to 39% from 35%.

Breaking down gross margin by business, Domain Services' gross margin for the first quarter of 2022 decreased 4% from Q1 last year to \$19.7 million from \$20.5 million. As a percentage of revenue, gross margin for Domain Services was 32% compared with 33%.

Platform Services' gross margin increased nearly ten fold to \$5.9 million from \$0.6 million for Q1 2021, with the entirety of the increase being driven by revenues generated by the

underlying Mobile operator platform. As a percentage of revenue, gross margin for Platform Services was 86% compared with 87% in Q1 last year.

Fiber Internet Services' gross margin for Q1 increased 132% year over year to \$5.8 million from \$2.5 million for the same period of last year. I will remind you that gross margin for Fiber Internet Services is impacted by a number of factors and cost drivers that are incurred prior to subscriber revenue being generated that will cause some variability from quarter to quarter. These are detailed in my [second quarter 2021 prepared remarks](#).

As a percentage of revenue, gross margin for Fiber Internet Services expanded to 59% from 49%. The increase is primarily due to the timing of revenue relative to the incursion of costs, including utilization of our field and engineering labor related to the delivery of our network.

Network expenses for Q1 increased 45% to \$10.5 million from \$7.2 million for the same period of last year. The increase was driven by both the higher depreciation of our Fiber network assets as well as an increase in the workforce to support the growing Fiber network.

Total operating expenses for the first quarter of 2022 increased 40% to \$26 million from \$18.6 million for the same period last year. The increase is primarily the result of the following:

- People costs were up \$3.5 million this quarter, with increased workforce costs to support business expansion related to Ting Internet growth, including the first full quarterly inclusion of the Simply Bits team which joined this past November, as well the continued Platform Services build, and, to a lesser extent, the acquisition of the UNR assets and its development team in October 2021.
- Marketing costs increased by \$1 million, mainly driven by increased investments in the Ting Internet business, including Simply Bits.
- Professional fees increased \$0.4 million primarily related to regulatory and market development support for Ting Fiber.
- Facility and third-party contracting and support costs were up \$1.1 million, primarily related to Simply Bits, and stock-based compensation increased \$0.4 million. Other expenses including travel and credit card fees were up \$0.5 million driven by increased revenue and business activity.
- Amortization of intangible assets and loss on impairment of property and equipment increased \$0.5 million.
- And lastly, foreign exchange impacts increased expenses by \$0.2 million this quarter. Specifically, we did not have any mark-to-market remeasurements for our forward currency contracts that do not qualify for hedge accounting as we are not currently holding any such contracts compared to a gain of \$0.3 million in Q1 of last year, resulting in a year-over-year loss of \$0.3 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 \$0.2 million in the first quarter of 2021, which had the impact of decreasing our expenses \$0.1 million on a year-over-year basis.

As a percentage of revenue, operating expenses increased to 32% from 26%.

We reported a net loss for Q1 2022 of \$3 million, or \$0.28 per share, compared with net income of \$2.1 million, or \$0.20 per share, for the same period of last year. The net loss was driven predominantly by the accelerated build of our Fiber network and ongoing ramp of internet operations as well as higher depreciation and interest expenses. Note our tax expense reflects our geographic mix, with taxes payable in Canada on our legacy domains business.

Adjusted EBITDA for Q1 was \$11.3 million, down 11% from \$12.7 million for Q1 2021. That total breaks down amongst our three businesses as follows:

- Adjusted EBITDA for Domain Services was \$11.8 million, down 11% year over year from \$13.2 million. As Dave mentioned earlier, a significant portion of this decline relates to an outsized rebate in Q1 2021.
- Adjusted EBITDA for Platform Services was \$2.0 million compared with a negative \$1.1 million last year.
- Adjusted EBITDA for Fiber Internet Services was negative \$4.3 million compared with negative \$3.9 million in Q1 2021, with the larger loss reflecting higher costs required to support the accelerated expansion of that business.
- And finally, the Corporate category had positive adjusted EBITDA of \$1.8 million compared with \$4.5 million in Q1 last year with the decline primarily driven by, and as expected, the lower earnout from the sale of the Ting Mobile customers to DISH. As customers continue to churn, lower transitions services margins and lower contribution from the mobile subscribers retained.

Turning to our balance sheet, cash and cash equivalents at the end of Q1 were \$6.2 million, compared with \$9.1 million at the end of the fourth quarter of 2021 and \$8.3 million at the end of the first quarter of 2021.

During the quarter, we generated \$5.4 million in cash from operations compared with \$14.1 million in Q1 last year, with the decrease being primarily due to increased prepaid expenses, timing of A/R collections and the recognition of a contract asset this quarter in the Platform Services business.

We also added \$16.5 million to cash via a further draw down on our loan, as well as \$0.5 million from the exercise of stock options.

These sources of cash were more than offset by our investment of \$23.1 million in property and equipment, primarily for the accelerated build-out of the Ting Fiber Internet network as well as the continued build of the Wavelo platform.

Finally, deferred revenue at the end of Q1 was \$152 million, up 3% from \$148 million at the end of the fourth quarter of last year but down 3% from \$157 million at the first quarter of last year.

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

Closing Remarks [Elliot Noss, President and CEO]

Thanks, Dave.

I have been thinking a lot about the difference between when value is created and when value is realized.

Right now, for both Wavelo and Ting, there is a huge gap between the value being created and the value realized as reflected in the TCX stock price.

For Wavelo, telecom software is a new segment. Existing TCX investors have yet to fully learn it, and existing telecom investors have no idea who TCX is. And even at a purely financial level, it is difficult for investors to really understand or appreciate Wavelo until the DISH migrations are substantially completed and investors can get a better sense of what ongoing subscription revenue will look like.

For Ting, while the coax-to-fiber transition in the US is a unique, multi-generational opportunity—both in terms of the returns and in terms of how much capital can be deployed—it is a long-term investment. We are virtually alone as a public company competing with private-equity backed platforms for a reason. The fantastic returns are not realized for some time and are hidden by the financials until they become ripe.

A ton of value is being created, but it is a challenge to see it realized. We have been here before. In the late aughts and early teens, we had two businesses: Domains and Ting Mobile. Domains was generating solid cash and was winning in the market. Many of its competitors were starting to get squeezed by years of short-term choices while Tucows was making long term choices. The competitors were ripening on the vine into acquisition targets.

Ting Mobile, meanwhile, had clearly found a better mousetrap. We had a better offering that was not yet copied by the big incumbents, we had found some customer acquisition

advantages by being very early in vehicles such as podcasts, and we held on to our gains with best-in-the-world customer satisfaction.

But the stock did not move until investors clearly saw the cash being generated by Ting Mobile and until the acquisition opportunities came off the vine and into our cupboard. And of course, then it moved significantly.

Now, history never repeats, but it does rhyme. We have been here before. We know what the gap between value creation and value realization looks like—and we know how to both live through it and to take advantage of it. Both we and our investors have the benefit of having been here before. The benefit of experience.

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@tucows.com by Friday, May 13th, and look for our recorded Q&A audio response and transcript to this call to be posted to the Tucows website on Wednesday, May 25th, at approximately 4 p.m. Eastern time. Thank you.
