tucows

Q2 2022 Q&A Transcript

Introduction [Monica Webb, Senior Director, Investor Relations]

Welcome to Tucows' question and answer dialogue for Q2 2022. 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 Q2 2022 Financial Results and updated reports. I would also like to remind investors like to receive our quarterly reports and Q&A via email, please make the request to our ir@tucows.com email.

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.

Today's commentary includes responses to questions submitted to us following the pre-recorded management remarks regarding the quarter and outlook for the Company. 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 questions and/or any direct email you may receive do not address the meat of your questions, please let us know.

Go ahead, Elliot.

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

Thank you, Monica. And welcome to our Q&A for our second quarter 2022 financial results.

Almost all of our questions this quarter related to the Ting Internet business, and most of those were looking for more specifics on Ting's recent financing.

With respect to the size of the financing, in the original announcement and the quarterly management remarks were details on the up to $200 USD million in financing from

Generate. In the Q2 remarks, we discussed up to an additional $400 million in network partnerships. To clarify, this is completely separate from the $200 million financing of Ting's own projects. The additional up to $400 million that Generate has agreed to invest is in new networks where Ting and Generate would partner – similar to the existing partnerships we have in Westminster, Fullerton, Solana Beach and Encinitas – with Generate financing, building and owning the networks and Ting acting as an anchor ISP tenant.

We note that partner networks are becoming more and more popular, at least in terms of companies wanting to build and finance networks. There still seems to be a dearth of ISPs to ride those networks.

The significance of the $400 million figure is to allow for a simple linear calculation of the interest rate. You will hear us mostly talk about the cost of this financing as 13%. That's because we comfortably expect to partner on a minimum of $400 million worth of those networks. In fact, I wouldn't be surprised if the number far exceeded that. If we partner on $400 million of networks, or more, the interest rate will be 13%. If we partner on none, it will be 17%. It will be linear in between those numbers. A project could come from either Ting's own city engagement pipeline or from Generate's subsidiary, Ubiquity. And finally, for clarity, we have complete discretion over which projects we bring to Generate and which projects we decide to build ourselves.

Next I would like to talk about the $600 million valuation. We have noted that we did not include common equity in this financing, which we feel very good about, as we expect the common equity of Ting to appreciate significantly over the next year or two. This is not boastful, but rather simple math. Businesses like ours are valued within a defined range of dollars per pass, and/or dollars per customer. Given the pace that we are building at, twelve months from now, we expect to have 50 to 100% more homes passed, and more customers. We expect a corresponding increase in the equity value of Ting. That is far in excess of the coupon on the preferred equity, with a very comfortable buffer around it. Finally, the $600 million is a pre-money valuation.

There were questions about the tax deductibility of the preferred equity coupon. The payments on the preferred equity are tax deductible based upon the structure of the security.

I would also like to share some comments about our mature vs. growth market disclosure. As a reminder, in Q1 of this year, we provided additional disclosure on our fiber business by differentiating between mature and growth market contributions in page 2 of our KPI Summary. A mature market is one where the average age of addresses in the market exceeds two years, and a growth market is up to two years. We are using the two year mark because that's around the time where we start to see the transition from a high investment phase in that market, where we've had growing EBITDA losses, into a period where cash starts to powerfully flow. Network construction spend diminishes and further capex is mostly success-based. Subscriber penetration continues to increase, and our operational costs are low. You can also reference my initial explanation in the fiber section of the Q1 transcript.

This quarter, after the Finance team concluded the heavy lift from the Ting financing, we realized we needed to make a couple of adjustments in the way we were reporting this data. First, we digested that the matching of revenues and expenses was difficult, as we track customers and therefore revenue by neighborhood and we track expenses at a "footprint" level. This may be city-wide, regional, or even at a state level. To best understand this, in our North Carolina and South Denver footprints, we are still building significant numbers of new homes, many of which are in greenfield developments and thus have lots of growth-related operating expenses associated with them.

We appreciate that investors are interested in seeing both revenue growth and profitability. Revenue is easy. However, going forward, we have to give more thought to how to best let investors see the profitability. Also, the Cedar footprint in Colorado, and the Simply Bits footprint in Arizona – both of which had been acquired by Ting and include significant non-fiber footprints – were reflected in the fiber "growth" market contribution numbers, but neither is yet in active fiber construction. We're looking at how to most accurately capture their revenue, and discuss it in the next quarter.

We will look to find more practical ways to enable investors to follow profitability. For now, I will note that we continue to achieve the lofty targets we have set for ourselves on take rates, and we are seeing the profitability we thought possible on a net level. Leave this with us.

I'd also like to cover a related issue that's a result of the timing of the Ting financing. You've heard me say that in my view, the financing took too long. Probably a quarter too long. You also know us as responsible operators. Accordingly, in the latter part of the quarter – really through the back half of the quarter, on an increasing basis – we slowed down the build machine. We did this for all the reasons that you would want us to. There were a couple of financial implications of this that did come up in questions. First and simplest, accounts payable was high. And I will note that this was particularly true with a couple of the very largest vendors in the fiber space. You know that we pride ourselves on our relationships with all of our stakeholders, and it's times like this where the benefits of our focus on relationships comes into play. It helped us manage payables as we addressed the financing. You will see that number normalize next quarter, and we appreciate our partners' support.

The second place where this had an impact, and where we had a couple of questions, was around Ting Internet revenue. Although this business continues on its path of robust growth, there was a slight deceleration in revenue growth this quarter, driven by a couple of factors. First, in any given quarter, our installs come from both orders generated in the quarter, and from existing pre-orders. Because of our tactical decision to slow down the build machine, we made fewer addresses serviceable with pre-orders attached to them. The performance of our orders in existing serviceable footprints was completely on pace – in fact, it was our best quarter ever. But the point remains that the implication of slowing down the build machine meant less new serviceable addresses, and particularly those that included pre-orders, which meant decelerated revenue growth. But still significant growth.

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.

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