Q1 2023 Q&A Transcript

Introduction [Monica Webb, Vice President of Investor Relations]

Welcome to Tucows' question and answer dialogue for Q1 2023. 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 Q1 2023 Financial Results and updated reports. I would also like to remind investors that if you would like to receive our quarterly reports and Q&A via email, please make the request to ir@tucows.com.

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 full 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 first quarter 2023 financial results.

It was great to see so many of you in person and on the livestream for our recent investor day. As a result of that opportunity to dive more deeply into our business assumptions and operations, we have a lighter Q&A this quarter. We have a couple small clarifications on TCX; a couple of questions on Ting; and nothing more on Tucows Domains or Wavelo, although I will say that we had positive feedback on both these businesses as investors were able to dig a little deeper on investor day.

Tucows

With Tucows, I have a few questions on the overall business that I'll address first.

We talked about 2023 guidance for Adjusted EBITDA in our Q4 management remarks and Q&A, and I'd like to reiterate our expectations for each business segment. For Tucows Domains, which achieved $44.8 million in Adjusted EBITDA in 2022, guidance is in the same $45 million range. For Wavelo, which did $3.8 million in Adjusted EBITDA in 2022, we have guidance of $4 to $6 million in EBITDA, which is an update from the $2 to $4 million we provided in the Q4 Q&A. In 2022, a larger portion of Wavelo's revenues came from one-time professional services from DISH, whereas in 2023, the revenue stream is transitioning towards the long-term subscriber-based revenue model. For Ting, which had an Adjusted EBITDA loss of $21.6 million in 2022, as we continued to ramp investment into building fiber, guidance for 2023 is around a $40 million Adjusted EBITDA loss. And for the Corporate segment, which in 2022 did $10.4 million in Adjusted EBITDA, we are giving guidance of $5 million for 2023, reflecting a lower expected Mobile contribution and increased investments in Corporate services.

We had a question about the Tucows syndicated debt level of $233 million in Q1 of 2023 that was cited at our investor day, and how that reconciled with the number for the debt cited in our Q1 10-Q, of $237 million. As our CFO Dave Singh noted in his comments in the Q1 management remarks, our March 31st, 2023, syndicated loan balance for covenant calculation purposes was a net $232.9 million when factoring in letters of credit and cash on hand of up to $5 million. So for emphasis, the differential reflects cash on hand of up to $5 million, which gets netted when we calculate leverage. And it's cash on hand as it relates to the non-Ting operations as the syndicated debt only applies to Tucows, not Ting business.

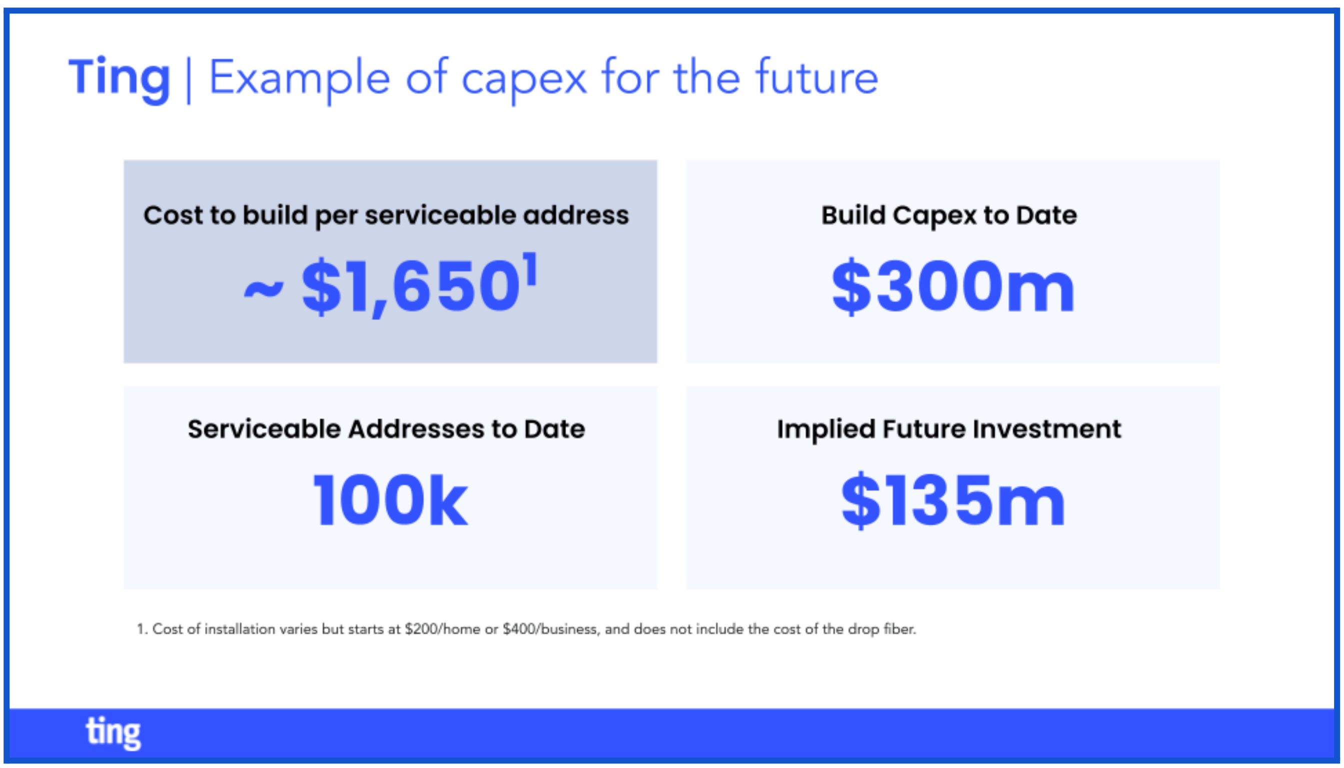
Ting

Turning to Ting, one of the questions we had coming out of investor day was on the implied cost per pass in the sample build plan we presented. This provides a great opportunity for us to show that dividing passes by capex in any period other than when we stop building entirely, will simply not yield useful information. The question that we were asked could be paraphrased as, "Ting spent a long time talking about a build cost in the $1,650 range. Ting also presented a possible build plan that showed $1.45 billion of capital deployed. It presented that build plan as yielding roughly 450,000 organic passes and 450,000 partner passes. That looks like it's costing you over $3,000 per pass! How do you explain that!"

We appreciate the question as it gives us a chance to use a real example. There are four major factors that need to be taken into account. First, this model has nearly $350 million in installation capex in order to load the network. Second, there is nearly $130 million in operating losses through the period of that model. Third, there is capex, outside of install capex, in partner markets. This is for things like data center footprint and fleet. This is another $18-and-change million dollars. Fourth, the network is not fully built at that point. There is roughly $240 million in capital deployed that will go towards future addresses. This last point is important. It is very difficult – and more importantly unrealistic – to have a model that is of any use as an operating guideline, that goes from deploying a significant amount of capital on build capex in one year – say over $100 million – to zero the following year. There will be a natural tapering in any plan.

To help understand this further, if we look at our build to date and simply backsolve to a build cost of $1,650, and look at the roughly 100,000 passed addresses to date, we will see that we imply roughly $135 million of $300 million in capital spent to date includes operating losses, install capex, partner capex, and roughly $75 million spent on addresses not yet serviceable, out of $240 million in build capex. Or over 30% of build capital spent to date is on addresses not yet serviceable. But of course we always gain the benefit eventually.

We have included a slide in the transcript to help illustrate this point.



Coming out of shareholder dialogue, I'm going to use our project in Alexandria, Virginia, where microtrenching started last fall, and the first addresses were lit in March of this year, to emphasize this point. It's a nice example as it is our largest organic market to date that is complex to build due to the age and historic nature of the city, but also comes with a large share of MxUs, which provide density and lower per address costs, but also barriers to entry.

We spent most of 2021 in substantive discussions and negotiations with the City. In fact our dialogue with the City commenced years before. There was engineering feasibility work, legal work as part of the City's franchise process, weekly meetings with the City, and deep planning on materials, vendors, route planning and permit management. The final franchise agreement was signed in May of 2022, and we procured vendors and materials, local facilities and electronics. Microtrenching construction for the network began in September of 2022.

Clearly that is a lot of up-front effort being spent on work and materials that benefits the overall project. And there's an additional element that front loads costs in Alexandria – the high proportion of MxUs in the city. We design and build the capacity for those buildings, and pass by them as we build, although winning those customers is a longer sales cycle involving property owners and managers – so those addresses and their significantly per address reduced costs, will bring down the per SA cost over time as we gain the right to enter and wire those buildings.

As a result, as of the end of Q1 2023, we have already spent $10.8 million on build capex in Alexandria, and we ended Q1 with only 894 addresses. You can see clearly that at this point calculating a cost per address is silly. Using the framework we outlined above, we can instead see that at the end of Q1 2023 we had spent $9.3 million on future addresses, or 86%. We note that the total cost of the Alexandria build will get close to $100 million.

We provided additional support for our business assumptions at our recent investor day. We did have further requests for projections on how the business results, based on our assumptions, would flow through to the consolidated financials over the next few fiscal years. We will not be providing a five-year model. We will not be providing projections beyond what we already provide. The fiber market will be incredibly dynamic for the next five years. The key for us operationally is to stick to the guideposts. If we keep building networks effectively, loading them proficiently, and operating them effectively, the numbers will flow.

Closing Remarks

It was great seeing so many of you earlier this month. I came away having two things deeply reinforced. First, that we have a unique group of shareholders. Unique in concentration with a very few of us owning most of the float. Unique in our long-term value orientation. Unique in the length of our holding periods. And for the rest of you, unique in your support, feedback and the frankness of our communication. I feel we get no free passes and are held to a high standard, but the nature of the communication is extremely productive. In my experience the relationships are very different from those that other public company CEOs experience.

The second thing is the difficulty of helping investors follow the fiber build. It is so much capital, with such a long payback, and such a trough in operating costs. It has so many moving parts – not only across functions, but, particularly in construction within functions. I am watching companies like Frontier and AT&T struggle with the same problems at a much, much lower percentage of operations. We will keep working at this, trying to improve the disclosure, but I do not expect a magic bullet. Thankfully we are closer to the end of this challenge than we are to the beginning. Once these networks start to produce meaningful cash, as they inevitably will, the problem recedes.

We now have a clear sense of where Ting stands in the industry. We are building well. More expensively than many others – but by choice with an eye towards keeping ongoing maintenance costs as low as possible, and customer satisfaction as high as possible. We have what may well be the best churn in the industry. It is lower than most of our mid-market fiber peers and much lower than the larger industry players. We are loading our networks efficiently, but our only natural advantage in CAC is our high customer satisfaction. Others have marketing machines that are much larger and with budgets that dwarf ours. Unlike mobile, in fixed Internet we can focus our efforts and compete.

We appreciate all of you and we are enjoying turning our efforts to the execution phase of this generational opportunity.

Thank you for listening in on our Q&A, and a reminder that if you feel that the recorded answers or any direct email you may receive do not address your question, please follow up with us at ir@tucows.com.