

WOW! Third Quarter Earnings Release Conference Call

Moderator: Rich Fish

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3:00 p.m. ET

Operator: Good afternoon, Ladies and Gentlemen. Welcome to the Third Quarter 2014 WOW! Internet Cable and Phone Earnings Release Conference Call.

As a reminder, I want to advise everyone that this call is being recorded. At this time I would like to turn the call over to Mr. Rich Fish, WOW!'s Chief Financial Officer. Please go ahead Mr. Fish.

Rich Fish: Thanks, Melissa. Good afternoon everyone and thanks for joining us on our third quarter earnings call. With me today, is WOW! CEO, Steven Cochran, who'll be giving an update on our operating activities, and then I'll cover the financial results for the quarter. After that, we'll open it up for Q&A.

Before we get started, we need to remind everyone in our call that we'll be making forward looking statements about our expected operating results, our business strategy, and other matters relating to our business. We disclaim any obligation to update those forward looking statements. Those statements involve known and unknown risks, uncertainties, and other factors that may cause our actual operating results, financial position, or performance to be materially different from those expressed or implied in our forward looking statements.

We've discussed in our recent 10-K, some important assumptions and business risks that could cause our actual results to differ materially from those in the forward-looking statements. You should refer to that filing for complete discussion of those risks.

In addition, please note that in our call today and in our beliefs, we refer to certain non-GAAP financial measures including adjusted EBITDA. These measures are reconciled in our earnings release to the most comparable GAAP measures contained in our financial statements that's filed with the SEC.

So with that, I'll turn it over to Steven to give everyone an update on the business.

Steven Cochran: Thanks, Rich. Good afternoon, everyone. Thanks for joining us. Sure, you have seen we had another busy quarter, the highlight of which was closing the sale of our South Dakota assets. We're quickly approaching the end of the year. It continues to be an interesting time in our industry. We pretty much have an announcement every other day of something doing, of something new in our industry that's impacting how we're looking at the business.

We continue to see a number of activities that have been putting some pressure on our customers, on our RGU base, and operating results; including a competitive landscape that's dramatically changing, the cost of the programming skyrocketing, increased sensitivity to rate increases from our customer base, and really, the resulting changes in our customer's viewing habits and behaviors. All of which, we continue to work through and evaluate how to adjust as we move forward.

So as we disclosed in our filings, we've excluded the South Dakota customers from our RGUs as of 9/30, as the transaction closed on that day. Included were 53,000 total customers and 110,000 RGUs that were part of that transaction.

Although the third quarter historically has been one of our strongest quarters from a customer acquisition perspective, we saw a bit of changing customer behavior especially as it relates to price sensitivity, and customers who are willing to let go of video and phone service. Before the impact of the South Dakota System sale, we actually saw organic growth in total customers and in HSD customers with an overall decline in RGUs that was related to disconnects on the phone and video side.

Our connect activity was in line with expectations, but we experienced much of our voluntary disconnects in the third quarter and in a couple of markets specifically due to pretty aggressive competitive environments and discounting promotions. Specifically, as it relates to Comcast, we have seen, since the announcement of their deal, a much higher level of discounting and

aggressiveness from a competitive offer standpoint, and had been impacted by that throughout the year, as well as I think, some of the sensitivity around the multiple rate increases that we had during the year; which we've talked about on previous calls, and just as a reminder on that, we've had a cycle of rate increases.

The first quarter we did our normal rate increase to the majority of the company. We had a couple other smaller markets that were effective April 1st. Then in the second quarter, we did some ancillary fee increases. In the third quarter, we did a sports tier specifically in the Southeast associated with a channel launch. And then we're right now, as we speak, going through our November rate increase. Actually, for the full year rate increase, we've accelerated it into the current year, really to kind of, make the timing more appropriate with when we got our programming cost increase; make sure we fully realize it, as well as making sure that any disputes that we may have with programmers don't coincide exactly with a rate increase. That was kicked off, really in October, given the notification periods. We learned a lot, especially from the first rate increase we did throughout the year. And I think we saw that as we implemented the sports fee, we got a much better stick rate on what we saw through that rate increase. As we implemented this newest rate increase, we continued to utilize the lessons learned. We're early in the process, but we're feeling good about the execution on changes that we've made. But obviously, it is early and we'll continue to monitor the customer reactions and make adjustments as necessary.

As we've been discussing, we've talked a lot about – the third quarter is normally a good connect quarter. We have a lot of college markets that have come back, just moved, finished up, and we usually see a lot of activity as we did this time; but we were impacted by the higher voluntary disconnect. That really is what impacted our results.

Customer churn increased on a sequential basis, as we averaged 3.1% compared to the second quarter, where it was 2.8%. The majority of this ties to two items, I think, specifically to the aggressiveness we talked about in a couple of our markets with Comcast, as well as some of the rate increases in

the Southeast, and, our kind of unwillingness to discount as much as we have historically during some of the other rate increase periods.

As we move forward as far as other lines of business, from a business service standpoint, we continue to see a lot of momentum. We're really starting to see the results of products that we launched in the first quarter. We also successfully launched hosted VoIP in the third quarter, got our first customer signed up on that. From a sales standpoint, we really see that the book is starting to fill from a sales funnel standpoint, and each quarter is looking better. What we have in the funnel looks good, and it's going to be from a variety of channels, some of which, the channels didn't exist this time last year.

From a year-over-year standpoint, our sales for the third quarter were 56% higher than they were in the third quarter of last year. And so, we had our best install quarter, so we really feel good about the momentum we're building in that line of the business.

From a staffing and process standpoint, we continue to focus on the development and re-engineering of our back office infrastructure. One of the things – we activated an indirect sales channel partner in the third quarter, we signed up a number of those just now starting to activate, and are starting to see sales coming in. At the same time, we had a third party outbound telemarketer that we ended the relationship with, because we weren't seeing that. So really, we continued to refine and fine-tune the best way to continue to drive the most sales, the most efficient way.

Our objective continues to be one of building scalability into our process, but making sure that as we're doing that, we're really focusing on efficiency, simplicity. Going after the areas of the market where we can get our return, where we have the most opportunity, and not necessarily going after every segment of the market.

Lastly, before I turn it over to Rich on the financials, just to highlight our South Dakota sale, we closed on it on September 30th for \$262 million. We have a transition services agreement that will be in place with Vast

Broadband, which is the operating name for the company that acquired our systems. We expect that to definitely go through the first quarter, and maybe into a portion of the second quarter. But we're really happy with how that transaction unfolded. It went very smoothly and the operations are going well for the acquirer.

So, with that, I'll turn it over to Rich and look forward to answering any questions you guys have at the end.

Rich Fish: OK. Thanks, Steven. For the quarter, total revenue and adjusted EBITDA was \$323.2 million and \$109.9 million, respectively. Total revenue was up \$3.4 million sequentially, or just a little over 1%; and on a year-over-year basis, it was an increase of about \$25.8 million, which was an increase of about 8.7%. Adjusted EBITDA at \$109.9 million was down sequentially by about a million and a half or 1.4%, and was a decrease of \$2.4 million or 2.2% on a year-over-year basis.

We've mentioned it before, but I do think it bears repeating that because the transaction closed with South Dakota on the last day of the quarter, even though the reported customers in RGUs related to the South Dakota systems have been appropriately excluded, as Steven said, 53,000 total customers and about 110,000 total RGUs. The operating results for the South Dakota Systems are included in our reported results for the quarter.

On a combined basis, inside of revenue, total subscription revenue was \$288.4 million for the quarter, which was really essentially flat on a sequential basis. That's why the increase was about \$100,000. Although we had, within the quarter, strong HSD net new connects, the impact of disconnects with video and phone, as Steven referred to, had a negative offsetting impact that kept that being flat.

On a year-over-year basis, third quarter total subscription revenue was an increase of about \$13.5 million over last year or about 4.9%. The vast majority of that was attributable to volume, \$15.1 million from volume as a result of strong subscriber acquisition activity throughout the year, which is really inside of the RGU profile, streamed primarily by HSD RGUs, which on

a year-over-year basis, before the sale of South Dakota, was an increase of almost 50,000 HSD subscribers.

That volume increase was offset by approximately \$1.6 million decrease in rate, primarily as a result of continued pressure on ARPU and changes in product mix, as customers are increasingly downgrading RGUs out of a triple and a double-play bundle. At the end of the quarter, total ARPU for the quarter was up sequentially, just slightly at 17 cents per sub at the total revenue line item, and on a year-over-year basis was up \$3.58.

The other line items in revenue – other commercial revenue for the quarter totaled \$6.6 million, which was up about half a million or 8.2% sequentially. And on a year-over-year basis was an increase of about \$3.6 million or 120%. That's primarily the result of, number one, the increased commercial installation, the booked MRC that Steven referred to, as well as the acquisition of Bluemile, which was at the end of the third quarter of last year. So all of that is in for Bluemile.

Other revenue for the quarter totaled \$28.2 million sequentially. That was an increase of \$2.8 million or about 11%, and \$8.7 million or 45% roughly on a year-over-year basis. Inside the total, or other revenues, both the sequential and the year-over-year increases were driven primarily by the increased ancillary customer billings that we have spoken about in the last couple of quarters throughout the year, such as late fees, reactivation fees, service protection plan, installation fees, et cetera.

Moving to CapEx. Gross CapEx for the quarter totaled \$63.1 million. We also had a decrease in CapEx-related working capital during the quarter totaling \$3.2 million. So, the net cash outflow showing up on our statement of cash flow related to CapEx during the quarter is about \$66.3 million.

From a leverage standpoint, senior secured leverage at the end of the quarter, we're pro forming the full year impact of both Bluemile and Anne Arundel Broadband. Senior secured leverage was 4.2 times, and total leverage also pro forma for the acquisitions was 6.95 times.

So that concludes the prepared remarks. Now, I'll turn it back over to the Operator to open it up for questions.

Operator: At this time, I would like to remind everyone, in order to ask a question, press star, then the number one on your telephone keypad. We'll pause for just a moment to compile the Q&A roster.

Your first question comes from the line of Mike Pace with JP Morgan. Your line is open.

Mike Pace: Hi, guys. Good afternoon. Question, if you could just help us understand the change in the different RGU buckets during the quarter, I guess, either with South Dakota or excluding South Dakota, which I thought I heard you say something about HSD, but I couldn't quite follow it. So if we could go back there, it would be great.

Rich Fish: Sure, Mike. I guess the way we could kind of think about it, and we'll talk about it, is it would describe changes up through the quarter, or for the quarter, on a sequential as well as the year-over-year basis prior to the disposition. Then net of the disposition at the end of the day, equals the reported totals.

So, inside of the RGU buckets, total customers on a quarter over quarter basis, we had an increase of a thousand customers on a sequential basis. And on a year-over-year basis we increased 37.7 thousand. Inside of the RGUs on a sequential basis, we had increased in HSD subs of approximately 5 thousand, a reduction of video subs of 11.3 (thousand) and telephony subs of 11.6 (thousand).

Mike Pace: Got you.

Rich Fish: So total RGU sequential losses on a net basis was just under 18,000 for the quarter. On a year-over-year basis, an increase, as I said, of 37.7 thousand total customers; and then inside of the RGU buckets was an increase of 49,200 HSD subs, video subs were down 3,000, and telephony subs were down 22,100 for net RGU increase of 24,100.

Mike Pace: OK. And then maybe thinking about the video, it sounds like Comcast was the biggest culprit there for you guys. But I guess I'm just trying to understand also, these are your customers that left for Comcast video but kept your high-speed data ...

Steven Cochran: I would say it's probably not that, Mike. I'd say it's probably more likely the customer who left you for a triple play offering that you're replacing with an HSD customer, or you're replacing with a one or two product customer. I think it's less likely that we have a customer who is taking services from both of us.

Mike Pace: Yes. OK.

Steven Cochran: And it's kind of – that's kind of the churn issue, in general, is you know, what is going out the door. And there's a combination of what's going out the door. Some of what's going out the door is customers who are leaving you and taking multiple services with them, and there are others who are truly just downgrading. But then what you're replacing them with generally isn't of the same triple-play customer.

Mike Pace: Understand. And then just programming cost, and I'll break it out specifically, but you did highlight that line item. You know, is that – I'm assuming it's still growing double digits year-over-year. Can you be any more specific with that?

Steven Cochran: Yes. I think we talked early in the year that our programming cost for this year was going to be 14% on a cost per customer basis, and that kind of played out... I think it was actually probably a little higher than that when you look at the fact that some of them happened throughout the year. So if you took more of an annualized impact, I think it would be closer to like a 17-ish, 17 1/2 percent range.

As we move into next year, I think it's better than what it was this year, but I don't know that it's a lot better than what it was, just because, you know, it's a (re-trend) cycle. And while we don't have near the level of negotiations and majors, because this year, we had Viacom, Disney, Scripts, combined with a number of other kind of smaller things, but some pretty large deals had to be

redone, and so you get the reset pricing which is always much more painful than just what's built into the fields.

Next year, we got a number of (re trends) which, we are expecting and will be painful, but we don't have kind of the big programming families. I think the only contract we have coming up is Discovery. That's part of one of the big families.

Mike Pace: OK. And then finally, you received cash for the acquisition. Can you just remind us intentions for that cash and what your debt agreements say that you need to do and by when?

Steve Cochran: Yes. I think I'll let Rich speak to the debt agreement piece. But I don't think we have specific plans for them now, other than be in position to utilize them when the time is right, either for an acquisition opportunity or a refinancing opportunity. And, you know, we'll see what comes up. There's nothing in the pipeline right now from an acquisition standpoint. But we also want to make sure that we don't miss out on an opportunity because these things come around.

So, we're kind of waiting it out to see. I think, Rich, you can talk about how long we have?

Rich Fish: Yes. We have up to 12 months as it relates to redeploying the asset proceeds back into an investment. I'd call it a 12-18 provision. It's 12 months to really execute an agreement to the extent that it represents an M&A event that would be executed within 12 months, that would close inside of an 18-month window. Failing identification of an opportunity like that, we would use it for debt reduction.

Mike Pace: Great. Thanks, guys.

Steve Cochran: Sure.

Operator: Again, if you would like to ask a question, star one on your telephone keypad. Your next question comes from the line of David Phipps with Citi. Your line is open.

David Phipps: Hi. Thank you. Can you talk a little bit about any tax ramifications from your \$52.6 million long-term gain?

Steve Cochran: Yes, we have NOLs that offset all of it, so there will be no cash impact.

David Phipps: OK. Fair enough. And so, when we – given the number of things that are going on and the mix of your customer base, so your price hiking in the summer quarter, you've got some competition. Seasonally, last year was very solid for adds. As we look at the quarter this year or – will the pattern repeat itself, I guess?

Steve Cochran: Yes, I would say that. What our expectations are is that the fourth quarter will be a little rough again from the standpoint of RGU adds just because we are pushing through the rates. But I think our first quarter has the potential to be much stronger than what we have historically, as we kind of look at into next year and aren't having the repeated cycle of rate increases. It will give us the potential to, two things – one, not the messaging and talking with the customers about rate all the time; but – two, be more aggressive on our safe side. It's a lot harder to be aggressive in the safe mode when you've got rate increase going on, or else if you do you don't realize much of your rate increase. And so, I think we'll have the ability to be a bit more aggressive on the safe side. In addition, we won't have all the incremental volume that comes from people calling because of the rate increase.

So I think fourth quarter, I think financially, should be better because of the rate increase. Subscriber-wise probably not. Significantly better... I think as we move into December and on into the first quarter, I think the sub trends will look much better.

David Phipps: And then the financial results were included from the South Dakota properties, basically through the whole quarter, then we've reset what the adds are. So if we – can you tell us what an annual revenue was for that South Dakota group. Is it somewhere around like \$48 million or \$50 million?

Rich Fish: I don't have the revenue off the top of my head. Just let me look at something real quickly. South Dakota revenue on an LTM basis is roughly \$83 million.

David Phipps: Eighty-three million, OK. So, all right, so that just gives us a baseline. So we should expect revenue to be apples to apples will be down by \$21 million sequentially.

Steven Cochran: Right. Yes.

David Phipps: And that would explain all of that.

Steven Cochran: Yep.

David Phipps: Is there – so when we apportion some of the SG&A, is that scalable and we'll move out? Or will SG&A remain relatively flat, sequentially?

Steven Cochran: No, I think there are pieces, right? I mean clearly that is within – and there are a number of items that clearly goes specifically with the asset. And I would say the majority of the items go specifically with the asset, including your call center cost, the basic level of SG&A ...

Rick Fish: Technicians.

Steven Cochran: Yes, technicians, pole rent... I mean there are so many things that are tied specifically to that, that are included in the SG&A side that will go away. And then specifically through the transition services agreement, we are providing them kind of at cost, some of the other SG&A until they kind of build it up and then it will go away on our side as well. We'll make it go away on our side.

David Phipps: And then finally, is your \$35 million on the revolver. I guess you get the proceeds very late on the quarter. Any intention to repay the revolver?

Rich Fish: Yes, it's – the draw was early, it was in July to partially fund the payment on the bonds. The revolver has been repaid down to zero in early October. So, it's currently setting in zero.

David Phipps: OK. All right. Those are my questions. Thank you.

Steven Cochran: Thanks, David.

Operator: And there are no further questions in queue at this time. I'd turn the call back over to Mr. Steven Cochran, CEO, for any closing comments.

Steven Cochran: Thank you all. I appreciate listening in, and we look forward to updating you again next quarter. Thanks.

Operator: Ladies and gentlemen, that concludes today's conference call. You may now disconnect.

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