45th Annual J.P. Morgan
Global Technology, Media and Telecom Conference
#TMTBoston MAY 22-24, 2017 The Westin Copley Place, Boston MA

Rogers

Rogers presentation delivered at the 45th Annual J.P. Morgan Global Technology, Media and Telecom Conference on Tuesday, May 23, 2017 at 3:00 PM

Richard Choe: Hi, my name is Richard Choe. I cover Canadian communications for JP Morgan. I want to welcome Tony Staffieri, CFO of Rogers Communications. Thank you for being with us today.

Starting out, a real differentiator for the Canadian communications companies right now versus the US companies, Canada is seeing some real strong both postpaid subscribers and serious revenue or output growth.

Can we first go over what you're seeing in terms of subscribers and customer loadings after two years where things were not as good? Over the past few quarters, it seems like there's been real growth and not just stuff like tabloids or home phone type of stuff.

Tony Staffieri: Sure. First off, let me say thank you, Richard, for having Rogers here. We appreciate the opportunity. Maybe before I get into some of the aspects of service revenue and in RPU, it might be helpful, particularly for those not familiar with Rogers and Canada, to provide a little bit of context.

Rogers is one of the largest telecom players in the Canadian market. We're the largest national wireless player. We're also the largest cable player in the market. We have a media business as well that is the largest content owner of sports within Canada, either directly or through rights. Those are the spaces we play in.

We've recently gone through a CEO transition. We now have a new CEO on board, Joe Natale. Joe joined us about three weeks ago. Joe comes to Rogers from one of our national competitors, and so he brings with him a wealth of experience and a proven track record.

We're really excited to have Joe on board and can already see the potential for upside value on top of some of the recent success that we've been seeing in the marketplace.

In terms of our overall framework within Canada, Canada continues to do well as an economy.

Population continues to grow in the two to three percent range, GDP growth as well. In addition to an expanding population, what you see is a healthy growth in consumer wallet share, if you will.

On the regulatory front, we've had a new government in place for just coming on two years now. I would say this government continues to show itself to be very thoughtful and strategic about the industry, very much interested in facilities-based investments by the telecom players.

Some recent decisions in particular on MBNO it's clear that they're not interested in that type of construct for the Canadian market. I would say the regulatory front continues to be stable and encouraging. Finally, within Rogers, we've gone through a bit of a turnaround over the last several years.

What you will have seen over the last several quarters is strong improvement in fundamentals, particularly in cable and wireless. That leads into your question, Richard, on how we're seeing on the wireless side. Wireless, traditionally, in Canada is been growing postpaid subscribers at a rate of about 2 to 2.5 percent.

Starting in about mid-2016 we've seen that rate of growth to three to four percent. We continue to see the prospects for that continued wireless growth, the momentum to continue at least for the next little while. Population growth is one contributor that I talked about. Wireless penetration in Canada still sits in the mid-80s, so there's quite a bit of room for upside growth on that front.

Big drivers, a couple of things on service revenue, data usage just as you see anywhere else has been the big driver, when we look at our customer metrics, grows anywhere from 35 to 45 percent year on year, in terms of data consumption. The market, us included, has been fairly disciplined in converting that into healthy RPU growth.

In the last quarter, we reported blended RPU growth of two percent, our postpaid RPU growth is just above that. We see RPU growth being healthy from that perspective as well.

We also see very strong ARPA growth as well, so our share everything construct has been very useful in adding the number of devices, and that's helping the penetration rates that I talked about earlier come along and they're additive.

In spite of the number of devices increasing, as I said, RPU continues to increase as well.

Richard: It seems like a lot of this growth isn't low end, low usage. It's higher end, higher usage.

As your networks have gotten faster have you seen data growth pull that along and people take bigger buckets?

Tony: The phenomenon we've seen in Canada is not unlike you've seen in the US. Perhaps there's a bit of a time lag to it. Smartphone penetration continues to be healthy and robust.

As we look to higher penetration of those smartphones, more and more of them -- the majority of our traffic today -- sits on LTE. That migration has largely happened. Not a lot left in terms of data traffic on 3G, except largely for machine-to-machine type of traffic.

That piece of it is moving well and continues to be one of the biggest drivers of RPU growth for us in the industry.

Richard: The Canadian wireless market seems a lot more overall stable than the US market with the four players versus the three, even though there are some regional ones. I think more the equal sizing of the companies are relative more equal sizes, versus two large players in the US and two smaller ones in the US.

How can you talk about the competitive environment in wireless, because it seems like it's very competitive still, just not value-destroying?

Tony: I think that's a good way to put it, Richard. I would say there's three incumbents that are well-capitalized. While there's always competitive intensity, particularly around certain periods or cycles in the calendar year, I would say a lot of that intensity is somewhat rational. We seem to all be focused on lifetime value economics.

We're willing to invest in handset subsidies, provided that the LTVs are there. You continue to see that type of discipline, if you will, in the marketplace. As we look to some of the fourth-player entrants that exist in the marketplace, I would describe them, for those of you not familiar, as predominantly regionally based. In each of the regions we have a fourth player.

Very small share, but even when you look at the way they've been playing in the market, I would describe them as somewhat rational. They generally operate as a slight discount to the incumbents, but nowhere near the type of disruptive pricing that you've seen play out in the US marketplace.

Certainly, when you look to our plans, we've been translating, and we are still largely on a subsidy model. As an industry, we've stayed away from equipment financing. We don't see that as long-term-value-enhancing, at least not right now.

We continue to be on the subsidy model and as handset costs have increased. We and the industry has done a good job of translating that into higher RPUs. We see that with the fourth-player entrants as well.

Richard: Churn has improved recently and it's been incrementally getting better. Where do you think that can go? Do you think we can see sub-one-percent churn, which obviously would be very good and increase that lifetime value?

Tony: Churn's a big opportunity for us. We've always done well on the gross ad side of the market, generally getting more than our fair share. Traditionally, on the gross ad side we've gotten 33 to upwards of 40 percent market share. A lot of key advantages we have there, first of which is our distribution network on the gross ad side.

Of late we've ramped up the focus on churn as a big value driver for us. Given we have the largest wireless base in Canada, churn improvements for us translate into much higher value than, say, our competitors.

We've seen good progress. Last quarter you would have seen churn at 1.10 percent churn and a very healthy improvement year-on-year. Is sub-one percent possible? Absolutely. Is it achievable? We think so. We think having someone like Joe onboard that has a demonstrated track record of best-in-class churn improvements is going to bode well for Rogers.

We think there's an opportunity. I would say one percent would be our interim stake in the ground of what we'd like to get to. We're seeing other players hovering around 09 percent. The bar keeps moving lower. That's good for the industry and our target will keep moving as well. There's no structural reason that we can't ultimately achieve best-in-class churn for our sector.

Richard: I guess one thing in Canada is the spectrum position seemed to be more evenly spread out with continued growth, with increased data usage. How do you feel about Rogers' spectrum position? When could we see a broadcast auction in Canada at some point?

Tony: As you know, we're very comfortable with the spectrum position we have. We sit with a very healthy position. Coming out of the 700 auction, we did fairly well in terms of getting some of the key spectrum pieces that we were after.

As we look to the next spectrum auction of 600, hard to tell, the government hasn't announced anything definitive in terms of timeline. Just based on process and reading of the tea leaves, we would estimate that probably not sooner than 2019 is when we can see the next spectrum auction.

Given our success in the 700 and acquiring that low-band spectrum, we don't see the need to invest anywhere nearly as much as we did at the last auction in the upcoming auction, but it's still quite a few years out.

Richard: I guess it might be interesting to go through your thoughts on how Rogers might approach 5G mainly because you have a cable plan, you have a wireless network with the strong backhaul. As you think about rolling of 5G or starting to trial it, what are Rogers' plans with 5G?

Tony: There are two parts to the question. One is, in terms of our plans for 5G, as many of you probably know, 5G is really an evolutionary network technology, so it isn't something that is going to replace 4G but rather build on top of the 4G network that we already have. As we look out, we think we're well-positioned to implement 5G.

We intend to fast follow on that. We've partnered with Vodafone and a few other large players in terms of following technology roadmaps on that. As the standards for it solidify, what you're going to expect Rogers to do, just given our overall scale in the global world of wireless, we will slip-string behind where the industry is going and fast follow on 5G.

The second part of your question is how do we feel about backhaul capabilities on the 5G. We feel good and strong about where we're at with that. Today, we have, as you would expect, good coax, but in particular fiber coverage in urban markets.

Where we don't have it, there's a healthy process to buy. When the economics makes sense, we build. In the overall scheme of the 5G roadmap, we don't see that as necessarily a problem nor a big capex investment for us.

Richard: I guess a lot of other companies around the world talk about having a quad play. You obviously could have a quad play and probably do have a quad play.

Is it a significant portion of the business or do people really just separate the two [inaudible] tie it, but that's with a, I would say, disadvantage to wireless business. It seems like it's even more driven by price, whereas you have a more robust wireless business and more areas. Is it an opportunity or is it something that you'd rather keep separate?

Tony: Long-term, we do see it as a big opportunity. As you said, we're fortunate that we've been a quad play player for some time having both wireless and cable. Wireless being national for us and the cable footprint focused in the Ontario and Atlantic provinces. As the cable footprint gets bigger, there's a better opportunity for overlap.

You're right, the quad play to date has generally been limited to a bundled price discount. There hasn't been a lot on what I would call the global product roadmap that would allow for a better user experience seamlessly between wireless and in-home cable, but we think that's yet to come.

The other piece of it is, what we do know is a key ingredient for an effective quad play is to have a very strong cable base and cable MPS.

As we've made improvements on our cable front, particularly on the Internet, and soon with the launch of the Comcast X1 product for video and the Xfinity digital home, we think that's only going to further our cable MPS, our cable customer loyalty, and the opportunities for quad play. All that to say is the upside for quad play is still there and hasn't really been exploited in the marketplace.

Richard: Given even with the recent rebound in subscriber ads, you're obviously being held by churn a little bit, margins continue to improve. What is the long-term margin outlook for Rogers both for this year, maybe beyond? What are you doing there to improve margin?

Tony: If we rewind the clock a few years, we said job one for us was to focus on revenue growth and subscriber growth, together with RPU growth. That's been coming in nicely. In mid-2016, the focus then shifted to translating more that revenue growth to a healthy flow-through and actually start to grow adjustment operating profit and margins as well. You've seen that come in.

I would say, still lots of opportunity on margin expansion for us. Cost initiatives, while we've always done some, has moved up on our priority list. Certainly, you can expect as Joe outlines his priority that cost efficiency improvements is going to be high on the list.

We see it as a significant value driver, just as high as churn and customer experience improvements as well in the next little while. As you look to wireless, you can expect us to improve margins over the next 12 to 24 months from where they are today.

I don't want to provide too much guidance on it, but we think it would be a material shift and return to where we traditionally been in wireless margins, and similarly on the cable side as more and more of our revenue comes from the higher margin Internet.

Combined with cost improvements that we have on the roadmap for cable, we think cable is well poised not only for margin expansion, beyond the 47 percent that it has today, but also cash flow growth as we move to get our capital intensity on the wireline side of the business down and more in line with industry norms over the next few years.

Richard: That was somewhere I wanted to go. Generally, I've always thought of Rogers as having 12 maybe 13 percent capex intensity on the wireless side, and that's come down significantly to about 10 percent last year.

Is that a new level that we should expect? It's seems like it's being done without any sacrifice to investment in the network, speeds, and customer experience.

Tony: Wireless capital intensity, the number that you saw for 2016 at just under 10 percent and an even lower capital intensity the last few quarters, I would describe it solely as timing. We think the right capital intensity number for wireless sits more in the 12 to 13 percent range, which is generally where you see the rest of the industry at.

As you think about our cash flow and our capital allocation, think about intensity for wireless being more in that range.

Richard: Moving to the cable side, starting with more of a macro view, in your cable footprint what are you seeing in terms of household formation with population growth? What are your opportunities generally within your footprint in terms of penetration in both, maybe with video and broadband subscribers?

Tony: On the cable side, our cable footprint is largely centered around the province of Ontario, which still is one of the fastest growing provinces in the country. Our cable footprint naturally grows at about 2.5 to 3 percent a year. It's healthy growth in terms of sizeable market on the cable side.

We've approached cable in a couple of ways, one is we wanted to focus on our natural competitive advantage, which as a cable operator has been on Internet. What we know is the majority of households are now choosing their in-home service provider based on quality of

Internet and that's our competitive strength.

We started to execute aggressively on that in mid-2016, and it's been a big contributor to us to start to win back households. We're seeing subscriber and household performance that we haven't seen for six years, since our Telco competitor first started fiber builds in our footprint.

That's giving us added traction and it's coming with quality RPU improvements as well. Internet RPU for us continues to grow at a health 5 to 10 percent on average. That's been our lead product on the cable side.

As I mentioned, in the first quarter of 2018 we will launch the Comcast X1 video product, as well as the in-home digital WiFi experience. We think that will be the second leg of our product superiority on the cable side and will only help us increase penetration, but also increase ARPA.

Household ARPA for us has been growing of late largely because of the Internet, but once we add to the growing video RPU we think that's significantly going to help grow overall household ARPA as well.

Richard: In terms of the broadband service you're leading with, what are most of the customers taking? What kind of speeds are being offered? How has that changed over time?

Tony: Our entire footprint is eligible for one gig of speed. We pass 4.2 million homes today, and all of those homes are eligible for one gig as I mentioned. We've been very aggressive in promoting speeds out there. The average speed of our base is over 100 megs of speed.

For our competitors, they are still deploying FTTH. They generally cap out at 50 megs, where they don't have fiber to the home. We see that as a big opportunity for us. We are seeing consumers not only taking the higher speeds, but they're willing to pay more for it.

As we improve the in-home experience with the next generation of WiFi modems, and as I said, the Xfinity digital home platform, we think that's going to give us long-term competitive advantage.

As the Telco deploys fiber to the home they can eventually -- several years out -- match us on raw horsepower, but we think when you combine that with the front-end X1 experience for video and digital home, that's going to be a difficult customer to unstick. We think that's going to help brand loyalty for us.

Richard: I assume it's a very big priority to get X1 out at the beginning of next year. How aggressive will you be in rolling it out? What is the ideal household that you're going to be going after in your markets?

Tony: Generally, I would say, expect us to follow the Comcast/Cox recipe for this. The one piece of advice that we got loudly and clearly was, pace the demand for this in the early stages. When we launch, the plan is to limit the volume on launch for about a quarter.

Then as we perfect the processes, everything from the bi-flows to the back-end billing, and any type of servicing that needs to happen. We want that process to meet certain quality levels that we've set for ourselves. Then once we've done that then we plan to expand the launch of that.

At a certain point in late 2018, early 2019, we will stop sale on our legacy product. That will be the beginning of an aggressive move to move our cable base to all IP. Aspirationally we think about late 2021 as a date to when we ought to be able to move an all IP network on cable. Clearly, that brings with it a number of cost and spectrum advantages us.

Richard: The version of X1 that you're launching is IP based, what advantages does that have over [inaudible] ?

Tony: The IP version, it's two things, one is from a cost perspective it moves us more quickly to all IP. The CPE roadmap, or customer-prem equipment, and the IP version continues to come down from what it is today in the high-grid version of X1.

From a customer experience standpoint, the customer, if they're on the high grid version isn't going to see a big change first, but as you would expect the IP version is going to allow for a lot more flexibility in integration of new features such as YouTube.

I think they already have Netflix integrated today. YouTube, and there will be more to follow, I'm sure. As that happens just the ease of integration is going to be much more user friendly. Then as I said, overall from a cost perspective it affords quite a bit of cost advantages relative to a high grid model.

Richard: If people want to ask questions please raise your hand. Moving on to the overall base -- we'll get you a microphone -- video losses are getting less, broadband continues to grow, with the launch of X1 I think you'll end up having cost advantages down the line.

How should we think about where revenue will go for the cable business, and then the longer-term margins? You talked about wanting to improve them.

Tony: In the cable business, what we've seen over the last three quarters is a return to growth overall. In our most recent query you would have seen cable revenue flat year on year. What's included in there is a regulatory re-price that happened on the wholesale segment of the market, which is very small, but on a year on year basis it had an impact, and a full one point impact.

If you exclude that we actually have a cable business that has been growing and continues to grow. It was at one percent, and profitability would have otherwise been at four percent growth. We expect those numbers to continue to head in the right direction on a go-forward basis, but it's been a healthy trend that we've seen on that front.

Richard: I think we have a question from the audience.

Audience Member: Could you talk about the incremental margins you're seeing on the broadband product with the broadband growth that you described, and also how much capital intensity is associated with that?

Tony: On the broadband side as you would expect, the incremental revenue comes in at pretty close to 100 percent margin. There is very little what I would describe as apex. Our cable margins are naturally helped by the makeshift to Internet as that more and more is the majority of our revenue and revenue growth.

Video on the other hand would sit at roughly a 50 percent margin. You can see how over time that will be a natural help to margin expansion on the cable side. The offset to that is capacity to support the data traffic that that drives.

It largely comes in the form of segmentation, so fewer homes per node is the path we've been on. We've been following a relatively consistent investment program, and we'll continue to follow that over time.

What we find is we've gotten a lot better at targeting capex to the neighborhoods where we're seeing the increased demand and the increased revenue. The one thing that we like and you all probably like about the capex model is it's an extremely efficient capital allocation program from an ROI perspective.

We like the prospects that we see for ROI. Today, our capital intensity sits at just over 30 percent, which is high for cable. Two drivers for that, one has been the investment in IPTV. Given our abandonment of our own home grown product, we are now making the one-time investment this year into the Comcast X1 implementation.

After that we move to a variable cost model with Comcast. Notwithstanding that we still see the opportunity for margin improvements. It's not going to come at the expense of margin. Then the second piece is CPE.

In today's model, if you think about the average customer having just over two televisions, each one of those requires on average a HD PVR. Average install for home today for us is over $1,000. As we move to the X1, it will be sub-$400. You can see how quickly that moves the needle on capital intensity.

Those two will be the biggest driver. We see ourselves not only get too far ahead of ourselves in terms of guidance, but over several years, you ought to expect us to move towards what you see the US cable companies operating at in terms of capital intensity.

Audience Member: Just one more, could you comment a little bit more on the churn? You mentioned at the beginning, overall churn was 1.1 or so monthly. Could you talk about the variation around that overall number and, for instance, where you see the lowest churn and the highest churn within the base?

Tony: Sure. On the wireless side, I should preface it by saying we've seen healthy churn improvements on both the wireless and on the cable side. Even our video business, if you look at the last year in a bit, very healthy churn improvements there.

The 1.10 that I mentioned was on the wireless side for the last quarter. As you would expect, Share Everything or put another way, the higher end, is where we're seeing the best churn performance just as a customer adds more devices. Much like you've seen in the US, you see churn coming down on that side of it.

All portfolios are seeing good churn improvement even in the prepaid space. We're seeing healthy churn improvements there as well. We had a bit of an issue with the distributor in the first quarter on the prepaid side relating to commissions that we fixed. That's back on track.

If you look back on the postpaid side, the variations between what I call the full Share Everything and maybe a sim-only customer, as you would expect, you see slightly higher churn on sim-only. Even that churn rate has been coming down consistently over the last several quarters.

It's happening on all fronts, but the distribution is as you would expect across the spectrum on the value of the customer.

Audience Member: Can you go back a little bit to the 600-megahertz auction, your comments there? Can you talk about how you actually feel like you need that spectrum? Obviously, there's different strategies by the big incumbents here in the US as to how much they thought they need it. Arguably, you guys have attractive spectrum position than the incumbents here.

I guess it's a multipart because, to the extent that that auction goes forward and the incumbents don't necessarily need it that much, maybe that's an opportunity for Shaw or somebody else to get pretty important spectrum for them. If indeed that plays out, does that create a more just on your part of creating beltless network across the various cable operators? I'm so sorry for a long one.

Tony: A couple of parts to it. Let me try to go through them. As we think about the 600, we've obviously been watching how it's played out here in the US. As you mentioned, we sit with a different spectrum position in some of the US players.

In particular, our success in the 700 means we don't think we need to spend anywhere nearly as much as we did on the 700 for the next spectrum auction. I'd hate to venture what a number would look like, but it would be materially less is our view as best we could see now.

Second part of your question is, if that is the case, where you were going, are we worried about one of the new entrants picking up substantial spectrum?

In the province of Quebec, we have a network sharing arrangement with Videotron. As best we can tell, their aspirations continue to stay centered on the province of Quebec. We think that works out well for us with the network sharing arrangement we have with them.

In terms of outside of Quebec, whether it's Freedom, Shaw, or anyone else, that's always a bit of a concern. I would add that spectrum is only one enabler on the network side. There's real tower building, an infill, that needs to go with that.

As you all know, that's a continuous, expansive journey that they would need to undertake. That could be a competitive threat for us, but practically, not sure what it would mean in the immediate or near-term.

Would it land itself to a network sharing arrangement? As far as we can see, we think we sit in a pretty healthy spectrum position and healthy network position. That's a strong competitive advantage for us.

Entering into a network sharing arrangement, something we don't take lightly, and we'd hate to transfer some of that competitive advantage unnecessarily. Right now, we don't see the need to do that is the short answer to your question.

Richard: Great. Thank you.

Tony: OK, Richard. Thank you very much. Thank you all.
