WOW! Fourth Quarter 2014 Earnings Conference Call

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11:00 a.m. ET

Operator: Good morning, ladies and gentlemen, and welcome to the Fourth Quarter 2014 WOW! Internet, Cable & 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, Chris. Good morning, everyone, and thanks for joining us on this year-end 2014 earnings call. With me today is Steven Cochran, WOW!'s CEO who will be giving an update on our operating activities and then I will cover the financial results for the year.

After that, we'll open it up for Q&A. Before we get started, we need to remind everyone that in our call we'll be making some 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. These 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 discussed in our 10-K that we filed last week some important assumptions and business risks that could cause our actual results to differ materially from those in the forward-looking statements and you should refer to that filing for a complete discussion of those risks.

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

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

Steven Cochran: Great. Thanks, Rich. Good morning to everyone and thanks for joining us. There's probably not a lot of suspense built up for this call as we pre-released our numbers last month and reported both financial and operating results that were in line with those numbers.

Rich will go through the financial results in more detail, but we're very pleased with our numbers and the fact that we're able to report total revenue and adjusted EBITDA were up sequentially, on a pro forma basis, over the third quarter by 2.4 percent and 7.2 percent, respectively.

We had a lot going on in the fourth quarter. Specifically, as most of you are probably aware, we implemented a RIF during the fourth quarter as we continued to take a hard look at our cost structure to make sure that we're able to compete aggressively and feel that we're well positioned for growth during 2015.

From a customer activity standpoint, we went into some detail last quarter and mentioned that we expected our trends to continue into the fourth quarter as we were implementing our annual rate increases, over half of our customer base in the month of November.

Our last annual rate increase a year ago January did not yield what we needed to from a stick perspective, so we were very focused on the execution of this rate increase even if that meant customer growth would be impacted.

So we redesigned a good portion of the processes surrounding the notification of the rate increase, as well as, the customer care process from what we learned during last year's increase. This has contributed to a much improved stick rate and we therefore feel like we've mitigated the rate risk for 2015.

Well, we always want to grow our customer base and right now, we're in a period of prioritizing the profitability of our customer base over pure growth while acknowledging that all customers and especially all RGUs do not have the same value.

Some of our competitors seem to be a bit more focused on market share right now, which impacts the level of our customer loss in the short-term, but we feel that this is definitely within the tolerable range while we strive to really manage to the margin and deliver free cash flow.

That doesn't stop us as far as how we go after the customers. We continue to proactively adjust our offerings to the change in customer needs with a heavy focus on delivering a superior high-speed data experience.

With that in mind, we launched a 110-meg Internet service throughout the majority of our footprint recently. So, from a pure customer activity standpoint, fourth quarter churn returned to more normalized levels at 2.8 percent compared to our third quarter, where it averaged 3.1 percent.

But connect activity was a bit softer throughout the quarter, really impacted by two things: One, we pulled back a bit on acquisition and marketing activity and (secondly), we had a bit of distraction associated with some of the corporate reorganization that we had going on.

From a fourth quarter total number standpoint, we saw an overall decline in total customers and RGUs. From a customer standpoint, we lost just about 7,000 customers in the quarter. On a year-over-year basis, we saw an overall increase in total subscribers of about 4,000 and the total increase in HSD customers of just about 20,000, but saw declines in video and telephony customers, of about a 40,000 decline in video customers and about a 37,000 decline in telephone customers.

Going forward, we expect to see similar customer and RGU trends whereby we'll continue to see increased focus on overall customer gains and high-speed data gains, but expect to see a decline in video and telephony RGUs as we continue to focus on acquiring and retaining profitable customer relationships.

So we're now at the end of the first quarter, we can report customer trend activities for the first quarter. This is very similar to what we saw in the fourth quarter. This was driven primarily by the January results where we were still dealing with the rate increase for almost 20 percent of our customer base and a bit of a marketing pullback that we had in the fourth quarter that didn't kick back in.

So more recently, however, the customer activity in the second half of February, as well as, throughout March has begun to improve and we have accounted for these customer trends in the published guidance that we issued last month.

From a business services perspective, we continue to focus on bringing product parity across all of our markets. We talked about a number of product launches last year, which were Metro Ethernet, SIP trunks, Hosted Voice, etc.

In the fourth quarter, we launched Hosted Voice over fiber in all of the, Legacy WOW markets. We also increased our business Internet speeds to 110, 60 and 30-meg throughout 12 of our markets, and we began the proof of concepts on launching Ethernet over HFC, all important products to continue to move that business forward.

We're very pleased with progress in our sales funnel and our booked MRC in the fourth quarter. We're continuing to see the momentum improve. Our fourth quarter booked sales increased 25 percent over the fourth quarter of 2013.

We continue to look at ways to expand our sales channel. Our wholesale relationship, you know, we made great progress on the wholesale side and continued to expand those relationships in the fourth quarter. We sold into 45 different logos.

From a partner standpoint, our indirect channel continues to increase. We signed one of the largest national master agents in the industry, and then we've also established a success base outbound call center program with an outside vendor.

So, we see that there's a great growth opportunity in the future and we continue to expand our different forms of reaching out and hitting the market.

From a revenue standpoint for commercial, we saw sequential growth of 4.3 percent, and year-over-year growth of 9.2 percent. I feel like it's definitely trending in the right direction and expect to see - continue to see the positive trends as we move into 2015.

So with that, I'll turn it over to Rich to update on the financial results.

Rich Fish: Thanks, Steven. For the quarter, we reported total revenue and adjusted EBITDA of $309.2 million and $107.7 million respectively, and for the year, we reported total revenue of $1.264 billion and adjusted EBITDA of $438.1 million.

As we previously talked about and disclosed the divestiture of the South Dakota Systems occurred late in the third quarter and our reported results include the results of operation for the South Dakota Systems for the first nine months of the year.

So, on a pro forma basis excluding South Dakota, total revenue for the fourth quarter and year-end was $309.2 million and $1.209 billion, respectively, and adjusted EBITDA for the fourth quarter and year-ended was $107.7 million and $412.3 million, respectively.

Looking at the fourth quarter, fourth quarter total revenue of $309.2 million was up sequentially, $7.2 million, or 2.4 percent, over the pro forma third quarter excluding South Dakota, and was up on a year-over-year basis by $19.4 million or 6.7 percent over the pro forma fourth quarter of 2013.

Fourth quarter adjusted EBITDA of $107.7 million was up sequentially by $7.2 million or 7.2 percent over the pro forma third quarter and was up on a year-over-year basis by $6.7 million or 6.6 percent over the pro forma fourth quarter of last year.

For the year 2014 pro forma, total revenue of $1.209 billion was up on a year-over-year basis by $62.9 million or 5.2 percent over pro forma 2013, and 2014 pro forma adjusted EBITDA of $412.3 million was up on a year-over-year basis by $3.3 million or 0.8 percent over pro forma adjusted EBITDA for last year.

Inside of total revenue looking at subscription revenue, fourth quarter total subscription revenue increased $6 million, or 2.2 percent on a sequential basis over the pro forma third quarter, of which about $7.1 million was attributable to increases in ARPU as a result of the annual rate increase that Steven spoke about that went into effect during the fourth quarter, and that was offset by a $1.1 million decrease attributable to the customer losses experienced during the quarter.

On a year-over-year basis, fourth quarter total subscription revenue increased $18.5 million, or 7.2 percent over the pro forma fourth quarter of 2013 of which $14.4 million was attributable to increases in ARPU and about $4.1 million was driven by year-over-year increase in total customers.

For the year, pro forma total subscription revenue for 2014 increased $49.8 million or 4.8 percent on a year-over-year basis over the pro forma total for last year of which about $36.6 million was attributable to increases in ARPU and $13.2 million was attributable to the gain in customers throughout the year.

Looking at ARPU, total ARPU for the fourth quarter was up on a sequential basis by about $2.76 per total average customer and up on a year-over-year basis by $7.74 per total average customer.

Other components of revenue are: reported other commercial services revenue for the year totaled $24.6 million, which was an increase of $7.6 million or 44.7 percent on a year-over-year basis, and that was primarily as a result of the acquisition of BlueMile at the end of the third quarter in 2013 and the inclusion this year of a full 12 months of operating results related to BlueMile.

Reported other revenue for the year totaled $105.7 million which was an increase of $26.8 million or 34 percent on a year-over-year basis, driven by increased ancillary customer billings for late fees, reactivation fees, service protection plan, installation fees, et cetera.

Moving to CAPEX. Gross CAPEX for the year totaled $254.5 million; however, we also had an increase in CAPEX related working capital of $2.6

million. So our statement of cash flows for the year shows total cash outflow related to CAPEX for the year totaling $251.9 million.

On a pro forma basis, however, stripping out South Dakota, CAPEX for the year totaled $238.8 million. Looking at the balance sheet liquidity, we ended the year with about $264 million in cash and cash equivalents, and per our credit agreement have 12 months to reinvest the proceeds from the sale of the South Dakota Systems.

In addition, under our revolver, we have approximately $192 million of borrowing capacity available to us. So from a leveraged standpoint on a net debt basis, senior secured leverage at the end of the year on a pro forma basis was 4.1x and total leverage also on a pro forma net debt basis was 6.8x.

And finally, we put out guidance for 2015 last month. So to reiterate, we're anticipating total revenue for 2015 to be between $1.255 billion and $1.275 billion, which is the midpoint growth percentage of about 4.6 percent and adjusted EBITDA to be between $440 and $450 million with a midpoint growth percentage of 7.9 percent.

CAPEX is estimated to be between $205 and $215 million. So, as you can see and as we've discussed recently, we're really anticipating a fairly significant improvement in our free cash flow profile for the upcoming year.

So that concludes our prepared remarks and I'll turn it back over to Chris to open the call up for questions.

Operator: Thank you. And at this time, I would just like to remind everyone in order to ask a question, please press star, followed by the number one on your telephone keypad. The first question is from Mike Pace with J.P. Morgan. Your line is open.

Mike Pace: Hi, guys. Good morning. Can you hear me?

Steven Cochran: Sure. How's it going, Michael?

Mike Pace: Pretty good. So I guess including today's M&A announcement from Charter and Bright House, I'm wondering if you could share with us, as all of this pending M&A that we're expecting to close you know how that changes your footprint. I think I saw a slide once before.

And today's announcement, I guess you know how we do we think about you know the competitiveness in that market and with the new owner and then over the next year or so following if all these transactions take place, how do you think this can be disruptive and do you see that as an opportunity for you guys?

Steven Cochran: Yes. So to speak specifically to this one Bright House, we compete with them in two areas: Primarily in Pinellas County, Florida, where we only have about 7 percent penetration. It was a market Knology hadn't spent a lot in, historically.

We put a lot of resources behind once we took over and have seen nice growth in that market since doing that, but we still have very low penetration relative to the majority of our markets.

Not only you know is the Bright House deal announced in that market, there's also been the announcement of the Verizon/Frontier deal. So clearly, that's a market that over the next – sorry, just to circle back, the other area we compete with them (Bright House) in is in Michigan, one market within our Michigan footprint where we compete with Bright House.

So, as I was saying though that in Pinellas County in particular with both of those transactions happening, we see obviously a significant opportunity. We feel we've done a lot of the dirty work to get ready for the disruption to come in that market and you know we'll look forward to the opportunity to try and compete aggressively when they have to go through the transitions that they will go through.

Overall looking at our footprint, if you kind of pro forma for the transaction this morning you know we go from, talking about from a homes passed standpoint we go from 50 percent of our footprint having Comcast and 24 percent of our footprint having Time Warner and only 6 percent Charter and

10 percent Bright House to about 26 percent Comcast and 65 percent that is a combination of Charter and Great Land Connections.

So clearly you know, Charter is a good operator. They've made a lot of progress in the recent changes, but we also have experience competing against good operators when they go through transitions and usually that's a good opportunity for us.

So I think we've been heavily focused in, you know part of our RIF, part of our reduction on initiatives. Has all been about creating stability to make sure that when the opportunity comes around that we're well positioned to take advantage of those opportunities.

We know that all these things take some time and you know the Comcast deal is pushed back a bit it sounds like and this Bright House deal will go through regulatory approval process as well. And so we're just trying to be smart and patient and make sure when the opportunities present themselves that we're ready to take advantage of it.

Mike Pace: And are the key disruption periods, is that when companies go through a change in billing systems or set-top boxes or channel line-up changes or…

Steven Cochran: Yes, you see a little bit of all of that kind of stuff. I mean, the name change in general, there's a name change, there's often a billing change, sometimes there's a technology change, for instance, and the markets in Columbus and Cleveland, they've not gone through an all-digital conversion under Time Warner.

So you know given Charter's flat form, that's something that they'll go through and we found that to be disruptive in the path. I mean, there's a net – you know there's also people issues and reporting structures changes to who's running things and who's supporting things especially when you have regional structures and those structures change.

And so there's a lot of impact, and I can't say that any one impact is – has – is more relevant than another because you don't know what it is that's going to be the thing that causes the customer to say "hey, I'm going to pick up my phone and see what WOW! can do for me," and so – but all of those things together usually gives us some opportunity to make a positive impression and drive change that might not have happened without the transaction.

Mike Pace: Great. And then turning to programming cost, as you budgeted your rate increases at the end of last year including the November rate increase…

Steven Cochran: Yes.

Mike Pace: … what were you thinking about in terms of programming costs in '15 and how did those shake-out versus what you were budgeting?

Steven Cochran: Yes. So I guess – I guess the good news is we were expecting the worst. We actually thought that we were going to come in around 17 percent (increase). We had a – you know it's a little tougher to predict when you go through the retrans cycles because you've got so many different parties that you're dealing with on the retrans, and then we had a couple of other larger deals including Discovery and others.

And so we had actually based our rate increase on an anticipation that our programming costs were going up 17 percent on a per customer basis. We ended up closer to kind of 12 and a half (percent).

And so probably picked up a little bit of margin room there relative to what we thought (which) gives us a little bit more wiggle room on the saves side as well. Still you know I guess, it's a – it's a sad…it's a sad day when we're excited about 12 and a half percent and especially 12 and a half percent on a large number. And I think as we look into next year, we have minimal contract renewals and so we've got a pretty good feel that it's going to come in around the 9 percent range.

And you know once again you know we're kind of jumping for joy for 9 percent when there was a time when a 6 percent increase we were devastated by.

So, you know, obviously it's a changing world which has us changing how we look at what we offer customers, what we prioritize, those kinds of things, but a – from the true economics of it you know it ended up being better than we expected and we feel pretty good about what is coming next year.

Mike Pace: And just one more. Just M&A for you guys…

Steven Cochran: Yes.

Mike Pace: … you have some cash that you need to reinvest. Is there anything that you guys are looking at? I'm assuming you'd focus more on the commercial stuff than residential, but any thoughts there?

Steven Cochran: Yes, there's definitely nothing eminent on that, Michael. I mean, there's a – there's a handful of things out there that we could look at. I think we've had a heavy focus on creating stability and allowing that to help us get to a better position from just sustainability and a free cash flow standpoint.

And there's not a lot out there that you could take over that wouldn't cause some level of disruption on our side, and I think just given the opportunities we have coming our way, we're going to be pretty cautious to make sure that if we do do something from an acquisition standpoint, we feel that we can manage the disruption.

And just to speak to that for a second, I mean, we've seen – we've talked about this as a plan moving into the fourth quarter and we have clearly seen that in the first quarter from a standpoint of really seeing the impact of less activity both from a reduction in truck rolls from less call center activity.

A number of things have – we had hoped and we had budgeted for stability to represent itself financially and it has come through very nicely in that form. And so we're still in the first half of some of the changes that we're making and probably don't want to get in the midst of an acquisition that's going to change that unless it's something we feel that is really, you know – really has a great opportunity to drive – to create value or is limited from a disruption standpoint.

Mike Pace: Great. Thank you.

Steven Cochran: Sure.

Operator: Your next question is from Lauren Gallagher with Credit Suisse. Your line is open.

Lauren Gallagher: Hi, guys. Thanks for all the additional color. In terms of since it's basically the last day of 1Q, I was just wondering if you could provide any insight kind of in terms of what you saw during the quarter, whether you saw kind of churned to pine, increased connects on the subscriber side?

And it seems like the fact that you're somewhat – you're basically confirming the fiscal guidance at financial performance in Q1 has maintained pretty well as well.

Steven Cochran: Yes, I think – I think that's fair. Clearly, from a customer standpoint kind of what we expected to see, which was the continuation of what we saw in the fourth quarter definitely happened through the first 45 days of the year as we had – you know we had – we had about 20 percent of our base that was getting a rate increase because they were on a rate guarantee until January 1st.

So we were still dealing with some rate increase. We had also pulled back some of the marketing in the fourth quarter.

And so it takes a while to ramp that back up again. And so I think you know the trends definitely continue into the first quarter with what we saw. We did see it improve throughout the quarter as both the marketing kicked in and the churn associated with rate increase in particular backed down.

So the trend's moving in the right direction, but you know the overall numbers still look very similar to what we saw in the fourth quarter. I think financially though we're very pleased with where the quarter's coming out especially as it relates to the expense side and what we're able to do from a initiative standpoint, from a stability standpoint, from a reduction in calls through call center, truck rolls, all those kinds of things. We're very pleased with how the first quarter's progressing.

Lauren Gallagher: OK. Great. And then two quick follow-ups, if you don't mind? Can you just confirm you're only going to be doing one price increase in October for this year?

Steven Cochran: That is our plan to do a price increase sometime in the fall. I think the date is still to be determined, but we'll have our annual rate increase sometime in the fall.

Lauren Gallagher: OK. And then a final question, the fact that you say nothing's really eminent on the M&A side, how do you kind of view the South Dakota proceeds and kind of any timeline on when you might potentially either retire debt? I believe you can use it for CAPEX underneath the credit facility and then obviously last resort it sounds like is M&A at this point; is that the correct way to think about it or…

Steven Cochran: Yes – no, I wouldn't say last. I mean – I don't think we would ever go do a deal just because we had the proceeds to do it. If a deal presented itself that was the right deal that fit into the criteria I talked about before and we still have that, we would use it and I think that's definitely one of the reasons we're probably hanging on to it is to give us kind of the flexibility both from – because we do have the ability to announce a deal and it buys us a little bit more time down the road, but to give us as much flexibility time-wise also knowing that sometime this summer when our bonds become – come off the no-call for the first time hopefully having some ability to do something with that making sure you know we've got as much flexibility as possible and I think, not that we can specifically use it for that, but I think having cash on the balance sheet gives us more flexibility than not and relative to the savings we would have by paying down debt in the short-term.

Lauren Gallagher: OK. Great. Thanks for the color.

Steven Cochran: Sure.

Operator: And again if you'd like to ask a question, that was star, followed by the number one on your telephone keypad. Your next question is from Michael McCaffrey with Shenkman Capital. Your line is open.

Michael McCaffrey: Thanks. I just wanted to clarify the improvement you've seen in Q1 as it relates to subscriber trends, is the best way to think about that is sequential improvement month-over-month and…

Steven Cochran: Yes. Yes, exactly.

Michael McCaffrey: Oh. OK. And I – and I guess – I'm sorry, go ahead.

Steven Cochran: No. No, I didn't say anything. Sorry, Michael. And if you had more to that question, sorry. I jumped in. I apologize.

Michael McCaffrey: No. No. No. I just wanted to clarify that it has been a sequential improvement that you've seen month-over-month and obviously, we're just entering into April now. So I guess the other question I had was to the extent now that the Comcast transaction closing that is being pushed out until the summer months do you have any sense for whether you think some of the irrational promotional activity that you had cited before, are we likely to see that continue for another quarter or so until that deal wraps up or have you seen any….?

Steven Cochran: Yes. No, that would be my guess. I mean, we really haven't seen any pullback, but I would say even over the last couple of weeks, which this isn't unusual for them, we've seen this often, the – right at the end of the quarter, heavy, heavy push. We've seen a little bit of that over the last couple of weeks of the quarter.

So I would anticipate that – I would anticipate that there was a heavy push across the company there to drive subs right before the end of the quarter and my guess is we'll continue to see that until the deal closes.

Michael McCaffrey: OK. Great. Thank you.

Operator: And there are no further questions at this time. We'll turn the call back over to our presenters.

Steven Cochran: Very good. Thank you so much for participating. We look forward to talking to you again about our first quarter results in about 45 days. So thanks and take care.

Rich Fish: Thanks, everyone.

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

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