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Rogers

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Richard Chun: Hi. I'd like to welcome Joe Natale, President and CEO of Rogers Communications, who joined Rogers last April as President and CEO.

Prior to that, he was President and CEO of Telus. My name's Richard Chun. I'm part of the communications team here at JP Morgan. I would like to first start off with wireless.

We're seeing really nice growth resurgence, so to speak, after a few lean years. What do you think's driving this subscriber growth, and what are you seeing?

Joe Natale: Overall, I believe Canada is the most underpenetrated and fastest growing wireless market in the developed world overall. We're sitting at about 86 percent penetration. There's no reason why we shouldn't in the fullness of time, get to the US levels of roughly 120 percent penetration.

You couple that with a growing population of two percent population growth driven by immigration, housing starts, continuous growth in housing starts. We have a good backdrop for continuous growth in the market as a whole.

As the largest wireless player, having a strong history of both leading financial and subscriber methods, I think we're well poised to take advantage of that growth.

Richard: The Canadian wireless market has been pretty competitive for a long time. How would you characterize the environment now? Are you seeing someone try to take more than their fair share? Is it just kind of falling out naturally?

Joe: Last year, we had five percent penetration growth. This Q1 again, five percent growth. Five percent growth translates into anywhere between one point three and one point five million new customers per year.

I think there's a lot of opportunity for all the players to get the requisite share of the market. With that kind of growth, as a result, we're seeing a competitive market, but also a disciplined market from that perspective.

Richard: I think between the relative sizes and networks the Canadian markets since it's growing, you're not seeing any kind of irrational behavior by any players. Something that, I guess, we're seeing down here once in a while.

Joe: Canada is largely a post-paid market similar to the US. It's a market that's inherently based on subsidy versus equipment financing. It is a market with a low population density, three and a half Canadians per square kilometer.

Therefore, playing in the wireless game in Canada requires deep pockets. It requires an investment in infrastructure, based on both the regulatory environment and the expectation of Canadians for high-quality networks.

We have amongst the highest quality networks anywhere on the planet with very strong performance, in terms of capacity and coverage as a whole.

I think it's given rise to a certain type of wireless market. If you could look back over the history of wireless in Canada, it's about 35 years old. As an industry, we became cumulative cash flow positive about eight or nine years ago.

I think that by definition means a marketplace with much more of a focus on making sure there is proper economic returns coming out of that investment as a whole. We don't have the T-Mobile effect that we've seen in the US market.

Yes, there are four players in each of the key markets. The current environment really strives for balance of competition with strong economic consideration.

Richard: To go along with that subscriber growth that you've seen, our crew and service revenue have been growing. I assume part of that has been driven by increased usage on the higher quality networks.

What are you seeing usage wise, and where can service revenue and RPU growth go over time?

Joe: That's a great question. We think that this is a continued opportunity for more revenue and RPU growth as a whole. On average, Canada has about roughly about a gig of data usage per month per subscriber.

In the US, the number is roughly around three times that amount, because of unlimited plans in the US. We don't see any sort of overall push for unlimited in Canada, just because the quality of networks, in terms of expectation and the expense of covering our vast geography would really hurt the infrastructure and the investment that's been made to date.

We cover 98, 99 percent of Canada. Think about Canada as one of the largest landmasses on the planet, with LTE, because of that investment thesis as a whole.

As it relates to that overall economic condition, I think we're in a good spot with respect to the future of wireless and the thesis for investment around it.

Richard: As long as it's done in a rational investment manner, do you expect the one gig to eventually move up to two and maybe three over a long period of time?

It doesn't seem like there's any reason why Canadians wouldn't be using it through phones as much, maybe the economic impact.

Joe: No question. I think the network experience is far different than Canada than it is in the US. I travel all through the US. I've got a lot of family in the US. This has been a different network experience as a whole.

I think there's room to monetize that data on the road from one gig to one and a half gig to two gig. Based on providing value, naturally, the market is growing by about 30 to 40 percent per year in terms of increased demand for data in Canada.

The key is to make sure that we continue to deliver on that demand to customers, at the same time, drive out costs in our business and our infrastructure, we can realize the economic value from marching from one to two to three gig.

Richard: I think part of improving that value is the high quality network, but also getting churn down and being able to keep customers longer. What has Rogers been doing to lower churn and getting that under one percent?

Joe: Been working hard on that front. We posted another great quarter in terms of overall post trade churn performance at 1.08 percent, down a few points from a year ago. The best record in many years in our business.

We're going to continue chipping away at churn. We already lead the industry with respect to gross loading. We have one of the strongest distribution networks and have led quarter on quarter for years in terms of gross additions.

Our goal is to get churn to a leading performance level, as well. That's going to be done with a combination of efforts, one around just driving far greater customer service capabilities, driving far greater self-serve capabilities for our customers.

That's going to be done through much better and stronger focus on managing our base of customers proactively, using analytics and all kinds of outbound efforts and activities. We're just starting to mount some of those efforts.

Our goal is to have the best of both worlds. We think we can have the best of both worlds, and that is industry-leading gross loading with industry-leading churn performance, in the fullness of time.

We're not going to get there overnight. It will take a lot of heavy lifting through the course of the next few years, but the timeline will continue and we'll continue to chip away at it a few basis points each and every cycle as a whole.

I think it's there for the taking. There's nothing structurally holding us back from doing that. The important thing to consider is that churn improvement, customer service improvement goes hand in hand with cost improvement.

The two are really two sides of the same coin. There is a fallacy out there that says in order to improve customer services and improve churn, you have to somehow spend more money.

We believe by systematically going after the friction points, the problems around churn, we'll actually take costs out of the equation. As a simple example, last year, we took almost 47,000,000 phone calls at roughly $10 a phone call.

That's a very expensive cost of operating one part of our operations. Similar costs points across stores, across our field technician force, et cetera. We're on a mission to drive that call volume down and really focus on the calls that at the most value to customers.

Take longer on the calls that matter more and eradicate the calls that aren't adding any value whatsoever. That's part of the churn equation and the margin improvement equation.

Richard: Going along with that, is this a long-term keep working at it, changing the culture or adjusting the culture internally and seeing that improvement over a short period of time, or is it going to take a while?

Joe: It's going to take a few years to get to where we want to get over all. We're just going to keep chipping away at it. If it was one or two things to fix, we would have done it by now.

To give you an example, we started this routine of looking at friction points based on ideas that come from both our front-line agents and come from customers directly.

In Q1 alone, we remediated about 54 different items that are starting to have some traction. Some of them affect a small group of customers, some of them affect thousands of customers. If it was one or two key ideas, we would have already been done with them.

We got here through a series of increasing complexities in our business, not really making some of the correct investments, in terms of customer service along the way. We're going to make our way to a better place by reversing some of those items and making the right investments, but it's going to take time to do so. It's a game of inches that you play over a long period of time.

You hit the point, as well, Richard. Culture is a big part of it. It's one thing to go after all these points, but you have to build a culture where serving the customer and putting customers first is top of mind every step of the way.

In everybody's activity, whether you're on the front line, and whether you're in product management, in marketing, in finance, or legal, it has to be an important part of your thinking.

Richard: That makes sense. You mentioned course loadings and how Rogers has led there. Is this driven by brand or distribution, both? Can other companies catch up to your level of distribution? Just wanted to get a sense.

Joe: I think it's driven by a few things. One, it's driven by the quality of our network. We've got a very strong and capable network. I talked about that already. Secondly, it's driven by the strength of our distribution. Our products are offered in about 2,500 points of distribution across the country.

A thousand of them are exclusive to Rogers' brands. The remainder are a series of either joint ventures or independent third-party retailers.

The category wireless, for sure, is over-distributed in Canada. There's not exactly a lot of room for more points of distribution. You go in the average mall and there can be 10, 20 places to buy a wireless device.

Landlords are saying, "Enough." We understand we're well covered. We built that distribution network over the last 35 years. It's something that is a strategic advantage for us as an organization. We continue to invest in the nature of those stores.

You look at some of our new format stores. These are places to experience what's happening in the world of wireless, and the world of cable TV, and the world of Internet. Both the wireless world and the smart home will come to fruition for customers.

More than ever, we have to be at the forefront of sharing those ideas with customers. The store needs to be a destination, not just a place to pay your bill, or look at a phone or a device. I think that's the game we're playing.

The barrier to both investing in networks in high. The calculus of our business really trades on population density, as I talked about earlier. Population density in Canada is about one-tenth of the US.

We've built the largest owned wireless network in the country with some 8,000 macro towers and a growing array of small cells at the same time. That took a long time to build. We're covering every nook and cranny of the country. Add that to the distribution footprint. Those are things that are hard to overcome if you're newer to the game.

Richard: I guess you developed your 4G network to a pretty high standard, but a lot of people are talking about 5G. How is Rogers' network prepositioned in its 4G network? How do you think the transition will go to 5G?

Joe: Right now, we're just in the middle of a network uplift program to make the transition from 4G to 4.5G. 4.5G will be a number of technologies that are fully leverage-able into the 5G world.

One thing we've done recently is we've chosen Ericsson as our national partner for the 4.5G uplift. We're picking the latest radio access gear that is not only capable of supporting multi-carrier aggregation, supporting four-by-four MIMAL, all the things that are part of 4G.

It will be 5G ready in terms of only requiring software, upgradable efforts to make the move to 5G. That's one thing that we're doing.

The second thing that we're doing is a series of 5G trials across our business. You may have seen recently that we're testing some of the high-capacity, high-volume capability of small cells in 5G. We lit up 100 small cells inside the Rogers Centre where the Toronto Blue Jays play. We saw incredible performance.

I think 5G plays a role in venues. When that stadium is at full capacity, it's almost 50,000 people. 50,000 trying to stream video all at once is a very important test case or condition for one of the 5G applications.

We're also looking at the various industry verticals around IoT, asking ourselves the question, "Which industries will be most predisposed to making an investment in IoT capabilities in Canada?"

We're going to be at the forefront of those industries. It's largely a B2B play. We've got a strong capability in that arena. We'll be leveraging that.

The third area that we're watching very carefully around is fixed wireless. We're going to watch carefully as AT&T, and Verizon and others across the globe build the case and build the technological solutions for fixed wireless. We'll be there ready to understand how ell that's going and be a fast follower in looking at where that's evolving to.

Those are the three overall areas for 5G. This will be a year of planning, of economic case development, of starting to do some of the foundational work. Then, as we head into 2019, we'll see much more of a building phase starting to emerge, based on where we're placing our bets.

The thing about 5G that's important to understand is that 5G is not like the move from 3 to 4G. 3 to 4G was a rip and replace of the entire infrastructure. 5G will happen in an evolutionary way.

Based on the use cases that we pick, the geographies where we want to implement those use cases, it will be much more evolutionary in nature, and much less significant of a massive capital campaign like 3 to 4G was.

Richard: In terms of the fixed wireless offering, given that you're already building or have a very strong network, is this out of foot, opportunity for you? How big could that be? How much work have you done there?

Joe: Our focus right now is in footprint. We pass about 4.3 million homes with our cable footprint. We have the largest cable system in Canada, in terms of addressable homes. We've already rolled out DOCSIS 3.1 to the entire footprint. The entire footprint is capable of one-gigabyte speeds to each home location.

In the last five or six years, we've been running fiber to the prim in any new builds, whether it's a brand-new single-dwelling subdivision, or whether it's new condo buildings.

If you've seen some of the housing development in the economic center of Canada where we have most of our footprint, in Toronto and the surrounding area, you'll know that there's been a lot of housing development, a lot of condo towers being built. We feel we're very well equipped.

We'll look at fixed wireless as a complementary idea within that footprint. Right now, it really becomes an economic trade-off. As we look at adding capacity, building out on the fringe of our network, do we do so with fiber? Do we do so with coaxial? What, do we try something with fixed wireless?

Until the case is proven on fixed wireless, we'll just be doing some trials and watching it evolve. We have no plans right now to go outside of footprint, really focusing on the footprint that we have, and continue to drive the growth that we're seeing in the business.

Richard: In terms of small cells, do you see that as a cost savings in terms of building capacity that people are using, or is it really expensive to build and you're very targeted?

Joe: We see small cells, the biggest opportunity around small cells is to offload the macro network. With the macro network, in some parts of our network is such that we just can't keep adding macro towers. It's becoming more difficult to actually get sites in some of the urban dense areas to add to the macro tower. You're getting to the sort of law of diminishing returns.

You continue splitting cells in an urban area and you actually don't get double the capacity, you get sort of a diminutive kind of outcome from that.

To me, the most obvious application of small cells is to offload the macro towers in dense urban settings where you can attach small cells to buildings, to street furniture, to bus stops, wherever you can get access back hall in power. I think that's the great complementarity of small cell to macro cell.

At the same time, we leveraged the power of 5G to do things like network slicing, to manage quality of service in a different way and start to evolve the proposition. We've grown up in this business with tonnage being our main focus. How many gigs can I sell you? I think it's an opportunity to 5G to have different sorts of value added transactions priced differently.

Surfing the net should be a different value transaction than someone performing essential mission critical first responder service or healthcare service, whatever that might be. We have an opportunity to do that as we kind of leverage that technology, as well.

It's capacity at a better per unit cost and enabling business cases that are different from today's world.

Richard: You talked about it a little bit earlier, but going back to wireless margins. In terms of, you feel like you could still improve the margin and lower churn without necessarily increasing costs. We saw a nice improvement in the first quarter, year over year. Should we expect that kind of going forward as these initiatives kind of continue to roll through?

Joe: We don't provide specific guidance around margins, but what we have said is that we are striving for a 200 basis point improvement in each of our wireless and cable businesses using 2016 as a baseline, by the end of 2018.

We're on track to do exactly that in both those businesses. We're kind of just over halfway there and we can look at our guidance, you can easily reverse engineer where we're headed to from that perspective.

Richard: You mentioned it a little bit on the CAPEX side in terms of the build, the network [inaudible] . It was running below the normal level, 10, 12 percent, now it's kind of come back up. How long should we see the, what's driving the increase and how long should we see it at that, what's the natural long term level?

Joe: You're right. We were kind of running below sort of industry peer levels in terms of CAPEX intensity in wireless, because we waited for the right moment in time to do the uplift to 4.5G.

I think it served us well. We're seeing better unit costs for equipment as a result. Now the equipment is actually 5G ready, where early 4.5G equipment now needs to be replaced for those that went very early in the process.

That's good from that perspective. You should expect to see us in line with industry peers over sort of an appreciable horizon or period of time. There will be sort of ups and downs in a given year, but we're committed to being in that sort of industry peer zone as a whole.

Richard: Moving over to the cable business, losses were about half of what they were a year ago. What are you doing in terms of mitigating the, some of the overwielding that is going on in your markets?

Joe: With respect to, you talk about video losses, on the Internet side, we've grown Internet penetration now consistently every quarter for the last 11 quarters. Really, feel we have a superior product in the 1 Gig service offering, and it's competing well against our competitors in the marketplace.

You're right, on the video side of the equation, a year ago, we had 24,000 video losses, this past Q1, it was 12,000. What we did is we really started to focus the attention more on the multi-product household.

The easiest category of customer to get is the Internet only condo dweller looking for a promotional opportunity. I think as an organization, historically, we've been too focused on that promotional hopper category. All we're doing there is we're trading customers back and forth based on the next promotion.

I've been pushing the team to look at the multi-product household, offer them a capability that will be stick here and have a great lifetime value, and you're starting to see some of the efforts of that focus.

The thing is that we're still only fighting with one hand. The other hand's tied behind our backs. Our legacy TV product is just that, a legacy TV product.

We're in the midst of an employee trial around the IPTV version of Xfinity, and it is a great product oriented solution. Once we get that to market, I think we'll have both hands to fight with and you'll see an even greater opportunity for us, with respect to lifetime value of the household and overall economics of the household.

Richard: It's gotten very good reviews. What has the employees said about it, and how should we expect it to be rolled out over time?

Joe: The employees love it. We now have it in over 2,000 employee homes. We're adding anywhere from 300 to 400 a week. We've got great demand from employees, as many as 6,000 in backlog waiting for the installation.

The goal was very much to create the excitement inside the house to make it relevant and important to all of our people, who'll be serving our customers. But also, more importantly, pressure testing all of the operational and support processes.

The platform works very well. It is the same platform that Comcast is using, the same sort of, that they are trialing in different parts of the country in the US.

I've had it in my home since October. I think it's a great product that has a lot of wonderful features, not just voice control, but deep Netflix integration, cloud PVR. We're going to be having a bunch of other capabilities that will make a difference in the marketplace.

Employees are really giving us great feedback. We've asked them to be very tough, very brutal on us, because we don't want to sugar coat it internally. The feedback has been terrific.

Our plan is to have a soft launch in the next few months, and then do a full scale launch later this year. We're not talking about exact dates for sensitivity reasons, but we're ready to go in carrying out that approach. Then at some point, over the next little while, we will stop sell the legacy product, and really drive a full or rollover of our base over the next few years.

Richard: Can you talk a little bit about how your cost structure is going to change, both in the OPEX and CAPEX side. As you roll out X1 through your markets, probably, you're spending a little bit more now in CAPEX. But over time, where will it go and how will that factor off X2?

Joe: Yeah, absolutely. I mean, cable CAPEX intensity is higher right now. Our resting heart rate on CAPEX intensity will be much lower in the few years. One driven by the implementation efforts around the platform itself, the one time upfront costs. The other thing that will bring it down from a CAPEX point of view is the cost of installation will go down dramatically.

Right now, the average home costs us about $1100 to install. It's a combination of labor, a couple of HD PVR boxes, a gateway, some wiring, just the effort of doing that. The equivalent household in the X1 IPTV world would be closer to about $400. Inherently, on a per home basis, that's a substantial improvement.

Add to that some of the operating improvements along the way. There are a number of capabilities with the product that allows us to see deeply into the home and look at all the endpoints. As a result, we can do a lot more troubleshooting before we even arrive at the house.

Also, if you look at the content discovery capabilities of the product, it's very good. I've stopped using the programming guide, I'm using the voice command. I can see what's available on different services.

Our goal is to be agnostic to OTT services and really incorporate all the possible capabilities that are there, so people never have to leave our environment. They can watch on Netflix, they can program something on their PVR from the cloud, they can buy it from our on demand catalog, and we'll keep integrating other OTT providers over the fullness of time.

We think that discoverability will drive a far better on demand improvement in revenue and stickiness overall for the home. That's the real value, is stickiness from the home.

Richard: It seems like there's a churn, lowering the churn component, people are happier, they want to use the product more and don't want to switch. But there also could be a revenue uplift from the on demand and maybe other ancillary services that can be put on there.

Joe: Absolutely. But we do think that Internet is the anchor to the home. The entire focus, really, is around Internet. Internet is the new dial tone, if we can call it that. Right now, Internet ARPU sits at around $70 for us. We're on a mission to keep driving that Internet ARPU, we've been growing it about 5 or 10 percent per year.

I want to get to a point where the video revenue growth is a nice to have, where the economics of that cable business improves based on the merits of the Internet capability in and of itself, and everything else around it that we're going to wrap around the smart home.

It's not just video entertainment services. We're talking about alarm monitoring in the smart home support, we're talking about all the home automation ideas that sit on the road map beyond the Xfinity video platform. All of them will be opportunities to continue to drive lifetime revenue, and continue to drive churn improvement and make the home stickier for that anchor product being Internet.

Richard: If anyone wants to ask a question, please, like, raise your hand and we'll get you a microphone. But wanted to finish up with the cable. Bell is starting to mass market their fiber in Toronto. What are you seeing initial reactions to the mass marketing in [inaudible] ?

Joe: Just a couple of points to think about in that context. First of all, if you look at our footprint in Ontario, roughly four million homes, Bell's penetration in that entire footprint we estimate to be at about 25 percent with fiber to the prem.

There's Toronto proper and then there's the greater Toronto area and all of Ontario. It is the largest mass of homes and value in the country, it's the most, the broadest, most important market from a residential services point of view. Number one is the comment.

Second comment I would make is that we've been competing with Bell for 10 years as it relates to fiber services, first fiber to the node and then fiber to the prem.

Bear in mind what I said earlier, for the last 5 to 7 years, we've been driving fiber to the prem in new homes and in condo buildings. When housing starts are growing by about two percent per year for the last number of years, that's an appreciable part of our base, as well.

We have many instances of communities where we're competing fiber to fiber, we're competing fiber to coax, we're competing fiber to DSL, we're competing fiber to ATM. We've got all these different sort of conditions and areas.

I think we feel comfortable in all of those different realms overall, in terms of the level of capability. We have a superior Internet product. One gig availability across the entire footprint. With the advent of X1, I think we will have the other part of the equation.

We have been growing at penetration now for the last 11 quarters. If you look at our results quarter in and quarter out, our competitor has about twice the footprint we have. On an Internet additions per size of footprint, I think we perform very well.

Richard: Just finishing out with that X1 part, you said you feel like you're fighting with one hand tied behind your back. Is this going to be a sea change for you to be able to have this level of sophistication for this part of the video business? Maybe you could gain back share or keep the bigger share.

Joe: I think it's a very important change for us. Internally, I've been calling it the revenge of cable. It's back with a great interface and a great capability that is not trying to fight LTT, but integrating it into the offering.

It's leveraging the power of current technology for discovery and use in terms of the household, which I think is an important part of that overall consideration.

I do think that it's a game changer for us. It's going to happen over time, Richard. It's not something that's going to happen overnight. We're going to roll it across our base in a very systematic fashion as a whole.

There's a lot of excitement around the product and the offering. What's even more exciting is we've had the benefit of seeing the roadmap for both the X5 services and the X home services that are behind it.

There are a series of offerings and innovations that I think are even more compelling around really bringing the power of the automated home to the mass market.

Right now if you have any number of connected devices in your home, you probably have as many apps to try to control them and manage them. Bringing this all together into one environment, integrating it with Internet and video I think is a very powerful combination.

Richard: Any questions, or I'll keep going. In terms of capital allocation, it seems like this is an investment period, both in wireless and cable.

Once you get through this, it seems like not only are the numbers going to be better, the investments can be pulled back. Is that when we're going to see the dividends to start to grow again? Is it going to take a little bit longer than that?

Joe: What I said to my team, it's been just over 12 months since I've taken over at the helm of Rogers.

I said our primary focus, above and beyond all else, has to be to grow the core business and reinforce the long term sustainable financial results of this organization.

The growth that goes into those investments so that we can continue to regenerate that types of returns that you are seeing from us. That is job one. Our goal is to also bring balance sheet leverage to a different place.

We were up as high as 3.3, we closed the year at 2.8, we're down to 2.7, we're headed to 2.6. I'd like to see the balance sheet leverage get to 2.5 or below. We feel confident around the guidance that we put forward for the year.

We don't have any other extraneous uses for our cash, if that's part of the question, as well. We're very much focused on the core business and therefore there will be a moment of time in the future where we will revisit the notion of increasing the dividend.

We're committed to a cash return model to shareholders. A combination of dividends and share buybacks. It's a question of when, not a question of if.

Richard: I think we're out of time.

Joe: Thank you.

Richard: Thank you.

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