

TUCOWS INC /PA/  
Form 10-Q  
May 15, 2013  
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2013

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934

For the transition period from            to

Commission file number 1-32600

TUCOWS INC.

(Exact Name of Registrant as Specified in Its Charter)

Pennsylvania  
(State or Other Jurisdiction of  
Incorporation or Organization)

23-2707366  
(I.R.S. Employer  
Identification No.)

96 Mowat Avenue,  
Toronto, Ontario M6K 3M1, Canada  
(Address of Principal Executive Offices) (Zip Code)

(416) 535-0123  
(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days: Yes    No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T §232.405 of this chapter during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes    No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act): Yes No

As of May 13, 2013, there were 40,263,709 outstanding shares of common stock, no par value, of the registrant.

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TRADEMARKS, TRADE NAMES AND SERVICE MARKS

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convenience, any trademarks referred to in this Quarterly Report may appear without the ® or TM symbol, but such references are not intended to indicate, in any way, that we or the owner of such trademark, as applicable, will not assert, to the fullest extent under applicable law, our or its rights, or the right of the applicable licensor, to these trademarks.

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PART I.  
FINANCIAL INFORMATION

## Item 1. Consolidated Financial Statements

Tucows Inc.  
Consolidated Balance Sheets  
(Dollar amounts in U.S. dollars)

	March 31 2013	December 31, 2012
Assets	(unaudited)	
Current assets:		
Cash and cash equivalents	\$4,286,319	\$6,415,679
Accounts receivable, net of allowance for doubtful accounts of \$72,888 as of March 31, 2013 and \$73,970 as of December 31, 2012	4,961,583	4,413,265
Inventory	308,804	587,104
Prepaid expenses and deposits	5,419,706	5,081,408
Derivative instrument asset, current portion (note 4)	83,622	412,944
Prepaid domain name registry and ancillary services fees, current portion	46,207,926	45,170,167
Income taxes recoverable	830,631	1,730,631
Total current assets	62,098,591	63,811,198
Derivative instrument asset, long-term portion (note 4)	-	31,838
Prepaid domain name registry and ancillary services fees, long-term portion	12,322,678	12,318,723
Property and equipment	1,675,546	1,352,144
Deferred tax asset, long-term portion (note 7)	5,970,237	5,970,462
Intangible assets (note 5)	16,146,218	16,415,651
Goodwill	18,873,127	18,873,127
Total assets	\$117,086,397	\$118,773,143
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$2,599,091	\$1,928,459
Accrued liabilities	1,998,027	2,522,229
Customer deposits	4,394,250	4,955,671
Derivative instrument liability, current portion (note 4)	249,155	-
Loan payable, current portion (note 6)	8,100,000	3,700,000
Deferred revenue, current portion	56,417,381	54,997,887
Accreditation fees payable, current portion	561,259	512,847
Deferred tax liability, current portion (note 7)	850,039	914,429
Income taxes payable (note 7)	464,261	1,255,108
Total current liabilities	75,633,463	70,786,630
Derivative instrument liability, long-term portion (note 4)	26,611	-
Deferred revenue, long-term portion	16,002,554	16,002,464
Accreditation fees payable, long-term portion	141,179	145,592
Deferred rent, long-term portion	59,654	54,150

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Deferred tax liability, long-term portion (note 7)	5,206,200	5,234,100
Stockholders' equity (note 11)		
Preferred stock - no par value, 1,250,000 shares authorized; none issued and outstanding	-	-
Common stock - no par value, 250,000,000 shares authorized; 40,121,797 shares issued and outstanding as of March 31, 2013 and 44,322,159 shares issued and outstanding as of December 31, 2012	9,297,924	10,084,417
Additional paid-in capital	28,293,757	33,931,529
Deficit	(17,433,264 )	(17,509,843 )
Accumulated other comprehensive income (loss)	(141,681 )	44,104
Total stockholders' equity	20,016,736	26,550,207
Total liabilities and stockholders' equity	\$ 117,086,397	\$ 118,773,143

Commitments and contingencies (note 10)

See accompanying notes to unaudited consolidated financial statements

Tucows Inc.  
Consolidated Statements of Operations and Comprehensive Income  
(Dollar amounts in U.S. dollars)  
(unaudited)

	Three months ended March 31,	
	2013	2012
Net revenues (note 9)	\$29,985,022	\$27,537,306
<b>Cost of revenues (note 9):</b>		
Cost of revenues	22,077,899	19,267,125
Network expenses (*)	1,254,213	1,256,890
Depreciation of property and equipment	137,072	147,418
Amortization of intangible assets (note 5)	35,910	35,910
Total cost of revenues	23,505,094	20,707,343
Gross profit	6,479,928	6,829,963
<b>Expenses:</b>		
Sales and marketing (*)	2,847,086	2,184,635
Technical operations and development (*)	1,133,830	1,113,145
General and administrative (*)	1,698,632	1,783,453
Depreciation of property and equipment	50,939	47,415
Amortization of intangible assets (note 5)	219,030	219,030
Loss (gain) on currency forward contracts (note 4)	234,638	(562,109 )
Total expenses	6,184,155	4,785,569
Income from operations	295,773	2,044,394
<b>Other income (expense):</b>		
Interest expense, net	(99,362 )	(40,969 )
Other income, net	-	508,800
Total other income (expense)	(99,362 )	467,831
Income before provision for income taxes	196,411	2,512,225
Provision for income taxes (note 7)	119,832	848,606
Net income	76,579	1,663,619
Other comprehensive income (loss), net of tax of \$96,777	\$(185,785 )	-
Comprehensive income (loss) for the period	\$(109,206 )	\$1,663,619
Basic earnings per common share (note 8)	\$0.00	\$0.04
Shares used in computing basic earnings per common share (note 8)	40,331,438	46,221,465

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Diluted earnings per common share (note 8)	\$0.00	\$0.03
Shares used in computing diluted earnings per common share (note 8)	44,311,323	48,954,451
(*) Stock-based compensation has been included in operating expenses as follows:		
Network expenses	\$6,126	\$6,046
Sales and marketing	\$26,410	\$22,782
Technical operations and development	\$15,247	\$12,843
General and administrative	\$27,059	\$20,794

See accompanying notes to consolidated financial statements



Tucows Inc.  
Consolidated Statements of Cash Flows  
(Dollar amounts in U.S. dollars)  
(unaudited)

	Three months ended March 31,	
	2013	2012
Cash provided by:		
Operating activities:		
Net income for the period	\$76,579	\$1,663,619
Items not involving cash:		
Depreciation of property and equipment	188,011	194,833
Amortization of deferred financing charges	-	1,500
Amortization of intangible assets	254,940	254,940
Deferred income taxes (recovery)	(92,065 )	212,088
Deferred rent	5,504	7,269
Acquisition of domain names	-	(3,664 )
Disposal of domain names	14,493	15,738
Gain on disposition of intangible assets	-	(508,800 )
(Gain) loss on change in the fair value of forward contracts	451,141	(701,843 )
Stock-based compensation	74,842	62,465
Change in non-cash operating working capital:		
Accounts receivable	(548,318 )	(1,014,729 )
Inventory	278,300	-
Prepaid expenses and deposits	(338,298 )	(1,108,098 )
Prepaid domain name registry and ancillary services fees	(1,041,714 )	(2,919,423 )
Income taxes recoverable/payable	109,153	619,073
Accounts payable	605,924	913,969
Accrued liabilities	(524,202 )	268,911
Customer deposits	(561,421 )	257,000
Deferred revenue	1,419,584	3,823,832
Accreditation fees payable	43,999	41,954
<b>Net cash provided by operating activities</b>	<b>416,452</b>	<b>2,080,634</b>
Financing activities:		
Proceeds received on exercise of stock options	38,509	130,712
Repurchase of common stock	(6,537,616 )	(5,893,447 )
Proceeds received on loan payable	5,200,000	4,000,000
Repayment of loan payable	(800,000 )	(538,333 )
<b>Net cash used in financing activities</b>	<b>(2,099,107 )</b>	<b>(2,301,068 )</b>
Investing activities:		
Additions to property and equipment	(446,705 )	(330,273 )
Proceeds on disposal of intangible assets	-	508,800
<b>Net cash (used in) provided by investing activities</b>	<b>(446,705 )</b>	<b>178,527</b>
<b>Decrease in cash and cash equivalents</b>	<b>(2,129,360 )</b>	<b>(41,907 )</b>

Cash and cash equivalents, beginning of period	6,415,679	6,408,209
Cash and cash equivalents, end of period	\$4,286,319	\$6,366,302
Supplemental cash flow information:		
Interest paid	\$99,504	\$41,176
Supplementary disclosure of non-cash investing and financing activities:		
Property and equipment acquired during the period not yet paid for	\$161,223	\$50,401

See accompanying notes to unaudited consolidated financial statements

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

### 1. ORGANIZATION OF THE COMPANY:

Tucows Inc., a Pennsylvania corporation (referred to throughout this report as the “Company”, “Tu cows”, “we”, “us” or through similar expressions), together with our consolidated subsidiaries, is a global distributor of Internet services, including domain name registration, security and identity products through digital certificates, email and mobile telephony services through its global Internet-based network of Internet Service Providers, web hosting companies and other providers of Internet services to end-users.

We were incorporated under the laws of the Commonwealth of Pennsylvania in November 1992 under the name Infonautics, Inc. In August 2001, we completed our acquisition of Tucows Inc., a Delaware corporation, and we changed our name from Infonautics, Inc. to Tucows Inc. Our principal executive office is located in Toronto, Ontario and we have other offices in the Netherlands, Germany and the United States.

### 2. BASIS OF PRESENTATION:

The accompanying unaudited interim consolidated balance sheets, and the related consolidated statements of operations and comprehensive income and cash flows reflect all adjustments, consisting of normal recurring adjustments, that are, in the opinion of management, necessary for a fair presentation of the financial position of Tucows and its subsidiaries as at March 31, 2013 and the results of operations and cash flows for the interim periods ended March 31, 2013 and 2012. The results of operations presented in this Quarterly Report on Form 10-Q are not necessarily indicative of the results of operations that may be expected for future periods.

The accompanying unaudited interim consolidated financial statements have been prepared by Tucows in accordance with the rules and regulations of the Securities and Exchange Commission (the “SEC”). Certain information and footnote disclosure normally included in the Company's annual audited consolidated financial statements and accompanying notes have been condensed or omitted. These interim consolidated financial statements and accompanying notes follow the same accounting policies and methods of application used in the annual financial statements and should be read in conjunction with the Company's audited consolidated financial statements and notes thereto for the year ended December 31, 2012 included in Tucows' 2012 Annual Report on Form 10-K filed with the SEC on March 15, 2013.

There have been no material changes to our significant accounting policies during the three months ended March 31, 2013 as compared to the significant accounting policies described in our Annual Report on Form 10-K for the fiscal year ended December 31, 2012.

The Company recognizes the effects of events or transactions that occur after the balance sheet date but before financial statements are issued (“subsequent events”) if there is evidence that conditions related to the subsequent event existed at the date of the balance sheet date, including the impact of such events on management's estimates and assumptions used in preparing the financial statements. Other significant subsequent events that are not recognized in the financial statements, if any, are disclosed to the notes to the unaudited interim consolidated financial statements.

### 3. NEW ACCOUNTING POLICIES:

Recent Accounting Pronouncements Adopted

Testing Indefinite-Lived Intangible Assets for Impairment

On January 1, 2013, the Company adopted Accounting Standards Update No. 2012-02, Intangibles —Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment (“ASU 2012-02”) which allows entities to use a qualitative approach to test indefinite-lived intangible assets for impairment. ASU 2012-02 allows an entity to first perform a qualitative assessment to determine whether it is more likely than not that the indefinite-lived intangible asset is impaired. If an entity concludes that this is the case, it is required to determine the fair value of the indefinite-lived intangible asset and perform the quantitative impairment test by comparing the fair value with the carrying amount. The adoption of ASU 2012-02 did not materially impact the carrying value of our recorded indefinite-lived intangible assets. The Company will perform its next annual indefinite-lived intangible asset impairment test on December 31, 2013.

## Reclassification Out of Accumulated Other Comprehensive Income

The Company adopted Accounting Standards Update No. 2013-02, Comprehensive Income (Topic 220): “Reporting of Amounts Reclassified out of Accumulated Other Comprehensive Income.” (“ASU 2013-02”), effective January 1, 2013 and applied prospectively, which requires expanded disclosures for amounts reclassified out of accumulated other comprehensive income by component. The guidance requires the presentation of amounts reclassified out of accumulated other comprehensive income by the respective line items of net income but only if the amount reclassified is required under U.S. GAAP to be reclassified to net income in its entirety in the same reporting period. For other amounts that are not required under U.S. GAAP to be reclassified in their entirety to net income, a cross-reference to other disclosures that provide additional detail about those amounts is required. The adoption of ASU 2013-02 Company did not materially impact on the Company’s consolidated financial statements.

## 4. Derivative instruments and hedging activities:

## Foreign currency forward contracts

In October 2012, the Company entered into a hedging program with a Canadian chartered bank to limit the potential foreign exchange fluctuations incurred on its future cash flows related to a portion of payroll, rent and payments to a Canadian domain name registry supplier that are denominated in Canadian dollars and are expected to be paid by its Canadian operating subsidiary. As part of its risk management strategy, the Company uses derivative instruments to hedge a portion of the foreign exchange risk associated with these costs. The Company does not use these forward contracts for trading or speculative purposes. These forward contracts typically mature between one and eighteen months.

The Company has designated these transactions as cash flow hedges of forecasted transactions under ASC Topic 815 “Derivatives and Hedging” (ASC Topic 815). As the critical terms of the hedging instrument, and of the entire hedged forecasted transaction, are the same, in accordance with ASC Topic 815, the Company has been able to conclude that changes in fair value or cash flows attributable to the risk of being hedged are expected to completely offset at inception and on an ongoing basis. Accordingly, quarterly unrealized gains or losses on the effective portion of these contracts have been included within other comprehensive income. The fair value of the contracts, as of March 31, 2013, is recorded as derivative instrument assets and liabilities.

As of March 31, 2013, the notional amount of forward contracts that the Company held to sell U.S. dollars in exchange for Canadian dollars was \$23.3 million, of which \$15.1 million met the requirements of ASC Topic 815 and were designated as hedges (March 31, 2012 - \$25.3 million of which none were designated as hedges).

## Fair value of derivative instruments and effect of derivative instruments on financial performance

The effect of these derivative instruments on our consolidated financial statements as of, and for the three months ended March 31, 2013, were as follows (amounts presented do not include any income tax effects).

## Fair value of derivative instruments in the consolidated balance sheets

Derivatives	Balance Sheet Location	As of March 31, 2013 Fair Value Asset (Liability)	As of December 31, 2012 Fair Value Asset (Liability)
	Derivative instruments	\$ (215,483)	\$ 377,703

Foreign currency forward contracts designated as cash flow hedges				
Foreign currency forward contracts not designated as cash flow hedges	Derivative instruments	\$	23,339	\$ 67,079
Total foreign currency forward contracts	Derivative instruments	\$	(192,144)	\$ 444,782

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Effects of derivative instruments on income and other comprehensive income (OCI) for the three months ended March 31, 2013 is as follows:

Derivatives in Cash Flow Hedging Relationship	Amount of Gain or (Loss) Recognized in OCI on Derivative (Effective Portion)	Location of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Amount of Gain or (Loss) Reclassified from OCI into Income (Effective Portion)	Location of Gain or (Loss)	Amount of Gain or (Loss)
				Recognized in Income on Derivative Portion and Excluded from Effectiveness Testing)	Recognized in Income on Derivative Portion and Excluded from Effectiveness Testing)
Foreign currency forward contracts	\$ (185,785)	—	—	—	—

In addition to the above, for those foreign currency forward contracts not designated as hedged, the Company has recorded a gain of \$0.1 million and \$0.6 million for the three months ended March 31, 2013 and March 31, 2012 respectively in the consolidated statement of operations and comprehensive income.

## 5. INTANGIBLE ASSETS:

Intangible assets consist of acquired technology, brand, customer relationships, surname domain names and our portfolio of domain names. As reflected in the table below, these balances are being amortized on a straight-line basis over the life of the intangible assets, except for the surname domain names and portfolio domain names; which have been determined to have an indefinite life and which are tested annually for impairment.

A summary of acquired intangible assets for the three months ended March 31, 2013 is as follows:

	Technology 2 – 7 years	Brand 7 years	Customer relationships 4 – 7 years	Surname domain names indefinite life	Direct navigation domain names indefinite life	Total
Net book value, December 31, 2012	\$ 83,790	\$ 398,290	\$ 1,810,180	\$ 12,110,017	\$ 2,013,374	\$ 16,415,651
Sales of domain names	—	—	—	(1,947)	(12,546)	(14,493)
Amortization expense	(35,910)	(43,410)	(175,620)	—	—	(254,940)
Net book value, March 31, 2013	\$ 47,880	\$ 354,880	\$ 1,634,560	\$ 12,108,070	\$ 2,000,828	\$ 16,146,218

As of March 31, 2013, the accumulated amortization for the definite life intangibles was \$4.4 million.

6. LOAN PAYABLE:

The Company has credit agreements (collectively the “Amended Credit Facility”) with the Bank of Montreal (the “Bank” or “BMO”) that were amended on November 19, 2012, and which provide it with access to two revolving demand loan facilities (the “2012 Demand Loan Facilities”), a treasury risk management facility and an operating demand loan.

Two Revolving Demand Loan Facilities.

The 2012 Demand Loan Facilities are governed by the terms of the Offer Letter, dated November 19, 2012, between the Company and the Bank.

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Under the terms of the Amended Credit Facility, our prior demand loan facilities have been amended to provide an aggregate of \$14 million in funds available through the 2012 Demand Loan Facilities, which consist of a demand loan revolving facility (the “2012 DLR Loan”) and a demand loan revolving reducing facility (the “2012 DLRR Loan”). The 2012 DLR Loan accrues interest at the Bank’s U.S. Base Rate plus 1.25%. The Company may elect to pay interest on the 2012 DLRR Loan either at the Bank’s U.S. Base Rate plus 1.25% or LIBOR plus 2.50%. Aggregate advances under the 2012 Demand Loan Facilities may not exceed \$14 million and no more than \$2 million of such advances may be used to finance repurchases of Company common stock. The 2012 Demand Loan Facilities are subject to an undrawn aggregate standby fee of 0.20% following the first draw, which such fee is payable quarterly in arrears.

Repayment of advances under the 2012 DLR Loan consist of interest only payments made monthly in arrears and prepayment is permitted without penalty. The outstanding balance under the 2012 DLR Loan as of December 31st of each year is to be fully repaid within 30 days of December 31st through an equivalent advance made under the 2012 DLRR Loan. Advances under the 2012 DLRR Loan will be made annually and solely for such purpose. Each advance under the 2012 DLRR Loan is to be repaid in equal monthly principal payments plus interest, over a period of four years from the date of such advance.

At December 31, 2012, the outstanding balance under the 2011 DLR Loan was \$3.7 million. In accordance with the terms of the Amended Credit Facility, on January 1, 2013, the outstanding balance under the 2011 DLR Loan was fully repaid through an equivalent advance made under the 2012 DLRR Loan. Under the terms of the 2012 DLRR Loan this balance is to be repaid in equal monthly principal payments plus interest through December 31, 2016. At March 31, 2013, the outstanding balance under the 2012 DLRR Loan was \$2.9 million.

On January 7, 2013, the Company successfully concluded a modified “Dutch auction tender offer”, which was funded from available cash and an advance under the 2012 DLR Loan in the amount of \$5.2 million. Under the terms of the offer, the Company repurchased an aggregate of 4,114,121 shares of its common stock at a purchase price of \$1.50 per share, for a total of \$6,171,656, excluding transaction costs of approximately \$106,000. At March 31, 2013, the outstanding balance under the 2012 DLR Loan was \$5.2 million.

#### Treasury Risk Management Facility

The Amended Credit Facility also provides for a \$3.5 million settlement risk line to assist the Company with hedging Canadian dollar exposure through foreign exchange forward contracts and/or currency options. Under the terms of the Amended Credit Facility, the Company may enter into such agreements at market rates with terms not to exceed 18 months. As of March 31, 2013, the Company held contracts in the amount of \$23.3 million to trade U.S. dollars in exchange for Canadian dollars.

#### Operating Demand Loan

The Amended Credit Facility also provides the Company with a \$1.0 million operating demand loan facility to assist in meeting its operational needs (the “Operating Demand Loan”). The Operating Demand Loan accrues interest at the Bank’s U.S. Base Rate plus 1.25%. Interest is payable monthly in arrears with any borrowing under the Operating Demand Loan fluctuating widely with periodic clean-up, at a minimum on an annual basis. The Company has also agreed to pay to the Bank a monthly monitoring fee of US\$500 with respect to this loan. The Operating Demand Loan is payable on demand at any time, at the sole discretion of the Bank, with or without cause, and the Bank may terminate the Operating Demand Loan at any time. As of March 31, 2013, the Company had no amounts outstanding under its Operating Demand Loan.

#### General Terms

The Company's Amended Credit Facility contains customary representations and warranties, affirmative and negative covenants, and events of default. The Company's obligations under the Amended Credit Facility are guaranteed and secured by a security interest in substantially all of its assets. The Amended Credit Facility also requires that the Company comply with certain non-financial covenants and restrictions. In addition, the Company has agreed to comply with the following financial covenants at all times, which are to be calculated on a rolling four quarter basis: (i) Maximum Total Funded Debt to EBITDA of 2.00:1; and (ii) Minimum Fixed Charge Coverage of 1.20:1. Further, its Maximum Annual Capital Expenditures cannot exceed \$3.6 million per year, which limit will be reviewed on an annual basis. As of March 31, 2013, the Company was in compliance with these covenants.

Scheduled principal loan repayments are as follows:

Remainder of 2013	750,000
2014	2,300,000
2015	2,300,000
2016	1,450,000
2017	1,300,000

## 7. INCOME TAXES

For the three months ended March 31, 2013, the Company recorded a provision for income taxes of \$0.1 million on income before income taxes of \$0.2 million, using an estimated effective tax rate for its 2013 fiscal year adjusted for certain minimum state taxes. Comparatively, for the three months ended March 31, 2012, the Company recorded a provision for income taxes of \$0.8 million on income before taxes of \$2.5 million, using an estimated effective tax rate for its 2012 fiscal year.

The effective tax rate for the three months ended March 31, 2013 differs from the effective rate for the comparative period ended March 31, 2012 as a result of state taxes.

In assessing the realizability of deferred tax assets, the Company considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the years in which those temporary differences become deductible. The Company considers projected future taxable income, uncertainties related to the industry in which they operate, and tax planning strategies in making this assessment.

The Company follows the provisions of FASB ASC Topic 740, Income Taxes to account for income tax exposures. The application of this interpretation requires a two-step process that separates recognition of uncertain tax benefits from measurement thereof.

The Company had approximately \$0.4 million of total gross unrecognized tax benefit as of March 31, 2013 and \$0.4 million of total gross unrecognized tax benefit as of December 31, 2012, which if recognized would favorably affect its income tax rate in future periods. The unrecognized tax benefit relates primarily to prior year Pennsylvania state franchise taxes, unrecognized tax benefits for potential 2012 research and development tax credits as well as prior year German income tax. The Company recognizes accrued interest and penalties related to income taxes in income tax expense. The Company did not have significant interest and penalties accrued at March 31, 2013 and December 31, 2012, respectively. The Company believes that it is reasonably possible that all of the unrecognized tax benefits will decrease in the next twelve months as it is anticipated that the tax authorities will finalize their review of prior taxes owing in Pennsylvania and Germany and the 2012 Canadian research and development claim will be filed and assessed.

## 8. BASIC AND DILUTED EARNINGS PER COMMON SHARE:

Basic earnings per common share has been calculated by dividing net income for the period by the weighted average number of common shares outstanding during each period. Diluted earnings per share has been calculated by dividing net income for the period by the weighted average number of common shares and potentially dilutive common shares outstanding during the period. In computing diluted earnings per share, the treasury stock method is used to determine the number of shares assumed to be purchased from the conversion of common shares equivalents or the proceeds of option exercises.

The following table is a summary of the basic and diluted earnings per common share:

	Three months ended March 31, 2013	Three months ended March 31, 2012
Numerator for basic and diluted earnings per common share:		
Net income (loss) for the period	\$ 76,579	\$ 1,663,619
Denominator for basic and diluted earnings per common share:		
Basic weighted average number of common shares outstanding	40,331,438	46,221,465
Effect of outstanding stock options	3,979,885	2,732,986
Diluted weighted average number of shares outstanding	44,311,323	48,954,451
Basic earnings (loss) per common share	\$ 0.00	\$ 0.04
Diluted earnings (loss) per common share	\$ 0.00	\$ 0.03

For the three months ended March 31, 2013, outstanding options to purchase 633,000 common shares were not included in the computation of diluted income per common share because all such options had exercise prices greater than the average market price of the common shares.

During the three months ended March 31, 2013, 4,114,121 common shares were repurchased and cancelled under the terms of a modified Dutch auction tender offer announced in December 2012.

During the three months ended March 31, 2013, 143,073 common shares were repurchased and cancelled under the terms of our stock repurchase program announced in March 2013.

During the three months ended March 31, 2012, 7,570,236 common shares were repurchased and cancelled under the terms of a modified Dutch auction tender offer announced in December 2011.

The computation of earnings per share and diluted earnings per share for the three months ended March 31, 2013 and 2012 include reductions in the number of shares outstanding due to these repurchases.

## 9. SUPPLEMENTAL INFORMATION:

(a) The following is a summary of the Company's revenue earned from each significant revenue stream:

	Three months ended March 31,	
	2013	2012
<b>Wholesale</b>		
Domain Services	\$ 21,895,900	\$ 21,107,976
Value Added Services	2,688,690	2,688,718
Total Wholesale	24,584,590	23,796,694
<b>Retail</b>		
Portfolio	4,266,707	1,849,595
	1,133,725	1,891,017
	\$ 29,985,022	\$ 27,537,306

During the three months ended March 31, 2013 and 2012, no customer accounted for more than 10% of total revenue. As at March 31, 2013, one customer accounted for 13% of accounts receivable, while as at March 31, 2012, no customer accounted for more than 10% of accounts receivable.

(b) The following is a summary of the Company's cost of revenues from each significant revenue stream:

	Three months ended March 31,	
	2013	2012
<b>Wholesale</b>		
Domain Services	\$ 18,454,302	\$ 17,620,059
Value Added Services	562,038	507,151
Total Wholesale	19,016,340	18,127,210
<b>Retail</b>		
Portfolio	2,860,581	929,760
	200,978	210,155
Network, other costs	1,254,213	1,256,890
Network, depreciation and amortization costs	172,982	183,328
	\$ 23,505,094	\$ 20,707,343

(c) The following is a summary of the Company's property and equipment by geographic region:

	March 31, 2013	December 31, 2012
Canada	\$ 1,272,862	\$ 1,026,570
United States	385,603	306,679
Germany	17,081	18,895
	\$ 1,675,546	\$ 1,352,144

(d) The following is a summary of the Company's amortizable intangible assets by geographic region:

	March 31, 2013	December 31, 2012
Canada	\$ 834,400	\$ 1,062,100
Germany	1,202,920	1,230,160

\$	2,037,320	\$	2,292,260
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(e) The following is a summary of the Company's deferred tax asset, net of valuation allowance, by geographic region:

	March 31, 2013	December 31, 2012
Canada	\$ 5,970,237	\$ 5,970,462
	\$ 5,970,237	\$ 5,970,462

#### 10. COMMITMENTS AND CONTINGENCIES:

The Company is involved in various legal claims and lawsuits in connection with its ordinary business operations. The Company intends to vigorously defend these claims. While the final outcome with respect to any actions or claims outstanding or pending as of March 31, 2013 cannot be predicted with certainty, management does not believe that the resolution of these claims, individually or in the aggregate, will have a material adverse effect on the Company's financial position.

#### 11. STOCKHOLDERS' EQUITY:

The following unaudited table summarizes stockholders' equity transactions for the three month period ended March 31, 2013:

	Common stock Number	Common stock Amount	Additional paid in capital	Deficit	Accumulated Other Comprehensive Income	Total stockholders' equity
Balances, December 31, 2012	44,322,159	\$ 10,084,417	\$ 33,931,529	\$ (17,509,843)	\$ 44,104	\$ 26,550,207
Exercise of stock options	56,857	65,009	(26,500)	—	—	38,509
Repurchase and retirement of shares	(4,114,121)	(822,887)	(5,454,854)	—	—	(6,277,741)
Normal Course Issuer Bid	(143,073)	(28,615)	(231,260)	—	—	(259,875)
Cancellation of restricted stock	(25)	—	—	—	—	—
Stock-based compensation	—	—	74,842	—	—	74,842
Net income for the period	—	—	—	76,579	—	76,579
Other comprehensive income	—	—	—	—	(185,785)	(185,785)
Balances, March 31, 2013	40,121,797	\$ 9,297,924	\$ 28,293,757	\$ (17,433,264)	\$ (141,681)	\$ 20,016,736

On January 7, 2013, the Company announced that it successfully concluded a modified “Dutch auction tender offer” that was previously announced on November 21, 2012. Under the terms of the offer, the Company repurchased an aggregate of 4,114,121 shares of its common stock at a purchase price of \$1.50 per share, for a total of \$6,171,656, excluding transaction costs of approximately \$106,000. The purchase price and all transaction costs were funded from available cash and an additional advance under its Amended Credit Facility from the Bank in the amount of \$5.2 million. All shares purchased in the tender offer received the same price and all shares repurchased were immediately retired. As a result of the completion of the tender offer, as of January 31, 2013, the Company had 40,226,875 shares issued and outstanding.

On March 1, 2013, the Company announced a stock buyback program. Under this buyback program, the Company may repurchase up to \$10 million of the Company's common stock over the 12-month period that commenced on March 1, 2013. The Company repurchased 143,073 shares under this program during the three month period ended March 31, 2013 for a total of \$259,875.



## 12. SHARE-BASED PAYMENTS

## (a) Stock options

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model, consistent with the guidance on stock compensation. Because option-pricing models require the use of subjective assumptions, changes in these assumptions can materially affect the fair value of the options. The assumptions presented in the table below represent the weighted average of the applicable assumption used to value stock options at their grant date. The Company calculates expected volatility based on historical volatility of the Company's common shares. The expected term, which represents the period of time that options granted are expected to be outstanding, is estimated based on historical exercise experience. The Company evaluated historical exercise behavior when determining the expected term assumptions. The risk-free rate assumed in valuing the options is based on the U.S. Treasury yield curve in effect at the time of grant for the expected term of the option. The Company determines the expected dividend yield percentage by dividing the expected annual dividend by the market price of our common shares at the date of grant.

During the three months ended March 31, 2013, stock options to purchase 150,000 common shares were granted. During the three months ended March 31, 2012, stock options to purchase 45,000 common shares were granted.

The stock options granted during the three months ended March 31, 2013 expire in 2019.

Details of stock option transactions for the three months ended March 31, 2013 and March 31, 2012 are as follows:

	Three months ended March 31, 2013		Three months ended March 31, 2012	
	Number of Shares	Weighted Average exercise price per share	Number of Shares	Weighted Average exercise price per share
Outstanding, beginning of period	8,592,686	\$ 0.64	8,746,041	\$ 0.57
Granted	150,000	1.44	45,000	1.05
Exercised	(56,857)	0.68	(294,217)	0.44
Forfeited	(13,813)	1.06	(38,125)	0.84
Expired	—	—	—	—
Outstanding, end of period	8,672,016	\$ 0.65	8,458,699	\$ 0.57
Options exercisable, end of period	7,044,598	\$ 0.57	6,746,199	\$ 0.54

As of March 31, 2013, the exercise prices, weighted average remaining contractual life and intrinsic values of outstanding options were as follows:

Exercise price	Outstanding Number	Options outstanding		Aggregate intrinsic value	Options exercisable		
		Weighted average exercise price per share	Weighted Average remaining contractual life (years)		Weighted average exercise price per share	Aggregate intrinsic value	
\$0.31 - \$0.48	3,113,904	\$ 0.38	0.4	\$ 4,187,302	3,113,904	\$ 0.38	\$ 4,187,302
\$0.56 - \$0.94	4,650,112	\$ 0.69	2.7	4,773,988	3,689,444	\$ 0.69	3,803,637

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\$1.05	-	\$1.44	908,000	\$ 1.37	5.8	317,170	241,250	\$ 1.35	88,337
			8,672,016	\$ 0.65	2.2	\$ 9,278,460	7,044,598	\$ 0.57	\$ 8,079,276

Total unrecognized compensation cost relating to unvested stock options at March 31, 2013, prior to the consideration of expected forfeitures, was approximately \$662,000 and is expected to be recognized over a weighted average period of 2.2 years.

The Company recorded stock-based compensation of \$74,677 and \$62,284 for the three months ended March 31, 2013 and 2012, respectively.

The Company has not capitalized any stock-based compensation expense as part of the cost of an asset.

## (b) Restricted stock awards

During the three months ended March 31, 2013, no restricted stock awards were granted to any employees of the Company.

Restricted stock awards generally vest annually over a four year period. Holders of restricted stock may not sell, assign, transfer, pledge or otherwise dispose of an unvested stock. Unvested shares of restricted stock are held in escrow by the Company until the holder's interest in such shares vests.

Holders of restricted stock have full stockholder rights with respect to any shares of Company stock issued to the participant under a stock award, whether or not the holder's interest in those shares is vested. Accordingly, the holder has the right to vote such shares and to receive any regular cash dividends paid on such shares.

All compensation costs relating to restricted stock awards have been recognized at March 31, 2013, prior to the consideration of expected forfeitures.

The Company recorded stock-based compensation associated with restricted stock awards of \$165 and \$181 for the three months ended March 31, 2013 and 2012, respectively.

## 13. FAIR VALUE MEASUREMENT

ASC Topic 820, "Fair Value Measurements and Disclosures" establishes a valuation hierarchy for disclosure of the inputs to valuation used to measure fair value. This hierarchy prioritizes the inputs into three broad levels. Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities. Level 2 inputs are quoted prices for similar assets and liabilities in active markets or inputs that are observable for the asset or liability, either directly or indirectly through market corroboration, for substantially the full term of the financial instrument. Level 3 inputs are unobservable inputs based on the Company's own assumptions used to measure assets and liabilities at fair value. A financial asset or liability's classification within the hierarchy is determined based on the lowest level input that is significant to the fair value measurement.

The following table provides a summary of the fair values of the Company's derivative instrument assets and liabilities measured at fair value on a recurring basis at March 31, 2013:

	March 31, 2013			Assets at Fair Value
	Fair Value Level 1	Measurements Level 2	Using Level 3	
Derivative instrument asset	\$	—\$ 83,622	\$	—\$ 83,622
Total Assets	\$	—\$ 83,622	\$	—\$ 83,622
Derivative instrument liability	\$	—\$ 275,766	\$	—\$ 275,766
Total Liabilities	\$	—\$ 275,766	\$	—\$ 275,766

The following table provides a summary of the fair values of the Company's derivative instrument assets measured at fair value on a recurring basis as at December 31, 2012:

	December 31, 2012			Assets at Fair Value
	Fair Value Level 1	Measurements Level 2	Using Level 3	

Derivative instrument asset	\$	—\$ 444,782	\$	—\$ 444,782
Total Assets	\$	—\$ 444,782	\$	—\$ 444,782

The carrying values of cash and cash equivalents, restricted cash, accounts receivable, accounts payable, accreditation fees payable, customer deposits, loan payable and accrued liabilities approximate their fair values due to the relatively short periods to maturity of the instruments. The fair value of these financial assets and liabilities is determined using Level 2 inputs.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains, in addition to historical information, forward-looking statements by us with regard to our expectations as to financial results and other aspects of our business that involve risks and uncertainties and may constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Words such as “may,” “should,” “anticipate,” “believe,” “plan,” “estimate,” “expect,” “intend” and other expressions are intended to identify forward-looking statements. The forward-looking statements contained in this report include statements regarding, among other things, the Company's foreign currency requirements, specifically for the Canadian dollar; the number of new, renewed and transferred-in domain names we register as our business develops and competes; the effect of a potential global top level domain (“gTLD”) expansion by the Internet Corporation for Assigned Names and Numbers (“ICANN”) on the number of domains we register and the impact it may have on related revenues; our belief that the market for domain name registration will trend upward gradually and may be affected by market volatility; our belief that, by increasing the number of services we offer, we will be able to generate higher revenues; the revenue that our parked page vendor relationships may generate in the future; the effectiveness of our intellectual property protection, including our ability to license proprietary rights to network partners and to register additional trademarks and service marks; the potential impact of current and pending claims on our business; our valuations of certain deferred tax assets; our expectation to collect our outstanding receivables, net of our allowance for doubtful accounts; our expectation regarding fluctuations in certain expense and cost categories; our expectations regarding future revenue from our patent assignments; our expectations regarding our unrecognized tax benefit and the timing or completion of certain audits of our US tax returns; our expectations regarding cash from operations to fund our business; our expectation regarding increased competition due to the introduction of new gTLDs by ICANN; the impact of cancellations of or amendments to market development fund programs under which we receive funds; and our belief that a slowing economy may lead to a decrease in advertising spending. These statements are based on management's current expectations and are subject to a number of uncertainties and risks that could cause actual results to differ materially from those described in the forward-looking statements. Many factors affect our ability to achieve our objectives and to successfully develop and commercialize our services including:

Our ability to continue to generate sufficient working capital to meet our operating requirements;

Our ability to maintain a good working relationship with our vendors and customers;

The ability of vendors to continue to supply our needs;

Actions by our competitors;

Our ability to achieve gross profit margins at which we can be profitable;

Our ability to attract and retain qualified personnel in our business;

Our ability to effectively manage our business;

Our ability to obtain and maintain approvals from regulatory authorities on regulatory issues;

Pending or new litigation; and

Factors set forth under the caption “Item 1A Risk Factors” in our Annual Report on Form 10-K for the fiscal year ended December 31, 2012.

This list of factors that may affect our future performance and financial and competitive position and also the accuracy of forward-looking statements is illustrative, but it is by no means exhaustive. Accordingly, all forward-looking statements should be evaluated with the understanding of their inherent uncertainty. All forward-looking statements included in this document are based on information available to us as of the date of this document, and we assume no obligation to update these cautionary statements or any forward-looking statements except to the extent of any obligations under the Securities Exchange Act of 1934 or the Securities Act of 1933. These statements are not guarantees of future performance.

We qualify all the forward-looking statements contained in this Quarterly Report on Form 10-Q by the foregoing cautionary statements.

## OVERVIEW

Our mission is to provide simple useful services that help people unlock the power of the Internet. We accomplish this by reducing the complexity our customers' experience as they acquire, deliver or use Internet services such as domain name registration, email and other Internet services.

Our primary distribution channel is a global network of more than 13,000 resellers in more than 100 countries who typically provide their customers, the end-users of the Internet, with a critical component for establishing and maintaining an online presence. Our primary focus is serving the needs of this network of resellers by providing superior services, easy-to-use interfaces, proactive and attentive customer service, reseller-oriented technology and agile design and development processes. We seek to provide superior customer service to our resellers by anticipating their business needs and technical requirements. This includes providing easy-to-use interfaces that enable resellers to quickly and easily integrate our services into their individual business processes, and offering brandable end-user interfaces that emphasize simplicity and visual appeal. We also provide "second tier" support to our resellers by email and phone in the event resellers experience issues or problems with our services. In addition, our Network Operating Center provides proactive support to our resellers by monitoring all services and network infrastructure to address deficiencies before customer services are impacted.

We believe that the underlying platforms for our services are one of the most mature, reliable and functional reseller-oriented provisioning and management platforms in our industry, and we continue to refine, evolve and improve these services for both resellers and end-users.

Our principal place of business is located in Canada. We report our financial results as one operating segment. Our chief operating decision maker regularly reviews our operating results on a consolidated basis, principally to make decisions about how we utilize our resources and to measure our consolidated operating performance. To assist us in forecasting growth and to help us monitor the effectiveness of our operational strategies, our chief operating decision maker regularly reviews revenue for each of our service offerings in order to gain more depth and understanding of the key business metrics driving our business. Accordingly, we report revenue in the following service areas:

Wholesale, primarily branded as OpenSRS, derives revenue from its Domain Service and from providing Value-Added Services. The OpenSRS Domain Service manages over 14 million domain names under the Tucows ICANN registrar accreditation and for other registrars under their own accreditations. Value-Added Services include hosted email which provides email delivery and webmail access to millions of mailboxes, Internet security services, publishing tools and reseller billing services. All of these services are made available to end-users through a network of over 13,000 web hosts, Internet service providers ("ISPs"), and other resellers around the world. In addition, we also derive revenue from the bulk sale of domain names and advertising from the OpenSRS Domain Expiry Stream and the Marketing Development Funds we receive from vendors from time-to-time to expand or maintain the market position for their services.

Retail, primarily our Hover and Ting websites, derives revenues from the sale of domain name registration, email services and mobile phone service to individuals and small businesses. Retail also includes our Personal Names Service – based on over 40,000 surname domains – that allows roughly two-thirds of Americans to purchase an email address based on their last name.

Portfolio generates advertising revenue from our domain name portfolio and from our two large advertising-supported websites, butterscotch.com and tu cows.com. We also generate revenue by offering names in our domain portfolio for resale via our reseller network and other channels.

Our business model is characterized primarily by non-refundable, up-front payments, which lead to recurring revenue and positive operating cash flow.

For the three months ended March 31, 2013 and 2012, we reported revenue of \$30.0 million and \$27.5 million, respectively. For the three months ended March 31, 2013 and 2012, our OpenSRS domain service offering accounted for 73% and 76% of our total revenue, respectively.



## KEY BUSINESS METRICS

We regularly review a number of business metrics, including the following key metrics to, assist us in evaluating our business, measure the performance of our business model, identify trends impacting our business, determine resource allocations, formulate financial projections and make strategic business decisions. The following table sets forth, the key business metrics which we believe are the primary indicators of our performance for the periods presented:

Total new, renewed and transferred-in domain name registrations:

	Three months ended	
	2013(1)	2012(1)
	March 31, (in 000's)	
Total new, renewed and transferred-in domain name registrations	2,458	2,576

- (1) For a discussion of these period to period changes in the domains provisioned and how they impacted our financial results see the Net Revenue discussion below.

Domain names under management:

	March 31,	
	2013(1)	2012(1)
	(in "000's)	
Domain names under management:		
Registered using the Tucows Registrar Accreditation	10,718	10,712
Registered using our Resellers' Registrar Accreditations	3,355	1,299
Total domain names under management	14,073	12,011

- (1) For a discussion of these period to period changes in domains under management and how they impacted our financial results see the Net Revenue discussion below.

## OPPORTUNITIES, CHALLENGES AND RISKS

The increased competition in the market for Internet services in recent years, which the Company expects will continue to intensify in the short and long term, poses a material risk for the Company. As new registrars are introduced, existing competitors expand service offerings and competitors offer price discounts to gain market share, the Company faces pricing pressure, which can adversely impact its revenues and profitability. To address these risks, the Company has focused on leveraging the scalability of its infrastructure and its ability to provide proactive and attentive customer service to aggressively compete to attract new customers and to maintain existing customers.

Our direct costs to register domain names on behalf of our customers are almost exclusively controlled by registries such as Verisign and by ICANN. Verisign provides all the registry services operations for the .com, .net, .cc, .tv and .name domain names. ICANN is a private sector, not-for-profit corporation formed to oversee a number of Internet related tasks, including domain registrations for which it collects fees. The market for wholesale registrar services is both price sensitive and competitive, particularly for large volume customers, such as large web hosting companies and owners of large portfolios of domain names. We have a relatively limited ability to increase the pricing of domain name registrations without negatively impacting our ability to maintain or grow our customer base.

We are participating in ICANN's New gTLD program to own and/or operate up to four of our own gTLD registries. The New gTLD program is expected to result in the delegation of New gTLDs commencing in 2013. The New gTLD Program's goals include enhancing competition and consumer choice, and enabling the benefits of innovation via the introduction of a wide range of new gTLDs. We believe that such expansion, once completed, will result in an increase in the number of domains we register and related revenues commencing in 2013. In addition, while the delegation of New gTLDs could substantially change the domain name industry in unexpected ways, we believe that the New gTLD Program will provide us with new revenue opportunities commencing in 2013.

Under the terms of the New gTLD program, in April 2012 we paid the required \$1.1 million application fee in support of our application for six domain strings under ICANN's new gTLD Program. A declining percentage of these evaluation fees are refundable if any application is withdrawn prior to our executing a registry agreement with ICANN. In May 2012 we withdrew two of our applications and under the terms of the New gTLD application process have received a full refund of \$0.4 million against these applications. While there can be no assurance that we will be awarded any gTLDs, we have determined that the applications embody probable economic benefit and they have been capitalized and are included in prepaid expenses and deposits at March 31, 2013. As part of the New gTLD Program, we may elect to receive partial cash refunds for certain gTLD applications, and to the extent we elect to sell or dispose of certain gTLD applications throughout the process, we may also incur gains or losses on amounts invested. Gains on the sale of our interest in gTLDs will be recognized when realized, while losses will be recognized when deemed probable. Upon the delegation of operator rights for each gTLD by ICANN, which we expect to commence in 2013, gTLD application fees will be reclassified as finite lived intangible assets and amortized on a straight-line basis over their estimated useful life.

From time-to-time certain of our vendors provide us with Market Development Funds to expand or maintain the market position for their services. Any decision by these vendors to cancel or amend these programs for any reason, may result in payments in future periods not being commensurate with what we have achieved during past periods.

Sales of domain names from our domain portfolio have a negative impact on our advertising revenue as these names are no longer available for advertising purposes. In addition, the timing of larger domain names portfolio sales is unpredictable and may lead to significant quarterly and annual fluctuations in our Portfolio revenue.

Our revenue is primarily realized in U.S. dollars and a major portion of our operating expenses are paid in Canadian dollars. Fluctuations in the exchange rate between the U.S. dollar and the Canadian dollar may have a material effect on our business, financial condition and results from operations. In particular, we may be adversely affected by a significant weakening of the U.S. dollar against the Canadian dollar on a quarterly and an annual basis. Our policy with respect to foreign currency exposure is to manage our financial exposure to certain foreign exchange fluctuations with the objective of neutralizing some or all of the impact of foreign currency exchange movements by entering into foreign exchange forward contracts to mitigate the exchange risk on a portion of our Canadian dollar exposure. We may not always enter into such forward contracts and such contracts may not always be available and economical for us. Additionally, the forward rates established by the contracts may be less advantageous than the market rate upon settlement.

## Net Revenues

### Wholesale - OpenSRS Domain Service

Historically, our OpenSRS Domain Service has constituted the largest portion of our business and encompasses all of our services as an accredited registrar related to the registration, renewal, transfer and management of domain names. In addition, this service fuels other revenue categories as it often is the initial service for which a reseller will engage us, enabling us to follow on with other services and allowing us to add to our portfolio by purchasing names registered through us upon their expiration.

With the acquisition of EPAG Domainservices GmbH (“EPAG”) in August 2011, we now offer registration services for over 200 TLDs.

With respect to the sale of domain registrations, our pricing structure for domain names provides visibility into the various fees that make up the cost of a domain name by breaking out the cost of the registry and ICANN fees

separately from our management fee. Effective January 2012, registry fees for the .com and .net registrations were increased by the registry to \$7.85 and \$5.11, respectively. In November 2012, Verisign renewed its agreement with ICANN to serve as the authoritative registry operator for the .com registry until November 2018. Under the terms of the renewal, Verisign agreed to continue the current pricing of \$7.85 per domain name registration throughout the term of the agreement and in December 2012, announced their intention, effective July 1, 2013, to increase the registry fee for .net to \$5.62. The management fee provides our resellers with access to our provisioning and management tools to enable them to register and administer domain names and access to additional services like WHOIS privacy and DNS services, enhanced domain name suggestion tools and access to our premium domain names. We earn fees in connection with each new, renewed and transferred-in registration and from providing provisioning services to resellers and registrars on a monthly basis. Domain registrations are generally purchased for terms of one to ten years, with a majority having a one-year term.

#### Wholesale – OpenSRS Value-Added Services

We derive revenue from our hosted email service through our global distribution network. Our hosted email service is offered on a per account, per month basis, and provides resellers with a reliable, scalable “white label” hosted email solution that can be customized to their branding and business model requirements. The hosted email service also includes spam and virus filtering on all accounts. End-users can access the hosted email service via a full-featured, multi-language AJAX-enabled web interface or through traditional desktop email clients, such as Microsoft Outlook or Apple Mail, using IMAP or POP/SMTP.

We also derive revenue from other Value-Added Services primarily from provisioning SSL and other trust certificates. In addition, we derive revenue from the bulk sale of domain names and advertising from the OpenSRS Domain Expiry Stream.

Other services included in Value-Added Services include web publishing tools, special discounts on 3rd party services and fees we receive from time-to-time from vendors to expand or maintain the market position for their services. In addition, we provide billing, provisioning and customer care software solutions to ISPs through our Platypus billing software.

#### Retail – Hover

We derive revenues from Hover's sale of retail Internet domain name registration and email services to individuals and small businesses.

#### Retail - Ting

We derive revenue from Ting's sale of retail mobile phones and services to individuals and small businesses.

#### Portfolio

We derive revenue from our portfolio of domain names by displaying advertising on the domains and by making them available for sale or lease. When a user types one of these domain names into a web browser, they are presented with dynamically generated links that are pay-per-click advertising. Every time a user clicks on one of these links, it generates revenue for us through our partnership with third-parties who provide syndicated pay-per-click advertising (“parked page vendors”).

Our parked page vendor relationships may not continue to generate levels of revenue commensurate with what we have achieved during past periods. Our ability to generate online advertising revenue from parked page vendors depends on their advertising networks' assessment of the quality and performance characteristics of Internet traffic resulting from online advertisements rendered on their websites. We have no control over any of these quality assessments. Parked page vendors may from time to time change their existing, or establish new, methodologies and metrics for valuing the quality of Internet traffic and delivering pay-per-click advertisements. Any changes in these methodologies, metrics and advertising technology platforms could decrease the amount of revenue that we generate from online advertisements. In addition, parked page vendors may at any time change or suspend the nature of the service that they provide to online advertisers. These types of changes or suspensions would adversely impact our ability to generate revenue from pay-per-click advertising.

Portfolio names are sold through our premium domain name service, auctions or in negotiated sales. The size of our domain name portfolio varies over time, as we acquire and sell domains on a regular basis to maximize the overall value and revenue generation potential of our portfolio. In evaluating names for sale, we consider the potential

foregone revenue from pay-per-click advertising, as well as other factors. The name will be offered for sale if, based on our evaluation, the name is deemed non-essential to our business and management believes that deriving proceeds from the sale is strategically more beneficial to the Company.

Portfolio names that have been acquired from third-parties or through acquisition are included as intangible assets with indefinite lives on our consolidated balance sheet.

We also generate advertising and other revenue through two ad-supported content sites, butterscotch.com and tucows.com. These sites primarily derive revenue from banner and text advertising. In addition, their revenue is derived from software developers who rely on us as a primary source of distribution. Software developers use our Author Resource Center to submit their products for inclusion on our site and to purchase promotional placements of their software.

## Critical Accounting Policies

The following is a discussion of our critical accounting policies and methods. Critical accounting policies are defined as those that are both important to the portrayal of our financial condition and results of operations and are reflective of significant judgments and uncertainties made by management that may result in materially different results under different assumptions and conditions. Note 2 to the consolidated financial statements for the year ended December 31, 2012, includes further information on the significant accounting policies and methods used in the preparation of our consolidated financial statements.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate the application of these estimates, including those related to the recoverability of investments, useful lives and valuation of intangible assets, valuation of goodwill, fair value measurement of assets and liabilities, product development costs, revenue recognition and deferred revenue and accounting for income taxes. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual amounts could differ significantly from these estimates.

### Revenue recognition policy

We earn revenues from the following services:

- Wholesale (Domain Service and other Value-Added Services);
- Retail (Hover and Ting)
- Portfolio (Domain Portfolio monetization and sales).

With respect to the sale of domain registrations and other Internet services, we earn registration fees in connection with each new, renewed and transferred-in registration and from providing provisioning services to resellers and registrars on a monthly basis. We also enter into revenue arrangements in which a reseller may purchase a combination of services (multiple element arrangements). When a standalone selling price exists for each deliverable, we allocate revenue to each deliverable based on the relative selling price of each of the deliverables. The standalone selling price is established for each deliverable by the price charged when that deliverable is sold separately by the Company which is vendor specific objective evidence (“VSOE”). For arrangements where the Company does not sell the deliverable separately, the selling price is determined based on third party evidence (“TPE”), which is the price at which a competitor or third party sells the same or similar and largely interchangeable deliverable on a standalone basis. In instances where VSOE and TPE do not exist, the Company uses an estimated selling price for the deliverable, which is the price at which a company would transact if the deliverable were sold by the vendor regularly on a standalone basis. Payments for the full term of all services are received at the time of activation of service and where appropriate are recorded as deferred revenue and are recognized as earned ratably over the term of provision of service. This accounting treatment reasonably approximates a recognition pattern that corresponds with the provision of the services during the quarters and the year.

Revenue from the sale of domain names consists primarily of amounts earned for the transfer of rights to domain names that are currently under the Company's control. Collectability of revenues generated is subject to a high level of uncertainty; accordingly revenues are recognized only when payment is received, except where a fixed contract has been negotiated, in which case revenues are recognized once all the terms of the contract have been satisfied.

We also generate advertising and other revenue through [tucows.com](http://tucows.com) and [butterscotch.com](http://butterscotch.com) as well as advertising revenue from our OpenSRS expired domain names and our domain name portfolio. Advertising and other revenue is recognized ratably over the period in which it is presented. To the extent that the minimum number of post-presentation impressions we guarantee to customers is not met, we defer recognition of the corresponding revenues until the guaranteed impressions are achieved. Revenue is also generated from vendors who are seeking to expand or maintain their services market position and is recognized once all the conditions have been met.

Changes to contractual relationships in the future could impact the amounts and timing of revenue recognition.

In those cases where payment is not received at the time of sale, additional conditions for recognition of revenue apply. The conditions are (i) that the collection of sales proceeds is reasonably assured and (ii) that we have no further performance obligations. We record expected refunds, rebates and credit card charge-backs as a reduction of revenues at the time of the sale based on historical experiences and current expectations. Should these expectations not be met, adjustments will be required in future periods.



We record provisions for possible uncollectible accounts receivable and contingent liabilities which may arise in the normal course of business. The allowance for doubtful accounts is calculated by taking into account factors such as our historical collection and write-off experience, the number of days the customer is past due and the status of the customer's account with respect to whether or not the customer is continuing to receive service. The contingent liability estimates are based on management's historical experience and various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the reported amounts of liabilities and expenses that are not readily apparent from other sources. Historically, credit losses have been within our expectations and the reserves we have established have been appropriate. However, we have, on occasion, experienced issues which have led to accounts receivable not being fully collected. Should these issues occur more frequently, additional provisions may be required.

#### Valuation of intangible assets, goodwill and long-lived assets

The excess of the fair value of purchase price over the fair values of the identifiable assets and liabilities from our acquisitions is recorded as goodwill. At March 31, 2013, we had \$18.9 million in goodwill related to our acquisitions and \$16.1 million in intangible assets. The goodwill recorded in relation to these acquisitions is not deductible for tax purposes. We report our financial results as one operating segment with three distinct service offerings, being Wholesale, Retail and Portfolio.

Finite life intangible assets, related to the acquisition of EPAG in August 2011, are being amortized on a straight-line basis over periods of two to seven years, and consist of technology, brand and customer relationships. Finite life intangible assets, related to the acquisition of Innerwise, Inc. in July 2007, are being amortized on a straight-line basis over periods of five to seven years, and consist of brand and customer relationships. Indefinite life intangible assets, acquired in the acquisition of Mailbank.com Inc. in June 2006, consist of surname domain names and direct navigation domain names.

We account for goodwill in accordance with FASB's authoritative guidance, which requires that goodwill and certain intangible assets are not amortized, but are subject to an annual impairment test. We complete our goodwill and certain intangible assets impairment test on an annual basis, during the fourth quarter of our fiscal year, or more frequently, if changes in facts and circumstances indicate that impairment in the value of goodwill and certain intangible assets recorded on our balance sheet may exist.

With regards to property and equipment and definite life intangible assets, we continually evaluate whether events or circumstances have occurred that indicate the remaining estimated useful lives of our definite-life intangible assets may warrant revision or that the remaining balance of such assets may not be recoverable. We use an estimate of the related undiscounted cash flows over the remaining life of the asset in measuring whether the asset is recoverable. There was no impairment recorded on definite-life intangible assets and property and equipment during the three months ended March 31, 2013 and 2012.

Our 2012 annual goodwill impairment analysis, which we performed for our reporting unit as of December 31, 2012, did not result in an impairment charge.

We determined the estimated fair value for our reporting unit using the market approach that is based on the publicly traded common shares of the Company to estimate fair value. The fair value was greater than the carrying value, therefore no impairment exists and the second step was not performed. The analysis was consistent with the approach we utilized in our analysis performed in prior years.

Any changes to our key assumptions about our businesses and our prospects, or changes in market conditions, could cause the fair value of our reporting unit to fall below its carrying value, resulting in a potential impairment charge. In

addition, changes in our organizational structure or how our management allocates resources and assesses performance, could result in a change in our operating segments or reporting units, requiring a reallocation and updated impairment analysis of goodwill. A goodwill or intangible asset impairment charge could have a material effect on our consolidated financial statements because of the significance of goodwill and intangible assets to our consolidated balance sheet. There was no impairment of goodwill or intangible assets as a result of the annual impairment tests completed during the fourth quarters of 2012 and 2011.

## Accounting for income taxes

We are subject to income taxes in the U.S. and numerous foreign jurisdictions. Significant judgment is required in evaluating our uncertain tax positions and determining our provision for income taxes. We apply a two-step approach to recognizing and measuring uncertain tax positions. The first step is to evaluate the tax position for recognition by determining if on the weight of available evidence it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit that is more than 50% likely to be realized upon settlement.

Although we believe we have adequately reserved for our uncertain tax positions, no assurance can be given that the final tax outcome of these matters will not be different. We adjust these reserves in light of changing facts and circumstances, such as the closing of a tax audit or the refinement of an estimate based on new information that may become available. To the extent that the final tax outcome of these matters is different than the amounts recorded, such differences will impact the provision for income taxes in the period in which such determination is made.

As we account for income taxes under the asset and liability method, we recognize deferred tax assets or liabilities for the anticipated future tax effects of temporary differences between the financial statement basis and the tax basis of our assets and liabilities. We record a valuation allowance to reduce the net deferred tax assets when it is more likely than not that the benefit from the deferred tax assets will not be realized. In assessing the need for a valuation allowance, historical and future levels of income, expectations and risks associated with estimates of future taxable income and ongoing tax planning strategies are considered. In the event that it is determined that the deferred tax assets to be realized in the future would be in excess of the net recorded amount, an adjustment to the deferred tax asset valuation allowance would be recorded. This adjustment would increase income in the period that such determination was made. Likewise, should it be determined that all or part of a recorded net deferred tax asset would not be realized in the future, an adjustment to increase the deferred tax asset valuation allowance would be charged to income in the period that such determination would be made.

On a periodic basis, we evaluate the probability that our deferred tax asset balance will be recovered to assess its realizability. To the extent we believe it is more likely than not that some portion of our deferred tax assets will not be realized, we will increase the valuation allowance against the deferred tax assets. Realization of our deferred tax assets is dependent primarily upon future taxable income. Our judgments regarding future profitability may change due to future market conditions, changes in U.S. or international tax laws and other factors. These changes, if any, may require possible material adjustments to these deferred tax assets, impacting net income or net loss in the period when such determinations are made.

## RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED MARCH 31, 2013 AS COMPARED TO THE THREE MONTHS ENDED MARCH 31, 2012

## NET REVENUES

The following table presents our net revenues, by revenue source:

	Three months ended March 31,	
	2013	2012
<b>Wholesale</b>		
Domain Services	\$21,895,900	\$21,107,976
Value Added Services	2,688,690	2,688,718
Total Wholesale	24,584,590	23,796,694
<b>Retail</b>		
Portfolio	4,266,707	1,849,595
	1,133,725	1,891,017
	\$29,985,022	\$27,537,306
Increase over prior period	\$2,447,716	
Increase - percentage	9	%

The following table presents our revenues, by revenue source, as a percentage of total revenues:

	Three months ended March 31,			
	2013		2012	
<b>Wholesale</b>				
Domain Services	73	%	76	%
Value Added Services	9	%	10	%
Total Wholesale	82	%	86	%
<b>Retail</b>				
Portfolio	14	%	7	%
	4	%	7	%
	100	%	100	%

Total net revenues for the three months ended March 31, 2013 increased by \$2.4 million or 9% to \$30.0 million when compared to the three months ended March 31, 2012. Deferred revenue decreased to \$72.4 million at March 31, 2013 from \$73.0 million at March 31, 2012. Deferred revenue has been impacted by certain of our customers who have acquired their own registrar accreditation no longer registering new domain names on our platform. Deferred revenue from domain name registrations and other services increased by \$1.4 million from \$71.0 million at December 31, 2012.

No customer accounted for more than 10% of revenue during the three months ended March 31, 2013 and March 31, 2012. At March 31, 2013, one customer accounted for 13% of accounts receivable, and as of March 31, 2012, no customer accounted for more than 10% of accounts receivable. Significant management judgment is required at the time revenue is recorded to assess whether the collection of the resulting receivables is reasonably assured. On an ongoing basis we assess the ability of our customers to make required payments. Based on this assessment, we expect the carrying amount of our outstanding receivables, net of allowance for doubtful accounts, to be fully collected.

## Wholesale

For the three months ended March 31, 2013, Wholesale revenue increased by \$0.8 million, or 3%, to \$24.6 million when compared to the three months ended March 31, 2012, the result of OpenSRS Domain Service revenue increasing by \$0.8 million or 4% to \$21.9 million. The increase in OpenSRS Domain Service revenue has been impacted by certain of our customers who have acquired their own registrar accreditation no longer registering new domain names on our platform. In addition, certain marketing initiatives undertaken by both vendors and resellers in fiscal 2012 have either been significantly scaled back or cancelled for fiscal 2013.

Value-Added Services remained relatively flat at \$2.7 million for the three months ended March 31, 2013 and 2012 respectively.

During the three months ended March 31, 2013, the number of transactions from all new, renewed and transferred-in domain name registrations that we processed decreased by 0.1 million transactions to 2.5 million when compared to the three months ended March 31, 2012.

In addition, the anticipated introduction of new gTLDs by ICANN (the "New gTLD Program") approved in June 2011 could substantially change the domain name industry in unexpected ways. We cannot assess the impact, if any, the introduction of these new TLDs will have on our revenues and results of operations. See "Item 1A Risk Factors" in our Annual Report on Form 10-K for the fiscal year ended December 31, 2012.

As of March 31, 2013, the total domain names under our management remained flat at 10.7 million, when compared to March 31, 2012. In addition, we provide provisioning services on a monthly basis to accredited registrars who use our technical systems to process domain registrations with their own accreditation. As of March 31, 2013, we managed 3.4 million domain names on behalf of other accredited registrars, an increase of 2.1 million compared to the 1.3 million we managed as of March 31, 2012. The increase is attributable to one of our accredited registrars transferring 1.8 million domain names they were directly managing under their own accreditation onto our platform.

#### Retail

Net revenues from Retail for the three months ended March 31, 2013 as compared to the three months ended March 31, 2012 increased by \$2.4 million to \$4.3 million. This increase reflects the impact of \$2.3 million in Ting's mobile device and service sales made during the quarter as well as the success that our retail marketing initiatives and improved websites are having on our ability to attract new customers and retain existing ones.

As of March 31, 2013, Ting had 16,000 subscribers and 26,000 mobile devices under its management. During the three months ended March 31, 2013, Ting added 6,000 subscribers and 11,000 devices.

#### Portfolio

For the three months ended March 31, 2013, Portfolio revenue decreased by \$0.8 million to \$1.1 million when compared to the three months ended March 31, 2012 primarily resulting from a decrease of \$0.5 million in portfolio domain name sales, which was primarily the result of lower sales of big ticket domains.

The market for monetization of domain names is rapidly evolving and is being impacted by uncertainty around the implementation of ICANN's new gTLD Program.

We have two primary buyers for our domain names - domain investors and businesses. While businesses domain sales continue to grow, we have begun to see evidence of domain investors interest slowing as they attempt to assess the impact the introduction of new gTLD's may have on their businesses. Accordingly, until the impact of new gTLD's can be appropriately assessed, we will be shifting our efforts towards appealing more to businesses while continuing to work with domain investors.

The decrease in revenue from our ad-supported sites was primarily the result of certain of our vendors electing not to repeat market development programs that they undertook during fiscal 2012 while parked pages advertising declined as a result of the impact our domain name sales have on our advertising revenue.

#### COST OF REVENUES

##### Wholesale

##### OpenSRS Domain Service

Cost of revenues for domain registrations represents the amortization of registry fees on a basis consistent with the recognition of revenues from our customers, namely ratably over the term of provision of the service. Registry fees,

the primary component of cost of revenues, are paid in full when the domain is registered, and are initially recorded as prepaid domain registry fees. This accounting treatment reasonably approximates a recognition pattern that corresponds with the provision of the services during the period. Market development funds that do not meet the criteria for revenue recognition under ASC 605-50 "Customer Payments and Incentives", are reflected as cost of goods sold and are recognized as earned.

#### Value-Added Services

Costs of revenues for Value-Added Services include licensing and royalty costs related to the provisioning of certain components of related to hosted email, fees paid to third-party service providers, primarily for trust certificates and for printing services in connection with Platypus. Fees payable for trust certificates are amortized on a basis consistent with the provision of service, generally one year, while email hosting fees and monthly printing fees are included in cost of revenues in the month they are incurred.

## Retail

Costs of revenues for our provision and management of Internet services through our retail site, Hover.com, include the amortization of registry fees on a basis consistent with the recognition of revenues from our customers, namely ratably over the term of provision of the service. Registry fees, the primary component of cost of revenues, are paid in full when the domain is registered, and are recorded as prepaid domain registry fees.

The costs of revenue for Ting's mobile phone service include hardware (the cost of devices sold to our customers) and network services (our customers' voice, messaging and data usage) provided by our Mobile Network Operator.

## Portfolio

Costs of revenues for our Portfolio represent the amortization of registry fees for domains added to our portfolio over the renewal period, which is generally one year, the value attributed under intangible assets to any domain name sold and any impairment charges that may arise from our assessment of our domain name intangible assets. As the total names in our portfolio continue to grow, this cost will become a more significant component of our cost of revenues. Payments for domain registrations are payable for the full term of service at the time of activation of service and are recorded as prepaid domain registry fees and are expensed ratably over the renewal term.

Costs of revenues for our larger ad-supported content sites (tucows.com and butterscotch.com) include the fees paid to third-party service providers, primarily for digital certificates sold through our content sites and content license fees.

## Network costs

Network costs include personnel and related expenses, depreciation and amortization, communication costs, equipment maintenance, stock-based compensation and employee and related costs directly associated with the management and maintenance of our network. Communication costs include bandwidth, co-location and provisioning costs we incur to support the supply of all our services.

The following table presents our cost of revenues, by revenue source:

	Three months ended March 31,	
	2013	2012
<b>Wholesale</b>		
Domain Services	\$18,454,302	\$17,620,059
Value Added Services	562,038	507,151
Total Wholesale	19,016,340	18,127,210
<b>Retail</b>	2,860,581	929,760
<b>Portfolio</b>	200,978	210,155
Network, other costs	1,254,213	1,256,890
Network, depreciation and amortization costs	172,982	183,328
	\$23,505,094	\$20,707,343
Increase over prior period	\$2,797,751	
Increase - percentage	14	%



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The following table presents our cost of revenues, as a percentage of total revenues:

	Three months ended March 31,			
	2013		2012	
<b>Wholesale</b>				
Domain Services	79	%	86	%
Value Added Services	2	%	2	%
<b>Total Wholesale</b>	<b>81</b>	<b>%</b>	<b>88</b>	<b>%</b>
<b>Retail</b>				
Portfolio	1	%	1	%
Network, other costs	5	%	6	%
Network, depreciation and amortization costs	1	%	1	%
	100	%	100	%

Total cost of revenues for the three months ended March 31, 2013 increased by \$2.8 million, or 14%, to \$23.5 million from \$20.7 million for the three months ended March 31, 2012.

Prepaid domain registration and other Internet services fees as of March 31, 2013 decreased by \$0.2 million to \$58.5 million from \$58.7 million at March 31, 2012.

#### Wholesale

Costs for Wholesale for the three months ended March 31, 2013 increased by \$0.9 million, or 5%, to \$19.0 million, when compared to the three months ended March 31, 2012.

This increase was primarily the result of increases in registration fees paid to the registries that were implemented on January 15, 2012.

#### Retail

Costs for Retail for the three months ended March 31, 2013 increased by \$1.9 million, to \$2.9 million, when compared to the three months ended March 31, 2012. This increase resulted primarily from an additional cost of \$2.1 million incurred in Ting mobile device and services sales made during the quarter, as well as the increased cost resulting from the additional volume in Hover services.

#### Portfolio

Costs for Portfolio remained relatively flat at \$0.2 million for the three months ended March 31, 2013 as compared to the three months ended March 31, 2012.

#### Network Costs

Network costs before depreciation and amortization remained relatively flat at \$1.3 million for the three months ended March 31, 2013 as compared to the three months ended March 31, 2012.

Network depreciation and amortization costs for the three months ended March 31, 2013 remained relatively flat at \$0.2 million.

These results reflect our improved efficiency we have achieved in operating and managing our co-location facilities, which has also enabled us to decrease our capital spend on network equipment.

### SALES AND MARKETING

Sales and marketing expenses consist primarily of personnel costs. These costs include commissions and related expenses of our sales, product management, public relations, call center, support and marketing personnel. Other sales and marketing expenses include customer acquisition costs, advertising and other promotional costs.

	Three months ended March 31,			
	2013		2012	
Sales and marketing	\$	2,847,086	\$	2,184,635
Increase over prior period	\$	662,451		
Increase - percentage		30	%	
Percentage of net revenues		9	%	8
				%

Sales and marketing expenses for the three months ended March 31, 2013 increased by \$0.7 million, or 30%, to \$2.8 million, when compared to the three months ended March 31, 2012. This increase primarily related to workforce costs

and marketing expenses incurred with our Ting mobile service offering in the amount of \$0.9 million. This increase was partially offset, by an amount of \$0.2 million, being predominantly variable people costs in traditional sales and marketing areas of our business.

## TECHNICAL OPERATIONS AND DEVELOPMENT

Technical operations and development expenses consist primarily of personnel costs and related expenses required to support the development of new or enhanced service offerings and the maintenance and upgrading of existing infrastructure. This includes expenses incurred in the research, design and development of technology that we use to register domain names, email, retail, domain portfolio and other Internet services, as well as to distribute our digital content services. Editorial costs relating to the rating and review of the software content libraries are included in the costs of product development. All technical operations and development costs are expensed as incurred.

	Three months ended March 31,			
	2013	2012		
Technical operations and development	\$1,133,830	\$1,113,145		
Increase over prior period	\$20,685			
Increase - percentage	2	%		
Percentage of net revenues	4	%	4	%

Technical operations and development expenses for the three months ended March 31, 2013 remained relatively flat at \$1.1 million when compared to the three months ended March 31, 2012.

## GENERAL AND ADMINISTRATIVE

	Three months ended March 31,			
	2013	2012		
General and administrative	\$1,698,632	\$1,783,453		
Decrease over prior period	\$(84,821)	)		
Decrease - percentage	(5	)%		
Percentage of net revenues	6	%	6	%

General and administrative expenses for the three months ended March 31, 2013 decreased by \$0.1 million, or 5%, to \$1.7 million as compared to the three months ended March 31, 2012. This decrease was primarily the result of lower workforce related costs and legal expenses in the amount of \$0.2 million. This decrease was partially offset by additional costs incurred in processing a higher volume of credit cards in the amount of \$0.1 million.

## DEPRECIATION OF PROPERTY AND EQUIPMENT

Property and equipment is depreciated on a straight-line basis over the estimated useful life of the assets.

	Three months ended March 31,			
	2013	2012		
Depreciation of property and equipment	\$50,939	\$47,415		
Increase over prior period	\$3,524			
Increase - percentage	7	%		
Percentage of net revenues	0	%	0	%

Depreciation costs remained relatively flat at \$0.05 million for the three months ended March 31, 2013 as compared to the three months ended March 31, 2012.

## AMORTIZATION OF INTANGIBLE ASSETS

	Three months ended March 31,			
	2013		2012	
Amortization of intangible assets	\$219,030		\$219,030	
Decrease over prior period	\$-			
Decrease - percentage	-	%		
Percentage of net revenues	1	%	1	%

Amortization of intangible assets consists of amounts arising in connection with the acquisition of Mailbank.com Inc. in June 2006, the acquisition of IYD in July 2007 and the acquisition of EPAG in July 2011.

Brand and customer relationships acquired in connection with the acquisitions of IYD and EPAG are amortized on a straight-line basis over seven years.

Customer relationships acquired in connection with the acquisition of Mailbank.com Inc. are each amortized on a straight-line basis over five years.

Technology acquired in connection with the acquisition of EPAG is amortized on a straight-line basis over two years.

#### LOSS (GAIN) ON CURRENCY FORWARD CONTRACTS

Although our functional currency is the U.S. dollar, a major portion of our fixed expenses are incurred in Canadian dollars. Our goal with regard to foreign currency exposure is, to the extent possible; to achieve operational cost certainty, manage financial exposure to certain foreign exchange fluctuations and to neutralize some of the impact of foreign currency exchange movements. Accordingly, we enter into foreign exchange contracts to mitigate the exchange rate risk on portions of our Canadian dollar exposure.

As we do not comply with the documentation requirements for hedge accounting on certain of our foreign exchange contracts, we account for the fair value of the derivative instruments on these contracts within the consolidated balance sheet as a derivative financial asset or liability and the corresponding change in fair value is recorded in the consolidated statement of operations.

	Three months ended March 31,	
	2013	2012
Loss (gain) on currency forward contracts	\$234,638	\$(562,109)
Increase over prior period	\$796,747	
Increase - percentage	(142)	)%
Percentage of net revenues	1	% (2) %

We have entered into certain forward exchange contracts that do not comply with the requirements of hedge accounting to meet a portion of our future Canadian dollar requirements through April 2014. The impact of the fair value adjustment on unrealized foreign exchange on these contracts for the three months ended March 31, 2013 was a net loss of \$0.4 million compared to a net gain of \$0.7 million for the three months ended March 31, 2012. This impact of the fair value adjustment on unrealized foreign exchange on these contracts was partially offset by a realized gain upon settlement of currency forward contracts of \$0.1 million for the three months ended March 31, 2013 and a realized loss of \$0.1 million for the three months ended March 31, 2012.

At March 31, 2013, our balance sheet reflects a derivative instrument asset of \$0.1 million, and a derivative instrument liability of \$0.3 million as a result of our existing foreign exchange contracts. At March 31, 2013 the value of our outstanding foreign exchange contracts amounted to \$23.3 million. Until their respective maturity dates, these contracts will fluctuate in value in line with movements in the Canadian dollar relative to the U.S. dollar.

#### OTHER INCOME AND EXPENSES

	Three months ended March 31,	
	2013	2012
Other income (expenses), net	\$(99,362)	\$467,831
Increase over prior period	\$(567,193)	
Increase - percentage	(121)	)%
Percentage of net revenues	(0)	)% 2 %

Other expenses for the three months ended March 31, 2013 were \$0.1 million when compared to other income of \$0.5 million for the three months ended March 31, 2012. This change primarily resulted from our selling certain

intangible assets with no book value for \$0.5 million during the three months ended March 31, 2012. In addition, we incurred interest expenses pursuant to the terms of our credit facility with the Bank of Montreal (as discussed below) of \$0.1 million during the three months ended March 31, 2013 compared to \$41,000 during the three months ended March 31, 2012.

## INCOME TAXES

The following table presents our provision for income taxes for the periods presented:

	Three months ended March 31,			
	2013		2012	
Provision for income taxes	\$ 119,832		\$ 848,606	
Decrease in provision over prior period	\$(728,774	)		
Decrease - percentage	(86	)%		
Percentage of income before income tax	61	%	34	%

For the three months ended March 31, 2013, we recorded a provision for income taxes of \$0.1 million on income before income taxes of \$0.2 million, using an estimated effective tax rate for our 2013 fiscal year adjusted for certain minimum state taxes. Comparatively, for the three months ended March 31, 2012, we recorded a provision for income taxes of \$0.8 million on income before taxes of \$2.5 million, using an estimated effective tax rate for our 2012 fiscal year.

The effective tax rate for the three months ended March 31, 2013 differs from the effective rate for the comparative period ended March 31, 2012 as a result of state taxes.

In assessing the realizability of deferred tax assets, we consider whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the years in which those temporary differences become deductible. We consider projected future taxable income, uncertainties related to the industry in which we operate, and tax planning strategies in making this assessment.

We follow the provisions of FASB ASC Topic 740, Income Taxes to account for income tax exposures. The application of this interpretation requires a two-step process that separates recognition of uncertain tax benefits from measurement thereof.

We had approximately \$0.4 million of total gross unrecognized tax benefit as of March 31, 2013 and \$0.4 million of total gross unrecognized tax benefit as of December 31, 2012, which if recognized would favorably affect our income tax rate in future periods. The unrecognized tax benefit relates primarily to prior year Pennsylvania state franchise taxes, unrecognized tax benefits for potential 2012 research and development tax credits as well as prior year German income tax. We recognize accrued interest and penalties related to income taxes in income tax expense. We did not have significant interest and penalties accrued at March 31, 2013 and December 31, 2012, respectively. We believe that it is reasonably possible that all of the unrecognized tax benefits will decrease in the next twelve months as it is anticipated that the tax authorities will finalize their review of prior taxes owing in Pennsylvania and Germany and the 2012 Canadian research and development claim will be filed and assessed.

## OTHER COMPREHENSIVE INCOME

To mitigate the impact of the change in fair value of our foreign exchange contracts on our financial results, in October 2012 we begun applying hedge accounting for the majority of the contracts we need to meet our Canadian dollar requirements on a prospective basis.

The following table presents other comprehensive income for the periods presented:



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	Three months ended March 31,	
	2013	2012
Other comprehensive income	\$(185,785 )	\$-
Increase in provision over prior period	\$(185,785 )	
Increase - percentage	(100 )%	
Percentage of net revenues	(1 )%	- %

28

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## LIQUIDITY AND CAPITAL RESOURCES

As of March 31, 2013, our cash and cash equivalents balance decreased by \$2.1 million to \$4.3 million when compared to December 31, 2012. Our principal sources of liquidity during the three months ended March 31, 2013 was net cash provided by operating activities of \$0.4 million and the proceeds of \$5.2 million we received from drawing down on our credit facility with the Bank of Montreal (the “Bank” or “BMO”) to fund the Dutch Tender Offer which closed in January 2013.

We have credit agreements (collectively the “Amended Credit Facility”) with the Bank that were amended on November 19, 2012, and which provide us with access to two revolving demand loan facilities (the “2012 Demand Loan Facilities”) that provide for a \$14 million, five year revolving credit facility, a \$3.5 million treasury risk management facility and a \$1.0 million operating demand loan. The Amended Credit Facility contains customary events of default and affirmative and negative covenants and restrictions, including certain financial maintenance covenants such as a maximum total funded debt to EBITDA ratio and a minimum fixed charge ratio. As of March 31, 2013, we were in compliance with all our covenants.

As of March 31, 2013, the outstanding principal balance outstanding under our Amended Credit Facility was \$8.1 million with \$6.9 million still available for borrowing under the facility. In addition, under our Treasury Risk Management Facility we can place approximately \$39 million in foreign exchange forward contracts and/or currency options to trade U.S. dollars in exchange for Canadian dollars. As of March 31, 2013, we held contracts in the amount of \$23.3 million to trade U.S. dollars in exchange for Canadian dollars.

### Cash Flow from Operating Activities

Net cash inflows from operating activities was \$0.4 million, a decrease of 80% or \$1.7 million when compared to the three months ended March 31, 2012. Net income for the three months ended March 31, 2013 was \$0.1 million, which included non-cash charges and recoveries of \$0.8 million such as a provision for deferred tax, gain on currency forward contracts, depreciation, amortization and stock-based compensation. This income was partially offset by changes in our working capital of \$0.7 million. Positive contributions of \$2.4 million from movements in deferred revenue, accounts payable, prepaid tax and inventory were offset by our utilizing \$3.0 million to fund deferred registration costs, a reduction in customer deposits, accounts receivable, lower accruals and prepaid expenses. These changes in our working capital were primarily driven by the timing of payments in the normal business cycle.

### Cash Flow from Financing Activities

Net cash used in financing activities during the three months ended March 31, 2013 totaled \$2.1 million. Net cash of \$6.5 million was used to fund the repurchase of 4.1 million of our shares through a modified “Dutch auction tender offer” that was successfully concluded on January 4, 2013 and to repurchase 0.1 million shares under our current Normal Course Issuer Bid during the three months ended March 31, 2013. In addition, \$0.8 million was used to fund principal repayments under our Amended Credit Facility. These uses of funds in financing activities were partially offset by our drawing \$5.2 million under our Amended Credit Facility in January 2013 to fund a portion of the modified Dutch auction tender offer.

Net cash used in financing activities during the three months ended March 31, 2012 totaled \$2.3 million. Net cash of \$5.9 million was used to fund the repurchase of 7.6 million of our shares through a modified “Dutch auction tender offer” that was successfully concluded on January 25, 2012. In addition, \$0.5 million was used to fund principal repayments under our Amended Credit Facility. These uses of funds in financing activities were partially offset by our drawing \$4.0 million under our Amended Credit Facility in January 2012 to fund a portion of the modified Dutch auction tender offer and the proceeds of \$0.1 million received on the exercise of options by our directors and

employees during the three months ended March 31, 2012.

#### Cash Flow from Investing Activities

Investing activities during the three months ended March 31, 2013 used net cash of \$0.4 million to acquire additional property and equipment. Investing activities during the three months ended March 31, 2012 provided net cash of \$0.3 million by the selling of certain intangible assets with no book value for \$0.5 million, which was partially offset by an amount of \$0.3 million used to acquire additional property and equipment

Based on our operations, we believe that our cash flow from operations will be adequate to meet our anticipated requirements for working capital, capital expenditures and our loan repayments for at least the next 12 months.

We may choose to raise additional funds or seek other financing arrangements to facilitate more rapid expansion, develop new or enhance existing products or services, respond to competitive pressures or acquire or invest in complementary businesses, technologies, services or products.

If additional financing is required, we may not be able to raise it on acceptable terms, or at all, and additional financing may be dilutive to existing investors. We may also evaluate potential acquisitions of other businesses, products and technologies. To complete potential acquisitions, we may issue additional securities or need additional equity or debt financing and any additional financing may be dilutive to existing investors. There are currently no material understandings, commitments or agreements regarding the acquisition of other businesses.

Subsequent events

None.

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## Item 3. Quantitative and Qualitative Disclosures About Market Risk

We develop products in Canada and sell these services in North America and Europe. Our sales are primarily made in U.S. dollars, while a major portion of expenses are incurred in Canadian dollars. Our financial results could be affected by factors such as changes in foreign currency exchange rates or weak economic conditions in foreign markets. Our interest income is sensitive to changes in the general level of Canadian and U.S. interest rates, particularly since the majority of our investments are in short-term instruments. Based on the nature of our short-term investments, we have concluded that there is no material interest rate risk exposure as of March 31, 2013. We are also subject to market risk exposure related to changes in interest rates under our Amended Credit Facility. We do not expect that any changes in interest rates will be material; however, fluctuations in interest rates are beyond our control. We will continue to monitor and assess the risks associated with interest expense exposure and may take additional actions in the future to mitigate these risks.

Although our functional currency is the U.S. dollar, a substantial portion of our fixed expenses are incurred in Canadian dollars. Our policy with respect to foreign currency exposure is to manage financial exposure to certain foreign exchange fluctuations with the objective of neutralizing some of the impact of foreign currency exchange movements. Exchange rates are, however, subject to significant and rapid fluctuations, and therefore we cannot predict the prospective impact of exchange rate fluctuations on our business, results of operations and financial condition. Accordingly, we have entered into foreign exchange contracts to mitigate the exchange rate risk on portions of our Canadian dollar exposure.

At March 31, 2013, the Company had the following outstanding forward exchange contracts to trade U.S. dollars in exchange for Canadian dollars:

Maturity date	Notional amount of U.S. dollars	Weighted average exchange rate of U.S. dollars	Fair value
April – June, 2013	5,270,000	1.0300	64,983
July – September, 2013	4,930,000	1.0047	(72,654)
October – December, 2013	5,480,000	1.0071	(78,584)
January – March, 2014	5,720,000	1.0095	(79,278)
April 2014	1,940,000	1.0109	(26,611)
Total	\$ 23,340,000	1.0127	\$ (192,144)

As of March 31, 2013 the Company has \$23.3 million of outstanding foreign exchange forward contracts which will convert to CDN \$23.6 million. Of these contracts, \$15.1 million met the requirements for hedge accounting (as at March 31, 2012 – nil).

We have performed a sensitivity analysis model for foreign exchange exposure over the three months ended March 31, 2013. The analysis used a modeling technique that compares the U.S. dollar equivalent of all expenses incurred in Canadian dollars, at the actual exchange rate, to a hypothetical 10% adverse movement in the foreign currency exchange rates against the U.S. dollar, with all other variables held constant. Foreign currency exchange rates used were based on the market rates in effect during the three months ended March 31, 2013. The sensitivity analysis indicated that a hypothetical 10% adverse movement in foreign currency exchange rates would result in a decrease in net income for the three months ended March 31, 2013 of approximately \$0.6 million. There can be no assurances that the above projected exchange rate decrease will materialize. Fluctuations of exchange rates are beyond our control. We will continue to monitor and assess the risk associated with these exposures and may take additional

actions in the future to hedge or mitigate these risks.

#### Credit Risk

Financial instruments that potentially subject us to concentrations of credit risk consist principally of cash equivalents, marketable securities, foreign exchange contracts and accounts receivable. Our cash, cash equivalents and short-term investments are in high-quality securities placed with major banks and financial institutions whom we have evaluated as highly creditworthy and commercial paper. With respect to accounts receivable, we perform ongoing evaluations of our customers, generally granting uncollateralized credit terms to our customers, and maintaining an allowance for doubtful accounts based on historical experience and our expectation of future losses.

Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Based on that evaluation, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures as of the end of the period covered by this report have been designed and are functioning effectively to provide reasonable assurance that the information required to be disclosed by us in reports filed under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the Security and Exchange Commission's rules and is accumulated and communicated to our management, including our principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. We believe that a controls system, no matter how well designed and operated, cannot provide absolute assurance that the objectives of the controls system are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected.

(b) Change in Internal Control over Financial Reporting

No change in our internal control over financial reporting occurred during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II.  
OTHER INFORMATION

Item 1. Legal Proceedings

We are involved in various investigations, claims and lawsuits arising in the normal conduct of our business, none of which, individually or in the aggregate, in our opinion, will materially harm our business. We cannot assure that we will prevail in any litigation. Regardless of the outcome, any litigation may require us to incur significant litigation expense and may result in significant diversion of our attention.

Item 1A. Risk Factors

In addition to the other information set forth in this Quarterly Report, you should also carefully consider the risk factors discussed in Part I, “Item 1A. Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2012, all of which could materially affect our business, financial condition or operating results and should be considered before making an investment decision regarding our securities. The risks described in our Annual Report on Form 10-K are not the only risks facing the Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may adversely affect our business, financial condition or operating results.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

In the three months ended March 31, 2013 we used \$6.3 million to repurchase 4.1 million shares of the Company's common stock pursuant to a “Dutch auction tender offer”.

In the three months ended March 31, 2013, we used \$0.3 million to repurchase 0.1 million shares of the Company's common stock pursuant to its previously announced stock buyback program, which commenced on March 1, 2013.

All shares repurchased were cancelled. The following table shows the monthly activity related to our stock repurchases for the three months ended March 31, 2013.

Period	Total number of shares purchased (1) (2)	Average price paid per share	Total number of shares purchased as part of publicly announced plans or programs	Approximate dollar value of shares that may yet be purchased under the plans or programs
January 1, 2013 through January 31, 2013	4,114,121	\$ 1.50	4,114,121	—
February 1, 2013 through February 28, 2013	—	—	—	—
March 1, 2013 through March 31, 2013	143,073	1.82	143,073	—
Total	4,257,194	\$ 1.51	4,257,194	\$ 9,740,125

(1) On January 7, 2013, the Company announced that it successfully concluded a modified “Dutch auction tender offer” that was previously announced on November 21, 2012. Under the terms of the offer, the Company repurchased an aggregate of 4,114,121 shares of its common stock at a purchase price of \$1.50 per share, for a total of \$6,171,656, excluding transaction costs of approximately \$106,000. The purchase price and all transaction costs were funded from available cash and an additional advance under our Amended Credit Facility from the



Bank in the amount of \$5.2 million. All shares purchased in the tender offer received the same price and all shares repurchased were immediately retired. As a result of the completion of the tender offer, as of January 31, 2013, the Company had 40,226,875 shares issued and outstanding.

(2) On March 1, 2013 the Company announced the commencement of a Stock Buyback Program, which authorized the repurchase of up to \$10 million of its common stock through the NYSE Amex Exchange. All shares repurchased under this program are to be immediately retired. The Stock Buyback Program will terminate on February 28, 2014.

Item 4. Mine Safety Disclosures

Not applicable.

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Item 6. Exhibits

(a) Exhibits.

Exhibit No.	Description
3.1	Fourth Amended and Restated Articles of Incorporation of Tucows Inc. (Incorporated by reference to Exhibit 3.1 filed with Tucows' Current Report on Form 8-K, as filed with the SEC on November 29, 2007).
3.2	Second Amended and Restated Bylaws of Tucows Inc. (Incorporated by reference to Exhibit 3.2 filed with Tucows' Annual Report on Form 10-K for the year ended December 31, 2006, as filed with the SEC on March 29, 2007).
3.3	Amendment No. 1 to Second Amended and Restated Bylaws of Tucows Inc. (Incorporated by reference to Exhibit 3.3 filed with Tucows' Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2012, as filed with the SEC on August 14, 2012).
31.1	Chief Executive Officer's Rule 13a-14(a)/15d-14(a) Certification *
31.2	Chief Financial Officer's Rule 13a-14(a)/15d-14(a) Certification *
32.1	Chief Executive Officer's Section 1350 Certification †
32.2	Chief Financial Officer's Section 1350 Certification †
101.INS**	XBRL Instance
101.SCH**	XBRL Taxonomy Extension Schema
101.CAL**	XBRL Taxonomy Extension Calculation
101.DEF**	XBRL Taxonomy Extension Definition
101.LAB**	XBRL Taxonomy Extension Labels
101.PRE**	XBRL Taxonomy Extension Presentation

Information is furnished and not filed or a part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections.

\*\* XBRL

\* Filed herewith.

† Furnished herewith.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: May 15, 2013

TUCOWS INC.

By: /s/ Elliot Noss  
Elliot Noss  
President and Chief Executive Officer

By: /s/ Michael Cooperman  
Michael Cooperman Chief Financial Officer  
(Principal Financial and Accounting Officer)

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