

TUCOWS INC /PA/  
Form 10-Q  
November 10, 2011

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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 September 30, 2011

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,

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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 November 9, 2011, there were 53,477,524 outstanding shares of common stock, no par value, of the registrant.

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TRADEMARKS, TRADE NAMES AND SERVICE MARKS

Tucows®, Butterscotch® and OpenSRS® are registered trademarks of Tucows, Inc. or its subsidiaries. Other service marks, trademarks and trade names of Tucows, Inc. or its subsidiaries may be used in this Quarterly Report on Form 10-Q (this “Quarterly Report”). All other service marks, trademarks and trade names referred to in this Quarterly Report are the property of their respective owners. Solely for 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.



PART I.  
FINANCIAL INFORMATION

## Item 1. Consolidated Financial Statements

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

	September 30, 2011 (unaudited)	December 31, 2010
Assets		
Current assets:		
Cash and cash equivalents	\$4,653,765	\$4,205,729
Accounts receivable, net of allowance for doubtful accounts of \$63,669 as of September 30, 2011 and \$65,000 as of December 31, 2010	4,289,462	3,021,995
Prepaid expenses and deposits	3,756,375	2,363,876
Derivative instrument asset, current portion (note 7)	1,090	833,960
Prepaid domain name registry and ancillary services fees, current portion	43,005,543	37,016,871
Income taxes recoverable	330,093	620,000
Total current assets	56,036,328	48,062,431
Prepaid domain name registry and ancillary services fees, long-term portion	12,693,752	12,820,479
Property and equipment	1,313,611	1,552,349
Deferred financing charges	4,500	15,600
Deferred tax asset, long-term portion (note 8)	3,569,000	4,155,600
Intangible assets (note 5)	17,741,695	16,883,401
Goodwill	18,873,127	17,990,807
Total assets	\$110,232,013	\$101,480,667
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$1,301,612	\$1,664,006
Accrued liabilities	1,720,279	1,346,436
Customer deposits	3,903,564	3,960,312
Derivative instrument liability, current portion (note 7)	1,193,751	-
Loan payable, current portion (note 6)	1,559,722	1,305,883
Deferred revenue, current portion	52,372,852	45,832,374
Accreditation fees payable, current portion	562,374	547,810
Deferred tax liability, current portion (note 8)	569,000	1,155,600
Income taxes payable	200,940	-
Total current liabilities	63,384,094	55,812,421
Derivative instrument liability, long-term portion (note 7)	431,483	-

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Deferred revenue, long-term portion	16,564,604	16,738,429
Accreditation fees payable, long-term portion	159,614	168,580
Deferred rent, long-term portion	19,274	-
Deferred tax liability, long-term portion (note 8)	5,373,600	4,840,000
Stockholders' equity (note 12)		
Preferred stock - no par value, 1,250,000 shares authorized; none issued and outstanding	-	-
Common stock - no par value, 250,000,000 shares authorized; 53,477,874 shares issued and outstanding as of September 30, 2011 and 53,448,591 shares issued and outstanding as of December 31, 2010	11,349,613	11,324,866
Additional paid-in capital	40,938,602	40,700,587
Accumulated other comprehensive income	(26,121 )	-
Deficit	(27,962,750 )	(28,104,216 )
Total stockholders' equity	24,299,344	23,921,237
Total liabilities and stockholders' equity	\$ 110,232,013	\$ 101,480,667

See accompanying notes to unaudited consolidated financial statements

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

	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Net revenues (note 10)	\$25,094,056	\$21,209,468	\$70,695,186	\$62,501,219
Cost of revenues:				
Cost of revenues	17,658,648	14,903,525	49,578,724	42,871,489
Network expenses (*)	1,193,669	1,087,930	3,691,995	3,500,826
Depreciation of property and equipment	159,191	231,253	608,961	794,368
Amortization of intangible assets (note 5)	23,960	74,802	49,680	224,406
Total cost of revenues (note 10)	19,035,468	16,297,510	53,929,360	47,391,089
Gross profit	6,058,588	4,911,958	16,765,826	15,110,130
Operating expenses:				
Sales and marketing (*)	1,867,085	1,830,999	5,663,759	5,480,228
Technical operations and development (*)	1,220,953	1,053,768	3,651,782	3,486,718
General and administrative (*)	1,279,082	633,457	3,509,395	2,049,813
Depreciation of property and equipment	48,874	40,239	140,556	127,559
Amortization of intangible assets (note 5)	201,180	360,540	785,920	1,081,620
Loss (gain) on change in fair value of forward exchange contracts	2,152,243	(141,981 )	2,458,104	1,669,031
Total expenses	6,769,417	3,777,022	16,209,516	13,894,969
Income (loss) from operations	(710,829 )	1,134,936	556,310	1,215,161
Other income (expenses):				
Interest (expense) income, net	(18,718 )	(26,917 )	(38,915 )	(99,812 )
Other income	-	-	374,977	-
Total other income (expenses)	(18,718 )	(26,917 )	336,062	(99,812 )
Income (loss) before provision for income taxes	(729,547 )	1,108,019	892,372	1,115,349
Provision for income taxes (note 8)	422,592	24,863	750,906	235,105
Net income (loss) for the period	\$(1,152,139 )	\$1,083,156	\$141,466	\$880,244
Basic earnings (loss) per common share (note 9)				
	\$(0.02 )	\$0.02	\$-	\$0.01
	53,452,205	57,351,161	53,444,959	59,255,739

Shares used in computing basic earnings  
(loss) per common share (note 9)

Diluted earnings (loss) per common share  
(note 9)

\$(0.02 ) \$0.02 \$- \$0.01

Shares used in computing diluted earnings  
(loss) per common share (note 9)

53,452,205 59,185,793 55,748,777 61,223,369

Stock-based compensation has been included  
in expenses as follows(\*):

Network expenses	\$5,808	\$6,557	\$17,170	\$15,759
Sales and marketing	\$22,695	\$30,358	\$67,155	\$71,589
Technical operations and development	\$13,020	\$19,058	\$40,122	\$51,903
General and administrative	\$79,364	\$99,813	\$124,170	\$174,437

See accompanying notes to unaudited consolidated financial statements



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

	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Cash provided by (used in):				
Operating activities:				
Net income (loss) for the period	\$ (1,152,139 )	\$ 1,083,156	\$ 141,466	\$ 880,244
Items not involving cash:				
Depreciation of property and equipment	208,065	271,492	749,517	921,927
Amortization of deferred financing charges	3,000	6,000	11,100	20,100
Amortization of intangible assets	225,140	435,342	835,600	1,306,026
Deferred tax recovery	(18,400 )	-	(18,400 )	-
Deferred rent	5,310	-	19,274	-
Disposal of domain names	8,816	5,084	29,907	17,090
Unrealized loss (gain) in the fair value of forward exchange contracts	2,152,243	(141,981 )	2,458,104	1,669,031
Stock-based compensation	120,887	155,786	248,617	313,688
Changes in non-cash operating working capital:				
Accounts receivable	412,735	53,373	(715,829 )	(510,232 )
Prepaid expenses and deposits	264,660	489,843	(958,989 )	61,356
Prepaid fees for domain name registry and ancillary services fees	(1,074,068 )	(2,355,886 )	(4,823,650 )	(5,786,558 )
Income taxes recoverable	173,008	(165,000 )	333,008	127,000
Accounts payable	(531,095 )	(244,194 )	(327,272 )	(443,624 )
Accrued liabilities	(113,972 )	(231,633 )	267,595	(264,317 )
Customer deposits	170,762	240,907	(86,941 )	78,147
Deferred revenue	788,835	2,287,739	5,046,102	6,023,890
Accreditation fees payable	(15,607 )	(14,435 )	6,185	13,882
Net cash provided by operating activities	1,628,180	1,875,593	3,215,394	4,427,650
Financing activities:				
Proceeds received on exercise of stock options	10,685	-	14,145	14,809
Repurchase of common stock	-	-	-	(6,914,792 )
Proceeds received on loan payable	2,530,000	-	2,530,000	-
Repayment of loan payable	(1,319,040 )	(478,561 )	(2,276,161 )	(1,435,682 )

Net cash provided by (used in) financing activities	1,221,645	(478,561 )	267,984	(8,335,665 )
<b>Investing activities:</b>				
Additions to property and equipment	(138,909 )	(33,111 )	(629,935 )	(292,790 )
Acquisition of EPAG Domainservices GMBH, net of cash acquired	(2,392,461 )	-	(2,392,461 )	-
Net cash used in investing activities	(2,531,370 )	(33,111 )	(3,022,396 )	(292,790 )
Foreign exchange loss on cash held in foreign currencies	(12,946 )	-	(12,946 )	-
Increase (decrease) in cash and cash equivalents	305,509	1,363,921	448,036	(4,200,805 )
Cash and cash equivalents, beginning of period	4,348,256	4,067,668	4,205,729	9,632,394
Cash and cash equivalents, end of period	\$ 4,653,765	\$ 5,431,589	\$ 4,653,765	\$ 5,431,589
<b>Supplemental cash flow information:</b>				
Interest paid	\$ 18,890	\$ 27,001	\$ 39,197	\$ 99,798
<b>Supplementary disclosure of non-cash investing activity:</b>				
Property and equipment acquired during the period not yet paid for	\$ 124,979	\$ 146,158	\$ 124,979	\$ 146,158

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 and email through its global Internet-based distribution 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 Germany, the United States and the United Kingdom.

### 2. BASIS OF PRESENTATION:

The accompanying unaudited interim consolidated balance sheets, and the related consolidated statements of operations 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 September 30, 2011 and the results of operations and cash flows for the interim periods ended September 30, 2011 and 2010. 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, 2010 included in Tucows’ 2010 Annual Report on Form 10-K filed with the SEC on March 22, 2011.

There have been no material changes to our significant accounting policies during the three and nine months ended September 30, 2011 as compared to the significant accounting policies described in our Annual Report on Form 10-K for the fiscal year ended December 31, 2010.

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. ACQUISITIONS:

- a. Acquisition of EPAG Domainservices GMBH:

On August 1, 2011, Tucows (Germany) Inc. (“Tucows Germany”), one of the Company’s wholly owned subsidiaries, acquired 100% of the outstanding capital stock of EPAG Domainservices GMBH (“EPAG”), from QSC AG. EPAG, based in Bonn, Germany, is an ICANN-accredited registrar with over 400,000 domains under management and is notable for offering over 200 Top Level Domains (TLDs). Consideration for the acquisition of EPAG was approximately US\$2.4 million (€1.7 million to purchase the shares and the settlement of a working capital adjustment of €0.25 million) through an all-cash transaction which was financed by utilizing the Company’s non-revolving, reducing demand loan facility in the amount of US\$2.5 million. In August 2011, the Company repaid \$1.0 million of this loan. The acquisition consideration is net of cash acquired of US\$0.1 million and a loan receivable from EPAG assumed in the amount of US\$0.1 million. In connection with the acquisition, the Company incurred approximately US\$0.1 million of acquisition costs during the three months ended September 30, 2011 and recorded the expenses in the general and administrative expenses line in the consolidated statement of operations. These costs include legal and other professional services.

The Company has accounted for the acquisition of EPAG using the acquisition method as required in ASC 805, Business Combinations. As such, fair values have been assigned to the assets and liabilities acquired and the excess of the total purchase price over the fair value of the net assets acquired is recorded as goodwill. The Company has completed the final valuation of the fair value assessment of certain intangible assets. The goodwill represents business benefits the Company anticipates realizing from optimizing resources and access to additional domain name TLD's. The goodwill is not expected to be deductible for tax purposes.

Purchase price allocation

The following table summarizes the Company's purchase price allocation based on the fair value of the assets acquired and liabilities assumed on August 1, 2011:

Accounts receivable	\$587,595	
Cash acquired	118,477	
Prepaid expenses and deposits	468,523	
Prepaid domain name registry fees	1,116,798	
Property and equipment	29,198	
Intangible assets	1,723,800	
Goodwill	882,320	
Total assets acquired		4,926,711
Accounts payable	92,950	
Accrued liabilities	140,658	
Customer deposits	32,603	
Deferred revenue	1,425,182	
Income taxes payable	172,380	
Deferred tax liability	552,000	
Total liabilities acquired		2,415,773
Purchase price	\$	2,510,938

The intangible assets acquired include technology in the amount of \$0.3 million, brand in the amount of \$0.2 million and customer relationships in the amount of \$1.2 million. The residual value from the purchase price has been allocated to goodwill. The technology is being amortized over two years, while the customer relationships and brand are being amortized over seven years.

The amount of EPAG's revenues and net loss included in Tucows' Consolidated Statements of Operations for the three and nine months ended September 30, 2011, and the unaudited pro forma revenues and net income of the combined entity had the acquisition been consummated as of January 1, 2010, are set forth below:

	Revenues	Net loss *
Actual from August 1, 2011 to September 30, 2011	\$584,192	\$16,564
	Three months ended September 30, 2011	Nine months ended September 30, 2011
	2010	2010

Supplemental Unaudited Pro Forma  
Information

Total revenue	\$25,457,160	\$21,879,318	\$72,929,498	\$64,502,708
Net income **	\$(1,187,457	) \$1,125,845	\$(25,074	) \$1,015,639

\* Included within net loss for the period reported above are \$57,440 of estimated amortization charges relating to the allocated values of intangible assets.

\*\* Included in pro forma net income are estimated amortization charges relating to the allocated values of intangible assets for all period reported above.

The unaudited pro forma financial information in the table above is presented for informational purposes only and is not indicative of the results of operations that would have been achieved if the acquisition had taken place at the beginning of the period presented or the result that may be realized in the future.

#### 4. NEW ACCOUNTING POLICIES:

##### Recent Accounting Pronouncements Adopted

##### Comprehensive Income

In June 2011, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update No. 2011-05, “Comprehensive Income” (Topic 220)—Presentation of Comprehensive Income (“ASU 2011-05”), to require an entity to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. ASU 2011-05 eliminates the option to present the components of other comprehensive income as part of the statement of equity. ASU 2011-05 is effective for us in our first quarter of the fiscal year ending December 31, 2012 (“Fiscal 2012”) and will be applied retrospectively. We are currently evaluating the impact of our pending adoption of ASU 2011-05 on our consolidated financial statements.

##### Fair Value Measurement and Disclosures

In May 2011, the FASB issued Accounting Standards Update No. 2011-04, “Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standards” (Topic 820)—Fair Value Measurement (“ASU 2011-04”), to provide a consistent definition of fair value and ensure that the fair value measurement and disclosure requirements are similar between U.S. GAAP and International Financial Reporting Standards. ASU 2011-04 changes certain fair value measurement principles and enhances the disclosure requirements particularly for level 3 fair value measurements (as defined in note 14 below). ASU 2011-04 is effective for us in the fiscal year ending December 31, 2012 (Fiscal 2012) and we do not believe these provisions will have a material impact on our consolidated financial statements.

##### Testing Goodwill for Impairment

In September 2011, the FASB issued Accounting Standards Update No. 2011-08, Intangibles—Goodwill and Other (Topic 350)—Testing Goodwill for Impairment (“ASU 2011-08”), to allow entities to use a qualitative approach to test goodwill for impairment. ASU 2011-08 permits an entity to first perform a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying value. If it is concluded that this is the case, it is necessary to perform the currently prescribed two-step goodwill impairment test. Otherwise, the two-step goodwill impairment test is not required. ASU 2011-08 is effective for us in Fiscal 2012 and earlier adoption is permitted. We are currently evaluating the impact of our pending adoption of ASU 2011-08 on our consolidated financial statements. We do not expect the adoption of ASU 2011-08 to materially impact the carrying value of our recorded goodwill.

## 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 September 30, 2011 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, June 30, 2011	\$ —	\$ 440,300	\$ 1,628,000	\$ 12,123,647	\$ 2,059,903	\$ 16,251,850
Acquisition of EPAG Domainservices GMBH	287,300	215,475	1,221,025	—	—	1,723,800
Sales of domain names	—	—	—	(974 )	(7,841 )	(8,815 )
Amortization expense	(23,960 )	(40,435 )	(160,745 )	—	—	(225,140 )
Net book value, September 30, 2011	\$ 263,340	\$ 615,340	\$ 2,688,280	\$ 12,122,673	\$ 2,052,062	\$ 17,741,695

A summary of acquired intangible assets for the nine months ended September 30, 2011 is as:

	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, 2010	\$ 25,720	\$ 519,780	\$ 2,133,260	\$ 12,125,918	\$ 2,078,723	\$ 16,883,401
Acquisition of EPAG Domainservices GMBH	287,300	215,475	1,221,025	—	—	1,723,800
Sales of domain names	—	—	—	(3,245 )	(26,661 )	(29,906 )
Amortization expense	(49,680 )	(119,915 )	(666,005 )	—	—	(835,600 )
Net book value, September 30, 2011	\$ 263,340	\$ 615,340	\$ 2,688,280	\$ 12,122,673	\$ 2,052,062	\$ 17,741,695

## 6. LOAN PAYABLE:

The Company has credit agreements (collectively the “Amended Credit Facility”) with the Bank of Montreal (“bank”) that were amended on July 27, 2011, which provides the Company with access to the following facilities:



1. Existing Demand Loan 1

Under the Amended Credit Facility, the Company will continue to repay the \$0.4 million balance outstanding as of July 27, 2011 under Existing Demand Loan 1 in equal monthly installments of \$0.2 million plus interest. The Company may elect to pay interest on Existing Demand Loan 1 either at the BMO U.S. Base Rate plus 1.30% or at LIBOR plus 3.25%. The Company expects the Existing Demand Facility 1 to be fully repaid during October 2011.

2. Treasury Risk Management Facility

The Amended Credit Facility continues to provide for a \$3.5 million, settlement risk line to assist the Company with hedging U.S. 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 September 30, 2011, the Company has contracts in the amount of \$31.9 million to trade U.S. dollars in exchange for Canadian dollars, (see Note 3).

## 3. Existing Operating Demand Loan

The Amended Credit Facility continues to provide a \$1.0 million operating demand loan to the Company to assist it in meeting its operational needs. As of September 30, 2011, the Company has no borrowing under this facility. Interest is payable monthly in arrears at a rate of BMO U.S. Base Rate plus 1.25%. The Company has also agreed to pay to the Bank a monthly monitoring fee of \$500.

## 4. Amended Credit Facilities

Under the terms of the Amended Credit Facility, Existing Demand Loan 2 has been restructured to provide an aggregate of \$8.0 million in funds available through a demand loan revolving facility (the “2011 DLR Loan”) and a demand loan revolving, reducing facility (the “2011 DLRR Loan”). Aggregate advances under the 2011 Demand Loan Facilities may not exceed \$8.0 million which may be used to finance the repurchases of the Company’s common stock and for certain permitted acquisitions. No more than \$2.0 million of such advances may be used to finance repurchases of the Company’s common stock and the 2011 DLR Loan accrues interest at the BMO U.S. Base Rate plus 1.25%. Repayment of advances under the 2011 DLR Loan consists of interest only payments made monthly in arrears and prepayment is permitted without penalty.

On July 28, 2011, the Company drew down \$2.5 million on the 2011 DLR Loan to fund the acquisition of EPAG Domainservices GmbH as more fully described under Note 3, Acquisitions. On August 11, 2011 the Company prepaid \$1.0 million of this loan. Any outstanding balance under the 2011 DLR Loan as of December 31st of each year is to be fully repaid within 31 days of December 31st through an equivalent advance being made under the 2011 DLRR Loan. Advances under the 2011 DLRR Loan are repayable in 48 equal monthly principal payments plus interest. Advances under the 2011 DLRR Loan will be made annually and solely for such purpose. The Company may elect to pay interest on the 2011 DLRR Loan either at the BMO U.S. Base Rate plus 1.25% or LIBOR plus 2.50%. The 2011 Demand Loan Facilities are subject to an undrawn aggregate standby fee of 0.20% following the first draw, which fee is payable quarterly in arrears.

## Amended Credit Facility – General Terms and Conditions

Under the Amended Credit Facility, the Company will continue to make annual cash sweep payments to the Bank; based on its audited financial statements provided, however, that such payments will be applied solely to amounts outstanding under the 2011 DLRR Loan in inverse order of maturity, and will no longer be applied to outstanding balances under Existing Demand Loan 1 or the 2011 DLR Loan.

Under the terms of the agreement, the Company has agreed to comply with certain customary non-financial covenants and restrictions. In addition, the Company has agreed to comply with the following financial covenants at all times: (i) Maximum Senior Funded Debt to EBITDA of 2.00:1; (ii) Maximum Total Funded Debt to EBITDA of 2.50:1; and (iii) Minimum Fixed Charge Coverage of 1.25:1. Further, the Company’s Maximum Annual Capital Expenditures cannot exceed \$3.6 million per year, which such limit will be reviewed on an annual basis. As of, and for the period ended, September 30, 2011, the Company was in compliance with these covenants.

Principal loan repayments over the next five years are as follows:

2011	\$1,559,722
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## 7. DERIVATIVE INSTRUMENT ASSETS AND LIABILITIES:

The Company enters into foreign currency contracts to hedge a portion of the Company's expected Canadian dollar requirements. All derivative financial instruments are recorded at fair value on our consolidated balance sheet. The fair value of our foreign currency contracts at September 30, 2011 was a net unrealized loss of \$1.6 million as compared to a net unrealized gain of \$0.8 million at December 31, 2010. The net unrealized loss is a result of fluctuations in foreign exchange rates between the date the currency forward contracts were entered into and the valuation date at period end.

At September 30, 2011, 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
October – December, 2011	\$750,000	0.9560	\$1,090
October – December, 2011	4,700,000	1.0015	(208,672 )
2011	5,450,000	0.9950	(207,582 )
January – March, 2012	5,100,000	1.0251	(345,692 )
April – June, 2012	5,100,000	1.0220	(335,397 )
July – September, 2012	5,100,000	1.0147	(303,990 )
October – December, 2012	5,100,000	1.0147	(307,174 )
2012	20,400,000	1.0191	(1,292,253 )
January – March, 2013	6,000,000	0.9730	(124,309 )
2013	6,000,000	0.9730	(124,309 )
Total	\$31,850,000	0.9918	\$(1,624,144 )

The Company does not apply hedge accounting and, therefore, for the three and nine months ended September 30, 2011, the Company recorded a loss of \$2.2 million and \$2.5 million, respectively, in the fair value of forward contracts in its consolidated statements of operations. For the three months ended September 30, 2010, the Company recorded a gain on forward contracts of \$0.1 million, while for the nine months ended September 30, 2010, the Company recorded a loss on forward contracts of \$1.7 million.

## 8. INCOME TAXES

For the nine months ended September 30, 2011, the Company recorded a provision for income taxes of \$0.8 million on income before income taxes of \$0.9 million, using an estimated effective tax rate for its 2011 fiscal year adjusted for certain foreign exchange losses for which the Company does not anticipate obtaining a current tax benefit. Comparatively, for the nine months ended September 30, 2010, the Company recorded a provision for income taxes of \$0.2 million on income before income taxes of \$1.1 million, using an estimated effective tax rate for its 2010 fiscal year adjusted for certain foreign exchange losses for which the Company does not anticipate obtaining a current tax benefit. This amount is offset by a recovery of \$0.1 million in respect of refundable Ontario research tax credits.

As of December 31, 2010, the Company recorded a valuation allowance of \$3.7 million and a net deferred tax asset of \$3.0 million. As of September 30, 2011 the Company has recorded a non-current deferred tax asset of \$3.6 million

and a current deferred tax liability of \$0.6 million. As of September 30, 2011 and December 31, 2010, the Company has also recorded a non-current deferred tax liability related to the temporary difference arising on indefinite life intangibles of \$4.8 million. In addition, during the three months ended September 30, 2011, the Company recorded a non-current deferred tax liability related to the temporary difference on acquired intangibles of \$0.5 million.

The Company analyzes the carrying value of its net deferred tax assets on a regular basis. In determining future taxable income, assumptions are made to forecast federal, state and international operating income, the reversal of temporary timing differences, and the implementation of any feasible and prudent tax planning strategies. The assumptions require significant judgment regarding the forecasts of future taxable income, and are consistent with other forecasts used to manage the business. During the nine months ended September 30, 2011, there was no reversal of the valuation allowance. The valuation allowance will be maintained until sufficient evidence exists to support a reversal of the valuation allowance.

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 \$0.2 million of total gross unrecognized tax benefit as of September 30, 2011 and \$0.2 million of total gross unrecognized tax benefit as of December 31, 2010, 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 and other insignificant US state taxes as well as unrecognized tax benefits for 2010 Canadian research and development tax credits. The Company is evaluating whether to file a Canadian research and development claim for 2011 and expects that if such a claim is filed the amount of credits are not expected to be significant. 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 as of September 30, 2011 and December 31, 2010, respectively. The Company believes it is reasonably possible that all of the unrecognized tax benefit will decrease in the next twelve months as it is anticipated that the U.S. tax authorities will finalize their review of prior taxes owing in Pennsylvania within the period, certain other prior year state tax returns will be filed and the 2010 Canadian research and development claim will be assessed.

#### 9. 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 September 30, 2011	Three months ended September 30, 2010	Six months ended September 30, 2011	Six months ended September 30, 2010
Numerator for basic and diluted earnings (loss) per common share:				
Net income (loss) for the period	\$(1,152,139 )	\$1,083,156	\$141,466	\$880,244
Denominator for basic and diluted earnings (loss) per common share:				
Basic weighted average number of common shares outstanding	53,452,205	57,351,161	53,444,959	59,255,739
Effect of outstanding stock options	—	1,834,632	2,303,818	1,967,630
Diluted weighted average number of shares outstanding	53,452,205	59,185,793	55,748,777	61,223,369
Basic earnings (loss) per common share	\$(0.02 )	\$0.02	\$—	\$0.01
Diluted earnings (loss) per common share	\$(0.02 )	\$0.02	\$—	\$0.01

For the three months ended September 30, 2011, 5,511,474 shares underlying potentially dilutive securities of were excluded from the computation of diluted weighted average number of shares outstanding as they were anti-dilutive to the basic loss per share. During the three months ended September 30, 2010, outstanding options to purchase 3,755,000 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.

For the nine months ended September 30, 2011, outstanding options to purchase 3,243,000 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 and as a result are considered anti-dilutive. During the nine months ended September 30, 2010, outstanding options to purchase 3,023,500 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 nine months ended September 30, 2010, 3,409,300 common shares were repurchased and cancelled under the terms of our stock repurchase program announced in February 2010. No shares were repurchased under this program during the nine months ended September 30, 2011.

The computation of earnings per share and diluted earnings per share for the three and nine months ended September 30, 2010 includes reductions in the number of shares outstanding due to these repurchases. No common shares were repurchased during the three or nine months ended September 30, 2011.

#### 10. SUPPLEMENTAL INFORMATION:

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

	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
OpenSRS :				
Domain Services	\$ 19,698,403	\$ 16,517,427	\$ 55,458,510	\$ 47,669,347
Email Services	636,210	577,606	1,949,963	1,796,452
Other Services	1,211,955	1,086,102	3,685,167	3,264,758
Total OpenSRS Services	21,546,568	18,181,135	61,093,640	52,730,557
YummyNames	1,784,510	1,249,128	4,471,992	4,592,297
Hover	1,357,878	1,147,576	3,831,299	3,388,036
Butterscotch	405,100	631,629	1,298,255	1,790,329
	\$ 25,094,056	\$ 21,209,468	\$ 70,695,186	\$ 62,501,219

No customer accounted for more than 10% of the Company's revenue for the three and nine months ended September 30, 2011 or the three and nine months ended September 30, 2010. 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.

As of September 30, 2011, one customer accounted for 13% of accounts receivable, all of which has been paid subsequent to September 30, 2010. As of September 30, 2010, two customers accounted for 29% of accounts receivable.

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

	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
OpenSRS :				
Domain Services	\$ 16,469,844	\$ 13,817,541	\$ 46,144,055	\$ 39,523,115
Email Services	73,800	97,001	270,534	321,459
Other Services	432,888	416,938	1,232,082	1,204,403
Total OpenSRS Services	16,976,532	14,331,480	47,646,671	41,048,977
YummyNames	179,312	179,894	564,638	636,389
Hover	494,879	380,262	1,332,743	1,129,996
Butterscotch	7,925	11,889	34,672	56,127
Network, other costs	1,193,669	1,087,930	3,691,995	3,500,826
Network, depreciation and amortization costs	183,151	306,055	658,641	1,018,774
	\$ 19,035,468	\$ 16,297,510	\$ 53,929,360	\$ 47,391,089

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

	September 30, 2011	December 31, 2010
Canada	\$ 930,290	\$ 1,041,692
Europe	24,123	—
United States	359,198	510,657
	\$ 1,313,611	\$ 1,552,349

#### 11. 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 September 30, 2011 cannot be predicted with certainty, management believes that their resolution will not have a material adverse effect on the Company's financial position.



## 12. STOCKHOLDERS' EQUITY:

The following unaudited table summarizes stockholders' equity transactions for the three and nine month period ended September 30, 2011:

	Common Stock Shares	Common Stock Amount	Additional Paid in Capital	Accumulated Other Comprehensive Income	Deficit	Total Stockholders' equity
Balances, December 31, 2010	53,448,591	\$ 11,324,866	\$ 40,700,587	\$ —	\$ (28,104,216)	\$ 23,921,237
Exercise of stock options	7,250	6,268	(2,808 )	—	—	3,460
Stock-based compensation	—	—	127,730	—	—	127,730
Cancellation of restricted stock	(450 )	—	—	—	—	—
Net income for the period	—	—	—	—	1,293,605	1,293,605
Balances, June 30, 2011	53,455,391	11,331,134	40,825,509	—	(26,810,611)	25,346,032
Exercise of stock options	22,583	18,479	(7,794 )	—	—	10,685
Stock-based compensation	—	—	120,887	—	—	120,887
Cancellation of restricted stock	(100 )	—	—	—	—	—
Accumulated other comprehensive income	—	—	—	(26,121 )	—	(26,121 )
Net loss for the period	—	—	—	—	(1,152,139 )	(1,152,139 )
Balances, September 30, 2011	53,477,874	\$ 11,349,613	\$ 40,938,602	\$ (26,121 )	\$ (27,962,750)	\$ 24,299,344

On February 16, 2010, the Company's Board of Directors authorized the repurchase of up to \$10 million of the Company's common stock at the Company's discretion. Under this repurchase program, the Company did not repurchase any shares during the three months ended September 30, 2010, and repurchased 3,409,300 shares during the nine months ended September 30, 2010. This repurchase program was terminated on September 9, 2010 when Tucows announced its intention to commence a Dutch Auction Tender Offer.

## 13. SHARE-BASED PAYMENTS

- (a) Stock options

The Company's 1996 Stock Option Plan (the "1996 Plan") was established for the benefit of the employees, officers, directors and certain consultants of the Company. The maximum number of common shares which may be set aside for issuance under the 1996 Plan was 11,150,000 shares, provided that the Board of Directors of the Company has the right, from time to time, to increase such number subject to the approval of the stockholders of the Company when required by law or regulatory authority. Generally, options issued under the 1996 Plan vest over a four-year period. The 1996 Plan expired on February 25, 2006 and no options have been issued from the 1996 Plan after that date.

The Company's Amended and Restated 2006 Equity Compensation Plan (the "2006 Plan"), serves as a successor to the 1996 Plan. The 2006 Plan was established for the benefit of the employees, officers, directors and certain consultants of the Company. The Plan was amended and restated at the Annual General Meeting of the Stockholders on September 7, 2010 to extend the term thereof to September 6, 2020 and to increase the number of shares of common stock authorized for issuance thereunder from 5,000,000 to 6,900,000. The 6,900,000 common shares that have been set aside for issuance under the 2006 Plan are to provide eligible persons with the opportunity to acquire a proprietary interest, or otherwise increase their proprietary interest, in Tucows. Generally, options issued under the 2006 Plan vest over a four-year period and have a term not exceeding seven years.

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 September 30, 2011, stock options to purchase 706,000 common shares were granted, compared to options to purchase 200,000 common shares granted during the three months ended September 30, 2010.

During the nine months ended September 30, 2011, stock options to purchase 706,000 common shares were granted, compared to options to purchase 1,794,000 common shares granted during the nine months ended September 30, 2010.

The stock options granted during the three and nine months ended September 30, 2011 expire on various dates through 2018.

Details of stock option transactions for the three months ended September 30, 2011 and September 30, 2010 are as follows:

	Three months ended September 30, 2011		Three months ended September 30, 2010	
	Number of Shares	Weighted Average exercise price per share	Number of Shares	Weighted Average exercise price per share
Outstanding, beginning of period	8,237,124	\$0.55	8,224,083	\$0.56
Granted	706,000	0.74	220,000	0.62
Exercised	(22,583 )	0.47	—	—
Forfeited	(24,875 )	0.75	(61,042 )	0.65
Expired	—	—	—	—
Outstanding, end of period	8,895,666	\$0.54	8,383,041	\$0.56
Options exercisable, end of period	7,155,916	\$0.54	6,267,541	\$0.51

Details of stock option transactions for the nine months ended September 30, 2011 and September 30, 2010 are as follows:

	Nine months ended September 30, 2011		Nine months ended September 30, 2010	
	Number of Shares	Weighted Average exercise price per share	Number of Shares	Weighted Average exercise price per share
Outstanding, beginning of period	8,272,249	\$0.56	7,203,977	\$0.56
Granted	706,000	0.74	1,794,000	0.69
Exercised	(29,833 )	0.47	(33,678 )	0.44
Forfeited	(52,750 )	0.72	(99,167 )	0.66
Expired	—	—	(482,091 )	1.02
Outstanding, end of period	8,895,666	\$0.54	8,383,041	\$0.56
Options exercisable, end of period	7,155,916	\$0.54	6,267,541	\$0.51



As of September 30, 2011, the exercise prices, weighted average remaining contractual life and intrinsic values of outstanding options were as follows:

Exercise price	Options outstanding			Options exercisable			
	outstanding	Weighted average exercise price per share	Weighted average remaining contractual life (years)	Aggregate intrinsic value	Number exercisable	Weighted average exercise price per share	Aggregate intrinsic value
\$ 0.31-\$0.49	3,667,712	\$ 0.38	1.8	\$ 1,386,302	3,667,712	\$ 0.38	\$ 1,386,302
\$ 0.56-\$0.75	4,110,454	\$ 0.66	4.6	423,364	2,370,704	\$ 0.63	315,672
\$ 0.80-\$0.99	1,117,500	\$ 0.86	2.3	—	1,117,500	\$ 0.86	—
	8,895,666	\$ 0.57	3.1	\$ 1,809,666	7,155,916	\$ 0.54	\$ 1,701,974

Total unrecognized compensation cost relating to unvested stock options at September 30, 2011, prior to the consideration of expected forfeitures, was approximately \$597,000 and is expected to be recognized over a weighted average period of 2.8 years.

The Company recorded stock-based compensation of \$120,685 and \$155,570 for the three months ended September 30, 2011 and 2010, respectively.

The Company recorded stock-based compensation of \$248,058 and \$313,055 for the nine months ended September 30, 2011 and 2010, 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 and nine months ended September 30, 2011, 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.

Holder 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.

Total unrecognized compensation cost relating to unvested restricted stock awards at September 30, 2011, prior to the consideration of expected forfeitures, was approximately \$1,100 and is expected to be recognized over a weighted average period of 1.5 years.

The Company recorded stock-based compensation associated with restricted stock awards of \$202 and \$216 for the three months ended September 30, 2011 and 2010, respectively.

The Company recorded stock-based compensation associated with restricted stock awards of \$558 and \$633 for the nine months ended September 30, 2011 and 2010, respectively.



## 14. 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 September 30, 2011:

	September 30, 2011			Assets at Fair Value
	Level 1	Level 2	Level 3	
Derivative instrument asset	\$—	\$1,090	\$—	\$1,090
Total Assets	\$—	\$1,090	\$—	\$1,090
Derivative Instrument liability	\$—	\$1,625,234	\$—	\$1,625,234
Total Liabilities	\$—	\$1,625,234	\$—	\$1,625,234

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, 2010:

	December 31, 2010			Assets at Fair Value
	Level 1	Level 2	Level 3	
Derivative instrument asset	\$—	\$833,960	\$—	\$833,960
Total Assets	\$—	\$833,960	\$—	\$833,960

## 15. RECLASSIFICATION

Certain of the prior periods' comparative figures have been reclassified to conform with the presentation adopted in the current period.

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” and “intend,” and other similar 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 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 TLDs by ICANN; 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, 2010.



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 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 12,000 resellers in over 120 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 Operations 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 some 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 platforms for both resellers and end-users.

On August 1, 2011, we completed the acquisition of EPAG for a total consideration of approximately US\$2.4 Million. EPAG is an ICANN-accredited registrar with over 400,000 domains under management and is notable for offering over 200 Top Level Domains (TLDs). We believe that the acquisition of EPAG provides highly complementary services, sales channels and operating capabilities and that completing the acquisition further strengthens our position as a leader in wholesale domain registration and extends our ability to provide a broad TLD coverage to our resellers. In addition, it has brought us customers to whom we have substantial cross- and up-sell opportunity. We have determined that the operations of EPAG are consistent with our OpenSRS service and therefore, no change to our operating segment resulted. See Note 3, Acquisitions for additional information on the acquisition.

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:

OpenSRS, our wholesale service, manages eleven million domain names, under its accreditation by the Internet Corporation for Assigned Names and Numbers, or ICANN, as well as names Tucows manages for other registrars under their own accreditations; millions of mailboxes and tens of thousands of digital certificates through a network of over 12,000 web hosts, Internet service providers, or ISPs, and other resellers around the world. In addition, OSRS provides ISPs with Platypus, our industry-specific solution for billing, service provisioning and customer account management.

Hover, our retail service, offers services similar to those of OpenSRS to consumers and small businesses.

YummyNames, our domain portfolio service, manages tens of thousands of domain names, most of which generate advertising revenue and many of which we offer for resale via our reseller network and other channels. Included in the YummyNames domain portfolio are over 42,000 domains that allow over two-thirds of Americans to purchase a

domain or email address based on their name.

Butterscotch, our content service, operates two advertising-supported websites, butterscotch.com and tucows.com/downloads, which provide content to help consumers overcome the complexity of modern technology and the Internet.

Our business model is characterized by non-refundable, up-front payments, which lead to recurring revenue and positive operating cash flow. We are an ICANN-accredited registrar and manage ten million domains under our ICANN accreditation, as well as names we manage for other registrars under their own accreditations.

For the three months ended September 30, 2011 and 2010, we reported revenue of \$25.1 million and \$21.2 million, respectively. For the three months ended September 30, 2011 and 2010, our OpenSRS domain service offering accounted for 78% of each of our total revenue.

For the nine months ended September 30, 2011 and 2010, we reported revenue of \$70.7 million and \$62.5 million, respectively. For the nine months ended September 30, 2011 and 2010, our OpenSRS domain service offering accounted for 79% and 77% 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, 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:

	Three months ended September 30, 2011		Nine months ended September 30, 2011		2010
			(in 000's) (1)		
Total new, renewed and transferred-in domain name registrations provisioned	2,164	1,811	6,372	5,583	
Domain names under management:					
Provisioned on behalf of Tucows	10,348	8,665	10,348	8,665	
Provisioned on behalf of accredited registrars	1,368	1,746	1,368	1,746	
Total domain names under management	11,716	10,411	11,716	10,411	

(1) The increase in domains under management reflects the 400,000 domains added through the acquisition of EPAG Domainservices GMBH which we acquired on August 1, 2011.

(2) For a discussion of these period to period changes in the domains provisioned and 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.

Additional competition to our business may arise from the upcoming introduction of new TLDs by ICANN. ICANN have announced their intention to accept applications for new gTLDs domain name extensions by the beginning of 2012 with new registration opportunities available by the end of 2012. We do not yet know the impact, if any, that these new domain extensions may have on our business. Applicants for such new TLDs (including ones for which we could apply) may have greater financial, technical, marketing and other resources than we do. Furthermore, ICANN will allow the operators of new gTLDs to also own, be owned 100% by or otherwise affiliated with a registrar which may place us at a competitive disadvantage. While we may apply for one or more of these new domain extensions, there is no certainty that we will ultimately be successful, and even if we are successful in obtaining one or more of these new domain extensions, there is no guarantee that such extensions will be any more successful than the domain name extensions obtained by our competitors.

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.

In 2007, we entered into contractual agreements with Verisign for the supply of domain names. These agreements expire in 2012. Under the agreements, Verisign charges a fee for .com and .net domain names of \$7.34 and \$5.40 respectively, for each year for which a domain name is registered. In addition, in terms of Verisign's agreement with ICANN, Verisign has the right to increase the fee it charges for a .com or .net domain name by up to an additional 7% once in either 2011 or 2012. Mandated registry price increases such as this will adversely increase our service costs as a percentage of our total revenue. To implement this price increase however, Verisign is required to give registrars six months' notice.

In 2009, our contractual agreement with ICANN was amended to extend the terms of the agreement through June 30, 2014. Under the agreement, ICANN charges a \$0.18 fee for each year that a domain name is registered in the TLDs that fall within its purview. In addition, ICANN recently announced the timing and framework for a potentially significant expansion of the number of generic TLDs, or gTLDs. Although there can be no assurance that any gTLD expansion will occur, we believe that such expansion, if any, should result in an increase in the number of domains we register and related revenues.

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.

Display advertising from the desk-top software download site has historically been the largest source of Butterscotch revenue. This revenue stream has suffered from the secular shift away from desktop software. This shift may result in a decline in Butterscotch revenue.

#### Net Revenues

##### OpenSRS

We derive revenue from our reseller network by providing them with reseller services that comprise (a) domain service, (b) email service and (c) other services. From time to time we receive fees from vendors to expand or maintain the market position for their services. These market development funds are recognized as earned and are reflected under other services. In the case where these programs do not meet the criteria for revenue recognition under ASC 605-50 "Customer Payments and Incentives", they are reflected as cost of goods sold. Additionally, other services include revenue from secure sockets layer, or SSL certificates sales, as well as revenue from the sale of blogware, billing services and website building tools that are used by our resellers to create bundles of Internet services for their end-users.

##### 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 customer will engage us, enabling us to follow on with other services and allowing us to add to our domain portfolio by purchasing names registered through us upon their expiration. We also provide resellers with the ability to sell personal names. This service allows resellers the opportunity to sell email addresses based on our domain portfolio of surname domain names.

With the acquisition of EPAG, we now offer registration services for over 200 Top Level Domains (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 July 2010, registry fees for the .com and .net registrations supplied by

our largest registry supplier, Verisign, were increased by an additional 7%. This increase in registry fees, in accordance with our pricing policy, was passed on to our customers at cost. 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 name services. 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. Except for certain large customers with whom we have negotiated alternative arrangements, payments for the full term of service are received at the time of activation of service. All fees received in connection with domain name registration are non-refundable, and where appropriate, are recorded as deferred revenue and 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.

### OpenSRS Email Service

We derive revenue from our hosted email service through our global distribution network. Our 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 email service also includes spam and virus filtering on all accounts. End-users can access the email service via a full-featured, multi-language AJAX-enabled web interface, a WAP mobile interface, or through traditional desktop email clients, such as Microsoft Outlook or Apple Mail, using IMAP or POP/SMTP and 2GB of email storage.

We earn fees for email services when such services are activated. Email services are generally purchased monthly and, at month-end, are either deducted on a pre-authorized basis from reseller’s deposit account, or are invoiced.

### Other OpenSRS Services

We derive revenue from other services primarily from provisioning SSL certificates. From time to time, we also receive fees from vendors to expand or maintain the market position for their services. These market development funds are earned as incurred and are reflected under other services revenue. Any accrued market development funds are offset against accounts receivable. In addition, we provision blogware and website building tools that are used by our resellers to create bundles of Internet services for their end-users, as well as the provision of billing, provisioning and customer care software solutions to ISPs through our Platypus billing software.

We earn fees from such services when a service is activated. These services are generally purchased for terms of one month to three years. Platypus software is generally purchased for terms of one month to one year. Payments for services are for the full term of all services at the time of activation of service, are non-refundable and, where appropriate, are recorded as deferred revenue and recognized as earned ratably over the service term. This accounting treatment reasonably approximates a recognition pattern that corresponds with the provision of the services during the quarters and the year.

### YummyNames

We derive revenue from our portfolio of domain names by displaying advertising on the domains and by making them available for sale or lease. In addition we display advertising on “parked pages” within OpenSRS. Parked pages are domain names registered with us that do not yet contain an active website. 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.

In addition, we also offer the same services to our customers, allowing them to make available names registered by them for monetization on a similar basis. For customer names, we earn a referral fee for premium names or names sold or leased, and participate on a revenue share basis for names offered through our pay-per-click advertising program.

We recognize revenue from these services, net of any fees payable to resellers or customers, immediately upon completion of the service, or in the case of advertising revenue, on a monthly basis once the advertising has been served.

## Hover

Hover sells retail Internet domain name registration and email services to individuals and small businesses via its website at <http://hover.com>. These services include the sale of personalized email through TuCows' portfolio of surname-based domain names as well as simplified interfaces that allow customers to connect their domain names to websites and email addresses through a unique domain forwarding system.

Our customers purchase services in one to ten year terms, with a majority of services purchased for a one-year term. Payments for the full term of all services are received at the time of service activation and, where appropriate, are recorded as deferred revenue and 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 quarterly and annual periods.

## Butterscotch

We also generate advertising and other revenue through two ad-supported content sites, [butterscotch.com](http://butterscotch.com) and [tucows.com](http://tucows.com).

[Butterscotch.com](http://butterscotch.com) and [Tucows.com](http://tucows.com) primarily derive revenue from banner and text advertising on their sites. In addition, their revenue is derived from software developers who rely on us as a primary source of distribution.

Advertising and other revenue is recognized ratably over the period in which it is presented. To the extent that we do not meet the minimum number of post-presentation impressions that we guarantee to customers, we defer recognition of the corresponding revenues until the guaranteed impressions are achieved. Custom video production revenue is recognized on acceptance of the completed video by the customer.

## 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, 2010, or Fiscal 2010, 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 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:  
OpenSRS (Domain, Email and Other Services);  
YummyNames;

Hover; and  
Butterscotch.

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 fair value exists for all elements, we allocate revenue to each element based on the relative fair value of each of the elements. Fair value is established by the price charged when that element is sold separately. For arrangements where fair value exists only for the undelivered elements, we defer the fair value of the undelivered elements and recognize the difference between the total arrangement fee and the amount deferred for the undelivered items as revenue related to the delivered items, assuming all other criteria for revenue recognition have been met. 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.

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Revenue from the sale of domain names, through YummyNames, 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 our online libraries of shareware, freeware and online services presented at our websites, [tucows.com](http://tucows.com) and [butterscotch.com](http://butterscotch.com). 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. Custom video production revenue is recognized on acceptance of the completed video by the customer.

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 establish reserves for possible uncollectible accounts receivable and other 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 reserves may be required.

#### Valuation of Intangible Assets, Goodwill and Long-lived Assets

Goodwill represents the excess of purchase price over the fair values assigned to the net assets acquired in business combinations. Finite life intangible assets, related to the acquisition of EPAG Domainservices GMBH in July 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.

Goodwill and indefinite life intangibles are not amortized, but are tested for impairment annually or more frequently if circumstances indicate potential impairment, through a comparison of fair value to carrying amount. Goodwill and indefinite life intangibles are tested for impairment annually at the same time every year, and when an event occurs or circumstances change such that it is reasonably possible that impairment may exist. We review goodwill and indefinite life intangibles at least annually for possible impairment in the fourth quarter of each year as more fully described under the caption "Critical Accounting Policies" in our Annual Report on Form 10-K for the fiscal year ended December 31, 2010.

With regards to property, equipment and definite life intangible assets, we continually evaluate whether events or circumstances have occurred that indicate the remaining estimated useful lives of its 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 and nine months ended September 30, 2011 or during the three and nine months ended September 30, 2010.

Determining the number of reporting units and the fair value of a reporting unit requires us to make judgments and involves the use of significant estimates and assumptions. These estimates and assumptions include revenue growth rates and operating margins used to calculate projected future cash flows, risk-adjusted discount rates, future economic and market conditions, and determination of appropriate market comparables as more fully described under the caption "Critical Accounting Policies" in our Annual Report on Form 10-K for the fiscal year ended December 31, 2010. We base our fair value estimates on assumptions we believe to be reasonable but that are unpredictable and inherently uncertain. The long-term financial forecast represents the best estimate that we have at this time and we believe that its underlying assumptions are reasonable. However, actual performance in the near-term and longer-term could be materially different from these forecasts, which could impact future estimates of fair value of our reporting units and may result in a charge to earnings in future periods due to the potential for a write-down of goodwill in connection with such tests.

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. As of September 30, 2011, we had \$18.0 million in goodwill and \$16.3 million in intangible assets.

#### 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. 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 assets 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 AND NINE MONTHS ENDED SEPTEMBER 30, 2011 AS COMPARED TO THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2010

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

	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
OpenSRS :				
Domain Services	\$ 19,698,403	\$ 16,517,427	\$ 55,458,510	\$ 47,669,347
Email Services	636,210	577,606	1,949,963	1,796,452
Other Services	1,211,955	1,086,102	3,685,167	3,264,758
Total OpenSRS Services	21,546,568	18,181,135	61,093,640	52,730,557
YummyNames	1,784,510	1,249,128	4,471,992	4,592,297
Hover	1,357,878	1,147,576	3,831,299	3,388,036
Butterscotch	405,100	631,629	1,298,255	1,790,329
	\$ 25,094,056	\$ 21,209,468	\$ 70,695,186	\$ 62,501,219
Increase over comparative period				
	\$ 3,884,588		\$ 8,193,967	
Increase - percentage	18	%	13	%

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

	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
OpenSRS :				
Domain Services	78	%	78	%
Email Services	3	%	3	%
Other Services	5	%	5	%
Total OpenSRS Services	86	%	86	%
YummyNames	7	%	6	%
Hover	5	%	5	%
Butterscotch	2	%	3	%
	100	%	100	%

Deferred revenue from domain name registrations and other services at September 30, 2011 increased to \$68.9 million from \$62.3 million at September 30, 2010. Deferred revenue as of September 30, 2011 includes \$1.4 million that was recorded at fair value on the acquisition of EPAG on August 1, 2011. The fair value of deferred revenue was determined by estimating the future costs for customer service that will be incurred over the remaining life of the deferred revenue contract plus the prepaid registry fees, with a normal profit margin added to fulfill the related contractual obligations. The fair value of the acquired deferred revenue was approximately 23% less than the pre-acquisition historical basis of EPAG.

No customer accounted for more than 10% of revenue during the three and nine months ended September 30, 2011 and, at September 30, 2011, one customer accounted for 13% of accounts receivable, all of which has been paid subsequent to September 30, 2011. As of September 30, 2010, two customers accounted for 29% 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.

#### OpenSRS

For the three months ended September 30, 2011, OpenSRS revenue increased by \$3.4 million, or 19%, to \$21.5 million when compared to the three months ended September 30, 2010, primarily as a result of OpenSRS domain revenue increasing by \$3.2 million or 19% to \$19.7 million. This increase resulted primarily from our success in attracting customers with increased transaction volumes and the impact of the 7% registration fee increase implemented in July 2010 for registration fees paid to certain registries. In addition, email revenue increased by \$0.1 million or 10% to \$0.6 million and other services increased by \$0.1 million or 12% to \$1.2 million as a result of market development funds vendors have provided us to expand or maintain the market position for their services. Other service increases may not be repeatable as our vendor partners may elect to cancel or amend their marketing programs at any time.

For the nine months ended September 30, 2011, OpenSRS revenue increased by \$8.4 million, or 16%, to \$61.1 million when compared to the nine months ended September 30, 2010, primarily as a result of OpenSRS domain revenue increasing by \$7.8 million or 16% to \$55.5 million. This increase resulted primarily from the impact of passing on the 7% registration fee increase implemented in July 2010 for registration fees paid to certain registries and from our success in attracting customers with increased transaction volumes. In addition, email revenue increased by \$0.2 million or 9% to \$1.9 million and other services increased by \$0.4 million or 13% to \$3.7 million as a result of market development funds vendors have provided us to expand or maintain the market position for their services. Other service increases may not be repeatable as our vendor partners may elect to cancel or amend their marketing programs at any time.



During the three months ended September 30, 2011, the number of transactions from all new, renewed and transferred-in domain name registrations that we processed increased by 0.4 million transactions to 2.2 million transactions as compared to the three months ended September 30, 2010. During the nine months ended September 30, 2011, the number of transactions from all new, renewed and transferred-in domain name registrations that we processed increased by 0.8 million transactions to 6.4 million transactions as compared to the nine months ended September 30, 2010. While we anticipate that the number of new, renewed and transferred-in domain name registrations will continue to incrementally increase in the long term, the volatility in the market could affect the growth of domain names that we manage.

In addition, new TLDs, including new IDN TLDs, ccTLDs and gTLDs, may be introduced by ICANN in 2012. 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, 2010.

As of September 30, 2011, the total domain names under our management increased by 1.6 million to 10.3 million, when compared to September 30, 2010. This increase includes the 0.4 million domains that were added through the acquisition of EPAG. 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 September 30, 2011, we managed 1.4 million domain names on behalf of other accredited registrars, a decrease of 0.3 million compared to the 1.7 million managed for accredited registrars as of September 30, 2010. The decrease is primarily attributable to the loss of an accredited registrar who had 0.3 million domains under management with us who have transferred their domain registration business to a competitive registrar with whom they have a reciprocal supply arrangement.

#### YummyNames

Net revenues from our YummyNames domain portfolio service for the three months ended September 30, 2011 as compared to the three months ended September 30, 2010 increased by \$0.5 million, or 43%, to \$1.8 million.

Net revenues from our YummyNames domain portfolio service for the nine months ended September 30, 2011 as compared to the nine months ended September 30, 2010 decreased by \$0.1 million, or 3%, to \$4.5 million.

During the three months ended September 30, 2011, we earned \$1.5 million by making domain names in our portfolio available for sale or lease compared to \$0.9 million during the three months ended September 30, 2010. In addition we earned \$0.3 million from our pay-per-click advertising or parked pages program during the three months ended September 30, 2011 compared to \$0.3 million during the three months ended September 30, 2010.

During the nine months ended September 30, 2011, we earned \$3.7 million by making domain names in our portfolio available for sale or lease compared to \$3.6 million during the nine months ended September 30, 2010. In addition we earned \$0.8 million from our pay-per-click advertising or parked pages program during the nine months ended September 30, 2011 compared to \$1.0 million for the nine months ended September 30, 2010.

The increase in portfolio sales primarily reflects the timing of portfolio domain names sales and the decreased contribution we receive from third-parties on the delivery of advertisements on parked pages as a result of changes parked page vendors have experienced from their advertising network partners.

The market for monetization of domain names is rapidly evolving and there is no guarantee that we will be able to continue to acquire the same caliber of names for our portfolio from future expiring domains or that names we acquire in future will provide the same revenue impact as we have experienced from past acquisitions. In addition, the revenue we derive from domain portfolio services is driven by general macroeconomic factors that affect internet advertising. Our advertising revenues are typically sensitive to economic conditions and tend to decline in recessionary periods

and other periods of economic uncertainty.

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## Hover

The increase in net revenues from Hover for the three months ended September 30, 2011 as compared to the three months ended September 30, 2010 increased by \$0.2 million, or 18%, to \$1.4 million. We believe that this increase reflects the success our marketing initiatives and improved website are having on our ability to attract new customers and retain existing ones.

Net revenues from Hover for the nine months ended September 30, 2011 as compared to the nine months ended September 30, 2010 increased by \$0.4 million, or 13%, to \$3.8 million. We believe that this increase reflects the success of our marketing initiatives and improved website in attracting new customers and retaining existing ones.

## Butterscotch

Net revenues from Butterscotch for the three months ended September 30, 2011 as compared to the three months ended September 30, 2010 decreased by \$0.2 million, or 36%, to \$0.4 million.

Net revenues from Butterscotch for the nine months ended September 30, 2011 as compared to the nine months ended September 30, 2010 decreased by \$0.5 million, or 27%, to \$1.3million.

These decreases reflect the decrease in revenue from certain corporate video initiatives that were undertaken during fiscal 2010 not recurring during fiscal 2011 as well as a decrease in revenues from the display advertising from the Tucows.com desk-top software libraries (which historically has been the largest source of Butterscotch revenue) and our Author Resource Center.

## COST OF REVENUES

### OpenSRS

#### 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.

#### OpenSRS Email Service

Cost of revenues for email services are payable to third-party providers for licensing and royalty costs related to the provision of certain components of our email services. Fees payable for these components are included in the cost of revenues in the month they are incurred.

#### Other OpenSRS Services

Costs of revenues for other reseller services include fees paid to third-party service providers, primarily for SSL certificates and for printing services in connection with Platypus. Fees payable for SSL certificates are amortized on a basis consistent with the provision of service, generally one year, while monthly printing fees are included in cost of revenues in the month they are incurred.

YummyNames

Costs of revenues for our domain portfolio service 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.

## Hover

Costs of revenues for our provision and management of Internet services on a retail basis 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 and includes the amortization of registry fees payable to renew the domains in our surname portfolio. 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.

## Butterscotch

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

## General

As a significant portion of our expenses are incurred in Canadian dollars, the strengthening of the Canadian dollar relative to the U.S. dollar has negatively impacted all of our operating costs during the three and nine months ended September 30, 2011 when compared to the three and nine months ended September 30, 2010. The Canadian dollar relative to the U.S. dollar has strengthened, on average, by approximately 8% as compared to the three months ended September 30, 2010 and by approximately 7% as compared to the nine months ended September 30, 2010. 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.

## 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 September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
OpenSRS :				
Domain Services	\$ 16,469,844	\$ 13,817,541	\$ 46,144,055	\$ 39,523,115
Email Services	73,800	97,001	270,534	321,459
Other Services	432,888	416,938	1,232,082	1,204,403
Total OpenSRS Services	16,976,532	14,331,480	47,646,671	41,048,977
YummyNames	179,312	179,894	564,638	636,389
Hover	494,879	380,262	1,332,743	1,129,996
Butterscotch	7,925	11,889	34,672	56,127
Network, other costs	1,193,669	1,087,930	3,691,995	3,500,826
Network, depreciation and amortization costs	183,151	306,055	658,641	1,018,774
	\$ 19,035,468	\$ 16,297,510	\$ 53,929,360	\$ 47,391,089
Increase over comparative period	\$ 2,737,958		\$ 6,538,271	

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Increase - percentage	17	%		14	%
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The following table presents our cost of revenues, as a percentage of total revenues:

	Three months ended September 30,				Nine months ended September 30,			
	2011		2010		2011		2010	
OpenSRS :								
Domain Services	65	%	66	%	65	%	63	%
Email Services	0	%	0	%	0	%	1	%
Other Services	2	%	2	%	2	%	2	%
Total OpenSRS Services	67	%	68	%	67	%	66	%
YummyNames	1	%	1	%	1	%	1	%
Hover	2	%	2	%	2	%	2	%
Butterscotch	0	%	0	%	0	%	0	%
Network, other costs	5	%	5	%	5	%	5	%
Network, depreciation and amortization costs	1	%	1	%	1	%	2	%
	76	%	77	%	76	%	76	%

Total cost of revenues for the three months ended September 30, 2011 increased by \$2.7 million, or 17%, to \$19.0 million from \$16.3 million for the three months ended September 30, 2010.

Total cost of revenues for the nine months ended September 30, 2011 increased by \$6.5 million, or 14%, to \$53.9 million from \$47.4 million for the nine months ended September 30, 2010.

We expect cost of sales to increase as a result of transactional volumes and the competitive and general business environment during Fiscal 2011.

Prepaid domain registration and other Internet services fees as of September 30, 2011 increased by \$6.2 million, or 13%, to \$55.7 million from \$49.5 million at September 30, 2010. Included in this increase is an amount of \$1.1 million that was recorded, at fair value, on the acquisition of EPAG. No adjustment to the fair value to the pre-acquisition prepaid domain registration and other Internet services fees was deemed necessary as the assessment of prepaid registry fees is based on the actual period the domain has been registered for multiplied by the number of days of service that have been prepaid for each domain name at the acquisition.

#### OpenSRS

Costs for OpenSRS for the three months ended September 30, 2011 increased by \$2.6 million, or 18%, to \$17.0 million, when compared to the three months ended September 30, 2010.

Costs for OpenSRS for the nine months ended September 30, 2011 increased by \$6.6 million, or 16%, to \$47.6 million, when compared to the nine months ended September 30, 2010.

This increase was primarily the result of increased domain registration volumes and increases in registration fees paid to the registries that were implemented in July 2010 experienced during the three and nine months ended September 30, 2011 when compared to the three and nine months ended September 30, 2010. This increase was partially offset by market development funds of \$0.4 million we received for the nine months ended September 30, 2011.

#### YummyNames

Costs for YummyNames for the three months ended September 30, 2011 as compared to the three months ended September 30, 2010 remained relatively flat at \$0.2 million.

Costs for YummyNames for the nine months ended September 30, 2011 decreased by \$0.1 million, or 11%, to \$0.6 million, when compared to the nine months ended September 30, 2010.

We believe that these decreases primarily reflect the impact of advertising vendors' changes to search methodologies and search algorithms on search yields from our pay-per-click advertising or parked pages programs, which we believe have resulted in fewer names meeting our economic threshold for purchase.

#### Hover

Costs for Hover for the three months ended September 30, 2011 increased by \$0.1 million, or 30%, to \$0.5 million, when compared to the three months ended September 30, 2010.

Costs for Hover for the nine months ended September 30, 2011 increased by \$0.2 million, or 18%, to \$1.3 million, when compared to the nine months ended September 30, 2010.

#### Network costs

Network costs before depreciation and amortization for the three months ended September 30, 2011 increased by \$0.1 million, or 10%, to \$1.2 million, when compared to the three months ended September 30, 2010. Network depreciation and amortization costs for the three months ended September 30, 2011 decreased by \$0.1 million to \$0.2 million.

Network costs before depreciation and amortization for the nine months ended September 30, 2011 increased by \$0.2 million, or 5%, to \$3.7 million, when compared to the nine months ended September 30, 2010. Network depreciation and amortization costs for the nine months ended September 30, 2011 decreased by \$0.4 million to \$0.7 million.

These results reflect our improved efficiency 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 September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Sales and marketing	\$ 1,867,085	\$ 1,830,999	\$ 5,663,759	\$ 5,480,228
Increase over comparative period	\$ 36,086		\$ 183,531	
Increase - percentage	2	%	3	%
Percentage of net revenues	7	%	9	%

Sales and marketing expenses for the three months ended September 30, 2011 as compared to the three months ended September 30, 2010 remained relatively flat at \$1.9 million, despite the negative impact of the approximately 8% strengthening, on average, in the Canadian dollar relative to the U.S. dollar compared to the three months ended September 30, 2010.

Sales and marketing expenses for the nine months ended September 30, 2011 increased by \$0.2 million or 3% to \$5.7 million when compared to the nine months ended September 30, 2010. This increase was primarily due to additional workforce related expenses of approximately \$0.1 million incurred in the marketing area, an amount of approximately \$0.1 million of marketing initiatives incurred to validate a new service offering, as well as the negative impact of the approximately 7% strengthening, on average, in the Canadian dollar relative to the U.S. dollar compared to the nine months ended September 30, 2010.

## 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 September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Technical operations and development	\$ 1,220,953	\$ 1,053,768	\$ 3,651,782	\$ 3,486,718
Increase over comparative period	\$ 167,185		\$ 165,064	
Increase - percentage	16	%	5	%
Percentage of net revenues	5	%	5	%

Technical operations and development expenses for the three months ended September 30, 2011 increased by \$0.2 million or 16% to \$1.2 million when compared to the three months ended September 30, 2010. This increase was primarily due to the negative impact of the approximately 8% strengthening, on average, in the Canadian dollar relative to the U.S. dollar compared to the three months ended September 30, 2010 had on workforce related costs, as well as approximately \$0.1 million incurred to validate a new service offering.

Technical operations and development expenses for the nine months ended September 30, 2011 increased by \$0.2 million or 5% to \$3.7 million when compared to the nine months ended September 30, 2010. This increase was primarily due to the negative impact of the approximately 7% strengthening, on average, in the Canadian dollar relative to the U.S. dollar compared to the nine months ended September 30, 2010 had on workforce related costs, as well as approximately \$0.1 million incurred to enhance our end user interfaces for new service offerings.

## GENERAL AND ADMINISTRATIVE

General and administrative expenses consist primarily of compensation and related costs for managerial and administrative personnel, fees for professional services, public listing expenses, rent, foreign exchange and other general corporate expenses.

	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
General and administrative	\$ 1,279,082	\$ 633,457	\$ 3,509,395	\$ 2,049,813
Increase over comparative period	\$ 645,625		\$ 1,459,582	
Increase - percentage	102	%	71	%
Percentage of net revenues	5	%	3	%

General and administrative expenses for the three months ended September 30, 2011 increased by \$0.6 million, or 102%, to \$1.3 million as compared to the three months ended September 30, 2010. This was primarily as a result of our recording a foreign exchange gain of \$0.3 million during the three months ended September 30, 2011 as compared to a foreign exchange gain of \$0.6 million during the three months ended September 30, 2010. This gain in foreign exchange was primarily the result of the strengthening, on average, of the Canadian dollar relative to the U.S. dollar by approximately 8% from the three months ended September 30, 2010. This increase was also as a result of an increase in professional fees, facility and workforce costs of \$0.3 million during the three months ended September 30, 2011.

General and administrative expenses for the nine months ended September 30, 2011 increased by \$1.5 million, or 71%, to \$3.5 million as compared to the nine months ended September 30, 2010. This was primarily as a result of our recording a foreign exchange gain of \$1.1 million during the nine months ended September 30, 2011 as compared to a foreign exchange gain of \$2.0 million during the nine months ended September 30, 2010. This gain in foreign exchange was primarily the result of the strengthening, on average, of the Canadian dollar relative to the U.S. dollar by approximately 7% from the nine months ended September 30, 2010. This increase was also as a result of an increase in professional fees, facility costs, workforce and travel of \$0.6 million during the nine months ended September 30, 2011, as compared to the nine months ended September 30, 2010.

## 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 September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Depreciation of property and equipment	\$ 48,874	\$ 40,239	\$ 140,556	\$ 127,559
Increase over comparative period	\$ 8,635		\$ 12,997	
Increase - percentage	21	%	10	%
Percentage of net revenues	-	%	-	%

Depreciation costs for the three and nine months ended September 30, 2011 increased by \$9,000 and \$13,000, or 21% and 10%, to \$49,000 and \$141,000 respectively.

During the remainder of Fiscal 2011 we are planning on reconfiguring our Toronto facility to better support our agile teams.

AMORTIZATION OF INTANGIBLE ASSETS

	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Amortization of intangible assets	\$ 201,180	\$ 360,540	\$ 785,920	\$ 1,081,620
Decrease over comparative period	\$ (159,360 )		\$ (295,700 )	
Decrease - percentage	(44 )%		(27 )%	
Percentage of net revenues	1 %	2 %	1 %	2 %

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 CHANGE IN FAIR VALUE OF FORWARD EXCHANGE 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, we account for the fair value of the derivative instruments 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 September 30, 2011		2010		Nine months ended September 30, 2011		2010	
Loss on change in fair value of forward contracts	\$	2,152,243	\$	(141,981 )	\$	2,458,104	\$	1,669,031
Increase over comparative period	\$	2,294,224			\$	789,073		
Increase - percentage		(1,616 )%				47 %		
Percentage of net revenues		9 %		1 %		3 %		3 %

We have entered into forward exchange contracts to meet a portion of our future Canadian dollar requirements through March 2013. The impact of the fair value adjustment on unrealized foreign exchange on these contracts for the three and nine months ended September 30, 2011 was a net loss of \$2.2 million and \$2.5 million, respectively, as compared to a net gain of \$0.1 million and a net loss of \$1.7 million, respectively, for the three and nine months ended September 30, 2010. This net loss in fair value of forward contracts results from a combination of the impact from the change in foreign exchange rates over time, as well as from the impact of the settlement of forward exchange contracts as they mature.

At September 30, 2011, our balance sheet reflects a derivative instrument liability of \$1.6 million as a result of our existing foreign exchange contracts. Until their respective maturity dates, these contracts will fluctuate in value in line with movements in the Canadian vs. U.S. dollar.

#### OTHER INCOME AND EXPENSES

	Three months ended September 30, 2011		2010		Nine months ended September 30, 2011		2010	
Other income (expenses), net	\$	(18,718 )	\$	(26,917 )	\$	336,062	\$	(99,812 )
Increase over comparative period	\$	8,199			\$	435,874		
Increase - percentage		(30 )%				(437 )%		

Percentage of net revenues	-	%	-	%	-	%	-	%
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Other income remained relatively flat and amounted to \$19,000 for the three months ended September 30, 2011, as compared to \$26,000 for the three months ended September 30, 2010.

Other income increased by approximately \$0.4 million to \$0.3 million for the nine months ended September 30, 2011, as compared to other expenses of \$0.1 million for the nine months ended September 30, 2010. This primarily resulted from the third party who is commercializing the Infonautics patents that we assigned to them in 2002, undertaking a routine audit of one of their licensees. As a result of the audit, we received an additional payment of \$0.3 million in March 2011 and \$0.1 million in June 2011. As the costs of commercializing the patents have increased, we do not expect any future revenue received to be material.

Other income for the three and nine months ended September 30, 2011 decreased when compared to the three and nine months ended September 30, 2010 as the interest payable pursuant to the terms of our Amended Credit Facility.

## INCOME TAXES

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

	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Provision for income taxes	\$ 422,592	\$ 24,863	\$ 750,906	\$ 235,105
Increase over comparative period	\$ 397,729		\$ 515,801	
Increase - percentage	(1,600 )%		219 %	
Percentage of income before provision for income taxes	- 58 %	2 %	84 %	21 %

For the nine months ended September 30, 2011, we recorded a provision for income taxes of \$0.8 million on income before income taxes of \$0.9 million, using an estimated effective tax rate for our 2011 fiscal year adjusted for certain foreign exchange losses for which we do not anticipate obtaining a current tax benefit. Comparatively, for the nine months ended September 30, 2010, we recorded a current tax recovery of \$0.2 million on income before taxes of \$1.1 million, using an estimated effective tax rate for its 2010 fiscal year adjusted for certain foreign exchange losses for which the Company does not anticipate obtaining a current tax benefit. This amount is offset by a recovery of \$0.1 million in respect of refundable Ontario research tax credits.

As of December 31, 2010, we recorded a valuation allowance of \$3.7 million and a net deferred tax asset of \$3.0 million. As of September 30, 2011 we have recorded a non-current deferred tax asset of \$3.6 million and a current deferred tax liability of \$0.6 million. As of September 30, 2011 and December 31, 2010, we have also recorded a non-current deferred tax liability related to the temporary difference arising on indefinite life intangibles of \$4.8 million. In addition, during the three months ended September 30, 2011, the Company recorded a non-current deferred tax liability related to the temporary difference on acquired intangibles of \$0.5 million.

We analyze the carrying value of our net deferred tax assets on a regular basis. In determining future taxable income, assumptions are made to forecast federal, state and international operating income, the reversal of temporary timing differences, and the implementation of any feasible and prudent tax planning strategies. The assumptions require significant judgment regarding the forecasts of future taxable income, and are consistent with other forecasts used to manage the business. During the nine months ended September 30, 2011, there was no reversal of the valuation allowance. The valuation allowance will be maintained until sufficient evidence exists to support a reversal of the valuation allowance.

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 \$0.2 million of total gross unrecognized tax benefit as of September 30, 2011 and \$0.2 million of total gross unrecognized tax benefit as of December 31, 2010, 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 and other insignificant US state taxes as well as unrecognized tax benefits for 2010 research and development tax credits. We are evaluating whether to file a Canadian research and development claim for 2011 and expect that if such a claim is filed the amount of credits are not expected to be significant. We recognize accrued interest and penalties related to income taxes in income tax expense. We did not have significant interest and penalties

accrued as of September 30, 2011 and December 31, 2010, respectively. We believe that it is reasonably possible that all of the unrecognized tax benefit will decrease in the next twelve months as it is anticipated that the U.S. tax authorities will finalize their review of prior taxes owing in Pennsylvania within the period, certain other prior year state tax returns will be filed and the 2010 Canadian research and development claim will be assessed.



## LIQUIDITY AND CAPITAL RESOURCES

As of September 30, 2011, our cash and cash equivalents balance increased by \$0.5 million to \$4.7 million, when compared to December 31, 2010. Our principal sources of liquidity during the nine months ended September 30, 2011 was net cash provided by operating activities of \$3.2 million and our Amended Credit Facility with the Bank of Montreal. Fluctuations in foreign exchange rates had a material impact on the balances of our assets and liabilities year-over-year as reported in our consolidated balance sheets, which impacted amounts shown in our consolidated statement of cash flows.

Our Amended Credit Facility with the Bank of Montreal provides us access to:

1. a non-revolving, reducing demand loan facility that was used to fund the acquisition of Innerwise, Inc. during 2007 under which \$29,000 was owing as of September 30, 2011. This remaining balance will be fully repaid by October 2011;
2. a demand loan facility for an aggregate of \$8.0 million through an annually revolving facility that automatically converts any outstanding balances under the revolving facility as of December 31st of each year to a non-revolving, reducing demand loan facility repayable in equal monthly principal payments plus interest over 48 months. Advances under this facility are to be used principally to fund acquisitions. Up to \$2.0 million of any advances under this demand loan facility can be used to finance the repurchase of our common shares. On July 29, 2011, \$2.5 million was drawn under this demand loan facility to fund the acquisition of EPAG Domainservices GmbH on August 1, 2011 of which \$1.0 million was repaid on August 11, 2011. As of September 30, 2011, we had \$1.5 million owing under this credit facility;
3. an operating demand loan for \$1.0 million to fund operational requirements. As of September 30, 2011, we had no borrowings under this credit facility; and
4. a Treasury Risk Management Facility for \$3.5 million to be used as a line to fund any settlement risk exposure that may arise from foreign exchange contracts we enter into from time to time to mitigate the exchange rate risk on portions of our Canadian dollar exposure. At September 30, 2011, we had forward exchange contracts to trade \$31.9 million U.S. dollars in exchange for Canadian dollars.

Net cash provided by operating activities for the nine months ended September 30, 2011 totaled \$3.2 million, compared to \$4.4 million for the nine months ended September 30, 2010. Net cash provided by operating activities, before changes in non-cash operating working capital decreased by \$0.6 million to \$4.5 million for the nine months ended September 30, 2011 compared to \$5.1 million for the nine months ended September 30, 2010 primarily the result of the impact of the strengthening Canadian dollar and our forward exchange contracts have on our results.

Net cash used in non-cash operating working capital increased by \$0.6 million to \$1.3 million for the nine months ended September 30, 2011 compared to \$0.7 million for the nine months ended September 30, 2010. This additional investment of cash in non-cash working capital was primarily the result of an increase of \$1.2 million in accounts receivable and the deposits we maintain with our registry suppliers to support our increased sales volumes. In addition, customers reduced their deposits by \$0.2 million as part of the normal operating cycle. These working capital uses were partially offset by an increase in accounts payable and accruals of \$0.6 million and a decrease in income taxes recoverable of \$0.2 million.

Net cash provided by financing activities during the nine months ended September 30, 2011 totaled \$0.3 million as compared to net cash used of \$8.3 million during the nine months ended September 30, 2010. Of the \$8.3 million used during the nine months ended September 30, 2010, \$6.9 million was used to fund share repurchases as described in

the following paragraph. On July 29, 2011, under our Amended Credit Facility, we drew down \$2.5 million to fund the acquisition of EPAG Domainservices GmbH on August 1, 2011. On August 11, 2011 \$1.0 million of this was repaid. In addition, under our non-revolving, reducing demand loan facility that was used to fund the acquisition of Innerwise, Inc. in the nine months ended September 30, 2011 \$1.3 million was used for principal repayments compared to \$1.4 million during the nine months ended September 30, 2010.

Under our share repurchase programs we used \$4.5 million to repurchase 6.3 million shares pursuant to the terms of a Dutch auction tender offer completed during January 2010 and \$2.4 million to repurchase 3.4 million of our shares under the terms of our stock repurchase program announced in February 2010.

Investing activities used net cash of \$3.0 million during the nine months ended September 30, 2011, \$2.4 million to fund the acquisition, net of cash acquired, of EPAG Domainservices GmbH on August 1, 2011 and to acquire additional property and equipment during the nine months ended September 30, 2011 of \$0.6 million, as compared to the \$0.3 million acquired during the nine months ended September 30, 2010.

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.

## 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 September 30, 2011. 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 September 30, 2011, 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
October – December, 2011	\$750,000	0.9560	\$1,090
October – December, 2011	4,700,000	1.0015	(208,672 )
2011	5,450,000	0.9950	(207,582 )
January – March, 2012	5,100,000	1.0251	(345,692 )
April – June, 2012	5,100,000	1.0220	(335,397 )
July – September, 2012	5,100,000	1.0147	(303,990 )
October – December, 2012	5,100,000	1.0147	(307,174 )
2012	20,400,000	1.0191	(1,292,253 )
January – March, 2013	6,000,000	0.9730	(124,309 )
2013	6,000,000	0.9730	(124,309 )
Total	\$31,850,000	0.9918	\$(1,624,144 )

During the three months ended September 30, 2011, the Company entered into foreign exchange forward contracts to hedge a portion of its expected Canadian dollar requirements. These contracts have a notional value of US\$23.9 million which mature at various dates between August 2011 and March 2013.

As of September 30, 2011 the Company has \$31.9 million of outstanding foreign exchange forward contracts which will convert to CDN \$31.7 million.

The Company does not apply hedge accounting and, therefore, for the nine months ended September 30, 2011, the Company recorded a loss of \$2.5 million in the fair value of forward contracts in its consolidated statements of operations. For the nine months ended September 30, 2010, the Company recorded a loss on forward contracts of \$1.7 million.

We have performed a sensitivity analysis model for foreign exchange exposure over the three months ended September 30, 2011. 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 September 30, 2011. 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 September 30, 2011 of approximately \$0.5 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 SEC'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, in our opinion, will 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, 2010, 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 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).
10.1	Offer Letter, dated July 27, 2011, between Tucows.com Co and the Bank of Montreal (incorporated herein by reference to Exhibit 10.1 to Tucows Inc.'s Current Report on Form 8-K, filed with the Securities and Exchange Commission on August 3, 2011).
10.2	Operating Loan Agreement, dated September 10, 2010, between Tucows.com co. and the Bank of Montreal (incorporated herein by reference to Exhibit 10.1 to Tucows Inc.'s Current Report on Form 8-K, filed with the Securities and Exchange Commission on September 13, 2010).
10.3	Offer Letter, dated August 30, 2010, between Tucows Inc. and the Bank of Montreal (incorporated herein by reference to Exhibit 10.2 to Tucows Inc.'s Current Report on Form 8-K, filed with the Securities and Exchange Commission on September

10.4	13, 2010). Loan Agreement, dated as of June 25, 2007, by and among Tu cows.com Co., Tu cows (Delaware) Inc., Tu cows Inc., Mailbank Nova Scotia Co., Tu cows Domain Holdings Co., Innerwise, Inc. and Bank of Montreal (incorporated herein by reference to Exhibit 10.1 to Tu cows Inc.'s Current Report on Form 8-K, filed with the Securities and Exchange Commission on July 31, 2007).
10.5	Guaranty, dated July 25, 2007, by Tu cows Inc. in favor of the Bank of Montreal (incorporated herein by reference to Exhibit 10.2 to Tu cows Inc.'s Current Report on Form 8-K, filed with the Securities and Exchange Commission on July 31, 2007).
10.6	Security Agreement, dated July 25, 2007, by Tu cows Inc. in favor of the Bank of Montreal (incorporated herein by reference to Exhibit 10.3 to Tu cows Inc.'s Current Report on Form 8-K, filed with the Securities and Exchange Commission on July 31, 2007).
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

\*\* XBRL

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.

\* 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: November 10, 2011

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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