TUCOWS INC /PA/
Form 10-Q
August 13, 2014

**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 June 30, 2014**

**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** | **23-2707366** |
| (State or Other Jurisdiction of Incorporation or Organization) | (I.R.S. Employer Identification No.) |

**96 Mowat Avenue,**

**Toronto, Ontario M6K 3M1, Canada**

(Address of Principal Executive Offices) (Zip Code)

**(416) 535-0123**

(Registrant's Telephone Number, Including Area Code)

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

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

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

| | |
|---|---|
| Large accelerated filer | Accelerated filer |
| Non-accelerated filer<br>(Do not check if a smaller reporting company) | 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 August 12, 2014, there were 11,328,147 outstanding shares of common stock, no par value, of the registrant.

**TUCOWS INC.**

**Form 10-Q Quarterly Report**

**INDEX**



**TRADEMARKS, TRADE NAMES AND SERVICE MARKS**

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**PART I.**

**FINANCIAL INFORMATION**

**Item 1. Consolidated Financial Statements**

**Tucows Inc.**

**Consolidated Balance Sheets**

**(Dollar amounts in U.S. dollars)**

**(unaudited)**

| | June 30, 2014 (unaudited) | December 31, 2013 |
|---|---|---|
| **Assets** | | |
| Current assets: | | |
| Cash and cash equivalents | $14,164,518 | $12,418,888 |
| Accounts receivable, net of allowance for doubtful accounts of $130,472 as of June 30, 2014 and $91,226 as of December 31, 2013 | 6,919,130 | 5,305,403 |
| Inventory | 481,140 | 309,686 |
| Prepaid expenses and deposits | 4,935,573 | 4,309,039 |
| Prepaid domain name registry and ancillary services fees, current portion | 46,379,230 | 44,209,591 |
| Deferred tax asset, current portion (note 7) | 1,250,468 | 1,081,526 |
| Income taxes recoverable (note 7) | 631,632 | 475,889 |
| Total current assets | 74,761,691 | 68,110,022 |
| Prepaid domain name registry and ancillary services fees, long-term portion | 12,090,838 | 11,838,579 |
| Property and equipment | 1,693,720 | 1,757,836 |
| Deferred tax asset, long-term portion (note 7) | 5,814,675 | 5,370,037 |
| Intangible assets (note 5) | 14,379,154 | 15,403,228 |
| Goodwill | 18,873,127 | 18,873,127 |
| Total assets | $127,613,205 | $121,352,829 |
| **Liabilities and Stockholders' Equity** | | |
| Current liabilities: | | |
| Accounts payable | $3,185,060 | $2,361,481 |
| Accrued liabilities | 3,743,663 | 3,913,034 |
| Customer deposits | 4,487,871 | 4,500,946 |
| Derivative instrument liability, (note 4) | 59,077 | 491,098 |

| | | |
|---|---|---|
| Loan payable (note 6) | 5,358,333 | 6,300,000 |
| Deferred revenue, current portion | 57,609,511 | 54,379,719 |
| Accreditation fees payable, current portion | 505,645 | 473,811 |
| Income taxes payable (note 7) | 194,303 | 1,024,004 |
| Total current liabilities | 75,143,463 | 73,444,093 |
| | | |
| Deferred revenue, long-term portion | 16,025,103 | 15,638,517 |
| Accreditation fees payable, long-term portion | 132,020 | 135,522 |
| Deferred rent, long-term portion | 88,359 | 75,979 |
| Deferred tax liability, long-term portion (note 7) | 5,108,500 | 5,141,500 |
| | | |
| Stockholders' equity (note 11) | | |
| Preferred stock - no par value, 1,250,000 shares authorized; none issued and outstanding | - | - |
| Common stock - no par value, 250,000,000 shares authorized;11,240,992 shares issued and outstanding as of June 30, 2014 and 10,907,063 shares issued and outstanding as of December 31, 2013 | 13,513,124 | 11,859,267 |
| Additional paid-in capital | 29,138,165 | 28,632,311 |
| Deficit | (11,505,358 ) | (13,329,379 ) |
| Accumulated other comprehensive income (loss) | (30,171 ) | (244,981 ) |
| Total stockholders' equity | 31,115,760 | 26,917,218 |
| Total liabilities and stockholders' equity | $127,613,205 | $121,352,829 |

Commitments and contingencies (note 10)

See accompanying notes to unaudited consolidated financial statements

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**Tucows Inc.**

**Consolidated Statements of Operations and Comprehensive Income**

**(Dollar amounts in U.S. dollars)**

**(unaudited)**

| | **Three months ended June 30,** | | **Six months ended June 30,** | |
|---|---|---|---|---|
| | **2014** | **2013** | **2014** | **2013** |
| Net revenues (note 9) | $35,588,001 | $31,173,357 | $69,990,395 | $61,158,379 |
| Cost of revenues (note 9): | | | | |
| Cost of revenues | 24,736,004 | 23,007,506 | 49,052,643 | 45,085,405 |
| Network expenses (*) | 1,144,697 | 1,269,808 | 2,288,341 | 2,524,021 |
| Depreciation of property and equipment | 173,963 | 151,356 | 356,937 | 288,428 |
| Amortization of intangible assets | - | 35,910 | - | 71,820 |
| Total cost of revenues | 26,054,664 | 24,464,580 | 51,697,921 | 47,969,674 |
| Gross profit | 9,533,337 | 6,708,777 | 18,292,474 | 13,188,705 |
| Expenses: | | | | |
| Sales and marketing (*) | 3,762,441 | 2,946,586 | 7,784,215 | 5,793,672 |
| Technical operations and development (*) | 1,107,532 | 748,137 | 2,197,430 | 1,881,967 |
| General and administrative (*) | 1,886,319 | 1,698,697 | 3,654,119 | 3,397,329 |
| Depreciation of property and equipment | 52,538 | 54,922 | 108,842 | 105,861 |
| Amortization of intangible assets | 219,030 | 219,030 | 438,060 | 438,060 |
| Impairment of indefinite life intangible assets (note 5) | 326,457 | - | 577,145 | - |
| Loss on currency forward contracts (note 4) | 96,545 | 146,639 | 647,916 | 381,277 |
| Total expenses | 7,450,862 | 5,814,011 | 15,407,727 | 11,998,166 |
| Income from operations | 2,082,475 | 894,766 | 2,884,747 | 1,190,539 |
| Other income (expense): | | | | |
| Interest expense, net | (69,348) | (93,428) | (143,181) | (192,790) |
| Total other income (expense) | (69,348) | (93,428) | (143,181) | (192,790) |
| Income before provision for income taxes | 2,013,127 | 801,338 | 2,741,566 | 997,749 |
| Provision for income taxes (note 7) | 665,945 | 213,708 | 917,545 | 333,540 |
| Net income | 1,347,182 | 587,630 | 1,824,021 | 664,209 |

| | | | | |
|---|---|---|---|---|
| Other comprehensive income (loss), net of tax | 370,868 | (260,941) | 7,687 | (446,726) |
| Unrealized income (loss) on hedging activities | | | | |
| Net amount reclassified to earnings | 59,409 | - | 207,123 | - |
| Other comprehensive income (loss) net of tax of $111,897 and $133,761 for the three months ended June 30, 2014 and June 30, 2013, and $224,137 and $230,538 for the six months ended June 30, 2014 and June 30, 2013 | 430,277 | (260,941) | 214,810 | (446,726) |
| Comprehensive income for the period | $1,777,459 | $326,689 | $2,038,831 | $217,483 |
| | | | | |
| Basic earnings per common share (note 8) | $0.12 | $0.06 | $0.16 | $0.07 |
| | | | | |
| Shares used in computing basic earnings per common share (note 8) | 11,219,101 | 10,080,815 | 11,124,357 | 10,081,831 |
| | | | | |
| Diluted earnings per common share (note 8) | $0.11 | $0.05 | $0.16 | $0.06 |
| | | | | |
| Shares used in computing diluted earnings per common share (note 8) | 11,729,547 | 11,069,713 | 11,684,529 | 11,073,504 |
| | | | | |
| (*) Stock-based compensation has been included in operating expenses as follows: | | | | |
| Network expenses | $6,916 | $7,932 | $15,797 | $14,058 |
| Sales and marketing | $30,804 | $33,909 | $66,803 | $60,319 |
| Technical operations and development | $18,447 | $20,370 | $36,652 | $35,617 |
| General and administrative | $29,190 | $29,044 | $67,082 | $56,103 |

See accompanying notes to consolidated financial statements

**Tucows Inc.**

**Consolidated Statements of Cash Flows**

**(Dollar amounts in U.S. dollars)**

**(unaudited)**

| | **Three months ended June 30,** | | **Six months ended June 30,** | |
|---|---|---|---|---|
| | **2014** | **2013** | **2014** | **2013** |
| Cash provided by: | | | | |
| Operating activities: | | | | |
| Net income for the period | $1,347,182 | $587,630 | $1,824,021 | $664,209 |
| Items not involving cash: | | | | |
| Depreciation of property and equipment | 226,501 | 206,278 | 465,779 | 394,289 |
| Amortization of intangible assets | 219,030 | 254,940 | 438,060 | 509,880 |
| Impairment of indefinite life intangible asset | 326,457 | - | 577,145 | - |
| Deferred income taxes (recovery) | (415,246) | 113,748 | (758,477) | 21,683 |
| Excess tax benefits from share-based compensation expense | 594,899 | - | (418,901) | - |
| Amortization of deferred rent | 9,168 | 4,372 | 12,380 | 9,876 |
| Disposal of domain names | 7,247 | 20,876 | 8,869 | 35,369 |
| Loss (gain) on change in the fair value of forward contracts | (192,460) | 114,846 | (105,314) | 565,987 |
| Stock-based compensation | 85,357 | 91,255 | 186,334 | 166,097 |
| Change in non-cash operating working capital: | | | | |
| Accounts receivable | (350,806) | (665,972) | (1,613,727) | (1,214,290) |
| Inventory | 28,293 | 121,380 | (171,454) | 399,680 |
| Prepaid expenses and deposits | (259,698) | 635,193 | (626,534) | 296,895 |
| Prepaid domain name registry and ancillary services fees | (606,215) | (341,273) | (2,421,898) | (1,382,987) |
| Income taxes recoverable | (133,242) | (2,789) | (566,543) | 106,364 |
| Accounts payable | (866,473) | 1,797 | 803,942 | 607,721 |
| Accrued liabilities | 253,027 | 1,025,886 | (169,371) | 501,684 |
| Customer deposits | 16,054 | 273,851 | (13,075) | (287,570) |
| Deferred revenue | 867,445 | 557,152 | 3,616,378 | 1,976,736 |
| Accreditation fees payable | (21,755) | (28,082) | 28,332 | 15,917 |
| Net cash (used in) / provided by operating activities | 1,134,765 | 2,971,088 | 1,095,946 | 3,387,540 |
| | | | | |
| Financing activities: | | | | |
| Proceeds received on exercise of stock options | 130,782 | 279,685 | 1,041,863 | 318,194 |
| Excess tax benefits from share-based compensation expense | - | - | 1,013,800 | - |
| Repurchase of common stock | - | - | (82,286) | (6,537,616) |
| Proceeds received on loan payable | - | - | - | 5,200,000 |
| Repayment of loan payable | (325,000) | (600,000) | (941,667) | (1,400,000) |
| Net cash provided by / (used in) financing activities | (194,218) | (320,315) | 1,031,710 | (2,419,422) |
| | | | | |
| Investing activities: | | | | |

| | | | | |
|---|---|---|---|---|
| Additions to property and equipment | (313,281 ) | (471,966 ) | (382,026 ) | (918,671 ) |
| Net cash used in investing activities | (313,281 ) | (471,966 ) | (382,026 ) | (918,671 ) |
| Increase (decrease) in cash and cash equivalents | 627,266 | 2,178,807 | 1,745,630 | 49,447 |
| Cash and cash equivalents, beginning of period | 13,537,252 | 4,286,319 | 12,418,888 | 6,415,679 |
| Cash and cash equivalents, end of period | $14,164,518 | $6,465,126 | $14,164,518 | $6,465,126 |
| Supplemental cash flow information: | | | | |
| Interest paid | $69,437 | $97,369 | $143,386 | $196,873 |
| Income taxes paid, net | $588,916 | $198,462 | $1,258,540 | $187,313 |
| Supplementary disclosure of non-cash investing and financing activities: | | | | |
| Property and equipment acquired during the period not yet paid for | $19,637 | $4,864 | $19,637 | $4,864 |

See accompanying notes to unaudited consolidated financial statements

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**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**1. ORGANIZATION OF THE COMPANY:**

Tucows Inc., a Pennsylvania corporation (referred to throughout this report as the “Company”, “Tucows”, “we”, “us” or through similar expressions), together with our consolidated subsidiaries, is a global distributor of Internet services, including domain name registration, security and identity products through digital certificates, email and mobile telephony services on both a wholesale and retail basis.

We were incorporated under the laws of the Commonwealth of Pennsylvania in November 1992 under the name Infonautics, Inc. In August 2001, we completed our acquisition of Tucows Inc., a Delaware corporation, and we changed our name from Infonautics, Inc. to Tucows Inc. Our principal executive office is located in Toronto, Ontario and we have other offices in the Netherlands, Germany and the United States. Our common stock is listed on NASDAQ under the symbol “TCX” and on the Toronto Stock Exchange under the symbol “TC”.

**2. BASIS OF PRESENTATION:**

The accompanying unaudited interim consolidated balance sheets, and the related consolidated statements of operations and comprehensive income and cash flows reflect all adjustments, consisting of normal recurring adjustments, that are, in the opinion of management, necessary for a fair presentation of the financial position of Tucows and its subsidiaries as at June 30, 2014 and the results of operations and cash flows for the interim periods ended June 30, 2014 and 2013. 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, 2013 included in Tucows' 2013 Annual Report on Form 10-K filed with the SEC on March 18, 2014.

There have been no material changes to our significant accounting policies during the three months ended June 30, 2014 as compared to the significant accounting policies described in our Annual Report on Form 10-K for the fiscal year ended December 31, 2013.

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 in the notes to the unaudited interim consolidated financial statements.

**3. NEW ACCOUNTING POLICIES:**

*Recent Accounting Pronouncements Adopted*

On July 18, 2013, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2013-11, Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists ("ASU 2013-11"). ASU 2013-11 requires an entity to present an unrecognized tax benefit, or a portion of an unrecognized tax benefit, as a reduction of a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward except as follows: to the extent a net operating loss carryforward, a similar tax loss or a tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position or the tax law of the applicable tax jurisdiction does not require the entity to use, and the entity does not intend to use, the deferred tax asset for such purpose, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be combined with a deferred tax asset. We adopted ASU 2013-11 in the quarter ending March 31, 2014 and the adoption did not have a material impact on our Condensed Consolidated Financial Statements.

On May 28, 2014, the FASB issued Accounting Standards Update 2014-09, "Revenue from Contracts with Customers" ("ASU 2014-09" or "new standard"). The new standard is effective for annual and interim periods beginning January 1, 2017, and early adoption is prohibited. ASU 2014-09 may be adopted by applying the provisions of the new standard on a retrospective basis to the periods included in the financial statements or on a modified retrospective basis which would result in the recognition of a cumulative effect of adopting ASU 2014-09 in the first quarter of 2017. We have not yet decided which implementation method we will adopt. The new standard replaces virtually all existing generally accepted accounting principles ("GAAP") on revenue recognition and replaces them with a principles-based approach for determining revenue recognition using a new five step model. The core principle of ASU 2014-09 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 also includes new accounting principles related to the deferral and amortization of contract acquisition and fulfillment costs. We are studying the new standard and starting to evaluate and determine the impact the new standard will have on the timing of revenue recognition under our customer agreements and the amount of contract related costs that will be deferred. We cannot, however, provide any estimate of the impact of adopting the new standard at this time.

**4. Derivative instruments and hedging activities:**

*Foreign currency forward contracts*

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

The Company has designated these transactions as cash flow hedges of forecasted transactions under ASC Topic 815 "Derivatives and Hedging" ("ASC Topic 815"). As the critical terms of the hedging instrument, and of the entire hedged forecasted transaction, are the same, in accordance with ASC Topic 815, the Company has been able to conclude that changes in fair value or cash flows attributable to the risk of being hedged are expected to completely offset at inception and on an ongoing basis. Accordingly, quarterly unrealized gains or losses on the effective portion of these contracts have been included within other comprehensive income. The fair value of the contracts, as of June 30, 2014, is recorded as derivative instrument liabilities.

As of June 30, 2014, the notional amount of forward contracts that the Company held to sell U.S. dollars in exchange for Canadian dollars was $13.5 million, of which $10.5 million met the requirements of ASC Topic 815 and were designated as hedges (June 30, 2013 - $18.1 million of which $15.1 million were designated as hedges). As of June 30, 2014, the Company has forward contracts with a notional amount of $3.0 million, which are not accounted for as hedges. The change in fair value of $0.2 million for these contracts is recorded on the statement of operations.

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

The effect of these derivative instruments on our consolidated financial statements as of, and for the six months ended June 30, 2014, were as follows (amounts presented do not include any income tax effects).

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

| Derivatives | Balance Sheet Location | As of June 30, 2014 Fair Value Asset (Liability) | As of December 31, 2013 Fair Value Asset (Liability) |
|---|---|---|---|
| Foreign currency forward contracts designated as cash flow hedges | Derivative instruments | $ (45,886 ) | $ (118,505 ) |
| Foreign currency forward contracts not designated as cash flow hedges | Derivative instruments | $ (13,191 ) | $ (372,593 ) |
| Total foreign currency forward contracts | Derivative instruments | $ (59,077 ) | $ (491,098 ) |

*Effects of derivative instruments on income and other comprehensive income (OCI) for the three months ended June 30, 2014and June 30, 2013 are as follows:*

| **Derivatives in Cash Flow Hedging Relationship** | **Amount of Gain or (Loss) Recognized in OCI on Derivative (Effective Portion)** | **Location of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)** | **Amount of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)** | **Location of Gain or (Loss) Recognized in Income on Derivative (ineffective Portion and Amount Excluded from Effectiveness Testing)** | **Amount of Gain or (Loss) Recognized in Income on Derivative (ineffective Portion and Amount Excluded from Effectiveness Testing)** |
|---|---|---|---|---|---|
| Foreign currency forward contracts for the three months ended June 30, 2014 | $ 430,277 | Operating expenses | $ (200,756) | — | — |
| | | Cost of revenues | $ (31,457) | | |
| Foreign currency forward contracts for the three months ended June 30, 2013 | $ (260,941) | Operating expenses | $ — | — | — |
| | | Cost of revenues | $ — | | |

*Effects of derivative instruments on income and other comprehensive income (OCI) for the six months ended June 30, 2014 and June 30, 2013 are as follows:*

| **Derivatives in Cash Flow** | **Amount of** | **Location of** | **Amount of** | **Location of** | **Amount of** |
|---|---|---|---|---|---|

| **Hedging Relationship** | **Gain or (Loss) Recognized in OCI on Derivative (Effective Portion)** | **Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)** | **Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)** | **Gain or (Loss) Recognized in Income on Derivative (ineffective Portion and Amount Excluded from Effectiveness Testing)** | **Gain or (Loss) Recognized in Income on Derivative (ineffective Portion and Amount Excluded from Effectiveness Testing)** |
|---|---|---|---|---|---|
| Foreign currency forward contracts for the six months ended June 30, 2014 | $ 214,810 | Operating expenses | $ (506,138 ) | — | — |
| | | Cost of revenues | $ (72,101 ) | | |
| Foreign currency forward contracts for the six months ended June 30, 2013 | $ (446,726 ) | Operating expenses | $ — | — | — |
| | | Cost of revenues | $ — | | |

In addition to the above, for those foreign currency forward contracts not designated as hedges, the Company has recorded a loss of $0.1 million upon settlement and a gain of $0.2 million for the change in fair value of outstanding contracts for the three months ended June 30, 2014, in the consolidated statement of operations and comprehensive income. The Company has recorded a loss of $0.2 million upon settlement and a gain of $0.1 million for the change in fair value of outstanding contracts for the six months ended June 30, 2014, in the consolidated statement of operations and comprehensive income.

**5. INTANGIBLE ASSETS:**

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

A summary of acquired intangible assets for the three months ended June 30, 2014 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, March 31, 2014 | $ — | $181,240 | $ 932,080 | $11,856,948 | $1,961,620 | $14,931,888 |
| Sales of domain names | — | — | — | (973) | (6,274) | (7,247) |
| Impairment of indefinite life intangible assets | — | — | — | (326,457) | — | (326,457) |
| Amortization expense | — | (43,410) | (175,620) | — | — | (219,030) |
| Net book value, June 30, 2014 | $ — | $137,830 | $ 756,460 | $11,529,518 | $1,955,346 | $14,379,154 |

A summary of acquired intangible assets for the six months ended June 30, 2014 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 | Total |
|---|---|---|---|---|---|---|

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| | | | | | **life** | | |
| Net book value, December 31, 2013 | $ | — | $224,650 | $ 1,107,700 | $12,096,712 | $1,974,166 | $15,403,228 |
| Sales of domain names | | — | — | — | (2,595) | (6,274) | (8,869) |
| Impairment of indefinite life intangible assets | | — | — | — | (564,599) | (12,546) | (577,145) |
| Amortization expense | | — | (86,820) | (351,240) | — | — | (438,060) |
| Net book value, June 30, 2014 | $ | — | $137,830 | $ 756,460 | $11,529,518 | $1,955,346 | $14,379,154 |

As of June 30, 2014, the accumulated amortization for the definite life intangibles was $5.5 million.

With regard to indefinite life intangible assets, as part of our normal renewal process during the three and six months ended June 30, 2014, we made an assessment that certain domain names acquired in the June 2006 acquisition of Mailbank.com Inc. should not be renewed and were allowed to expire. Accordingly, these domain names, with a book value of $0.3 million and $0.6 million, have been written off and recorded as impairment of indefinite life intangible assets during the three and six months ended June 30, 2014, respectively. No impairment was recorded on indefinite-life intangible assets during the three and six months ended June 30, 2013.

**6. LOAN PAYABLE:**

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

*Two Revolving Demand Loan Facilities.*

The 2012 Demand Loan Facilities are governed by the terms of the Offer Letter, dated as of November 19, 2012, by and between the Company and the Bank and filed with the SEC on November 21, 2012.

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

Repayment of advances under the 2012 DLR Loan consist of interest only payments made monthly in arrears and prepayment is permitted without penalty. The outstanding balance under the 2012 DLR Loan as of December 31st of each year is to be fully repaid within 30 days of December 31st through an equivalent advance made under the 2012 DLRR Loan. Advances under the 2012 DLRR Loan will be made annually and solely for such purpose. Each advance under the 2012 DLRR Loan is to be repaid in equal monthly principal payments plus interest, over a period of four years from the date of such advance. At June 30, 2014, the 2012 DLR Loan was fully repaid. At June 30, 2014, the outstanding balance under the 2012 DLRR Loan was $5.4 million, bearing interest at 5% per annum.

*Treasury Risk Management Facility*

The Amended Credit Facility also provides for a $3.5 million settlement risk line to assist the Company with hedging Canadian dollar exposure through foreign exchange forward contracts and/or currency options. Under the terms of the Amended Credit Facility, the Company may enter into such agreements at market rates with terms not to exceed 18 months. As of June 30, 2014, the Company held contracts in the amount of $13.5 million to trade U.S. dollars in exchange for Canadian dollars.

*Operating Demand Loan*

The Amended Credit Facility also provides the Company with a $1.0 million operating demand loan facility to assist in meeting its operational needs (the “Operating Demand Loan”). The Operating Demand Loan accrues interest at the Bank’s U.S. Base Rate plus 1.25%. Interest is payable monthly in arrears with any borrowing under the Operating Demand Loan fluctuating widely with periodic clean-up, at a minimum on an annual basis. The Company has also agreed to pay to the Bank a monthly monitoring fee of US$500 with respect to this loan. The Operating Demand Loan is payable on demand at any time, at the sole discretion of the Bank, with or without cause, and the Bank may terminate the Operating Demand Loan at any time. As of June 30, 2014, the Company had no amounts outstanding under its Operating Demand Loan.

*General Terms*

The Company’s Amended Credit Facility contains customary representations and warranties, affirmative and negative covenants, and events of default. The Company’s obligations under the Amended Credit Facility are guaranteed and secured by a security interest in substantially all of its assets. The Amended Credit Facility also requires that the Company comply with certain customary non-financial covenants and restrictions. In addition, the Company has agreed to comply with the following financial covenants at all times, which are to be calculated on a rolling four quarter basis: (i) Maximum Total Funded Debt to EBITDA of 2.00:1; and (ii) Minimum Fixed Charge Coverage of 1.20:1. Further, its Maximum Annual Capital Expenditures cannot exceed $3.6 million per year, which limit will be reviewed on an annual basis. As of June 30, 2014, the Company was in compliance with these covenants, and expects to be in compliance for the next twelve months.

Scheduled principal loan repayments are as follows:

| | |
|---|---|
| Remainder of 2014 | $ 1,200,000 |
| 2015 | 1,558,333 |
| 2016 | 1,300,000 |
| 2017 | 1,300,000 |

**7. INCOME TAXES**

For the six months ended June 30, 2014, the Company recorded a provision for income taxes of $0.9 million on income before income taxes of $2.7 million, using an estimated effective tax rate for the fiscal year ending December 31, 2014 (“fiscal 2014”) adjusted for certain minimum state taxes. Comparatively, for the six months ended June 30, 2013, the Company recorded a provision for income taxes of $0.3 million on income before taxes of $1.0 million, using an estimated effective tax rate for its fiscal year ending December 31, 2013 (“fiscal 2013”).

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

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

The Company had approximately $0.1 million of total gross unrecognized tax benefit as of June 30, 2014 and $0.3 million of total gross unrecognized tax benefit as of June 30, 2013, which if recognized would favorably affect its income tax rate in future periods. The unrecognized tax benefit relates primarily to prior year Pennsylvania state franchise taxes. The decrease of $0.2 million from June 30, 2013 primarily relates to the finalization of prior year German income tax returns. The Company recognizes accrued interest and penalties related to income taxes in income tax expense. The Company did not have significant interest and penalties accrued at June 30, 2014 and December 31, 2013, respectively.

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

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

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

| | Three months ended June 30, 2014 | Three months ended June 30, 2013 | Six months ended June 30, 2014 | Six months ended June 30, 2013 |
|---|---|---|---|---|
| Numerator for basic and diluted earnings per common share: | | | | |
| Net income for the period | $1,347,182 | $587,630 | $1,824,021 | $664,209 |
| Denominator for basic and diluted earnings per common share: | | | | |
| Basic weighted average number of common shares outstanding | 11,219,101 | 10,080,815 | 11,124,357 | 10,081,831 |
| Effect of outstanding stock options | 510,446 | 988,898 | 560,172 | 991,673 |

| | | | | |
|---|---|---|---|---|
| Diluted weighted average number of shares outstanding | 11,729,547 | 11,069,713 | 11,684,529 | 11,073,504 |
| Basic earnings per common share | $0.12 | $0.06 | $0.16 | $0.07 |
| Diluted earnings per common share | $0.11 | $0.05 | $0.16 | $0.06 |

For the three months ended June 30, 2014, outstanding options to purchase 38,000 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 six months ended June 30, 2014, outstanding options to purchase 39,000 common shares were not included in the computation of diluted income per common share because all such options had exercise prices greater than the average market price of the common shares.

During the six months ended June 30, 2014, 6,092 common shares were repurchased and cancelled under the terms of our stock repurchase program announced in March 2014, non of which occurred during the quarter ended June 30, 2014.

During the six months ended June 30, 2013, 1,028,530 common shares were repurchased and cancelled under the terms of a modified Dutch auction tender offer announced in December 2012.

During the six months ended June 30, 2013, 35,768 common shares were repurchased and cancelled under the terms of our stock repurchase program announced in March 2013.

The computation of earnings per share and diluted earnings per share for the three and six months ended June 30, 2014 and 2013 include reductions in the number of shares outstanding due to these repurchases.

**9. SEGMENT REPORTING:**

(a) We are organized and managed based on two segments, which are differentiated primarily by their services, the markets they serve and the regulatory environments in which they operate. The two segments are Domain Services and Network Access Services and are described as follows:

1. Domain Services – This segment includes wholesale and retail domain name registration services, value added services and portfolio services. The Company primarily earns revenues from the registration fees charged to resellers in connection with new, renewed and transferred domain name registrations; the sale of retail Internet domain name registration and email services to individuals and small businesses; and by making its portfolio of domain names available for sale or lease. Domain Services revenues are attributed to the country in which the contract originates, primarily Canada.

2. Network Access Services - This segment derives revenue from the sale of retail mobile phones and services to individuals and small businesses through the Ting website. Revenues are generated in the United States.

The Chief Executive Officer is the chief operating decision maker and regularly reviews the operations and performance by segment. The chief operating decision maker reviews gross margin as a key measure of performance for each segment and to make decisions about the allocation of resources. Sales and marketing expenses, technical operations and development expenses, general and administrative expenses, depreciation of property and equipment, loss on disposition of property and equipment, amortization of intangibles, loss (gain) on currency forward contracts, other income (expense), and provision for income taxes, are organized along functional lines and are not included in the measurement of segment profitability. Total assets and total liabilities are centrally managed and are not reviewed at the segment level by the chief operating decision maker.

Information by reportable segments, which is regularly reported to the chief operating decision maker is as follows:

| **Three months ended June 30, 2014** | **Domain Name Services** | **Network Access Services** | **Consolidated Totals** |
|---|---|---|---|
| Net Revenues | $27,328,156 | $8,259,845 | $35,588,001 |
| Cost of Revenues | 19,696,030 | 5,039,974 | 24,736,004 |
| Gross Profit before network expenses | 7,632,126 | 3,219,871 | 10,851,997 |
| | | | |
| Network expenses | | | 1,318,660 |
| Gross Profit | | | 9,533,337 |

| | |
|---|---|
| Expenses: | |
| Sales and marketing | 3,762,441 |
| Technical operations and development | 1,107,532 |
| General and administrative | 1,886,319 |
| Depreciation of property and equipment | 52,538 |
| Amortization of intangibles | 219,030 |
| Write-off / impairment of indefinite life intangible assets | 326,457 |
| Loss on currency forward contracts | 96,545 |
| Income from operations | 2,082,475 |
| Other expenses, net | 69,348 |
| Income before provision for income taxes | $ 2,013,127 |

| **Six months ended June 30, 2014** | **Domain Name Services** | **Network Access Services** | **Consolidated Totals** |
|---|---|---|---|
| Net Revenues | $55,018,398 | $14,971,997 | $69,990,395 |
| Cost of Revenues | 39,731,238 | 9,321,405 | 49,052,643 |
| Gross Profit before network expenses | 15,287,160 | 5,650,592 | 20,937,752 |
| | | | |
| Network expenses | | | 2,645,278 |
| Gross Profit | | | 18,292,474 |
| | | | |
| Expenses: | | | |
| Sales and marketing | | | 7,784,215 |
| Technical operations and development | | | 2,197,430 |
| General and administrative | | | 3,654,119 |
| Depreciation of property and equipment | | | 108,842 |
| Amortization of intangibles | | | 438,060 |
| Write-off / impairment of indefinite life intangible assets | | | 577,145 |
| Loss on currency forward contracts | | | 647,916 |
| Income from operations | | | 2,884,747 |
| Other expenses, net | | | 143,181 |
| Income before provision for income taxes | | | $2,741,566 |

| **Three months ended June 30, 2013** | **Domain Name Services** | **Network Access Services** | **Consolidated Totals** |
|---|---|---|---|
| Net Revenues | $27,439,382 | $3,733,975 | $31,173,357 |
| Cost of Revenues | 20,067,878 | 2,939,628 | 23,007,506 |
| Gross Profit before network expenses | 7,371,504 | 794,347 | 8,165,851 |
| | | | |
| Network expenses | | | 1,457,074 |
| Gross Profit | | | 6,708,777 |
| | | | |
| Expenses: | | | |
| Sales and marketing | | | 2,946,586 |
| Technical operations and development | | | 748,137 |
| General and administrative | | | 1,698,697 |
| Depreciation of property and equipment | | | 54,922 |
| Amortization of intangibles | | | 219,030 |
| Loss on currency forward contracts | | | 146,639 |
| Income from operations | | | 894,766 |
| Other expenses, net | | | 93,428 |
| Income before provision for income taxes | | | $801,338 |

**Six months ended June 30, 2013**

| | Domain Name Services | Network Access Services | Consolidated Totals |
|---|---|---|---|
| Net Revenues | $55,076,140 | $6,082,239 | $61,158,379 |
| Cost of Revenues | 40,035,792 | 5,049,613 | 45,085,405 |
| Gross Profit before network expenses | 15,040,348 | 1,032,626 | 16,072,974 |
| | | | |
| Network expenses | | | 2,884,269 |
| Gross Profit | | | 13,188,705 |
| | | | |
| Expenses: | | | |
| Sales and marketing | | | 5,793,672 |
| Technical operations and development | | | 1,881,967 |
| General and administrative | | | 3,397,329 |
| Depreciation of property and equipment | | | 105,861 |
| Amortization of intangibles | | | 438,060 |
| Loss on currency forward contracts | | | 381,277 |
| Income from operations | | | 1,190,539 |
| Other expenses, net | | | 192,790 |
| Income before provision for income taxes | | | $997,749 |

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

| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| | **2014** | **2013** | **2014** | **2013** |
| **Domain Services:** | | | | |
| Wholesale | | | | |
| Domain Services | $21,503,086 | $21,800,101 | $43,152,040 | $43,696,001 |
| Value Added Services | 2,395,726 | 2,559,427 | 4,999,331 | 5,248,117 |
| Total Wholesale | 23,898,812 | 24,359,528 | 48,151,371 | 48,944,118 |
| | | | | |
| Retail | 2,540,538 | 2,001,354 | 4,924,601 | 3,919,798 |
| Portfolio | 888,806 | 1,078,500 | 1,942,446 | 2,212,224 |
| Total Domain Services | 27,328,156 | 27,439,382 | 55,018,418 | 55,076,140 |
| | | | | |
| **Network Access Services:** | | | | |
| Ting | 8,259,845 | 3,733,975 | 14,971,977 | 6,082,239 |
| Total Network Access Services | 8,259,845 | 3,733,975 | 14,971,977 | 6,082,239 |
| | | | | |
| | $35,588,001 | $31,173,357 | $69,990,395 | $61,158,379 |

During the three and six months ended June 30, 2014 and 2013, no customer accounted for more than 10% of total revenue. As at June 30, 2014, one customer accounted for 12% of accounts receivable, while as at June 30, 2013, no customer accounted for more than 10% of accounts receivable.

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

| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| | **2014** | **2013** | **2014** | **2013** |
| **Domain Services:** | | | | |
| Wholesale | | | | |
| Domain Services | $17,809,325 | $18,484,667 | $36,044,540 | $36,938,969 |
| Value Added Services | 563,011 | 520,456 | 1,103,733 | 1,082,494 |
| Total Wholesale | 18,372,336 | 19,005,123 | 37,148,273 | 38,021,463 |
| | | | | |
| Retail | 1,110,659 | 833,327 | 2,126,075 | 1,583,923 |
| Portfolio | 213,035 | 229,428 | 456,890 | 430,406 |
| Total Domain Services | 19,696,030 | 20,067,878 | 39,731,238 | 40,035,792 |

| | | | | |
|---|---|---|---|---|
| **Network Access Services:** | | | | |
| Ting | 5,039,974 | 2,939,628 | 9,321,405 | 5,049,613 |
| Total Network Access Services | 5,039,974 | 2,939,628 | 9,321,405 | 5,049,613 |
| | | | | |
| **Network Expenses:** | | | | |
| Network, other costs | 1,144,697 | 1,269,808 | 2,288,341 | 2,524,021 |
| Network, depreciation and amortization costs | 173,963 | 187,266 | 356,937 | 360,248 |
| Total Network Expenses | 1,318,660 | 1,457,074 | 2,645,278 | 2,884,269 |
| | | | | |
| | $26,054,664 | $24,464,580 | $51,697,921 | $47,969,674 |

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

| | **June 30, 2014** | **December 31, 2013** |
|---|---|---|
| Canada | $1,184,101 | $1,292,425 |
| United States | 464,442 | 453,223 |
| Germany | 45,177 | 12,188 |
| | $1,693,720 | $1,757,836 |

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

| | **June 30, 2014** | **December 31, 2013** |
|---|---|---|
| Canada | $55,900 | $271,300 |
| Germany | 838,390 | 1,061,050 |
| | $894,290 | $1,332,350 |

(f) The following is a summary of the Company's deferred tax asset, net of valuation allowance, by geographic region:

| | June 30, 2014 | December 31, 2013 |
|---|---|---|
| Canada | $7,065,143 | $6,451,563 |
| | $7,065,143 | $6,451,563 |

**10. COMMITMENTS AND CONTINGENCIES:**

The Company is involved in various legal claims and lawsuits in connection with its ordinary business operations. The Company intends to vigorously defend these claims. While the final outcome with respect to any actions or claims outstanding or pending as of June 30, 2014 cannot be predicted with certainty, management does not believe that the resolution of these claims, individually or in the aggregate, will have a material adverse effect on the Company's financial position.

**11. STOCKHOLDERS' EQUITY:**

The following unaudited table summarizes stockholders' equity transactions for the three month period ended June 30, 2014:

| | Common stock | | Additional paid in capital | | Accumulated Other Comprehensive Income | Total stockholders' equity |
|---|---|---|---|---|---|---|
| | Number | Amount | capital | Deficit | Income | equity |
| Balances, March 31, 2014 | 11,192,884 | $13,301,296 | $29,133,854 | $(12,852,540) | $ (460,448 ) | $29,122,162 |
| Exercise of stock options | 48,108 | 211,828 | (81,046 ) | — | — | 130,782 |
| Stock-based compensation | — | — | 85,357 | — | — | 85,357 |
| Net income for the period | — | — | — | 1,347,182 | — | 1,347,182 |
| Unrealized loss on foreign currency forward contracts treated as hedges | — | — | — | — | 370,868 | 370,868 |
| | — | — | — | — | 59,409 | 59,409 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Reclassification to net income due to settlement of foreign currency forward contracts treated as hedges | | | | | | |
| Balances, June 30, 2014 | 11,240,992 | $13,513,124 | $29,138,165 | $(11,505,358) | $ (30,171) | $31,115,760 |

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The following unaudited table summarizes stockholders' equity transactions for the six month period ended June 30, 2014:

| | Common stock | | Additional paid in | | Accumulated Other Comprehensive | Total stockholders' |
|---|---|---|---|---|---|---|
| | Number | Amount | capital | Deficit | Income | equity |
| Balances, December 31, 2013 | 10,907,063 | $11,859,267 | $28,632,311 | $(13,329,379) | $(244,981) | $26,917,218 |
| Exercise of stock options | 340,021 | 1,658,731 | (616,868) | — | — | 1,041,863 |
| Repurchase and retirement of shares | (6,092) | (4,874) | (77,412) | — | — | (82,286) |
| Stock-based compensation | — | — | 186,334 | — | — | 186,334 |
| Income tax effect related to stock options exercised | — | — | 1,013,800 | — | — | 1,013,800 |
| Net income for the period | — | — | — | 1,824,021 | — | 1,824,021 |
| Unrealized loss on foreign currency forward contracts treated as hedges | — | — | — | — | 7,687 | 7,687 |
| Reclassification to net income due to settlement of foreign currency forward contracts treated as hedges | — | — | — | — | 207,123 | 207,123 |
| Balances, June 30, 2014 | 11,240,992 | $13,513,124 | $29,138,165 | $(11,505,358) | $(30,171) | $31,115,760 |

On January 7, 2013, the Company announced that it successfully concluded a modified “Dutch auction tender offer” that was previously announced on November 21, 2012. Under the terms of the offer, the Company repurchased an aggregate of 1,028,531 shares of its common stock at a purchase price of $6.00 per share, for a total of $6,171,656, excluding transaction costs of approximately $106,000. The purchase price and all transaction costs were funded from available cash and an additional advance under our Amended Credit Facility from the Bank in the amount of $5.2 million. All shares purchased in the tender offer received the same price and all shares repurchased were immediately retired. As a result of the completion of the tender offer, as of January 31, 2013, the Company had 10,056,719 shares issued and outstanding.

On March 1, 2013, the Company announced a stock buyback program. Under this buyback program, the Company was permitted to repurchase up to $10 million of the Company's common stock over the 12-month period that commenced on March 1, 2013. The Company repurchased 35,769 shares under this program during the three months ended March 31, 2013 for a total of $259,875.

On March 5, 2014, the Company announced a stock buyback program. Under this buyback program, the Company may repurchase up to $20 million of the Company's common stock over the 12-month period that commenced on March 4, 2014. The Company repurchased 6,092 shares under this program during the six months ended June 30, 2014 (none of which occurred during the quarter ended June 30, 2014) for a total of $82,286.

**12. SHARE-BASED PAYMENTS**

(a) Stock options

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

During the three and six months ended June 30, 2014, no stock options to purchase common shares were granted. During the three and six months ended June 30, 2013, stock options to purchase 82,875 and 120,375 common shares, respectively were granted.

Details of stock option transactions for the three months ended June 30, 2014 and June 30, 2013 are as follows:

| | **Three months ended June 30, 2014** | | **Three months ended June 30, 2013** | |
|---|---|---|---|---|
| | **Number of Shares** | **Weighted Average exercise price per share** | **Number of Shares** | **Weighted Average exercise price per share** |
| Outstanding, beginning of period | 1,107,257 | $ 3.97 | 2,168,003 | $ 2.60 |
| Granted | — | — | 82,876 | 8.56 |
| Exercised | (48,108 ) | 2.72 | (129,929 ) | 2.16 |
| Forfeited | (6,091 ) | 5.71 | (3,829 ) | 5.28 |
| Expired | (750 ) | 3.20 | — | — |
| Outstanding, end of period | 1,052,308 | $ 4.01 | 2,117,121 | $ 2.84 |
| Options exercisable, end of period | 824,641 | $ 3.34 | 1,741,361 | $ 2.40 |

Details of stock option transactions for the six months ended June 30, 2014 and June 30, 2013 are as follows:

| | **Six months ended June 30, 2014** | | **Six months ended June 30, 2013** | |
|---|---|---|---|---|
| | **Number of Shares** | **Weighted Average exercise price per share** | **Number of Shares** | **Weighted Average exercise price per share** |
| Outstanding, beginning of period | 1,407,639 | $ 3.80 | 2,148,170 | $ 2.60 |
| Granted | — | — | 120,376 | 8.56 |
| Exercised | (340,021 ) | 3.06 | (144,143 ) | 2.16 |
| Forfeited | (11,685 ) | 5.64 | (7,282 ) | 5.28 |
| Expired | (3,625 ) | 3.36 | — | — |
| Outstanding, end of period | 1,052,308 | $ 4.01 | 2,117,121 | $ 2.84 |
| Options exercisable, end of period | 824,641 | $ 3.34 | 1,741,361 | $ 2.40 |

As of June 30, 2014, the exercise prices, weighted average remaining contractual life and intrinsic values of outstanding options were as follows:

| | | | Options outstanding | | | | Options exercisable | | |
|---|---|---|---|---|---|---|---|---|---|
| Exercise price | | | Outstanding Number | 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 |
| $2.24 | - | $2.40 | 227,092 | $ 2.35 | 0.6 | $2,244,993 | 227,092 | $ 2.35 | $2,244,993 |
| $2.48 | - | $2.80 | 346,013 | $ 2.76 | 2.5 | 3,280,763 | 346,013 | $ 2.76 | 3,280,763 |
| $2.92 | - | $3.76 | 147,891 | $ 3.01 | 3.4 | 1,365,339 | 99,125 | $ 3.05 | 910,840 |
| $4.20 | - | $10.16 | 331,312 | $ 6.91 | 5.1 | 1,766,626 | 152,411 | $ 6.32 | 901,775 |
| | | | 1,052,308 | $ 4.01 | 3.0 | $8,657,721 | 824,641 | $ 3.34 | $7,338,371 |

Total unrecognized compensation cost relating to unvested stock options at June 30, 2014, prior to the consideration of expected forfeitures, was approximately $691,000 and is expected to be recognized over a weighted average period of 2.3 years.

The Company recorded stock-based compensation of $85,357 and $91,255 for the three months ended June 30, 2014 and 2013, respectively.

The Company recorded stock-based compensation of $186,334 and $165,932 for the six months ended June 30, 2014 and 2013, respectively.

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

**13. FAIR VALUE MEASUREMENT**

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

The following table provides a summary of the fair values of the Company's derivative instrument assets and liabilities measured at fair value on a recurring basis at June 30, 2014:

| | June 30, 2014 Fair Value Measurements Using | | | Assets at |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Fair Value |
| Derivative instrument liability | $— | $59,077 | $ — | $59,077 |
| Total Liabilities | $— | $59,077 | $ — | $59,077 |

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, 2013:

| | December 31, 2013 Fair Value Measurements Using | | | Assets at |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Fair Value |
| Derivative instrument liability | $— | $491,098 | $ — | $491,098 |
| Total Liabilities | $— | $491,098 | $ — | $491,098 |

The carrying values of cash and cash equivalents, accounts receivable, accounts payable, accreditation fees payable, customer deposits, loan payable and accrued liabilities approximate their fair values due to the relatively short periods to maturity of the instruments.

**14. SUBSEQUENT EVENTS**

*Forward exchange forward contracts*

During July 2014, the Company entered into foreign exchange forward contracts to hedge a portion of its expected Canadian dollar requirements for the fiscal year ending December 31, 2015 (“fiscal 2015”).. These contracts have a notional value of $10.2 million, whereby $10.2 million is converted into Canadian dollars during 2015 at an average foreign exchange rate of US$1.00: Cdn$1.0858.

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

**SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS**

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

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

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

The ability of vendors to continue to supply our needs;

Actions by our competitors;

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

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

Our ability to effectively manage our business;

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

Pending or new litigation; and

Factors set forth under the caption “Item 1A Risk Factors” in our Annual Report on Form 10-K for the fiscal year ended December 31, 2013.

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

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

**OVERVIEW**

Our mission is to provide simple useful services that help people unlock the power of the Internet. We accomplish this by reducing the complexity our customers' experience as they acquire, deliver or use the Internet or Internet services such as domain name registration, email and other Internet services. We are organized and managed based on two service offerings, Domain Services and Network Access Services, which are differentiated primarily by their services, the markets they serve and the regulatory environments in which they operate.

Our principal place of business is located in Canada. We report our financial results as two operating segments, Domain Services, which derives revenue from three distinct service offerings – Wholesale, Retail and Portfolio, and Network Access Services, which derives revenue from the sale of retail mobile phones and services to individuals and small businesses. 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 Domain Services and Network Access Services revenue separately.

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

***Domain Services***

Domain Services include wholesale and retail domain name registration services, value added services and portfolio services. We earn revenues primarily from the registration fees charged to resellers in connection with new, renewed and transferred domain name registrations; the sale of retail Internet domain name registration and email services to individuals and small businesses; and by making our portfolio of domain names available for sale or lease. Domain Services revenues are attributed to the country in which the contract originates, primarily Canada

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

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

Wholesale, primarily branded as OpenSRS, derives revenue from its Domain Service and from providing Value-Added Services. The OpenSRS Domain Service manages 13.6 million domain names under the Tucows ICANN registrar accreditation and for other registrars under their own accreditations. Value-Added Services include hosted email which provides email delivery and webmail access to millions of mailboxes, Internet security services, publishing tools and reseller billing services. All of these services are made available to end-users through a network of over 13,000 web hosts, Internet service providers (“ISPs”), and other resellers around the world. In addition, we also derive revenue from the bulk sale of domain names and advertising from the OpenSRS Domain Expiry Stream and the Marketing Development Funds we receive from vendors from time-to-time to expand or maintain the market position for their services.

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

Portfolio generates advertising revenue from our domain name portfolio and from our advertising-supported website, tucows.com. We also generate revenue by offering names in our domain portfolio for resale via our reseller network and other channels. In addition, we generate revenue from the payments for the sale of rights to gTLD strings under the New gTLD program.

***Network Access Services***

Network Access Services derives revenue from the sale of retail mobile phones and services to individuals and small businesses through the Ting website. Ting revenues are generated in the United States.

For the three months ended June 30, 2014 and June 30, 2013, we reported revenue of $35.6 million and $31.2 million, respectively. For the three months ended June 30, 2014 and June 30, 2013, our OpenSRS domain service offering accounted for 61% and 71% of our total revenue, respectively.

For the six months ended June 30, 2014 and June 30, 2013, we reported revenue of $70.0 million and $61.2 million, respectively. For the six months ended June 30, 2014 and June 30, 2013, our OpenSRS domain service offering accounted for 62% and 71% of our total revenue, respectively.

**KEY BUSINESS METRICS**

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

**Domain Services**

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

| | **Three months ended** | | **Six months ended** | |
|---|---|---|---|---|
| | **June 30, 2014 (1) (in 000's)** | **2013 (1)** | **June 30, 2014 (1) (in 000's)** | **2013 (1)** |
| Total new, renewed and transferred-in domain name registrations | 2,386 | 2,418 | 4,814 | 4,821 |

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

Domain names under management:

| | June 30, 2014 (1) (in 000's) | 2013 (1) |
|---|---|---|
| Domain names under management: | | |
| Registered using the Tucows Registrar Accreditation | 10,365 | 10,832 |
| Registered using our Resellers' Registrar Accreditations | 3,204 | 3,410 |
| Total domain names under management | 13,569 | 14,242 |

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

**Network Access Services**

| | June 30, 2014 (1) (in 000's) | 2013 (1) |
|---|---|---|
| Ting subscribers under management | 73,000 | 25,000 |
| Ting devices under management | 113,000 | 40,000 |

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

**OPPORTUNITIES, CHALLENGES AND RISKS**

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

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

We are still participating in ICANN's New gTLD program to own a minority interest in four contested New gTLD strings. As all these strings are contested, there can be no assurance that we will be part of a successful bid for any of these new gTLD strings.

In July 2014, we participated in a confidential private auction for .group. As a result of the auction, we have withdrawn our application for .group and the amounts received will be recorded as portfolio revenue in the three months ended September 30, 2014.

While there can be no assurance that we will be awarded any gTLDs, we intend to continue to pursue contested gTLD operator rights and in order to prevail, may incur significant additional costs to acquire such rights. Any such additional costs will be capitalized and included in prepaid expenses and deposits until such time as the relevant gTLD is delegated by ICANN. Other costs incurred by the Company as part of its gTLD initiative not directly attributable to the acquisition of gTLD operator rights are expensed as incurred.

To the extent we elect to sell or dispose of any of our rights under the New gTLD Program, any gains realized on the sale of our interest will be recognized as portfolio revenue, while losses will be recognized when deemed probable. Should we be successful in acquiring any contested gTLD operator rights, any capitalized gTLD costs will be reclassified as finite lived intangible assets and amortized on a straight-line basis over their estimated useful life.

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

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

As a Mobile Virtual Network Operator “MVNO” our Ting service is reliant on our Mobile Network Operator “MNO” providing a competitive network. Our MNO is currently undertaking a significant network modernization plan. Deployment of new and sophisticated technology on a very large scale entails risks. Should they fail to implement, maintain and expand their network capacity and coverage, adapt to future changes in technologies and continued access to and deployment of adequate spectrum successfully, our ability to provide wireless services to our subscribers, to retain and attract subscribers and to maintain and grow our subscriber revenues could be adversely affected, which would negatively impact our operating margins.

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

**Net Revenues**

**<u>Domain Services</u>**

*Wholesale - OpenSRS Domain Service*

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

We receive revenues for each domain registration or other Internet service processed through our system by Service Providers.

With respect to the sale of domain registrations, we earn registration fees in connection with each new, renewed and transferred-in registration and from providing provisioning services to Service Providers and registrars on a monthly basis. Domain registrations are generally purchased for terms of one to ten years. Payments for the full term of all services, or billed revenue, 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.

*Wholesale – OpenSRS Value-Added Services*

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

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

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

*Retail – Hover*

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

*Portfolio*

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

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

Portfolio names are sold through our premium domain name service, auctions or in negotiated sales. The size of our domain name portfolio varies over time, as we acquire and sell domains on a regular basis to maximize the overall value and revenue generation potential of our portfolio. In evaluating names for sale, we consider the potential foregone revenue from pay-per-click advertising, as well as other factors. The name will be offered for sale if, based on our evaluation, the name is deemed non-essential to our business and management believes that deriving proceeds from the sale is strategically more beneficial to the Company. In addition, we generate revenue from the payments for the sale of rights to gTLD strings under the New gTLD program.

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

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

**Network Access Services**

*Ting*

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

**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, 2013 includes further information on the significant accounting policies and methods used in the preparation of our consolidated financial statements.

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

**Revenue recognition policy**

We earn revenues from the following services:

Domain Services

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

Network Access Services

- Ting.

Domain Services

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

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

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

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

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

Network Access Services

Ting earns revenue by selling both mobile phone services and equipment to individuals and small businesses through its website, Ting.com. Service revenues are recognized once services have been provided and are based upon either usage (e.g., minutes of traffic/bytes of data processed), period of time (e.g., monthly service fees), various regulatory fees imposed on us by governmental authorities or other established fee schedules. Revenues for wireless services are billed based on the actual amount of monthly services utilized by each customer during their billing cycle on a postpaid basis. Our billing cycle for each customer is computed based on their activation date and not on our reporting period. As a result, we are required to estimate the amount of revenues earned but not billed from the end of each billing cycle to the end of each reporting period. These estimates are based on an assessment of the actual services rendered to each customer since the last billing period against our rate plans existing at that time. Adjustments affecting revenue may occur in periods subsequent to the billing period when the services were provided and are recognized as revenue during the current billing cycle. In addition, revenues associated with the sale of wireless devices and accessories to subscribers are recognized when title and risk of loss is transferred to the subscriber and shipment has occurred. Incentive marketing credits given to customers are recorded as a reduction of revenue.

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

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

The excess of the fair value of purchase price over the fair values of the identifiable assets and liabilities from our acquisitions is recorded as goodwill. At June 30, 2014 we had $18.9 million in goodwill related to our acquisitions and $14.4 million in intangible assets. All goodwill and intangible assets related to our Domain Services segment. The goodwill recorded in relation to these acquisitions is not deductible for tax purposes. We report our financial results as two operating segments, Domain Services with three distinct service offerings, being Wholesale, Retail and Portfolio and Network Access Services which derives revenue from the sale of retail mobile phones and services to individuals and small businesses.

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

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

With regards to property and equipment and definite life intangible assets, we continually evaluate whether events or circumstances have occurred that indicate the remaining estimated useful lives of our definite-life intangible assets may warrant revision or that the remaining balance of such assets may not be recoverable. We use an estimate of the related undiscounted cash flows over the remaining life of the asset in measuring whether the asset is recoverable. There was no impairment recorded on definite-life intangible assets and property and equipment during the three and six months ended June 30, 2014 and June 30, 2013.

With regard to indefinite life intangible assets, as part of our normal renewal process during the three and six months ended June 30, 2014, we assessed that certain domain names acquired in the June 2006 acquisition of Mailbank.com Inc. should not be renewed and were allowed to expire. Accordingly, these domain names, with a book value of $0.3 million and $0.6 million, respectively, have been written off and recorded as write off / impairment of indefinite life intangible assets during the three and six months ended June 30, 2014. No impairment or write off was recorded on indefinite-life intangible assets during the three and six months ended June 30, 2013.

Our 2013 annual goodwill impairment analysis, which we performed for our Domain Services reporting unit as of December 31, 2013, did not result in an impairment charge.

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

Any changes to our key assumptions about our businesses and our prospects, or changes in market conditions, could cause the fair value of our reporting unit to fall below its carrying value, resulting in a potential impairment charge. In addition, changes in our organizational structure or how our management allocates resources and assesses performance, could result in a change in our operating segments or reporting units, requiring a reallocation and updated impairment analysis of goodwill. A goodwill or intangible asset impairment charge could have a material effect on our consolidated financial statements because of the significance of goodwill and intangible assets to our consolidated balance sheet. There was no impairment of goodwill or intangible assets as a result of the annual impairment tests completed during the fourth quarters of 2013 and 2012.

**Accounting for income taxes**

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

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

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

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

**RESULTS OF OPERATIONS FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2014 AS COMPARED TO THE THREE AND SIX MONTHS ENDED JUNE 30, 2013**

**NET REVENUES**

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

| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| | 2014 | 2013 | 2014 | 2013 |
| **Domain Services:** | | | | |
| Wholesale | | | | |
| Domain Services | $21,503,086 | $21,800,101 | $43,152,040 | 43,696,001 |
| Value Added Services | 2,395,726 | 2,559,427 | 4,999,331 | 5,248,117 |
| Total Wholesale | 23,898,812 | 24,359,528 | 48,151,371 | 48,944,118 |
| | | | | |
| Retail | 2,540,538 | 2,001,354 | 4,924,601 | 3,919,798 |
| Portfolio | 888,806 | 1,078,500 | 1,942,446 | 2,212,224 |
| Total Domain Services | 27,328,156 | 27,439,382 | 55,018,418 | 55,076,140 |
| | | | | |
| **Network Access Services:** | | | | |
| Ting | 8,259,845 | 3,733,975 | 14,971,977 | 6,082,239 |
| Total Network Access Services | 8,259,845 | 3,733,975 | 14,971,977 | 6,082,239 |
| | | | | |
| | $35,588,001 | $31,173,357 | $69,990,395 | $61,158,379 |
| Increase over prior period | $4,414,644 | | $8,832,016 | |
| Increase - percentage | 14 % | | 14 % | |

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

| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| | 2014 | 2013 | 2014 | 2013 |
| **Domain Services:** | | | | |
| Wholesale | | | | |

| | | | | |
|---|---|---|---|---|
| Domain Services | 61 % | 71 % | 62 % | 71 % |
| Value Added Services | 7 % | 8 % | 7 % | 9 % |
| Total Wholesale | 68 % | 79 % | 69 % | 80 % |
| | | | | |
| Retail | 7 % | 6 % | 7 % | 6 % |
| Portfolio | 2 % | 3 % | 3 % | 4 % |
| Total Domain Services | 77 % | 88 % | 79 % | 90 % |
| | | | | |
| **Network Access Services:** | | | | |
| Ting | 23 % | 12 % | 21 % | 10 % |
| Total Network Access Services | 23 % | 12 % | 21 % | 10 % |
| | | | | |
| | 100 % | 100 % | 100 % | 100 % |

Total net revenues for the three months ended June 30, 2014 increased by $4.4 million or 14% to $35.6 million when compared to the three months ended June 30, 2013.

Total net revenues for the six months ended June 30, 2014 increased by $8.8 million or 14% to $70.0 million when compared to the six months ended June 30, 2013.

Deferred revenue increased to $73.6 million at June 30, 2014 from $73.0 million at June 30, 2013 and increased by $3.6 million from $70.0 million at December 31, 2013.

No customer accounted for more than 10% of revenue during the three and six months ended June 30, 2014 and June 30, 2013. At June 30, 2014, one customer accounted for 12% of accounts receivable, and at June 30, 2013, no customer accounted for more than 10% of accounts receivable. Subsequent to the end of the quarter, this receivable has been fully repaid. Significant management judgment is required at the time revenue is recorded to assess whether the collection of the resulting receivables is reasonably assured. On an ongoing basis we assess the ability of our customers to make required payments. Based on this assessment, we expect the carrying amount of our outstanding receivables, net of allowance for doubtful accounts, to be fully collected.

***Wholesale***

During the three months ended June 30, 2014, domain services revenue decreased by $0.3 million to $21.5 million when compared to the three months ended June 30, 2013. During the six months ended June 30, 2014, domain services revenue decreased by $0.6 million to $43.2 million when compared to the six months ended June 30, 2013.

During the three months ended June 30, 2014, the number of transactions from all new, renewed and transferred-in domain name registrations that we processed remained relatively flat at 2.4 million when compared to the three months ended June 30, 2013. During the six months ended June 30, 2014, the number of transactions processed was also flat at 4.8 million when compared to the six months ended June 30, 2013.

We anticipate that the number of new, renewed and transferred-in domain name registrations will remain relatively flat for the year, with some variability from quarter to quarter, and with growth in the core business being off-set with a handful of large clients migrating their business to their own accreditations.

As of June 30, 2014, the total domains under management decreased slightly to 10.4 million when compared to June 30, 2013. This comes as a result of the same factors impacting domain transactions mentioned above. 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 June 30, 2014, we managed 3.2 million domain names on behalf of other accredited registrars compared to 3.4 million at the end of June 30, 2013.

During the three months ended June 30, 2014, value added services revenue decreased by $0.2 million to $2.4 million when compared to the three months ended June 30, 2013. During the six months ended June 30, 2014, value added services revenue decreased by $0.2 million to $5.3 million when compared to the three months ended June 30, 2013. This is primarily the result of one large customer no longer using our eMail platform.

***Retail***

Net revenues from Retail for the three and six months ended June 30, 2014, as compared to the three and six months ended June 30, 2013, increased by $0.5 million, or 27%, to $2.5 million and by $1.0 million, or 26%, to $4.9 million, respectively. These increases were largely due to the success that our retail marketing initiatives and improved websites are having on our ability to attract new customers and retain existing ones for Hover.

***Portfolio***

Net revenues from Portfolio for the three and six months ended June 30, 2014, as compared to the three and six months ended June 30, 2013, decreased by $0.2 million to $0.9 million and by $0.3 million to $1.9 million, respectively. These decreases were primarily due to a decrease in online advertising revenues.

***Network Access Services***

Net revenues from Ting mobile phone services and equipment for the three months ended June 30, 2014, as compared to the three months ended June 30, 2013, increased by $4.5 million or 121% to $8.3 million. Net revenues from Ting mobile phone services and equipment for the six months ended June 30, 2014, as compared to the six months ended June 30, 2013, increased by $8.9 million, or 146%, to $15.0 million. This increase primarily reflects the impact the larger subscriber base is having on service revenues. As of June 30, 2014, Ting had 73,000 subscribers and 113,000 mobile devices under its management compared to 25,000 subscribers and 40,000 devices under management as of June 30, 2013.

**COST OF REVENUES**

***Wholesale***

*OpenSRS Domain Service*

Cost of revenues for domain registrations represents the amortization of registry fees on a basis consistent with the recognition of revenues from our customers, namely ratably over the term of provision of the service. Registry fees, the primary component of cost of revenues, are paid in full when the domain is registered, and are initially recorded as prepaid domain registry fees. This accounting treatment reasonably approximates a recognition pattern that corresponds with the provision of the services during the period. Market development funds that do not meet the criteria for revenue recognition under ASC 605-50 “Customer Payments and Incentives”, are reflected as cost of goods sold and are recognized as earned.

*Value-Added Services*

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

***Retail***

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

***Portfolio***

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

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

***Network Access Services***

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

***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 June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| | 2014 | 2013 | 2014 | 2013 |
| **Domain Services:** | | | | |
| Wholesale | | | | |
| Domain Services | $17,809,325 | 18,484,667 | $36,044,540 | 36,938,969 |
| Value Added Services | 563,011 | 520,456 | 1,103,733 | 1,082,494 |
| Total Wholesale | 18,372,336 | 19,005,123 | 37,148,273 | 38,021,463 |
| | | | | |
| Retail | 1,110,659 | 833,327 | 2,126,075 | 1,583,923 |
| Portfolio | 213,035 | 229,428 | 456,890 | 430,406 |
| Total Domain Services | 19,696,030 | 20,067,878 | 39,731,238 | 40,035,792 |
| | | | | |
| **Network Access Services:** | | | | |
| Ting | 5,039,974 | 2,939,628 | 9,321,405 | 5,049,613 |
| Total Network Access Services | 5,039,974 | 2,939,628 | 9,321,405 | 5,049,613 |
| | | | | |
| **Network Expenses:** | | | | |
| Network, other costs | 1,144,697 | 1,269,808 | 2,288,341 | 2,524,021 |
| Network, depreciation and amortization costs | 173,963 | 187,266 | 356,937 | 360,248 |
| Total Network Expenses | 1,318,660 | 1,457,074 | 2,645,278 | 2,884,269 |
| | | | | |
| | $26,054,664 | $24,464,580 | $51,697,921 | $47,969,674 |
| Increase over prior period | $1,590,084 | | $3,728,247 | |
| Increase - percentage | 6 % | | 8 % | |

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

| | Three months ended June 30, | | | | Six months ended June 30, | | | |
|---|---|---|---|---|---|---|---|---|
| | 2014 | | 2013 | | 2014 | | 2013 | |
| **Domain Services:** | | | | | | | | |
| Wholesale | | | | | | | | |
| Domain Services | 50 | % | 59 | % | 51 | % | 60 | % |
| Value Added Services | 2 | % | 2 | % | 2 | % | 2 | % |
| Total Wholesale | 52 | % | 61 | % | 53 | % | 62 | % |
| | | | | | | | | |
| Retail | 3 | % | 3 | % | 3 | % | 3 | % |
| Portfolio | 1 | % | 1 | % | 1 | % | 1 | % |
| Total Domain Services | 56 | % | 65 | % | 57 | % | 66 | % |
| | | | | | | | | |
| **Network Access Services:** | | | | | | | | |
| Ting | 14 | % | 9 | % | 13 | % | 8 | % |
| Total Network Access Services | 14 | % | 9 | % | 13 | % | 8 | % |
| | | | | | | | | |
| **Network Expenses:** | | | | | | | | |
| Network, other costs | 3 | % | 4 | % | 3 | % | 4 | % |
| Network, depreciation and amortization costs | 0 | % | 1 | % | 1 | % | 1 | % |
| Total Network Expenses | 3 | % | 5 | % | 4 | % | 5 | % |
| | | | | | | | | |
| | 73 | % | 79 | % | 74 | % | 79 | % |

Total cost of revenues for the three months ended June 30, 2014 increased by $1.6 million, or 6%, to $26.1 million when compared to the three months ended June 30, 2013.

Total cost of revenues for the six months ended June 30, 2014 increased by $3.7 million, or 8%, to $51.7 million when compared to the six months ended June 30, 2013.

Prepaid domain registration and other Internet services fees as of June 30, 2014 decreased by $0.4 million to $58.5 million from $58.9 million at June 30, 2013. Prepaid domain registration and other Internet services fees have been impacted by certain of our customers, who have acquired their own registrar accreditation, no longer registering new domain names on our platform.

***Wholesale***

Costs for Wholesale for the three and six months ended June 30, 2014 decreased by $0.6 million, or 3%, to $18.4 million and by $0.9 million, or 2%, to $37.1 million, respectively, when compared to the three and six months ended June 30, 2013. This reduction in costs is primarily the result of an ongoing shift in product mix to higher margin domain services and with growth in the core wholesale domain services business being off-set with a handful of large clients migrating their business to their own accreditations.

***Retail***

Costs for Retail for the three and six months ended June 30, 2014 increased by $0.3 million, to $1.1 million and by $0.5 million, to $2.1 million, respectively, when compared to the three and six months ended June 30, 2013. These increases resulted primarily from the increased cost of additional volume in Hover services.

***Portfolio***

Costs for Portfolio remained relatively flat at $0.2 million and $0.4 million for both the three and six months ended June 30, 2014 and June 30, 2013, respectively.

***Network Access Services***

Costs for Ting for the three and six months ended June 30, 20014 increased by $2.1 million, to $5.0 million and by $4.3 million, to $9.3 million, respectively, when compared to the three and six months ended June 30, 2013. This increase primarily reflects the impact the larger subscriber base is having on service costs.

***Network Costs***

Network costs before depreciation and amortization for the three and six months ended June 30, 2014 decreased by $0.1 million, to $1.1 million and by $0.2 million, to $2.3 million, respectively, when compared to the three and six months ended June 30, 2013. These decreases resulted primarily from improved productivity in workforce related costs as well as a decrease in contract and outside service costs.

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**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 June 30,** | | **Six months ended June 30,** | |
|---|---|---|---|---|
| | **2014** | **2013** | **2014** | **2013** |
| Sales and marketing | $3,762,441 | $2,946,586 | $7,784,215 | $5,793,672 |
| Increase over prior period | $815,855 | | $1,990,543 | |
| Increase - percentage | 28 % | | 34 % | |
| Percentage of net revenues | 11 % | 9 % | 11 % | 9 % |

Sales and marketing expenses for the three and six months ended June 30, 2014 increased by $0.8 million, or 28%, to $3.8 million and by $2.0 million, or 34%, to $7.8 million, respectively, when compared to the three and six months ended June 30, 2013. These increases were primarily related to workforce and marketing expenses incurred in acquiring and servicing Ting subscribers. We expect sales and marketing expenses for fiscal 2014 to increase in absolute dollars, as we adjust our marketing programs and sales and customer support personnel costs primarily to support our Ting marketing and customer service needs.

**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 June 30,** | | **Six months ended June 30,** | |
|---|---|---|---|---|
| | **2014** | **2013** | **2014** | **2013** |
| Technical operations and development | $1,107,532 | $748,137 | $2,197,430 | $1,881,967 |
| Increase over prior period | $359,395 | | $315,463 | |
| Increase - percentage | 48 % | | 17 % | |
| Percentage of net revenues | 3 % | 2 % | 3 % | 3 % |

Technical operations and development expenses for the three and six months ended June 30, 2014 increased by $0.4 million, or 48%, to $1.1 million and by $0.3 million, or 17%, to $2.2 million, respectively, when compared to the three and six months ended June 30, 2013. This increase was partially offset by our recognizing a 2010 Ontario Interactive Digital Media Tax Credit of $0.5 million, primarily related to eligible personnel costs, during the quarter ended June 30, 2013.

**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 June 30,** | | **Six months ended June 30,** | |
|---|---|---|---|---|
| | **2014** | **2013** | **2014** | **2013** |
| General and administrative | $1,886,319 | $1,698,697 | $3,654,119 | $3,397,329 |
| Increase over prior period | $187,622 | | $256,790 | |
| Increase - percentage | 11 % | | 8 % | |
| Percentage of net revenues | 5 % | 5 % | 5 % | 6 % |

General and administrative expenses for the three and six months ended June 30, 2014 increased by $0.2 million, or 11%, to $1.9 million and by $0.3 million, or 8%, to $3.7 million, respectively, when compared to the three and six months ended June 30, 2013. These increases were the result of incremental workforce related costs and increased credit card processing fees and bad debts primarily related to the growth of Ting. These increases were partly offset by increased gains in foreign exchange.

**DEPRECIATION OF PROPERTY AND EQUIPMENT**

| | **Three months ended June 30,** | | **Six months ended June 30,** | |
|---|---|---|---|---|
| | **2014** | **2013** | **2014** | **2013** |
| Depreciation of property and equipment | $52,538 | $54,922 | $108,842 | $105,861 |
| Decrease over prior period | $(2,384 ) | | $2,981 | |
| Decrease - percentage | (4 )% | | 3 % | |
| Percentage of net revenues | 0 % | 0 % | 0 % | 0 % |

Depreciation costs remained relatively flat at $0.05 million and $0.1 million for the three and six months ended June 30, 2014 and June 30, 2013, respectively.

**AMORTIZATION OF INTANGIBLE ASSETS**

| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| | **2014** | **2013** | **2014** | **2013** |
| Amortization of intangible assets | $219,030 | $219,030 | $438,060 | $438,060 |
| (Decrease) increase over prior period | $- | | $- | |
| Decrease - percentage | - % | | - % | |
| Percentage of net revenues | 1 % | 1 % | 1 % | 1 % |

Amortization of intangible assets consists of amounts arising in connection with 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.

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

**IMPAIRMENT OF INDEFINITE LIFE INTANGIBLE ASSETS**

| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| | **2014** | **2013** | **2014** | **2013** |
| Impairment of indefinite life intangible assets | $326,457 | $ - | $577,145 | $ - |
| Increase over prior period | $326,457 | | $577,145 | |
| Increase - percentage | - % | | - % | |
| Percentage of net revenues | 1 % | - % | 1 % | - % |

As part of our normal renewal process during the three and six months ended June 30, 2014, we assessed that certain domain names acquired in the June 2006 acquisition of Mailbank.com Inc. should not be renewed and were allowed to expire. Accordingly, these domain names, with a book value of $0.3 million and $0.6 million, have been written off and recorded as impairment of indefinite life intangible assets during the three and six months ended June 30, 2014, respectively. No impairment was recorded on indefinite-life intangible assets during the three and six months ended June 30, 2013.

**LOSS ON CURRENCY FORWARD CONTRACTS**

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

| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| | 2014 | 2013 | 2014 | 2013 |
| Loss on currency forward contracts | $96,545 | $146,639 | $647,916 | $381,277 |
| (Decrease) increase over prior period | $(50,094) | | $266,639 | |
| (Decrease) /increase - percentage | (34)% | | 70% | |
| Percentage of net revenues | 0% | 0% | 1% | 1% |

As of June 30, 2014, we have entered into certain forward exchange contracts that do not comply with the requirements of hedge accounting to meet a portion of our future Canadian dollar requirements through December 2014. The impact of the fair value adjustment on outstanding contracts for the three months ended June 30, 2014 was a net gain of $0.2 million, compared to a net loss of $0.2 million for the three months ended June 30, 2013 and for six months ended June 30, 2014 was a net gain of $0.1 million, compared to a net loss of $0.6 million for the six months ended June 30, 2013 In addition, the impact of the fair value adjustment on outstanding contracts was increased by a realized loss upon settlement of currency forward contracts of $0.3 million for the three months ended June 30, 2014 and by a realized loss of $0.8 million for the six months ended June 30, 2014. During the three and six months ended June 30, 2013, the impact of the fair value adjustment on outstanding contracts was partly offset by a realized gain upon settlement of currency forward contracts of $0.1 million and of $0.2 million, respectively.

At June 30, 2014, our balance sheet reflects a net derivative instrument liability of $0.1 million as a result of our existing foreign exchange contracts.

**OTHER INCOME AND EXPENSES**

| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| | 2014 | 2013 | 2014 | 2013 |
| Other income (expense), net | $(69,348) | $(93,428) | $(143,181) | $(192,790) |
| Increase over prior period | $24,080 | | $49,609 | |
| Increase - percentage | (26)% | | (26)% | |
| Percentage of net revenues | 0% | 0% | 0% | 0% |

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Other expenses for the three and six months ended June 30, 2104 remained relatively unchanged when compared to the three and six months ended June 30, 2013 and primarily consist of interest we incur in connection with our credit facility with the Bank of Montreal (as discussed below).

**INCOME TAXES**

| | **Three months ended June 30,** | | **Six months ended June 30,** | |
|---|---|---|---|---|
| | **2014** | **2013** | **2014** | **2013** |
| Provision for income taxes | $665,945 | $213,708 | $917,545 | $333,540 |
| Increase in provision over prior period | $452,237 | | $584,005 | |
| Increase - percentage | 212 % | | 175 % | |
| Percentage of net revenues | 2 % | 1 % | 1 % | 1 % |

For the six months ended June 30, 2014, we recorded a provision for income taxes of $0.9 million on income before income taxes of $2.7 million, using an estimated effective tax rate for fiscal 2014 adjusted for certain minimum state taxes. Comparatively, for the six months ended June 30, 2013, we recorded a provision for income taxes of $0.3 million on income before taxes of $1.0 million, using an estimated effective tax rate for its 2013 fiscal year.

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

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

We had approximately $0.1 million of total gross unrecognized tax benefit as of June 30, 2014 and $0.3 million of total gross unrecognized tax benefit as of June 30, 2013, 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. The decrease of $0.2 million from June 30, 2013 primarily relates to the finalization of prior year German income tax returns. We recognize accrued interest and penalties related to income taxes in income tax expense. We did not have significant interest and penalties accrued at June 30, 2014 and December 31, 2013, respectively.

**OTHER COMPREHENSIVE INCOME (LOSS)**

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

The impact of the fair value adjustment on outstanding hedged contracts for the three and six months ended June 30, 2014 was a net gain in other comprehensive income of $0.4 million and $0.2 million, respectively. The impact of the fair value adjustment on outstanding hedged contracts for the three and six months ended June 30, 2103 was a net loss in other comprehensive income of $0.3 million and $0.4 million, respectively.

| | **Three months ended June 30,** | | **Six months ended June 30,** | |
|---|---|---|---|---|
| | **2014** | **2013** | **2014** | **2013** |
| Comprehensive income (loss) | $430,277 | $(260,941 ) | $214,810 | $(446,726 ) |
| Decrease in provision over prior period | $691,218 | | $661,536 | |
| Increase - percentage | (265 )% | | (148 )% | |
| Percentage of net revenues | 1 % | (1 )% | 0 % | (1 )% |

**LIQUIDITY AND CAPITAL RESOURCES**

As of June 30, 2014, our cash and cash equivalents balance increased by $1.7 million to $14.2 million when compared to December 31, 2013. Our principal sources of liquidity during the six months ended June 30, 2014 resulted from the exercise of stock options of $2.1 million and cash provided by operating activities of $1.1 million. The resulting proceeds from the exercise of stock options of $2.1 million includes an excess tax benefit from share based compensation expenses of $1.0 million. These sources of funds were partly offset by the repayment of our loan in the amount of $0.9 million, our repurchasing stock through an NCIB in the amount of $0.1 million and additions to property and equipment amounting to $0.4 million.

We have credit agreements (collectively the "Amended Credit Facility") with the Bank of Montreal which provide us with access to a demand loan revolving facility (the "2012 DLR Loan") and a demand loan revolving reducing facility (the "2012 DLRR Loan") that provide for a $14 million, five-year revolving credit facility, a $3.5 million treasury risk management facility and a $1.0 million operating demand loan. At June 30, 2014 the balance under the 2012 DLRR Loan was $5.4 million and the balance under the 2012 DLR Loan was fully repaid.

In accordance with the terms of the demand loan facilities, repayment of advances under the 2012 DLR Loan consist of interest only payments at U.S. Base Rate plus 1.25%, made monthly in arrears, and prepayment is permitted without penalty. In accordance with the terms of the demand loan facilities, the outstanding balance under the 2012 DLR Loan as of December 31, 2013 of $5.2 million was fully repaid through an equivalent advance made under the 2012 DLRR Loan and will be repaid in equal monthly principal payments plus interest, over a period of four years. Prepayment is permitted without penalty.

The Amended Credit Facility also provides for a $3.5 million settlement risk line to assist us with hedging Canadian dollar exposure through foreign exchange forward contracts and/or currency options. Under the terms of the Amended Credit Facility, we may enter into such agreements at market rates with terms not to exceed 18 months. As of June 30, 2014, we held contracts in the amount of $13.5 million to trade U.S. dollars in exchange for Canadian dollars.

The Amended Credit Facility contains customary events of default and affirmative and negative covenants and restrictions, including certain financial maintenance covenants such as a maximum total funded debt to EBITDA ratio and a minimum fixed charge ratio. As of June 30, 2014, we were in compliance with all our covenants.

***Cash Flow from Operating Activities***

Net cash provided by operating activities during the six months ended June 30, 2014 was $1.1 million, as compared to $3.4 million during the six months ended June 30, 2013.

Our net income before the impact of non-cash charges of $0.4 million during the six months ended June 30, 2014 was $2.2 million. Included in the add-back for non-cash charges is depreciation, amortization and the impairment of indefinite life intangible assets which was partially offset by the excess tax benefits on share-based compensation of $0.4 million, the recovery of deferred taxes and the provision for unrealized gains on currency forward contracts.

In addition, changes in our working capital was driven by our utilizing an additional $5.6  million to fund increases in prepaid domain name registry fees, accounts receivable, prepaid expenses and inventory and a reduction in accrued liabilities, customer deposits and income taxes recoverable. These amounts were partly offset by positive contributions of $4.5 million from movements in deferred revenue, accounts payable and accreditation fees payable.

***Cash Flow from Financing Activities***

Net cash inflows from financing activities during the six months ended June 30, 2014 totaled $1.0 million as compared to a usage of $2.4 million during the six months ended June 30, 2013. Net cash inflows amounting to $2.1 million resulted from the exercise of stock options by both our employees and directors, including an excess tax benefit from share based compensation expenses of $1.0 million. Theses cash inflows were partially offset by our using net cash of $0.9 million to fund principal repayments under our Amended Credit Facility. In addition, $0.1 million was used to fund the repurchase of 6,092 of our shares under our current Normal Course Issuer Bid during the six months ended June 30, 2014, none of which occurred during the quarter ending June 30, 2014.

***Cash Flow from Investing Activities***

Investing activities during the six months ended June 30, 2014 used net cash of $0.4 million to acquire additional property and equipment.

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

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

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

**SUBSEQUENT EVENTS**

*Forward exchange forward contracts*

During July 2014, the Company entered into foreign exchange forward contracts to hedge a portion of its expected Canadian dollar requirements for the 2015 fiscal year. These contracts have a notional value of $10.2 million, whereby $10.2 million is converted into Canadian dollars during 2015 at an average foreign exchange rate of US$1.00: Cdn$1.0858.

**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 June 30, 2014. 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 June 30, 2014, we 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 |
|---|---|---|---|
| July – September, 2014 | 6,710,000 | 1.0634 | (26,417) |
| October – December, 2014 | 6,810,000 | 1.0648 | (32,660) |
| Total | $13,520,000 | 1.0641 | $(59,077) |

As of June 30, 2014 we have $13.5 million of outstanding foreign exchange forward contracts which will convert to CDN $14.4 million. Of these contracts, $10.5 million met the requirements for hedge accounting (June 30, 2013 - $18.1 million of which $13.8 million were designated as hedges).

We have performed a sensitivity analysis model for foreign exchange exposure over the three months ended June 30, 2014. 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 June 30, 2014. 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 June 30, 2014 of approximately $0.6 million. There can be no assurances that the above projected exchange rate decrease will materialize. Fluctuations of exchange rates are beyond our control. We will continue to monitor and assess the risk associated with these exposures and may take additional actions in the future to hedge or mitigate these risks.

**Credit Risk**

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

**Item 4. Controls and Procedures**

(a) Evaluation of Disclosure Controls and Procedures

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

(b) Change in Internal Control over Financial Reporting

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

**PART II.**

**OTHER INFORMATION**

**Item 1. Legal Proceedings**

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

**Item 1A. Risk Factors**

In addition to the other information set forth in this Quarterly Report, you should also carefully consider the risk factors discussed in Part I, “Item 1A. Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2013, 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 4. Mine Safety Disclosures**

Not applicable.

**Item 6. Exhibits**

(a) Exhibits.

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

| | |
|---|---|
| ** 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: August 12, 2014 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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