

TUCOWS INC /PA/  
Form 10-Q  
November 07, 2018

Table of Contents

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, DC 20549**

**FORM 10-Q**

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

**For the quarterly period ended September 30, 2018**

**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 (I.R.S. Employer  
Incorporation or Organization) 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 every Interactive Data File required to be submitted 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 such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

Emerging Growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of November 6, 2018, there were 10,615,925 outstanding shares of common stock, no par value, of the registrant.

Table of Contents

**TUCOWS INC.**

**Form 10-Q Quarterly Report**

**INDEX**

**PART I**

**FINANCIAL INFORMATION**

Item 1. <u>Consolidated Financial Statements</u>	3
<u>Consolidated Balance Sheets (unaudited) as of September 30, 2018 and December 31, 2017</u>	3
<u>Consolidated Statements of Operations and Comprehensive Income (unaudited) for the three and nine months ended September 30, 2018 and 2017</u>	4
<u>Consolidated Statements of Cash Flows (unaudited) for the three and nine months ended September 30, 2018 and 2017</u>	5
<u>Notes to Consolidated Financial Statements (unaudited)</u>	6
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	27
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	49
Item 4. <u>Controls and Procedures</u>	50

**PART II**

**OTHER INFORMATION**

Item 1. <u>Legal Proceedings</u>	51
Item 1A. <u>Risk Factors</u>	51
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	51
Item 3. <u>Defaults Upon Senior Securities</u>	51
Item 4. <u>Mine Safety Disclosures</u>	51
Item 5. <u>Other Information</u>	51

Item 6. <u>Exhibits</u>	52
<u>Signatures</u>	53

## **TRADEMARKS, TRADE NAMES AND SERVICE MARKS**

Tucows®, EPAG®, Hover®, OpenSRS®, Platypus®, Ting®, eNom®, Roam®, Roam Mobility®, Bulkregister® and YummyNames® are registered trademarks of Tucows Inc. or its subsidiaries. Other service marks, trademarks and trade names of Tucows Inc. or its subsidiaries may be used in this Quarterly Report on Form 10-Q (this “Quarterly Report”). All other service marks, trademarks and trade names referred to in this Quarterly Report are the property of their respective owners. Solely for convenience, any trademarks referred to in this Quarterly Report may appear without the ® or TM symbol, but such references are not intended to indicate, in any way, that we or the owner of such trademark, as applicable, will not assert, to the fullest extent under applicable law, our or its rights, or the right of the applicable licensor, to these trademarks.

Table of Contents**PART I.****FINANCIAL INFORMATION****Item 1. Consolidated Financial Statements****Tucows Inc.****Consolidated Balance Sheets****(Dollar amounts in thousands of U.S. dollars)****(unaudited)**

	<b>September 30, 2018</b>	<b>December 31, 2017*</b>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 10,775	\$ 18,049
Accounts receivable, net of allowance for doubtful accounts of \$132 as of September 30, 2018 and \$168 as of December 31, 2017	11,529	12,376
Inventory	3,140	2,944
Prepaid expenses and deposits	14,554	14,186
Prepaid domain name registry and ancillary services fees, current portion (note 11 (b))	91,590	103,302
Income taxes recoverable	3,109	3,004
Total current assets	134,697	153,861
Prepaid domain name registry and ancillary services fees, long-term portion (note 11 (b))	19,636	23,701
Property and equipment	40,220	24,620
Contract costs (note 11 (a))	1,383	-
Intangible assets (note 6)	51,505	58,414
Goodwill (note 6)	90,054	90,054
Total assets	\$ 337,495	\$ 350,650
<b>Liabilities and Stockholders' Equity</b>		
Current liabilities:		
Accounts payable	\$ 8,242	\$ 7,026
Accrued liabilities	6,877	6,412
Customer deposits	11,885	15,255
Derivative instrument liability (note 5)	62	-

Edgar Filing: TUCOWS INC /PA/ - Form 10-Q

Deferred rent, current portion	21	21
Loan payable, current portion (note 7)	17,810	18,290
Deferred revenue, current portion	120,459	129,155
Accreditation fees payable, current portion	1,035	1,175
Income taxes payable	1,128	1,226
Total current liabilities	167,519	178,560
Deferred revenue, long-term portion	28,033	31,427
Accreditation fees payable, long-term portion	260	289
Deferred rent, long-term portion	121	130
Loan payable, long-term portion (note 7)	46,605	58,634
Deferred gain	258	429
Deferred tax liability (note 8)	19,265	19,834
Redeemable non-controlling interest (note 4 (a))	-	1,136
Stockholders' equity (note 13)		
Preferred stock - no par value, 1,250,000 shares authorized; none issued and outstanding	-	-
Common stock - no par value, 250,000,000 shares authorized; 10,615,566 shares issued and outstanding as of September 30, 2018 and 10,583,879 shares issued and outstanding as of December 31, 2017	15,635	15,368
Additional paid-in capital	3,462	2,167
Retained earnings	56,373	42,676
Accumulated other comprehensive income	(36 )	-
Total stockholders' equity	75,434	60,211
Total liabilities and stockholders' equity	\$ 337,495	\$ 350,650
Commitments and contingencies (note 16)		

\*The Company has initially applied ASC 2014-09 (Topic 606) using the modified retrospective method. Under this method, the comparative information is not restated.

See accompanying notes to unaudited consolidated financial statements

Table of Contents**Tucows Inc.****Consolidated Statements of Operations and Comprehensive Income****(Dollar amounts in thousands of U.S. dollars, except per share amounts)****(unaudited)**

	<b>Three months ended September 30, 2018</b>		<b>Nine months ended September 30, 2018</b>		<b>2017</b>	
Net revenues (note 10)	\$83,519	\$85,008	\$260,401	\$238,800		
Cost of revenues (note 10)						
Cost of revenues	55,105	60,731	178,578	169,488		
Network expenses	2,315	2,461	7,590	7,064		
Depreciation of property and equipment	1,339	823	3,698	2,128		
Amortization of intangible assets (note 6)	499	499	1,497	1,335		
Total cost of revenues	59,258	64,514	191,363	180,015		
Gross profit	24,261	20,494	69,038	58,785		
Expenses:						
Sales and marketing	8,412	7,384	24,629	22,051		
Technical operations and development	2,207	1,910	6,657	5,402		
General and administrative	4,120	3,381	12,906	10,124		
Depreciation of property and equipment	106	155	309	486		
Amortization of intangible assets (note 6)	1,797	1,746	5,456	4,735		
Impairment of indefinite life intangible assets (note 6)	-	2		2		
Loss (gain) on currency forward contracts (note 5)	(27)	) (54	) 22	(115	)	
Total expenses	16,615	14,524	49,979	42,685		
Income from operations	7,646	5,970	19,059	16,100		
Other income (expenses):						
Interest expense, net	(914	) (864	) (2,761	) (2,703	)	
Other income, net	(16	) 157	181	512		
Total other income (expenses)	(930	) (707	) (2,580	) (2,191	)	
Income before provision for income taxes	6,716	5,263	16,479	13,909		
Provision for income taxes (note 8)	1,370	1,823	3,781	2,781		



Edgar Filing: TUCOWS INC /PA/ - Form 10-Q

Net income before redeemable non-controlling interest	5,346	3,440	12,698	11,128
Redeemable non-controlling interest	-	(69	) (26	) (312
Net income attributable to redeemable non-controlling interest	-	69	26	312
Net income for the period	5,346	3,440	12,698	11,128
Other comprehensive income, net of tax				
Unrealized income (loss) on hedging activities (note 5)	144	309	(112	) 638
Net amount reclassified to earnings (note 5)	63	(318	) 76	(416
Other comprehensive income (loss) net of tax of \$ (59) and \$ 5 for the three months ended September 30, 2018 and September 30, 2017, \$ 19 and \$ (127) for the nine months ended September 30, 2018 and September 30, 2017 (note 5)	207	(9	) (36	) 222
Comprehensive income, net of tax for the period	\$5,553	\$3,431	\$12,662	\$11,350
Basic earnings per common share (note 9)	\$0.50	\$0.33	\$1.20	\$1.06
Shares used in computing basic earnings per common share (note 9)	10,611,579	10,564,311	10,599,243	10,522,841
Diluted earnings per common share (note 9)	\$0.50	\$0.32	\$1.18	\$1.03
Shares used in computing diluted earnings per common share (note 9)	10,794,297	10,785,342	10,795,668	10,785,050

\*The Company has initially applied ASC 2014-09 (Topic 606) using the modified retrospective method. Under this method, the comparative information is not restated.

See accompanying notes to unaudited consolidated financial statements

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

	<b>Three months ended September 30,</b>		<b>Nine months ended September 30,</b>	
	<b>2018</b>	<b>2017</b>	<b>2018</b>	<b>2017</b>
Cash provided by:				
Operating activities:				
Net income for the period	\$5,346	\$3,440	\$12,698	\$11,128
Items not involving cash:				
Depreciation of property and equipment	1,445	978	4,007	2,614
Loss on write off of property and equipment	-	8	-	17
Amortization of debt discount and issuance costs	72	57	211	204
Amortization of intangible assets	2,296	2,245	6,953	6,070
Impairment of indefinite life intangible asset	-	2	-	2
Change in capitalized contract costs	(29 )	-	21	-
Deferred income taxes (recovery)	(369 )	(1,445 )	(861 )	(3,011 )
Excess tax benefits on share-based compensation expense	(191 )	(444 )	(532 )	(2,615 )
Amortization of deferred rent	(5 )	-	(9 )	6
Loss on disposal of domain names	5	8	70	25
Other income	-	(129 )	(171 )	(386 )
Loss (gain) on change in the fair value of forward contracts	(30 )	1	13	(37 )
Stock-based compensation	711	203	1,904	834
Change in non-cash operating working capital:				
Accounts receivable	685	533	847	(332 )
Inventory	108	(643 )	(196 )	(1,739 )
Prepaid expenses and deposits	874	202	(368 )	(2,169 )
Prepaid domain name registry and ancillary services fees	4,229	3,084	15,777	570
Income taxes recoverable	(137 )	2,225	293	1,815
Accounts payable	778	(644 )	1,048	(4,682 )
Accrued liabilities	107	981	465	994
Customer deposits	(1,049 )	(1,905 )	(3,370 )	1,163
Deferred revenue	(3,559 )	(1,425 )	(12,090 )	7,543
Accreditation fees payable	(73 )	(50 )	(169 )	(200 )
Net cash provided by operating activities	11,214	7,282	26,541	17,814
Financing activities:				
Proceeds received on exercise of stock options	23	68	62	173
Payment of tax obligations resulting from net exercise of stock options	(116 )	(117 )	(404 )	(1,438 )

Edgar Filing: TUCOWS INC /PA/ - Form 10-Q

Proceeds received on loan payable	-	-	2,500	86,998
Repayment of loan payable	(4,387 )	(4,573 )	(15,212 )	(15,403 )
Payment of loan payable costs	(4 )	(16 )	(8 )	(620 )
Net cash (used in) provided by financing activities	(4,484 )	(4,638 )	(13,062 )	69,710
Investing activities:				
Additions to property and equipment	(7,003 )	(2,859 )	(19,439 )	(9,461 )
Acquisition of a portion of the minority interest in Ting Virginia, LLC (note 4(a))	-	-	(1,200 )	(2,000 )
Acquisition of Enom Incorporated, net of cash (note 4(b))	-	-	-	(76,237 )
Acquisition of intangible assets	(113 )	(2,384 )	(114 )	(2,384 )
Net cash used in investing activities	(7,116 )	(5,243 )	(20,753 )	(90,082 )
Decrease in cash and cash equivalents	(386 )	(2,599 )	(7,274 )	(2,558 )
Cash and cash equivalents, beginning of period	11,161	15,146	18,049	15,105
Cash and cash equivalents, end of period	\$10,775	\$12,547	\$10,775	\$12,547
Supplemental cash flow information:				
Interest paid	\$919	\$870	\$2,781	\$2,717
Income taxes paid, net	\$1,793	\$1,308	\$5,370	\$6,313
Supplementary disclosure of non-cash investing and financing activities:				
Property and equipment acquired during the period not yet paid for	\$382	\$186	\$382	\$186

\*The Company has initially applied ASC 2014-09 (Topic 606) using the modified retrospective method. Under this method, the comparative information is not restated.

See accompanying notes to unaudited consolidated financial statements

Table of Contents

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**1. Organization of the Company:**

Tucows Inc. (referred to throughout this report as the “Company”, “Tucows”, “we”, “us” or through similar expressions) provides simple useful services that help people unlock the power of the Internet. The Company provides U.S. consumers and small businesses with mobile phone services nationally and high-speed fixed Internet access in selected towns. The Company is also a global distributor of Internet services, including domain name registration, digital certificates, and email. It provides these services primarily through a global Internet-based distribution network of Internet Service Providers, web hosting companies and other providers of Internet services to end-users.

**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 September 30, 2018 and the results of operations and cash flows for the interim periods ended September 30, 2018 and 2017. 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 United States Securities and Exchange Commission (the “SEC”). Certain information and footnote disclosures normally included in the Company's annual audited consolidated financial statements and accompanying notes have been condensed or omitted. Other than the exception noted below, 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, 2017 included in Tucows' 2017 Annual Report on Form 10-K filed with the SEC on March 6, 2018 (the “2017 Annual Report”). There have been no material changes to our significant accounting policies and estimates during the nine months ended September 30, 2018 as compared to the significant accounting policies and estimates described in our 2017 Annual Report, except for the adoption of Accounting Standards Update (“ASU”) No. 2014-09, *Revenue from Contracts with Customers* (Topic 606) (“ASU 2014-09”). See note 3 – Recent accounting pronouncements for more information.

Beginning with the Company's Quarterly Report on Form 10-Q ended June 30, 2018 filed with the SEC August 8, 2018, all dollar values of current and comparative figures in the financial statements and accompanying tables have been rounded to the nearest thousand (\$000), except when otherwise indicated.

During the preparation of these interim financial statements, the Company identified an immaterial error that affects the classification of expenses for the three and nine months ended September 30, 2017. This correction of the comparative periods resulted in a decrease in cost of revenues of \$0.3 million, a decrease in sales and marketing expense of \$0.2 million, and an increase in general and administrative expenses of \$0.5 million for both the three and nine months ended September 30, 2017 compared to the amounts previously reported.

### 3. Recent accounting pronouncements:

#### *Recent Accounting Pronouncements Adopted*

On January 1, 2018, the Company adopted Accounting Standards Updates ("ASU") No. 2017-01, *Business Combinations (Topic 805): Clarifying the Definition of a Business* and ASU 2015-16, *Simplifying the Accounting for Measurement-Period Adjustments*. The adoption of these updates did not have a significant impact on the consolidated financial statements. We also adopted ASU 2014-09 on January 1, 2018. The impact of such adoption is described in more detail below.

#### *ASU 2014-09: Adoption of Revenue from Contracts with Customers (Topic 606)*

On January 1, 2018, the Company adopted ASU 2014-09 using the modified retrospective method by recognizing the cumulative effect of initially applying ASU 2014-09 as an adjustment to the opening balance of equity as at January 1, 2018. The results for reporting periods beginning after January 1, 2018 are presented under ASU 2014-09, while prior period amounts are not adjusted and continue to be reported in accordance with our historic accounting policy, under Accounting Standards Codification ("ASC") Topic 605, Revenue Recognition (ASC Topic 605). The adoption of ASU 2014-09 did not affect the Company's cash flows from operating, investing, or financing activities. Furthermore, the impact on timing of revenue recognition was not material as the treatment of revenue for services rendered over time is consistent under ASU 2014-09 and ASC Topic 605. The details of the significant changes and quantitative impact of the changes are set out below. For a more comprehensive description of how the Company recognizes revenue under the new revenue standard in accordance with its performance obligations, see note 10 – Revenue for more information.

The Company previously recognized commission fees related to Ting Mobile, Ting Internet, eNom domain registration and eNom domain related value-added service contracts as selling expenses when they were incurred.

Under ASU 2014-09, when these commission fees are deemed incremental and are expected to be recovered, the Company capitalizes as an asset such commission fees as costs of obtaining a contract. These commission fees are amortized into income consistently with the pattern of transfer of the good or service to which the asset relates. The amortization of deferred costs of acquisition are amortized into Sales and marketing expense. The estimation of the amortization period for the costs to obtain a contract requires judgement.

Table of Contents

Under ASU 2014-09, the Company has applied the following practical expedients

- a) When the amortization period for costs incurred to obtain a contract with a customer is less than one year, the Company has elected to apply a practical expedient to expense the costs as incurred; and
- b) For mobile and internet access services, where the performance obligation is part of contracts that have an original expected duration of one year or less (typically one month), the Company has elected to apply a practical expedient to not disclose revenues expected to be recognized in the future related performance obligations that are unsatisfied (or partially unsatisfied).

On January 1, 2018 as a result of adopting ASU 2014-09, the Company recorded a contract cost asset of \$1.4 million with a corresponding increase to opening retained earnings and deferred tax liability of \$1.1 million and \$0.3 million, respectively, due to the deferral of costs of obtaining contracts.

The impact of the changes to the Company's financial statements in the current period are as follows (*Dollar amounts in thousands of U.S. dollars*):

September 30, 2018			
Consolidated Balance Sheet	As reported	Adjustments	Balances without adoption of Topic 606
Assets			
Contract Costs (note 11(a))	\$1,383	\$ (1,383)	) \$-
Total assets	337,495	\$ (1,383)	) \$336,112
Liabilities and Shareholders' Equity			
Deferred tax liability (note 8)	\$19,265	\$ (336)	) \$18,929
Retained earnings	56,373	(1,047)	) 55,326
Total Liabilities and Shareholders' Equity	\$337,495	\$ (1,383)	) \$336,112

Three months ended,  
September 30, 2018

Nine months ended,  
September 30, 2018

Balances  
without

Balances  
without

<b>Consolidated Statements of Operations and Comprehensive Income</b>	<b>As reported</b>	<b>Adjustments</b>	<b>adoption of Topic 606</b>	<b>As reported</b>	<b>Adjustments</b>	<b>adoption of Topic 606</b>
Expenses						
Sales and marketing	\$8,412	\$ 29	\$ 8,441	\$24,629	\$ (21	) \$24,608
Income before provision for income taxes	6,716	(29	) 6,687	16,479	21	16,500
Provision for income taxes (note 8)	1,370	(7	) 1,363	3,781	5	3,786
Net income for the period	\$5,346	\$ (22	) \$ 5,324	\$12,698	\$ 16	\$12,714



Table of Contents

Consolidated Statements of Cash Flows	Three months ended, September 30, 2018			Nine months ended, September 30, 2018		
	As reported	Adjustments	Balances without adoption of Topic 606	As reported	Adjustments	Balances without adoption of Topic 606
Net income for the period	\$5,346	\$ (22 )	\$ 5,324	\$12,698	\$ 16	\$ 12,714
Items not involving cash						
Amortization contract costs	(29 )	29	(0 )	21	(21 )	-
Deferred income taxes (recovery)	(369 )	(7 )	(376 )	(861 )	5	(856 )
Net cash provided by operating activities	11,214	\$ -	\$ 11,214	\$26,541	\$ -	\$ 26,541

*Recent Accounting Pronouncements Not Yet Adopted*

In August 2018, the Financial Accounting Standards Board (“FASB”) issued ASU No. 2018-15, *Intangibles—Goodwill and Other—Internal-Use Software* (Subtopic 350-40): Customer’s Accounting for Fees Paid in a Cloud Computing Arrangement (“ASU 2018-15”). ASU 2018-15 helps entities evaluate the accounting for fees paid by a customer in a cloud computing arrangement (hosting arrangement) by providing guidance on accounting for implementation costs when the cloud computing arrangement does not include a licence and is accounted for as a service contract. The amendments in ASU 2018-15 require an entity (customer) in a hosting arrangement to assess which implementation costs to capitalize vs expense as it relates to a service contract. The amendments also require the entity (customer) to expense the capitalized implementation costs of a hosting arrangement that is a service contract over the term of the hosting arrangement. ASU 2018-15 will be effective for the Company for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. The Company is currently in the process of evaluating the quantitative impact of this Update, and transition methods.

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)* (“ASU 2016-02”). ASU 2016-02 requires lessees to recognize the assets and liabilities that arise from leases on the balance sheet. More specifically, ASU 2016-02 requires the recognition on the balance sheet of a lease liability to make lease payments by lessees and a right-of-use asset representing its right to use the underlying asset for the lease term. The new guidance will also require significant additional disclosure about the amount, timing and uncertainty of cash flows from leases. The new guidance is effective for annual and interim reporting periods beginning after December 15, 2018, which begins on January 1, 2019 for the Company. The amendments should be applied at the beginning of the earliest period presented using a modified retrospective approach with earlier application permitted as of the beginning of an interim or annual reporting period. The Company will adopt this guidance in the first quarter of fiscal 2019. The Company is currently in the process of evaluating the impact of transition methods. While we are continuing to assess all potential impacts of the standard, we currently believe the most significant impact relates to our accounting for administrative office

operating leases.

#### **4. Acquisitions:**

##### **(a) Blue Ridge Websoft**

On February 27, 2015, Ting Fiber, Inc. (“Ting”), one of the Company’s wholly owned subsidiaries, acquired a 70% ownership interest in Ting Virginia, LLC and its subsidiaries, Blue Ridge Websoft, LLC (doing business as Blue Ridge Internet Works), Fiber Roads, LLC and Navigator Network Services, LLC for consideration of approximately \$3.5 million.

On February 1, 2017, under the terms of a call option in the agreement, Ting acquired an additional 20% interest in Ting Virginia, LLC from the selling shareholders (the “Minority Shareholders”) for consideration of \$2.0 million.

On February 13, 2018, the Company entered into an agreement Minority Shareholders pursuant to which the Minority Shareholders could immediately exercise their put option to sell their remaining 10% ownership interest in Ting Virginia, LLC for \$1.2 million to the Company. The put option was exercised on February 13, 2018 and the Company paid \$1.2 million for the remaining 10% ownership interest and Ting Virginia, LLC became a wholly-owned subsidiary of the Company.

##### **(b) eNom, Incorporated**

On January 20, 2017, the Company entered into a Stock Purchase Agreement (the “Purchase Agreement”) with its indirect wholly owned subsidiary, Tucows (Emerald), LLC, Rightside Group, Ltd., and Rightside Operating Co., pursuant to which Tucows (Emerald), LLC purchased from Rightside Operating Co. all of the issued and outstanding capital stock of eNom, Incorporated (“eNom”), a domain name registrar business. The purchase price was \$77.8 million, which represented the agreed upon purchase of \$83.5 million less an amount of \$5.7 million related to the working capital deficiency acquired.

Table of Contents**5. Derivative instruments and hedging activities:***Foreign currency forward contracts*

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

The Company has designated certain of these transactions as cash flow hedges of forecasted transactions under ASC Topic 815, *Derivatives and Hedging* (“ASC Topic 815”). For certain contracts, as the critical terms of the hedging instrument and 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 and cash flows attributable to the risk of being hedged are expected to completely offset at inception and on an ongoing basis. Accordingly, unrealized gains or losses on the effective portion of these contracts have been included within other comprehensive income (“OCI”). The fair value of the contracts, as of September 30, 2018, is recorded as derivative instrument liabilities. For certain contracts where the hedged transactions are no longer probable to occur, the loss on the associated forward contract is reclassified from accumulated other comprehensive income (“AOCI”) to earnings.

As of September 30, 2018, the notional amount of forward contracts that the Company held to sell U.S. dollars in exchange for Canadian dollars was \$10.7 million, of which \$9.5 million were designated as hedges. As of December 31, 2017 the Company held no contracts to trade U.S. dollars in exchange for Canadian dollars.

As of September 30, 2018, we had the following outstanding forward exchange contracts to trade U.S. dollars in exchange for Canadian dollars:

<b>Maturity date (Dollar amounts in thousands of U.S. dollars)</b>	<b>Notional amount of U.S. dollars</b>	<b>Weighted average exchange rate</b>	<b>Fair value</b>
--	--	---	-----------------------

		<b>of U.S. dollars</b>	
October - December 2018	6,049	1.2802	(50 )
January - March 2019	1,639	1.2852	(4 )
April - June 2019	1,599	1.2831	(4 )
July - September 2019	1,444	1.2809	(4 )
	\$ 10,731	1.2815	\$ (62 )

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

The effect of these derivative instruments on our consolidated financial statements were as follows (amounts presented do not include any income tax effects).

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

		<b>As of September 30, 2018 Fair Value</b>	<b>As of December 31, 2017 Fair Value</b>
<b>Derivatives (Dollar amounts in thousands of U.S. dollars)</b>	<b>Balance Sheet Location</b>	<b>Asset (Liability)</b>	<b>Asset (Liability)</b>
Foreign currency forward contracts designated as cash flow hedges (net)	Derivative instruments	\$ (55 )	\$ -
Foreign currency forward contracts not designated as cash flow hedges (net)	Derivative instruments	\$ (7 )	\$ -
Total foreign currency forward contracts (net)	Derivative instruments	\$ (62 )	\$ -

Table of Contents

*Movement in Accumulated Other Comprehensive Income ("AOCI") balance for the three months ended September 30, 2018 (Dollar amounts in thousands of U.S. dollars):*

	Gains and losses on cash	Tax impact	Total AOCI
	flow hedges		
Opening AOCI balance – June 30, 2018	\$ (321 )	\$ 78	\$ (243 )
Other comprehensive income (loss) before reclassifications	183	(39 )	144
Amount reclassified from AOCI	83	(20 )	63
Other comprehensive income (loss) for the three months ended September 30, 2018	266	(59)	207
Ending AOCI balance – September 30, 2018	\$ (55 )	\$ 19	\$ (36 )

*Movement in AOCI balance for the nine months ended September 30, 2018 (Dollar amounts in thousands of U.S. dollars):*

	Gains and losses on cash	Tax impact	Total AOCI
	flow hedges		
Opening AOCI balance – December 31, 2017	\$ —	\$ —	\$ —
Other comprehensive income (loss) before reclassifications	(155 )	43	(112 )
Amount reclassified from AOCI	100	(24 )	76
Other comprehensive income (loss) for the nine months ended September 30, 2018	(55 )	19	(36 )
Ending AOCI balance – September 30, 2018	\$ (55 )	\$ 19	\$ (36 )

*Effects of derivative instruments on income and OCI for the three months ended September 30, 2018 and September 30, 2017 are as follows (Dollar amounts in thousands of U.S. dollars):*

	Amount of	Gain or (Loss)	Recognized in Income on	Derivative (ineffective)	Portion and Amount Excluded from Effectiveness Testing)	Effectiveness Testing)
Derivatives in Cash Flow Hedging Relationship	Amount of Gain or (Loss)	Location of Gain or (Loss)	Amount of Gain or (Loss)	Location of Gain or (Loss)	Recognized in Income on	Derivative (ineffective)
	Gain or (Loss)	Gain or (Loss)	Gain or (Loss)	Gain or (Loss)	Recognized in Income on	Derivative (ineffective)
	Recognized	Reclassified	Reclassified	Derivative	Derivative	Derivative
	in OCI, net of	from	from	(ineffective	(ineffective	(ineffective
	tax, on	AOCI into	AOCI into	Portion and	Portion and	Portion and
	Derivative	Income	Income,	Amount	Amount	Amount
	(Effective	(Effective	(Effective	Excluded from	Excluded	Excluded
	Portion)	Portion)	Portion)	Effectiveness	Effectiveness	Effectiveness
	Portion)	Portion)	Portion)	Testing)	Testing)	Testing)
Foreign currency forward contracts for the three months ended September 30, 2018	\$ 207	Operating expenses	\$ (71	) Operating expenses	\$ —	—
		Cost of revenues	\$ (12	) Cost of revenues		
Foreign currency forward contracts for the three months ended September 30, 2017	\$ (9	Operating expenses	\$ 432	Operating expenses	\$ —	—
	)	Cost of revenues	\$ 66	Cost of revenues		

Table of Contents

*Effects of derivative instruments on income and other comprehensive income (OCI) for the nine months ended September 30, 2018 and September 30, 2017 are as follows (Dollar amounts in thousands of U.S. dollars):*

	Amount of	Location of	Amount of	Location of	Amount of	Location of
	Gain or	Gain or	Gain or	Gain or	Gain or	Gain or
	(Loss)	(Loss)	(Loss)	(Loss)	(Loss)	(Loss)
	Recognized	Recognized	Recognized	Recognized	Recognized	Recognized
	in	in	in	in	in	in
	Income	Income	Income	Income	Income	Income
	on	on	on	on	on	on
	Derivative	Derivative	Derivative	Derivative	Derivative	Derivative
	(ineffective	(ineffective	(ineffective	(ineffective	(ineffective	(ineffective
	Portion and	Portion and	Portion and	Portion and	Portion and	Portion and
	Amount	Amount	Amount	Amount	Amount	Amount
	Excluded from	Excluded from	Excluded from	Excluded from	Excluded from	Excluded from
	Effectiveness	Effectiveness	Effectiveness	Effectiveness	Effectiveness	Effectiveness
	Testing)	Testing)	Testing)	Testing)	Testing)	Testing)
	from	from	from	from	from	from
	Effectiveness	Effectiveness	Effectiveness	Effectiveness	Effectiveness	Effectiveness
	Testing)	Testing)	Testing)	Testing)	Testing)	Testing)
		Operating	\$ (87	) Operating	\$ —	
		expenses		expenses		
Foreign currency forward contracts for the	\$ (36	) Cost of revenues	\$ (13	) Cost of revenues	—	
nine months ended September 30, 2018						
		Operating	\$ 561	Operating	\$ —	
		expenses		expenses		
Foreign currency forward contracts for the	\$ 222	Cost of revenues	\$ 91	Cost of revenues	—	
nine months ended September 30, 2017						

In addition to the above, for those foreign currency forward contracts not designated as hedges, the Company recorded a loss on settlement of less than \$0.1 million for the three months ended September 30, 2018 (gain of \$0.1 million for the three months ended September 30, 2017) and a gain of less than \$0.1 million for the change in fair value of outstanding contracts for the three months ended September 30, 2018 (loss of less than \$0.1 million for the three months ended September 30, 2017), in the consolidated statement of operations and comprehensive income.

The Company has recorded a loss of less than \$0.1 million upon settlement for the nine months ended September 30, 2018 (gain of \$0.1 million for the nine months ended September 30, 2017) and a loss of less than \$0.1 million for the change in fair value of outstanding contracts for the nine months ended September 30, 2018 (gain of less than \$0.1 million for the nine months ended September 30, 2017), in the consolidated statement of operations and comprehensive income.

## **6. Goodwill and Other Intangible Assets:**

### **Goodwill**

Goodwill represents the excess of the purchase price over the fair value of tangible and identifiable intangible assets acquired and liabilities assumed in our acquisitions.

The Company's Goodwill balance is \$90.1 million as of September 30, 2018 (December 31, 2017 – \$90.1 million). The Company's goodwill relates 98% (\$87.9 million) to its Domain Services operating segment and 2% (\$2.2 million) to its Network Access Services operating segment.

Goodwill is not amortized, but is subject to an annual impairment test, or more frequently if impairment indicators are present.



Table of Contents**Other Intangible Assets:**

Intangible assets consist of acquired brand, technology, customer relationships, surname domain names, direct navigation domain names and network rights. The Company considers its intangible assets consisting of surname domain names and direct navigation domain names as indefinite life intangible assets. The Company has the exclusive right to these domain names as long as the annual renewal fees are paid to the applicable registry. Renewals occur routinely and at a nominal cost. The indefinite life intangible assets are not amortized but are subject to impairment assessments performed throughout the year. As part of the normal renewal evaluation process during the periods ended September 30, 2018 and September 30, 2017, the Company assessed that certain domain names that were originally acquired in the June 2006 acquisition of Mailbank.com Inc. that were up for renewal, should be renewed.

Intangible assets, comprising brand, technology, customer relationships and network rights are being amortized on a straight-line basis over periods of four to fifteen years.

A summary of acquired intangible assets for the three months ended September 30, 2018 is as follows (*Dollar amounts in thousands of U.S. dollars*):

Amortization period	Surname domain names	Direct navigation domain names	Brand	Customer relationships	Technology	Network rights	Total
	indefinite life	indefinite life	7 years	4 - 7 years	2 years	15 years	
Balances June 30, 2018	\$ 11,201	\$ 1,495	\$ 9,892	\$ 29,429	\$ 1,138	\$ 538	\$ 53,693
Acquisition of customer relationships				113			113
Additions to/(disposals from) domain portfolio, net	(2 )	(3 )	-	-	-	-	(5 )
Amortization expense	-	-	(446 )	(1,351 )	(488 )	(11 )	(2,296 )
Balances September 30, 2018	\$ 11,199	\$ 1,492	\$ 9,446	\$ 28,191	\$ 650	\$ 527	\$ 51,505

A summary of acquired intangible assets for the nine months ended September 30, 2018 is as follows (*Dollar amounts in thousands of U.S. dollars*):

Surname	Direct	Brand	Customer relationships	Technology	Network	Total
---------	--------	-------	------------------------	------------	---------	-------

Amortization period	domain names	navigation domain names					rights
	indefinite life	indefinite life	7 years	4 - 7 years	2 years	15 years	
Balances December 31, 2017	\$ 11,210	\$ 1,551	\$ 10,793	\$ 32,186	\$ 2,113	\$ 561	\$ 58,414
Acquisition of customer relationships	-	-	-	114	-	-	114
Additions to/(disposals from) domain portfolio, net	(11 )	(59 )	-	-	-	-	(70 )
Amortization expense	-	-	(1,347 )	(4,109 )	(1,463 )	(34 )	(6,953 )
Balances September 30, 2018	\$ 11,199	\$ 1,492	\$ 9,446	\$ 28,191	\$ 650	\$ 527	\$ 51,505

The following table shows the estimated amortization expense in future periods, assuming no further additions to acquired intangible assets are made (*Dollar amounts in thousands of U.S. dollars*):

	<b>Year ending December 31,</b>
Remainder of 2018	\$ 2,285
2019	7,349
2020	7,187
2021	7,187
2022	7,187
Thereafter	7,619
Total	\$ 38,814

As of September 30, 2018, the accumulated amortization for the definite life intangible assets was \$22.3 million.

## 7. Loan payable:

2017 Amended Credit Facility

On January 20, 2017, the Company entered into an amended and restated secured Credit Agreement (the “2017 Amended Credit Agreement”) with Bank of Montreal (“BMO”), Royal Bank of Canada and Bank of Nova Scotia (collectively with “Lenders”) under which the Company increased its access to funds to an aggregate of \$140 million. This amendment and restatement to the Company’s 2016 Credit Facility (defined below), among other things, reduced the existing Tucows non-revolving facility (such existing non-revolving facility, together with other existing facilities, the “Existing Facilities”) from \$40.0 million to \$35.5 million, and established a new non-revolving credit facility of \$84.5 million (the “Facility D”). The Company immediately drew down \$84.5 million under Facility D to fund the acquisition of eNom. See note 4 – Acquisitions for more information. The “2016 Credit Facility” refers to the credit facility established under the Company’s secured credit agreement among the Company, BMO and the Lenders, dated as of August 18, 2016.

Table of Contents

In connection with the 2017 Amended Credit Agreement, the Company incurred \$0.6 million of fees paid to lenders and debt issuance costs, which have been reflected as a reduction to the carrying amount of the loan payable and will be amortized over the term of the credit facility agreement.

The obligations of the Company under the 2017 Amended Credit Facility are secured by a first priority lien on substantially all of the personal property and assets of the Company.

The 2017 Amended Credit Facility has a four-year term. Under the 2017 Amended Credit Facility, the Company has access to an aggregate of up to \$140 million in funds that are available as follows:

- a \$5 million revolving credit facility ("Facility A");
- a \$15 million revolving reducing term facility ("Facility B");
- a \$35.5 million non-revolving facility ("Facility C"); and
- a \$84.5 million non-revolving facility ("Facility D").

Borrowings under the 2017 Amended Credit Facility accrue interest and standby fees at variable rates based on borrowing elections by the Company and the Company's Total Funded Debt to EBITDA as described below. The purpose of Facility A is for general working capital and general corporate requirements, while Facility B and Facility C support share repurchases, acquisitions and capital expenditures associated with the Company's Fiber to the Home program ("FTTH"). Facility D was provided and used for the acquisition of eNom.

The repayment terms for Facility A require monthly interest payments with any final principal payment becoming due upon maturity of the 2017 Amended Credit Facility. Under the repayment terms for Facility B, at December 31st of each year, balances drawn during the year that remain outstanding will become payable on a quarterly basis commencing the first quarter of the following year, for the period of amortization based on the purpose of the draw. For Facilities C and D, each draw will become payable beginning the first full quarter post initial draw for the period of amortization based on the purpose of the draw. The amortization periods for Facilities B, C and D are based on the purposes of the draws as follows: draws for share repurchases are repaid over four years, draws for acquisitions over five years and draws for FTTH capital expenditures over seven years. The 2017 Amended Credit Facility also includes a mechanism that is triggered based on the Company's Total Funded Debt to EBITDA calculation at the end of each fiscal year. If Total Funded Debt to EBITDA exceeds 2.25:1 at December 31 of each year during the term, the Company is obligated to make a repayment of 50% of Excess Cash Flow as defined under the agreement.

The 2017 Amended Credit Facility contains customary representations and warranties, affirmative and negative covenants, and events of default. The 2017 Amended Credit Facility requires that the Company 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 Ratio of 2.50:1 until September 30, 2018 and 2.25:1 thereafter; and (ii) minimum

Fixed Charge Coverage Ratio of 1.20:1. Further, the Company's maximum annual Capital Expenditures cannot exceed \$50.0 million per year, which limit will be reviewed on an annual basis. In addition, funded share repurchases are not to exceed \$20 million, or up to \$40 million so long as the total loans related to share repurchases do not exceed 1.5 times of trailing twelve months EBITDA. As at and for the periods ending September 30, 2018, and September 30, 2017, the Company was in compliance with these covenants.

On January 24, 2018, the Company entered into the Second Interim Amendment to First Amended and Restated Credit Agreement (the "Second Interim Amendment") with BMO and the Lenders. The Second Interim Amendment provides that certain defined terms in Section 1.01 of the Credit Agreement are added and updated to reflect the inclusion of liabilities to Sprint Mobile similar to the previous inclusion of T-Mobile liabilities. The Second Interim Amendment also permits Tucows to retain bank accounts with Silicon Valley Bank with the aggregate amount held in such accounts not to exceed \$3.0 million.

Borrowings under the 2017 Amended Credit Facility will accrue interest and standby fees based on the Company's Total Funded Debt to EBITDA ratio and the availment type as follows:

Availment type or fee	If Total Funded Debt to EBITDA is:							
	Less than 1.00	Greater than or equal to 1.00 and less than 2.00	Greater than or equal to 2.00 and less than 2.25	Greater than or equal to 2.25				
Canadian dollar borrowings based on Bankers' Acceptance or U.S. dollar borrowings based on LIBOR (Margin)	2.00 %	2.25 %	2.75 %	3.25 %				
Canadian or U.S. dollar borrowings based on Prime Rate or U.S. dollar borrowings based on Base Rate (Margin)	0.75 %	1.00 %	1.50 %	2.00 %				
Standby fees	0.40 %	0.45 %	0.55 %	0.65 %				

Table of Contents

The following table summarizes the Company's borrowings under the credit facilities (Dollar amounts in thousands of U.S. dollars):

	<b>September 30,</b>	<b>December 31,</b>
	<b>2018</b>	<b>2017</b>
Facility B	2,500	-
Facility C	3,393	5,930
Facility D	59,148	71,823
Less: unamortized debt discount and issuance costs	(626 )	(829 )
Total loan payable	64,415	76,924
Less: loan payable, current portion	17,810	18,290
Loan payable, long-term portion	46,605	58,634

The following table summarizes our scheduled principal repayments as of September 30, 2018 (Dollar amounts in thousands of U.S. dollars):

Remainder of 2018	4,386
2019	17,900
2020	17,900
2021	24,855
	\$65,041

*Other Credit Facilities*

Prior to the Company entering into the 2016 Credit Facility, the Company had credit agreements (collectively the "Amended Credit Facility") with BMO that were amended on November 19, 2012, and which provided it with access to two revolving demand loan facilities, a treasury risk management facility, an operating demand loan and a credit card facility. The Company continues to have access to the treasury risk management facility and credit card facility, with the remaining loan facilities having been extinguished.

The treasury risk management facility under the Amended Credit Facility 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 September 30, 2018, the Company held contracts in the

amount of \$10.7 million to trade U.S. dollars in exchange for Canadian dollars. See note 5 – Derivative instruments and hedging activities for more information.

In the fourth quarter of, 2017, the Company entered into a corporate credit card program with the Bank of Nova Scotia and the Lenders. The program provides that BMO and the Bank of Nova Scotia may establish corporate credit card facilities with the Company in an amount of up to \$5 million, which was established in the fourth quarter of 2017.

## **8. Income taxes**

For the three months ended September 30, 2018, we recorded an income tax expense of \$1.4 million on income before income taxes of \$6.7 million, using an estimated effective tax rate for the fiscal year ending December 31, 2018 (“Fiscal 2018”) adjusted for certain minimum state taxes as well as the inclusion of a \$0.2 million tax recovery related to ASU 2016-09, which requires all excess tax benefits and tax deficiencies related to employee share-based payments to be recognized through income tax expense. Comparatively, for the three months ended September 30, 2017, the Company recorded an income tax expense of \$1.8 million on income before taxes of \$5.3 million, using an estimated effective tax rate for the 2017 fiscal year and adjusted for the \$0.4 million tax recovery impact related to ASU 2016-09.

## Table of Contents

For the nine months ended September 30, 2018, we recorded an income tax expense of \$3.8 million on income before income taxes of \$16.5 million, using an estimated effective tax rate for Fiscal 2018 adjusted for certain minimum state taxes as well as the inclusion of a \$0.5 million tax recovery related to ASU 2016-09, which requires all excess tax benefits and tax deficiencies related to employee share-based payments to be recognized through income tax expense. Comparatively, for the nine months ended September 30, 2017, the Company recorded income tax expense of \$2.8 million on income before taxes of \$13.9 million, using an estimated effective tax rate for the 2017 fiscal year and adjusted for the \$2.6 million tax recovery impact related to ASU 2016-09.

In assessing the realizability of deferred tax assets, management 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. Management considers projected future taxable income, uncertainties related to the industry in which the Company operates, and tax planning strategies in making this assessment.

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 September 30, 2018 and December 31, 2017, respectively.

### **9. Basic and diluted earnings per common share:**

Basic earnings per common share has been calculated on the basis of net income for the period divided by the weighted average number of common shares outstanding during each year. Diluted earnings per share gives effect to all dilutive potential common shares outstanding at the end of the year assuming that they had been issued, converted or exercised at the later of the beginning of the year or their date of issuance. 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 share equivalents or the proceeds of the exercise of options.

The following table reconciles the numerators and denominators of the basic and diluted earnings per common share computation (Dollar amounts in thousands of U.S. dollars, except per share amounts):

<b>Three months ended September 30,</b>		<b>Nine months ended September 30,</b>	
<b>2018</b>	<b>2017</b>	<b>2018</b>	<b>2017</b>

Numerator for basic and diluted earnings per common share:



Edgar Filing: TUCOWS INC /PA/ - Form 10-Q

Net income for the period	\$5,346	\$3,440	\$12,698	\$11,128
Denominator for basic and diluted earnings per common share:				
Basic weighted average number of common shares outstanding	10,611,579	10,564,311	10,599,243	10,522,841
Effect of outstanding stock options	182,718	221,031	196,425	262,209
Diluted weighted average number of shares outstanding	10,794,297	10,785,342	10,795,668	10,785,050
Basic earnings per common share	\$0.50	\$0.33	\$1.20	\$1.06
Diluted earnings per common share	\$0.50	\$0.32	\$1.18	\$1.03

For the three months ended September 30, 2018, outstanding options to purchase 440,000 common shares were not included in the computation of diluted income per common share because all such options' exercise price was greater than the average market price of the common shares for the period as compared to the three months ended September 30, 2017, where 345,200 outstanding options were not included in the computation.

For the nine months ended September 30, 2018, outstanding options to purchase 440,000 common shares were not included in the computation of diluted income per common share because all such options' exercise price was greater than the average market price of the common shares for the period as compared to the nine months ended September 30, 2017, where 349,700 outstanding options were not included in the computation.

During the three and nine months ended September 30, 2018, the Company did not repurchase any shares under the stock buyback program commenced on February 14, 2018, which will be terminated on or before February 13, 2019.

During the three and nine months ended September 30, 2017 and the nine months ended September 30, 2018, the Company did not repurchase any shares under the stock buyback program commenced on March 1, 2017, which terminated on February 14, 2018.

During the nine months ended September 30, 2017, the company did not repurchase any shares under the stock buyback program commenced on February 10, 2016, which terminated on February 9, 2017.

Table of Contents

**10. Revenue**

*Significant accounting policy*

The Company's revenues are derived from (a) the provisioning of mobile and fiber Internet services; and from (b) domain name registration contracts, other domain related value-added services, domain sale contracts, and other advertising revenue. Amounts received in advance of meeting the revenue recognition criteria described below are recorded as deferred revenue. All products are generally sold without the right of return or refund.

Revenue is measured based on consideration specified in a contract with a customer and excludes any sales incentives and amounts collected on behalf of third parties. The Company recognizes revenue when it satisfies a performance obligation by transferring control over a product or service to a customer.

*Nature of goods and services*

The following is a description of principal activities – separated by reportable segments – from which the Company generates its revenue. For more detailed information about reportable segments. See note 12 – Segment reporting for more information.

(a) Network Access Services

The Company generates Network Access Services revenues primarily through the provisioning of mobile services ("Ting Mobile"). Other sources of revenue include the provisioning of fixed high-speed Internet access ("Ting Internet") as well as billing solutions to Internet Service Providers ("ISPs").

Ting wireless usage contracts grant customers access to standard talk, text and data mobile services. Ting mobile contracts are billed based on the actual amount of monthly services utilized by each customer during their billing cycle and charged to customers on a postpaid basis. Voice minutes, text messages and megabytes of data are each billed separately based on a tiered pricing program. The Company recognizes revenue for Ting mobile usage based on the actual amount of monthly services utilized by each customer.

Ting Internet contracts provide customers Internet access at their home or business through the installation and use of our fiber optic network. Ting Internet contracts are generally prepaid and grant customers with unlimited bandwidth based on a fixed price per month basis. Because consideration is collected before the service period, revenue is initially deferred and recognized as the Company performs its obligation to provide Internet access. Though the Company does not consider the installation of fixed Internet access to be a distinct performance obligation, the fees related to installation are immaterial and therefore revenue is recognized as billed.

Both Ting Mobile and Ting Internet access services are primarily contracted through the Ting website, for one month at a time and contain no commitment to renew the contract following each customer's monthly billing cycle. The Company's billing cycle for all Ting Mobile and Ting Internet customers is computed based on the customer's activation date. In order to recognize revenue as the Company satisfies its obligations, we compute the amount of revenues earned but not billed from the end of each billing cycle to the end of each reporting period. In addition, revenues associated with the sale of wireless devices and accessories and Internet hardware 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.

Our Roam Mobility brand also offers standard talk, text and data mobile services. Roam customers prepay for their usage through the Roam Mobility website. When prepayments are received the amount is deferred, and subsequently recognized as the Company satisfies its obligation to provide mobile services. In addition, revenues associated with the sale of SIM cards 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.

In those cases, where payment is not received at the time of sale, revenue is not recognized at contract inception unless the collection of the related accounts receivable is reasonably assured. The Company records costs that reflect 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.

#### (b) Domain Services

Domain registration contracts, which can be purchased for terms of one to ten years, provide our resellers and retail registrant customers with the exclusive right to a personalized internet address from which to build an online presence. The Company enters into domain registration contracts in connection with each new, renewed and transferred-in domain registration. At the inception of the contract, the Company charges and collects the registration fee for the entire registration period. Though fees are collected upfront, revenue from domain registrations are recognized ratably over the registration period as domain registration contracts contain a 'right to access' license of IP, which is a distinct performance obligation measured over time. The registration period begins once the Company has confirmed that the requested domain name has been appropriately recorded in the registry under contractual performance standards.

## Table of Contents

Domain related value-added services like digital certifications, WHOIS privacy and hosted email provide our resellers and retail registrant customers tools and additional functionality to be used in conjunction with domain registrations. All domain related value-added services are considered distinct performance obligations which transfer the promised service to the customer over the contracted term. Fees charged to customers for domain related value-added services are collected at the inception of the contract, and revenue is recognized on a straight-line basis over the contracted term, consistent with the satisfaction of the performance obligations.

The Company is an ICANN accredited registrar. Thus, the Company is the primary obligor with our reseller and retail registrant customers and is responsible for the fulfillment of our registrar services to those parties. As a result, the Company reports revenue in the amount of the fees we receive directly from our reseller and retail registrant customers. Our reseller customers maintain the primary obligor relationship with their retail customers, establish pricing and retain credit risk to those customers. Accordingly, the Company does not recognize any revenue related to transactions between our reseller customers and their ultimate retail customers.

The Company also sells the rights to the Company's portfolio domains or names acquired through the Company's domain expiry stream. Revenue generated from sale of domain name contracts, containing a distinct performance obligation to transfer the domain name rights under the Company's control, is generally recognized once the rights have been transferred and payment has been received in full.

Advertising revenue is derived through domain parking monetization, whereby the Company contracts with third-party Internet advertising publishers to direct web traffic from the Company's domain expiry stream domains and Internet portfolio domains to advertising websites. Compensation from Internet advertising publishers is calculated variably on a cost-per-action basis based on the number of advertising links that have been visited in a given month. Given that the variable consideration is calculated and paid on a monthly basis, no estimation of variable consideration is required.

### *Disaggregation of Revenue*

The following is a summary of the Company's revenue earned from each significant revenue stream (Dollar amounts in thousands of U.S. dollars):

<b>Three months ended September 30,</b>		<b>Nine months ended September 30,</b>	
<b>2018</b>	<b>2017*</b>	<b>2018</b>	<b>2017*</b>

Network Access Services:

Mobile Services	\$22,546	\$21,749	\$66,829	\$60,090
Other Services	2,033	1,442	5,664	3,978
Total Network Access Services	24,579	23,191	72,493	64,068

Domain Services:

Wholesale				
Domain Services	45,070	47,770	146,038	135,413
Value Added Services	4,541	4,203	13,576	13,526
Total Wholesale	49,611	51,973	159,614	148,939
Retail	8,731	8,873	25,644	22,937
Portfolio	598	971	2,650	2,856
Total Domain Services	58,940	61,817	187,908	174,732
	\$83,519	\$85,008	\$260,401	\$238,800

During the three and nine months ended September 30, 2018, no customer accounted for more than 10% of total revenue. During the three and nine months ended September 30, 2017, no customer accounted for more than 10% of revenue. As at September 30, 2018 and December 31, 2017, no customer accounted for more than 10% of accounts receivable.

Table of Contents

The following is a summary of the Company's cost of revenue from each significant revenue stream (Dollar amounts in thousands of U.S. dollars):

	<b>Three months ended September 30, 2018</b>		<b>Nine months ended September 30, 2018</b>	
	<b>2017*</b>		<b>2017*</b>	
<b><u>Network Access Services:</u></b>				
Mobile Services	\$ 11,399	\$ 12,365	\$ 34,643	\$ 32,634
Other Services	872	595	3,103	2,366
Total Network Access Services	12,271	12,960	37,746	35,000
<b><u>Domain Services:</u></b>				
Wholesale				
Domain Services	37,414	42,293	124,572	119,207
Value Added Services	807	687	2,412	1,878
Total Wholesale	38,221	42,980	126,984	121,085
Retail	4,465	4,611	13,320	12,776
Portfolio	148	180	528	627
Total Domain Services	42,834	47,771	140,832	134,488
<b><u>Network Expenses:</u></b>				
Network, other costs	2,315	2,461	7,590	7,064
Network, depreciation and amortization costs	1,838	1,322	5,195	3,463
	4,153	3,783	12,785	10,527
	\$ 59,258	\$ 64,514	\$ 191,363	\$ 180,015

*Contract Balances*

The following table provides information about contract liabilities (deferred revenue) from contracts with customers. The Company accounts for contract assets and liabilities on a contract-by-contract basis, with each contract presented as either a net contract asset or a net contract liability accordingly.

Given that Company's long-term contracts with customers are billed in advance of service, the Company's contract liabilities relate to amounts recorded as deferred revenues. The Company does not have material streams of contracted revenue that have not been billed.

Deferred revenue primarily relates to the portion of the transaction price received in advance related to the unexpired term of domain name registrations and other domain related value-added services, on both a wholesale and retail basis, net of external commissions.

The opening balance of deferred revenue was \$160.6 million as of January 1, 2018. Significant changes in deferred revenue were as follows (Dollar amounts in thousands of U.S. dollars):

	<b>Three months ended</b>	<b>Nine months ended</b>
	<b>September 30, 2018</b>	<b>September 30, 2018</b>
Balance, beginning of period	\$ 152,052	\$ 160,582
Deferred revenue	54,181	170,904
Recognized revenue <sup>1</sup>	(57,741 )	(182,994 )
Balance, end of period	\$ 148,492	\$ 148,492

<sup>1</sup>As a result of the bulk transfers of 2.65 million domain names to Namecheap on January 5, 2018 and 0.24 million domain names to Namecheap on September 25, 2018, recognized revenue for the three and nine months ended September 30, 2018 includes \$1.7 million and \$16.3 million, respectively, related to previously deferred revenue, a portion of which would have otherwise been recognized after September 30, 2018.

*Remaining Performance Obligations:*

As the Company fulfills its performance obligations, the following table includes revenues expected to be recognized in the future related performance obligations that are unsatisfied (or partially unsatisfied) as at September 30, 2018 (Dollar amounts in thousands of U.S. dollars):

For mobile and internet access services, where the performance obligation is part of contracts that have an original expected duration of one year or less (typically one month), the Company has elected to apply a practical expedient to not disclose revenues expected to be recognized in the future related performance obligations that are unsatisfied (or partially unsatisfied) (Dollar amounts in thousands of US dollars).

Table of Contents

**September  
30,**

**2018**

Remainder of 2018	\$ 48,701
2019	76,153
2020	10,331
2021	5,040
2022	3,244
Thereafter	4,760
<b>Total</b>	<b>\$ 148,229</b>

## **11. Contract Costs**

### **(a) Deferred costs of acquisition**

We recognize an asset for the incremental costs of obtaining a contract with a customer if we expect the period of benefit of those costs to be longer than one year and those costs are expected to be recoverable under the term of the contract. We have identified certain sales incentive programs that meet the requirements to be capitalized, and therefore, capitalized them as contract costs in the amount of \$1.4 million at September 30, 2018.

Capitalized contract acquisition costs are amortized into operating expense based on the transfer of goods or services to which the assets relate which typically range 2 – 10 years. For the three months ended September 30, 2018, the Company capitalized \$0.2 million and also amortized \$0.2 million of contract costs, respectively. For the nine months ended September 30, 2018, the Company capitalized \$0.7 million and also amortized \$0.7 million of contract costs, respectively. There was no impairment loss recognized in relation to the costs capitalized during the three or nine months ending September 30, 2018. The breakdown of the movement in the contract costs balance for the three and nine months ending September 30, 2018 is as follows (Dollar amounts in thousands of U.S. dollars):

<b>Three months ended</b>	<b>Nine months ended</b>
<b>September 30, 2018</b>	<b>September 30, 2018 <sup>(1)</sup></b>



Balance, beginning of period	\$ 1,354		\$ 1,404
Deferral of costs	245		684
Recognized costs	(216	)	(705 )
Balance, end of period	\$ 1,383		\$ 1,383

<sup>(1)</sup>The beginning balance consists entirely of a cumulative adjustment recorded on January 1, 2018 as a result of the modified retrospective adoption of ASU 2014-09. See note 3 – Recent accounting pronouncements for more information.

When the amortization period for costs incurred to obtain a contract with a customer is less than one year, we have elected to apply a practical expedient to expense the costs as incurred. These costs include our internal sales compensation program and certain partner sales incentive programs.

Table of Contents

## (b)Deferred costs of fulfillment

Deferred costs to fulfill contracts generally consist of domain registration costs which have been paid to a domain registry, and are capitalized as Prepaid domain name registry and ancillary services fees. These costs are deferred and amortized over the life of the domain which generally ranges from one to ten years. For the three months ended September 30, 2018, the Company capitalized \$39.5 million and also amortized \$43.7 million of contract costs, respectively. For the nine months ended September 30, 2018, the Company capitalized \$126.6 million and also amortized \$142.4 million of contract costs, respectively. There was no impairment loss recognized in relation to the costs capitalized during the three or nine months ending September 30, 2018. Amortization expense is primarily included in cost of revenue. The breakdown of the movement in the prepaid domain name registry and ancillary services fees balance for the three and nine months ended September 30, 2018 is as follows (Dollar amounts in thousands of U.S. dollars).

	<b>Three months ended</b>	<b>Nine months ended</b>
	<b>September 30, 2018</b>	<b>September 30, 2018</b>
Balance, beginning of period	\$ 115,456	\$ 127,003
Deferral of costs	39,453	126,613
Recognized costs <sup>1</sup>	(43,683 )	(142,390 )
Balance, end of period	\$ 111,226	\$ 111,226

<sup>1</sup>As a result of the bulk transfers of 2.65 million domain names to Namecheap on January 5, 2018 and 0.24 million domain names to Namecheap on September 25, 2018, recognized revenue for the three and nine months ended September 30, 2018 includes \$1.7 million and \$16.2 million, respectively, related to previously deferred revenue, a portion of which would have otherwise been recognized after September 30, 2018.

**12. Segment reporting:**

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

1. Network Access Services - This segment derives revenue from the sale of mobile phones, telephony services, high speed Internet access, billing solutions to individuals and small businesses primarily through the Ting website. Revenues are generated in the U.S.

2. 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 and the U.S.

The Chief Executive Officer (the “CEO”) is the chief operating decision maker and regularly reviews the operations and performance by segment. The CEO reviews gross profit as (a) key measure of performance for each segment and (b) 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, amortization of intangibles assets, impairment of indefinite life intangible assets, gain on currency forward contracts and other expense net 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 CEO. The Company follows the same accounting policies for the segments as those described in notes 2 – Basis of presentation, 3 – Recent accounting pronouncements, and 10 - Revenue.

Table of Contents

Information by operating segments (with the exception of disaggregated revenue, which is discussed in note 10 - Revenue), which is regularly reported to the CEO is as follows (Dollar amounts in thousands of U.S. dollars):

	<b>Network Access  Services</b>	<b>Domain  Services</b>	<b>Consolidated  Totals</b>
<b>Three months ended September 30, 2018</b>			
Net Revenues	\$ 24,579	\$ 58,940	\$ 83,519
Cost of revenues			
Cost of revenues	12,271	42,834	55,105
Network expenses	479	1,836	2,315
Depreciation of property and equipment	1,026	313	1,339
Amortization of intangible assets	11	488	499
Total cost of revenues	13,787	45,471	59,258
Gross Profit	10,792	13,469	24,261
Expenses:			
Sales and marketing			8,412
Technical operations and development			2,207
General and administrative			4,120
Depreciation of property and equipment			106
Amortization of intangible assets			1,797
Loss (gain) on currency forward contracts			(27 )
Income from operations			7,646
Other income (expenses), net			(930 )
Income before provision for income taxes			\$ 6,716
<b>Three months ended September 30, 2017</b>			
	<b>Network Access  Services</b>	<b>Domain  Services</b>	<b>Consolidated  Totals</b>
Net Revenues	\$ 23,191	\$ 61,817	\$ 85,008
Cost of revenues			
Cost of revenues	12,960	47,771	60,731
Network expenses	445	2,016	2,461
Depreciation of property and equipment	578	245	823
Amortization of intangible assets	11	488	499
Total cost of revenues	13,994	50,520	64,514

Edgar Filing: TUCOWS INC /PA/ - Form 10-Q

Gross Profit	9,197	11,297	20,494
Expenses:			
Sales and marketing			7,384
Technical operations and development			1,910
General and administrative			3,381
Depreciation of property and equipment			155
Impairment of indefinite life intangible assets			2
Amortization of intangible assets			1,746
Loss (gain) on currency forward contracts			(54 )
Income from operations			5,970
Other income (expenses), net			(707 )
Income before provision for income taxes			\$ 5,263

Table of Contents

	<b>Network Access</b>	<b>Domain</b>	<b>Consolidated</b>
	<b>Services</b>	<b>Services</b>	<b>Totals</b>
<b>Nine months ended September 30, 2018</b>			
Net Revenues	\$ 72,493	\$ 187,908	\$ 260,401
Cost of revenues			
Cost of revenues	37,746	140,832	178,578
Network expenses	1,609	5,981	7,590
Depreciation of property and equipment	2,762	936	3,698
Amortization of intangible assets	34	1,463	1,497
Total cost of revenues	42,151	149,212	191,363
Gross Profit	30,342	38,696	69,038
Expenses:			
Sales and marketing			24,629
Technical operations and development			6,657
General and administrative			12,906
Depreciation of property and equipment			309
Amortization of intangible assets			5,456
Loss (gain) on currency forward contracts			22
Income from operations			19,059
Other income (expenses), net			(2,580 )
Income before provision for income taxes			\$ 16,479

	<b>Network Access</b>	<b>Domain</b>	<b>Consolidated</b>
	<b>Services</b>	<b>Services</b>	<b>Totals</b>
<b>Nine months ended September 30, 2017</b>			
Net Revenues	\$ 64,068	\$ 174,732	\$ 238,800
Cost of revenues			
Cost of revenues	35,000	134,488	169,488
Network expenses	1,398	5,666	7,064
Depreciation of property and equipment	1,494	634	2,128
Amortization of intangible assets	35	1,300	1,335
Total cost of revenues	37,927	142,088	180,015
Gross Profit	26,141	32,644	58,785
Expenses:			
Sales and marketing			22,051
Technical operations and development			5,402
General and administrative			10,124

Depreciation of property and equipment	486	
Loss on disposal of property and equipment	2	
Amortization of intangible assets	4,735	
Loss (gain) on currency forward contracts	(115	)
Income from operations	16,100	
Other income (expenses), net	(2,191	)
Income before provision for income taxes	\$ 13,909	

(b) The following is a summary of the Company's property and equipment by geographic region (*Dollar amounts in thousands of U.S. dollars*):

	<b>September 30, 2018</b>	<b>December 31, 2017*</b>
Canada	\$ 1,420	\$ 1,176
United States	38,746	23,417
Germany	54	27
	\$ 40,220	\$ 24,620

Table of Contents

(c) The following is a summary of the Company's amortizable intangible assets by geographic region (Dollar amounts in thousands of U.S. dollars):

	<b>September 30, 2018</b>	<b>December 31, 2017*</b>
Canada	\$ 6,860	\$ 7,749
United States	31,954	37,783
Germany	-	120
	\$ 38,814	\$ 45,652

(d) Valuation and qualifying accounts (Dollar amounts in thousands of U.S. dollars):

<b>Allowance for doubtful accounts excluding provision for credit notes</b>	<b>Balance at beginning of period</b>	<b>Charged to costs and expenses</b>	<b>Write-offs during period</b>	<b>Balance at end of period</b>
Nine months ended September 30, 2018	\$ 168	\$ (36 )	\$ -	\$ 132
Year ended December 31, 2017	\$ 164	\$ 4	\$ -	\$ 168

**13. Stockholders' Equity:**

The following table summarizes stockholders' equity transactions for the three-month period ended September 30, 2018 (Dollar amounts in thousands of U.S. dollars):

	<b>Common stock Number</b>	<b>Common stock Amount</b>	<b>Additional paid in capital</b>	<b>Retained earnings (deficit)</b>	<b>Accumulated other comprehensive income (loss)</b>	<b>Total stockholders' equity</b>
Balances, June 30, 2018	10,603,366	\$ 15,548	\$ 2,931	\$ 51,027	\$ (243 )	\$ 69,263
Exercise of stock options	15,782	87	(64 )	-	-	23
Shares deducted from exercise of stock options for payment of withholding taxes and exercise consideration	(3,582 )		(116 )	-	-	(116 )



Stock-based compensation (note 14)	-	-	711	-	-	711
Net income	-	-	-	5,346	-	5,346
Other comprehensive income	-	-	-	-	207	207
Balances, September 30, 2018	10,615,566	\$ 15,635	\$ 3,462	\$ 56,373	\$ (36 )	\$ 75,434

The following table summarizes stockholders' equity transactions for the nine-month period ended September 30, 2018 (Dollar amounts in thousands of U.S. dollars):

	<b>Common stock Number</b>	<b>Common stock Amount</b>	<b>Additional paid in capital</b>	<b>Retained earnings (deficit)</b>	<b>Accumulated other comprehensive loss</b>	<b>Total stockholders' equity</b>
Balances, December 31, 2017	10,583,879	\$ 15,368	\$ 2,167	\$ 42,676	\$ -	\$ 60,211
Impact of Adoption of ASU 2014-09	-	-	-	1,063	-	1,063
Balance on January 1, 2018	10,583,879	15,368	2,167	43,739	-	61,274
Exercise of stock options	44,498	267	(205 )	-	-	62
Shares deducted from exercise of stock options for payment of withholding taxes and exercise consideration	(12,811 )	-	(404 )	-	-	(404 )
Stock-based compensation (note 14)	-	-	1,904	-	-	1,904
Net income	-	-	-	12,698	-	12,698
Accretion of redeemable non-controlling interest in Ting Virginia, LLC.	-	-	-	(64 )	-	(64 )
Other comprehensive loss	-	-	-	-	(36 )	(36 )
Balances, September 30, 2018	10,615,566	\$ 15,635	\$ 3,462	\$ 56,373	\$ (36 )	\$ 75,434

On February 14, 2018, the Company announced that its Board of Directors has approved a stock buyback program to repurchase up to \$40 million of its common stock in the open market. Purchases will be made exclusively through the facilities of the NASDAQ Capital Market. The stock buyback program commenced on February 14, 2018 and will terminate on or before February 13, 2019. During the three and nine months ended September 30, 2018, the Company did not repurchase any shares under this program.

Table of Contents

On March 1, 2017, the Company announced that its Board of Directors had approved a stock buyback program to repurchase up to \$40 million of its common stock in the open market. Purchases were to be made exclusively through the facilities of the NASDAQ Capital Market. The stock buyback program commenced on March 1, 2017 and terminated on February 14, 2018. During the nine months ended September 30, 2018, the Company did not repurchase any shares under this program.

On February 9, 2016, the Company announced that its Board of Directors had approved a stock buyback program to repurchase up to \$40 million of its common stock in the open market. Purchases were to be made exclusively through the facilities of the NASDAQ Capital Market. The stock buyback program commenced on February 10, 2016 and terminated on February 9, 2017. During the nine months ended September 30, 2017, the Company did not repurchase any shares under this program.

#### 14. Share-based payments

##### Stock options

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model. 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 Tucows Inc. common shares at the date of grant.

Details of stock option transactions for the three months ended September 30, 2018 and September 30, 2017 are as follows (Dollar amounts in thousands of U.S. dollars, except per share amounts):

<b>Three months ended September 30,</b>	<b>Three months ended September 30,</b>
---	---

	<b>2018</b>		<b>2017*</b>	
	<b>Number of shares</b>	<b>Weighted average exercise price per share</b>	<b>Number of shares</b>	<b>Weighted average exercise price per share</b>
Outstanding, beginning of period	734,196	\$ 42.39	363,608	\$ 16.79
Granted	23,800	57.78	327,150	55.49
Exercised	(15,782 )	8.00	(30,051 )	6.67
Forfeited	(8,635 )	59.20	(1,050 )	51.87
Expired	-	-	-	-
Outstanding, end of period	733,579	43.43	659,657	36.39
Options exercisable, end of period	326,887	\$ 29.00	223,043	\$ 14.30

Details of stock option transactions for the nine months ended September 30, 2018 and September 30, 2017 are as follows (Dollar amounts in thousands of U.S. dollars, except per share amounts):

	<b>Nine months ended September 30, 2018</b>		<b>Nine months ended September 30, 2017*</b>	
	<b>Number of shares</b>	<b>Weighted average exercise price per share</b>	<b>Number of shares</b>	<b>Weighted average exercise price per share</b>
Outstanding, beginning of period	653,571	\$ 36.69	474,501	\$ 12.67
Granted	163,366	62.80	360,025	54.13
Exercised	(44,498 )	9.49	(165,673 )	7.79
Forfeited	(38,860 )	50.46	(9,196 )	22.08
Expired	-	-	-	-
Outstanding, end of period	733,579	43.43	659,657	36.39
Options exercisable, end of period	326,887	\$ 29.00	223,043	\$ 14.30

Table of Contents

As of September 30, 2018, the exercise prices, weighted average remaining contractual life and intrinsic values of outstanding options were as follows (Dollar amounts in thousands of U.S. dollars, except per share amounts):

Exercise price	Options outstanding				Options exercisable			
	Number outstanding	Weighted	Weighted	Aggregate intrinsic value	Number exercisable	Weighted	Weighted	Aggregate intrinsic value
		average	average			average	average	
		exercise	remaining			exercise	remaining	
		price per share	contractual life (years)			price per share	contractual life (years)	
\$5.52 - \$8.56	60,573	\$ 6.89	1.2	\$ 2,960	60,573	\$ 6.89	1.2	\$ 2,960
\$10.16 - \$19.95	108,063	16.39	2.7	4,254	95,563	15.98	2.6	3,801
\$21.10 - \$27.53	72,500	23.76	3.3	2,319	52,500	24.78	3.0	1,626
\$35.25 - \$37.35	14,375	35.89	4.7	286	10,625	36.11	4.4	209
\$43.15 - \$47.00	18,500	44.19	5.3	214	8,000	43.75	5.3	96
\$53.20 - \$58.65	337,275	55.67	5.6	108	99,626	55.21	5.4	68
\$64.10 - \$64.10	122,293	64.10	6.7	-	-	-	-	-
	733,579	\$ 43.43	4.8	\$ 10,141	326,887	\$ 29.00	3.4	\$ 8,760

Total unrecognized compensation cost relating to unvested stock options at September 30, 2018, prior to the consideration of expected forfeitures, is approximately \$7.4 million and is expected to be recognized over a weighted average period of 2.8 years.

Table of Contents

The Company recorded stock-based compensation of \$0.7 million and \$1.9 million for the three and nine months ended September 30, 2018 and \$0.2 million and \$0.8 million for the three and nine months ended September 30, 2017, respectively.

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

**15. Fair value measurement:**

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

The following table provides a summary of the fair values of the Company's derivative instrument assets and liabilities measured at fair value on a recurring basis at September 30, 2018 (*Dollar amounts in thousands of U.S. dollars*):

	<b>Fair Value Measurement Using</b>			<b>Assets (Liabilities)</b>
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	
				<b>at Fair value</b>
Derivative instrument asset	\$ -	\$ -	\$ -	\$ -
Derivative instrument liability	\$ -	\$ (62 )	\$ -	\$ (62 )

There were no derivative instrument assets or liabilities outstanding at December 31, 2017.

**16. Contingencies**

On August 30, 2017, Namecheap, Inc. (“Namecheap”) filed a complaint against the Company, eNom, Inc., and unknown John Does in the United States District Court for the Western District of Washington alleging breach of contract, breach of the implied duty of good faith and fair dealing, and unjust enrichment (the “Namecheap Federal Action”). On September 6, 2018, Tucows and Namecheap entered into a settlement agreement, pursuant to which the matter was amicably resolved, and the case dismissed, and Namecheap has provided Tucows an administrative fee for services in connection with transferring its domain names off Tucows’ platform.

The Company has other legal claims and lawsuits in connection with its ordinary business operations. The Company intends to vigorously defend these claims. While the final outcome with respect to any actions or claims outstanding or pending as of September 30, 2018 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.

Table of Contents

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

**SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS**

This Quarterly Report on Form 10-Q contains, in addition to historical information, forward-looking statements by us with regard to our expectations as to financial results and other aspects of our business that involve risks and uncertainties and may constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Words such as “may,” “should,” “anticipate,” “believe,” “plan,” “estimate,” “expect” and “intend,” and other similar expressions are intended to identify forward-looking statements. The forward-looking statements contained in this report include statements regarding, among other things: the competition we expect to encounter as our business develops and competes in a broader range of Internet services; our expectation regarding the acquisition of eNom, the Company's foreign currency requirements, specifically for the Canadian dollar; Ting mobile, Roam mobile and fixed Internet access subscriber growth and retention rates; our belief regarding the underlying platform for our domain services, our expectation regarding the trend of sales of domain names and advertising; 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; our expectation regarding litigation; 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 our unrecognized tax; our expectations regarding cash from operations to fund our business; the impact of cancellations of or amendments to market development fund programs under which we receive funds, our expectation regarding our ability to manage realized gains/losses from foreign currency contracts; and general business conditions and economic uncertainty. 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:

- Changes in the nature of key strategic relationships with our Mobile Virtual Network Operator ("MVNO") partners;

The effects of vigorous competition on a highly penetrated mobile telephony market, including the impact of competition on the price we are able to charge subscribers for services and devices and on the geographic areas served by our MVNO partner wireless networks;

- Our ability to manage any potential increase in subscriber churn or bad debt expense;

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

- Our ability to service our debt commitments;

- 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 attract and retain qualified personnel in our business;
  - Our ability to effectively manage our business;
  - The effects of any material impairment of our goodwill or other indefinite-lived intangible assets;
  - Our ability to obtain and maintain approvals from regulatory authorities on regulatory issues;
- Our ability to invest in the build-out of fiber networks into selected towns and cities to provide Internet access
- services to residential and commercial customers while maintaining the development and sales of our established services;
  - Adverse tax consequences such as those related to changes in tax laws or tax rates or their interpretations, including with respect to the impact of the Tax Cuts and Jobs Act of 2017;
- The application of judgment in determining our global provision for income taxes, deferred tax assets or liabilities or other tax liabilities given the ultimate tax determination is uncertain;



Table of Contents

• Our ability to effectively integrate acquisitions;

• Pending or new litigation; and

• Factors set forth herein under the caption “Item 1A Risk Factors” in our Annual Report on Form 10-K for the fiscal year ended December 31, 2017 filed with the SEC on March 6, 2018 (the “2017 Annual Report”).

As previously disclosed under the caption “Item 1A Risk Factors” in our 2017 Annual Report, data protection regulations may impose legal obligations on us that we cannot meet or that conflict with our ICANN contractual requirements.

Specifically, the European Commission has adopted the General Data Protection Regulation (the “GDPR”), which introduces numerous privacy-related changes for companies operating in the European Union, effective on May 25, 2018. The GDPR includes obligations around the procurement, processing, publication and sharing of personal data. Potential fines for violations of certain provisions of GDPR reach as high as 4% of a company’s annual total revenue, potentially including the revenue of its international affiliates. The interpretation and application of the GDPR is still unsettled for the industry. Our domain name registrar businesses, and the contracts we have with domain name registries and ICANN, require us to process and share personal data. The solutions we develop for GDPR-compliance may not be adequate in the views of regulatory authorities or ICANN, which may cause the loss of WHOIS privacy revenue or increase our costs of developing compliant solutions or subject us to litigation, liability, civil penalties, or loss of market share. As the privacy laws and regulations around the world continue to evolve, these changes could adversely affect our business operations in similar ways.

This list of factors that may affect our future performance and financial and competitive position and 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 as required by law. 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 of our customers' experience as they access the Internet (at home or on the go) and while using Internet services such as domain name registration, email and other Internet services. We are organized, managed and report our financial results as two segments, Network Access Services and Domain Services, which are differentiated primarily by their services, the markets they serve and the regulatory environments in which they operate.

Our management 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 management 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 Network Access Services and Domain Services revenue separately.

For the three months ended September 30, 2018 and September 30, 2017, we reported revenue of \$83.5 million and \$85.0 million, respectively.

For the nine months ended September 30, 2018 and September 30, 2017, we reported revenue of \$260.4 million and \$238.8 million, respectively.

### *Network Access Services*

Network Access Services includes mobile, fixed high-speed Internet access services and other revenues, including, billing solutions to small ISPs.

## Table of Contents

Our primary mobile service offering (“Ting Mobile”) is mainly distributed through the Ting website and to a lesser extent certain third-party retail stores and on-line retailers. We generate revenues from the sale of retail telephony services, mobile phone hardware and related accessories to individuals and small businesses through the Ting website. Ting Mobile’s primary focus is providing simple and easy to use services, including simple value pricing, in particular for multi-line accounts, and superior customer care. In the third quarter of 2017, the Company acquired the consumer-related assets of Otono- Networks Inc. (“Otono Networks”). The consumer assets relate to the mobile roaming and instant activation eSIM business under the Roam Mobility, Zipsim and Always Online Wireless brands (collectively “Roam Mobility brands”). The acquired portfolio operates as a MVNO on the same nationwide Global System for Mobile communications (“GSM”) network as Ting Mobile and distributes through third-party retail stores and product branded websites.

The Company also derives revenue from the sale of fixed high-speed Internet access (“Ting Internet”) in select towns including Holly Springs, North Carolina, Westminster, Maryland, Sandpoint, Idaho, Centennial, Colorado and Charlottesville, Virginia, with further expansion underway in existing Ting towns. Our primary sales channel of Ting Internet is through the Ting website. The primary focus of Ting Internet is to provide reliable Gigabit Internet services to consumer and business customers.

Revenues from Ting Mobile and Ting Internet are generated in the U.S. and are provided on a monthly basis with no fixed contract term. Revenues from Roam Mobility are generated in the U.S. and Canada on a prepaid usage basis with no fixed contract terms.

As of September 30, 2018, Ting managed mobile telephony services for approximately 295,000 subscribers and 169,000 accounts. For a discussion of subscribers and how they impacted our financial results, see the Net Revenue discussion below.

## ***Domain Services***

Domain Services includes wholesale and retail domain name registration services, value added services and portfolio services derived through our OpenSRS, eNom and Hover brands. We earn revenues primarily from the registration fees charged to resellers in connection with new, renewed and transferred domain name registrations. In addition, we earn revenues from the sale of retail 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 and the U.S.

Our primary distribution channel is a global network of approximately 37,000 resellers that operate in over 150 countries and who typically provide their customers, the end-users of Internet-based services, with solutions for

establishing and maintaining an online presence. Our primary focus is serving the needs of this network of resellers by providing the broadest portfolio of generic top-level domain (“gTLD”) and the country code top-level domain (“ccTLD”) options and related services, a white-label platform that facilitates the provisioning and management of domain names, a powerful Application Program Interface, easy-to-use interfaces, comprehensive management and reporting tools, and proactive and attentive customer service. Our services are integral to the solutions that our resellers deliver to their customers. We provide “second tier” support to our resellers by email, chat and phone in the event resellers experience issues or problems with our services. In addition, our Network Operating Center proactively monitors 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. Our business model is characterized primarily by non-refundable, up-front payments, which lead to recurring revenue and positive operating cash flow.

Wholesale, primarily branded as OpenSRS and eNom, derives revenue from its domain service and from providing value-added services. The OpenSRS and eNom domain services manage approximately 23.3 million domain names under the Tucows and eNom ICANN registrar accreditations and for other registrars under their own accreditations, which has decreased 5.0 million domain names since September 30, 2017. The reduction from prior year is primarily due to the bulk transfer of 2.89 million domain names to Namecheap’s credentials, which occurred in two bulk transfers. The first bulk transfer of 2.65 million names was completed by January 16, 2018, after King County Superior court (Washington) granted Namecheap Inc. a preliminary injunction on January 5, 2018, requiring the Company to bulk transfer the domain names under management. As a result of the bulk transfer that occurred in the first quarter of 2018, the Company recognized, on an accelerated basis, \$14.6 million of revenue and \$14.5 million of cost of revenues sold related to previously deferred revenue and deferred prepaid registry fees. Subsequent to the preliminary injunction noted above, on September 6, 2018, Tucows and Namecheap entered into an amicable settlement agreement to transfer the remaining 0.6 million domain names, of which 0.24 million domain names were transferred to Namecheap during the third quarter of 2018. As a result of the bulk transfer that occurred in the third quarter of 2018, the Company recognized, on an accelerated basis, an additional \$1.7 million of revenue and \$1.7 million of cost of revenues sold related to previously deferred revenue and deferred prepaid expenses. The remaining domain names as defined under the settlement agreement are expected to be transferred to Namecheap in the fourth quarter of 2018.

In addition, one of the resellers for which the Company registered domain names using the reseller’s accreditation, was acquired and the registrations were moved to the acquiring reseller, resulting in approximately 0.5 million domains being transferred in the first quarter of 2018. As the Company does not defer revenue associated with hosted registry services, there was no impact on deferred revenue as a result of the transfer.

Table of Contents

Value-Added Services include hosted email which provides email delivery and webmail access to millions of mailboxes, Internet security services, Internet hosting, WHOIS privacy, publishing tools and other value-added services. All of these services are made available to end-users through a network of 37,000 web hosts, ISPs, and other resellers around the world. In addition, we also derive revenue by monetizing domain names which are near the end of their lifecycle through advertising revenue or auction sale.

Retail, primarily the Hover and eNom portfolio of websites, including eNom, eNom Central and Bulkregister, derive 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 36,000 surname domains – that allows roughly two-thirds of Americans to purchase an email address based on their last name.

Table of Contents

Portfolio generates revenue by offering names in our domain portfolio for resale through a number of distribution channels including our reseller network. We also generate advertising revenue from our portfolio.

**KEY BUSINESS METRICS**

We regularly review a number of business metrics, including the following key metrics and non-U.S. generally accepted accounting principles (“GAAP”) measures, to assist us in evaluating our business, measure the performance of our business model, identify trends impacting our business, determine resource allocations, manage our operational cash flow, formulate financial projections and make strategic business decisions. The following tables set forth the key business metrics which we believe are the primary indicators of our performance for the periods presented:

**Adjusted EBITDA**

Tucows reports all financial information in accordance with U.S. GAAP. Along with this information, to assist financial statement users in an assessment of our historical performance, we typically disclose and discuss a non-GAAP financial measure, adjusted EBITDA, on investor conference calls and related events that exclude certain non-cash and other charges as we believe that the non-GAAP information enhances investors' overall understanding of our financial performance. Please see discussion of adjusted EBITDA in the Results of Operations section below.

**Network Access Services**

	<b>September 30,</b>	
	<b>2018</b>	<b>2017</b>
	(1)	(1,2)
	(in 000s)	
Ting mobile accounts under management	169	165
Ting mobile subscribers under management	295	281

(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.

(2) Subsequent to a review of our subscriber base in the first quarter of 2018, our comparative third quarter 2017 accounts under management were reduced by approximately 6,000.

**Domain Services**

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

	<b>Three months ended September 30,</b>	
	<b>2018</b>	<b>2017</b>
	<b>(1)</b>	<b>(1)</b>
	<b>(in 000's)</b>	
Total new, renewed and transferred-in domain name registrations provisioned	4,170	4,839

	<b>Nine months ended September 30,</b>	
	<b>2018 <sup>(1)</sup></b>	<b>2017 <sup>(1)</sup></b>
	<b>(in 000's)</b>	
Total new, renewed and transferred-in domain name registrations provisioned	13,444	14,604

<sup>(1)</sup> For a discussion of these period to period changes in the domain names provisioned and how they impacted our financial results, see the Net Revenues discussion below.

Domain names under management:

	<b>September 30,</b>	
	<b>2018 <sup>(1)</sup></b>	<b>2017 <sup>(1)</sup></b>
	<b>(in 000's)</b>	
Domain names under management:		
Registered using Registrar Accreditation belonging to the Tucows Group	18,990	22,708
Registered using Registrar Accreditations belonging to Resellers	4,344	5,597
Total domain names under management	23,334	28,305

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

Table of Contents

**OPPORTUNITIES, CHALLENGES AND RISKS**

As a MVNO, our Ting and Roam services are reliant on our Mobile Network Operators ("MNOs") providing competitive networks. Our MNOs each continue to invest in network expansion and modernization to improve their competitive positions. 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.

Ting has also enjoyed rapid growth in its first six years of operation. During this growth phase, we have been able to continue to grow gross customer additions and maintain a consistent churn rate, which has allowed us to maintain net new customer additions despite the impact of churn on a fast-growing customer base. We expect price competition to grow more intense in the industry which could result in increased customer churn or reductions of customer acquisition rates either of which could result in slower growth rates or in certain cases, our ability to maintain growth.

The communications industry continues to compete on the basis of network reach and performance, types of services and devices offered, and price.

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

Substantially all of our Domain Services revenue is derived from domain name registrations and related value-added services from wholesale and retail customers using our provisioning and management platforms. The market for wholesale registrar services is both price sensitive and competitive and is evolving with the introduction of new gTLDs, 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. Growth in our Domain Services revenue is dependent upon our ability to continue to attract and retain customers by maintaining consistent domain name registration and value-added service renewal rates and to grow our customer relationships through refining, evolving and improving our provisioning platforms and customer service for both resellers and end-users. In addition, we also generate revenue through pay-per-click advertising and the sale of names from our portfolio of domain names and through the domain expiry stream. The revenue associated with names sales and advertising has recently experienced flat to declining trends due to lower traffic and advertising yields in the marketplace, which we expect to continue.



Expanding data protection regulations may impose legal obligations on us that we cannot meet or that conflict with our ICANN contractual requirements. Specifically, the European Commission has adopted the GDPR, which introduces numerous privacy-related changes for companies operating in the European Union, effective on May 25, 2018. The solutions we develop for GDPR-compliance may not be adequate in the views of regulatory authorities or ICANN, which may cause the loss of WHOIS privacy revenue or increase our costs of developing compliant solutions or subject us to litigation, liability, civil penalties, or loss of market share. As the privacy laws and regulations around the world continue to evolve, these changes could adversely affect our business operations in similar ways.

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

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

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

Table of Contents

**Net Revenues**

**Network Access Services**

The Company generates Network Access Services revenues primarily through the provisioning of mobile services. Other sources of revenue include the provisioning of fixed high-speed Internet access as well as billing solutions to ISP.

*Mobile*

Ting wireless usage contracts grant customers access to standard talk, text and data mobile services. Ting mobile contracts are billed based on the actual amount of monthly services utilized by each customer during their billing cycle and charged to customers on a postpaid basis. Voice minutes, text messages and megabytes of data are each billed separately based on a tiered pricing program. The Company recognizes revenue for Ting mobile usage based on the actual amount of monthly services utilized by each customer.

Ting Mobile services are primarily contracted through the Ting website, for one month at a time and contain no commitment to renew the contract following each customer's monthly billing cycle. The Company's billing cycle for all Ting mobile customers is computed based on the customer's activation date. In order to recognize revenue as the Company satisfies its obligations, we compute the amount of revenues earned but not billed from the end of each billing cycle to the end of each reporting period. In addition, revenues associated with the sale of wireless devices and accessories are recognized when title and risk of loss is transferred to the customer and shipment has occurred. Incentive marketing credits given to customers are recorded as a reduction of revenue.

Our Roam Mobility brand also offers standard talk, text and data mobile services. Roam customers prepay for their usage through the Roam Mobility website. When prepayments are received the amount is deferred, and subsequently recognized as the Company satisfies its obligation to provide mobile services. In addition, revenues associated with the sale of SIM cards 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.

*Other services*

Other services derive revenues from providing Ting Internet to individuals and small businesses in select cities. In addition, we provide billing, provisioning and customer care software solutions to ISPs through our Platypus billing software. Ting fixed Internet access contracts provide customers Internet access at their home or business through the installation and use of our fiber optic network. Ting Internet contracts are generally prepaid and grant customers with unlimited bandwidth based on a fixed price per month basis. Since consideration is collected before the service period, revenue is initially deferred and recognized as the Company performs its obligation to provide Internet access. Though the Company does not consider the installation of fixed Internet access to be a distinct performance obligation, the fees related to installation are immaterial and therefore revenue is recognized as billed.

Ting Internet services are primarily contracted through the Ting website, for one month at a time and contain no commitment to renew the contract following each customer's monthly billing cycle. The Company's billing cycle for all Ting fixed Internet access customers is computed based on the customer's activation date. In order to recognize revenue as the Company satisfies its obligations, we compute the amount of revenues earned but not billed from the end of each billing cycle to the end of each reporting period. In addition, revenues associated with the sale of Internet hardware 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.

In those cases, where payment is not received at the time of sale, revenue is not recognized until contract inception unless the collection of the related accounts receivable is reasonably assured. The Company records costs that reflect 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.

Table of Contents

**Domain Services**

*Wholesale*

Domain registration contracts, which can be purchased for terms of one to ten years, provide our resellers and retail registrant customers with the exclusive right to a personalized internet address from which to build an online presence. The Company enters into domain registration contracts in connection with each new, renewed and transferred-in domain registration. At the inception of the contract, the Company charges and collects the registration fee for the entire registration period. Though fees are collected upfront, revenue from domain registrations are recognized ratably over the registration period as domain registration contracts contain a 'right to access' license of IP, which is a distinct performance obligation measured over time. The registration period begins once the Company has confirmed that the requested domain name has been appropriately recorded in the registry under contractual performance standards.

Historically, our wholesale domain service has constituted the largest portion of our business and encompasses all of our services as an accredited registrar related to the registration, renewal, transfer and management of domain names. In addition, this service fuels other revenue categories as it often is the initial service for which a reseller will engage us, enabling us to follow on with other services and allowing us to add to our portfolio by purchasing names registered through us upon their expiration. With the acquisition of eNom and its 24,000-reseller network, domain services will continue to be the largest portion of our business and will further fuel our ability to sell add-on services.

The Company is an ICANN accredited registrar. Thus, the Company is the primary obligor with our reseller and retail registrant customers and is responsible for the fulfillment of our registrar services to those parties. As a result, the Company reports revenue in the amount of the fees we receive directly from our reseller and retail registrant customers. Our reseller customers maintain the primary obligor relationship with their retail customers, establish pricing and retain credit risk to those customers. Accordingly, the Company does not recognize any revenue related to transactions between our reseller customers and their ultimate retail customers.

*Wholesale – Value-Added Services*

We derive domain related value-added services like digital certifications, WHOIS privacy and hosted email provide our resellers and retail registrant customers with tools and additional functionality to be used in conjunction with domain registrations. All domain related value-added services are considered distinct performance obligations which transfer the promised service to the customer over the contracted term. Fees charged to customers for domain related value-added services are collected at the inception of the contract, and revenue is recognized on a straight-line basis over the contracted term, consistent with the satisfaction of the performance obligations.

We also derive revenue from other value-added services primarily from Internet hosting services, advertising from the OpenSRS and eNom domain expiry streams.

### *Retail*

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

### *Portfolio*

We derive revenue from our portfolio of domain names parking monetization, whereby the Company contracts with third-party Internet advertising publishers to direct web traffic from the Company's domain expiry stream domains and Internet portfolio domains to advertising websites. Compensation from Internet advertising publishers is calculated variably on a cost-per-action basis based on the number of advertising links that have been visited in a given month.

The Company also sells the rights to the Company's portfolio domains or names acquired through the Company's domain expiry stream. Revenue generated from sale of domain name contracts, containing a distinct performance obligation to transfer the domain name rights under the Company's control, is generally recognized once the rights have been transferred and payment has been received in full. Domain 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.

## **Critical Accounting Policies**

The preparation of our consolidated financial statements in conformity with U.S. GAAP requires us to make estimates and judgements that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. There have been no material changes to the critical accounting policies and estimates as previously disclosed in Part II, Item 7 of our 2017 Annual Report, except for the adoption of Accounting Standard Update ("ASU") No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, which was adopted using the modified retrospective basis. Accordingly, comparative figures have not been restated. The adoption of ASU 2014-09 did not have a material impact on the timing of revenue recognition. For further information on our critical accounting

policies and estimates, see note 3 – Recent accounting pronouncements to the consolidated financial statements of the Company in Part I, Item 1 in this Quarterly Report on Form 10-Q.

Table of Contents**RESULTS OF OPERATIONS FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2018 AS COMPARED TO THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2017**

During the preparation of these interim financial statements, the Company identified an immaterial error that affects the classification of expenses for the three and nine months ended September 30, 2017. This correction of the comparative periods resulted in a decrease in cost of revenues of \$0.3 million, a decrease in sales and marketing expense of \$0.2 million, and an increase in general and administrative expenses of \$0.5 million for both the three and nine months ended September 30, 2017 compared to the amounts previously reported.

**NET REVENUES**

The following table presents our net revenues, by revenue source (*Dollar amounts in thousands of U.S. dollars*):

	<b>Three months ended September 30, 2018</b>		<b>Nine months ended September 30, 2018</b>	
	<b>2017*</b>		<b>2017*</b>	
<u>Network Access Services:</u>				
Mobile Services	\$22,546	\$21,749	\$66,829	\$60,090
Other Services	2,033	1,442	5,664	3,978
Total Network Access Services	24,579	23,191	72,493	64,068
<u>Domain Services:</u>				
Wholesale				
Domain Services	45,070	47,770	146,038	135,413
Value Added Services	4,541	4,203	13,576	13,526
Total Wholesale	49,611	51,973	159,614	148,939
Retail	8,731	8,873	25,644	22,937
Portfolio	598	971	2,650	2,856
Total Domain Services	58,940	61,817	187,908	174,732
	\$83,519	\$85,008	\$260,401	\$238,800
(Decrease) increase over prior period	\$(1,489 )		\$21,601	
(Decrease) increase - percentage	-2	%	9	%

The following table presents our revenues, by revenue source, as a percentage of total revenues (*Dollar amounts in thousands of U.S. dollars*):

	Three months ended September 30, 2018				Nine months ended September 30, 2018			
	2017*				2017*			
<u>Network Access Services:</u>								
Mobile Services	27	%	26	%	26	%	25	%
Other Services	2	%	2	%	2	%	2	%
Total Network Access Services	29	%	28	%	28	%	27	%
<u>Domain Services:</u>								
Wholesale								
Domain Services	55	%	56	%	56	%	56	%
Value Added Services	5	%	5	%	5	%	6	%
Total Wholesale	60	%	61	%	61	%	62	%
Retail								
Portfolio	1	%	1	%	1	%	1	%
Total Domain Services	71	%	72	%	72	%	73	%
	100	%	100	%	100	%	100	%

Total net revenues for the three months ended September 30, 2018 decreased by \$1.5 million or 2% to \$83.5 million when compared to the three months ended September 30, 2017. The three-month decrease was primarily driven by the \$14.6 million acceleration of revenue related to the Namecheap bulk transfer of 2.65 million names in the first quarter of 2018, a portion of which would have otherwise been recognized in the third quarter of 2018. The decrease was partially offset by the \$1.7 million of revenue accelerated in the third quarter of 2018 related to 0.24 million of additional names transferred to Namecheap, a portion of which would have otherwise been recognized after the third quarter of 2018. The decrease was also offset by the impact of the acquisition of the mobile roaming assets of Otono Networks in September 2017.

Total net revenues for the nine months ended September 30, 2018 increased by \$21.6 million or 9% to \$260.4 million when compared to the nine months ended September 30, 2017. The nine-month increase was primarily driven by the acceleration of previously deferred revenue as a result of two bulk transfers of domain names to Namecheap. As a result of the Namecheap bulk transfer of 2.65 million domain names that occurred in the first quarter of 2018, the Company accelerated \$14.6 million of revenue, a portion of which would have otherwise been recognized after the third quarter of 2018. Likewise, as a result of the Namecheap bulk transfer of 0.24 million domain names that occurred in the third quarter of 2018, the Company accelerated \$1.7 million of revenue, a portion of which would have otherwise been recognized after the third quarter of 2018. In addition, revenues increased due to the January 20, 2017 acquisition of eNom and the impact the acquisition of the mobile roaming assets of Otono Networks in September 2017.



Table of Contents

Deferred revenue from domain name registrations and other Internet services at September 30, 2018 decreased to \$148.5 million from \$160.6 million at December 31, 2017, primarily due to the bulk transfers discussed above.

During the three and nine months ended September 30, 2018, no customer accounted for more than 10% of total revenue. For the three and nine months ended September 30, 2017, no customer accounted for more than 10% of revenue. As at September 30, 2018 and December 31, 2017, no customer accounted for more than 10% of accounts receivable. Though a significant portion of the Company's domain services revenues are prepaid by our customers, where the Company does collect receivables, 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.

Table of Contents

***Network Access Services***

Net revenues from mobile phone equipment and services for the three months ended September 30, 2018 increased by \$0.8 million or 4% to \$22.5 million as compared to the three months ended September 30, 2017. This increase primarily reflects the growth in service revenues by \$1.6 million to \$20.4 million as compared to the three months ended September 30, 2017, due to the impact of the larger Ting subscriber base is having on Ting mobile service revenue and acquisition of the roaming assets of Otono Networks in September of 2017. Revenues from the sale of mobile hardware and related accessories decreased by \$0.8 million to \$2.1 million as compared to the three months ended September 30, 2017. The decrease in device revenue was primarily driven by reduced demand for high-priced devices compared to the three months ended September 30, 2017.

Net revenues from mobile phone equipment and services for the nine months ended September 30, 2018 increased by \$6.7 million or 11% to \$66.8 million as compared to the nine months ended September 30, 2017. This increase primarily reflects the growth in service revenues by \$6.8 million to \$60.3 million as compared to the nine months ended September 30, 2017, due to the impact of the larger Ting subscriber base is having on Ting mobile service revenue and acquisition of the roaming assets of Otono Networks in September of 2017. Revenues from the sale of mobile hardware and related accessories decreased by \$0.1 million to \$6.5 million as compared to the nine months ended September 30, 2017. The decrease in device revenue was primarily driven by reduced demand for high-priced devices compared to the nine months ended September 30, 2017.

Other revenues from Ting Internet and billing solutions generated \$2.0 million in revenue during the three months ended September 30, 2018, up \$0.6 million from the three months ended September 30, 2017. Growth in Ting Internet revenues was as a result of the increased Ting Internet footprint in Charlottesville, VA, Westminster, MD and Holly Springs, NC. The Company began offering Ting Internet in Sandpoint, ID in the second quarter of 2018 and in Centennial, CO in the third quarter of 2018.

Other revenues from Internet and billing solutions generated \$5.7 million in revenue during the nine months ended September 30, 2018, up \$1.7 million from the nine months ended September 30, 2017. Growth in Ting Internet revenues was as a result of the increased Ting Internet footprint in Charlottesville, VA, Westminster, MD and Holly Springs, NC. The Company began offering Ting Internet in Sandpoint, ID in the second quarter of 2018 and in Centennial, CO in the third quarter of 2018.

As of September 30, 2018, Ting Mobile had 169,000 accounts under management and 295,000 subscribers under management compared to 165,000 accounts and 281,000 subscribers under management as of September 30, 2017.

***Wholesale***

During the three months ended September 30, 2018, domain services revenue decreased by \$2.7 million or 6% to \$45.1 million when compared to the three months ended September 30, 2017. The decrease was primarily driven by the accelerated recognition of domains revenue associated with the Namecheap bulk transfer of 2.65 million names in the first quarter of 2018 and partially offset by the \$1.7 million acceleration of an additional 0.24 million names in the third quarter of 2018. During the nine months ended September 30, 2018, domain services revenue increased by \$10.6 million or 8% to \$146.0 million when compared to the nine months ended September 30, 2017. This increase primarily resulted from \$14.6 million of accelerated recognition of wholesale domain revenue associated with the Namecheap bulk transfer of 2.65 million names that took place during the first quarter of 2018 and the \$1.7 million of accelerated recognition of wholesale domain revenue associated with the additional 0.24 million names transferred to Namecheap in the third quarter of 2018. The Company expects to transfer an additional 0.4 million domain names in the fourth quarter of 2018 related to Namecheap. In addition, revenues increased compared to the nine months ended September 30, 2017 due to the January 20, 2017 acquisition of eNom. eNom revenues and gross margins in 2017 were negatively impacted by amortizing into revenue, deferred revenue that was recorded at fair value at the acquisition date which was approximately 10% lower than the historical cost basis of eNom.

The increase in revenue from the acquisition of eNom has been offset by the continued and ongoing migration of a few large, low margin customers. These customers have been moving their domain management and domain transaction processing to their own accreditations and in-house systems. As previously discussed, in the first and third quarter of 2018 the Company completed bulk transfers of 2.65 million and 0.24 million domain names respectively to Namecheap's credentials, which are the most significant migrations of this nature. In addition, one of the resellers for which the Company registered domain names using the reseller's accreditation, was acquired by a third party and the registrations were moved to the acquiring reseller, resulting in approximately 0.5 million domains being transferred in the first quarter of 2018. Due to these factors, total domains that we manage decreased to 23.3 million as of September 30, 2018, when compared to 28.3 million at September 30, 2017. While we anticipate that the number of new, renewed and transferred-in domain name registrations will continue to incrementally increase in the long term, the volatility of these factors could affect the growth of domain names that we manage.

Table of Contents

During the three months ended September 30, 2018, value added services revenue increased by \$0.3 million to \$4.5 million when compared to the three months ended September 30, 2017. During the nine months ended September 30, 2018, value added services revenue increased by \$0.1 million to \$13.6 million when compared to the nine months ended September 30, 2017. Both the three and nine month increases were primarily driven by increased expiry stream revenue.

***Retail***

Net revenues from retail for the three months ended September 30, 2018, as compared to the three months ended September 30, 2017, decreased by \$0.1 million, or 2%, to \$8.7 million. Net revenues from retail for the nine months ended September 30, 2018, as compared to the nine months ended September 30, 2017, increased by \$2.7 million, or 12%, to \$25.6 million. The nine-month increase was 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. In addition, our revenues and gross margins in 2017 were negatively impacted by amortizing into revenue, deferred revenue that was recorded at fair value at the acquisition date which was approximately 10% lower than the historical basis of eNom.

***Portfolio***

Net revenues from portfolio for the three months ended September 30, 2018, decreased by \$0.4 million to \$0.6 million, as compared to the three months ended September 30, 2017.

Net revenues from portfolio for the nine months ended September 30, 2018, decreased by \$0.2 million to \$2.7 million, as compared to the nine months ended September 30, 2017.

Table of Contents

**COST OF REVENUES**

**Network Access Services**

*Mobile*

Cost of revenues for mobile services includes the costs of provisioning mobile services, which is primarily our customers' voice, messaging, data usage provided by our MNOs, and the costs of providing mobile phone hardware, which is the cost of mobile phone devices and SIM cards sold to our customers, order fulfillment related expenses, and inventory write-downs.

*Other Services*

Cost of revenues for other services includes the costs for provisioning high speed Internet access, comprised of network access fees and software licenses, the costs of providing hardware, comprised of the cost of network routers sold to our customers, order fulfillment related expenses, and inventory write-downs and fees paid to third-party service providers, primarily for printing services in connection with billing services to ISPs.

**Wholesale**

*Domain Service*

Cost of revenues for domain registrations represents the amortization of registry and accreditation 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 represent a payment for distinct goods or services provided by the Company, and thus do not meet the criteria for revenue recognition under ASU 2014-09, are reflected as cost of goods sold and are recognized as earned.

*Value-Added Services*

Costs of revenues for value-added services include licensing and royalty costs related to the provisioning of certain components of related to hosted email, third-party hosting services. 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 sites, Hover.com and the eNom branded sites, include the amortization of registry and accreditation 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 our portfolio represent the amortization of registry fees for domains added to our portfolio over the renewal period, which is generally one year, the value attributed under intangible assets to any domain name sold and any impairment charges that may arise from our assessment of our domain name intangible assets. As the total names in our portfolio continue to grow, this cost will become a more significant component of our cost of revenues. Payments for domain registrations are payable for the full term of service at the time of activation of service and are recorded as prepaid domain registry fees and are expensed ratably over the renewal term.

Table of ContentsNetwork expenses

Network expenses 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 (*Dollar amounts in thousands of U.S. dollars*):

	<b>Three months ended September 30, 2018</b>		<b>Nine months ended September 30, 2018</b>	
		<b>2017*</b>		<b>2017*</b>
<b>Network Access Services:</b>				
Mobile Services	\$ 11,399	\$ 12,365	\$ 34,643	\$ 32,634
Other Services	872	595	3,103	2,366
Total Network Access Services	12,271	12,960	37,746	35,000
<b>Domain Services:</b>				
<b>Wholesale</b>				
Domain Services	37,414	42,293	124,572	119,207
Value Added Services	807	687	2,412	1,878
Total Wholesale	38,221	42,980	126,984	121,085
<b>Retail</b>				
Portfolio	4,465	4,611	13,320	12,776
Total Domain Services	148	180	528	627
	42,834	47,771	140,832	134,488
<b>Network Expenses:</b>				
Network, other costs	2,315	2,461	7,590	7,064
Network, depreciation and amortization costs	1,838	1,322	5,195	3,463
	4,153	3,783	12,785	10,527
	\$ 59,258	\$ 64,514	\$ 191,363	\$ 180,015
(Decrease) increase over prior period	\$ (5,256 )		\$ 11,348	
(Decrease) increase - percentage	-8	%	6	%

The following table presents our cost of revenues, as a percentage of total of cost of revenues (*Dollar amounts in thousands of U.S. dollars*):

	Three months ended September 30,				Nine months ended September 30,			
	2018	2017*			2018	2017*		
<u>Network Access Services:</u>								
Mobile Services	19	%	19	%	18	%	18	%
Other Services	1	%	1	%	2	%	1	%
Total Network Access Services	20	%	20	%	20	%	19	%
<u>Domain Services:</u>								
Wholesale								
Domain Services	64	%	66	%	65	%	67	%
Value Added Services	1	%	1	%	1	%	1	%
Total Wholesale	65	%	67	%	66	%	68	%
Retail								
Portfolio	0	%	0	%	0	%	0	%
Total Domain Services	73	%	74	%	73	%	75	%
Network Expenses:								
Network, other costs	4	%	4	%	4	%	4	%
Network, depreciation and amortization costs	3	%	2	%	3	%	2	%
	7	%	6	%	7	%	6	%
	100%	100	%		100%	100	%	

Total cost of revenues for the three months ended September 30, 2018, decreased by \$5.3 million, or 8%, to \$59.3 million when compared to the three months ended September 30, 2017. The decrease was primarily driven by the Namecheap bulk transfer of 2.65 million names in the first quarter of 2018, resulting in the accelerated recognition of \$14.5 million prepaid domain registry fees, a portion of which would have otherwise been recognized in the third quarter of 2018. The decrease was offset by the transfer of 0.24 million domain names to Namecheap in the third quarter of 2018, which resulted in the accelerated recognition of \$1.7 million of prepaid domain registry fees, a portion of which otherwise would have been recognized after the third quarter of 2018.



Table of Contents

Total cost of revenues for the nine months ended September 30, 2018, increased by \$11.3 million, or 6%, to \$191.4 million when compared to the nine months ended September 30, 2017. The increase was primarily driven by the Namecheap bulk transfer of 2.65 million names during the first quarter of 2018, resulting in the accelerated recognition of \$14.5 million of prepaid domain registry fees. The increase was also due to the Namecheap bulk transfer of 0.24 million domain names during the third quarter of 2018, resulting in the accelerated recognition of \$1.7 million of prepaid domain registry fees. A portion of the accelerated prepaid domain fees from both transfers would have otherwise been recognized after the third quarter of 2018. Additionally, the nine months ended September 30, 2017 were lower due to the January 20, 2017 acquisition of eNom and the impact the acquisition of the mobile roaming assets of Otono Networks in September 2017. Prepaid domain registration and other Internet services fees as of September 30, 2018, decreased to \$111.2 million from \$127.0 million as of December 31, 2017, primarily due to the bulk transfers discussed above.

**Network Access Services**

***Mobile and Other Services***

Cost of revenues from mobile phone equipment and services for the three months ended September 30, 2018, as compared to the three months ended September 30, 2017, decreased by \$1.0 million or 8% to \$11.4 million. This decrease was driven by improved pricing with mobile carriers, which reduced mobile service cost of revenue by \$0.1 million to \$9.1 million as compared to the three months ended September 30, 2017. Mobile hardware and related accessories costs decreased \$0.9 million to \$2.3 million as compared to the three months ended September 30, 2017. The decrease was primarily driven by reduced demand for high-priced devices compared to the three months ended September 30, 2017.

In addition, during the three months ended September 30, 2018, we incurred costs of \$0.9 million in provisioning high speed Internet access and billing solutions as compared to \$0.6 million during the three months ended September 30, 2017. The increase in costs was primarily due primarily to the expansion of the Ting Internet foot print and increasing subscriber base.

Cost of revenues from mobile phone equipment and services for the nine months ended September 30, 2018, as compared to the nine months ended September 30, 2017, increased by \$2.0 million or 6% to \$34.6 million. This increase primarily reflects the impact the subscriber base had on Ting mobile service cost of revenue as well as the acquisition of the mobile roaming assets of Otono Networks in September 2017 which combined grew by \$2.1 million to \$27.6 million as compared to the nine months ended September 30, 2017. Mobile hardware and related accessories costs decreased by \$0.1 million compared to the nine months ended September 30, 2017, to \$7.0 million. The decrease was primarily driven by reduced demand for high-priced devices compared to the nine months ended September 30, 2017.

In addition, during the nine months ended September 30, 2018, we incurred costs of \$3.1 million in provisioning high speed Internet access and billing solutions as compared to \$2.4 million during the nine months ended September 30, 2017. The increase in costs was primarily due primarily to the expansion of the Ting Internet foot print and increasing subscriber base.

### **Domain Services**

#### ***Wholesale***

Costs for wholesale and value-added services for the three months ended September 30, 2018 decreased by \$4.8 million, or 12%, to \$38.2 million when compared to the three months ended September 30, 2017. The three-month decrease resulted from \$14.5 million of accelerated recognition of prepaid domain registry fees associated with the Namecheap bulk transfer of 2.65 million names during the first quarter of 2018, a portion of which would have otherwise been recognized in the third quarter of 2018, and was offset by an acceleration of \$1.7 million of accelerated recognition of prepaid domain registry fees associated with the 0.24 million additional names transferred to Namecheap in the third quarter of 2018. Costs for wholesale and value-added services for the nine months ended September 30, 2018 increased by \$5.9 million, or 5%, to \$127.0 million when compared to the nine months ended September 30, 2017. The nine-month increase primarily resulted from \$14.5 million of accelerated recognition of prepaid domain registry fees associated with the Namecheap bulk transfer of 2.65 million names during the first quarter of 2018 and \$1.7 million of accelerated recognition of prepaid domain registry fees associated with the 0.24 million additional names transferred to Namecheap in the third quarter of 2018. In addition, cost of revenues increased due to the January 20, 2017 acquisition of eNom.

#### ***Retail***

Costs for retail for the three months ended September 30, 2018 decreased by \$0.1 million, to \$4.5 million when compared to the three months ended September 30, 2017. Costs for Retail for the nine months ended September 30, 2018 increased by \$0.5 million, to \$13.3 million when compared to the nine months ended September 30, 2017. The nine-month increase was largely due to increased sales volumes associated with the success our retail marketing initiatives and improved websites are having on our ability to attract new customers and retain existing ones.

Table of Contents

*Portfolio*

Costs for portfolio for the three months ended September 30, 2018 remained flat at \$0.1 million, when compared to the three months ended September 30, 2017. Costs for portfolio for the nine months ended September 30, 2018 decreased by \$0.1 million to \$0.5 million, when compared to the nine months ended September 30, 2017.

**Network Expenses**

Network costs for the three months ended September 30, 2018 increased by \$0.4 million to \$4.2 million when compared to the three months ended September 30, 2017. The three-month increase was driven by the expansion of the Company's network infrastructure. Costs for the nine months ended September 30, 2018 increased by \$2.3 million to \$12.8 million when compared to the nine months ended September 30, 2017. The nine-month increase is primarily due to the acquisition of eNom on January 20, 2017, including acquired developed platform technology.

Table of Contents**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.

	<b>Three months ended</b>		<b>Nine months ended September</b>			
	<b>September 30,</b>		<b>30,</b>			
	<b>2018</b>	<b>2017</b>	<b>2018</b>	<b>2017</b>		
<i>(Dollar amounts in thousands of U.S. dollars)</i>						
Sales and marketing	\$8,412	\$7,384	\$24,629	\$22,051		
Increase over prior period	\$1,028		\$2,578			
Increase - percentage	14	%	12	%		
Percentage of net revenues	10	%	9	%	9	%

Sales and marketing expenses for the three months ended September 30, 2018 increased by \$1.0 million, or 14%, to \$8.4 million when compared to the three months ended September 30, 2017. This three-month increase related primarily to an increase of \$1.0 million in workforce and stock-based compensation related costs, which have primarily been driven by workforce increases to support mobile and network access related growth, as well as foreign exchange impacts.

Sales and marketing expenses for the nine months ended September 30, 2018 increased by \$2.6 million, or 12%, to \$24.6 million when compared to the nine months ended September 30, 2017. This nine-month increase related primarily to an increase of \$3.5 million increased workforce and stock-based compensation related costs, which have primarily been driven by workforce increases to support mobile and network access related growth, and foreign exchange impacts. The increase was offset by a \$0.9 million decrease in marketing costs, largely due to timing of expenditures.

**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, network access services, email, retail, domain portfolio and other Internet services, as well as to distribute our digital content services. All technical operations and development costs are expensed as incurred.

<i>(Dollar amounts in thousands of U.S. dollars)</i>	<b>Three months ended</b>		<b>Nine months ended</b>			
	<b>September 30,</b>		<b>September 30,</b>			
	<b>2018</b>	<b>2017</b>	<b>2018</b>	<b>2017</b>		
Technical operations and development	\$2,207	\$1,910	\$6,657	\$5,402		
Increase over prior period	\$297		\$1,255			
Increase - percentage	16	%	23	%		
Percentage of net revenues	3	%	2	%	3	%

Technical operations and development expenses for the three months ended September 30, 2018 increased by \$0.3 million, or 16%, to \$2.2 million when compared to the three months ended September 30, 2017. The increase in costs relates primarily to increased salaries and benefits driven by an expanding workforce and wage inflation.

Technical operations and development expenses for the nine months ended September 30, 2018 increased by \$1.3 million, or 23%, to \$6.7 million when compared to the nine months ended September 30, 2017. The increase in costs relate primarily to increased salaries and benefits driven by an expanding workforce and wage inflation, as well as the eNom technical operations and development workforce that were included as of January 20, 2017.

## 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.

<i>(Dollar amounts in thousands of U.S. dollars)</i>	<b>Three months ended</b>		<b>Nine months ended September</b>			
	<b>September 30,</b>		<b>30,</b>			
	<b>2018</b>	<b>2017</b>	<b>2018</b>	<b>2017</b>		
General and administrative	\$4,120	\$3,381	\$12,906	\$10,124		
Increase over prior period	\$739		\$2,782			
Increase - percentage	22	%	27	%		
Percentage of net revenues	5	%	4	%	5	%

Table of Contents

General and administrative expenses for the three months ended September 30, 2018 increased by \$0.7 million, or 22%, to \$4.1 million when compared to the three months ended September 30, 2017. The increase was primarily driven by a rise in workforce, contract services, travel and stock-based compensation expenses of \$0.7 million. Other expenses including credit card processing fees related to growth of network access services and facilities costs decreased \$0.2 million, however the impact of foreign exchange revaluation on our monetary assets and liabilities had a \$0.2 million unfavourable impact, compared to the three months ended September 30, 2017.

General and administrative expenses for the nine months ended September 30, 2018 increased by \$2.8 million, or 27%, to \$12.9 million when compared to the nine months ended September 30, 2017. The increase was primarily driven by workforce, contract services, travel and stock-based compensation increased \$1.6 million. Other expenses including credit card processing fees related to growth of network access services and facilities costs increased \$0.2 million, while the impact of foreign exchanges revaluation of our monetary assets and liabilities had a \$1.0 million unfavourable impact, compared to the nine months ended September 30, 2017.

**DEPRECIATION OF PROPERTY AND EQUIPMENT**

<i>(Dollar amounts in thousands of U.S. dollars)</i>	<b>Three months ended</b>		<b>Nine months ended</b>			
	<b>September 30, 2018</b>	<b>2017</b>	<b>September 30, 2018</b>	<b>2017</b>		
Depreciation of property and equipment	\$ 106	\$ 155	\$ 309	\$ 486		
Decrease over prior period	\$(49 )		\$(177)			
Decrease - percentage	(32 %)		(36 %)			
Percentage of net revenues	0 %	0 %	0 %	0 %	0 %	0 %

Depreciation costs decreased by less than \$0.1 million to \$0.1 million as compared to the three months ended September 30, 2017.

Depreciation costs decreased by \$0.2 million to \$0.3 million as compared to the nine months ended September 30, 2017.

**AMORTIZATION OF INTANGIBLE ASSETS**

<i>(Dollar amounts in thousands of U.S. dollars)</i>	<b>Three months ended</b>	<b>Nine months ended</b>
--	---------------------------	--------------------------

	<b>September 30,</b>		<b>September 30,</b>	
	<b>2018</b>	<b>2017</b>	<b>2018</b>	<b>2017</b>
Amortization of intangible assets	\$1,797	\$1,746	\$5,456	\$4,735
Increase over prior period	\$51		\$721	
Increase - percentage	3	%	15	%
Percentage of net revenues	2	%	2	%

Amortization of intangible assets for the three months ended September 30, 2018 increased \$0.1 million to \$1.8 million as compared to the three months ended September 30, 2017. The three-month increase is primarily due to the acquisition of the mobile roaming assets of Otono Networks in September 2017. Amortization of intangible assets for the nine months ended September 30, 2018 increased \$0.7 million to \$5.5 million as compared to the nine months ended September 30, 2017. The nine-month increase was due to the full three-quarter impact of the acquisition of eNom as well as acquisition of the mobile roaming assets of Otono Networks in September 2017.

## LOSS (GAIN) ON CURRENCY FORWARD CONTRACTS

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

	<b>Three months ended September 30,</b>		<b>Nine months ended September 30,</b>	
	<b>2018</b>	<b>2017</b>	<b>2018</b>	<b>2017</b>
<i>(Dollar amounts in thousands of U.S. dollars)</i>				
Loss (gain) on currency forward contracts	\$(27)	\$(54)	\$22	\$(115)
Increase over prior period	\$27		\$137	
Increase - percentage	50	%	119	%
Percentage of net revenues	0	%	0	%

As of September 30, 2018, 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 September 2019. The Company recorded a net gain of less than \$0.1 million on the change in fair value of outstanding contracts as well as realized gain on matured contracts, for the three months ended September 30, 2018, as compared to a net gain of \$0.1 million for the change in fair value of outstanding contracts and the settlement of contracts not designated as hedges for the three months ended September 30, 2017.

The Company recorded a net loss of less than \$0.1 million on the change in fair value of outstanding contracts as well as realized gain on matured contracts, compared to a net gain of \$0.1 million for the nine months ended September 30, 2017.



Table of Contents

At September 30, 2018, 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**

<i>(Dollar amounts in thousands of U.S. dollars)</i>	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>September 30, 2018</b>	<b>2017</b>	<b>September 30, 2018</b>	<b>2017</b>
Other income (expense), net	\$ (930)	\$ (707)	\$ (2,580)	\$ (2,191)
Increase over prior period	\$ (223)		\$ (389 )	
Increase - percentage	32 %		18 %	
Percentage of net revenues	1 %	1 %	1 %	1 %

Other expenses during the three months ended September 30, 2018 was \$0.9 million and \$2.6 million for the nine months ended September 30, 2018, as compared to other expense of \$0.7 and \$2.2 million for the three and nine months ended September 30, 2017. Other expense consists primarily of the interest we incur in connection with our 2017 Amended Credit Facility (as discussed below), which was partially offset by income from the amortization of a \$1.5 million Joint Marketing Agreement commencing in November 2015. The interest incurred primarily relates to our loan balances related to the acquisition of eNom and funding for expenditures associated with the Company's Fiber to the Home program.

**INCOME TAXES**

<i>(Dollar amounts in thousands of U.S. dollars)</i>	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>September 30, 2018</b>	<b>2017</b>	<b>September 30, 2018</b>	<b>2017</b>
Provision for income taxes	\$1,370	\$1,823	\$3,781	\$2,781
Increase (decrease) in provision over prior period	\$ (453 )		\$1,000	
Increase (decrease) - percentage	(25 %)		36 %	
Effective tax rate	20 %	35 %	23 %	20 %

For the three months ended September 30, 2018, we recorded an income tax expense of \$1.4 million on income before income taxes of \$6.7 million, using an estimated effective tax rate for Fiscal 2018 adjusted for certain minimum state taxes as well as the inclusion of a \$0.2 million tax recovery related to ASU 2016-09, which requires all excess tax benefits and tax deficiencies related to employee share-based payments to be recognized through income tax expense. Comparatively, for the three months ended September 30, 2017, we recorded an income tax expense of \$1.8 million

on income before taxes of \$5.3 million, using an estimated effective tax rate for the 2017 fiscal year and reflecting the \$0.4 million tax recovery impacted related to ASU 2016-09.

For the nine months ended September 30, 2018, we recorded an income tax expense of \$3.8 million on income before income taxes of \$16.5 million, using an estimated effective tax rate for Fiscal 2018 adjusted for certain minimum state taxes as well as the inclusion of a \$0.5 million tax recovery related to the adoption of ASU 2016-09, which requires all excess tax benefits and tax deficiencies related to employee share-based payments to be recognized through income tax expense on a prospective basis. Comparatively, for the nine months ended September 30, 2017, we recorded an income tax expense of \$2.8 million on income before income taxes of \$13.9 million, using an estimated effective tax rate for Fiscal 2017 adjusted for certain minimum state taxes as well as the inclusion of a \$2.6 million tax recovery related to the adoption of ASU 2016-09.

In assessing the realizability of deferred tax assets, management 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. Management projected future taxable income, uncertainties related to the industry in which the Company operates, and tax planning strategies in making this assessment.

We recognize accrued interest and penalties related to income taxes in income tax expense. We did not have significant interest and penalties accrued at September 30, 2018 and December 31, 2017, respectively.

## **ADJUSTED EBITDA**

We believe that the provision of this supplemental non-GAAP measure allows investors to evaluate the operational and financial performance of our core business using similar evaluation measures to those used by management. We use adjusted EBITDA to measure our performance and prepare our budgets. Because adjusted EBITDA is a non-GAAP financial performance measure, our calculation of adjusted EBITDA may not be comparable to other similarly titled measures of other companies; and should not be considered in isolation, as a substitute for, or superior to measures of financial performance prepared in accordance with GAAP. Because adjusted EBITDA is calculated before recurring cash charges, including interest expense and taxes, and is not adjusted for capital expenditures or other recurring cash requirements of the business, it should not be considered as a liquidity measure. See the Consolidated Statements of Cash Flows included in the attached financial statements. Non-GAAP financial measures do not reflect a comprehensive system of accounting and may differ from non-GAAP financial measures with the same or similar captions that are used by other companies and/or analysts and may differ from period to period. We endeavor to compensate for these limitations by providing the relevant disclosure of the items excluded in the calculation of adjusted EBITDA to net income based on U.S. GAAP, which should be considered when evaluating the Company's results. Tucows strongly encourages investors to review its financial information in its entirety and not to rely on a single financial measure.



Table of Contents

Our adjusted EBITDA definition excludes depreciation, amortization of intangible assets, income tax provision, interest expense (net), stock-based compensation, asset impairment, gains and losses from unrealized foreign currency transactions and infrequently occurring items. Gains and losses from unrealized foreign currency transactions removes the unrealized effect of the change in the mark-to-market values on outstanding unhedged foreign currency contracts, as well as the unrealized effect from the translation of monetary accounts denominated in non-U.S. dollars to U.S. dollars.

The following table reconciles net income to adjusted EBITDA (*Dollar amounts in thousands of U.S. dollars*):

**Reconciliation of Net income to Adjusted EBITDA**  
**(In Thousands of US Dollars)**  
**(unaudited)**

	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2018</b>	<b>2017</b>	<b>2018</b>	<b>2017</b>
	<b>(unaudited)</b>	<b>(unaudited)</b>	<b>(unaudited)</b>	<b>(unaudited)</b>
<b>Net income for the period</b>	\$5,346	\$ 3,440	12,698	\$ 11,128
Depreciation of property and equipment	1,445	978	4,007	2,614
Amortization of intangible assets	2,296	2,245	6,953	6,070
Impairment of intangible assets	-	2	-	2
Interest expense, net	914	864	2,761	2,703
Provision for income taxes	1,370	1,823	3,781	2,781
Stock-based compensation	711	203	1,904	834
Unrealized loss (gain) on change in fair value of forward contracts	(35 )	1	7	(37 )
Unrealized loss (gain) on foreign exchange revaluation of foreign denominated monetary assets and liabilities	(269 )	(427 )	191	(761 )
Acquisition and other costs <sup>1</sup>	80	239	1,123	748
<b>Adjusted EBITDA</b>	<b>\$11,858</b>	<b>\$ 9,368</b>	<b>33,425</b>	<b>\$ 26,082</b>

<sup>1</sup>Acquisition and other costs represents transaction-related expenses, transitional expenses, such as duplicative post-acquisition

expenses,  
 primarily related to  
 our acquisition of  
 eNom in January  
 2017. Expenses  
 include severance  
 or transitional  
 costs associated  
 with department,  
 operational or  
 overall company  
 restructuring  
 efforts, including  
 geographic  
 alignments.

Adjusted EBITDA increased to \$11.9 million in the three months ended September 30, 2018 from \$9.4 million in the three months ended September 30, 2017. The increase in adjusted EBITDA from period-to-period was primarily driven an increased contribution by eNom and growth in Ting Mobile.

Adjusted EBITDA increased to \$33.4 million in the nine months ended September 30, 2018 from \$26.1 million in the nine months ended September 30, 2017. The increase in adjusted EBITDA from period to period was primarily driven by the acquisition of eNom on January 20, 2017, growth in domain services and Ting Mobile offset by the continued investment in the Company's Fiber to the Home program.

#### **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 began applying hedge accounting for the majority of the contracts we need to meet our Canadian dollar requirements on a prospective basis.

The following table presents OCI for the periods presented:

<i>(Dollar amounts in thousands of U.S. dollars)</i>	<b>Three months ended September 30,</b>		<b>Nine months ended September 30,</b>	
	<b>2018</b>	<b>2017</b>	<b>2018</b>	<b>2017*</b>
Other comprehensive income (loss)	\$207	\$ (9 )	\$(36 )	\$ 222
Increase over prior period	\$216		\$(258)	
Increase - percentage	(2,400 %)		(116 %)	

Percentage of net revenues	0	%	(0	%)	(0	%)	0	%
----------------------------	---	---	----	----	----	----	---	---

The impact of the fair value adjustments on outstanding hedged contracts for the three months ended September 30, 2018 was a gain in OCI of \$0.1 million as compared to a gain of \$0.3 million for the three months ended September 30, 2017. The impact of the fair value adjustment on outstanding hedged contracts for the nine months ended September 30, 2018 was a loss of \$0.1 million compared to a gain of \$0.6 million for the nine months ended September 30, 2017.

The net amount reclassified to earnings during the three months ended September 30, 2018 was a loss of \$0.1 million compared to a gain of \$0.3 million during the three months ended September 30, 2017. The net amount reclassified to earnings during the nine months ended September 30, 2018 was a loss of \$0.1 million compared to a gain of \$0.4 million during the nine months ended September 30, 2017.

Table of Contents

**LIQUIDITY AND CAPITAL RESOURCES**

As of September 30, 2018, our cash and cash equivalents balance decreased \$7.3 million when compared to December 31, 2017. Our principal uses of cash were \$15.2 million in loan repayments, \$1.2 million for the remaining 10% interest in Ting Virginia, LLC, \$0.5 million of other costs, including tax payment associated with stock option exercises and continued investment in property and equipment of \$19.4 million. These uses of cash were offset by proceeds from an advances of \$2.5 million from our 2017 Amended Credit Facility (defined below) to fund Fiber to the Home program (“FTTH”) and cash provided by operating activities of \$26.5 million for the nine months ended September 30, 2018.

*2017 Amended Credit Facility*

On January 20, 2017, the Company and certain of its subsidiaries entered into a First Amended and Restated Secured Credit Agreement (the “2017 Amended Credit Agreement”) with Bank of Montreal (“BMO”), Royal Bank of Canada (“RBC”) and Bank of Nova Scotia (the “Lenders”) under which the Company increased its access to funds to an aggregate of \$140 million. The 2017 Amended Credit Agreement amends and restates the Company’s Credit Agreement, dated as of August 18, 2016, with BMO and RBC. The 2017 Amended Credit Agreement, among other things, reduced the existing Tucows non-revolving facility (such existing non-revolving facility, together with other existing facilities, the “Existing Facilities”) from \$40.0 million to \$35.5 million, and established a new non-revolving credit facility of \$85 million (the “New Facility”), and together with the Existing Facilities, the “2017 Amended Credit Facility”). The obligations of the Company under the 2017 Amended Credit Agreement are secured by a first priority lien on substantially all of the personal property and assets of the Company.

Borrowings under the 2017 Amended Credit Agreement accrue interest and standby fees at variable rates based on borrowing elections by the Company and the Company’s total funded debt to EBITDA as described as described more fully in note 7 – Loan payable of the unaudited Consolidated Financial Statements of the Company in Part I, Item 1 in this Quarterly Report on Form 10-Q.

The 2017 Amended Credit Agreement. includes an additional repayment mechanism that is triggered based on the Company’s total funded debt to EBITDA calculation at the end of each fiscal year. If total funded debt to EBITDA exceeds 2.25:1 at December 31 of each year during the term, the Company is obligated to make a repayment of 50% of excess cash flow, all as set forth in the 2017 Amended Credit Agreement.

The 2017 Amended Credit Agreement 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 September 30, 2018, we were in compliance with all our covenants.

For more information on the 2017 Amended Credit Agreement, see note 7 – Loan payable to the Consolidated Financial Statements of the Company in Part I, Item 1 in this Quarterly Report on Form 10-Q.

*Other Credit Facilities*

In addition to the 2017 Amended Credit Agreement, the company is party to a Loan Agreement with BMO, as amended from time to time, most recently in June 2017 (the “2012 Amended Credit Agreement”), pursuant to which the Company currently maintains a treasury risk management facility and credit card facility.

The treasury risk management facility under the 2012 Amended Credit Agreement 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 2012 Amended Credit Agreement, the Company may enter into such agreements at market rates with terms not to exceed 18 months. As of September 30, 2018, the Company held contracts in the amount of \$10.7 million to trade U.S. dollars in exchange for Canadian dollars.

In the fourth quarter of 2017, the Company entered into a corporate credit card program with the Bank of Nova Scotia and the remaining Lenders. The program provides that BMO and the Bank of Nova Scotia may establish corporate credit card facilities with the Company in an amount of up to \$5 million.



Table of Contents

***Cash Flow from Operating Activities***

Net cash provided by operating activities during the nine months ended September 30, 2018 was \$26.5 million, as compared to \$17.8 million during the nine months ended September 30, 2017.

Net income, after adjusting for non-cash charges, during the nine months ended September 30, 2018 was \$24.3 million. Net income included non-cash charges and recoveries of \$11.6 million such as depreciation, amortization, stock-based compensation, excess tax benefits on stock-based compensation, other income, unrealized gains on currency forward contracts, and disposal of domain names. In addition, changes in our working capital provided \$2.2 million. Positive contributions of \$18.4 million from movements in domain registry fees, accounts receivable, accounts payable, accrued liabilities, and income taxes recoverable were offset by \$16.2 million utilized in changes from prepaid expenses, inventory, customer deposits, accreditation fees payable and deferred revenue.

***Cash Flow from Financing Activities***

Net cash outflows from financing activities during the nine months ended September 30, 2018 totaled \$13.1 million as compared to cash inflows of \$69.7 million during the nine months ended September 30, 2017. Cash outflows of \$15.3 million related to principal repayments and loan costs relating to our 2017 Amended Credit Facility and a \$0.3 million outflow from the net impact of exercise of stock options, offset by cash inflows of \$2.5 million from advances from our 2017 Amended Credit Facility. During the nine months ended September 30, 2017, the net cash inflow of \$69.7 million was primarily related to the \$87.0 million draw on the 2017 Amended Credit Facility to fund the acquisition of eNom and to fund FTTH capital expenditures, offset by \$17.3 million in loan principal and cost payments as well as tax obligations related to the net exercise of stock options.

***Cash Flow from Investing Activities***

Investing activities during the nine months ended September 30, 2018 used net cash of \$20.8 million as compared to using \$90.1 million during the nine months ended September 30, 2017.

On February 14, 2018, the Company acquired the remaining 10% interest in Ting Virginia, LLC. for a consideration of \$1.2 million. The consideration was funded through cash flow from operations. For additional details, see note Acquisitions to the interim unaudited financial statements of the Company in Part I, Item 1 in this Quarterly Report on Form 10-Q.

In addition, the Company invested \$19.4 million in property and equipment, primarily to support the continued expansion of our fiber footprint. The Company continues to invest in our existing Ting Towns of Charlottesville, VA, Holly Springs, NC and Westminster, MD as well as ramping construction in Sandpoint, ID and Centennial, CO, as we seek to extend both our current network and expand to new towns. We expect our capital expenditures on building and expanding our fiber network to increase significantly during Fiscal 2018.

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 or need 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.

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

### **Off-Balance Sheet Arrangements**

As of September 30, 2018, we did not have any off-balance sheet arrangements, as defined in Item 303(a)(4)(ii) of SEC Regulation S-K.

### **Contractual Obligations**

In our Annual Report on Form 10-K for the year ended December 31, 2017, we disclosed our contractual obligations.

As of September 30, 2018, there have been no other material changes to those contractual obligations outside the ordinary course of business.



Table of Contents**Item 3. Quantitative and Qualitative Disclosures about Market Risk**

We develop products in Canada and sell these services in North America and Europe. Our sales are primarily made in U.S. dollars, while a major portion of expenses are incurred in Canadian dollars. Our financial results could be affected by factors such as changes in foreign currency exchange rates or weak economic conditions in foreign markets. Our interest income is sensitive to changes in the general level of Canadian and U.S. interest rates, particularly since the majority of our investments are in short-term instruments. Based on the nature of our short-term investments, we have concluded that there is no material interest rate risk exposure as of September 30, 2018. We are also subject to market risk exposure related to changes in interest rates under our 2017 Amended Credit Facility. We do not expect that any changes in interest rates will be material during fiscal 2018; however, fluctuations in interest rates are beyond our control. We will continue to monitor and assess the risks associated with interest expense exposure and may take additional actions in the future to mitigate these risks.

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

At September 30, 2018, we had the following outstanding forward exchange contracts to trade U.S. dollars in exchange for Canadian dollars:

Maturity date (Dollar amounts in thousands of U.S. dollars)	Notional amount of U.S. dollars	Weighted average exchange rate	Fair value
		of U.S. dollars	
October - December 2018	6,049	1.2802	(50 )
January - March 2019	1,639	1.2852	(4 )
April - June 2019	1,599	1.2831	(4 )
July - September 2019	1,444	1.2809	(4 )
	\$ 10,731	1.2815	\$ (62 )

As of September 30, 2018, the Company had \$10.7 million of outstanding foreign exchange forward contracts which will convert to CDN \$13.8 million. Of these contracts, \$9.5 million met the requirements for hedge accounting (December 31, 2017 - the Company held nil contracts to trade U.S. dollars in exchange for Canadian dollars.

We have performed a sensitivity analysis model for foreign exchange exposure over the three months ended September 30, 2018. The analysis used a modeling technique that compares the U.S. dollar equivalent of all expenses incurred in Canadian dollars, at the actual exchange rate, to a hypothetical 10% adverse movement in the foreign currency exchange rates against the U.S. dollar, with all other variables held constant. Foreign currency exchange rates used were based on the market rates in effect during the three months ended September 30, 2018. The sensitivity analysis indicated that a hypothetical 10% adverse movement in foreign currency exchange rates would result in a decrease in net income for the three months ended September 30, 2018 of approximately \$0.8 million, before the effects of hedging. 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. Similarly, we enter into our foreign exchange contracts with major banks and financial institutions. 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.

### **Interest rate risk**

Our exposure to interest rate fluctuations relate primarily to our 2017 Amended Credit Facility.

As of September 30, 2018, we had an outstanding balance of \$65.0 million on the 2017 Amended Credit Facility. The 2017 Amended Credit Facility bears a base interest rate based on borrowing elections by the Company and the Company's total Funded Debt to EBITDA plus LIBOR. As of September 30, 2018, an adverse change of one percent on the interest rate would have the effect of increasing our annual interest payment on 2017 Amended Credit Facility by approximately \$0.7 million, assuming that the loan balance as of September 30, 2018 is outstanding for the entire period.

Table of Contents

**Item 4. Controls and Procedures**

(a) Evaluation of Disclosure Controls and Procedures

As required by Rule 13a-15(b) of the Securities Exchange Act of 1934 (the “Exchange Act”), management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated, as of the end of the period covered by this report, the effectiveness of our disclosure controls and procedures as defined in Exchange Act Rule 13a-15(e). Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives, and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Our disclosure controls and procedures are designed to provide reasonable assurance of achieving their control objectives. Based on the evaluation of our disclosure controls and procedures as of the end of the period covered by this annual report, our Chief Executive Officer and Chief Financial Officer concluded that, as of September 30, 2018 our disclosure controls and procedures were effective at the reasonable assurance level.

(b) Changes in Internal Control over Financial Reporting

The adoption of ASU 2014-09 did not require any material changes in our internal control over financial reporting. There were no other changes made in our internal controls over financial reporting during the nine months ended September 30, 2018 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

**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.

On August 30, 2017, Namecheap, Inc. (“Namecheap”) filed a complaint against the Company, eNom, Inc., and unknown John Does in the United States District Court for the Western District of Washington alleging breach of contract, breach of the implied duty of good faith and fair dealing, and unjust enrichment (the “Namecheap Federal Action”). On September 6, 2018, Tucows and Namecheap entered into a settlement agreement, pursuant to which the matter was amicably resolved, and the case dismissed. Namecheap has provided Tucows an administrative fee for services in connection with transferring its domain names off Tucows’ platform.

**Item 1A. Risk Factors**

In addition to the risk factor and 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, 2017, 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 this Quarterly Report and in our Annual Report on Form 10-K are not the only risks facing the Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may adversely affect our business, financial condition or operating results.

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

On March 1, 2017, The Company announced that its Board of Directors had approved a stock buyback program to repurchase up to \$40 million of its common stock in the open market. Purchases were to be made exclusively through the facilities of the NASDAQ Capital Market. The stock buyback program commenced on March 1, 2017 and terminated on February 14, 2018. During the nine months ended September 30, 2018, the Company did not

repurchase any shares under this program.

On February 14, 2018, the Company announced that its Board of Directors has approved a stock buyback program to repurchase up to \$40 million of its common stock in the open market. Purchases will be made exclusively through the facilities of the NASDAQ Capital Market. The stock buyback program commenced on February 14, 2018 and will terminate on or before February 13, 2019. During the nine months ended September 30, 2018, the Company did not repurchase any shares under this program.

### **Item 3. Defaults Upon Senior Securities**

None.

### **Item 4. Mine Safety Disclosures**

Not applicable.

### **Item 5. Other Information**

None.



Table of Contents

**Item 6. Exhibits**

(a) Exhibits.

**Exhibit**

<b>No.</b>	<b>Description</b>
3.1.1	<u>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).</u>
3.1.2	<u>Articles of Amendment to 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 January 3, 2014).</u>
3.2	<u>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).</u>
3.3	<u>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 quarter ended June 30, 2012).</u>
31.1	<u>Chief Executive Officer's Rule 13a-14(a)/15d-14(a) Certification *</u>
31.2	<u>Chief Financial Officer's Rule 13a-14(a)/15d-14(a) Certification *</u>
32.1	<u>Chief Executive Officer's Section 1350 Certification †</u>
32.2	<u>Chief Financial Officer's Section 1350 Certification †</u>
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 *

\* Filed herewith.

† Furnished herewith.

Table of Contents

**SIGNATURES**

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

Date: November 6, 2018 TUCOWS INC.

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

By:/s/ DAVINDER SINGH  
Davinder Singh  
  
Chief Financial Officer  
(Principal Financial and Accounting Officer)

Table of Contents

**EXHIBIT INDEX**

<b>Exhibit No.</b>	<b>Description</b>
3.1.1	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).
3.1.2	Articles of Amendment to 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 January 3, 2014).
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 quarter 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 *

\* Filed herewith.

† Furnished herewith.