

TUCOWS INC /PA/  
Form 10-K  
March 15, 2013

---

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-K  
FOR ANNUAL AND TRANSITION REPORTS PURSUANT TO  
SECTIONS 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934  
For the fiscal year ended December 31, 2012  
OR

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

Commission file number 001-32600

Tucows Inc.

(Exact Name of Registrant as Specified in Its Charter)

Pennsylvania

23-2707366

(State or Other Jurisdiction of Incorporation or  
Organization)

(I.R.S. Employer Identification No.)

96 Mowat Avenue

Toronto, Ontario, Canada

M6K 3M1

(Address of Principal Executive Offices)

(Zip Code)

Registrant's telephone number, including area code: (416) 535-0123

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class  
Common stock, no par value

Name of Each Exchange on Which Registered  
NYSE Amex

Securities registered pursuant to Section 12(g) of the Act:

(Title of Class)

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  
Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.  
Yes  No

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer <input type="checkbox"/>	Accelerated filer <input type="checkbox"/>	Non-accelerated filer <input type="checkbox"/> (Do not check if a smaller reporting company)	Smaller reporting company <input checked="" type="checkbox"/>
---	--	--	--

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

As of June 30, 2012 (the last day of our most recently completed second quarter), the aggregate market value of the common stock held by non-affiliates of the registrant was \$43.7 million. Such aggregate market value was computed by reference to the closing sale price per share of \$1.10 as reported on the NYSE Amex on such date. For purposes of making this calculation only, the registrant has defined affiliates as including all officers, directors and beneficial owners of more than ten percent of the common stock of the Company. In making such calculation, the registrant is not making a determination of the affiliate or non-affiliate status of any holders of shares of the registrant's common stock.

The number of shares outstanding of the registrant's common stock as of March 12, 2013 was 40,189,977.

#### TRADEMARKS, TRADE NAMES AND SERVICE MARKS

Tucows®, Butterscotch®, EPAG®, Hover®, OpenSRS®, Platypus®, Ting® 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 Annual Report on Form 10-K (this "Annual Report"). All other service marks, trademarks and trade names referred to in this Annual Report are the property of their respective owners. Solely for convenience, any trademarks referred to in this Annual 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.

TUCOWS INC.  
ANNUAL REPORT ON FORM 10-K  
For Fiscal Year Ended December 31, 2012

TABLE OF CONTENTS

		Page
<b>PART I</b>		
Item 1	Business	1
Item 1A	Risk Factors	7
Item 2	Properties	27
Item 3	Legal Proceedings	27
Item 4	Mine Safety Disclosures	27
<b>PART II</b>		
Item 5	Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities	28
Item 7	Management’s Discussion and Analysis of Financial Condition and Results of Operations	30
Item 7A	Quantitative and Qualitative Disclosures About Market Risk	54
Item 8	Financial Statements and Supplementary Data	55
Item 9	Changes in and Disagreements With Accountants on Accounting and Financial Disclosure	55
Item 9A	Controls and Procedures	55
Item 9B	Other Information	55
<b>PART III</b>		
Item 10	Directors, Executive Officers and Corporate Governance	56
Item 11	Executive Compensation	63
Item 12	Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	68
Item 13	Certain Relationships and Related Transactions, and Director Independence	70
Item 14	Principal Accountant Fees and Services	70
<b>PART IV</b>		
Item 15	Exhibits and Financial Statement Schedules	73

Information Concerning Forward-Looking Statements

This Annual Report on Form 10-K 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,” similar expressions are intended to identify forward-looking statements. The forward-looking statements contained in this report include statements regarding, among other things, the number of new, renewed and transferred-in domain names, the competition we expect to encounter as our business develops and competes in a broad range of Internet services, the effectiveness of our intellectual property protection, including our ability to license proprietary rights to network partners and to register additional trademarks and service marks, our belief that the market for domain name registration will trend upward gradually, our belief that it is more likely than not that net deferred assets will be realized; our intent to continue acquisitions of previously owned domain names, the effect of the anticipated generic top-level domain (“gTLD”) expansion by the Internet Corporation for Assigned Names and Numbers (“ICANN”) on the number of domains we register and related revenues; the impact on operations and risks relating to our potential participation in ICANN’s new gTLD program; our expectations regarding increases in certain costs and expenses; judgments and assessments regarding the collection of receivables; and our belief that, by increasing the number of applications and services we offer, we will be able to generate higher revenues. These statements are based on management’s current expectations and are subject to a number of uncertainties and risks that could cause actual results to differ materially from those described in the forward-looking statements. Many factors affect our ability to achieve our objectives and to successfully develop and commercialize our services including:

- Our ability to continue to generate sufficient working capital to meet our operating requirements;
- Our ability to maintain a good working relationship with our vendors and customers;
- The ability of vendors to continue to supply our needs;
- Actions by our competitors;
- Our ability to achieve gross profit margins at which we can be profitable;
- Our ability to attract and retain qualified personnel in our business;
- Our ability to effectively manage our business;
- Our ability to obtain and maintain approvals from regulatory authorities on regulatory issues;
- Our ability to develop and commercialize new services such as Ting while maintaining development and sales of our established services;
- Pending or new litigation; and
- Factors set forth herein under the caption “Item 1A Risk Factors”.

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. These statements are not guarantees of future performance.

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

## PART I

### ITEM 1. BUSINESS

#### 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 acquire, deliver or use Internet services such as domain name registration, email and other Internet services.

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

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

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

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

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

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

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

## Net Revenues

### Wholesale - OpenSRS Domain Service

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

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

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

### Wholesale – OpenSRS Value-Added Services

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

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

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

### Retail – Hover

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



Retail - Ting

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

2

---

## Portfolio

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

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

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

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

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

## Intellectual Property

We believe that we are well positioned in the wholesale domain registration and email markets due in part to our highly-recognized “Tu cows” and “OpenSRS” brands and the respect they confer on us as a defender of end-user rights and reseller friendly approaches to doing business. We were among the first group of 34 registrars to be accredited by ICANN in 1999, and we remain active in Internet governance issues.

Our success and ability to compete depend on our ability to develop and maintain the proprietary aspects of our brand name and technology. We rely on a combination of trademark, trade secret and copyright laws, as well as contractual restrictions to protect our intellectual property rights.

We have registered the Tu cows trademark in the United States, Canada and the European Union and we register additional service marks and trademarks as appropriate and where such protection is available.

We seek to limit disclosure of our intellectual property by requiring all employees and consultants with access to our proprietary information to commit to confidentiality, non-disclosure and work-for-hire agreements. All of our employees are required to sign confidentiality and non-use agreements, which provide that any rights they may have in copyrightable works or patentable technologies accrue to us. Before entering into discussions with potential vendors and partners about our business and technologies, we require them to enter into a non-disclosure agreement. If these discussions result in a license or other business relationship, we also generally require that the agreement containing the parties' rights and obligations include provisions for the protection of its intellectual property rights.

## Customers

The majority of the customers to whom we provide Reseller Services are generally either web hosts or ISPs. A small number are consultants and designers providing our services to their business clients. Our Retail Services customers are a very broad mix of consumers, small businesses and corporations.

No customer represented more than 10% of our consolidated revenues in any of the last three fiscal years.

While web hosts and ISPs are capitalizing on the growth in Internet usage and the demand for new services, they also face significant competition from numerous other service providers with competitive or comparable offerings. This has led such web hosts and ISPs to focus on core competencies, as such resellers are increasingly seeking to outsource non-core services. Outsourcing enables these resellers to better focus on customer acquisition and retention efforts by eliminating the need to own, develop and support non-core applications in-house.

## Seasonality

During the summer months and certain other times of the year, such as major holidays, Internet usage often declines. As a result, many of our services (OpenSRS, Hover and Butterscotch) may experience reduced demand during these times.

For example, our experience shows that new domain registrations and traffic on our download site decline during the summer months and around the year-end holidays. Seasonality may also affect advertising, which may have a slight impact on both the content group and the domain name portfolio's advertisement-based revenue. These seasonal effects could cause fluctuations in our financial results as well as the content site's performance statistics reported and measured by leading Internet audience measurement services such as comScore.

## Competition

Our competition may be divided into the following groups:

- Retail-oriented domain registrars, such as GoDaddy and Web.com through its acquisition of Network Solutions and Register.com, who compete with our Resellers and our own retail operations for end-users.
- Wholesale-oriented domain registrars, such as Demand Media through its acquisition of eNom, Wild West Domains (a division of GoDaddy) and Melbourne IT, who market services to resellers such as our customers.
- Wholesale Email Service providers, such as Google, Yahoo!, Microsoft, Bluetie and MailTrust.
- Ad-supported content providers, such as CNET's Download.com.

We expect to continue to experience significant competition from the competitors identified above and, as our business continues to develop, we expect to encounter competition from other providers of Internet services. Service providers, Internet portals, web hosting companies, email hosting companies, outsourced application companies, country code registries and major telecommunication firms may broaden their services to include services we offer.

We believe the primary competitive factors in our Reseller Services are:

- Providing superior customer service by anticipating the technical requirements and business objectives of resellers and providing them with technical advice to help them understand how our services can be customized to meet their particular needs.
- Providing cost savings over in-house solutions by relieving resellers of the expense of acquiring and maintaining hardware and software and the associated administrative burden.
- Enabling resellers to better manage their relationships with their end-users.
- Facilitating scalability through an infrastructure designed to support millions of transactions across millions of end-users.
- Providing superior technology and infrastructure, consisting of industry-leading software and hardware that allow resellers to provide these services to their customers without having to make substantial investments in their own software or hardware.

Although we encounter pricing pressure in many markets in which we compete, we believe the effects of that pressure are mitigated by the fact that we deliver a high degree of value to our resellers through our business and technical practices. We believe our status as a trusted supplier also allows us to mitigate the effects of this type of competition. We believe that the long-term relationships we have made with many resellers results in a sense of certainty that would not be available to those resellers through a competitor.

#### Employees

As of December 31, 2012, we had approximately 175 full-time employees. None of our employees are currently represented by a labor union. We consider our relations with our employees to be good.

#### Corporate Information

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

#### Executive Officers of the Registrant

The following table sets forth the names, ages and titles of persons currently serving as our executive officers.

Name	Age	Title
Elliot Noss	51	President and Chief Executive Officer
Michael Cooperman	62	Chief Financial Officer
David Woroch	51	Executive Vice President, Sales and Support

Elliot Noss has served as our President and Chief Executive Officer since May 1999 and served as Vice President of Corporate Services for Tucows Interactive Limited, which was acquired by Tucows in May 1999, from April 1997 to May 1999.

Michael Cooperman has served as our Chief Financial Officer since January 2000. From October 1997 to September 1999, Mr. Cooperman was the Chief Executive Officer of Archer Enterprise Systems Inc., a developer of sales force automation software.

David Woroch has served as our Executive Vice President, Sales and Support since June 3, 2009 and served as our Vice President Sales and Support since July 2001. From March 2000 to July 2001, Mr. Woroch served as our Director of Sales for North America. Before joining us, Mr. Woroch spent 13 years at IBM Canada in a variety of roles including sales, marketing, finance and strategic planning.

#### Investor Information

The public may read and copy any materials we file with the Securities and Exchange Commission, or SEC, at the SEC's Public Reference Room at 100 F Street, NE, Washington, DC 20549 on official business days during the hours of 10:00 am to 3:00 pm. The public may obtain information on the operation of the Public Reference Room by calling 1-800-SEC-0330. The SEC maintains an Internet site that contains reports, proxy and information statements and

other information regarding issuers that file electronically at <http://sec.gov>.

Our web site address is [turowsinc.com](http://turowsinc.com). We make available through our web site, free of charge, copies of our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 as soon as reasonably practicable after filing such material electronically or otherwise furnishing it to the SEC.

The information on the web site listed above is not and should not be considered part of this Annual Report on Form 10-K and is not incorporated by reference in this document.

We were incorporated in the Commonwealth of Pennsylvania in November 1992. Our executive offices are located at 96 Mowat Avenue, Toronto, Ontario, Canada M6K 3M1. Our telephone number is (416) 535-0123.



## ITEM 1A. RISK FACTORS

Our business faces significant risks. Some of the following risks relate principally to our business and the industry and statutory and regulatory environment in which we operate. Other risks relate principally to the securities markets and ownership of our stock. The risks described below may not be the only risks we face. Additional risks that we do not yet know of or that we currently think are immaterial may also impair our business operations. If any of the events or circumstances described in the following risk factors actually occur, our business, financial condition or results of operations could suffer, and the trading price of our common stock could decline.

### Risks Related to Our Business and Industry

We may not be able to maintain or improve our competitive position and may be forced to reduce our prices because of strong competition in the market for Internet services generally and domain name registration, in particular, which we expect will continue to intensify.

The market for Internet services generally and domain registrations in particular is intensely competitive and rapidly evolving as participants strive to protect their current market share and improve their competitive position, and we expect competition to intensify in the future. Most of our existing competitors are also expanding the variety of services that they offer. These competitors include, among others, domain name registrars, website design firms, website hosting companies, Internet service providers, Internet portals and search engine companies, including Google, Microsoft, Network Solutions, VeriSign and Yahoo!. Competitors like Microsoft, Google and Yahoo!, as well as other large Internet companies, have the ability to offer these services for free or at a reduced price as part of a bundle with other service offerings. If these companies decide to devote greater resources to the development, promotion and sale of these new products and services, greater numbers of individuals and businesses may choose to use these competitors as their starting point for creating an online presence and as a general platform for running their online business operations. In particular, VeriSign may in the future decide to offer additional services that compete with our domain name registration services or other services. If VeriSign were to become a competitor of ours in our core business areas, VeriSign would likely enjoy a number of competitive advantages, including its position as the largest registry, as well as superior financial and operational resources and customer awareness within our industry.

In addition, other large competitors, in an attempt to gain market share, may also offer aggressive price discounts on the services they offer. These pricing pressures may require us to match these discounts in order to remain competitive, which would reduce our margins, or potentially cause us to lose customers altogether who decide to purchase these discounted services.

We also face significant competition from other existing registrars and the continued introduction of new registrars in the domain registration industry. Currently ICANN has approximately 1,000 registrars who register domain names in one or more of the generic top level domains, or gTLDs, that it oversees. Not all of these accredited registrars, however, are operational. There are relatively few barriers to entry in this market, so as this market continues to develop we expect the number of competitors to increase. The continued entry into the domain registration industry and the rapid growth of some competitive registrars and service providers who have already entered the industry may make it difficult for us to maintain our current market share. As a result, we may not be able to compete effectively.

In addition, we cannot predict the impact on the domain name industry of the anticipated introduction of new gTLDs by ICANN. If we do not properly manage our response to any resulting changes in the business environment, it could adversely impact our competitive position or market share.

As our business model is premised upon selling multiple services through our resellers, we have competed aggressively to attract new clients and retain existing customers. As a result of these actions, our average selling prices

have fallen and we may be required, by marketplace factors or otherwise, to reduce, perhaps significantly, the prices we charge for our domain registration and related products and services. The decline in our average selling price has partially offset the impact of increased transaction volume on our revenue and profitability. The likelihood of further declines in our selling price will increase if our competitors who charge these reduced fees are able to maintain customer service comparable to ours. We may face continued pricing pressure in order to remain competitive, which would adversely impact our revenues and profitability. While we anticipate that the number of new, renewed and transferred-in domain registrations will incrementally increase, volatility in the market could result in our customers turning to other registrars, thereby impairing growth in the number of domains under our management and our ability to sell multiple services to such customers. Since our strategy is to expand the services we provide our customers, if we are unable to maintain our domain registrations, our ability to expand our business may be adversely effected.

Each registry and the ICANN regulatory body impose a charge upon the registrar for the administration of each domain registration. If these fees increase, this may have a significant impact upon our operating results.

Each registry typically imposes a fee in association with the registration of each domain. For example, Verisign, the registry for .com, presently charges a \$7.85 fee for each .com registration and ICANN currently charges a \$0.18 fee for each .com domain name registered in the generic top level domains, or gTLDs, that fall within its purview. We have no control over these agencies and cannot predict when they may increase their respective fees. In terms of the current registry agreement between ICANN and Verisign that was approved by the U.S. Department of Commerce in November 2012, VeriSign will continue as the exclusive registry for the .com gTLD until November 2018. In terms of our pricing policy, any fee increases by ICANN or any registry will be passed through to our resellers, while other registrars may choose to absorb them. If such cost increases act as a deterrent to registration, we may find that our profits are adversely impacted by these third-party fees.

We rely on our network of resellers to renew their domain registrations through us and to distribute our services, and if we are unable to maintain these relationships or establish new relationships, our revenues will decline.

The growth of our business depends on, among other things, our resellers' renewal of their customers' domain registrations through us. Resellers may choose to renew their domains with other registrars or their registrants may choose not to renew and pay for renewal of their domains. This may reduce our resellers' number of domain name registration customers which in turn would drive up their customer acquisition costs and harm our operating results. If resellers decide, for any reason, not to renew their registrations through us, it may in turn reduce the market to which our resellers could market our other higher-margin services, thereby further impacting our revenue and profitability and harming our operating results.

We believe that companies operating on the Internet are facing a period of consolidation. In addition, some of our resellers may decide to seek ICANN accreditation. Both of these situations could reduce the number of our active resellers, in which case our revenues may suffer.

If any of our competitors merge with one another, they will present a stronger combined force in the market and may attract the business of both existing and prospective resellers. Resellers may opt to build their own technical systems and seek ICANN accreditation in order that they may process domain applications themselves. If a number of our customers decide to pursue this option, our sales will decrease.

Our failure to secure agreements with country code registries or our subsequent failure to comply with the regulations of the country code registries could cause customers to seek a registrar that offers these services.

The country code top-level domain, or ccTLD, registries require registrars to comply with specific regulations. Many of these regulations vary from ccTLD to ccTLD. If we fail to comply with the regulations imposed by ccTLD registries, these registries will likely prohibit us from registering or continuing to register domains in their ccTLD. Any failure on our part to offer domain registrations in a significant number of ccTLDs or in a popular ccTLD would cause us to lose a competitive advantage and could cause resellers to elect to take their business to a registrar that does offer these services.

Our standard agreements may not be enforceable, which could subject us to liability.

We operate on a global basis and all of our resellers must execute our standard agreements that govern the terms of the services we provide to our customers. These agreements contain provisions intended to limit our potential liability arising from the provision of services to our resellers and their customers, including liability resulting from our failure to register or maintain domains properly, from downtime or poor performance with respect to our Internet services, or

for insecure or fraudulent transactions pursuant to which we have issued SSL certificates. As most of our customers purchase our services online, execution of our agreements by resellers occurs electronically or, in the case of our terms of use, is deemed to occur because of a user's continued use of the website following notice of those terms. We believe that our reliance on these agreements is consistent with the practices in our industry, but if a domestic, foreign or international court were to find that either one of these methods of execution is invalid or that key provisions of our services agreements are unenforceable, we could be subject to liability that has a material adverse effect on our business or we could be required to change our business practices in a way that increases our cost of doing business.

Regulation could reduce the value of Internet domain names or negatively impact the Internet domain acquisition process, which could significantly impair the value attributable to our acquisitions of Internet domain names.

The acquisition of expiring domain names for parked page commercialization, the sale of names or acquisition of names for other uses involves the registration of thousands of Internet domain names, both in the United States and internationally. We have and intend to continue to acquire previously-owned Internet domain names that have expired and have, following the period of permitted reclamation by their prior owners, been made available for sale. The acquisition of Internet domain names generally is governed by federal or international regulatory bodies. The regulation of Internet domain names in the United States and in foreign countries is subject to change. Regulatory bodies could establish additional requirements for previously-owned Internet domain names or modify the requirements for holding Internet domain names. As a result, we might not acquire or maintain names that contribute to our financial results in the same manner as we currently do. Because certain Internet domain names are important assets, a failure to acquire or maintain such Internet domain names could adversely affect our financial results and our growth. Any impairment in the value of these important assets could cause our stock price to decline.

We have presence in the hosted messaging and email market, which is a volatile business.

Factors that are likely to contribute to fluctuations in our operating results from provisioning hosted email services include:

- the demand for outsourced email services;
- our ability to attract and retain customers and provide customer satisfaction;
- the ability to upgrade, develop and maintain our systems and infrastructure and to effectively respond to the rapid technological changes in the email market;
- the budgeting and payment cycles of our existing and potential customers;
- the amount and timing of operating costs and capital expenditures relating to expansion of the email service; and
- the introduction of new or enhanced services by competitors.

In order to succeed in the hosted email business, our email product must remain competitive. We believe that some of the competitive factors affecting the market for hosted email services include:

- breadth of platform features and functionality of our offering and the sophistication and innovation of our competitors;
- scalability, reliability, performance and ease of expansion and upgrade;
- ease of integration with customers' existing systems; and
- flexibility to enable customers to manage certain aspects of their systems and leverage outsourced services in other cases when resources, costs and time to market reasons favor an outsourced offering.

We believe competition will continue to be strong and further increase as our market attracts new competition, current competitors aggressively pursue customers, increase the sophistication of their offerings and as new participants enter the market. Many of our current and potential competitors have longer operating histories, larger customer bases, greater brand recognition in the business and greater financial, marketing and other resources than we do. Any delay in our development and delivery of new services or enhancement of existing services would allow our competitors additional time to improve their product offerings and provide time for new competition to develop and market messaging services. Increased competition could result in pricing pressures, reduced operating margins and loss of market share, any of which could cause our financial results to decline.

If we are unable to maintain our relationships with our customers our revenue may decline.

Our network of resellers is our principal source for distributing services. We also rely on our resellers to market, promote and sell our services. Our ability to increase revenues in the future will depend significantly on our ability to maintain our reseller network, to sell more services through existing resellers and to develop our relationships with existing resellers by providing customer and sales support and additional products. Resellers have no obligations to distribute our services and may stop doing so at any time. If we are not able to maintain our relationships with resellers, our ability to distribute our services will be harmed, and our revenue may decline.

Disputes over registration of domain names, the activities of our reseller's customers or the content of their websites could subject us to liability and could negatively affect the public's perception of our corporate image.

As a registrar of domain names services, we may be subject to potential liability for illegal activities by our resellers' customers on their websites. We provide an automated service that enables users to register domain names. We do not monitor or review, nor does our accreditation agreement with ICANN require that we monitor or review, the appropriateness of the domain names we register for our customers or the content of their websites, and we have no control over the activities in which these customers engage. While we have policies in place to terminate domain names or to take other action if presented with evidence of illegal conduct, customers could nonetheless engage in prohibited activities without our knowledge.

Several bodies of law may be deemed to apply to us with respect to various customer activities. Because we operate in a relatively new and rapidly evolving industry, and since our industry is characterized by rapid changes in technology and in new and growing illegal activity, these bodies of laws are constantly evolving. Some of the laws that apply to us with respect to certain customer activities include the following:

- The Communications Decency Act of 1996, or CDA, generally protects online service providers, such as Tucows, from liability for certain activities of their customers, such as posting of defamatory or obscene content, unless the online service provider is participating in the unlawful conduct. Notwithstanding the general protections from liability under the CDA, we may nonetheless be forced to defend ourselves from claims of liability covered by the CDA, resulting in an increased cost of doing business.
- The Digital Millennium Copyright Act of 1998, or DMCA, provides recourse for owners of copyrighted material who believe that their rights under U.S. copyright law have been infringed on the Internet. Under this statute, we generally are not liable for infringing content posted by third parties. However, if we receive a proper notice from a copyright owner alleging infringement of its protected works by web pages for which we provide hosting services, and we fail to expeditiously remove or disable access to the allegedly infringing material, fail to post and enforce a digital rights management policy or a policy to terminate accounts of repeat infringers, or otherwise fail to meet the requirements of the safe harbor under the statute, the owner may seek to impose liability on us.

Although established statutory law and case law in these areas to date generally have shielded us from liability for customer activities, court rulings in pending or future litigation may serve to narrow the scope of protection afforded us under these laws. In addition, laws governing these activities are unsettled in many international jurisdictions, or may prove difficult or impossible for us to comply with in some international jurisdictions. Also, notwithstanding the exculpatory language of these bodies of law, we may be embroiled in complaints and lawsuits which, even if ultimately resolved in our favor, add cost to our doing business and may divert management's time and attention.

Finally, other existing bodies of law, including the criminal laws of various states, may be deemed to apply or new statutes or regulations may be adopted in the future, any of which could expose us to further liability and increase our costs of doing business.

Domain name registrars also face potential tort law liability for their role in wrongful transfers of domain names. The safeguards and procedures we have adopted may not be successful in insulating us against liability from such claims in the future. In addition, we face potential liability for other forms of “domain name hijacking,” including misappropriation by third parties of our network of customer domain names and attempts by third parties to operate websites on these domain names or to extort the customer whose domain name and website were misappropriated. Furthermore, our risk of incurring liability for a security breach on a customer website would increase if the security breach were to occur following our sale to a customer of an SSL certificate that proved ineffectual in preventing it. Finally, we are exposed to potential liability as a result of our private domain name registration service, wherein we become the domain name registrant, on a proxy basis, on behalf of our customers. While we have a policy of providing the underlying Whois information and reserve the right to cancel privacy services on domain names giving rise to domain name disputes including when we receive reasonable evidence of an actionable harm, the safeguards we have in place may not be sufficient to avoid liability in the future, which could increase our costs of doing business.



The international nature of our business exposes us to certain business risks that could limit the effectiveness of our growth strategy and cause our results of operations to suffer.

Expansion into international markets is an element of our growth strategy. Introducing and marketing our services internationally, developing direct and indirect international sales and support channels and managing foreign personnel and operations will require significant management attention and financial resources. We face a number of risks associated with expanding our business internationally that could negatively impact our results of operations, including:

- management, communication and integration problems resulting from cultural differences and geographic dispersion;
- compliance with foreign laws, including laws regarding liability of online resellers for activities of customers and more stringent laws in foreign jurisdictions relating to the privacy and protection of third-party data;
- accreditation and other regulatory requirements to provide domain name registration, website hosting and other services in foreign jurisdictions;
- competition from companies with international operations, including large international competitors and entrenched local companies;
- to the extent we choose to make acquisitions to enable our international expansion efforts, the identification of suitable acquisition targets in the markets into which we want to expand;
- difficulties in protecting intellectual property rights in international jurisdictions;
- political and economic instability in some international markets;
- sufficiency of qualified labor pools in various international markets;
- currency fluctuations and exchange rates;
- potentially adverse tax consequences or an inability to realize tax benefits; and
- the lower level of adoption of the Internet in many international markets.

We may not succeed in our efforts to expand our international presence as a result of the factors described above or other factors that may have an adverse impact on our overall financial condition and results of operations.

We currently license many third party technologies and may need to license further technologies which could delay and increase the cost of product and service developments.

We currently license certain technologies from third parties and incorporate them into certain of our services including email, anti-spam and anti-virus. The Internet services market is evolving and we may need to license additional technologies to remain competitive. We may not be able to license these technologies on commercially reasonable terms or at all. To the extent we cannot license necessary solutions, we may have to devote our resources to development of such technologies, which could delay and increase the cost of product and service developments

overall.

In addition, we may fail to successfully integrate licensed technology into our services. These third party licenses may expose us to increased risks, including risks related to the integration of new technology and potential intellectual property infringement claims. In addition, an inability to obtain needed licenses could delay product and service development until equivalent technology can be identified, licensed and integrated. Any delays in services or integration problems could hinder our ability to attract and retain customers and cause our business and operating results to suffer.

11

---

Our advertising revenues may be subject to fluctuations.

We believe that Internet advertising spending, as in traditional media, fluctuates significantly with economic cycles and during any calendar year, with spending being weighted towards the end of the year to reflect trends in the retail industry. Our advertisers can generally terminate their contracts with us at any time. Advertising spending is particularly sensitive to changes in general economic conditions and typically decreases when economic conditions are not favorable. A decrease in demand for Internet advertising could have a material adverse effect on our business, financial condition and results of operations.

We may acquire companies or make investments in, or enter into licensing arrangements with, other companies with technologies that are complementary to our business and these acquisitions or arrangements could disrupt our business, cause us to require additional financing and dilute your holdings in our company.

We may acquire companies, assets or the rights to technologies in the future in order to develop new services or enhance existing services, to enhance our operating infrastructure, to fund expansion, to respond to competitive pressures or to acquire complementary businesses. Entering into these types of arrangements entails many risks, any of which could materially harm our business, including:

- the diversion of management's attention from other business concerns;
- the failure to effectively integrate the acquired technology or company into our business;
- the incurring of significant acquisition costs;
- the loss of key employees from either our current business or the acquired business;  
and
- the assumption of significant liabilities of the acquired company.

In addition, absent sufficient cash flows from operations, we may need to engage in equity or debt financings to secure additional funds to meet our operating and capital needs. We may not be able to secure additional debt or equity financing on favorable terms, or at all, at the time when we need that funding. In addition, even though we may have sufficient cash flow, we may still elect to sell additional equity or debt securities or obtain credit facilities for other reasons. If we raise additional funds through further issuances of equity or convertible debt securities, our existing shareholders could suffer significant dilution in their percentage ownership of our company, and any new equity securities we issue could have rights, preferences and privileges senior to those of holders of our common stock. Any debt financing secured by us in the future could involve restrictive covenants relating to our capital raising activities and other financial and operational matters, which might make it more difficult for us to obtain additional capital, to pay dividends and to pursue business opportunities, including potential acquisitions. In addition, if we decide to raise funds through debt or convertible debt financings, we may be unable to meet our interest or principal payments.

Any of the foregoing or other factors could harm our ability to achieve anticipated levels of profitability from acquired businesses or to realize other anticipated benefits of acquisitions. We may not be able to identify or consummate any future acquisitions on favorable terms, or at all. If we do effect an acquisition, it is possible that the financial markets or investors will view the acquisition negatively. Even if we successfully complete an acquisition, it could adversely affect our business.

Our corporate culture has contributed to our success, and if we cannot maintain this culture as we grow, we could lose the innovation, creativity and teamwork fostered by our culture, and our business may be harmed.

We believe that a critical contributor to our success has been our corporate culture, which we believe fosters innovation, creativity and teamwork. As our organization grows and we are required to implement more complex organizational management structures, we may find it increasingly difficult to maintain the beneficial aspects of our corporate culture. This could negatively impact our future success.

Our business depends on a strong brand. If we are not able to maintain and enhance our brand, our ability to expand our customer base will be impaired and our business and operating results will be harmed.

In recognition of the evolving nature of the internet services market and to make it easier to clearly differentiate each service we offer from our competitors, we enhanced our branding by focusing our service offerings under four distinct brands namely “OpenSRS”, “YummyNames”, “Hover” and “Ting”. We also believe that maintaining and enhancing the “Tucows” corporate brand and our service brands is critical to expanding our customer base. We anticipate that, as our market becomes increasingly competitive, maintaining and enhancing our brands may become increasingly difficult and expensive. Maintaining and enhancing our brands will depend largely on our ability to be a technology leader providing high quality products and services, which we may not do successfully. To date, we have engaged in relatively little direct brand promotion activities. This enhances the risk that we may not successfully implement brand enhancement efforts in the future.

If we fail to protect our proprietary rights, the value of those rights could be diminished.

We rely upon copyright, trade secret and trademark law, confidentiality and nondisclosure agreements, invention assignment agreements and work-for-hire agreements to protect our proprietary technology, all of which offer only limited protection. We cannot ensure that our efforts to protect our proprietary information will be adequate to protect against infringement and misappropriation by third parties, particularly in foreign countries where laws or law enforcement practices may not protect proprietary rights as fully as in the United States of America and Canada.

We have licensed, and may in the future license, some of our trademarks and other proprietary rights to others. Third parties may also reproduce or use our intellectual property rights without seeking a license and thus benefit from our technology without paying for it. Third parties could also independently develop technology, processes or other intellectual property that are similar to or superior to those used by us. Actions by licensees, misappropriation of the intellectual property rights or independent development by others of similar or superior technology might diminish the value of our proprietary rights or damage our reputation.

The unauthorized reproduction or other misappropriation of our intellectual property rights, including copying the look, feel and functionality of our website could enable third parties to benefit from our technology without us receiving any compensation. The enforcement of our intellectual property rights may depend on our taking legal action against these infringing parties, and we cannot be sure that these actions will be successful.

Because of the global nature of the Internet, our websites can be viewed worldwide. However, we do not have intellectual property protection in every jurisdiction. Furthermore, effective trademark, service mark, copyright and trade secret protection may not be available in every country in which our services become available over the Internet. In addition, the legal standards relating to the validity, enforceability and scope of protection of intellectual property rights in Internet-related industries are uncertain and still evolving.

We may not be able to realize the intended and anticipated benefits from our acquisitions of expiring domain names, which could affect the value of these acquisitions to our business and our ability to meet our financial obligations and targets.

We may not be able to realize the intended and anticipated benefits that we currently expect from our acquisition of expiring domain names. These intended and anticipated benefits include increasing our cash flow from operations, broadening our Internet service offerings and delivering services that strengthen our reseller relationships.

Factors that could affect our ability to achieve these benefits include:

- A significant amount of revenue attributed to our domain name assets comes from the provision of personalized email services and the generation of revenue from third party advertisements on parked pages. Some of our existing resellers who provide similar services may perceive this as a competitive threat and therefore may decide to terminate their agreements with us because of our acquisitions of a substantial number of expiring domain names.
- We will need to continue to acquire commercially valuable expiring domain names to grow our presence in the field of direct navigation. We will need to continuously improve our technologies to acquire valuable expiring domain names as competition in the marketplace for appropriate expiring domain names intensifies. Our domain name acquisition efforts are subject to rules and guidelines established by registries which maintain Internet domain name registrations and other registrars who process and facilitate Internet domain name registrations. The registries and registrars may change the rules and guidelines for acquiring expiring domains in ways that may prove detrimental to our domain name acquisition efforts.

- The business of direct navigation is dependent on current technologies and user practices. If browser or search technologies were to change significantly, the practice of direct navigation may be altered to our disadvantage.

If the acquired assets are not integrated into our business as we anticipate, we may not be able to achieve the benefits of these acquired assets or realize the value paid for the asset acquisitions, which could materially harm our business, financial condition and results of operations.

We do not control the means by which end users access our web sites and material changes to current navigation practices or technologies or marketing practices could result in a material adverse effect on our business.

The success of our parked pages business depends in large part upon the current end user tendency to type desired destinations directly into the web browser. End users employ this practice of direct navigation to access our web sites primarily through the following methods: directly accessing our web sites by typing descriptive keywords or keyword strings into the uniform resource locator, or URL, address box of an Internet browser, accessing our web sites by clicking on bookmarked web sites and accessing our web sites indirectly through search engines and directories.

Each of these methods requires the use of a third party product or service, such as an Internet browser or search engine or directory. Internet browsers may provide alternatives to the URL address box to locate web sites, and search engines may from time to time change and establish rules regarding the indexing and optimization of web sites. Product developments and market practices for these means of access to our web sites are not within our control. We may experience a decline in traffic to our web sites if third party browser technologies or search engine methodologies and rules, including those affecting marketing efforts, are changed to our disadvantage.

If the practice of direct navigation becomes less popular either as a result of evolving technologies or user practices, our ability to generate revenue from the practice of click through advertising may suffer.

A significant amount of revenue generated from the commercialization of domain names owned by the Company is dependent on our agreements with third party providers. The monetization of these domain names is currently largely dependent on the paid listings allocated by these providers to the websites associated with our domain names. This allocation may depend on each provider's advertiser base, internal policies and other factors and determinations that may or may not be controlled by or known to us.

We may experience unforeseen liabilities in connection with our domain name portfolio, which could negatively impact our financial results.

We currently own a portfolio of domain names that were previously owned by another third-party. In addition, we have acquired, and intend to continue to acquire, other previously owned domain names. While we have a policy against acquiring domain names that infringe on third-party intellectual property rights, including trademarks or confusingly similar business names, in some cases, these acquired names may have trademark significance that is not readily apparent to us or is not identified by us in the bulk purchasing process. As a result, we may face demands by third party trademark owners asserting infringement or dilution of their rights and seeking transfer of the domain names through the Uniform Domain Name Resolution Policy, or UDRP, adopted by ICANN or actions under the Anticybersquatting Consumer Protection Act, or ACPA. We may also face actions from third-parties under national trademark or anti-competition legislation.

We review each claim or demand on its merits and we intend to transfer any such previously owned domain names acquired by us to parties that have demonstrated a valid prior right of claim. We cannot, however, guarantee that we will be able to resolve all such disputes without litigation. The potential violation of third party intellectual property

rights and potential causes of action under consumer protection laws may subject us to unforeseen liabilities, including injunctions and judgments for monetary damages.



Once any infringement is detected, disputes concerning the ownership or rights to use intellectual property could be costly and time-consuming to litigate, may distract management from operating the business, and may result in us losing significant rights and our ability to operate all or a portion of our business.

Claims of infringement of intellectual property or other rights of third parties against us could result in substantial costs. Third parties may assert claims of infringement of patents or other intellectual property rights against us concerning past, current or future technologies. Content obtained from third parties and distributed over the Internet by us may result in liability for defamation, negligence, intellectual property infringement, product or service liability and dissemination of computer viruses or other disruptive problems. We may also be subject to claims from third parties asserting trademark infringement, unfair competition and violation of publicity and privacy rights relating specifically to domains. As a domain name registrar, we regularly become involved in disputes over registration of domain names. Most of these disputes arise as a result of a third party registering a domain name that is identical or similar to another party's trademark or the name of a living person. These disputes are typically resolved through the UDRP, ICANN's administrative process for domain name dispute resolution, or less frequently through litigation under the ACPA, or under general theories of trademark infringement or dilution. The UDRP generally does not impose liability on registrars, and the ACPA provides that registrars may not be held liable for registering or maintaining a domain name absent a showing of bad faith intent to profit or reckless disregard of a court order by the registrars. However, we may face liability if we fail to comply in a timely manner with procedural requirements under these rules. In addition, these processes typically require at least limited involvement by us, and therefore increase our cost of doing business. The volume of domain name registration disputes may increase in the future as the overall number of registered domain names increases.

These claims and any related litigation could result in significant costs of defense, liability for damages and diversion of management's time and attention. Any claims from third parties may also result in limitations on our ability to use the intellectual property subject to these claims unless we are able to enter into agreements with the third parties making these claims. If a successful claim of infringement is brought against us and we fail to develop non-infringing technology or to license the infringed or similar technology on a timely basis, we may have to limit or discontinue the business operations which used the infringing technology.

We rely on technologies licensed from other parties. These third-party technology licenses may infringe on the proprietary rights of others and may not continue to be available on commercially reasonable terms, if at all. The loss of this technology could require us to obtain substitute technology of lower quality or performance standards or at greater cost, which could increase our costs and make our products and services less attractive to customers.

The law relating to the liability of online services companies for data and content carried on or disseminated through their networks is currently unsettled and could expose us to unforeseen liabilities.

It is possible that claims could be made against online services companies under U.S., Canadian or foreign law for defamation, negligence, copyright or trademark infringement, or other theories based on data or content disseminated through their networks, even if a user independently originated this data or content. Several private lawsuits seeking to impose liability upon Internet service companies have been filed in U.S. and foreign courts. While the United States has passed laws protecting ISPs from liability for actions by independent users in limited circumstances, this protection may not apply in any particular case at issue. Our ability to monitor, censor or otherwise restrict the types of data or content distributed through our network is limited. Failure to comply with any applicable laws or regulations in particular jurisdictions could result in fines, penalties or the suspension or termination of our services in these jurisdictions. Our insurance may not be adequate to compensate or may not cover us at all in the event we incur liability for damages due to data and content carried on or disseminated through our network. Any costs not covered by insurance that are incurred as a result of this liability or alleged liability, including any damages awarded and costs of litigation, could harm our business and prospects.

Privacy concerns relating to our technology could damage our reputation and deter current and potential users from using our services.

From time to time, concerns have been expressed about whether our services compromise the privacy of our users and others. Concerns about our practices with regard to the collection, use, disclosure or security of personal information or other privacy-related matters, even if unfounded, could damage our reputation and operating results and expose us to litigation and possible liability, including claims for unauthorized purchases with credit card information, impersonation, or fraud claims and other claims relating to the misuse of personal information and unauthorized marketing purposes. While we strive to comply with all applicable data protection laws and regulations, as well as our own privacy policies, any failure or perceived failure to comply may result in proceedings or actions against us by government entities or others, which could potentially have an adverse effect on our business.

In addition, due to the fact that our services are web based, the amount of data we store for our users on our servers (including personal information) has been increasing. Any systems failure or compromise of our security that results in the release of our users' data could seriously limit the adoption of our services as well as harm our reputation and brand and, therefore, our business. We may also need to expend significant resources to protect against security breaches. The risk that these types of events could seriously harm our business is likely to increase as we expand the number of Internet services we offer.

A large number of legislative proposals pending before the United States Congress, various state legislative bodies and foreign governments concern data protection. In addition, the interpretation and application of data protection laws in Europe and elsewhere are still unsettled. We cannot guarantee that our current information-collection procedures and disclosure policies will be found to be in compliance with existing or future laws or regulations. If our policies and procedures are found not to be in compliance, in addition to the possibility of fines, this could result in an order requiring that we change our data practices, which could in turn have a material effect on our business. Complying with these various laws could cause us to incur substantial costs or require us to change our business practices in a manner adverse to our business.

We are participating in ICANN's new gTLD Program that was approved in June 2011, which may present us with unique operational and other risks. If we are unsuccessful in managing these risks, our business, financial condition and results of operations could be adversely affected.

We are pursuing certain opportunities in connection with ICANN's new gTLD Program to own and/or operate one or more of our own gTLD registries. In June 2012, ICANN announced that it had received over 1,900 applications related to over 1,400 new gTLDs, with new registration opportunities for consumers expected to be available beginning in 2013. We have applied to operate four new gTLD registries on a stand-alone basis through a wholly owned subsidiary. We currently have no operating experience providing back-end registry services to existing registries or acting as an owner and operator of domain name registries for gTLD strings. Our participation in the new gTLD program may involve us in new and complex processes with respect to the application and awarding of gTLD strings by ICANN, which may require that we expend significant resources to integrate these processes into our current operations. Participation in the new program may also require us to rely upon, negotiate and collaborate with independent third parties, with whom we may not have long-term contracts. In addition, we expect to compete with other established and more experienced operators in these proposed service offerings and may not be able to compete effectively with these operators. If we are unsuccessful in managing these risks, our business, financial condition and results of operations could be adversely affected.

ICANN's new gTLD application and approval process for the new gTLD Program is new and untested. We may lose some of our current and future investment in the new gTLD Program which could adversely affect our business, financial condition and results of operations.

To date, we have invested approximately \$1 million in connection with our gTLD Initiative to pursue the opportunity to be a registry operator of new gTLDs under ICANN's new gTLD Program, and may be required to expend significant additional funds in order to be a successful applicant for the gTLD strings we have applied for. Our gTLD initiative also involves our active participation in a new, complex and untested process with respect to the application and awarding of gTLD strings by ICANN, which may require us to rely upon or negotiate and collaborate with independent third parties in order to be a successful applicant for contested gTLD strings in advance of gTLD strings being awarded by ICANN. There can be no assurances that we will ultimately be successful in acquiring new gTLD operator rights in ICANN's process for awarding gTLDs, or that we will be granted the right to be a registry operator by ICANN. Furthermore, there is no guarantee that any new gTLD operator rights acquired by us will be successful. If we are unsuccessful in pursuing either aspect of our gTLD initiative, we may lose some of our current and future investment in our gTLD initiative. In addition, the return on investment in our gTLD initiative may not

meet our current expectations justifying such investment. The loss of some of our investment or lower than expected return on investment in our gTLD initiative could adversely affect our business, financial condition and results of operations.\

Because we are required to recognize revenue for our services over the term of the applicable customer agreement, changes in our sales may not be immediately reflected in our operating results.

We recognize revenue from our customers ratably over the respective terms of their agreements with us as required by GAAP. Typically, our domain name registration agreements have terms that range from one to ten years, and our website hosting agreements have annual or month-to-month terms. Accordingly, any increases or decreases in sales during a particular period do not translate into immediate, proportional increases or decreases in revenue during that period, and a substantial portion of the revenue that we recognize during a quarter, is derived from deferred revenue from customer agreements that we entered into during previous quarters. As a result, we may not generate net earnings despite substantial sales activity during a particular period, since we are not permitted under GAAP to recognize all of the revenue from these sales immediately, and because we are required to reflect a significant portion of our related operating expenses in full during that period. Conversely, the existence of substantial deferred revenue may prevent deteriorating sales activity from becoming immediately observable in our consolidated statement of operations.

In addition, we may not be able to adjust spending in a timely manner to compensate for any unexpected revenue shortfall, and any significant shortfall in revenue relative to planned expenditures could negatively impact our business and results of operations.

Currency fluctuations may adversely affect us.

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. We do not account for these instruments as hedges in our consolidated financial statements.

If we do not maintain a low rate of credit card chargebacks, we will face the prospect of financial penalties and could lose our ability to accept credit card payments from customers, which would have a material adverse effect on our business, financial condition and results of operations.

A substantial majority of our revenue originates from online credit card transactions. Under current credit card industry practices, we are liable for fraudulent and disputed credit card transactions because we do not obtain the cardholder's signature at the time of the transaction, even though the financial institution issuing the credit card may have authorized the transaction. Under credit card association rules, penalties may be imposed at the discretion of the association. Any such potential penalties would be imposed on our credit card processor by the association. Under our contract with our processor, we are required to reimburse our processor for such penalties. Our current level of fraud protection, based on our fraudulent and disputed credit card transaction history, is within the guidelines established by the credit card associations. However, we face the risk that one or more credit card associations may, at any time, assess penalties against us or terminate our ability to accept credit card payments from customers, which would have a material adverse effect on our business, financial condition and results of operations.

Forecasting our tax rate is complex and subject to uncertainty.

We are subject to income and other taxes in a number of jurisdictions and our tax structure is subject to review by both domestic and foreign tax authorities. We must make significant assumptions, judgments and estimates to determine our current provision for income taxes, deferred tax assets and liabilities and any valuation allowance that may be recorded against our deferred tax assets. Although we believe that our estimates are reasonable, the ultimate determination of our tax liability is always subject to review by the applicable tax authorities. Any adverse outcome of such a review could have a negative effect on our operating results and financial condition in the period or periods for which such determination is made. Our current and future tax liabilities could be adversely affected by:

- international income tax authorities, including the Canada Revenue Agency and the U.S. Internal Revenue Service, challenging the validity of our arm's-length related party transfer pricing policies or the validity of our contemporaneous documentation.

- changes in the valuation of our deferred tax assets; or
- changes in tax laws, regulations, accounting principles or the interpretations of such laws.

In the event we are unable to satisfy regulatory requirements relating to internal control over financial reporting, or if these internal controls are not effective, our business and financial results may suffer.

Enacted in July 2010, The Dodd-Frank Act amended the Sarbanes-Oxley Act of 2002 to exclude smaller reporting companies, like Tucows, from the requirement to obtain an audit report on internal controls over financial reporting.

Effective internal controls are necessary for us to provide reasonable assurance with respect to our financial reports and to effectively prevent fraud. If we cannot provide reasonable assurance with respect to our financial reports and effectively prevent fraud, our brand and operating results could be harmed. Pursuant to the Sarbanes-Oxley Act of 2002, we are required to furnish a report by management on internal control over financial reporting, including management's assessment of the effectiveness of such control. Internal control over financial reporting may not prevent or detect misstatements because of its inherent limitations, including the possibility of human error, the circumvention or overriding of controls, or fraud. Therefore, even effective internal controls cannot guarantee assurance with respect to the preparation and fair presentation of financial statements. In addition, projections of any evaluation of the effectiveness of internal control over financial reporting to future periods are subject to the risk that the control may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. If we fail to maintain the adequacy of our internal controls, including any failure to implement required new or improved controls, or if we experience difficulties in their implementation, our business and operating results could be harmed, we could fail to meet our reporting obligations, which could have a material adverse effect on our operating results and on our stock price, and it could make it more difficult for us to attract and retain qualified persons to serve on our Board of Directors or as executive officers.

Impairment of goodwill and other intangible assets would result in a decrease in earnings.

Current accounting rules require that goodwill and other intangible assets with indefinite useful lives may no longer be amortized, but instead must be tested for impairment at least annually. These rules also require that intangible assets with definite useful lives be amortized over their respective estimated useful lives to their estimated residual values, and reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. To the extent such evaluation indicates that the useful lives of intangible assets are different than originally estimated, the amortization period is reduced or extended and, accordingly, the quarterly amortization expense is increased or decreased. We have substantial goodwill and other intangible assets, and we would be required to record a significant charge to earnings in our financial statements during the period in which any impairment of our goodwill or intangible assets is determined. Any impairment charges or changes to the estimated amortization periods could have a material adverse effect on our financial results.

We could suffer uninsured losses.

Although we maintain general liability insurance, claims could exceed the coverage obtained or might not be covered by our insurance. While we typically obtain representations from our technology and content providers and contractual partners concerning the ownership of licensed technology and informational content and obtain indemnification to cover any breach of these representations, we still may not receive accurate representations or adequate compensation for any breach of these representations. We may have to pay a substantial amount of money for claims that are not covered by insurance or indemnification or for claims where the existing scope or adequacy of insurance or indemnification is disputed or insufficient.

Adverse conditions in the U.S. and international economies could impact our results of operations.

Unfavorable general economic conditions, such as a recession or economic slowdown in the United States or in one or more of our other major markets, could negatively affect the affordability of and demand for some of our products and services. The recent national and global economic downturn resulted in, among other things, a decline in overall consumer and corporate spending. Consumer spending patterns are difficult to predict and are sensitive to the general economic climate, the consumers' level of disposable income, consumer debt and overall consumer confidence. Although the economy has shown signs of stabilization, there is no guarantee as to when or if overall consumer and corporate spending will return to pre-recession levels. Our services may be considered discretionary on the part of many of our current and potential customers and be dependent upon levels of consumer spending. As a result, resellers and consumers considering whether to purchase our services may be influenced by macroeconomic factors that affect consumer spending such as unemployment, continuing increases in fuel costs, conditions in the residential real estate and mortgage markets and access to credit.



To the extent conditions in the economy remain uncertain or deteriorate, our business could be impacted as customers choose to leave our services, to reduce their service level or to stop purchasing our services. In addition, our efforts to attract new customers may be adversely affected. The current economic conditions may also adversely impact our key vendors. In uncertain and adverse economic conditions, decreased consumer spending is likely to result in a variety of negative effects such as reduction in revenues, increased costs, lower gross margin percentages, increased allowances for doubtful accounts and write-offs of accounts receivable, and recognition of impairments of assets, including goodwill and other intangible assets. Uncertainty and adverse economic conditions may also lead to a decreased ability to collect payment for our services due primarily to a decline in the ability of our business customers to use or access credit, including through credit cards, which is how most of our customers pay for our services. We also expect to continue to experience volatility in foreign exchange rates, which could negatively impact the amount of expenses we incur and the net assets we record in future periods. If any of the above risks are realized, we may experience a material adverse effect on our business, financial condition and results of operations.

Our quarterly and annual operating results may fluctuate and our future revenues and profitability are uncertain.

Our quarterly and annual operating results may fluctuate significantly in the future as a result of a variety of factors, many of which are outside of our control. Our quarterly and annual operating results may be adversely affected by a wide variety of factors, including:

- our ability to maintain revenue growth at current levels or anticipate a decline in revenue from any of our services;
- our ability to identify and develop new technologies or services and to commercialize those technologies into new services in a timely manner;
- the mix of our services sold during the quarter or year;
- our ability to make appropriate decisions which will position us to achieve further growth;
- concentrated capital expenditures in any particular period to support our growth or for other reasons;
- changes in our pricing policies or those of our competitors, changes in domain name fees charged to us by Internet registries or ICANN, or other competitive pressures on selling prices;
- our ability to identify, hire, train, motivate and retain highly qualified personnel, and to achieve targeted productivity levels;
- market acceptance of Internet services generally and of new and enhanced versions of our services in particular;
- our ability to establish and maintain a competitive advantage;
- the continued development of our global distribution channel and our ability to compete in multiple countries successfully as part of our sales and marketing strategy;
-

the number and significance of service enhancements and new service and technology announcements by our competitors;

- our ability to identify, develop, deliver and introduce in a timely manner new and enhanced versions of our current service offerings that anticipate market demand and address customer needs;

- changes in foreign currency exchange rates and issues relating to the conversion to the Canadian dollar;
- foreign, federal or state regulation affecting our business;
- our ability to continue to attract users to our website;
- our ability to attract software developers to participate in our Author Resource Center;
- our ability to continue to attract advertisers to place content on our website;
- technical difficulties or other factors that result in system downtime;
- seasonality of the markets and businesses of our customers;
- news relating to our industry as a whole;
- our ability to enforce our intellectual property rights;
- our ability to manage Internet fraud and information theft; and
- current economic conditions.

Our operating expenses may increase. We base our operating expense budgets on expected revenue trends that are more difficult to predict in periods of economic uncertainty. We intend to continue our efforts to control discretionary spending; however, we will continue to selectively incur expenditures in areas that we believe will strengthen our position in the marketplace. If we do not meet revenue goals, we may not be able to meet reduced operating expense levels and our operating results will suffer. It is possible that in one or more future quarters, our operating results may be below our expectations and the expectations of public market analysts and investors. In that event, the price of our common stock may fall.

#### Risks Related To the Internet and Our Technology

Our business could be materially harmed if the administration and operation of the Internet no longer rely upon the existing domain system.

The domain registration industry continues to develop and adapt to changing technology. This development may include changes in the administration or operation of the Internet, including the creation and institution of alternate systems for directing Internet traffic without the use of the existing domain system. Some of our competitors have begun registering domains with extensions that rely on such alternate systems. These competitors are not subject to ICANN accreditation requirements and restrictions. Other competitors have attempted to introduce naming systems that use keywords rather than traditional domains. The widespread acceptance of any alternative systems could eliminate the need to register a domain to establish an online presence and could materially adversely affect our business, financial condition and results of operations.

The law relating to the use of and ownership in intellectual property on the Internet is currently unsettled and may expose us to unforeseen liabilities.

There have been ongoing legislative developments and judicial decisions concerning trademark infringement claims, unfair competition claims and dispute resolution policies relating to the registration of domains. To help protect ourselves from liability in the face of these ongoing legal developments, we have taken the following precautions:

- Our standard registration agreement requires that each registrant indemnify, defend and hold us harmless for any dispute arising from the registration or use of a domain registered in that person's name; and
- Since December 1, 1999, we have required our resellers to ensure that all registrants are bound to the UDRP as approved by ICANN.

Despite these precautions, we cannot be assured that our indemnity and dispute resolution policies will be sufficient to protect us against claims asserted by various third parties, including claims of trademark infringement and unfair competition.

New laws or regulations concerning domains and registrars may be adopted at any time. Our responses to uncertainty in the industry or new regulations could increase our costs or prevent us from delivering our domain registration services over the Internet, which could delay growth in demand for our services and limit the growth of our revenues. New and existing laws may cover issues such as:

- pricing controls;
- the creation of additional generic top level domains and country code domains;
- consumer protection;
- cross-border domain registrations;
- trademark, copyright and patent infringement;
- domain dispute resolution; and
- the nature or content of domains and domain registration.

An example of legislation passed in response to novel intellectual property concerns created by the Internet is the ACPA enacted by the United States government in November 1999. This law seeks to curtail a practice commonly known in the domain registration industry as cybersquatting. A cybersquatter is generally defined in the ACPA as one who registers a domain that is identical or similar to another party's trademark, or the name of another living person, with the bad faith intent to profit from use of the domain. The ACPA states that registrars may not be held liable for registration or maintenance of a domain for another person absent a showing of the registrar's bad faith intent to profit from the use of the domain. Registrars may be held liable, however, if they do not comply promptly with procedural provisions of the ACPA. For example, if there is litigation involving a domain, the registrar is required to deposit a certificate representing the domain registration with the court. If we are held liable under the ACPA, any liability could have a material adverse effect on our business, financial condition and results of operations.

If Internet usage does not grow or if the Internet does not continue to expand as a medium for commerce, our business may suffer.

Our success depends upon the continued development and acceptance of the Internet as a widely used medium for commerce and communication. Rapid growth in the uses of, and interest in, the Internet is a relatively recent phenomenon and its continued growth cannot be assured. A number of factors could prevent continued growth, development and acceptance, including:

- the unwillingness of companies and consumers to shift their purchasing from traditional vendors to online vendors;
- the Internet infrastructure may not be able to support the demands placed on it, and its performance and reliability may decline as usage grows;
-

security and authentication issues may create concerns with respect to the transmission over the Internet of confidential information; and

- privacy concerns, including those related to the ability of websites to gather user information without the user's knowledge or consent, may impact consumers' willingness to interact online.

Any of these issues could slow the growth of the Internet, which could limit our growth and revenues.

We believe that part of our growth will be derived from resellers in international markets and may suffer if Internet usage does not continue to grow globally.

We believe that a major source of growth for Internet-based companies will come from individuals and businesses outside the United States where Internet access and use is currently less prevalent. A substantial number of our resellers are currently based outside the United States and we plan to grow our business in other countries. If Internet usage in these jurisdictions does not increase as anticipated, our revenues may not grow as anticipated.

We may be unable to respond to the rapid technological changes in the industry, and our attempts to respond may require significant capital expenditures.

The Internet and electronic commerce are characterized by rapid technological change. Sudden changes in user and customer requirements and preferences, the frequent introduction of new applications and services embodying new technologies and the emergence of new industry standards and practices could make our applications, services and systems obsolete. The emerging nature of applications and services in the Internet application and services industry and their rapid evolution will require that we continually improve the performance, features and reliability of our applications and services. Our success will depend, in part, on our ability:

- to develop and license new applications, services and technologies that address the increasingly sophisticated and varied needs of our current and prospective customers; and
- to respond to technological advances and emerging industry standards and practices on a cost-effective and timely basis.

The development of applications and services and other proprietary technology involves significant technological and business risks and requires substantial expenditures and lead-time. We may be unable to use new technologies effectively or adapt our internally developed technology and transaction- processing systems to customer requirements or emerging industry standards in a timely manner, or at all. Our internal development teams may also be unable to keep pace with new technological developments that affect the marketplace for our services. In addition, as we offer new services and functionality, we will need to ensure that any new services and functionality are well integrated with our current services, particularly as we offer an increasing number of our services as part of bundled suites. To the extent that any new services offered by us do not interoperate well with our existing services, our ability to market and sell those new services would be adversely affected and our revenue level and ability to achieve and sustain profitability might be harmed. Updating technology internally and licensing new technology from third parties may require us to incur significant additional capital expenditures.

We could experience system failures and capacity constraints which could diminish our ability to effectively provide our services and could damage our reputation and harm our operating results.

The availability of our services depends on the continuing operation of our information technology and communications systems. Any damage to or failure of our systems could result in interruptions in our service, which could reduce our revenues and profits, and damage our brand. Our systems are vulnerable to damage or interruption from earthquakes, terrorist attacks, floods, fires, power loss, telecommunications failures, computer viruses, computer denial of service attacks or other attempts to harm our systems. Some of our data centers are located in areas with a high risk of major earthquakes. Our data centers are also subject to break-ins, sabotage and intentional acts of vandalism, and to potential disruptions if the operators of these facilities have financial difficulties. Some of our systems are not fully redundant, and our disaster recovery planning cannot account for all eventualities. The occurrence of a natural disaster, a decision to close a facility without adequate notice or other unanticipated problems

at our data centers could result in lengthy interruptions in our service.

Our systems face security risks, and any compromise of the security of these systems could result in liability for damages and in lost customers.

Our security systems may be vulnerable to unauthorized access by hackers or others, computer viruses and other disruptive problems. Someone who is able to circumvent security measures could misappropriate customer or proprietary information or cause interruptions in Internet operations. Internet and online resellers have in the past experienced, and may in the future experience, interruptions in service because of the accidental or intentional actions of Internet users, current and former employees or others.



We may need to expend significant capital and other resources to protect against the threat of security breaches or alleviate problems caused by breaches. Eliminating computer viruses and alleviating other security problems may require interruptions, delays or cessation of service to users accessing our websites and the web pages that deliver our content services. An information technology systems security breach may lead to a material disruption of our systems and/or the loss of business information, which may materially and adversely affect our business. Risks relating to such a security breach may include, among other things: a material adverse impact on our business and future financial results due to the theft, destruction, loss, misappropriation or release of confidential data, negative publicity resulting in reputation or brand damage with our customers, vendors or peers due to the theft, destruction, loss, misappropriation or release of confidential data, operational or business delays resulting from the disruption of information technology systems and subsequent clean-up and mitigation activities and adverse effects on our compliance with regulatory laws and regulations. Repeated or substantial interruptions could result in the loss of customers and reduced revenues.

We may have difficulty scaling and adapting our existing architecture to accommodate increased traffic and technology advances or changing business requirements, which could lead to the loss of customers and cause us to incur additional expenses.

To be successful, our network infrastructure must perform well and be reliable. The greater the user traffic and the greater the complexity of our services, the more computing power we will need. We have spent and expect to continue to spend substantial amounts on the purchase of new equipment to upgrade our technology and network infrastructure to enable it to handle increased traffic. This expansion is expensive and complex and could result in inefficiencies or operational failures. If we do not expand successfully, or if we experience inefficiencies and operational failures, the quality of our services and our customers' experience could decline. This could damage our reputation and lead us to lose current and potential customers. Cost increases, loss of traffic or failure to accommodate new technologies or changing business requirements could harm our operating results and financial condition.

We rely on bandwidth providers, data centers and other vendors in providing services to our customers, and any failure or interruption in the services provided by these third parties could harm our ability to operate our business and damage our reputation.

We rely on vendors, including data center and bandwidth providers in providing services to our customers. Any disruption in the network access or co-location services provided by these providers or any failure of these providers to handle current or increased volumes of use could significantly harm our business. Any financial or other difficulties our providers face may also have negative effects on our business. We exercise little control over these vendors, which increases our vulnerability to problems with the services they provide. We license technology and related databases to facilitate certain aspects of our data center and connectivity operations, including Internet traffic management services. We have experienced and expect to continue to experience interruptions and delays in service and availability for such elements. Any errors, failures, interruptions or delays in connection with these technologies and information services could harm our relationship with customers, adversely affect our brand and expose us to liabilities.

New tax treatment of companies engaged in Internet commerce may adversely affect the demand for our marketing services and our financial results.

Due to the global nature of the Internet, it is possible that, although our services and the Internet transmissions related to them typically originate in Virginia, Toronto and Germany, governments of other states or foreign countries might attempt to regulate our transmissions or levy sales, income or other taxes relating to our activities. Tax authorities at the international, federal, state and local levels are currently reviewing the appropriate treatment of companies engaged in Internet commerce. New or revised international, federal, state or local tax regulations may subject us or

our customers to additional sales, income and other taxes. We cannot predict the effect of current attempts to impose sales, income or other taxes on commerce over the Internet on TuCows or on our customers. New or revised taxes and, in particular, sales taxes, would likely increase the cost of doing business online and decrease the attractiveness of advertising and selling goods and services over the Internet. New taxes could also create significant increases in internal costs necessary to capture data, and collect and remit taxes. Any of these events could have an adverse effect on our business and results of operations.

We may be accused of intellectual property infringement of the technology we have employed to support both our back end platform and the products and services we offer to and through our resellers and may be sued for damages caused by actual use of the platforms or products and services and we may be required to pay substantial damage awards.

We seek to ensure that we have licensed or otherwise secured the necessary rights to use and offer for use all intellectual property relating to our platforms and the services we offer resellers through the platforms. Despite our efforts, we may be sued by third parties claiming rights in and to the technology we employ or by third parties who claim to have suffered as a result of any use, or inability to use, the platforms, products and services. If we are sued, defense of any such claims may require the resources of both our time and money. If a third-party is successful in its assertions, we may be required to pay damages that may have a material impact on our financial resources.

### Governmental and Regulatory Risks

Governmental and regulatory policies or claims concerning the domain registration system, and industry reactions to those policies or claims, may cause instability in the industry and disrupt our domain registration business.

#### ICANN Oversight of Domain Name Registration System

Before 1999, Network Solutions managed the domain registration system for the .com, .net and .org domains on an exclusive basis under a cooperative agreement with the U.S. government. In November 1998, the U.S. Department of Commerce authorized ICANN, a private sector, not for profit corporation, to oversee key aspects of the domain registration system. ICANN has been subject to strict scrutiny by the public and by the government in the United States of America. For example, in the United States of America, Congress has held hearings to evaluate ICANN's selection process for new top level domains. In addition, ICANN faces significant questions regarding its financial viability and efficacy as a private sector entity. ICANN may continue to evolve both its long term structure and mission to address perceived shortcomings such as a lack of accountability to the public and a failure to maintain a diverse representation of interests on its Board of Directors. We continue to face the risks that:

- the U.S. or any other government may reassess its decision to introduce competition into, or ICANN's role in overseeing, the domain registration market;
- the Internet community or the U.S. Department of Commerce or U.S. Congress may refuse to recognize ICANN's authority or support its policies, which could create instability in the domain registration system;
- some of ICANN's policies and practices, and the policies and practices adopted by registries and registrars, could be found to conflict with the laws of one or more jurisdictions;
- ICANN may lose any one of the several claims pending against it in both the U.S. and international courts, in which case its credibility may suffer and its policies may be discredited;
- the terms of the Registrar Accreditation Agreement, under which we are accredited as a registrar, could change in ways that are disadvantageous to us or under certain circumstances could be terminated by ICANN preventing us from operating our Registrar;

- ICANN and, under their registry agreements, VeriSign and other registries may impose increased fees received for each ICANN accredited registrar and/or domain name registration managed by those registries;
- ICANN or any registries may implement policy changes that would impact our ability to run our current business practices throughout the various stages of the lifecycle of a domain name;
- foreign constituents may succeed in their efforts to have domain name registration removed from a U.S. based entity and placed in the hands of an international cooperative; and
- international regulatory or governing bodies, such as the International Telecommunications Union or the European Union, may gain increased influence over the management and regulation of the domain registration system, leading to increased regulation in areas such as taxation and privacy.

If any of these events occur, they could create instability in the domain registration system. These events could also disrupt or suspend portions of our domain registration solution, which would result in reduced revenue.

#### Governmental Regulation Affecting the Internet

To date, government regulations have not materially restricted use of the Internet in most parts of the world. The legal and regulatory environment pertaining to the Internet, however, is uncertain and may change. New laws may be passed, existing but previously inapplicable laws may be deemed to apply to the Internet, or existing legal safe harbors may be narrowed, both by U.S. federal or state governments and by governments of foreign jurisdictions. These changes could affect:

- the liability of online resellers for actions by customers, including fraud, illegal content, spam, phishing, libel and defamation, infringement of third-party intellectual property and other abusive conduct;
- other claims based on the nature and content of Internet materials, such as pornography;
- user privacy and security issues;
- consumer protection;
- sales and other taxes, including the value-added tax of the European Union member states;
- characteristics and quality of services; and
- cross-border commerce.

The adoption of any new laws or regulations, or the application or interpretation of existing laws or regulations to the Internet, could hinder growth in use of the Internet and online services generally, and decrease acceptance of the Internet and online services as a means of communications, commerce and advertising. In addition, such changes in laws could increase our costs of doing business, subject our business to increased liability or prevent us from delivering our services over the Internet, thereby harming our business and results of operations.

We may be subject to government regulation that may be costly and may interfere with our ability to conduct business.

Although transmission of our websites primarily originates in Canada and the United States, the Internet is global in nature. Governments of foreign countries might try to regulate our transmissions or prosecute us for violations of their laws. Because of the increasing popularity and use of the Internet, federal, state and foreign governments may adopt laws or regulations in the future concerning commercial online services and the Internet, with respect to:

- user privacy;
- children;
- copyrights and other intellectual property rights and infringement;

- domains;
- pricing;
- content regulation;
- defamation;
- taxation; and
- the characteristics and quality of products and services.

Laws and regulations directly applicable to online commerce or Internet communications are becoming more prevalent. Laws and regulations such as those listed above or others, if enacted, could expose us to substantial liability and increase our costs of compliance and doing business.

#### Risks Related to our Stock

We do not intend to declare dividends on our common stock in the immediate future.

We anticipate that in the immediate future, our earnings, if any, will be retained for use in the business and that no cash dividends will be paid on our common stock. While we may decide to declare such dividends in the future, declaration of dividends on our common stock will depend upon, among other things, future earnings, our operating and financial condition, our capital requirements, ongoing market conditions and general business conditions.

Our share price is volatile, which may make it difficult for shareholders to sell their shares of common stock when they want to, at an attractive price.

Our share price has varied recently and the price of our common stock may decrease in the future, regardless of our operating performance. Investors may be unable to resell their common stock following periods of volatility because of the market's adverse reaction to this volatility.

The following factors may contribute to this volatility:

- actual or anticipated variations in our quarterly operating results;
- interruptions in our services;
- seasonality of the markets and businesses of our customers;
- announcements of new technologies or new services by our company or our competitors;
- our ability to accurately select appropriate business models and strategies;
- the operating and stock price performance of other companies that investors may view as comparable to us;
- news relating to our industry as a whole; and
- news relating to trends in our markets.

The stock market in general, and the market for Internet-related companies in particular, including our company, has experienced volatility. This volatility often has been unrelated to the operating performance of these companies. These broad market and industry fluctuations may cause the price of our common stock to drop, regardless of our performance.

Future sales of shares of our common stock by our existing shareholders could cause our share price to fall.

If our shareholders sell substantial amounts of common stock in the public market, the market price of the common stock could fall. The perception among investors that these sales will occur could also produce this effect.





## ITEM 2. PROPERTIES

We do not own any real property. Our principal administrative, engineering, marketing and sales office totals approximately 26,937 square feet and is located in Toronto, Ontario under a lease that expires on December 31, 2020. In addition, we also maintain offices of approximately 4,000 square feet in Starkville, Mississippi, approximately 2,900 square feet in Bonn, Germany and approximately 500 square feet in Amsterdam, Netherlands.

Substantially all of our computer and communications hardware is located at our facilities or at server hosting facilities in Toronto, Ontario and Ashburn, Virginia.

## ITEM 3. LEGAL PROCEEDINGS

We are involved in various investigations, claims and lawsuits arising in the normal conduct of our business, none of which, in our opinion, will 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 management attention.

## ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

## PART II

## ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

## Price Range of Common stock

Our common stock trades on the NYSE Amex under the symbol "TCX" and on the Toronto Stock Exchange under the symbol "TC". The following table sets forth the range of high and low sales prices for our common stock for the periods indicated.

Year	Fiscal Quarter Ended	High	Low
2013	January 1, 2013 through March 5, 2013	\$ 2.20	\$ 1.45
2012	March 31, 2012	1.23	0.75
	June 30, 2012	1.60	1.04
	September 30, 2012	1.39	1.06
	December 31, 2012	1.49	1.06
2011	March 31, 2011	0.90	0.72
	June 30, 2011	0.87	0.76
	September 30, 2011	0.82	0.71
	December 31, 2011	0.78	0.74

Our common stock was listed on the OTC Bulletin Board maintained by NASDAQ under the symbol "TCOW" through August 17, 2005. Our common stock began trading on the NYSE Amex (formerly the American Stock Exchange) on August 18, 2005.

As of March 5, 2013, Tucows had 387 shareholders of record, excluding shareholders whose shares are held in nominee or "street" name by brokers.

We have not declared or paid any cash dividends on our common stock during the fiscal years ended December 31, 2012 and December 31, 2011, and we do not intend to do so in the immediate future, but we may decide to do so in the future depending on ongoing market conditions. Our ability to pay any cash dividends on our common stock, should our Board of Directors decide to do so, is also dependent on our earnings and cash requirements.

## Equity Compensation Plan Information

On October 8, 2010, our 2006 Amended and Restated Equity Compensation Plan was amended to increase the number of shares which have been set aside for issuance by an additional 1.9 million shares to 6.9 million shares

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (#)	Weighted average exercise price of outstanding options, warrants and rights (\$)	Number of securities remaining available for future issuance under the plan (excluding securities reflected in the first column)

			(#)
Equity compensation plans approved by security holders:			
2006 Equity Compensation Plan	5,038,987	0.79	1,624,626
1996 Equity Compensation Plan	3,553,699	0.42	—
Equity compensation plans not approved by security holders	—	—	—
Total	8,592,686	0.64	1,624,626

Purchases of equity securities by the issuer and affiliated purchasers

Our stock buyback program, which we initially commenced on November 15, 2011, terminated on November 14, 2012. We did not repurchase any equity securities during the fourth quarter of the year ended December 31, 2012.

## ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

The following discussion and analysis should be read together with the audited consolidated financial statements of Tucows Inc. (the "Company", "we", "us" or "our") for the years ended December 31, 2012, 2011 and 2010 and accompanying notes set forth elsewhere in this report. All financial information is presented in U.S. dollars.

Some of the statements set forth in this section are forward-looking statements relating to our future results of operations. Our actual results may vary from the results anticipated by these statements. Please see "Information Concerning Forward-Looking Statements" on page 1.

### OVERVIEW

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

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

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

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

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

Marketing Development Funds we receive from vendors from time-to-time to expand or maintain the market position for their services.

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

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

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

For the years ended December 31, 2012, 2011 and 2010, we reported revenue of \$115 million, \$97 million and \$85 million, respectively. For the years ended December 31, 2012, 2011 and 2010, our OpenSRS domain service offering accounted for 77%, 79% and 77% of our total revenue, respectively.

## KEY BUSINESS METRICS

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

	2012	Year ended December 31, (1) 2011 (in 000's)	2010
Total new, renewed and transferred-in domain name registrations provisioned	9,213	8,576	7,396
Domain names under management			
Provisioned on behalf of Tucows	10,643	10,482	8,809
Provisioned on behalf of accredited registrars	3,363	1,400	1,400
Total domain names under management	14,006	11,882	10,209

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

## OPPORTUNITIES, CHALLENGES AND RISKS

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

Our direct costs to register domain names on behalf of our customers are almost exclusively controlled by registries such as Verisign and by ICANN. Verisign provides all the registry services operations for the .com, .net, .cc, .tv and .name domain names. ICANN is a private sector, not-for-profit corporation formed to oversee a number of Internet related tasks, including domain registrations for which it collects fees. The market for wholesale registrar services is

both price sensitive and competitive, particularly for large volume customers, such as large web hosting companies and owners of large portfolios of domain names. We have a relatively limited ability to increase the pricing of domain name registrations without negatively impacting our ability to maintain or grow our customer base.

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



Under the terms of the New gTLD program, in April 2012 we paid the required \$1.1 million application fee in support of our application for six domain strings under ICANN's new gTLD Program. A declining percentage of these evaluation fees are refundable if any application is withdrawn prior to our executing a registry agreement with ICANN. In May 2012 we withdrew two of our applications and under the terms of the New gTLD application process have received a full refund of \$0.4 million against these applications. While there can be no assurance that we will be awarded any gTLDs, we have determined that the applications embody probable economic benefit and they have been capitalized and are included in prepaid expenses and deposits at September 30, 2012. As part of the New gTLD Program, we may elect to receive partial cash refunds for certain gTLD applications, and to the extent we elect to sell or dispose of certain gTLD applications throughout the process, we may also incur gains or losses on amounts invested. Gains on the sale of our interest in gTLDs will be recognized when realized, while losses will be recognized when deemed probable. Upon the delegation of operator rights for each gTLD by ICANN, which we expect to commence in 2013, gTLD application fees will be reclassified as finite lived intangible assets and amortized on a straight-line basis over their estimated useful life.

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

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

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

## Net Revenues

### Wholesale - OpenSRS Domain Service

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

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

With respect to the sale of domain registrations, our pricing structure for domain names provides visibility into the various fees that make up the cost of a domain name by breaking out the cost of the registry and ICANN fees separately from our management fee. Effective January 2012, registry fees for the .com and .net registrations were

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

#### Wholesale – OpenSRS Value-Added Services

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

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

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

#### Retail – Hover

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

#### Retail - Ting

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

#### Portfolio

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

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

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

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

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

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

#### Critical Accounting Policies

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

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

#### Revenue recognition policy

We earn revenues from the following services:

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

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

of the services during the quarters and the year.

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

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

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

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

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

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

The excess of the fair value of purchase price over the fair values of the identifiable assets and liabilities from our acquisitions is recorded as goodwill. At December 31, 2012, we had \$18.9 million in goodwill related to our acquisitions and \$16.4 million in intangible assets. The goodwill recorded in relation to these acquisitions is not deductible for tax purposes. We report our financial results as one operating segment with three distinct service offerings, being Wholesale, Retail and Portfolio.

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

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

With regards to property, equipment and definite life intangible assets, we continually evaluate whether events or circumstances have occurred that indicate the remaining estimated useful lives of its definite-life intangible assets may

warrant revision or that the remaining balance of such assets may not be recoverable. We use an estimate of the related undiscounted cash flows over the remaining life of the asset in measuring whether the asset is recoverable. There was no impairment recorded on definite-life intangible assets and property and equipment during 2012 and 2011.



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

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

Any changes to our key assumptions about our businesses and our prospects, or changes in market conditions, could cause the fair value of our reporting unit to fall below its carrying value, resulting in a potential impairment charge. In addition, changes in our organizational structure or how our management allocates resources and assesses performance, could result in a change in our operating segments or reporting units, requiring a reallocation and updated impairment analysis of goodwill. A goodwill or intangible asset impairment charge could have a material effect on our consolidated financial statements because of the significance of goodwill and intangible assets to our consolidated balance sheet. There was no impairment of goodwill or intangible assets as a result of the annual impairment tests completed during the fourth quarters of 2012 and 2011.

#### Accounting for income taxes

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

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

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

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

require possible material adjustments to these deferred tax assets, impacting net income or net loss in the period when such determinations are made.

## RESULTS OF OPERATIONS FOR THE YEAR ENDED DECEMBER 31, 2012 AS COMPARED TO THE YEAR ENDED DECEMBER 31, 2011

## NET REVENUES

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

	Year ended December 31,	
	2012	2011
<b>Wholesale</b>		
Domain Services	\$ 87,434,450	\$ 76,201,058
Value Added Services	10,586,460	9,268,460
Total Wholesale	98,020,910	85,469,518
<b>Retail</b>		
Portfolio	10,740,844	5,263,118
	5,965,147	6,332,331
	\$ 114,726,901	\$ 97,064,967
Increase over prior period	\$ 17,661,934	
Increase - percentage	18%	

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

	Year ended December 31,			
	2012		2011	
<b>Wholesale</b>				
Domain Services	76	%	78	%
Value Added Services	10	%	10	%
Total Wholesale	86	%	88	%
<b>Retail</b>				
Portfolio	9	%	5	%
	5	%	7	%
	100	%	100	%

Total net revenues for Fiscal 2012 increased by \$17.7 million, or 18%, to \$114.7 million from \$97.1 million for the fiscal year ended December 31, 2011 ("Fiscal 2011"). Deferred revenue from domain name registrations and other Internet services at December 31, 2012 increased to \$71.0 million from \$69.2 million at December 31, 2011. Deferred revenue has been impacted by the transfer of a significant number of names by certain of our customers from our registrar accreditation to their own registrar accreditation. This required us to recognize all remaining deferred revenue associated with the transferred domain names during the current year.

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

## Wholesale

During Fiscal 2012, Wholesale revenue increased by \$12.6 million, or 15%, to \$98.0 million when compared to Fiscal 2011, primarily as a result of OpenSRS Domain Service revenue increasing by \$11.2 million or 15% to \$87.4 million. These increases resulted primarily from our success in attracting customers with increased transaction volumes, the impact of the transfer of a significant number of names certain of our customers from our registrar accreditation to their own registrar accreditation, the contribution from the EPAG acquisition that we completed during the third quarter of last year and the impact of our passing on the 7% registration fee increase implemented in January 2012 for registration fees paid to certain registries.

Value-Added Services increased by \$1.3 million or 14% to \$10.6 million when compared to Fiscal 2011. These increases resulted primarily from the sale of domain names and advertising from the OpenSRS Domain Expiry Stream and increased digital certificate sales.

During Fiscal 2012, the number of transactions from all new, renewed and transferred-in domain name registrations that we processed increased by 0.6 million transactions to 9.2 million when compared to Fiscal 2011. While we anticipate that the number of new, renewed and transferred-in domain name registrations will continue to incrementally increase in the long term, the volatility in the market could affect the growth of domain names that we manage.

As of December 31, 2012, the total domain names under our management increased by 0.2 million to 10.6 million, when compared to December 31, 2011. This increase was impacted by certain of our customers transferring a significant number of domain names from our registrar accreditation to their own registrar accreditation. In addition, we provide provisioning services on a monthly basis to accredited registrars who use our technical systems to process domain registrations with their own accreditation. As of December 31, 2012, we managed 3.4 million domain names on behalf of other accredited registrars, an increase of 2.0 million compared to the 1.4 million we managed as of December 31, 2011. The increase is attributable to one of our accredited registrars transferring 1.8 million domain names they were directly managing under their own accreditation onto our platform.

#### Retail

Net revenues from Retail for Fiscal 2012, as compared to Fiscal 2011, increased by \$5.5 million to \$10.7 million. This increase reflects the impact of \$4.0 million in Ting's mobile device and service sales made during Fiscal 2012 as well as the success that our retail marketing initiatives and improved websites are having on our ability to attract new customers and retain existing ones for Hover.

As of December 31, 2012, Ting had approximately 10,000 customers and approximately 15,000 mobile devices under our management.

#### Portfolio

During Fiscal 2012, Portfolio revenue decreased by \$0.4 million, or 5%, to \$6.0 million when compared to Fiscal 2011. This decrease primarily resulted from advertising and other revenue through our two ad-supported content sites, butterscotch.com and tu cows.com decreasing by \$0.8 million and the delivery of third-party advertisements on parked pages decreasing by \$0.4 million. These decreases were partially offset by the increase in sales of domain names from our domain name portfolio. The decrease in revenue from our ad-supported sites was primarily the result of certain of our vendors electing not to repeat market development programs that they undertook during Fiscal 2011 while parked pages advertising declined as a result of the impact our domain name sales have on our advertising revenue. The increase in portfolio sales primarily reflects the timing of portfolio domain name sales and may not be repeatable in future quarters. The market for monetization of domain names is rapidly evolving and there is no guarantee that we will be able to continue to acquire the same caliber of names for our portfolio from future expiring domains or that names we acquire in future will provide the same revenue impact as we have experienced from past acquisitions. In addition, the revenue we derive from our Portfolio is driven by general macroeconomic factors that affect Internet advertising. Our advertising revenues are typically sensitive to economic conditions and tend to decline in recessionary periods and other periods of economic uncertainty.

#### COST OF REVENUES

##### Wholesale

##### OpenSRS Domain Service

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

### Value-Added Services

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

### Retail

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

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

### Portfolio

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

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

### Network costs

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

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

	Year ended December 31,	
	2012	2011
<b>Wholesale</b>		
Domain Services	\$ 73,168,196	\$ 63,491,433
Value Added Services	2,032,328	1,969,374
Total Wholesale	75,200,524	65,460,807
<b>Retail</b>	6,804,863	1,881,063
<b>Portfolio</b>	832,008	746,517

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

Network, other costs	4,925,058	4,837,650
Network, depreciation and amortization costs	755,280	836,045
	\$ 88,517,733	\$ 73,762,082
Increase over prior period	\$ 14,755,651	
Increase - percentage		20%

39

---



The following table presents our cost of revenues, as a percentage of total cost of revenues for the periods presented:

	Year ended December 31,			
	2012		2011	
<b>Wholesale</b>				
Domain Services	83	%	86	%
Value Added Services	2	%	3	%
Total Wholesale	85	%	89	%
<b>Retail</b>				
Retail	8	%	2	%
Portfolio	1	%	1	%
Network, other costs	5	%	7	%
Network, depreciation and amortization costs	1	%	1	%
	100	%	100	%

Total cost of revenues for Fiscal 2012 increased by \$14.8 million, or 20%, to \$88.5 million from \$73.8 million in Fiscal 2011 primarily the result of increased sales volumes. Prepaid domain registration and other Internet services fees as of December 31, 2012 increased by \$1.7 million, or 3%, to \$57.5 million from \$55.8 million at December 31, 2011.

#### Wholesale

Costs for Wholesale for Fiscal 2012 increased by \$9.7 million, or 15%, to \$75.2 million, when compared to Fiscal 2011.

This increase was primarily the result of increased domain registration volumes and increases in registration fees paid to the registries that were implemented in January 2012 experienced during Fiscal 2012 when compared to Fiscal 2011.

#### Retail

Costs for Retail for Fiscal 2012, increased by \$4.9 million, to \$6.8 million, when compared to Fiscal 2011. This increase resulted primarily from an additional cost of \$4.1 million incurred in Ting mobile device and service sales made during the year, as well as the increased cost resulting from the additional volume in Hover services.

#### Portfolio

Costs for Portfolio remained relatively flat at \$0.8 million for Fiscal 2012 as compared to Fiscal 2011.

#### Network Costs

Network costs remained relatively flat at \$6.5 million for Fiscal 2012 as compared to Fiscal 2011.

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

#### SALES AND MARKETING

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

	Year ended December 31,	
	2012	2011
Sales and marketing	\$ 8,701,446	\$ 7,442,681
Increase over prior period	\$ 1,258,765	
Increase - percentage	17%	
Percentage of net revenues	8%	8%

Sales and marketing expenses for Fiscal 2012 increased by \$1.3 million, or 17%, to \$8.7 million as compared to Fiscal 2011. This increase primarily related to costs associated with the addition of Ting customers and the acquisition of EPAG in August 2011.

Excluding movements in exchange rates, we expect sales and marketing expenses for the fiscal year ending December 31, 2013 to increase slightly, in absolute dollars, as we adjust our marketing programs and sales and customer support personnel costs to meet future opportunities in the marketplace.

#### TECHNICAL OPERATIONS AND DEVELOPMENT

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

	Year ended December 31,	
	2012	2011
Technical operations and development	\$ 4,302,820	\$ 4,868,228
Decrease over prior period	\$ (565,408)	
Decrease - percentage	(12)%	
Percentage of net revenues	4%	5%

Technical operations and development expenses for Fiscal 2012 decreased by \$0.6 million, or 12%, to \$4.3 million when compared to Fiscal 2011. These decreases primarily resulted from a decrease in workforce costs.

We expect technical operations and development expenses for the year ended December 31, 2013 (“Fiscal 2013”), in absolute dollars, to increase slightly when compared to Fiscal 2012.

#### 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.

	Year ended December 31,	
	2012	2011
General and administrative	\$ 6,610,819	\$ 6,096,596
Increase over prior period	\$ 514,223	
Increase - percentage	8%	
Percentage of net revenues	6%	6%

General and administrative expenses for Fiscal 2012 increased by \$0.5 million, or 8%, to \$6.6 million as compared to Fiscal 2011. This increase was primarily the result of incremental workforce related costs as well as additional costs incurred in processing a higher volume of credit cards.

We expect general and administrative expenses for Fiscal 2013, in absolute dollars, to increase slightly when compared to Fiscal 2012.

## DEPRECIATION OF PROPERTY AND EQUIPMENT

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

	Year ended December 31,			
	2012		2011	
Depreciation of property and equipment	\$	190,420	\$	187,005
Increase over prior period	\$	3,415		
Increase - percentage		2	%	
Percentage of net revenues		0	%	0 %

Depreciation costs for Fiscal 2012 remained essentially flat at \$0.2 million.

## LOSS ON DISPOSITION OF PROPERTY AND EQUIPMENT

	Year ended December 31,			
	2012		2011	
Loss on disposition of property and equipment	\$	118,944	\$	42,165
Increase over prior period	\$	76,779		
Increase - percentage		182	%	
Percentage of net revenues		0	%	0 %

As part of our ongoing initiatives to improve the efficiency of our production environment, we retired some older computer hardware at our co-location facilities during Fiscal 2012, which resulted in a loss on the disposition of such equipment.

## AMORTIZATION OF INTANGIBLE ASSETS

	Year ended December 31,			
	2012		2011	
Amortization of intangible assets	\$	876,120	\$	1,004,950
Decrease over prior period	\$	(128,830)		
Decrease - percentage		(13)	%	
Percentage of net revenues		1	%	1 %

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

The brand and customer relationships acquired in connection with the acquisitions of Boardtown Corporation, Innerwise Inc. and EPAG are being amortized on a straight-line basis over seven years.

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

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

## LOSS (GAIN) ON CURRENCY FORWARD CONTRACTS

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

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

	Year ended December 31,			
	2012		2011	
Loss (gain) on currency forward contracts	\$	(682,851)	\$	535,223
(Decrease) increase over prior period	\$	(1,218,074)		
(Decrease) /increase - percentage		(228)	%	
Percentage of net revenues		(1)	%	1 %

We have entered into certain forward exchange contracts that do not comply with the requirements of hedge accounting to meet a portion of our future Canadian dollar requirements through April 2014. The impact of the fair value adjustment on unrealized foreign exchange on these contracts for Fiscal 2012 was a net gain of \$1.1 million compared to a net loss of \$1.5 million for Fiscal 2011. This impact of the fair value adjustment on unrealized foreign exchange on these contracts was partially offset by a realized loss upon settlement of currency forward contracts of \$0.4 million for Fiscal 2012 and a realized gain of \$1.0 million for Fiscal 2011.

At December 31, 2012, our balance sheet reflects a derivative instrument asset of \$0.4 million as a result of our existing foreign exchange contracts. Until their respective maturity dates, these contracts will fluctuate in value in line with movements in the Canadian dollar relative to the U.S. dollar.

#### OTHER INCOME AND EXPENSES

	Year ended December 31,			
	2012		2011	
Other income (expense), net	\$	336,848	\$	324,573
Increase over prior period	\$	12,275		
Increase - percentage		4	%	
Percentage of net revenues		0	%	0 %

Other income for Fiscal 2012 increased by \$12,000, to \$0.3 million, as compared with Fiscal 2011. This primarily resulted from our selling certain intangible assets with no book value for \$0.5 million during Fiscal 2012. This increase was partially offset by the \$0.4 million we received during Fiscal 2011 from the third party who is commercializing the Infonautics patents we assigned to them in 2002, undertaking a routine audit of one of their licensees.

In addition, other income for Fiscal 2012 decreased when compared to Fiscal 2011 as a result of the interest payable pursuant to the terms of our credit facility with the Bank of Montreal.

#### INCOME TAXES

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

	Year ended December 31,			
	2012		2011	
Provision for (recovery of) income taxes	\$	2,004,156	\$	(2,719,621)
Increase in provision over prior period	\$	4,723,777		

Increase - percentage	(174)	%		
Percentage of net revenues	2	%	(3)	%



We operate in various tax jurisdictions, and accordingly, our income is subject to varying rates of tax. Losses incurred in one jurisdiction cannot be used to offset income taxes payable in another jurisdiction. Our ability to use income tax loss carryforwards and future income tax deductions is dependent upon our operations in the tax jurisdictions in which such losses or deductions arise. Income taxes are computed using the asset and liability method, under which deferred tax assets and liabilities are determined based on the difference between the financial statement carrying values and tax base of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to affect taxable income. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized.

Fiscal 2012 includes tax on profits of \$2.1 million, offset by a recovery of \$0.1 million related to investment tax credits.

Our Fiscal 2011 provision included a deferred tax recovery of \$3.6 million related to the full release of our remaining valuation allowances. In addition, our Fiscal 2011 provision included a recovery of \$0.2 million related to revisions of prior year estimates and a recovery of \$0.04 million related to investment tax credits earned during the period. This was offset by a provision for Fiscal 2011 tax on profits of \$1.1 million.

We had approximately \$0.4 million of total gross unrecognized tax benefit as of December 31, 2012 and \$0.2 million of total gross unrecognized tax benefit as of December 31, 2011, which if recognized would favorably affect our income tax rate in future periods. The unrecognized tax benefit relates primarily to prior year Pennsylvania state franchise taxes and other insignificant U.S. state taxes, unrecognized tax benefits for potential 2012 research and development tax credits as well as prior year German income tax. We will record the tax benefit of the 2012 research and development claim once we have reasonable assurance that it is more likely than not that all or a portion of the benefit arising from the claim will be realized.

A reconciliation of the federal statutory income tax rate to our effective tax rate is set forth in Note 10 of Notes to Consolidated Financial Statements included in this Annual Report on Form 10-K.

#### OTHER COMPREHENSIVE INCOME

To mitigate the impact of the change in fair value of our foreign exchange contracts on our financial results, in October 2012 we 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 other comprehensive income for the periods presented:

	Year ended December 31,			
		2012		2011
Comprehensive income	\$	44,104	\$	-
Increase in provision over prior period	\$	44,104		
Increase - percentage		(100)	%	
Percentage of net revenues		0	%	- %

## RESULTS OF OPERATIONS FOR THE YEAR ENDED DECEMBER 31, 2011 AS COMPARED TO THE YEAR ENDED DECEMBER 31, 2010

## NET REVENUES

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

	Year ended December 31,	
	2011	2010
<b>Wholesale</b>		
Domain Services	\$ 76,201,058	\$ 64,977,121
Value Added Services	9,268,460	8,978,922
Total Wholesale	85,469,518	73,956,043
<b>Retail</b>		
Portfolio	5,263,118	4,559,833
	6,332,331	6,062,629
	\$ 97,064,967	\$ 84,578,505
Increase over prior period	\$ 12,486,462	
Increase - percentage	15	%

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

	Year ended December 31,			
	2011		2010	
<b>Wholesale</b>				
Domain Services	78	%	77	%
Value Added Services	10	%	11	%
Total Wholesale	88	%	88	%
<b>Retail</b>				
Portfolio	5	%	5	%
	7	%	7	%
	100	%	100	%

Total net revenues for Fiscal 2011 increased by \$12.5 million, or 15%, to \$97.1 million from \$84.6 million for the year ended December 31, 2010 ("Fiscal 2010"). Deferred revenue from domain name registrations and other Internet services at December 31, 2011 increased to \$69.2 million from \$62.6 million at December 31, 2010.

No customer accounted for more than 10% of revenue during Fiscal 2011 and, at December 31, 2011, one customer accounted for 16% of accounts receivable. Significant management judgment is required at the time of recording of revenue to assess whether the collection of the resulting receivables is reasonably assured. On an ongoing basis, we assess the ability of our customers to make required payments. Based on this assessment, we expect the carrying amount of our outstanding receivables, net of allowance for doubtful accounts, to be fully collected.

## Wholesale

During Fiscal 2011, OpenSRS revenue increased by \$11.5 million, or 16% to \$85.5 million when compared to Fiscal 2010 primarily as a result of OpenSRS domain revenue increasing by \$11.2 million or 17% to \$76.2 million. This

increase is primarily attributable to our success in attracting customers with increased transaction volumes, the impact of the EPAG acquisition and the impact of the 7% registration fee increase implemented in July 2010 for registration fees paid to certain registries. In addition, email revenue increased by \$0.3 million or 12% to \$2.6 million and other services increased by \$0.4 million or 10% to \$4.8 million as a result of market development funds vendors have provided us to expand or maintain the market position for their services. Other service increases in future periods may not be commensurate with what we have achieved during past periods as our vendor partners may elect to cancel or amend their marketing programs at any time. These increases were partially offset by \$0.4 million as a result of the timing of domain name sales from the OpenSRS Domain Expiry Stream.

During Fiscal 2011, the total new, renewed and transferred-in domain name registrations that we processed increased by 1.2 million or 16% to 8.6 million registrations as compared to Fiscal 2010. This increase resulted primarily from our continuing efforts to attract new clients and retain existing customers, as well as our acquisition of EPAG in August 2011.

As of December 31, 2011, the total domain names under our management had increased by 1.7 million, or 19%, to 10.5 million domain names, as compared to the total domain names under our management as of December 31, 2010. This increase is primarily the result in our success at attracting new customers with increased transaction volumes and includes the 0.4 million domains that were added through the acquisition of EPAG. In addition, we provide provisioning services on a monthly basis to accredited registrars who use our technical systems to process domain registrations with their own accreditation. The number of domain names we manage on behalf of other accredited registrars remained essentially flat at 1.4 million at both December 31, 2011 and December 31, 2010.

#### Portfolio

During Fiscal 2011, Portfolio revenue increased by \$0.3 million, or 4%, to \$6.3 million when compared to Fiscal 2010. This primarily resulted from increases in domain name sales from our portfolio of \$0.6 million being partially offset by lower advertising and other revenue through our two ad-supported content sites, butterscotch.com and tucows.com, decreasing by \$0.2 million and the delivery of third-party advertisements on parked pages decreasing by \$0.1 million.

#### Hover

Net revenues from Hover for Fiscal 2011 as compared to Fiscal 2010 increased by \$0.7 million, or 15%, to \$5.3 million. We believe that this increase reflects the success of our marketing initiatives and improved website in attracting new customers and retaining existing ones.

#### COST OF REVENUES

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

	Year ended December 31,	
	2011	2010
<b>Wholesale</b>		
Domain Services	\$ 63,491,433	\$ 54,087,893
Value Added Services	1,969,374	1,996,317
Total Wholesale	65,460,807	56,084,210
<b>Retail</b>		
Portfolio	1,881,063	1,527,727
Network, other costs	746,517	882,912
Network, depreciation and amortization costs	4,837,650	4,648,899
	836,045	1,331,576
	\$ 73,762,082	\$ 64,475,324
Increase over prior period	\$ 9,286,758	
Increase - percentage	14	%



The following table presents our cost of revenues, as a percentage of total cost of revenues for the periods presented:

	Year ended December 31,			
	2011		2010	
<b>Wholesale</b>				
Domain Services	86	%	85	%
Value Added Services	3	%	3	%
Total Wholesale	89	%	88	%
<b>Retail</b>				
Retail	2	%	2	%
Portfolio	1	%	1	%
Network, other costs	7	%	7	%
Network, depreciation and amortization costs	1	%	2	%
	100	%	100	%

Total cost of revenues for Fiscal 2011 increased by \$9.3 million, or 14%, to \$73.8 million from \$64.5 million in Fiscal 2010 primarily the result of increased sales volumes. Prepaid domain registration and other Internet services fees as of December 31, 2011 increased by \$6.0 million, or 12%, to \$55.8 million from \$49.8 million at December 31, 2010.

#### Wholesale

Costs for Wholesale for Fiscal 2011 increased by \$9.4 million, or 17%, to \$65.5 million, when compared to Fiscal 2010.

This increase was primarily the result of increased domain registration volumes that were experienced during Fiscal 2011 when compared to Fiscal 2010 and increases in registration fees paid to the registries that were implemented in July 2010.

#### Retail

Costs for Retail for Fiscal 2011 as compared to Fiscal 2010 increased by \$0.4 million, or 23%, to \$1.9 million, and primarily reflect our success in attracting new customers and retaining existing ones.

#### Portfolio

Costs for Portfolio decreased by \$0.1 million to \$0.8 million, when compared to Fiscal 2010.

#### Network costs

Network costs before depreciation and amortization for Fiscal 2011 increased by \$0.2 million, or 4%, to \$4.8 million, primarily as a result of increased workforce costs. Network costs were also negatively impacted by the approximately 5% strengthening, on average, in the Canadian dollar relative to the U.S. dollar compared to Fiscal 2010 which reflects our improved efficiency in operating and managing our co-location facilities.

Amortization of intangible assets consists of amounts arising in connection with the acquisition of technology from each of the Boardtown Corporation in April 2004, Mailbank.com Inc. in June 2006, IYD in July 2007 and EPAG in August 2011.

SALES AND MARKETING

	Year ended December 31,	
	2011	2010
Sales and marketing	\$ 7,442,681	\$ 7,217,754
Increase over prior period	\$ 224,927	
Increase - percentage	3%	
Percentage of net revenues	8%	9%

Sales and marketing expenses for Fiscal 2011 increased by \$0.2 million, or 3%, to \$7.4 million as compared to Fiscal 2010. The increase was primarily due to our direct sales and marketing efforts in 2011 and the acquisition of EPAG in August 2011. Sales and marketing expenses were also negatively impacted by the approximately 5% strengthening, on average, in the Canadian dollar relative to the U.S. dollar compared to Fiscal 2010.

#### TECHNICAL OPERATIONS AND DEVELOPMENT

	Year ended December 31,	
	2011	2010
Technical operations and development	\$ 4,868,228	\$ 4,577,898
Increase over prior period	\$ 290,330	
Increase - percentage	6%	
Percentage of net revenues	5%	5%

Technical operations and development expenses for Fiscal 2011 increased by \$0.3 million, or 6%, to \$4.9 million as compared to Fiscal 2010. The year-over-year increase was largely due to increased personnel and related costs that we incurred to further develop our platform and websites to support and grow our service offerings. Technical operations and development expenses were also negatively impacted by the approximately 5% strengthening, on average, in the Canadian dollar relative to the U.S. dollar compared to Fiscal 2010.

#### GENERAL AND ADMINISTRATIVE

	Year ended December 31,	
	2011	2010
General and administrative	\$ 6,096,596	\$ 5,123,074
Increase over prior period	\$ 973,522	
Increase - percentage	19%	
Percentage of net revenues	6%	6%

General and administrative expenses for Fiscal 2011 increased by \$1.0 million, or 19%, to \$6.1 million as compared to Fiscal 2010. The year-over-year increase was primarily due to a \$0.5 million increase in professional fees primarily related to our public company compliance initiatives and additional legal fees incurred in defending ourselves in domain name disputes to which we are named as a party and a \$0.3 million increase in facilities and rent expenses. General and administrative expenses were also negatively impacted by the approximately 5% strengthening, on average, in the Canadian dollar relative to the U.S. dollar compared to Fiscal 2010.

#### DEPRECIATION OF PROPERTY AND EQUIPMENT

	Year ended December 31,	
	2011	2010
Depreciation of property and equipment	\$ 187,005	\$ 170,844
Increase over prior period	\$ 16,161	
Increase - percentage	9%	
Percentage of net revenues	0%	0%

Depreciation costs for Fiscal 2011 remained essentially flat at \$0.2 million. In December 2011 we began to reconfigure our Toronto facility to better support our agile teams.

#### LOSS ON DISPOSITION OF PROPERTY AND EQUIPMENT

Year ended December 31,



	2011	2010
Loss on disposition of property and equipment	\$ 42,165	\$ -
Increase over prior period	\$ 42,165	
Increase - percentage	-%	
Percentage of net revenues	0%	-%

As part of our ongoing initiatives to improve the efficiency of our production environment, we retired some older computer hardware at our co-location facilities during Fiscal 2011, which resulted in a loss on the disposition of such equipment.

#### AMORTIZATION OF INTANGIBLE ASSETS

	Year ended December 31,	
	2011	2010
Amortization of intangible assets	\$ 1,004,950	\$ 1,442,160
Decrease over prior period	\$ (437,210)	
Decrease - percentage	(30)%	
Percentage of net revenues	1%	2%

Amortization of intangible assets consists of amounts arising in connection with the acquisition of Boardtown in April 2004, the acquisition of Mailbank.com Inc. in June 2006, the acquisition of Innerwise, Inc. in July 2007 and the acquisition of EPAG in August 2011.

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

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

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

	Year ended December 31,	
	2011	2010
Loss (gain) on currency forward contracts	\$ 535,223	\$ (872,539)
Increase over prior period	\$ 1,407,762	
Increase - percentage	(161)%	
Percentage of net revenues	1%	(1)%

We have entered into forward exchange contracts to meet a portion of our future Canadian dollar requirements through May 2013. The impact of the fair value adjustment on unrealized foreign exchange on these contracts for Fiscal 2011 was a net loss of \$1.5 million compared to a net loss of \$1.4 million for Fiscal 2010. This impact of the fair value adjustment on unrealized foreign exchange on these contracts was partially offset by the realized gain upon settlement of currency forward contracts of \$1.0 million for Fiscal 2011 and \$2.2 million for Fiscal 2010.

At December 31, 2011, our balance sheet reflects a derivative instrument liability of \$0.7 million as a result of our existing foreign exchange contracts. Until their respective maturity dates, these contracts will fluctuate in value in line with movements in the Canadian dollar relative to the U.S. dollar.

#### OTHER INCOME AND EXPENSES

	Year ended December 31,	
	2011	2010
Other income (expense), net	\$ 324,573	\$ (116,197)
Increase over prior period	\$ 440,770	
Increase - percentage	(379)%	
Percentage of net revenues	0%	(0)%

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

Also, net interest expense decreased by \$0.05 million during Fiscal 2011 when compared to the Fiscal 2010, primarily as a result of the impact of the capital repayments we have made.

## INCOME TAXES

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

	Year ended December 31,	
	2011	2010
Provision for (recovery of) income taxes	\$ (2,719,621)	\$ 210,845
Increase in provision over prior period	\$ (2,930,466)	
Decrease - percentage	(1,390)%	
Percentage of net revenues	(3)%	0%

We operate in various tax jurisdictions, and accordingly, our income is subject to varying rates of tax. Losses incurred in one jurisdiction cannot be used to offset income taxes payable in another jurisdiction. Our ability to use income tax loss carryforwards and future income tax deductions is dependent upon our operations in the tax jurisdictions in which such losses or deductions arise. Income taxes are computed using the asset and liability method, under which deferred tax assets and liabilities are determined based on the difference between the financial statement carrying value and tax base of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to affect taxable income. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized.

We currently believe that based on the available information, it is more likely than not that our deferred tax assets will be realized, and accordingly, during Fiscal 2011, we have recorded a deferred tax recovery of \$3.6 million related to the full release of our remaining valuation allowances. In addition, our Fiscal 2011 provision included a recovery of \$0.2 million related to revisions of prior year estimates and a recovery of \$0.04 million related to investment tax credits earned during the period. This was offset by a provision for Fiscal 2011 tax on profits of \$1.1 million.

Our 2010 provision for income taxes primarily relates to tax on prior year profits of \$0.2 million, tax expense of \$0.1 million related to revisions to prior year estimates; offset by a recovery of \$0.05 million related to investment tax credits earned during the period.

We had approximately \$0.2 million of total gross unrecognized tax benefit as of December 31, 2011 and \$0.2 million of total gross unrecognized tax benefit as of December 31, 2010, which if recognized would favorably affect our income tax rate in future periods. The unrecognized tax benefit relates primarily to prior year Pennsylvania state franchise taxes and other insignificant U.S. state taxes as well as unrecognized tax benefits for potential 2011 research and development tax credits. We will record the tax benefit of the 2011 research and development claim once we have reasonable assurance that it is more likely than not that all or a portion of the benefit arising from the claim will be realized.

A reconciliation of the federal statutory income tax rate to our effective tax rate is set forth in Note 10 of Notes to Consolidated Financial Statements included in this Annual Report on Form 10-K.

## Liquidity and capital resources

As of December 31, 2012, our cash and cash equivalents balance remained flat at \$6.4 million when compared to December 31, 2011. Our principal sources of liquidity during Fiscal 2012 was net cash provided by operating activities of \$6.3 million, the proceeds of \$0.5 million we received on the sale of certain intangible assets with no book value and our credit facility with the Bank of Montreal (the “Bank” or “BMO”).

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

### Two Revolving Demand Loan Facilities.

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

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

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

On July 28, 2011, we drew down \$2.5 million on our prior demand loan revolving facility (“DLR Loan”) to fund the acquisition of EPAG as more fully described under Note 3, Business acquisitions. On December 31, 2011, in accordance with the terms of our prior revolving demand loan facilities, the remaining balance under the 2011 DLR Loan was fully repaid by an equivalent advance made under our prior demand loan revolving reducing loan facility (the “2011 DLRR Loan”). At June 30, 2012, the 2011 DLRR Loan was fully repaid.

During the period ended March 31, 2012, we successfully concluded a modified “Dutch auction tender offer”, which was funded from available cash and an advance under the 2011 DLR Loan in the amount of \$4.0 million. Under the terms of the offer, we repurchased an aggregate of 7,570,236 shares of our common stock at a purchase price of \$0.77 per share, for a total of \$5,829,082, excluding transaction costs of approximately \$64,000. At December 31, 2012, the outstanding balance under the 2012 DLR Loan was \$3.7 million.

### Treasury Risk Management Facility

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

December 31, 2012, we held contracts in the amount of \$29.3 million to trade U.S. dollars in exchange for Canadian dollars.

#### Operating Demand Loan

The Amended Credit Facility also provides us with a \$1.0 million operating demand loan facility to assist us in meeting our operational needs (the “Operating Demand Loan”). The Operating Demand Loan accrues interest at the Bank’s U.S. Base Rate plus 1.25%. Interest is payable monthly in arrears with any borrowing under the Operating Demand Loan fluctuating widely with periodic clean-up, at a minimum on an annual basis. We have also agreed to pay to the Bank a monthly monitoring fee of US\$500 with respect to this loan. The Operating Demand Loan is payable on demand at any time, at the sole discretion of the Bank, with or without cause, and the Bank may terminate the Operating Demand Loan at any time. As of December 31, 2012, we had no amounts outstanding under the Operating Demand Loan.

## General Terms

Our Amended Credit Facility contains customary representations and warranties, affirmative and negative covenants, and events of default. Our obligations under the Amended Credit Facility are guaranteed and secured by a security interest in substantially all of our assets. The Amended Credit Facility also requires that we comply with certain customary non-financial covenants and restrictions. In addition, we have agreed to comply with the following financial covenants at all times, which are to be calculated on a rolling four quarter basis: (i) Maximum Total Funded Debt to EBITDA of 2.00:1; and (ii) Minimum Fixed Charge Coverage of 1.20:1. Further, our Maximum Annual Capital Expenditures cannot exceed \$3.6 million per year, which limit will be reviewed on an annual basis. As of, and for the year ended, December 31, 2012, we were in compliance with these covenants.

## Cash Flow from Operating Activities

### Year ended December 31, 2012

Net cash inflows from operating activities were \$6.3 million, an increase of 8% when compared to the prior year. Net income during Fiscal 2012 was \$6.0 million, which included non-cash charges and recoveries of \$1.6 million such as a provision for deferred tax, gain on currency forward contracts, depreciation, amortization and stock-based compensation. The remainder of our source of net cash flow from operating activities was from changes in our working capital, with positive contributions of \$4.3 million from movements in deferred revenue, accounts payable, accrued expenses, income taxes recoverable and customer deposits being partially offset by our utilizing \$4.0 million to fund deferred registration costs, deposits with registries, accounts receivable and prepaid expenses.

### Year ended December 31, 2011

Net cash inflows from operating activities were \$5.9 million a decrease of 13% when compared to the prior year. Net income during Fiscal 2011 was \$7.1 million, which included non-cash charges and recoveries of \$0.9 million such as a deferred tax recovery, a gain on currency forward contracts, depreciation, amortization and stock-based compensation. We deployed an additional \$7.1 million in working capital to fund deferred registration costs, deposits with registries, accounts receivable, income taxes recoverable, prepaid expenses and accounts payable which was partially offset by positive contributions of \$5.9 million in movements in deferred revenue, accrued expenses and customer deposits.

### Year ended December 31, 2010

Net cash inflows from operating activities were \$6.8 million, an increase of 5% when compared to the prior year. Net income during Fiscal 2010 was \$6.9 million, which included non-cash charges and recoveries of \$4.8 million such as a loss on currency forward contracts, depreciation, amortization and stock-based compensation. We deployed an additional \$6.9 million in working capital to fund deferred registration costs, accounts receivable, accounts payable and accrued expenses which was partially offset by positive contributions of \$6.8 million in movements in deferred revenue, customer deposits and registry deposits.

## Cash Flow from Financing Activities

### Year ended December 31, 2012

Net cash used in financing activities during Fiscal 2012 totaled \$5.8 million as compared to \$0.4 million during Fiscal 2011. Net cash of \$9.1 million was used to fund the repurchase of 7.6 million of our shares through a modified "Dutch auction tender offer" that was successfully concluded on January 23, 2012 and to repurchase 2.4 million shares under our current Normal Course Issuer Bid during Fiscal 2012. A portion of the amount to fund the modified Dutch auction tender offer was from a \$4.0 million draw down on our DLR Loan facility. In addition, during Fiscal 2012, \$1.2 million was used to fund principal repayments under our loan agreements. These uses were partially offset by the proceeds of \$0.4 million we received on the exercise of options by directors and employees of the Company.

Year ended December 31, 2011

Net cash used in financing activities during Fiscal 2011 totaled \$0.4 million which arose out of our using our credit facilities with the Bank. During Fiscal 2011, we fully repaid the remaining \$1.3 million that was outstanding on the non-revolving, reducing demand loan facility we utilized to acquire Innerwise Inc. in July 2007. In addition, in July 2011, we utilized \$2.5 million of our non-revolving, reducing demand loan facility to fund the acquisition of EPAG and over the balance of the fiscal year repaid \$1.7 million of this loan.



Year ended December 31, 2010

Net cash used in financing activities during Fiscal 2010 totaled \$11.6 million. Of this \$11.6 million, \$9.7 million was used to fund share repurchases and \$1.9 million was used for principal repayments under our non-revolving, reducing demand loan facility in connection with the 2007 Innerwise Inc. acquisition.

Under our share repurchase programs we used \$7.3 million to repurchase 10.3 million of our shares pursuant to the terms of two Dutch auction tender offers completed during January 2010 and October 2010, and \$2.4 million to repurchase 3.4 million of our shares under the terms of our stock repurchase program announced in February 2010. These initiatives have resulted in a 20% reduction in our issued and outstanding shares as compared to our issued and outstanding shares at December 31, 2009.

#### Cash Flow from Investing Activities

Year ended December 31, 2012

Investing activities during Fiscal 2012 used net cash of \$0.5 million; \$1.0 million was used to acquire additional property and equipment, which was partially offset by the selling of certain intangible assets with no book value for \$0.5 million during Fiscal 2012.

Year ended December 31, 2011

Investing activities during Fiscal 2011 used net cash of \$3.2 million; \$2.4 million was used to fund the EPAG Domainservices GmbH acquisition and \$0.8 million to acquire additional property and equipment.

Year ended December 31, 2010

Investing activities during Fiscal 2010 used \$0.6 million to acquire additional property and equipment.

#### Subsequent events

On January 7, 2013, the Company announced that it successfully concluded a modified “Dutch auction tender offer” that was previously announced on November 21, 2012. Under the terms of the offer, the Company repurchased an aggregate of 4,114,437 shares of its common stock at a purchase price of \$1.50 per share, for a total of \$6,171,656, excluding transaction costs of approximately \$110,000. The purchase price and all transaction costs were funded from available cash and an additional advance under its Amended Credit Facility from the Bank in the amount of \$5.2 million. All shares purchased in the tender offer received the same price and all shares repurchased were immediately retired. As a result of the completion of the tender offer, as of January 31, 2013, the Company had 40,226,875 shares issued and outstanding.

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

#### Off Balance Sheet Arrangements and Contractual Obligations

We have not entered into any off balance sheet financial arrangements and have not established any special purpose entities as of December 31, 2012 nor have we guaranteed any debt or commitment of other entities. As such, we are not materially exposed to any financing, liquidity, market or credit risk that could arise if we had engaged in such relationships.



## ITEM 7A. 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 December 31, 2012. We are also subject to market risk exposure related to changes in interest rates under our Amended Credit Facility. We do not expect that any changes in interest rates will be material; however, fluctuations in interest rates are beyond our control. We will continue to monitor and assess the risks associated with interest expense exposure and may take additional actions in the future to mitigate these risks.

Although our functional currency is the U.S. dollar, a substantial portion of our fixed expenses are incurred in Canadian dollars. Our policy with respect to foreign currency exposure is to manage financial exposure to certain foreign exchange fluctuations with the objective of neutralizing some of the impact of foreign currency exchange movements. Exchange rates are, however, subject to significant and rapid fluctuations, and therefore we cannot predict the prospective impact of exchange rate fluctuations on our business, results of operations and financial condition. Accordingly, we have entered into foreign exchange contracts to mitigate the exchange rate risk on portions of our non-hedged Canadian dollar exposure. Additionally, we have hedged certain of our Canadian dollar foreign currency exposures relating to our payroll expenses in Canada. Based on the foreign exchange forward contracts outstanding as at June 30, 2012, a one cent change in the Canadian dollar to U.S. dollar exchange rates would cause a change of approximately \$1.0 million in the mark to market on our existing foreign exchange forward contracts.

At December 31, 2012, the Company had the following outstanding forward exchange contracts to trade U.S. dollars in exchange for Canadian dollars:

Maturity date	Notional amount of U.S. dollars	Weighted average exchange rate of U.S. dollars	Fair value
January – March, 2013	6,000,000	1.0277	193,941
April – June, 2013	5,270,000	1.0300	171,739
July - September, 2013	4,930,000	1.0047	22,820
October - December, 2013	5,480,000	1.0071	24,444
January – March, 2014	5,720,000	1.0095	24,218
April – May, 2014	1,940,000	1.0109	7,620
Total	\$ 29,340,000	1.0157	\$ 444,782

As of December 31, 2012 the Company has \$29.3 million of outstanding foreign exchange forward contracts which will convert to CDN \$29.8 million. Of these contracts, \$15.1 million met the requirements for hedge accounting (2011 – NIL).

We have performed a sensitivity analysis model for foreign exchange exposure over the three months ended December 31, 2012. 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 December 31, 2012. 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 December 31, 2012 of approximately \$0.5 million. There can be no assurances that the above projected exchange rate decrease will materialize. Fluctuations of exchange rates are beyond our control. We will continue to monitor and assess the risk associated with these exposures and may take additional actions in the future to hedge or mitigate these risks.

## Credit Risk

Financial instruments that potentially subject us to concentrations of credit risk consist principally of cash equivalents, marketable securities, foreign exchange contracts and accounts receivable. Our cash, cash equivalents and short-term investments are in high-quality securities placed with major banks and financial institutions whom we have evaluated as highly creditworthy and commercial paper. 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.

## ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Our consolidated financial statements and supplementary data required by this item are attached to this Annual Report on Form 10-K beginning on page F-1.

## ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

## ITEM 9A. CONTROLS AND PROCEDURES

### Disclosure Controls and Procedures

Under the supervision of our Chief Executive Officer and Chief Financial Officer, our management conducted an assessment of the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) as of the end of the period covered by this report. Based on the results of such assessment, management have concluded that our disclosure controls and procedures as of the end of the period covered by this report are effective.

### Internal Control over Financial Reporting.

Our management is responsible for establishing and maintaining adequate internal control over financial reporting for Tucows. There were no changes in our internal control over financial reporting during the year ended December 31, 2012 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within Tucows have been detected. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, control may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

Management's report on internal control over financial reporting is included on page F-2 of this Annual Report on Form 10-K.

ITEM 9B. OTHER INFORMATION

None.

55

---

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

Allen Karp  
Co-Chairman of the Board since September 2012  
and Director since October 2005

Mr. Karp, 73, was with Cineplex Odeon Corporation in various positions since 1986, where he retired as Chairman and Chief Executive Officer in 2002 and as Chairman Emeritus in 2005. From 1966 to 1986, he practiced law at the law firm of Goodman and Carr LLP, where he was named partner in 1970. Mr. Karp is a Director of Brookfield Real Estate Services Inc., the Chair of its corporate governance committee and sits on the audit committee. Mr. Karp is Chairman of the Board of Directors of IBI Group Inc., and is Chairman of the Nominating, Governance and Compensation Committee. Mr. Karp is a past director of the Toronto International Film Festival Group, where he served as Chairman of the Board from 1999 to 2007 and has served as Chairman of its Corporate Governance Committee since 2007.

Mr. Karp has extensive executive leadership skills, long-standing senior management experience, a strong ethics and compliance focus and audit committee experience. These skills and qualifications, in addition to his current service on the boards of directors of other public companies, enable him to bring valuable perspectives to our Board, particularly with respect to corporate governance matters, and qualify him to be a director of Tucows.

Rawleigh H. Ralls  
Co-Chairman of the Board since September 2012  
and Director since May 2009

Mr. Ralls, 51, is a founding partner of Lacuna, LLC, an investment management company focused on both public and private companies, which he formed in October 2006. Prior thereto, from 1999 to 2006, he was Chairman of Netidentity.com, an Internet email and web hosting company, where he led corporate strategy and development until the firm's sale in 2006. Mr. Ralls currently serves on the Board of Directors of a number of companies, including Savoya, LLC, IntraOp Medical, Knowledge Factor, and Mocupay, Inc.

Mr. Ralls has a wealth of industry experience, most notably the experience that he gained through his leadership of Netidentity.com. In addition, Mr. Ralls contributes a unique perspective to the Board's discussions and considerations based on the two decades of investing and portfolio management experience. All of these attributes qualify Mr. Ralls to be a director of Tucows.

Stanley Stern  
Chairman of the Board from August 2001 to May 2012  
and Director since January 2000

Mr. Stern, 56, has been a Managing Director and Head of Investment Banking, Technology and Financial Institutions, with Oppenheimer & Co. Inc., an investment banking firm, since April 2004. From February 2002 to March 2004, Mr. Stern served as a Managing Director and Head of Investment with C.E. Unterberg, Towbin, an investment banking firm. From January 2000 to February 2002, Mr. Stern served as Managing Director of STI Ventures Advisory USA Inc. and as a member of the Board of Directors and the investment committee of STI Ventures, a venture capital company focusing on the high technology market.

Mr. Stern has extensive experience with technology based companies in the context of his investment banking experience and has an in-depth knowledge of the Company's business strategy and management team, all of which qualify him to be a director of Tucows.

Eugene Fiume

Director since June 2005

Mr. Fiume, 55, has been a professor since 1995 and was a past Chair from 1998 to 2004 of the Department of Computer Science at the University of Toronto, where he also co-directs the Dynamic Graphics Project. He is the director of the Department's professional master's programme.

Mr. Fiume has held many advisory board roles in both the public and private sectors. He currently works with venture capital companies and SMEs on due diligence, strategy and human resources; he is also currently on the advisory board of the Intel Science and Technology Center for Visual Computing.



Mr. Fiume has an extensive and evolving knowledge of computer science in the context of his experience as a Professor at the University of Toronto. In addition, he has other valuable experience with technology companies generally that, in addition to the other attributes listed above, qualify him to be a director of Tucows.

Erez Gissin

Director since August 2001

Mr. Gissin, 54, has served since 2010 as a managing partner in Helios Energy Investment, a Renewable Energy investment fund, and since 2005 as the Chief Executive Officer of BCID Ltd., an investment company focusing on infrastructure development projects in China. From July 2000 to March 2005, Mr. Gissin has served as the Chief Executive Officer of IP Planet Networks Ltd., an Israeli satellite communication operator providing Internet backbone connectivity and solutions to Internet Service Providers. From July 1995 to July 2000, Mr. Gissin was Vice President, Business Development of Eurocom Communications Ltd., a holding company that controls several telecommunications services, equipment and Internet companies in Israel.

Mr. Gissin has a strong background in the internet communications industry and has gained significant institutional knowledge in his long tenure as one of our directors. Mr. Gissin also has significant leadership experience as the Chief Executive Officer of BCID Ltd. and IP Planet Networks Ltd. and has extensive financial acumen derived from his years of executive experience. All of these qualities qualify Mr. Gissin to be a director of Tucows.

Joichi Ito

Director since December 2008

Mr. Ito, 47, is the director of the MIT Media Lab. He is also the Chairman of Creative Commons, where he has served on the board since April 2008 and is a co-founder of Digital Garage, where he has served on the board since September 2006. Since June 2012, Mr. Ito has been a member of the Board of Directors of the New York Times Corporation.

From June 2002 until July 2008, Mr. Ito served on the board of Pia Corporation, a ticket and entertainment magazine company in Japan (Tokyo Stock Exchange 4337). Since May 2009 Mr. Ito has served on the board of CCC, a video rental franchise company in Japan (Tokyo Stock Exchange 4756). He served on the board of ICANN, a U.S. non-profit corporation, from December 2004 until December 2007. ICANN manages the domain name registration system that Tucows uses for its domain name business and ICANN receives fees from Tucows for domain name registrations.

Mr. Ito is also on the board of directors of a number of non-profit organizations, including The Knight Foundation, the MacArthur Foundation and The Mozilla Foundation. He has created numerous Internet companies, including PSINet Japan, Digital Garage (Tokyo Stock Exchange 4819) and Infoseek Japan and was an early stage investor in Twitter, Six Apart, Flickr, SocialText, Dopplr, Last.fm, Rupture and Kongregate. He has served and continues to serve on various Japanese central as well as local government committees and boards, advising the government on IT, privacy and computer security related issues.

Mr. Ito has extensive experience as a director of a number of publicly traded companies and has a wide range of experience with internet companies generally. This experience, along with Mr. Ito's domain specific knowledge, enables him to bring key experience to the Company and qualifies him to be a director of Tucows.

Lloyd Morrisett

Director since February 1994

Dr. Morrisett, 83, served as a director and as a member of the audit and compensation committees of Infonautics, Inc., our predecessor, beginning in February 1994. Dr. Morrisett also served as chairman of the Board of Directors of Infonautics beginning in March 1998 until we merged with Tucows Inc., a Delaware corporation ("Tucows Delaware"),

in August 2001 and became Tucows Inc. He is the co-founder of the Children's Television Workshop—now Sesame Workshop—and served from 1969 to 1998 as president of The Markle Foundation, a charitable organization.

The breadth of Dr. Morrisett's career has provided him with extensive business acumen and leadership experience. In addition, as a member of the board of directors of our predecessor, Dr. Morrisett is uniquely positioned to provide our Board and the Company with an important historical perspective with respect to the Company's operations and strategy. These factors, combined with Dr. Morrisett's experience as a public company board, audit committee and compensation committee member qualify him to be a director of Tucows.

Elliot Noss

Director since August 2001

Mr. Noss, 51, is our President and Chief Executive Officer and has served in such capacity since the completion of our merger with Tucows Delaware in August 2001. From May 1999 until completion of the merger in August 2001, Mr. Noss served as President and Chief Executive Officer of Tucows Delaware. Before that, from April 1997 to May 1999, Mr. Noss served as Vice President of Corporate Services of Tucows Interactive Ltd., which was acquired by Tucows Delaware in May 1999.

Mr. Noss's lengthy service as our Chief Executive Officer has provided him with extensive knowledge of, and experience with, Tucows' operations, strategy and financial position. In addition, Mr. Noss has widespread knowledge of the internet and software industry generally that, coupled with his operational expertise, qualifies him to be a director of Tucows.

Jeffrey Schwartz

Director since June 2005

Mr. Schwartz, 51, has served as a director of Dorel Industries since 1987 and as Executive Vice President and Chief Financial Officer since 2003. Mr. Schwartz is a graduate of McGill University in Montreal and has a degree in the field of business administration.

Mr. Schwartz has a significant amount of public-company financial expertise, particularly in his executive experience as the chief financial officer of Dorel Industries, Inc. This executive experience, along with Mr. Schwartz's service as one of our Audit Committee members (and as Chairman of our Audit Committee since 2005), qualifies him to be a director of Tucows.

Our directors are elected annually and serve until the election or appointment and qualification of their successors or their earlier death, resignation or removal.

#### Executive Officers

The required information regarding our executive officers is set forth in Part I hereof under the caption "Executive Officers of the Registrant" and is incorporated herein by reference.

#### Governance Principals

The governance principals of our Board of Directors include the charters of our audit committee, our Corporate Governance and Compensation Committee, our Code of Conduct, and our Code of Ethics. Each of these documents and various other documents embodying our governance principals are published on our website at [tucowsinc.com](http://tucowsinc.com). Amendments and waivers of our Code of Ethics will either be posted on our website or filed with the SEC on a Current Report on Form 8-K.

Mr. Karp and Mr. Ralls, two of our independent directors, serve as Co-Chairmen of the Board. The Board does not have a lead independent director. Our Board currently consists of nine directors, eight of whom the Board has determined are "independent" within the meaning of the independence requirements prescribed by the listing standards of NYSE Amex. In making this determination with respect to Mr. Ralls, the board considered whether his beneficial ownership of Tucows equity securities constituted a material relationship with the Company that would impair his independence, and concluded that he was independent. The Board believes that this structure, which provides an overwhelming majority of independent directors, coupled with the Board meeting in executive session without any management directors or non-independent directors present, is an appropriate structure for Tucows' Board. We believe that this structure provides appropriate and independent oversight by the Board. The Board regularly consults with our

Chief Executive Officer, who is also a director, and our corporate governance, nominating and compensation committee to review the various types of risk that affect TuCows and the strategies to mitigate such risks. The Board believes that this structure has been effective.

## Meetings

Our Board of Directors met six times during Fiscal 2012. Our Board of Directors also took action by unanimous written consent on two occasions during Fiscal 2012. With the exception of Mr. Ito, each director attended at least 80% of the total number of meetings of the Board of Directors and the committees on which he served during Fiscal 2012.

## Executive Sessions of Independent Directors

A majority of the independent directors meet quarterly in executive sessions without members of our management present. Since May 2012, Mr. Karp has been responsible for chairing the executive sessions. Prior to May 2012, Mr. Stern assumed this responsibility.

## Policy regarding attendance

Directors are expected, but are not required, to attend board meetings, meetings of committees on which they serve, and shareholder meetings, and to spend the time needed and meet as frequently as necessary to discharge their responsibilities properly. Elliot Noss attended our 2012 annual meeting of shareholders in person while the remainder of the Board of Directors were available by teleconference.

## Committees

Our Board of Directors has two committees, an audit committee established in accordance with Section 3(a)(58)(A) of the Securities Exchange Act of 1934, as amended, and a corporate governance, nomination and compensation committee. Our committees generally meet in connection with regularly scheduled quarterly and annual meetings of the Board of Directors, with additional meetings held as often as its members deem necessary to perform its responsibilities. From time to time, depending on the circumstances, the Board may form a new committee or disband a current committee.

The audit committee currently consists of Mr. Schwartz (Chair), Mr. Karp and Dr. Morrisett, all of whom are independent directors as defined in Section 121A of the NYSE Amex listing standards.

The audit committee held five meetings during Fiscal 2012. The audit committee also took action by unanimous written consent on one occasion during Fiscal 2012. The audit committee's purposes are:

- To assist the Board of Directors in its oversight of (1) our accounting and financial reporting processes and the audits of our financial statements, and (2) our compliance with legal and regulatory requirements;
- To interact directly with and evaluate the performance of the independent auditors, including to determine whether to engage or dismiss the independent auditors and to monitor the independent auditors' qualifications and independence; and
- To prepare the report required by the rules of the SEC to be included in our annual Form 10-K.

Each of the members of our Audit Committee is an independent director and satisfies the independence standards specified in Section 803 of the NYSE MKT listing requirements and Rule 10A-3 under the Exchange Act and is able to read and understand fundamental financial statements including balance sheets, income statements and cash flow

statements. Additionally, the Board of Directors has determined that Mr. Schwartz qualifies as an “audit committee financial expert” as defined under Item 407(d)(v) of Regulation S-K. The Board of Directors has adopted a written charter for the Audit Committee, which the Audit Committee has reviewed and determined to be in compliance with the rules set forth in the NYSE Amex listing requirements and which is available at [tuowsinc.com](http://tuowsinc.com).

The corporate governance, nomination and compensation committee currently consists of Mr. Karp (Chair), Mr. Schwartz, and Mr. Ralls, all of whom are independent directors as defined in Section 121A of the NYSE Amex listing standards.

The committee held two meetings during Fiscal 2012. The corporate governance, nomination and compensation committee also took action by unanimous written consent on one occasion during the 2012 fiscal year. The corporate governance, nomination and compensation committee's purposes are:

- To recommend and review the compensation structure for the Company's senior executives, including the Chief Executive Officer;
- To review employee compensation and benefit programs, including risk oversight;
- To develop and recommend to the Board a set of corporate governance guidelines applicable to the Company and to periodically review the guidelines;
- To oversee the Board's annual evaluation of its performance and the performance of the other Board committees;
- To advise the Board regarding membership and operations of the Board; and
- To identify individuals qualified to serve as members of the Board, to select, subject to ratification of the Board, the director nominees for the next annual meeting of shareholders and to recommend to the Board individuals to fill vacancies on the Board.

The corporate governance, nominating and compensation committee may delegate authority to one or more members of the committee or one or more members of management when appropriate, but no such delegation is allowed if the authority is required by law, regulation or listing standard to be exercised by the corporate governance, nominating and compensation committee as a whole. Each of the members of our corporate governance, nominating and compensation committee are independent directors as defined in Section 803 of the NYSE MKT listing standards. The Board of Directors has adopted a written charter for the corporate governance, nominating and compensation committee, which the corporate governance, nominating and compensation committee has reviewed and determined to be in compliance with the rules set forth in the NYSE MKT listing requirements and which is available at [tucowsinc.com](http://tucowsinc.com).

In considering candidates for nomination, our Board of Directors shall seek individuals who evidence strength of character, mature judgment and the ability to work collegially with others. Furthermore, it is the policy of our Board of Directors that it endeavor to have directors who collectively possess a broad range of skills, expertise, industry and other knowledge and business and other experience useful to the effective oversight of our business; therefore, in considering whether to nominate a person for election as a director, the independent directors and our Board of Directors will consider, among other factors, the contribution such person can make to the collective competencies of the Board based on such person's background. In determining whether to nominate a current director for re-election, the Board will take into account these same criteria as well as the director's past performance, including his or her participation in and contributions to the activities of the Board.

#### Shareholder nominations to the Board

Our corporate governance, nominating and compensation committee is responsible for identifying potential nominees to the Board, and will consider any candidate proposed in good faith by one of our shareholders. As set forth in the charter of the corporate governance, nominating and compensation committee, recommendations submitted by the Company's shareholders shall be timely submitted, along with the following to the attention of the Chairperson of the corporate governance, nominating and compensation committee at 96 Mowat Avenue, Toronto, Ontario M6K 3M1 Canada, the following:

- the candidate's name and the information about the individual that would be required to be included in a proxy statement under the rules of the SEC;
- information about the relationship between the candidate and the nominating shareholder;
- the consent of the candidate to serve as a director; and
- proof of the number of our common stock that the nominating shareholder owns and the length of time the shares have been owned.

In order for a shareholder nominee to be considered by the corporate governance, nominating and compensation committee, the shareholder nomination must be delivered at least 120 days before the date on which we first mailed our proxy materials for our prior year's annual meeting of shareholders. Subject to compliance with statutory or regulatory requirements, our Board of Directors does not expect that candidates recommended by shareholders will be evaluated in a different manner than other candidates.



#### Ethics policy for senior officers

Our Board of Directors has adopted an ethics policy for our senior officers, including our Chief Executive Officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions. A copy of the ethics policy for senior officers can be obtained without charge from our Internet web site at [tucowsinc.com](http://tucowsinc.com).

#### Communications with the Board of Directors

We provide an informal process for shareholders to send communications to our Board of Directors. If you wish to communicate with our Board of Directors, you may send correspondence to the attention of our Secretary at 96 Mowat Avenue, Toronto, Ontario M6K 3M1 Canada. The Secretary will submit your correspondence to one of the co-chairman of the Board of Directors, the chairman of the appropriate committee, or the appropriate individual director, as applicable.

#### Director compensation

Directors who are employees receive no additional or special compensation for serving as directors. The Board of Directors determines the total amount of the annual retainer as well as the amounts of any meeting or committee fee based upon recommendations from the corporate governance, nomination and compensation committee of the board and input from the chief executive officer.

#### Equity compensation

Under the terms of our 2006 Amended and Restated Equity Compensation Plan (the "2006 Plan"), we make automatic formula grants of nonqualified stock options to our non-employee directors and members of committees of our Board of Directors as described below. All stock-based compensation for our Non-employee directors is governed by the 2006 Plan or its predecessor, our 1996 Equity Compensation Plan (the "1996 Plan"). All options granted under the automatic formula grants are immediately exercisable, have an exercise price equal to the fair market value per common shares as determined by the per share price as of the close of business on the date of grant and have a five-year term. Options are granted to directors under the Amended and Restated 2006 Plan as follows:

- on the date each non-employee director becomes a director, he or she is granted options to purchase 17,500 shares of our common stock;
- on the date each director becomes a member of the audit committee, he or she is granted options to purchase 15,000 shares of our common stock;
- on the date each director becomes a member of the corporate governance, nomination and compensation committee, he or she is granted options to purchase 10,000 shares of our common stock;
- on each date on which we hold our annual meeting of shareholders, each non-employee director in office immediately before and after the annual election of directors will receive an automatic grant of options to purchase 15,000 of our common stock;

## Non-Equity compensation

The co-chairman of our Board receives an annual fee of \$15,000 each. All non-employee directors receive an annual fee of \$15,000. Non-employee directors who serve as members of our audit committee receive an annual fee of \$10,000 with the chairman of our audit committee receiving an additional \$4,000. Non-employee directors who serve on our corporate governance, nomination and compensation committee, receive an annual fee of \$10,000 with the chairman of our corporate governance, nomination and compensation committee receiving an additional \$4,000. In addition, all non-employee directors receive the following meeting attendance fees:

## Director meeting attendance fees:

May Board Meeting Personal Attendance Fee (inclusive of Committee fees)	\$	6,000
November Board Meeting Personal Attendance Fee (inclusive of Committee fees)	\$	4,000
Regularly Scheduled Telephonic Board Meeting Attendance Fees (per meeting)	\$	750
Regularly Scheduled Telephonic Audit Committee Meeting Attendance Fees (per meeting)	\$	400
Regularly Scheduled Telephonic Corporate Governance, Nomination and Compensation Committee Meeting Attendance Fees (per meeting)	\$	400

All fees paid to directors are paid in quarterly installments.

We also purchase directors and officer's liability insurance for the benefit of our directors and officers as a group in the amount of \$10 million. We also reimburse our directors for their reasonable out-of-pocket expenses incurred in attending meetings of our Board of Directors or its committees. No fees are payable to directors for attendance at specially called meetings of the board.

The table below shows all compensation paid to each of our non-employee directors during 2012. Each of the directors listed below served for the entire year.

Name (a)	Fees earned or paid in cash (\$) (b)	Option awards \$(1)(2) (d)	All other compensation (\$) (g)	Total (\$) (h)
Stanley Stern	29,800	6,060	—	35,860
Eugene Fiume	18,750	6,060	—	24,810
Erez Gissin	18,750	6,060	—	24,810
Joichi Ito	11,250	8,333	—	19,583
Allen Karp	46,210	11,363	—	57,573
Lloyd Morrisett	36,750	6,060	—	42,810
Rawleigh Ralls	26,043	17,423	—	43,466
Jeffrey Schwartz	38,750	11,363	—	50,113
	226,303	72,722	—	299,025

- (1) On September 11, 2012 under the 2006 Plan, our non-employee directors were awarded these automatic formula option grants. Under the 2006 Plan, these options vested immediately and carry an exercise price of \$1.38. All these options remained outstanding at December 31, 2012 and have a five year term. The aggregate grant date fair value of the option grants was calculated in accordance with FASB ASC 718 and based on the Black-Scholes option-pricing model and used the same assumptions that

are set forth in Note 9 to our audited consolidated financial statements included in this Annual Report on Form 10-K for the fiscal year ended December 31, 2012.

#### SECTION 16(A) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Securities Exchange Act of 1934, as amended, requires our directors and executive officers and persons who own more than ten percent of a registered class of our equity securities to file with the SEC reports of ownership and reports of changes in ownership of our common stock and our other equity securities. These persons are required by SEC regulation to furnish us with copies of all Section 16(a) reports they file.

We believe that, under the SEC's rules and based solely upon our review of the copies of the Forms 3, 4 and 5 furnished to us, or written representations from certain reporting persons that any such Forms have been filed in a timely manner and that all of our executive officers, directors and persons who own more than ten percent of a registered class of our equity securities complied with all Section 16(a) filing requirements applicable to them during 2012.

## Stock ownership of management

We encourage stock ownership by our directors, officers and employees to align their interests with your interests as shareholders. Under Section 16(a) of the Securities and Exchange Act of 1934, as amended, directors, officers and certain beneficial owners of the Company's equity securities are required to file reports of their transactions in the Company's equity securities with the SEC on specified due dates. With respect to Fiscal 2012, reports of transactions by all directors, officers and such beneficial holders were timely filed, with the exceptions of Mr. Karp, who failed to timely file his Form 4 with respect to the purchase of 10,000 shares of common stock upon the exercise of options, and Messrs. Noss, Cooperman and Woroch, who failed to timely file their Forms 4 with respect to grants of options. In making this statement, the Company has relied on the written representations of its directors, officers and holders of more than ten percent of our outstanding common stock as reported in their filings with the SEC.

## ITEM 11. EXECUTIVE COMPENSATION

## Summary compensation table

The following Summary Compensation table provides a summary of the compensation earned by the chief executive officer, Elliot Noss, and our two other most highly compensated executive officers for services rendered in all capacities during 2012. Specific aspects of this compensation are dealt with in further detail in the tables that follow. All dollar amounts below are shown in U.S. dollars. If necessary, amounts that were paid in Canadian dollars during the 2011 fiscal year were converted into U.S. dollars based upon the exchange rate of 1.0004 Canadian dollars for each U.S. dollar, which represents the average Bank of Canada exchange rate for 2012.

Name and Principal Position	Year	Salary (\$)	Bonus(1) (\$)	Stock Awards(2) (\$)	Option Awards(3) (\$)	All Other Compensation(4) (\$)	Total (\$)
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)
Elliot Noss President and Chief Executive Officer	2012	350,860	200,470	—	23,070	10,495	584,895
Michael Cooperman Chief Financial Officer	2011	345,090	93,405	—	14,385	10,636	463,516
Michael Cooperman	2012	274,890	142,493	—	23,070	12,295	452,748
David Woroch Vice President, Sales	2011	270,315	64,417	—	14,385	12,459	361,576
David Woroch	2012	228,909	147,491	—	23,070	8,696	408,166
Vice President, Sales	2011	224,309	64,417	—	14,385	8,812	311,923

(1) Represents bonus earned during the fiscal years ended December 31, 2012, 2011 and 2010.

Of the 2012 amount, the following amounts will be paid in February 2013:

Elliot Noss	\$ 95,589
Michael Cooperman	\$ 62,975
David Woroch	\$ 65,787

Of the 2011 amount, the following amounts were paid in March 2012:

Elliot Noss	\$ 25,443
Michael Cooperman	\$ 17,547

David Woroch	\$	17,547
--------------	----	--------

- (2) Represents the aggregate grant date fair value of such awards, calculated in accordance with FASB ASC 718. Please see Note 9 entitled “Stock Options” in the notes to our audited financial statements, for a discussion of the assumptions underlying these calculations.
- (3) Represents the aggregate grant date fair value of such awards, calculated in accordance with FASB ASC 718. Please see Note 9 entitled “Stock Options” in the notes to our audited financial statements, for a discussion of the assumptions underlying these calculations.

(4) Amounts reported in this column are comprised of the following items:

	Year	Additional Health Spending Credits (\$)	Car Allowance (\$)	Health Club Membership (\$)	All Other Compensation (\$)
Elliot Noss	2012	1,499	8,996	—	10,495
	2011	1,519	9,117	—	10,636
Michael Cooperman	2012	1,499	8,397	2,399	12,295
	2011	1,519	8,509	2,431	12,459
David Woroch	2012	1,499	7,197	—	8,696
	2011	1,519	7,293	—	8,812

#### Outstanding Equity Awards at Fiscal Year-End

The following table sets forth information concerning stock options held by the named executive officers as of December 31, 2012:

Name and Principal Position	Number of Securities Underlying Unexercised Options (#) Exercisable	Number of Securities Underlying Unexercised Options (#) Unexercisable	Option Exercise Price (\$)	Option Expiration Date
Elliot Noss	214,575	—	0.37	8/5/13
	223,991	—	0.37	8/5/13
	1,394,738	—	0.37	8/5/13
	76,500	—	0.36	8/4/13
	200,000	—	0.58	8/10/14
	150,000	—	0.85	3/18/14
	60,000	—	0.60	5/22/15
	64,000	64,000	0.70	5/16/17
	8,750	26,250	0.73	8/14/18
	—	30,000	1.38	5/17/19
	2,392,554	120,250		
Michael Cooperman	621,475	—	0.37	8/5/13
	150,000	—	0.58	8/10/14
	120,000	—	0.85	3/18/14
	75,000	—	0.60	5/22/15
	64,000	64,000	0.70	5/16/17
	8,750	26,250	0.73	8/14/18
	—	30,000	1.38	5/17/19
	1,039,225	120,250		
David Woroch	30,000	—	0.36	8/4/13
	60,000	—	0.58	8/10/14

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

	80,000	—	0.85	3/18/14
	65,000	—	0.60	5/22/15
	64,000	64,000	0.70	5/16/17
	8,750	26,250	0.73	8/14/18
	—	30,000	1.38	5/17/19
	307,750	120,250		

64

---

The stock options grants listed in the above table were issued under our 1996 Plan as well as under our 2006 Plan.

Under the 1996 Plan, these options vest over a period of four years and have a 10 year term. These options are not exercisable for one year after the grant. Thereafter they become exercisable at the rate of 25% after the first year, with the remaining 75% vesting evenly at each month end over the next 36 months, becoming fully exercisable after the fourth year.

Under the 2006 Plan, these options vest over a period of four years and have a 7 year term. These options are not exercisable for one year after the grant. Thereafter they become exercisable at the rate of 25% per annum, becoming fully exercisable after the fourth year.

#### Potential Payments on Termination or Change In Control

We have certain agreements that require us to provide compensation to our named executive officers in the event of a termination of employment or a change in control of Tucows. These agreements are summarized following the table below and do not include any payment for termination for cause. The tables below show estimated compensation payable to each named executive officer upon various triggering events. Actual amounts can only be determined upon the triggering event.

Elliot Noss(1)	2012	Termination without Cause	Change in Control
<b>Compensation</b>			
Base Salary/Severance(2)		\$ 681,074	\$ 2,481,074
Bonus Plan(3)		339,864	339,864
Acceleration of Unvested Equity Awards(4)		67,798	67,798
<b>Benefits(5)</b>			
Car Allowance		8,996	8,996
Healthcare Flexible Spending Account		1,499	1,499
Health club		—	—
		\$ 1,099,231	\$ 2,899,231

Michael Cooperman(1)	2012	Termination without Cause	Change in Control
<b>Compensation</b>			
Base Salary/Severance(2)		\$ 422,351	\$ 1,322,351
Bonus Plan(3)		177,262	177,262
Acceleration of Unvested Equity Awards(4)		60,685	67,798
<b>Benefits(5)</b>			
Car Allowance		8,397	8,397
Healthcare Flexible Spending Account		1,499	1,499
Health club		2,399	2,399
		\$ 672,593	\$ 1,579,706

David Worocho(1)	2012	Termination without Cause	Change in Control
<b>Compensation</b>			
Base Salary/Severance(2)		\$ 332,024	\$ 332,024
Bonus Plan(3)		175,430	175,430
Acceleration of Unvested Equity Awards(4)		13,325	13,325



<b>Benefits(5)</b>			
Car Allowance		7,197	7,197
Healthcare Flexible Spending Account		1,499	1,499
Health club		—	—
	\$	529,475	\$ 529,475

---

(1) For the purpose of the table we assumed an annual base salary at the executive's level as of December 31, 2012

- (2) Severance for Mr. Noss is compensation for one year plus one month additional compensation for each completed year of service capped at 24 months. For Messrs. Cooperman and Woroch, severance compensation is for six months plus one month additional compensation for each completed year of service.
- (3) For the purpose of the table we assumed that the annual incentive bonus target as of December 31, 2012 had been achieved and that no overachievement bonus or special bonuses would be payable.
- (4) For purposes of the above table, we have assumed that if we terminate Mr. Noss without cause all his unvested options vest automatically and that for Messrs. Cooperman or Woroch, that their options continue to vest through any severance period. On a change in control we have assumed that all unvested options for Messrs. Noss or Cooperman vest automatically and that for Mr. Woroch, that his options continue to vest through and until the end of any severance period. Amounts disclosed in this table equal the closing market value of our common stock as of December 30, 2012, minus the exercise price, multiplied by the number of unvested shares of our common stock that would vest. The closing market value of our common stock on December 31, 2012 was \$1.44.
- (5) Pay for unused vacation, extended health, matching registered retirement savings plan benefit, life insurance and accidental death and dismemberment insurance are standard programs offered to all employees and are therefore not reported.

#### Employment Agreements—Termination

Employment contracts are currently in place for each of the named executive officers, whose contracts detail the severance payments that will be provided on termination of employment and the consequent obligations of non-competition and non-solicitation.

The following details the cash severance payment that will be paid to each of the named executive officers in the event of termination without cause or termination for good reason.

Upon termination without cause, Mr. Woroch is entitled to a severance payment in the amount of six months' compensation plus one months' compensation for each additional completed year of service. Severance payments can be made in equal monthly installments. Mr. Woroch is bound by a standard non-competition covenant for a period of twelve months following their termination.

Messrs Noss and Cooperman's employment agreements are subject to early termination by us due to:

- the death or disability of the executive;
- for "cause;" or
- without "cause."

If we terminate Mr. Noss without "cause," he is entitled to receive 12 months of compensation plus one month of compensation for each year of service, to a maximum of 24 months of compensation.

If we terminate Mr. Cooperman's employment without "cause," he is entitled to receive six months of compensation plus one month of compensation for each year of service.

For purposes of the employment agreements, "cause" is defined to mean the executive's conviction (or plea of guilty or nolo contendere) for committing an act of fraud, embezzlement, theft or other act constituting a felony or willful failure or an executive's refusal to perform the duties and responsibilities of his position, which failure or refusal is not cured within 30 days of receiving a written notice thereof from our Board of Directors.

#### Employment Agreements—Change in Control

Under their employment agreements, both Mr. Noss and Mr. Cooperman are also entitled to the change in control benefits described in the following paragraph if:

- the executive resigns with or without “good reason” within the 30-day period immediately following the date that is six months after the effective date of the “change in control;” or
- within 18 months after a “change in control” and executive’s employment is terminated either:
  - without “cause;” or
  - by resignation for “good reason.”

If an executive’s employment is terminated following a change in control under the circumstances described in the preceding paragraph, the executive is entitled to receive a lump sum payment based upon the fair market value of the Company on the effective date of the “change in control” as determined by our Board of Directors in the exercise of good faith and reasonable judgment taking into account, among other things, the nature of the “change in control” and the amount and type of consideration, if any, paid in connection with the “change in control.” Depending on the fair market value of the company, the lump sum payments range from \$375,000 to \$2 million in the case of Mr. Noss, and from \$187,500 to \$1 million in the case of Mr. Cooperman. In addition to the lump sum payments, all stock options held by the executive officers will be immediately and fully vested and exercisable as of the date of termination.

A “change in control” is generally defined as:

- the acquisition of 50% or more of our common stock;
- a change in the majority of our Board of Directors unless approved by the incumbent directors (other than as a result of a contested election); and
- certain reorganizations, mergers, consolidations, liquidations or dissolutions, unless certain requirements are met regarding continuing ownership of our outstanding common stock.

“Good reason” is defined to include the occurrence of one or more of the following:

- the executive’s position, management responsibilities or working conditions are diminished from those in effect immediately prior to the change in control, or he is assigned duties inconsistent with his position;
- the executive is required to be based at a location in excess of 30 miles from his principal job location or office immediately prior to the change in control;
- the executive’s base compensation is reduced, or the executive’s compensation and benefits taken as a whole are materially reduced, from those in effect immediately prior to the change in control; or

- we fail to obtain a satisfactory agreement from any successor to assume and agree to perform our obligations to the executive under his employment agreement.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The following table sets forth the beneficial ownership of our common stock, as of March 5, 2013, by each of our chief executive officer, our two other most highly compensated executive officers, as well as by all of our directors and executive officers as a group. The information on beneficial ownership in the table and related footnotes is based upon data furnished to us by, or on behalf of, the persons referred to in the table. Unless otherwise indicated in the footnotes to the table, each person named has sole voting power and sole investment power with respect to the shares included in the table.

Name	Beneficial Ownership of Common Stock				Percent of Class(1)
	Common Stock Beneficially Owned Excluding Options	Stock Options Exercisable within 60 Days of March 5, 2013	Total Common Stock Beneficially Owned		
Elliot Noss	820,254(2)	2,392,554	3,212,808	7.5%	
Michael Cooperman	148,850(3)	1,039,225	1,188,075	2.9%	
David Worocho	260,000	307,750	567,750	1.4%	
Stanley Stern	213,850	182,500	396,350	*	
Eugene Fiume	5,000	110,000	115,000	*	
Erez Gissin	15,000	140,000	155,000	*	
Joichi Ito	—	105,000	105,000	*	
Allen Karp	40,000(4)	207,500	247,500	*	
Lloyd Morrisett	120,000(5)	227,500	347,500	*	
Rawleigh Ralls	4,250,000(6)	115,000	4,365,000	10.8%	
Jeffrey Schwartz	15,000	197,500	212,500	*	
All directors and executive officers as a group (13 persons)	5,888,154	5,500,029	11,388,183	24.9%	

\* Less than 1%.

- (1) Based on 40,213,850 shares outstanding as of March 5, 2013, adjusted for shares of common stock beneficially owned but not yet issued.
- (2) Includes an aggregate of 786,883 shares of common stock that are indirectly owned by Mr. Noss. Of these shares, Mr. Noss and his wife share investment and voting power over 90,072 shares held in three RRSP accounts belonging to Mr. Noss' wife, 589,942 shares are held in Mr. Noss' RRSP accounts and 106,869 shares are held by two separate family trusts for which Mr. Noss is the trustee.
- (3) Includes 148,750 shares of common stock that are held in Mr. Cooperman's RRSP account.
- (4) These shares of common stock are directly owned by Mr. Karp's wife.
- (5) These shares of common stock are owned jointly by Dr. Morrisett and his wife.

- (6) Includes an aggregate of 4,250,000 shares of common stock that are indirectly owned by Mr. Ralls. Of these shares, 225,000 shares are held in Mr. Ralls' IRA account, 25,000 shares are held in Mrs Ralls' IRA account and 4,000,000 are held by Lacuna Hedge Fund LLLP ("Lacuna Hedge") and are indirectly owned by Lacuna, LLC ("Lacuna LLC") and Lacuna Hedge GP LLLP ("Lacuna Hedge GP"). Lacuna LLC is the sole general partner of Lacuna Hedge GP, which is the sole general partner of Lacuna Hedge. Neither Lacuna LLC nor Lacuna Hedge GP directly owns any securities of the Company. Each of Lacuna LLC and Lacuna Hedge GP disclaims beneficial ownership of the shares held by Lacuna Hedge, except to the extent of its pecuniary interest therein. Mr. Ralls is a member of Lacuna LLC. Mr. Ralls disclaims beneficial ownership of the shares held by Lacuna Hedge, except to the extent of his pecuniary interest therein.

Principal shareholders.

The following table sets forth information with respect to each shareholder known to us to be the beneficial owner of more than 5% of our outstanding common stock as of March 5, 2012.

Name and Address of Beneficial Owner	Beneficial Ownership of Common Stock	
	Number of Shares Beneficially Owned	Percent of Class(1)
Lacuna, LLC 1100 Spruce Street, Suite 202 Boulder, CO 80302	4,000,000(2)	9.9%
Elliot Noss 96 Mowat Avenue Toronto, ON M6K 3M1	3,212,808(3)	7.5%

- 
- (1) Based on 40,213,850 shares outstanding as of March 5, 2013.
- (2) As disclosed on Form 4, filed with the SEC on August 20, 2012 by Mr. Ralls. These shares are held by Lacuna Hedge Fund LLLP (“Lacuna Hedge”) and are indirectly owned by Lacuna, LLC (“Lacuna LLC”) and Lacuna Hedge GP LLLP (“Lacuna Hedge GP”). Lacuna LLC serves as the sole general partner of Lacuna Hedge GP, which serves as the sole general partner of Lacuna Hedge. Neither Lacuna LLC nor Lacuna Hedge GP directly owns any securities of the Issuer. Each of Lacuna LLC and Lacuna Hedge GP disclaims beneficial ownership of the securities held by Lacuna Hedge, except to the extent of its pecuniary interest therein. Mr. Ralls is a member of Lacuna LLC. Mr. Ralls disclaims beneficial ownership of the securities held by Lacuna Hedge, except to the extent of his pecuniary interest therein.
- (3) As disclosed on Form 4A, filed with the SEC on February 26, 2013 by Mr. Noss. These shares includes an aggregate of 786,883 shares of common stock that are indirectly owned by Mr. Noss. Of these shares, Mr. Noss and his wife share investment and voting power over 90,072 shares held in three RRSP accounts belonging to Mr. Noss’ wife, 589,942 shares are held in Mr. Noss’ RRSP accounts and 106,869 shares are held by two separate family trusts for which Mr. Noss is the trustee.

#### Equity Compensation Plan Information at Fiscal Year Ended December 31, 2012

Plan category	Number of securities to be issued upon exercise of outstanding options,	Weighted average exercise price of outstanding options, warrants and	Number of securities remaining available for future issuance under the plan (excluding
---------------	---	--	--



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

	warrants and rights (#)	rights (\$)	securities reflected in the first column) (#)
Equity compensation plans approved by security holders:			
2006 Equity Compensation Plan	5,038,987	\$ 0.79	1,624,628
1996 Equity Compensation Plan	3,553,699	\$ 0.42	—
Equity compensation plans not approved by security holders	—	—	—
<b>Total</b>	<b>8,592,686</b>	<b>\$ 0.64</b>	<b>1,624,628</b>

## ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

## Review, Approval or Ratification of Transactions with Related Persons

The Audit Committee of the Board of Directors is responsible for reviewing and, if appropriate, approving all related party transactions between us and any officer or director that would potentially require disclosure pursuant to the Audit Committee charter. As of the date of this Annual Report on Form 10-K, we expect that any transactions in which related persons have a direct or indirect interest will be presented to the Audit Committee for review and approval. While neither the Audit Committee nor the board have adopted a written policy regarding related party transactions, the Audit Committee makes inquiries to our management and our auditors when reviewing such transactions. Neither we nor the audit committee are aware of any transaction that was required to be reported with the SEC where such policies and procedures either did not require review or were not followed.

## Director Independence

Our Board of Directors has determined that each of Messrs. Stern, Fiume, Gissin, Ito, Karp, Ralls, Schwarz and Dr. Morrisett are independent directors as defined in Section 121A of the NYSE Amex listing standards. In this Annual Report on Form 10-K, each of these eight directors are referred to individually as an “independent director” and collectively as the “independent directors.”

## ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

A summary of the fees of KPMG LLP for the years ended December 31, 2012 and 2011 are set forth below:

	2012 Fees	2011 Fees
Audit Fees(1)	\$ 265,500	\$ 228,700
Audit-Related Fees	—	25,300
Tax Fees(2)	127,000	109,000
All Other Fees	—	—
<b>Total Fees</b>	<b>\$ 392,500</b>	<b>\$ 363,000</b>

- 
- (1) Consists of fees and expenses for the audit of consolidated financial statements, the reviews of our Quarterly Reports on Form 10-Q and services associated with registration statements.
- (2) Consists of fees and expenses for tax consulting services.

Audit Committee pre-approval of audit and permissible non-audit services of independent auditors.

The Audit Committee has adopted a pre-approval policy that provides guidelines for the audit, audit-related, tax and other non-audit services that may be provided to us by our independent auditors. Under this policy, the audit committee pre-approves all audit and certain permissible accounting and non-audit services performed by the independent auditors. These permissible services are set forth on an attachment to the policy that is updated at least annually and may include audit services, audit-related services, tax services and other services. For audit services, the independent auditor provides the audit committee with an audit plan including proposed fees in advance of the annual audit. The Audit Committee approves the plan and fees for the audit.

With respect to non-audit and accounting services of our independent auditors that are not pre-approved under the policy, the employee making the request must submit the request to our chief financial officer. The request must include a description of the services, the estimated fee, a statement that the services are not prohibited services under the policy and the reason why the employee is requesting our independent auditors to perform the services. If the aggregate fees for such services are estimated to be less than or equal to \$25,000, our chief financial officer will submit the request to the chairman of the audit committee for consideration and approval, and the engagement may commence upon the approval of the chairman. The chairman is required to inform the full audit committee of the services at its next meeting. If the aggregate fees for such services are estimated to be greater than \$25,000, our chief financial officer will submit the request to the full audit committee for consideration and approval, generally at its next meeting or special meeting called for the purpose of approving such services. The engagement may only commence upon the approval of full audit committee.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

The following documents are filed as part of this Annual Report on Form 10-K:

1. Financial Statements. The financial statements listed in the accompanying index to consolidated financial statements are filed as part of this Annual Report on Form 10-K.
2. Financial Statement Schedules. Schedules are not submitted because they are not required or are not applicable, or the required information is shown in the consolidated financial statements or notes thereto.
3. Exhibits. The Exhibits listed below are filed or incorporated by reference as part of this Annual Report on Form 10-K. Where so indicated by footnote, exhibits which were previously filed are incorporated by reference. For exhibits incorporated by reference, the location of the exhibit in the previous filing is indicated in the footnotes below.

Exhibit No.	Description
3.1	Fourth Amended and Restated Articles of Incorporation of Tucows Inc. (Incorporated by reference to Exhibit 3.1 filed with Tucows' Current Report on Form 8-K, as filed with the SEC on November 29, 2007).
3.2	Second Amended and Restated Bylaws of Tucows Inc. (Incorporated by reference to Exhibit 3.2 filed with Tucows' Annual Report on Form 10-K for the year ended December 31, 2006, as filed with the SEC on March 29, 2007).
3.3	Amendment No. 1 to Second Amended and Restated Bylaws of Tucows Inc. (Incorporated by Reference to Exhibit 3.3 filed with Tucows' Quarterly Report on Form 10-Q for the quarter ended June 30, 2012).
10.1*	2006 Equity Compensation Plan, as amended and restated effective as of July 29, 2010 (Incorporated by reference to Exhibit 99(d)(1) filed with Tucows' Schedule TO, as filed with the SEC on September 17, 2010).
10.2*	Employment Agreement dated January 22, 2003 between Tucows.com Co. and Elliot Noss (Incorporated by reference to Exhibit 10.5 filed with Tucows' Annual Report on Form 10-K for the year ended December 31, 2003, as filed with the SEC on March 28, 2004).
10.3*	Employment Agreement dated March 11, 2003 between Tucows.com Co. and Michael Cooperman (Incorporated by reference to Exhibit 10.5 filed with Tucows' annual Report on Form 10-K for the year ended December 31, 2003, as filed with the SEC on March 28, 2004).
10.4	Lease between 707932 Ontario Limited and Tucows International Corporation, dated December 10, 1999 (Incorporated by reference to exhibit number 10.9 filed with Tucows' Annual Report on Form 10-K for the year ended December 31, 2001, as filed with the SEC on April 1, 2002).
10.5	Lease extension between 707932 Ontario Limited and Tucows Inc. and Tucows.com Co., dated September 4, 2004 (Incorporated by reference to Exhibit 10.5 filed with Tucows' Annual Report on Form 10-K for the year ended December 31, 2004, as filed with the SEC on March 24, 2005).
10.6*	

Description of Tucows Fiscal 2004 At Risk Compensation Plan (Incorporated by reference to Exhibit 10.9 filed with Tucows' Annual Report on Form 10-K for the year ended December 31, 2004, as filed with the SEC on March 24, 2005).

- 10.7 Registrar Accreditation Agreement, effective as of June 25, 2005, as amended June 22, 2009, by and between the Internet Corporation for Assigned Names and Numbers and Tucows.com Co. (Incorporated by reference to Exhibit 10.7 filed with Tucows' Annual Report on Form 10-K for the year ended December 31, 2010, as filed with the SEC on March 22, 2011).
- 10.8 Registry-Registrar Agreement, dated as of October 4, 2001, by and between VeriSign, Inc. and Tucows Inc. (Incorporated by reference to Exhibit 10.13 filed with Amendment No. 1 to Tucows' registration statement on Form S-1 (Registration No. 333-125843), as filed with the SEC on July 7, 2005).

- 10.11 Loan Agreement, dated as of June 25, 2007, by and among Tucows.com Co., Tucows (Delaware) Inc., Tucows Inc., Mailbank Nova Scotia Co., Tucows Domain Holdings Co., Innerwise, Inc. and Bank of Montreal (Incorporated by reference to Exhibit 10.1 filed with Tucows' Current Report on Form 8-K, as filed with the SEC on July 31, 2007).

Exhibit No.	Description
10.12	Guaranty, dated July 25, 2007, by Tucows Inc. in favor of Bank of Montreal (Incorporated by reference to Exhibit 10.2 filed with Tucows' Current Report on Form 8-K, as filed with the SEC on July 31, 2007).
10.13	Security Agreement, dated July 25, 2007, by Tucows Inc. in favor of Bank of Montreal (Incorporated by reference to Exhibit 10.3 filed with Tucows' Current Report on Form 8-K, as filed with the SEC on July 31, 2007).
10.14	Financing Commitment, dated July 19, 2007, by and between Tucows.com Co. and Bank of Montreal (Incorporated by reference to Exhibit 10.3 filed with Tucows' Current Report on Form 8-K, as filed with the SEC on July 31, 2007).
10.15	Operating Loan Agreement, dated September 10, 2010, between Tucows.com Co. and the Bank of Montreal. (Incorporated by reference to Exhibit 10.1 filed with Tucows' Current Report on Form 8-K, as filed with the SEC on September 13, 2010).
10.16	Offer Letter, dated August 30, 2010, between Tucows Inc. and the Bank of Montreal. (Incorporated by reference to Exhibit 10.2 filed with Tucows' Current Report on Form 8-K, as filed with the SEC on September 13, 2010).
10.17	Offer Letter, dated July 27, 2011, between Tucows.com Co and the Bank of Montreal (incorporated herein by reference to Exhibit 10.1 to Tucows Inc.'s Current Report on Form 8-K, filed with the Securities and Exchange Commission on August 3, 2011).
10.18	Letter of Acknowledgment, dated December 13, 2011, between Tucows.com Co and the Bank of Montreal. (Incorporated by reference to Exhibit 10.1 filed with Tucows' Current Report on Form 8-K, as filed with the SEC on December 13, 2011).
10.19	Offer Letter, dated November 19, 2012, between Tucows.com Co. and the Bank of Montreal (Incorporated by reference to Exhibit 10.1 filed with Tucows' Current Report on Form 8-K, as filed with the SEC on November 21, 2012).
10.20	Amended and Restated Supplemental Agreement, dated December 14, 2012, between Tucows.com Co., Tucows (Delaware), Inc. and the Bank of Montreal (Incorporated by reference to Exhibit 10.1 filed with Tucows' Current Report on Form 8-K, as filed with the SEC on December 20, 2012).
10.21	Guaranty, dated December 14, 2012, by Ting Inc. in favor of the Bank of Montreal (Incorporated by reference to Exhibit 10.2 filed with Tucows' Current Report on Form 8-K, as filed with the SEC on December 20, 2012).
10.22	Security Agreement, dated December 14, 2012, by Ting Inc. in favor of the Bank of Montreal (Incorporated by reference to Exhibit 10.3 filed with Tucows' Current Report on Form 8-K, as filed with the SEC on December 20, 2012).
21.1#	Subsidiaries of Tucows Inc.
23.1#	Consent of KPMG LLP, Independent Registered Public Accounting Firm.
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.

---

\* Management or compensatory contract required to be filed pursuant to Item 15(c) of the requirements for Form 10-K reports.

# Filed herewith.

73

---



INDEX TO FINANCIAL STATEMENTS  
Consolidated Financial Statements of Tucows Inc.

	Pages
Consolidated Financial Statements of Tucows Inc.	F-1
Management's Report on Internal Control over Financial Reporting	F-2
Report of Independent Registered Public Accounting Firm	F-3
Consolidated Balance Sheets as of December 31, 2012 and 2011	F-4
Consolidated Statements of Comprehensive Income for the years ended December 31, 2012, 2011 and 2010	F-5
Consolidated Statements of Stockholders' Equity for the years ended December 31, 2012, 2011 and 2010	F-6
Consolidated Statements of Cash Flows for the years ended December 31, 2012, 2011 and 2010	F-7
Notes to Consolidated Financial Statements	F-8

## MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934 as amended. Our internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America and includes those policies and procedures that:

- Pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of our assets;
- Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America;
- Provide reasonable assurance that our receipts and expenditures are being made only in accordance with authorization of our management and directors; and
- Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of our assets that could have a material effect on the financial statements.

Because of its inherent limitations, such as resource constraints, human error, lack of knowledge or awareness and the possibility of intentional circumvention of these controls, internal control over financial reporting may not prevent or detect misstatements. Furthermore, the design of any control system is based, in part, upon assumptions about the likelihood of future events, for which assumptions may ultimately prove to be incorrect. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

Our management assessed the effectiveness of its internal control over financial reporting as of December 31, 2012. In making this assessment, management used the criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on its assessment, management has concluded that the Company's internal control over financial reporting was effective as of December 31, 2012.

This Annual Report on Form 10-K does not include an attestation report of the Company's registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the Company's registered public accounting firm pursuant to rules of the SEC that permit the Company to provide only management's report in this Annual Report on Form 10-K.

/s/ Elliot Noss  
Elliot Noss  
President and Chief Executive Officer  
(Principal Executive Officer)

/s/ Michael Cooperman  
Michael Cooperman  
Chief Financial Officer  
(Principal Financial Officer)

March 15, 2013

March 15, 2013



Report of the Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of Tu cows Inc.:

We have audited the accompanying consolidated balance sheets of Tu cows Inc., as of December 31, 2012 and December 31, 2011, and the related consolidated statements of comprehensive income, stockholders' equity and cash flows for each of the years in the three-year period ended December 31, 2012. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Tu cows Inc. as of December 31, 2012 and December 31, 2011, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2012, in conformity with U. S. generally accepted accounting principles.

/s/ KPMG LLP  
Chartered Accountants, Licensed Public  
Accountants  
Toronto, Canada

March 12, 2013

F-3

---

## Tucows Inc.

## Consolidated Balance Sheets

(Dollar amounts in U.S. dollars)

	December 31, 2012	December 31, 2011
<b>Assets</b>		
<b>Current assets:</b>		
Cash and cash equivalents	\$ 6,415,679	\$ 6,408,209
Accounts receivable, net of allowance for doubtful accounts of \$73,970 as of December 31, 2012 and \$57,415 as of December 31, 2011	4,413,265	3,880,184
Inventory	587,104	205,597
Prepaid expenses and deposits	5,081,408	3,756,308
Derivative instrument asset, current portion (note 4)	412,944	-
Prepaid domain name registry and ancillary services fees, current portion	45,170,167	43,209,033
Income taxes recoverable	1,730,631	867,093
<b>Total current assets</b>	<b>63,811,198</b>	<b>58,326,424</b>
Derivative instrument asset, long-term portion (note 4)	31,838	87,023
Prepaid domain name registry and ancillary services fees, long-term portion	12,318,723	12,600,154
Property and equipment (note 5)	1,352,144	1,437,564
Deferred financing charges	-	2,300
Deferred tax asset, long-term portion (note 10)	5,970,462	6,880,377
Intangible assets (note 6)	16,415,651	17,482,590
Goodwill (note 3)	18,873,127	18,873,127
<b>Total assets</b>	<b>\$ 118,773,143</b>	<b>\$ 115,689,559</b>
<b>Liabilities and Stockholders' Equity</b>		
<b>Current liabilities:</b>		
Accounts payable	\$ 1,928,459	\$ 1,051,115
Accrued liabilities	2,522,229	2,081,968
Customer deposits	4,955,671	4,202,899
Derivative instrument liability, current portion (note 4)	-	781,027
Loan payable, current portion (note 7)	3,700,000	850,000
Deferred revenue, current portion	54,997,887	52,683,546
Accreditation fees payable, current portion	512,847	555,869
Deferred tax liability, current portion (note 10)	914,429	880,008
Income taxes payable (note 10)	1,255,108	158,258
<b>Total current liabilities</b>	<b>70,786,630</b>	<b>63,244,690</b>
Derivative instrument liability, long-term portion (note 4)	-	5,479
Deferred revenue, long-term portion	16,002,464	16,492,155

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

Accreditation fees payable, long-term portion	145,592	156,061
Deferred rent, long-term portion	54,150	26,487
Deferred tax liability, long-term portion (note 10)	5,234,100	5,345,700
Stockholders' equity (note 8)		
Preferred stock - no par value, 1,250,000 shares authorized; none issued and outstanding	-	-
Common stock - no par value, 250,000,000 shares authorized; 44,322,159 shares issued and outstanding as of December 31, 2012 and 53,497,584 shares issued and outstanding as of December 31, 2011	10,084,417	11,358,959
Additional paid-in capital	33,931,529	40,994,013
Deficit	(17,509,843 )	(21,933,985 )
Accumulated other comprehensive income	44,104	-
Total stockholders' equity	26,550,207	30,418,987
Total liabilities and stockholders' equity	\$ 118,773,143	\$ 115,689,559

Commitments and contingencies (note 13)

Subsequent events (note 15)

See accompanying notes to consolidated financial statements

## Tucows Inc.

## Consolidated Statements of Comprehensive Income

(Dollar amounts in U.S. dollars)

	Year ended December 31,		
	2012	2011	2010
Net revenues (note 16)	\$ 114,726,901	\$ 97,064,967	\$ 84,578,505
Cost of revenues (note 16):			
Cost of revenues	82,837,395	68,088,387	58,494,849
Network expenses (*)	4,925,058	4,837,650	4,648,899
Depreciation of property and equipment	611,640	750,455	1,032,368
Amortization of intangible assets	143,640	85,590	299,208
Total cost of revenues	88,517,733	73,762,082	64,475,324
Gross profit	26,209,168	23,302,885	20,103,181
Expenses:			
Sales and marketing (*)	8,701,446	7,442,681	7,217,754
Technical operations and development (*)	4,302,820	4,868,228	4,577,898
General and administrative (*)	6,610,819	6,096,596	5,123,074
Depreciation of property and equipment	190,420	187,005	170,844
Loss on disposition of property and equipment	118,944	42,165	-
Amortization of intangible assets	876,120	1,004,950	1,442,160
Loss (gain) on currency forward contracts (note 2(l))	(682,851 )	535,223	(872,539 )
Total expenses	20,117,718	20,176,848	17,659,191
Income from operations	6,091,450	3,126,037	2,443,990
Other income (expense):			
Interest expense, net	(192,863 )	(50,404 )	(116,197 )
Other income, net (note 11)	529,711	374,977	-
Total other income (expense)	336,848	324,573	(116,197 )
Income before provision for income taxes	6,428,298	3,450,610	2,327,793
Provision for (recovery of) income taxes (note 10)	2,004,156	(2,719,621 )	210,845
Net income	4,424,142	6,170,231	2,116,948
Other comprehensive income, net of tax of \$22,975	\$ 44,104	-	-
Comprehensive income for the year	\$ 4,468,246	\$ 6,170,231	\$ 2,116,948

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

Basic earnings per common share (note 12)	\$0.10	\$0.12	\$0.04
Shares used in computing basic earnings per common share (note 12)	45,832,862	53,454,675	57,982,248
Diluted earnings per common share (note 12)	\$0.09	\$0.11	\$0.04
Shares used in computing diluted earnings per common share (note 12)	49,134,944	55,749,433	59,955,788

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

Network expenses	\$24,480	\$22,972	\$22,406
Sales and marketing	\$92,168	\$91,244	\$96,300
Technical operations and development	\$59,141	\$51,984	\$71,012
General and administrative	\$184,910	\$144,756	\$210,284

See accompanying notes to consolidated financial statements

F-5

---



## Tucows Inc.

## Consolidated Statements of Stockholders' Equity

(Dollar amounts in U.S. dollars)

	Common stock Number	Amount	Additional paid in capital	Deficit	Accumulated Other Comprehensive Income	Total stockholders' equity
Balances, December 31, 2009	67,080,353	\$ 14,030,384	\$ 47,287,351	\$ (30,221,164)	\$ -	\$ 31,096,571
Exercise of stock options	33,678	27,350	(12,541 )	-	-	14,809
Repurchase and retirement of shares (note 8)	(13,664,340)	(2,732,868 )	(6,974,225 )	-	-	(9,707,093 )
Cancellation of restricted stock	(1,100 )	-	-	-	-	-
Stock-based compensation (note 9)	-	-	400,002	-	-	400,002
Net income	-	-	-	2,116,948	-	2,116,948
Balances, December 31, 2010	53,448,591	11,324,866	40,700,587	(28,104,216)	-	23,921,237
Exercise of stock options	73,708	38,846	(7,500 )	-	-	31,346
Repurchase and retirement of shares (note 8)	(23,765 )	(4,753 )	(13,689 )	-	-	(18,442 )
Cancellation of restricted stock	(950 )	-	-	-	-	-
Other proceeds	-	-	3,659	-	-	3,659
Stock-based compensation (note 9)	-	-	310,956	-	-	310,956
Net income	-	-	-	6,170,231	-	6,170,231
Balances, December 31, 2011	53,497,584	11,358,959	40,994,013	(21,933,985)	-	30,418,987
Exercise of stock options	766,340	713,746	(295,638 )	-	-	418,108
Repurchase and retirement of shares (note 8)	(9,941,440 )	(1,988,288 )	(7,127,545 )	-	-	(9,115,833 )

Cancellation of restricted stock	(325 )	-	-	-	-	-
Stock-based compensation (note 9)	-	-	360,699	-	-	360,699
Net income	-	-	-	4,424,142	-	4,424,142
Other comprehensive income	-	-	-	-	44,104	44,104
Balances, December 31, 2012	44,322,159	\$ 10,084,417	\$ 33,931,529	\$ (17,509,843)	\$ 44,104	\$ 26,550,207

See accompanying notes to consolidated financial statements

## Tucows Inc.

## Consolidated Statements of Cash Flows

(Dollar amounts in U.S. dollars)

	Year ended December 31,		
	2012	2011	2010
Cash provided by:			
Operating activities:			
Net income for the year	\$4,424,142	\$6,170,231	\$2,116,948
Items not involving cash:			
Depreciation of property and equipment	802,060	937,460	1,203,212
Loss on disposition of property and equipment	118,944	42,165	-
Amortization of deferred financing charges	2,300	13,300	25,400
Amortization of intangible assets	1,019,760	1,090,540	1,741,368
Deferred income taxes (recovery)	832,736	(3,046,669 )	-
Deferred rent	27,663	26,487	-
Acquisition of domain names	(3,664 )	-	-
Disposal of domain names	50,843	34,071	31,584
Gain on disposition of intangible assets	(508,800 )	-	-
(Gain) loss on change in the fair value of forward contracts	(1,100,161 )	1,533,443	1,370,710
Stock-based compensation	360,699	310,956	400,002
Change in non-cash operating working capital:			
Accounts receivable	(533,081 )	(270,594 )	(199,950 )
Inventory	(381,507 )	(205,597 )	-
Prepaid expenses and deposits	(1,325,100 )	(923,909 )	135,046
Prepaid domain name registry and ancillary services fees	(1,679,703 )	(4,855,039 )	(6,114,599 )
Income taxes recoverable	233,312	(261,215 )	54,000
Accounts payable	931,467	(611,532 )	(35,210 )
Accrued liabilities	547,590	515,931	(571,930 )
Customer deposits	752,772	209,984	335,995
Deferred revenue	1,824,650	5,179,716	6,260,225
Accreditation fees payable	(53,491 )	(4,460 )	16,114
Net cash provided by operating activities	6,343,431	5,885,269	6,768,915
Financing activities:			
Proceeds received on exercise of stock options	418,108	31,346	14,809
Repurchase of common stock	(9,115,833 )	(18,442 )	(9,707,093 )
Proceeds received on short swing sale	-	3,659	-
Proceeds received on loan payable	4,000,000	2,530,000	-
Repayment of loan payable	(1,150,000 )	(2,985,883 )	(1,914,242 )
Net cash used in financing activities	(5,847,725 )	(439,320 )	(11,606,526 )
Investing activities:			
Additions to property and equipment	(997,036 )	(851,008 )	(589,054 )
	-	(2,392,461 )	-

Acquisition of EPAG Domainservices GMBH, net of cash acquired			
Proceeds on disposal of intangible assets	508,800	-	-
Net cash (used in) provided by investing activities	(488,236 )	(3,243,469 )	(589,054 )
Increase (decrease) in cash and cash equivalents	7,470	2,202,480	(5,426,665 )
Cash and cash equivalents, beginning of year	6,408,209	4,205,729	9,632,394
Cash and cash equivalents, end of year	\$6,415,679	\$6,408,209	\$4,205,729
Supplemental cash flow information:			
Interest paid	\$195,509	\$53,166	\$116,242
Income taxes paid	\$1,025,000	\$550,000	\$200,685
Supplementary disclosure of non-cash investing and financing activities:			
Property and equipment acquired during the period not yet paid for	\$96,515	\$257,967	\$273,333

See accompanying notes to consolidated financial statements

Tucows Inc.

Notes to Consolidated Financial Statements

(Dollar Amounts in U.S. dollars)

1. Organization of the Company:

Tucows Inc. (the “Company”) is a global distributor of Internet services, including domain name registration, security and identity products through digital certificates, email and mobile telephony services through its global Internet-based distribution network of Internet Service Providers, web hosting companies and other providers of Internet services to end-users.

2. Significant accounting policies:

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”) and are stated in U.S. dollars, except where otherwise noted. Certain of the prior year comparative figures have been reclassified to conform with the financial statement presentation adopted in the current year.

(a) Basis of presentation

These consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All significant intercompany balances and transactions have been eliminated on consolidation.

Investments over which the Company is unable to exercise significant influence, are recorded at cost and written down only when there is evidence that a decline in value that is other than temporary has occurred.

(b) Use of estimates

The preparation of the consolidated financial statements in accordance with U.S. GAAP requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, management evaluates its estimates, including those related to amounts recognized for or carrying values of revenues, bad debts, investments, goodwill and intangible assets which require estimates of future cash flows and discount rates, income taxes, contingencies and litigation, and estimates of credit spreads for determination of the fair value of derivative instruments. Management bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances at the time they are made. Under different assumptions or conditions, the actual results will differ, potentially materially, from those previously estimated. Many of the conditions impacting these assumptions and estimates are outside of the Company’s control.

(c) Cash and cash equivalents

All highly liquid investments, with an original term to maturity of three months or less are classified as cash and cash equivalents.

(d) Inventory

Inventory primarily consists of mobile devices and other accessories, and is stated at the lower of cost or net realizable value. Cost is determined based on actual cost of the mobile device or accessory shipped.

The net realizable value of inventory is analyzed on a regular basis. This analysis includes assessing obsolescence, sales forecasts, product life cycle, marketplace and other considerations. If assessments regarding the above factors adversely change, we may be required to write down the value of inventory.

F-8

---

## (e) Property and equipment

Property and equipment are stated at cost, net of accumulated depreciation. Depreciation is provided on a straight-line basis so as to depreciate the cost of depreciable assets over their estimated useful lives at the following rates:

Asset	Rate
Computer equipment	30%
Computer software	100%
Furniture and equipment	20%
Leasehold improvements	Over term of lease

The Company reviews the carrying values of its property and equipment for potential impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If the estimated undiscounted future cash flows expected to result from the use of the group of assets and its eventual disposition is less than its carrying amount, it is considered to be impaired. The amount of the impairment loss recognized is measured as the amount by which the carrying value of the asset exceeds the fair value of the asset, with fair value being determined based upon discounted cash flows or appraised values, depending on the nature of the assets.

## (f) Goodwill and Intangible assets

Goodwill represents the excess of purchase price over the fair values assigned to the net assets acquired in business combinations. Finite life intangible assets, related to the acquisition of EPAG Domainservices GMBH (“EPAG”) in August 2011, are being amortized on a straight-line basis over periods of two to seven years, and consist of technology, brand and customer relationships. Finite life intangible assets, related to the acquisition of Innerwise, Inc. in July 2007, are being amortized on a straight-line basis over periods of five to seven years, and consist of brand and customer relationships. Indefinite life intangible assets, acquired in the acquisition of Mailbank.com Inc. in June 2006, consist of surname domain names and direct navigation domain names.

The Company does not amortize goodwill and indefinite life intangibles, but tests for impairment annually or more frequently if circumstances indicate potential impairment, through a comparison of fair value to its carrying amount. The Company reviews goodwill at least annually for possible impairment in the fourth quarter of each year.

Goodwill is tested for impairment as part of a two-step process. The first step uses a market approach that is based on the publicly traded common shares of the Company to estimate fair value. If the carrying value is less than the fair value, no impairment exists and the second step need not be performed. If the carrying value is greater than the fair value then the second step will be performed. In the second step, the impairment is computed by comparing the implied fair value of the Company’s goodwill with the carrying amount of that goodwill.

For the second step the Company uses a discounted cash flow or income approach in which future expected cash flows are converted to present value using factors that consider the timing and risk of the future cash flows. The estimate of cash flows used is prepared on an unleveraged debt-free basis. The discount rate reflects a market-derived weighted average cost of capital. The Company believes that this approach is appropriate because it provides a fair value estimate based upon the Company’s expected long-term operating and cash flow performance. The projections are based upon the Company’s best estimates of projected economic and market conditions over the related period including growth rates, estimates of future expected changes in operating margins and cash expenditures.

Other significant estimates and assumptions include terminal value growth rates, terminal value margin rates, future capital expenditures and changes in future working capital. If assumptions and estimates used to allocate the purchase price or used to assess impairment prove to be inaccurate, future asset impairment charges could be required. At

December 31, 2012, the Company had goodwill of \$18.9 million. The Company completed its latest annual impairment test and fair value analysis for goodwill, and there were no impairments present and no impairment charge was recorded during the years ended December 31, 2012, 2011 and 2010.

The Company has other finite life intangible assets consisting of patented and non-patented technologies. These intangible assets are amortized over their expected economic lives. The lives are determined based upon the expected use of the asset, the stability of the industry, expected changes in and replacement value of distribution networks and other factors deemed appropriate.

F-9

---



The Company continually evaluates whether events or circumstances have occurred that indicate the remaining estimated useful lives of its definite-lived intangible assets may warrant revision or that the remaining balance of such assets may not be recoverable. The Company uses an estimate of the related undiscounted cash flows over the remaining life of the asset in measuring whether the asset is recoverable. There was no impairment recorded on definite-life intangible assets and other long-lived assets during 2012 and 2011.

(g) Revenue recognition

The Company's revenues are derived from domain name registration fees on both a wholesale and retail basis, the sale of domain names, the provisioning of other Internet services and advertising and other revenue. Amounts received in advance of meeting the revenue recognition criteria described below are recorded as deferred revenue.

The Company earns registration fees in connection with each new, renewed and transferred-in registration and from providing provisioning of other Internet services to resellers and registrars on a monthly basis. Service has been provided in connection with registration fees once the Company has confirmed that the requested domain name has been appropriately recorded in the registry under contractual performance standards.

Domain names are generally purchased for terms of one to ten years. Registration fees charged for domain name registration and provisioning services are recognized on a straight-line basis over the life of the contracted term. Other Internet services that are provisioned for annual periods or longer, are recognized on a straight-line basis over the life of the contracted term. Other Internet services that are provisioned on a monthly basis are recognized as services are provided.

For arrangements with multiple deliverables, the Company allocates revenue to each deliverable if the delivered item(s) has value to the customer on a standalone basis and, if the arrangement includes a general right of return relative to the delivered item, delivery or performance of the undelivered item(s) is considered probable and substantially in the control of the Company. The fair value of the selling price for a deliverable is determined using a hierarchy of (1) Company specific objective and reliable evidence, then (2) third-party evidence, then (3) best estimate of selling price. The Company allocates any arrangement fee to each of the elements based on their relative selling prices.

Revenue generated from the sale of domain names, earned from transferring the rights to domain names under the Company's control, are recognized once the rights have been transferred and payment has been received in full.

The Company also generates advertising and other revenue through its online libraries of shareware, freeware and online services presented on its website. Advertising and other revenues are recognized ratably over the period in which it is presented. To the extent that minimum guaranteed impressions are not met, the Company defers recognition of the corresponding revenues until the guaranteed impressions are achieved.

In those cases where payment is not received at the time of sale, additional conditions for recognition of revenue are that the collection of the related accounts receivable is reasonably assured and the Company has no further performance obligations. 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.

The Company establishes provisions for possible uncollectible accounts receivable and other contingent liabilities which may arise in the normal course of business. Historically, credit losses have been within the Company's expectations and the provisions the Company has established have been appropriate. However, the Company has, on occasion, experienced issues which have led to accounts receivable not being fully collected. Should these issues

occur more frequently, additional provisions may be required.

(h) Deferred revenue

Deferred revenue primarily relates to the unearned portion of revenues received in advance related to the unexpired term of registration fees from domain name registrations and other Internet services, on both a wholesale and retail basis, net of external commissions. Revenue received in advance of the provision of services from our software libraries advertising is deferred and recognized in the month that the services are provided.

F-10

---

(i) Accreditation fees payable

In accordance with ICANN rules, the Company has elected to pay ICANN fees incurred on the registration of Generic Top-Level Domains on an annual basis. Accordingly, accreditation fees that relate to registrations completed prior to ICANN rendering a bill are accrued and reflected as accreditation fees payable.

(j) Prepaid domain name registry fees

Prepaid domain name registry and other Internet services fees represent amounts paid to registries, and country code domain name operators for updating and maintaining the registries, as well as to suppliers of other Internet services. Domain name registry and other Internet services fees are recognized on a straight-line basis over the life of the contracted registration term.

(k) Translation of foreign currency transactions

The Company's functional currency is the United States dollar. Monetary assets and liabilities of the Company and of its wholly owned subsidiaries that are denominated in foreign currencies are translated into United States dollars at the exchange rates prevailing at the balance sheet dates. Non-monetary assets and liabilities are translated at the historical exchange rates. Transactions included in operations are translated at the average rate for the year. A foreign exchange gain amounting to \$8,000 has been recorded in general and administrative expenses during the year ended December 31, 2012 ("Fiscal 2012"). A foreign exchange loss amounting to \$0.1 million has been recorded in general and administrative expenses during the year ended December 31, 2011 ("Fiscal 2011"). A foreign exchange gain amounting to \$0.1 million has been recorded in general and administrative expenses during the years ended December 31, 2010 ("Fiscal 2010").

(l) Derivative Financial Instruments

During Fiscal 2102, we used derivative financial instruments to manage foreign currency exchange risk. We account for these instruments in accordance with ASC Topic 815, "Derivatives and Hedging" (Topic 815), which requires that every derivative instrument be recorded on the balance sheet as either an asset or liability measured at its fair value as of the reporting date. Topic 815 also requires that changes in our derivative financial instruments' fair values be recognized in earnings; unless specific hedge accounting and documentation criteria are met (i.e. the instruments are accounted for as hedges). We recorded the effective portions of the gain or loss on derivative financial instruments that were designated as cash flow hedges in accumulated and other comprehensive income in our accompanying Consolidated Balance Sheets. Any ineffective or excluded portion of a designated cash flow hedge, if applicable, is recognized in net income.

For certain contracts, the Company has not complied with the documentation standards required for its forward foreign exchange contracts to be accounted for as hedges and has, therefore, accounted for such forward foreign exchange contracts at their fair values with the changes in fair value recorded in net income. The fair value of the forward exchange contracts are determined using an estimated credit adjusted mark-to-market valuation which takes into consideration the Company and the counterparty credit risk.

(m) Product development costs

Product development costs are expensed as incurred. The Company accounts for the costs of computer software developed or obtained for internal use as follows: costs that are incurred in the preliminary stage of software development are expensed as incurred. Costs incurred during the application and development stage are capitalized and generally include external direct costs of materials and services consumed in the development and payroll and

payroll- related costs for employees who are directly associated with the development project. Costs incurred in the post implementation and operation stage are expensed as incurred. During the years ended December 31, 2012, 2011 and 2010, the Company did not capitalize any amounts of such costs relating to the development of internal use software. The capitalized costs of computer software developed for internal use are amortized on a straight-line basis over one year from the date the software is put into use.

F-11

---

(n) Income taxes

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized net income in the year that includes the enactment date. A valuation allowance is recorded if it is not “more likely than not” that some portion of or all of a deferred tax asset will be realized.

The Company recognizes the impact of an uncertain income tax position at the largest amount that is more-likely-than-not to be sustained upon audit by the relevant taxing authority and includes consideration of interest and penalties. An uncertain income tax position will not be recognized if it has less than a 50% likelihood of being sustained. The liability for unrecognized tax benefits is classified as non-current unless the liability is expected to be settled in cash within 12 months of the reporting date.

The Company is entitled to earn investment tax credits (“ITCs”), which are credits related to specific qualifying expenditures as prescribed by Canadian Income Tax legislation. These ITCs relate primarily to research and development expenses. The ITCs are recognized as a reduction in income tax expense once the Company has reasonable assurance that the amounts will be realized.

(o) Stock-based compensation

Stock-based compensation expense recognized during the period is based on the value of the portion of stock-based payment awards that is ultimately expected to vest. As stock-based compensation expense recognized in net income for 2012 is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures.

(p) Earnings per common shares

Basic earnings per common share has been calculated on the basis of income for the year 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.

(q) Concentration of credit risk

Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of cash equivalents, accounts receivable and forward foreign exchange contracts. Cash equivalents and restricted cash consist of deposits with major commercial banks, the maturities of which are three months or less from the date of purchase. With respect to accounts receivable, the Company performs periodic credit evaluations of the financial condition of its customers and typically does not require collateral from them. The counterparty to any forward foreign exchange contracts is a major commercial bank which management believes does not represent a significant credit risk. Management assesses the need for allowances for potential credit losses by considering the credit risk of specific customers, historical trends and other information. No customer accounted for more than 10% of revenue in 2011, 2010 or 2009. No customers accounted for 10% of accounts receivable at December 31, 2012, one customer accounted for 16% of accounts receivable at December 31, 2011, and three customers accounted for 35% of accounts receivable at December 31, 2010. All of these accounts receivable have subsequently been collected.

(r) Fair values of financial assets and financial liabilities

The fair value of cash and cash equivalents, restricted cash, accounts receivable, accounts payable, accreditation fees payable, customer deposits and accrued liabilities (level 2 measurements) approximate their carrying values due to the relatively short periods to maturity of the instruments.

The fair value of the forward exchange contracts are determined using an estimated credit-adjusted mark-to-market valuation (a level 2 measurement) which takes into consideration the Company and the counterparty credit risk.

F-12

---

(s) Segment reporting

The Company operates in one business segment.

The Company's revenues are attributed to the country in which the contract originates, primarily Canada. Revenues from domain names issued from the Toronto, Canada location are attributed to Canada because it is impracticable to determine the country of the customer.

The Company's assets are located in Canada, the United States, Germany and the Netherlands.

(t) Reclassifications

Beginning in the first quarter of 2012, Tucows reclassified its revenue streams into three distinct service offerings: Wholesale, Retail and Portfolio. The realignment is intended to better reflect the manner in which these revenue streams are generated and assessed by management. The comparatives for Fiscals 2011 and 2010 have been updated to reflect this reclassification.

Recent Accounting Pronouncements Adopted

Comprehensive Income

The Company adopted Accounting Standards Update No. 2011-05, Comprehensive Income (Topic 220)—Presentation of Comprehensive Income ("ASU 2011-05"), effective January 1, 2012. ASU 2011-5 was applied retrospectively and requires the Company to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. ASU 2011-05 eliminates the option to present the components of other comprehensive income as part of the statement of equity.

Fair Value Measurement and Disclosures

The Company adopted Accounting Standards Update No. 2011-04, Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standards (Topic 820)—Fair Value Measurement ("ASU 2011-04"), effective January 1, 2012 and applied retrospectively, which provides a consistent definition of fair value and ensures that the fair value measurement and disclosure requirements are similar between U.S. GAAP and International Financial Reporting Standards. ASU 2011-04 changes certain fair value measurement principles and enhances the disclosure requirements particularly for level 3 fair value measurements (as defined in note 14 below). The adoption of ASU 2011-08 did not impact the fair value measurements of our assets and/or liabilities.

Testing Goodwill for Impairment

The Company adopted Accounting Standards Update No. 2011-08, Intangibles—Goodwill and Other (Topic 350)—Testing Goodwill for Impairment ("ASU 2011-08"), effective January 1, 2012, which allows entities to use a qualitative approach to test goodwill for impairment. ASU 2011-08 permits an entity to first perform a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying value. If it is concluded that this is the case, it is necessary to perform the currently prescribed two-step goodwill impairment test. Otherwise, the two-step goodwill impairment test is not required. The adoption of ASU 2011-08 did not materially impact the carrying value of our recorded goodwill. The Company will perform its next annual goodwill impairment testing on December 31, 2013.

#### Recent Accounting Pronouncements Not Yet Adopted

In July 2012, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update No. 2012-02, Intangibles — Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment (“ASU 2012-02”) to allow entities to use a qualitative approach to test indefinite-lived intangible assets for impairment. ASU 2012-02 allows an entity to first perform a qualitative assessment to determine whether it is more likely than not that the indefinite-lived intangible asset is impaired. If an entity concludes that this is the case, it is required to determine the fair value of the indefinite-lived intangible asset and perform the quantitative impairment test by comparing the fair value with the carrying amount. ASU 2012-02 is effective for annual and interim indefinite-lived intangible asset impairment tests performed for fiscal years beginning after September 15, 2012 and early adoption is permitted. We do not expect the adoption of ASU 2012-02 to materially impact the carrying value of our recorded indefinite-lived intangible assets.

F-13

---



## 3. Business acquisitions:

## a. Acquisition of EPAG Domainservices GMBH:

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

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

## Purchase price allocation

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

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

The intangible assets acquired include technology in the amount of \$0.3 million, the EPAG brand in the amount of \$0.2 million and customer relationships in the amount of \$1.2 million. The residual value from the purchase price has

been allocated to goodwill. The technology is being amortized over two years, while the customer relationships and brand are being amortized over seven years.

F-14

---

The amount of EPAG's revenues and net loss included in Tucows' Consolidated Statements of Comprehensive Income for the years ended December 31, 2011, and the unaudited pro forma revenues and net income of the combined entity had the acquisition been consummated as of January 1, 2010, are set forth below:

	Revenues	Net loss *
Actual from August 1, 2011 to December 31, 2011	\$ 1,588,228	\$ 29,184
	Year ended December 31, 2011	2010
<b>Supplemental Unaudited Pro Forma Information</b>		
Total revenue	\$ 99,299,279	\$ 87,341,726
Net income **	\$ 5,903,687	\$ 2,300,429

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

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

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

b. Goodwill:

Goodwill represents the excess of purchase price over the fair value of tangible or identifiable intangible assets acquired and liabilities assumed in our acquisitions. Intangible assets consist of acquired technology, brand, customer relationships, non-competition agreements, surname domain names and direct navigation domain names. Intangible assets, comprising technology, brand, customer relationships and non-competition arrangements related to the acquisition of Boardtown Corporation in April 2004, the acquisition of the Hosted Messaging Business of Critical Path, Inc. in January 2006, the acquisition of Mailbank.com Inc. in June 2006, the acquisition of Innerwise, Inc. in July 2007 and the acquisition of EPAG Domainservices GmbH in August 2011, are being amortized on a straight-line basis over periods of two to seven years.

The Company has other finite life intangible assets consisting of patented and non-patented technologies. These intangible assets are amortized over their expected economic lives. The lives are determined based upon the expected use of the asset, the estimated average life of the replacement parts of the reporting unit's products, the stability of the industry, expected changes in and replacement value of distribution networks and other factors deemed appropriate.

Goodwill consists of the following:

	Boardtown Corporation	Hosted Messaging Assets of Critical Path	Innerwise Inc.	Mailbank.com Inc.	EPAG Domainservices GmbH	Total
Balances, December 31, 2010	\$ 2,044,847	\$ 4,072,297	\$ 5,801,040	\$ 6,072,623	\$ —	\$ 17,990,807

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

Balances, December 31, 2011	\$	2,044,847	\$	4,072,297	\$	5,801,040	\$	6,072,623	\$	882,320	\$	18,873,127
Balances, December 31, 2012	\$	2,044,847	\$	4,072,297	\$	5,801,040	\$	6,072,623	\$	882,320	\$	18,873,127

F-15

---

The Company accounts for goodwill in accordance with FASB's authoritative guidance, which requires that goodwill and certain intangible assets are not amortized, but are subject to an annual impairment test. The Company completes its goodwill and certain intangible assets impairment test on an annual basis, during the fourth quarter of its fiscal year, or more frequently, if changes in facts and circumstances indicate that impairment in the value of goodwill and certain intangible assets recorded on its balance sheet may exist. The Company determined the estimated fair value for its reporting unit using the market approach that is based on the publicly traded common shares of the Company to estimate fair value. The carrying value was greater than the fair value, therefore no impairment exists and the second step was not performed.

With regards to property, equipment and definite life intangible assets, the Company continually evaluates whether events or circumstances have occurred that indicate the remaining estimated useful lives of its definite-life intangible assets may warrant revision or that the remaining balance of such assets may not be recoverable. The Company measures recoverability of assets to be held and used by comparing the carrying amount of the assets to future undiscounted net cash flows expected to be generated by the assets. Recoverability measurement and estimation of undiscounted cash flows is done at the lowest possible levels for which there are identifiable cash flows. If such assets fail the recoverability test, the impairment to be recognized is measured as the amount by which the carrying amount of assets exceeds the fair value of the assets. Assets to be disposed of are recorded at the lower of the carrying amount or fair value less costs to sell. Management must exercise judgment in determining whether an event has occurred that may impair the value of the long-lived assets. Factors that could indicate that impairment may exist include significant underperformance relative to a plan or long-term projections, significant changes in business strategy, significant negative industry or economic trends or a significant decline in our stock price or in the value of our reporting units for a sustained period of time. There was no impairment recorded on definite-life intangible assets and property and equipment during 2012 and 2011. As of December 31, 2012, the Company had \$16.4 million in intangible assets.

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

##### Foreign currency forward contracts

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

The Company has designated these transactions as cash flow hedges of forecasted transactions under ASC Topic 815 "Derivatives and Hedging" (ASC Topic 815). As the critical terms of the hedging instrument, and of the entire hedged forecasted transaction, are the same, in accordance with ASC Topic 815, the Company has been able to conclude that changes in fair value or cash flows attributable to the risk of being hedged are expected to completely offset at inception and on an ongoing basis. Accordingly, quarterly unrealized gains or losses on the effective portion of these contracts have been included within other comprehensive income. The fair value of the contracts, as of December 31, 2012, is recorded as derivative instrument assets and liabilities.

As of December 31, 2012, the notional amount of forward contracts that the Company held to sell U.S. dollars in exchange for Canadian dollars was \$29.3 million, of which \$15.1 million met the requirements of ASC Topic 815 and were designated as hedges (December 31, 2011 - \$30.4 million of which none were designated as hedges).

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

The effect of these derivative instruments on our consolidated financial statements as of, and for the year ended December 31, 2012, were as follows (amounts presented do not include any income tax effects).

Fair value of derivative instruments in the consolidated balance sheets (see note 14)

Derivatives	Balance Sheet Location	Year ended December 31, 2012 Fair Value Asset (Liability)	Year ended December 31, 2011 Fair Value Asset (Liability)
Foreign currency forward contracts designated as cash flow hedges	Derivative instruments	\$377,703	\$—
Foreign currency forward contracts not designated as cash flow hedges	Derivative instruments	\$67,079	\$(699,483)
<b>Total foreign currency forward contracts</b>	<b>Derivative instruments</b>	<b>\$444,782</b>	<b>\$(699,483)</b>

#### Effects of derivative instruments on income and other comprehensive income (OCI)

Derivatives in Cash Flow Hedging Relationship	Amount of Gain or (Loss) Recognized in OCI on Derivative (Effective Portion)	Location of Reclassified from Accumulated OCI into Income (Effective Portion)	Amount of Reclassified from Accumulated OCI into Income (Effective Portion)	Location of Gain or (Loss) Recognized in Income on Derivative (ineffective Portion and Amount Excluded from Effectiveness Testing)	Amount of Gain or (Loss) Recognized in Income on Derivative (ineffective Portion and Amount Excluded from Effectiveness Testing)
Foreign currency forward contracts	\$44,104	—	—	—	—

## 5. Property and equipment:

Property and equipment consist of the following:

	December 31, 2012	December 31, 2011
Computer equipment	\$ 6,529,764	\$ 7,348,211
Computer software	1,157,609	2,659,331
Furniture and equipment	542,213	403,953
	8,229,586	10,411,495
Less:		
Accumulated depreciation	6,877,442	8,973,931
	\$ 1,352,144	\$ 1,437,564

Depreciation of property and equipment:

	Year ended December 31, 2012	Year ended December 31, 2011	Year ended December 31, 2010
Depreciation of property and equipment	\$ 802,060	\$ 937,460	\$ 1,203,212

## 6. Intangible assets:

Intangible assets consist of acquired technology, brand, customer relationships, non-competition agreements, surname domain names and direct navigation domain names. These balances are being amortized, on a straight-line basis over the term of the intangible assets, as reflected in the table below.

Acquired intangible assets consist of the following:

	Technology 2 - 7 years	Brand 7 years	Customer relationships 4 - 7 years	Surname domain names indefinite life	Direct navigation domain names indefinite life	Total
Balances, December 31, 2010	\$ 25,720	\$ 519,780	\$ 2,133,260	\$ 12,125,918	\$ 2,078,723	\$ 16,883,401
Additions to/(disposals from) domain portfolio, net	—	—	—	(5,841)	(28,230)	(34,071)
Acquisition of EPAG Domainservices GmbH	287,300	215,475	1,221,025	—	—	1,723,800
Amortization expense	(85,590)	(163,325)	(841,625)	—	—	(1,090,540)
Balances, December 31, 2011	227,430	571,930	2,512,660	12,120,077	2,050,493	17,482,590
Additions to/(disposals from)	—	—	—	(10,060)	(37,119)	(47,179)

domain portfolio, net							
Amortization							
expense	(143,640)	(173,640)	(702,480)	—	—	(1,019,760)	
Balances, December							
31, 2012	\$ 83,790	\$ 398,290	\$ 1,810,180	\$ 12,110,017	\$ 2,013,374	\$ 16,415,651	

F-18

---



The following table shows the estimated amortization expense for each of the next 5 years, assuming no further additions to acquired intangible assets are made:

	Year ending December 31,
2013	\$ 959,910
2014	596,620
2015	205,320
2016	205,320
2017	205,320
Total	\$ 2,172,490

Indefinite life intangible assets represent domain names acquired from third parties and surname and direct navigation domain names related to the acquisition of Mailbank.com Inc. in June 2006. These assets are not being amortized and are being tested for impairment annually and whenever events or changes in circumstances indicate that their carrying value may not be recoverable. The Company uses a discounted cash flow or income approach to estimate the fair value of its indefinite life intangible assets. In the discounted cash flow approach, expected cash flows are converted to present value using factors that consider the timing and risk of the future cash flows. The estimate of cash flows used is prepared on an unleveraged debt-free basis. The discount rate reflects a market-derived weighted average cost of capital. The Company believes that this approach is appropriate because it provides a fair value estimate based upon the Company's expected long-term operating and cash flow performance. The projections are based upon the Company's best estimates of projected economic and market conditions over the related period including growth rates, estimates of future expected changes in operating margins and cash expenditures. Other significant estimates and assumptions include terminal value growth rates, terminal value margin rates, future capital expenditures and changes in future working capital. If assumptions and estimates used to allocate the purchase price or used to assess impairment prove to be inaccurate, future asset impairment charges could be required. At December 31, 2012, the Company had indefinite life assets of \$14.1 million. The Company completed its latest annual impairment test and fair value analysis for indefinite life intangible assets, and there were no impairments present and no impairment charge was recorded during the years ended December 31, 2012, 2011 and 2010.

#### 7. Loan payable:

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

#### Two Revolving Demand Loan Facilities.

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

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

undrawn aggregate standby fee of 0.20% following the first draw, which such fee is payable quarterly in arrears.

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

On July 28, 2011, the Company drew down \$2.5 million on our prior demand loan revolving facility (the “2011 DLR Loan”) to fund the acquisition of EPAG as more fully described under Note 3, Business acquisitions. On December 31, 2011, in accordance with the terms of our prior revolving demand loan facilities, the remaining balance under the 2011 DLR Loan was fully repaid by an equivalent advance made under our prior demand loan revolving reducing facility (the “2011 DLRR Loan”). At June 30, 2012, the 2011 DLRR Loan was fully repaid.

During the period ended March 31, 2012, the Company successfully concluded a modified “Dutch auction tender offer”, which was funded from available cash and an advance under the 2011 DLR Loan in the amount of \$4.0 million. Under the terms of the offer, the Company repurchased an aggregate of 7,570,236 shares of its common stock at a purchase price of \$0.77 per share, for a total of \$5,829,082, excluding transaction costs of approximately \$64,000. At December 31, 2012, the outstanding balance under the 2012 DLR Loan was \$3.7 million.

#### Treasury Risk Management Facility

The Amended Credit Facility also provides for a \$3.5 million settlement risk line to assist the Company with hedging Canadian dollar exposure through foreign exchange forward contracts and/or currency options. Under the terms of the Amended Credit Facility, the Company may enter into such agreements at market rates with terms not to exceed 18 months. As of December 31, 2012, the Company held contracts in the amount of \$29.3 million to trade U.S. dollars in exchange for Canadian dollars.

#### Operating Demand Loan

The Amended Credit Facility also provides the Company with a \$1.0 million operating demand loan facility to assist in meeting its operational needs (the “Operating Demand Loan”). The Operating Demand Loan accrues interest at the Bank’s U.S. Base Rate plus 1.25%. Interest is payable monthly in arrears with any borrowing under the Operating Demand Loan fluctuating widely with periodic clean-up, at a minimum on an annual basis. The Company has also agreed to pay to the Bank a monthly monitoring fee of US\$500 with respect to this loan. The Operating Demand Loan is payable on demand at any time, at the sole discretion of the Bank, with or without cause, and the Bank may terminate the Operating Demand Loan at any time. As of December 31, 2012, the Company had no amounts outstanding under its Operating Demand Loan.

#### General Terms

The Company’s Amended Credit Facility contains customary representations and warranties, affirmative and negative covenants, and events of default. The Company’s obligations under the Amended Credit Facility are guaranteed and secured by a security interest in substantially all of its assets. The Amended Credit Facility also requires that the Company comply with certain customary non-financial covenants and restrictions. In addition, the Company has agreed to comply with the following financial covenants at all times, which are to be calculated on a rolling four quarter basis: (i) Maximum Total Funded Debt to EBITDA of 2.00:1; and (ii) Minimum Fixed Charge Coverage of 1.20:1. Further, its Maximum Annual Capital Expenditures cannot exceed \$3.6 million per year, which limit will be reviewed on an annual basis. As of, and for the year ended, December 31, 2012, the Company was in compliance with these covenants.

Scheduled principal loan repayments are as follows:

2013	1,000,000
2014	1,000,000
2015	1,000,000
2016	700,000

F-20

---

8. Common shares:

The Company's authorized common share capital is 250 million shares of common stock without nominal or par value. On December 31, 2012, there were 44,322,159 shares of common stock outstanding.

Repurchase of common shares:

(a) Modified Dutch Tender Offers:

On January 23, 2012, the Company announced that it successfully concluded a modified "Dutch auction tender offer" that was previously announced on December 15, 2011. Under the terms of the offer, the Company repurchased an aggregate of 7,570,236 shares of its common stock at a purchase price of \$0.77 per share, for a total of \$5,829,082, excluding transaction costs of approximately \$64,000. The purchase price and all transaction costs were funded from available cash and an additional advance under its Amended Credit Facility from the Bank in the amount of \$4.0 million. All shares purchased in the tender offer received the same price and all shares repurchased were immediately cancelled. As a result of the completion of the tender offer, as of January 23, 2012, the Company had 46,047,053 shares issued and outstanding.

(b) Normal Course Issuer Bids:

On November 11, 2011 the Company commenced an NCIB which authorized the repurchase up to 3,840,000 shares of its common stock. During Fiscal 2011 the Company repurchased 23,765 of its common shares under the NCIB at an average purchase price of \$0.78 per share, for a total of \$18,442. The purchase price and all transaction costs were funded from available cash. All shares repurchased under the NCIB were immediately retired. This NCIB was suspended upon the commencement of the modified Dutch auction tender offer on December 15, 2011.

On March 16, 2012, the Company announced that it was reinstating its previously announced stock buyback program, which initially commenced on November 11, 2011 and which was temporarily suspended when the Company undertook its Dutch auction tender offer. Under this buyback program, the Company may repurchase up to 3,840,000 shares of the Company's common stock over the 12-month period that commenced on November 15, 2011. The Company repurchased 2,371,204 shares under this program during the year ended December 31, 2012.

9. Stock option plans:

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

On November 22, 2006, the shareholders of the Company approved the Company's 2006 Equity Compensation Plan (the "2006 Plan"), which was amended and restated effective July 29, 2010 and which serves as a successor to the 1996 Plan. The 2006 Plan has been established for the benefit of the employees, officers, directors and certain consultants of the Company. The maximum number of common shares which have been set aside for issuance under the 2006 Plan is 5.0 million shares. On October 8, 2010, the 2006 Plan was amended to increase the number of shares which have been set aside for issuance by an additional 1.9 million shares to 6.9 million shares. Generally, options issued under the 2006 Plan vest over a four-year period and have a term not exceeding seven years, except for automatic formula grants of non-qualified stock options, which are immediately exercisable and have a five year term.

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 Tu cows Inc. common shares at the date of grant.

F-21

---

The fair value of stock options granted during the years ended December 31, 2012, 2011 and 2010 was estimated using the following assumptions:

	Year ended December 31,		
	2012	2011	2010
Volatility	52.1%	73.7%	71.9%
Risk-free interest rate	0.5%	0.8%	1.9%
Expected life (in years)	4.0	4.0	4.4
Dividend yield	—%	—%	—%
The weighted average grant date fair value for options issued, with the exercise price equal to market value on the date of grant	\$ 0.56	\$ 0.38	\$ 0.39

Details of stock option transactions are as follows:

	Year ended December 31, 2012		Year ended December 31, 2011		Year ended December 31, 2010	
	Number of shares	Weighted average exercise price per share	Number of shares	Weighted average exercise price per share	Number of shares	Weighted average exercise price per share
Outstanding, beginning of year	8,746,041	\$ 0.57	8,272,249	\$ 0.56	7,213,977	\$ 0.56
Granted	779,000	1.36	706,000	0.74	1,804,000	0.69
Exercised	(766,340)	0.55	(73,708)	0.43	(33,678)	0.44
Forfeited	(163,001)	0.80	(98,500)	0.69	(204,959)	0.66
Expired	(3,014)	0.44	(60,000)	0.80	(507,091)	1.02
Outstanding, end of year	8,592,686	\$ 0.64	8,746,041	\$ 0.57	8,272,249	\$ 0.56
Options exercisable, end of year	7,090,892	\$ 0.57	7,042,415	\$ 0.54	6,205,248	\$ 0.51

The stock options expire at various dates through 2019.

As of December 31, 2012, the exercise prices, weighted average remaining contractual life of outstanding options and intrinsic values were as follows:

Exercise price	Number outstanding	Options outstanding			Options exercisable		
		Weighted average exercise price per share	Weighted average remaining contractual life (years)	Aggregate intrinsic value	Number exercisable	Weighted average exercise price per share	Aggregate intrinsic value
\$ 0.31 - \$0.48	3,130,574	\$ 0.38	0.6	\$ 3,333,310	3,130,574	\$ 0.38	\$ 3,333,310
\$ 0.56 - \$0.75	3,790,112	\$ 0.66	3.3	2,970,677	2,823,318	\$ 0.64	2,264,948
\$ 0.80 - \$1.38	1,672,000	\$ 1.08	3.4	594,960	1,137,000	\$ 0.96	548,010
	8,592,686	\$ 0.64		\$ 6,898,947	7,090,892	\$ 0.57	\$ 6,146,268

Total unrecognized compensation cost relating to unvested stock options at December 31, 2012, prior to the consideration of expected forfeitures, is approximately \$0.6 million and is expected to be recognized over a weighted average period of 2.3 years.

The total intrinsic value of options exercised during the years ended December 31, 2012, 2011 and 2010 was \$296,000, \$25,000 and \$10,000, respectively. Cash received from the exercise of stock options during the years ended December 31, 2012, 2011 and 2010 was \$418,108, \$31,346 and \$14,809 respectively.

F-22

---



The Company recorded stock-based compensation amounting to \$0.4 million, \$0.3 million and \$0.4 million for the years ended December 31, 2012, 2011 and 2010 respectively.

#### 10. Income taxes:

The provision for income taxes differs from the amount computed by applying the statutory federal income tax rate of 34% to income before provision for income taxes as a result of the following:

	Year ended December 31, 2012	Year ended December 31, 2011	Year ended December 31, 2010
Income for the year before provision for income taxes	\$ 6,428,298	\$ 3,450,610	\$ 2,327,793
Computed expected tax expense	\$ 2,185,621	\$ 1,173,207	\$ 791,450
Increase (reduction) in income tax expense resulting from:			
State income taxes	16,071	8,627	5,819
Permanent differences, including foreign exchange	21,728	13,700	(22,812)
Investment tax credits recovered	(106,941)	(41,833)	(50,311)
Other, including alternative minimum tax and adjustments to opening deferred tax assets	(112,323)	(218,252)	82,928
Change in beginning of the year balance of the valuation allowance allocated to income tax expense	—	(3,655,070)	(596,229)
Provision for (recovery of) income taxes	\$ 2,004,156	\$ (2,719,621)	\$ 210,845

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and liabilities as of December 31, 2012 and 2011 are presented below:

	December 31, 2012	December 31, 2011
<b>Deferred tax assets:</b>		
Deferred revenue	\$ 5,429,220	\$ 5,648,563
Amortization	541,242	1,231,814
Total gross deferred tax assets	5,970,462	6,880,377
Less valuation allowance	—	—
Net deferred tax assets	\$ 5,970,462	\$ 6,880,377
Deferred income tax asset, current portion	—	—
Deferred income tax asset, long-term portion	5,970,462	6,880,377
	\$ 5,970,462	\$ 6,880,377
<b>Deferred tax liabilities:</b>		
Reserves and other	\$ (914,429)	\$ (880,008)
Limited life intangible assets	(394,100)	(505,700)
Indefinite life intangible assets	(4,840,000)	(4,840,000)
Total deferred tax liabilities	(6,148,529)	(6,225,708)
Less deferred tax liability, current portion	(914,429)	(880,008)
Deferred tax liability, long-term portion	\$ (5,234,100)	\$ (5,345,700)

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. During the fourth quarter of 2011 management released its remaining valuation allowance of \$3.6 million.

At December 31, 2012 Tucows' unrecognized tax benefits amounted to \$0.4 million, which if recognized would favorably affect the income tax rate in future periods. The unrecognized tax benefit relates primarily to prior year Pennsylvania state franchise taxes and other insignificant US state taxes, unrecognized tax benefits for potential 2012 research and development tax credits as well as prior year German income tax. We will record the tax benefit of the 2012 research and development claim once we have reasonable assurance that it is more likely than not that all or a portion of the benefit arising from the claim will be realized.

The Company recognizes accrued interest and penalties related to unrecognized tax benefits in tax expense. The Company did not have any significant interest and penalties accrued as of January 1, 2011 and December 31, 2012.

Tucows believes that it is reasonably possible that \$0.4 million of the unrecognized tax benefit will decrease in the next twelve months as it is anticipated that the foreign tax authorities will finalize their review of prior years' taxes owing in Pennsylvania and Germany respectively and that the 2012 ITC claim will be filed and assessed within that period.

The following is a reconciliation of Tucows' change in uncertain tax position under ASC 740, "Income Taxes":

	Total Gross Unrecognized Tax Benefits
Balance as at December 31, 2011	\$ 167,000
Increase in uncertain tax benefits for the current year	100,000
Increase in uncertain tax benefits for the prior year	165,000
Decrease in uncertain tax benefits of prior years	(50,000)
Balance as at December 31, 2012	\$ 382,000

#### 11. Other income, net:

In 2002, various patents which were acquired by us in the merger with Infonautics in 2001 were assigned to an unrelated third party. In connection with the assignment of these patents, we retained the right to a share of any cash flow received by the unrelated third party relating to the commercialization of these patents. As a result of this assignment, during the year ended December 31, 2011 we received an amount of \$0.4 million. No amount was received during the years ended December 31, 2012 and 2010.

In March 2012, we received an amount of \$0.5 million on the sale of certain intangible assets with no book value.

#### 12. Earnings per common share:

The following table reconciles the numerators and denominators of the basic and diluted earnings per common share computation:

	Year ended December 31, 2012	Year ended December 31, 2011	Year ended December 31, 2010
Numerator for basic and diluted earnings per common share:			
Net income for the year	\$ 4,424,142	\$ 6,170,231	\$ 2,116,948
Denominator for basic and diluted earnings per common share:			
Basic weighted average number of common shares outstanding	45,832,862	53,454,675	57,982,248
Effect of stock options	3,302,082	2,294,758	1,973,540
Diluted weighted average number of shares outstanding	49,134,944	55,749,433	59,955,788
Basic earnings per common share	\$ 0.10	\$ 0.12	\$ 0.04
Diluted earnings per common share	\$ 0.09	\$ 0.11	\$ 0.04

Options to purchase 755,187 common shares were outstanding during 2012 (2011: 3,148,750; 2010: 2,937,000) but were not included in the computation of diluted income per common share because the options' exercise price was greater than the average market price of the common shares. The options which expire in years 2013 to 2018 were still

outstanding at the end of 2012.

F-24

---

## 13. Commitments and contingencies:

(a) The Company has several non-cancelable lease and purchase obligations primarily for general office facilities and equipment that expire over the next ten years. Future minimum payments under these agreements are as follows:

2013	\$ 2,017,000
2014	1,543,000
2015	1,481,000
2016	995,000
2017	953,000
Thereafter	1,584,000

Rental expense under operating lease agreements was \$0.9 million, \$0.9 million and \$0.6 million for the years ended December 31, 2012, 2011 and 2010, respectively.

(b) In the normal course of its operations, the Company becomes involved in various legal claims and lawsuits. The Company intends to vigorously defend these claims. While the final outcome with respect to any actions outstanding or pending as of December 31, 2012 cannot be predicted with certainty, it is the opinion of management that their resolution will not have a material adverse effect on the Company's financial position.

## 14. 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 instruments measured at fair value on a recurring basis as at December 31, 2012:

	December 31, 2012			Assets at Fair Value
	Fair Value Measurement Using			
	Level 1	Level 2	Level 3	
Derivative instrument asset	\$ —	\$ 444,782	\$ —	\$ 444,782
Total Assets	\$ —	\$ 444,782	\$ —	\$ 444,782

The following table provides a summary of the fair values of the Company's derivative instruments measured at fair value on a recurring basis as at December 31, 2011:

	December 31, 2011			Assets at Fair Value
	Fair Value Measurement Using			
	Level 1	Level 2	Level 3	
Derivative instrument asset	\$ —	\$ 87,023	\$ —	\$ 87,023
Total Assets	\$ —	\$ 87,023	\$ —	\$ 87,023

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

Derivative instrument liability	\$ —	\$ 786,506	\$ —	\$ 786,506
Total Liabilities	\$ —	\$ 786,506	\$ —	\$ 786,506

F-25

---

## 15. Subsequent events:

On January 7, 2013, the Company announced that it successfully concluded a modified “Dutch auction tender offer” that was previously announced on November 21, 2012. Under the terms of the offer, the Company repurchased an aggregate of 4,114,437 shares of its common stock at a purchase price of \$1.50 per share, for a total of \$6,171,656, excluding transaction costs of approximately \$110,000. The purchase price and all transaction costs were funded from available cash and an additional advance under its Amended Credit Facility from the Bank in the amount of \$5.2 million. All shares purchased in the tender offer received the same price and all shares repurchased were immediately retired. As a result of the completion of the tender offer, as of January 31, 2013, the Company had 40,226,875 shares issued and outstanding.

## 16. Supplemental information:

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

	Year ended December 31,		
	2012	2011	2010
<b>Wholesale:</b>			
Domain Services	\$ 87,434,450	\$ 76,201,058	\$ 64,977,121
Value Added Services	10,586,460	9,268,460	8,978,922
Total Wholesale	98,020,910	85,469,518	73,956,043
Retail	10,740,844	5,263,118	4,559,833
Portfolio	5,965,147	6,332,331	6,062,629
	\$ 114,726,901	\$ 97,064,967	\$ 84,578,505

During the years ended December 31, 2012, 2011 and 2010, no customer accounted for more than 10% of total revenue. As at December 31, 2012, no customers accounted for more than 10% of accounts receivable, as at December 31, 2011, one customer accounted for 16% of accounts receivable, while as at December 31, 2010, three customers accounted for 35% of accounts receivable.

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

	Year ended December 31,		
	2012	2011	2010
<b>Wholesale:</b>			
Domain Services	\$ 73,168,196	\$ 63,491,433	\$ 54,087,893
Value Added Services	2,032,328	1,969,374	1,996,317
Total Wholesale	75,200,524	65,460,807	56,084,210
Retail	6,804,863	1,881,063	1,527,727
Portfolio	832,008	746,517	882,912
Network, other costs	4,925,058	4,837,650	4,648,899
Network, depreciation and amortization costs	755,280	836,045	1,331,576
	\$ 88,517,733	\$ 73,762,082	\$ 64,475,324

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

	Year ended December 31,	
	2012	2011

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

Canada	\$	1,026,570	\$	1,027,122
United States		306,679		390,231
Germany		18,895		20,211
	\$	1,352,144	\$	1,437,564

F-26

---



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

	Year ended December 31,	
	2012	2011
Canada	\$ 1,062,100	\$ 1,732,900
Germany	1,230,160	1,579,120
	\$ 2,292,260	\$ 3,312,020

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

	Year ended December 31,	
	2012	2011
Canada	\$ 5,970,462	\$ 6,880,377
	\$ 5,970,462	\$ 6,880,377

(f) Valuation and qualifying accounts:

	Balance at beginning year	Charged to (recovered) costs and expenses	Write-offs during year	Balance at end of year
Allowance for doubtful accounts, including provision for credit notes				
2012	\$ 62,415	\$ 16,555	\$ —	\$ 78,970
2011	\$ 65,000	\$ (2,585)	\$ —	\$ 62,415
2010	\$ 115,000	\$ (50,000)	\$ —	\$ 65,000
Valuation allowance for deferred tax asset:				
2012	\$ —	\$ —	\$ —	\$ —
2011	\$ 3,655,070	\$ (3,655,070)	\$ —	\$ —
2010	\$ 4,251,000	\$ (595,930)	\$ —	\$ 3,655,070

EXHIBIT INDEX

Exhibit No.	Description
3.1	Fourth Amended and Restated Articles of Incorporation of Tucows Inc. (Incorporated by reference to Exhibit 3.1 filed with Tucows' Current Report on Form 8-K, as filed with the SEC on November 29, 2007).
3.2	Second Amended and Restated Bylaws of Tucows Inc. (Incorporated by reference to Exhibit 3.2 filed with Tucows' Annual Report on Form 10-K for the year ended December 31, 2006, as filed with the SEC on March 29, 2007).
3.3	Amendment No. 1 to Second Amended and Restated Bylaws of Tucows Inc. (Incorporated by Reference to Exhibit 3.3 filed with Tucows' Quarterly Report on Form 10-Q for the quarter ended June 30, 2012).
10.1*	2006 Equity Compensation Plan, as amended and restated effective as of July 29, 2010 (Incorporated by reference to Exhibit 99(d)(1) filed with Tucows' Schedule TO, as filed with the SEC on September 17, 2010).
10.2*	Employment Agreement dated January 22, 2003 between Tucows.com Co. and Elliot Noss (Incorporated by reference to Exhibit 10.5 filed with Tucows' Annual Report on Form 10-K for the year ended December 31, 2003, as filed with the SEC on March 28, 2004).
10.3*	Employment Agreement dated March 11, 2003 between Tucows.com Co. and Michael Cooperman (Incorporated by reference to Exhibit 10.5 filed with Tucows' Annual Report on Form 10-K for the year ended December 31, 2003, as filed with the SEC on March 28, 2004).
10.4	Lease between 707932 Ontario Limited and Tucows International Corporation, dated December 10, 1999 (Incorporated by reference to exhibit number 10.9 filed with Tucows' Annual Report on Form 10-K for the year ended December 31, 2001, as filed with the SEC on April 1, 2002).
10.5	Lease extension between 707932 Ontario Limited and Tucows Inc. and Tucows.com Co., dated September 4, 2004 (Incorporated by reference to Exhibit 10.5 filed with Tucows' Annual Report on Form 10-K for the year ended December 31, 2004, as filed with the SEC on March 24, 2005).
10.6*	Description of Tucows Fiscal 2004 At Risk Compensation Plan (Incorporated by reference to Exhibit 10.9 filed with Tucows' Annual Report on Form 10-K for the year ended December 31, 2004, as filed with the SEC on March 24, 2005).
10.7	Registrar Accreditation Agreement, effective as of June 25, 2005, as amended June 22, 2009, by and between the Internet Corporation for Assigned Names and Numbers and Tucows.com Co. (Incorporated by reference to Exhibit 10.7 filed with Tucows' Annual Report on Form 10-K for the year ended December 31, 2010, as filed with the SEC on March 22, 2011).

- 10.8 Registry-Registrar Agreement, dated as of October 4, 2001, by and between VeriSign, Inc. and Tucows Inc. (Incorporated by reference to Exhibit 10.13 filed with Amendment No. 1 to Tucows' registration statement on Form S-1 (Registration No. 333-125843), as filed with the SEC on July 7, 2005).
- 10.11 Loan Agreement, dated as of June 25, 2007, by and among Tucows.com Co., Tucows (Delaware) Inc., Tucows Inc., Mailbank Nova Scotia Co., Tucows Domain Holdings Co., Innerwise, Inc. and Bank of Montreal (Incorporated by reference to Exhibit 10.1 filed with Tucows' Current Report on Form 8-K, as filed with the SEC on July 31, 2007).
-

Exhibit No.	Description
10.12	Guaranty, dated July 25, 2007, by Tucows Inc. in favor of Bank of Montreal (Incorporated by reference to Exhibit 10.2 filed with Tucows' Current Report on Form 8-K, as filed with the SEC on July 31, 2007).
10.13	Security Agreement, dated July 25, 2007, by Tucows Inc. in favor of Bank of Montreal (Incorporated by reference to Exhibit 10.3 filed with Tucows' Current Report on Form 8-K, as filed with the SEC on July 31, 2007).
10.14	Financing Commitment, dated July 19, 2007, by and between Tucows.com Co. and Bank of Montreal (Incorporated by reference to Exhibit 10.3 filed with Tucows' Current Report on Form 8-K, as filed with the SEC on July 31, 2007).
10.15	Operating Loan Agreement, dated September 10, 2010, between Tucows.com Co. and the Bank of Montreal. (Incorporated by reference to Exhibit 10.1 filed with Tucows' Current Report on Form 8-K, as filed with the SEC on September 13, 2010).
10.16	Offer Letter, dated August 30, 2010, between Tucows Inc. and the Bank of Montreal. (Incorporated by reference to Exhibit 10.2 filed with Tucows' Current Report on Form 8-K, as filed with the SEC on September 13, 2010).
10.17	Offer Letter, dated July 27, 2011, between Tucows.com Co and the Bank of Montreal (incorporated herein by reference to Exhibit 10.1 to Tucows Inc.'s Current Report on Form 8-K, filed with the Securities and Exchange Commission on August 3, 2011).
10.18	Letter of Acknowledgment, dated December 13, 2011, between Tucows.com Co and the Bank of Montreal. (Incorporated by reference to Exhibit 10.1 filed with Tucows' Current Report on Form 8-K, as filed with the SEC on December 13, 2011).
10.19	Offer Letter, dated November 19, 2012, between Tucows.com Co. and the Bank of Montreal (Incorporated by reference to Exhibit 10.1 filed with Tucows' Current Report on Form 8-K, as filed with the SEC on November 21, 2012).
10.20	Amended and Restated Supplemental Agreement, dated December 14, 2012, between Tucows.com Co., Tucows (Delaware), Inc. and the Bank of Montreal (Incorporated by reference to Exhibit 10.1 filed with Tucows' Current Report on Form 8-K, as filed with the SEC on December 20, 2012).
10.21	Guaranty, dated December 14, 2012, by Ting Inc. in favor of the Bank of Montreal (Incorporated by reference to Exhibit 10.2 filed with Tucows' Current Report on Form 8-K, as filed with the SEC on December 20, 2012).
10.22	Security Agreement, dated December 14, 2012, by Ting Inc. in favor of the Bank of Montreal (Incorporated by reference to Exhibit 10.3 filed with Tucows' Current Report on Form 8-K, as filed with the SEC on December 20, 2012).
21.1#	Subsidiaries of Tucows Inc.
23.1#	Consent of KPMG LLP, Independent Registered Public Accounting Firm.

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

---

\* Management or compensatory contract required to be filed pursuant to Item 15(c) of the requirements for Form 10-K reports.

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

# Filed herewith.

---

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

Tucows Inc.

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

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons of behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ Elliot Noss Elliot Noss	President, Chief Executive Officer (Principal Executive Officer) and Director	March 15, 2013
/s/ Michael Cooperman Michael Cooperman	Chief Financial Officer (Principal Financial and Accounting Officer)	March 15, 2013
/s/ Stanley Stern Stanley Stern	Director	March 15, 2013
/s/ Eugene Fiume Eugene Fiume	Director	March 15, 2013
/s/ Erez Gissin Erez Gissin	Director	March 15, 2013
/s/ Joichi Ito Joichi Ito	Director	March 15, 2013
/s/ Allen Karp Allen Karp	Director	March 15, 2013
/s/ Lloyd N. Morrisett Lloyd N. Morrisett	Director	March 15, 2013

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

/s/ Rawleigh Ralls  
Rawleigh Ralls

Director

March 15, 2013

/s/ Jeffrey Schwartz  
Jeffrey Schwartz

Director

March 15, 2013