TUCOWS INC /PA/
Form 10-Q
November 12, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2014

OR

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

For the transition period from to

Commission file number 1-32600

TUCOWS INC.

(Exact Name of Registrant as Specified in Its Charter)

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

96 Mowat Avenue,

Toronto, Ontario M6K 3M1, Canada

(Address of Principal Executive Offices) (Zip Code)

(416) 535-0123

(Registrant's Telephone Number, Including Area Code)

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

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

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

Large accelerated filer	Accelerated filer
Non-accelerated filer (Do not check if a smaller reporting company)	Smaller reporting company

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

As of November 12, 2014, there were 11,302,843 outstanding shares of common stock, no par value, of the registrant.

TUCOWS INC.

Form 10-Q Quarterly Report

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TRADEMARKS, TRADE NAMES AND SERVICE MARKS

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PART I.

FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements

Tucows Inc.

Consolidated Balance Sheets

(Dollar amounts in U.S. dollars)

	September 30, 2014 (unaudited)	**December 31, 2013**
Assets		
Current assets:		
Cash and cash equivalents	$13,589,246	$12,418,888
Accounts receivable, net of allowance for doubtful accounts of $127,330 as of September 30, 2014 and $91,226 as of December 31, 2013	6,914,690	5,305,403
Inventory	391,026	309,686
Prepaid expenses and deposits	4,322,231	4,309,039
Prepaid domain name registry and ancillary services fees, current portion	45,985,103	44,209,591
Deferred tax asset, current portion (note 7)	1,874,824	1,081,526
Income taxes recoverable	526,534	475,889
Total current assets	73,603,654	68,110,022
Prepaid domain name registry and ancillary services fees, long-term portion	11,911,238	11,838,579
Property and equipment	1,742,305	1,757,836
Deferred tax asset, long-term portion (note 7)	5,569,900	5,370,037
Intangible assets (note 5)	14,261,216	15,403,228
Goodwill	18,873,127	18,873,127
Total assets	$125,961,440	$121,352,829
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$3,574,165	$2,361,481
Accrued liabilities	4,957,900	3,913,034
Customer deposits	4,069,332	4,500,946
Derivative instrument liability, (note 4)	762,053	491,098
Loan payable (note 6)	-	6,300,000
Deferred revenue, current portion	57,182,978	54,379,719

Accreditation fees payable, current portion	484,989	473,811
Income taxes payable (note 7)	179,007	1,024,004
Total current liabilities	71,210,424	73,444,093
Deferred revenue, long-term portion	15,795,206	15,638,517
Accreditation fees payable, long-term portion	130,166	135,522
Deferred rent, long-term portion	90,191	75,979
Deferred tax liability, long-term portion (note 7)	5,092,000	5,141,500
Stockholders' equity (note 11)		
Preferred stock - no par value, 1,250,000 shares authorized; none issued and outstanding	-	-
Common stock - no par value, 250,000,000 shares authorized;11,301,891 shares issued and outstanding as of September 30, 2014 and 10,907,063 shares issued and outstanding as of December 31, 2013	13,984,072	11,859,267
Additional paid-in capital	28,883,823	28,632,311
Deficit	(8,814,453)	(13,329,379)
Accumulated other comprehensive income (loss)	(409,989)	(244,981)
Total stockholders' equity	33,643,453	26,917,218
Total liabilities and stockholders' equity	$125,961,440	$121,352,829

Commitments and contingencies (note 10)
Subsequent events (note 14)

See accompanying notes to unaudited consolidated financial statements

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Tucows Inc.

Consolidated Statements of Operations and Comprehensive Income

(Dollar amounts in U.S. dollars)

(unaudited)

	Three months ended September 30,		**Nine months ended September 30,**	
	2014	**2013**	**2014**	**2013**
Net revenues (note 9)	$38,874,183	$35,637,085	$108,864,578	$96,795,464
Cost of revenues (note 9):				
Cost of revenues	25,985,875	24,268,961	75,038,518	69,354,366
Network expenses (*)	1,139,515	1,192,450	3,427,856	3,716,471
Depreciation of property and equipment	172,019	164,283	528,956	452,711
Amortization of intangible assets (note 5)	-	11,970	-	83,790
Total cost of revenues	27,297,409	25,637,664	78,995,330	73,607,338
Gross profit	11,576,774	9,999,421	29,869,248	23,188,126
Expenses:				
Sales and marketing (*)	3,593,486	2,998,419	11,377,701	8,792,091
Technical operations and development (*)	1,041,136	1,215,327	3,238,566	3,097,294
General and administrative (*)	2,639,868	1,869,668	6,293,987	5,266,997
Depreciation of property and equipment	58,685	52,972	167,527	158,833
Amortization of intangible assets (note 5)	107,230	219,030	545,290	657,090
Impairment of indefinite life intangible assets (note 5)	-	-	577,145	-
Loss on currency forward contracts (note 4)	237,985	(28,068)	885,901	353,209
Total expenses	7,678,390	6,327,348	23,086,117	18,325,514
Income from operations	3,898,384	3,672,073	6,783,131	4,862,612
Other income (expense):				
Interest expense, net	(63,498)	(78,966)	(206,679)	(271,756)
Total other income (expense)	(63,498)	(78,966)	(206,679)	(271,756)
Income before provision for income taxes	3,834,886	3,593,107	6,576,452	4,590,856
Provision for income taxes (note 7)	1,143,981	999,747	2,061,526	1,333,287

Net income	2,690,905	2,593,360	4,514,926	3,257,569
Other comprehensive income (loss), net of tax				
Gain (loss) on hedging activities	(437,519)	402,026	(602,901)	(71,629)
Net amount reclassified to earnings	57,701	92,308	437,893	119,237
Other comprehensive income (loss) net of tax of $(197,852) and $257,505 for the three months ended September 30, 2014 and September 30, 2013, and $(85,955) and $24,800 for the nine months ended September 30, 2014 and September 30, 2013	(379,818)	494,334	(165,008)	47,608
Comprehensive income for the period	$2,311,087	$3,087,694	$4,349,918	$3,305,177
Basic earnings per common share (note 8)	$0.24	$0.24	$0.40	$0.32
Shares used in computing basic earnings per common share (note 8)	11,321,175	10,795,896	11,190,684	10,322,469
Diluted earnings per common share (note 8)	$0.23	$0.23	$0.39	$0.29
Shares used in computing diluted earnings per common share (note 8)	11,787,749	11,409,975	11,718,910	11,187,308
(*) Stock-based compensation has been included in operating expenses as follows:				
Network expenses	$6,600	$8,755	$22,397	$22,813
Sales and marketing	$37,637	$32,681	$104,440	$93,000
Technical operations and development	$22,716	$21,549	$59,368	$57,166
General and administrative	$163,759	$99,801	$230,841	$155,904

See accompanying notes to consolidated financial statements

Tucows Inc.

Consolidated Statements of Cash Flows

(Dollar amounts in U.S. dollars)

(unaudited)

	Three months ended September 30,		**Nine months ended September 30,**	
	2014	**2013**	**2014**	**2013**
Cash provided by:				
Operating activities:				
Net income for the period	$2,690,905	$2,593,360	$4,514,926	$3,257,569
Items not involving cash:				
Depreciation of property and equipment	230,704	217,255	696,483	611,544
Amortization of intangible assets	107,230	231,000	545,290	740,880
Impairment of indefinite life intangible asset	-	-	577,145	-
Deferred income taxes recovery	(49,214)	(99,786)	(807,691)	(78,103)
Excess tax benefits from share-based compensation expense	168,346	(1,056,014)	(250,555)	(1,056,014)
Amortization of deferred rent	1,832	7,872	14,212	17,748
Disposal of domain names	10,708	8,923	19,577	44,292
Loss (gain) on change in the fair value of forward contracts	125,305	(204,341)	19,991	361,646
Stock-based compensation	230,712	162,786	417,046	328,883
Change in non-cash operating working capital:				
Accounts receivable	4,440	758,089	(1,609,287)	(456,201)
Inventory	90,114	(150,686)	(81,340)	248,994
Prepaid expenses and deposits	613,342	543,111	(13,192)	840,006
Prepaid domain name registry and ancillary services fees	573,727	1,038,268	(1,848,171)	(344,719)
Income taxes recoverable	(227,558)	980,969	(794,101)	1,087,333
Accounts payable	326,610	92,473	1,130,552	700,194
Accrued liabilities	1,214,237	163,300	1,044,866	664,984
Customer deposits	(418,539)	(595,776)	(431,614)	(883,346)
Deferred revenue	(656,430)	(986,779)	2,959,948	989,957
Accreditation fees payable	(22,510)	(39,835)	5,822	(23,918)
Net cash (used in) / provided by operating activities	5,013,961	3,664,189	6,109,907	7,051,729
Financing activities:				
Proceeds received on exercise of stock options	343,953	1,136,061	1,385,816	1,454,255
Excess tax benefits from share-based compensation expense	741,512	1,056,014	1,755,312	1,056,014
Repurchase of common stock	(1,099,571)	-	(1,181,857)	(6,537,616)
Proceeds received on loan payable	-	-	-	5,200,000
Repayment of loan payable	(5,358,333)	(600,000)	(6,300,000)	(2,000,000)

Net cash provided by / (used in) financing activities	(5,372,439)	1,592,075	(4,340,729)	(827,347)
Investing activities:				
Additions to property and equipment	(216,794)	(171,442)	(598,820)	(1,090,113)
Net cash used in investing activities	(216,794)	(171,442)	(598,820)	(1,090,113)
Increase (decrease) in cash and cash equivalents	(575,272)	5,084,822	1,170,358	5,134,269
Cash and cash equivalents, beginning of period	14,164,518	6,465,126	12,418,888	6,415,679
Cash and cash equivalents, end of period	$13,589,246	$11,549,948	$13,589,246	$11,549,948
Supplemental cash flow information:				
Interest paid	$64,248	$92,610	$207,634	$289,483
Income taxes paid, net	$469,248	$(46,057)	$1,724,976	$141,256
Supplementary disclosure of non-cash investing and financing activities:				
Property and equipment acquired during the period not yet paid for	$82,132	$99,060	$82,132	$99,060

See accompanying notes to unaudited consolidated financial statements

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. ORGANIZATION OF THE COMPANY:

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

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

2. BASIS OF PRESENTATION:

The accompanying unaudited interim consolidated balance sheets, and the related consolidated statements of operations and comprehensive income and cash flows reflect all adjustments, consisting of normal recurring adjustments, that are, in the opinion of management, necessary for a fair presentation of the financial position of Tucows and its subsidiaries as at September 30, 2014 and the results of operations and cash flows for the interim periods ended September 30, 2014 and 2013. The results of operations presented in this Quarterly Report on Form 10-Q are not necessarily indicative of the results of operations that may be expected for future periods.

The accompanying unaudited interim consolidated financial statements have been prepared by Tucows in accordance with the rules and regulations of the Securities and Exchange Commission (the "SEC"). Certain information and footnote disclosure normally included in the Company's annual audited consolidated financial statements and accompanying notes have been condensed or omitted. These interim consolidated financial statements and accompanying notes follow the same accounting policies and methods of application used in the annual financial statements and should be read in conjunction with the Company's audited consolidated financial statements and notes thereto for the year ended December 31, 2013 included in Tucows' 2013 Annual Report on Form 10-K filed with the SEC on March 18, 2014.

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

For purposes of clarification, significant accounting policies regarding revenue recognition and derivative financial instruments are included below:

(a) 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 derives revenues from the provisioning of mobile phone services through its Ting website. These revenues are recognized once services have been provided. Revenues for wireless services are billed based on the actual amount of monthly services utilized by each customer during their billing cycle on a postpaid basis. The Company's billing cycle for each customer is computed based on the customer's activation date. As a result, the Company estimates the amount of revenues earned but not billed from the end of each billing cycle to the end of each reporting period. In addition, revenues associated with the sale of wireless devices and accessories to subscribers is recognized when title and risk of loss is transferred to the subscriber and shipment has occurred. Incentive marketing credits given to customers are recorded as a reduction of revenue.

Advertising revenue includes revenue derived from cost-per-action advertising links we display on third party websites who provide syndicated pay-per-click advertising on OpenSRS Domain Expiry Stream domains and the Company's Portfolio domains. In addition, the Company uses third party partners to derive pay-perclick advertising revenue on the Tucows.com website. Advertising revenue is recognized on a monthly basis based on the number of cost-per-action services that were provided in the month.

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.

(b) Derivative Financial Instruments

During Fiscal 2103 and Fiscal 2012, 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 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. The valuation technique used to measure the fair values of the derivative instruments is a discounted cash flow technique, with all significant inputs derived from or corroborated by observable market data, as no quoted market prices exist for the derivative instruments. Our discounted cash flow techniques use observable market inputs, such as foreign currency spot and forward rates.

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

3. NEW ACCOUNTING POLICIES:

Recent Accounting Pronouncements Adopted

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

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

In August 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No 2014-15 "Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern" (ASU 2014-15). ASU 2014-15 provides guidance on management's responsibility in evaluating whether there is substantial doubt about a company's ability to continue as a going concern and about related footnote disclosures. For each reporting period, management will be required to evaluate whether there are conditions or events that raise substantial doubt about a company's ability to continue as a going concern within one year from the date the financial statements are issued. ASU 2014-15 is effective for our fiscal year ending December 31, 2016, with early adoption permitted. We

do not believe the pending adoption of ASU 2014-15 will have a material impact on our consolidated financial statements.

4. Derivative instruments and hedging activities:

Foreign currency forward contracts

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

The Company has designated a portion of 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 September 30, 2014, is recorded as derivative instrument liabilities.

As of September 30, 2014, the notional amount of forward contracts that the Company held to sell U.S. dollars in exchange for Canadian dollars was $22.8 million, of which $19.0 million met the requirements of ASC Topic 815 and were designated as hedges (September 30, 2013 - $32.8 million of which $25.5 million were designated as hedges). As of September 30, 2014, the Company has forward contracts with a notional amount of $3.8 million, which are not accounted for as hedges. The decrease in fair value of $0.1 million for these contracts not accounted for as hedges is recorded on the statement of operations.

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

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

Fair value of derivative instruments in the consolidated balance sheets

Derivatives	**Balance Sheet Location**	**As of September 30, 2014 Fair Value Asset (Liability)**	**As of December 31, 2013 Fair Value Asset (Liability)**
Foreign currency forward contracts designated as cash flow hedges	Derivative instruments	$ (623,559)	$ (118,505)
Foreign currency forward contracts not designated as cash flow hedges	Derivative instruments	$ (138,494)	$ (372,593)
Total foreign currency forward contracts	Derivative instruments	$ (762,053)	$ (491,098)

Movement in AOCI balance for the three months ended September 30, 2014:

	Gains and losses on cash flow hedges	**Tax impact**	**Total AOCI**
Opening AOCI balance – June 30, 2014	$ (45,889)	$ 15,718	$ (30,171)
Other comprehensive income (loss)before reclassifications	(665,428)	227,909	(437,519)

Amount reclassified from accumulated other comprehensive income	87,758	(30,057)	57,701
Other comprehensive income (loss) for the three months ended September 30, 2014	(577,670)	197,852	(379,818)
Ending AOCI balance – September 30, 2014	$(623,559)	$213,570	$(409,989)

Movement in AOCI balance for the nine months ended September 30, 2014:

	Gains and losses on cash flow hedges	**Tax impact**	**Total AOCI**
Opening AOCI balance – December 31, 2013	$(372,596)	$127,615	$(244,981)
Other comprehensive income (loss)before reclassifications	(916,960)	314,059	(602,901)
Amount reclassified from accumulated other comprehensive income	665,997	(228,104)	437,893
Other comprehensive income (loss) for the nine months ended September 30, 2014	(250,963)	85,955	(165,008)
Ending AOCI balance – September 30, 2014	$(623,559)	$213,570	$(409,989)

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

Derivatives in Cash Flow Hedging Relationship	Amount of Gain or (Loss) Recognized in OCI on Derivative (Effective Portion)	Location of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Amount of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)
Foreign currency forward contracts for the three months ended September 30, 2014	$ (437,519)	Operating expenses	$ (40,112)
		Cost of revenues	$ (17,589)
Foreign currency forward contracts for the three months ended September 30, 2013	$ 402,026	Operating expenses	$ (77,036)
		Cost of revenues	$ (15,272)

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

Derivatives in Cash Flow Hedging Relationship	Amount of Gain or (Loss) Recognized in OCI on Derivative (Effective Portion)	Location of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Amount of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)
Foreign currency forward contracts for the nine months ended September 30, 2014	$ (602,901)	Operating expenses	$ (321,136)
		Cost of revenues	$ (116,757)
Foreign currency forward contracts for the nine months ended September 30, 2013	$ (71,629)	Operating expenses	$ (97,929)
		Cost of revenues	$ (21,309)

In addition to the above, for those foreign currency forward contracts not designated as hedges, the Company has recorded a loss of $25,000 upon settlement and a loss of $0.1 million for the change in fair value of outstanding contracts for the three months ended September 30, 2014, in the consolidated statement of operations and comprehensive income. The Company has recorded a gain of $36,000 upon settlement and a loss of $0.2 million for the change in fair value of outstanding contracts for the three months ended September 30, 2013, in the consolidated statement of operations and comprehensive income.

The Company has recorded a loss of $0.2 million upon settlement and a loss of $20,000 for the change in fair value of outstanding contracts for the nine months ended September 30, 2014, in the consolidated statement of operations and comprehensive income. The Company has recorded a loss of $0.2 million upon settlement and a loss of $0.4 million for the change in fair value of outstanding contracts for the nine months ended September 30, 2013, in the consolidated statement of operations and comprehensive income.

5. INTANGIBLE ASSETS:

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

A summary of acquired intangible assets for the three months ended September 30, 2014 is as follows:

	Brand 7 years	**Customer relationships 4 – 7 years**	**Surname domain names indefinite life**	**Direct navigation domain names indefinite life**	**Total**
Net book value, June 30, 2014	$137,830	$ 756,460	$11,529,518	$1,955,346	$14,379,154
Sales of domain names	—	—	(1,298)	(9,410)	(10,708)
Amortization expense	(19,610)	(87,620)	—	—	(107,230)
Net book value, September 30, 2014	$118,220	$ 668,840	$11,528,220	$1,945,936	$14,261,216

A summary of acquired intangible assets for the nine months ended September 30, 2014 is as follows:

	Brand 7 years	**Customer relationships 4 – 7 years**	**Surname domain names indefinite life**	**Direct navigation domain names indefinite life**	**Total**

Net book value, December 31, 2013	$224,650	$1,107,700	$12,096,712	$1,974,166	$15,403,228
Sales of domain names	—	—	(3,893)	(15,684)	(19,577)
Impairment of indefinite life intangible assets	—	—	(564,599)	(12,546)	(577,145)
Amortization expense	(106,430)	(438,860)	—	—	(545,290)
Net book value, September 30, 2014	$118,220	$668,840	$11,528,220	$1,945,936	$14,261,216

As of September 30, 2014, the accumulated amortization for the definite life intangibles was $5.6 million.

With regard to indefinite life intangible assets, as part of our normal renewal process we assessed that all domain names that were acquired in the June 2006 acquisition of Mailbank.com Inc. that were up for renewal should be renewed. Accordingly, during the three months ended September 30, 2014, no impairment on indefinite life assets was recorded. For the nine months ended September 30, 2014, domain names, with a book value of $0.6 million, were not renewed and were recorded as an impairment of indefinite life intangible assets. No impairment was recorded on indefinite-life intangible assets during the three and nine months ended September 30, 2013.

6. LOAN PAYABLE:

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

Two Revolving Demand Loan Facilities.

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

Repayment of advances under the 2012 DLR Loan consist of interest only payments made monthly in arrears and prepayment is permitted without penalty. The outstanding balance under the 2012 DLR Loan as of December 31st of each year is to be fully repaid within 30 days of December 31st through an equivalent advance made under the 2012 DLRR Loan. Advances under the 2012 DLRR Loan will be made annually and solely for such purpose. Each advance under the 2012 DLRR Loan is to be repaid in equal monthly principal payments plus interest, over a period of four years from the date of such advance. At September 30, 2014, the 2012 DLR Loan and the DLRR Loan were fully repaid. Both of these financing arrangements remain available to fund future operations of the Company, with no set expiry date.

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 September 30, 2014, the Company held contracts in the amount of $22.8 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 September 30, 2014, the Company had no amounts outstanding under its Operating Demand Loan.

General Terms

The Company’s Amended Credit Facility contains customary representations and warranties, affirmative and negative covenants, and events of default. The Company’s obligations under the Amended Credit Facility are guaranteed and secured by a security interest in substantially all of its assets. The Amended Credit Facility also requires that the Company comply with certain customary non-financial covenants and restrictions. In addition, the Company has agreed to comply with the following financial covenants at all times, which are to be calculated on a rolling four quarter basis: (i) Maximum Total Funded Debt to EBITDA of 2.00:1; and (ii) Minimum Fixed Charge Coverage of

1.20:1. Further, its Maximum Annual Capital Expenditures cannot exceed $3.6 million per year, which limit will be reviewed on an annual basis. As of September 30, 2014, the Company was in compliance with these covenants, and expects to be in compliance for the next twelve months.

7. INCOME TAXES

For the nine months ended September 30, 2014, the Company recorded a provision for income taxes of $2.1 million on income before income taxes of $6.6 million, using an estimated effective tax rate for the fiscal year ending December 31, 2014 adjusted for certain minimum state taxes. Comparatively, for the nine months ended September 30, 2013, the Company recorded a provision for income taxes of $1.3 million on income before taxes of $4.6 million, using an estimated effective tax rate for its fiscal year ending December 31, 2013.

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

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

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

8. BASIC AND DILUTED EARNINGS PER COMMON SHARE:

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

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

	Three months ended September 30, 2014	Three months ended September 30, 2013	Nine months ended September 30, 2014	Nine months ended September 30, 2013
Numerator for basic and diluted earnings per common share:				
Net income for the period	$2,690,905	$2,593,360	$4,514,926	$3,257,569
Denominator for basic and diluted earnings per common share:				
Basic weighted average number of common shares outstanding	11,321,175	10,795,896	11,190,684	10,322,469
Effect of outstanding stock options	466,574	614,079	528,226	864,839
Diluted weighted average number of shares outstanding	11,787,749	11,409,975	11,718,910	11,187,308
Basic earnings per common share	$0.24	$0.24	$0.40	$0.32
Diluted earnings per common share	$0.23	$0.23	$0.39	$0.29

For the three months ended September 30, 2014, outstanding options to purchase 98,000 common shares were not included in the computation of diluted income per common share because all such options had exercise prices greater than the average market price of the common shares.

For the nine months ended September 30, 2014, outstanding options to purchase 136,000 common shares were not included in the computation of diluted income per common share because all such options had exercise prices greater than the average market price of the common shares.

During the nine months ended September 30, 2014, 79,392 common shares were repurchased and cancelled under the terms of our stock repurchase program announced in March 2014, 73,300 of which occurred during the quarter ended September 30, 2014.

During the nine months ended September 30, 2013, 1,028,530 common shares were repurchased and cancelled under the terms of a modified Dutch auction tender offer announced in December 2012, none of which occurred during the quarter ended September 30, 2013.

During the nine months ended September 30, 2013, 35,768 common shares were repurchased and cancelled under the terms of our stock repurchase program announced in March 2013, none of which occurred during the quarter ended September 30, 2013.

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

9. SEGMENT REPORTING:

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

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

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

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

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

Three months ended September 30, 2014	**Domain Name Services**	**Network Access Services**	**Consolidated Totals**
Net Revenues	$29,125,494	$ 9,748,689	$38,874,183
Cost of Revenues	20,191,680	5,794,195	25,985,875
Gross Profit before network expenses	8,933,814	3,954,494	12,888,308
Network expenses			1,311,534
Gross Profit			11,576,774
Expenses:			
Sales and marketing			3,593,486
Technical operations and development			1,041,136
General and administrative			2,639,868
Depreciation of property and equipment			58,685
Amortization of intangibles			107,230
Loss on currency forward contracts			237,985
Income from operations			3,898,384
Other expenses, net			63,498
Income before provision for income taxes			$3,834,886

Nine months ended September 30, 2014	**Domain Name Services**	**Network Access Services**	**Consolidated Totals**
Net Revenues	$84,143,913	$24,720,665	$108,864,578
Cost of Revenues	59,922,918	15,115,600	75,038,518
Gross Profit before network expenses	24,220,995	9,605,065	33,826,060

Network expenses	3,956,812
Gross Profit	29,869,248
Expenses:	
Sales and marketing	11,377,701
Technical operations and development	3,238,566
General and administrative	6,293,987
Depreciation of property and equipment	167,527
Amortization of intangibles	545,290
Write-off / impairment of indefinite life intangible assets	577,145
Loss on currency forward contracts	