TUCOWS INC /PA/
Form 10-Q
August 08, 2018

Table of Contents

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, DC 20549**

**FORM 10-Q**

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

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

**OR**

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

**For the transition period from to**

**Commission file number 1-32600**

**TUCOWS INC.**

(Exact Name of Registrant as Specified in Its Charter)

| | |
|---|---|
| **Pennsylvania** | **23-2707366** |

| | |
|---|---|
| (State or Other Jurisdiction of 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, smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

| | |
|---|---|
| Large accelerated filer | Accelerated filer |
| Non-accelerated filer<br>(Do not check if a smaller reporting company) | Smaller reporting company |
| | Emerging Growth company |

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

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

As of August 6, 2018, there were 10,609,438 outstanding shares of common stock, no par value, of the registrant.

Table of Contents

**TUCOWS INC.**

**Form 10-Q Quarterly Report**

**INDEX**


**PART I**

**FINANCIAL INFORMATION**

| | | |
|---|---|---|
| Item 1. | Consolidated Financial Statements | 3 |
| | Consolidated Balance Sheets (unaudited) as of June 30, 2018 and December 31, 2017 | 3 |
| | Consolidated Statements of Operations and Comprehensive Income (unaudited) for the three and six months ended June 30, 2018 and 2017 | 4 |
| | Consolidated Statements of Cash Flows (unaudited) for the three and six months ended June 30, 2018 and 2017 | 5 |
| | Notes to Consolidated Financial Statements (unaudited) | 6 |
| Item 2. | Management's Discussion and Analysis of Financial Condition and Results of Operations | 27 |
| Item 3. | Quantitative and Qualitative Disclosures About Market Risk | 46 |
| Item 4. | Controls and Procedures | 47 |

**PART II**

**OTHER INFORMATION**

| | | |
|---|---|---|
| Item 1. | Legal Proceedings | 48 |
| Item 1A. | Risk Factors | 48 |
| Item 2. | Unregistered Sales of Equity Securities and Use of Proceeds | 48 |
| Item 3. | Defaults Upon Senior Securities | 48 |
| Item 4. | Mine Safety Disclosures | 48 |
| Item 5. | Other Information | 48 |

| | |
|---|---|
| Item 6. Exhibits | 49 |
| Signatures | 50 |


**TRADEMARKS, TRADE NAMES AND SERVICE MARKS**

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Table of Contents

**PART I.**

**FINANCIAL INFORMATION**

**Item 1. Consolidated Financial Statements**

**Tucows Inc.**

**Consolidated Balance Sheets**

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

**(unaudited)**

| | **June 30, 2018** | **December 31, 2017*** |
|---|---|---|
| **Assets** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 11,161 | $ 18,049 |
| Accounts receivable, net of allowance for doubtful accounts of $132 as of June 30, 2018 and $168 as of December 31, 2017 | 12,214 | 12,376 |
| Inventory | 3,248 | 2,944 |
| Prepaid expenses and deposits | 15,428 | 14,186 |
| Prepaid domain name registry and ancillary services fees, current portion (note 11 (b)) | 94,754 | 103,302 |
| Income taxes recoverable | 3,137 | 3,004 |
| Total current assets | 139,942 | 153,861 |
| Prepaid domain name registry and ancillary services fees, long-term portion (note 11 (b)) | 20,701 | 23,701 |
| Property and equipment | 34,538 | 24,620 |
| Contract costs (note 11 (a)) | 1,354 | - |
| Intangible assets (note 6) | 53,693 | 58,414 |
| Goodwill (note 6) | 90,054 | 90,054 |
| Total assets | $ 340,282 | $ 350,650 |
| **Liabilities and Stockholders' Equity** | | |
| Current liabilities: | | |
| Accounts payable | $ 7,340 | $ 7,026 |
| Accrued liabilities | 6,770 | 6,412 |
| Customer deposits | 12,934 | 15,255 |
| Derivative instrument liability (note 5) | 337 | - |

| | | |
|---|---|---|
| Deferred rent, current portion | 21 | 21 |
| Loan payable, current portion (note 7) | 17,721 | 18,290 |
| Deferred revenue, current portion | 122,976 | 129,155 |
| Accreditation fees payable, current portion | 1,099 | 1,175 |
| Income taxes payable | 1,477 | 1,226 |
| Total current liabilities | 170,675 | 178,560 |
| | | |
| Derivative instrument liability, long-term portion (note 5) | 27 | - |
| Deferred revenue, long-term portion | 29,075 | 31,427 |
| Accreditation fees payable, long-term portion | 269 | 289 |
| Deferred rent, long-term portion | 126 | 130 |
| Loan payable, long-term portion (note 7) | 51,012 | 58,634 |
| Deferred gain | 258 | 429 |
| Deferred tax liability (note 8) | 19,577 | 19,834 |
| | | |
| Redeemable non-controlling interest (note 4 (a)) | - | 1,136 |
| | | |
| Stockholders' equity (note 13) | | |
| | | |
| Preferred stock - no par value, 1,250,000 shares authorized; none issued and outstanding | - | - |
| Common stock - no par value, 250,000,000 shares authorized; 10,603,366 shares issued and outstanding as of June 30, 2018 and 10,583,879 shares issued and outstanding as of December 31, 2017 | 15,548 | 15,368 |
| Additional paid-in capital | 2,931 | 2,167 |
| Retained earnings | 51,027 | 42,676 |
| Accumulated other comprehensive income | (243) | - |
| Total stockholders' equity | 69,263 | 60,211 |
| Total liabilities and stockholders' equity | $340,282 | $350,650 |

Commitments and contingencies (note 16)

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

See accompanying notes to unaudited consolidated financial statements

3

Table of Contents

**Tucows Inc.**

**Consolidated Statements of Operations and Comprehensive Income**

**(Dollar amounts in thousands of U.S. dollars, except per share amounts)**

**(unaudited)**

| | **Three months ended June 30,** | | **Six months ended June 30,** | |
|---|---|---|---|---|
| | **2018** | **2017*** | **2018** | **2017*** |
| Net revenues (note 10) | $81,087 | $84,223 | $176,882 | $153,791 |
| Cost of revenues (note 10) | | | | |
| Cost of revenues | 54,501 | 59,445 | 123,473 | 108,756 |
| Network expenses | 2,701 | 2,261 | 5,275 | 4,604 |
| Depreciation of property and equipment | 1,228 | 714 | 2,359 | 1,305 |
| Amortization of intangible assets (note 6) | 499 | 455 | 998 | 836 |
| Total cost of revenues | 58,929 | 62,875 | 132,105 | 115,501 |
| Gross profit | 22,158 | 21,348 | 44,777 | 38,290 |
| Expenses: | | | | |
| Sales and marketing | 7,852 | 7,447 | 16,217 | 14,667 |
| Technical operations and development | 2,355 | 1,798 | 4,450 | 3,492 |
| General and administrative | 4,256 | 3,285 | 8,786 | 6,742 |
| Depreciation of property and equipment | 102 | 165 | 203 | 331 |
| Loss on disposition of property and equipment | - | 2 | - | 2 |
| Amortization of intangible assets (note 6) | 1,827 | 1,608 | 3,659 | 2,989 |
| Loss (gain) on currency forward contracts (note 5) | 52 | (27) | 49 | (61) |
| Total expenses | 16,444 | 14,278 | 33,364 | 28,162 |
| Income from operations | 5,714 | 7,070 | 11,413 | 10,128 |
| Other income (expense): | | | | |
| Interest expense, net | (951) | (970) | (1,847) | (1,838) |
| Other income, net | 73 | 225 | 197 | 354 |
| Total other income (expense) | (878) | (745) | (1,650) | (1,484) |
| Income before provision for income taxes | 4,836 | 6,325 | 9,763 | 8,644 |
| Provision for income taxes (note 8) | 1,228 | 1,083 | 2,411 | 958 |

| | | | | |
|---|---|---|---|---|
| Net income before redeemable non-controlling interest | 3,608 | 5,242 | 7,352 | 7,686 |
| Redeemable non-controlling interest | - | (117) | (26) | (243) |
| Net income attributable to redeemable non-controlling interest | - | 117 | 26 | 243 |
| Net income for the period | 3,608 | 5,242 | 7,352 | 7,686 |
| Other comprehensive income, net of tax | | | | |
| Unrealized income on hedging activities (note 5) | (273) | 143 | (256) | 329 |
| Net amount reclassified to earnings (note 5) | 13 | (17) | 13 | (98) |
| Other comprehensive income net of tax of $84 and and $71 for the three months ended June 30, 2018 and June 30, 2017, $78 and $131 for the six months ended June 30, 2018 and June 30, 2017 (note 5) | (260) | 126 | (243) | 231 |
| Comprehensive income for the period | $3,348 | $5,368 | $7,109 | $7,917 |
| Basic earnings per common share (note 9) | $0.34 | $0.50 | $0.69 | $0.73 |
| Shares used in computing basic earnings per common share (note 9) | 10,597,228 | 10,528,219 | 10,592,994 | 10,501,407 |
| Diluted earnings per common share (note 9) | $0.33 | $0.49 | $0.68 | $0.71 |
| Shares used in computing diluted earnings per common share (note 9) | 10,803,007 | 10,793,031 | 10,797,017 | 10,785,685 |

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

See accompanying notes to unaudited consolidated financial statements

Table of Contents

**Tucows Inc.**

**Consolidated Statements of Cash Flows**

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

**(unaudited)**

| | **Three months ended June 30,** | | **Six months ended June 30,** | |
|---|---|---|---|---|
| | **2018** | **2017*** | **2018** | **2017*** |
| Cash provided by: | | | | |
| Operating activities: | | | | |
| Net income for the period | $3,608 | $5,242 | $7,352 | $7,686 |
| Items not involving cash: | | | | |
| Depreciation of property and equipment | 1,330 | 879 | 2,562 | 1,636 |
| Loss on write off of property and equipment | - | 9 | - | 9 |
| Amortization of debt discount and issuance costs | 69 | 80 | 139 | 147 |
| Amortization of intangible assets | 2,326 | 2,064 | 4,657 | 3,825 |
| Change in capitalized contract costs | 25 | - | 50 | - |
| Deferred income taxes (recovery) | (445) | (2,885) | (492) | (1,565) |
| Excess tax benefits on share-based compensation expense | (197) | (1,182) | (341) | (2,171) |
| Amortization of deferred rent | (4) | 1 | (4) | 5 |
| Loss on disposal of domain names | 28 | 7 | 65 | 18 |
| Other income | (42) | (128) | (171) | (257) |
| Loss (gain) on change in the fair value of forward contracts | 46 | (163) | 43 | (301) |
| Stock-based compensation | 615 | 313 | 1,193 | 631 |
| Change in non-cash operating working capital: | | | | |
| Accounts receivable | 471 | (905) | 162 | (864) |
| Inventory | (350) | (1,267) | (304) | (1,096) |
| Prepaid expenses and deposits | (717) | 1,186 | (1,242) | (2,371) |
| Prepaid domain name registry and ancillary services fees | 204 | 2,976 | 11,548 | (2,513) |
| Income taxes recoverable | 165 | 2,513 | 430 | (147) |
| Accounts payable | (1,862) | (592) | 270 | (4,038) |
| Accrued liabilities | (401) | (1,818) | 358 | 13 |
| Customer deposits | (46) | 3,152 | (2,321) | 3,068 |
| Deferred revenue | 1,067 | (1,273) | (8,531) | 8,968 |
| Accreditation fees payable | (136) | (78) | (96) | (149) |
| Net cash provided by operating activities | 5,754 | 8,131 | 15,327 | 10,534 |
| | | | | |
| Financing activities: | | | | |
| Proceeds received on exercise of stock options | 32 | 85 | 39 | 105 |
| Payment of tax obligations resulting from net exercise of stock options | (141) | (609) | (288) | (1,322) |
| Proceeds received on loan payable | 2,500 | - | 2,500 | 86,998 |
| Repayment of loan payable | (6,253) | (4,572) | (10,825) | (10,830) |

| | | | | |
|---|---|---|---|---|
| Payment of loan payable costs | - | (13 ) | (4 ) | (604 ) |
| Net cash (used in) provided by financing activities | (3,862 ) | (5,109 ) | (8,578 ) | 74,347 |
| | | | | |
| Investing activities: | | | | |
| Additions to property and equipment | (7,319 ) | (2,909 ) | (12,436) | (6,602 ) |
| Acquisition of a portion of the minority interest in Ting Virginia, LLC (note 4(a)) | - | - | (1,200 ) | (2,000 ) |
| Acquisition of Enom Incorporated, net of cash (note 4(b)) | - | - | - | (76,238) |
| Acquisition of intangible assets | - | - | (1 ) | - |
| Net cash (used in) investing activities | (7,319 ) | (2,909 ) | (13,637) | (84,840) |
| | | | | |
| Decrease in cash and cash equivalents | (5,427 ) | 113 | (6,888 ) | 41 |
| | | | | |
| Cash and cash equivalents, beginning of period | 16,588 | 15,033 | 18,049 | 15,105 |
| Cash and cash equivalents, end of period | $11,161 | $15,146 | $11,161 | $15,146 |
| | | | | |
| Supplemental cash flow information: | | | | |
| Interest paid | $961 | $975 | $1,862 | $1,848 |
| Income taxes paid, net | $2,240 | $2,663 | $3,577 | $5,006 |
| Supplementary disclosure of non-cash investing and financing activities: | | | | |
| Property and equipment acquired during the period not yet paid for | $258 | $232 | $258 | $232 |

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

See accompanying notes to unaudited consolidated financial statements

5

Table of Contents

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

### 1. Organization of the Company:

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

### 2. Basis of presentation:

The accompanying unaudited interim consolidated balance sheets, and the related consolidated statements of operations and comprehensive income and cash flows reflect all adjustments, consisting of normal recurring adjustments, that are, in the opinion of management, necessary for a fair presentation of the financial position of Tucows and its subsidiaries as at June 30, 2018 and the results of operations and cash flows for the interim periods ended June 30, 2018 and 2017. The results of operations presented in this Quarterly Report on Form 10-Q are not necessarily indicative of the results of operations that may be expected for future periods.

The accompanying unaudited interim consolidated financial statements have been prepared by Tucows in accordance with the rules and regulations of the United States Securities and Exchange Commission (the “SEC”). Certain information and footnote disclosures normally included in the Company's annual audited consolidated financial statements and accompanying notes have been condensed or omitted. Other than the exception noted below, these interim consolidated financial statements and accompanying notes follow the same accounting policies and methods of application used in the annual financial statements and should be read in conjunction with the Company's audited consolidated financial statements and notes thereto for the year ended December 31, 2017 included in Tucows' 2017 Annual Report on Form 10-K filed with the SEC on March 6, 2018 (the “2017 Annual Report”). There have been no material changes to our significant accounting policies and estimates during the six months ended June 30, 2018 as compared to the significant accounting policies and estimates described in our 2017 Annual Report, except for the adoption of Accounting Standards Update (“ASU”) No. 2014-09, *Revenue from Contracts with Customers (Topic* 606*)* (“ASU 2014-09”). See Note 3 for more information.

Beginning with this Quarterly Report on Form 10-Q, all dollar values of current and comparative figures in the financial statements and accompanying tables have been rounded to the nearest thousand ($000), except when otherwise indicated.

**3. Recent accounting pronouncements:**

*Recent Accounting Pronouncements Adopted*

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

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

On January 1, 2018, the Company adopted ASU 2014-09 using the modified retrospective method by recognizing the cumulative effect of initially applying ASU 2014-09 as an adjustment to the opening balance of equity as at January 1, 2018. The results for reporting periods beginning after January 1, 2018 are presented under ASU 2014-09, while prior period amounts are not adjusted and continue to be reported in accordance with our historic accounting policy, under ASC 605, Revenue Recognition (Topic 605).  The adoption of Topic 606 did not affect the Company's cash flows from operating, investing, or financing activities. Furthermore, the impact on timing of revenue recognition was not material as the treatment of revenue for services rendered over time is consistent under Topic 606 and Topic 605. The details of the significant changes and quantitative impact of the changes are set out below. For a more comprehensive description of how the Company recognizes revenue under the new revenue standard in accordance with its performance obligations, see note 10.

The Company previously recognized commission fees related to Ting Mobile, Ting Internet, eNom domain registration and eNom domain related value-added service contracts as selling expenses when they were incurred. Under ASU 2014-09, when these commission fees are deemed incremental and are expected to be recovered, the Company capitalizes as an asset such commission fees as costs of obtaining a contract. These commission fees are amortized into income consistently with the pattern of transfer of the good or service to which the asset relates. The amortization of deferred costs of acquisition are amortized into Sales and marketing expense. The estimation of the amortization period for the costs to obtain a contract required judgement.

Table of Contents

Under Topic 606, the Company has applied the following practical expedients:

a) When the amortization period for costs incurred to obtain a contract with a customer is less than one year, the Company has elected to apply a practical expedient to expense the costs as incurred; and

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

On January 1, 2018 as a result of adopting ASU 2014-09, the Company recorded a contract cost asset of $1.4 million with a corresponding increase to opening retained earnings and deferred tax liability of $1.1 million and $0.3 million, respectively, due to the deferral of costs of obtaining contracts. The impact of the changes to the Company’s financial statements in the current period are as follows:

| **Consolidated Balance Sheet (Dollar amounts in thousands of U.S. dollars)** | **June 30, 2018** | | |
|---|---|---|---|
| | **As reported** | **Adjustments** | **Balances without adoption of Topic 606** |
| Assets | | | |
| Contract costs (note 11) | $1,354 | $ (1,354) | $(0) |
| Total assets | $340,282 | $ (1,354) | $338,928 |
| Liabilities and Shareholders' Equity | | | |
| Deferred tax liability (note 8) | $19,577 | $ (329) | $19,248 |
| Retained earnings | 51,027 | (1,025) | 50,002 |
| Total Liabilities and Shareholders' Equity | $340,282 | $ (1,354) | $338,928 |

| **Consolidated Statements of Operations and Comprehensive Income** | **Three months ended, June 30, 2018** | | | **Six months ended, June 30, 2018** | | |
|---|---|---|---|---|---|---|
| | **As** | **Adjustments** | **Balances** | **As** | **Adjustments** | **Balances** |

| (Dollar amounts in thousands of U.S. dollars) | reported | | without adoption of Topic 606 | reported | | without adoption of Topic 606 |
|---|---|---|---|---|---|---|
| Expenses | | | | | | |
| Sales and marketing | $7,852 | $ (25) | $ 7,827 | $16,217 | $ (50) | $16,167 |
| Income before provision for income taxes | 4,836 | 25 | 4,861 | 9,763 | 50 | 9,813 |
| Provision for income tax (note 8) | 1,228 | 6 | 1,234 | 2,411 | 12 | 2,423 |
| Net income for the period | $3,608 | $ 19 | $ 3,627 | $7,352 | $ 38 | $7,390 |

Table of Contents

| **Consolidated Statements of Cash Flows (Dollar amounts in thousands of U.S. dollars)** | **Three months ended, June 30, 2018** | | | **Six months ended, June 30, 2018** | | |
|---|---|---|---|---|---|---|
| | **As reported** | **Adjustments** | **Balances without adoption of Topic 606** | **As reported** | **Adjustments** | **Balances without adoption of Topic 606** |
| Net income for the period | $3,608 | $ 19 | $ 3,627 | $7,352 | $ 38 | $ 7,390 |
| Items not involving cash | | | | | | |
| Amortization contract costs | 25 | (25 ) | (0 ) | 50 | (50 ) | 0 |
| Deferred income taxes (recovery) | (445 ) | 6 | (439 ) | (492 ) | 12 | (480 ) |
| Net cash provided by operating activities | $5,754 | $ (0 ) | $ 5,754 | $15,327 | $ - | $ 15,327 |

*Recent Accounting Pronouncements Not Yet Adopted*

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

**4. Acquisitions:**

(a) Blue Ridge Websoft

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

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

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

(b) eNom, Incorporated

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

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

*Foreign currency forward contracts*

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

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

As of June 30, 2018, the notional amount of forward contracts that the Company held to sell U.S. dollars in exchange for Canadian dollars was $16.9 million, of which $14.9 million were designated as hedges. As of December 31, 2017 the Company held no contracts to trade U.S. dollars in exchange for Canadian dollars.

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

| Maturity date (Dollar amounts in thousands of U.S. dollars) | Notional amount of U.S. dollars | Weighted average exchange rate of U.S. dollars | Fair value |
|---|---|---|---|
| July - September 2018 | 6,130 | 1.2851 | (134 ) |
| October - December 2018 | 6,049 | 1.2802 | (144 ) |
| January - March 2019 | 1,640 | 1.2852 | (30 ) |
| April - June 2019 | 1,599 | 1.2831 | (29 ) |
| July - September 2019 | 1,444 | 1.2809 | (27 ) |
| | $ 16,862 | 1.2828 | $ (364 ) |

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

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

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

| Derivatives (Dollar amounts in thousands of U.S. dollars) | Balance Sheet Location | As of June 30, 2018 Fair Value Asset (Liability) | As of December 31, 2017 Fair Value Asset (Liability) |
|---|---|---|---|

| | | | |
|---|---|---|---|
| Foreign currency forward contracts designated as cash flow hedges (net) | Derivative instruments | $ (321 ) | $ - |
| Foreign currency forward contracts not designated as cash flow hedges (net) | Derivative instruments | $ (43 ) | $ - |
| Total foreign currency forward contracts (net) | Derivative instruments | $ (364 ) | $ - |

9

Table of Contents

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

| | Gains and losses on cash flow hedges | Tax impact | Total AOCI |
|---|---|---|---|
| Opening AOCI balance – March 31. 2018 | $ 23 | $ (6 ) | $ 17 |
| Other comprehensive income (loss) before reclassifications | (361 ) | 88 | (273 ) |
| Amount reclassified from accumulated other comprehensive income | 17 | (4 ) | 13 |
| Other comprehensive income (loss) for the three months ended June 30, 2018 | (344 ) | 84 | (260 ) |
| Ending AOCI balance – June 30, 2018 | $ (321 ) | $ 78 | $ (243 ) |

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

| | Gains and losses on cash flow hedges | Tax impact | Total AOCI |
|---|---|---|---|
| Opening AOCI balance – December 31, 2017 | $ — | $ — | $ — |
| Other comprehensive income (loss) before reclassifications | (338 ) | 82 | (256 ) |
| Amount reclassified from accumulated other comprehensive income | 17 | (4 ) | 13 |
| Other comprehensive income (loss) for the six months ended June 30, 2018 | (321 ) | 78 | (243 ) |
| Ending AOCI balance – June 30, 2018 | $ (321 ) | $ 78 | $ (243 ) |

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

| **Derivatives in Cash Flow Hedging Relationship** | **Amount of Gain or (Loss) Recognized in OCI, net of tax, on Derivative (Effective Portion)** | **Location of Gain or (Loss) Reclassified from AOCI into Income (Effective Portion)** | **Amount of Gain or (Loss) Reclassified from AOCI 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)** |
|---|---|---|---|---|---|
| | | Operating expenses | $ (1 ) | Operating expenses | $ — |
| Foreign currency forward contracts for the three months ended June 30, 2018 | $ (260 ) | Cost of revenues | $ (16 ) | Cost of revenues | — |
| | | Operating expenses | $ 24 | Operating expenses | $ — |
| Foreign currency forward contracts for the three months ended June 30, 2017 | $ 126 | Cost of revenues | $ 4 | Cost of revenues | — |

Table of Contents

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

| **Derivatives in Cash Flow Hedging Relationship** | **Amount of Gain or (Loss) Recognized in OCI, net of tax, on Derivative (Effective Portion)** | **Location of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)** | **Amount of Gain or (Loss) Reclassified from Accumulated OCI into Income, (Effective Portion)** | **Location of Gain or (Loss) Recognized in Income on Derivative (ineffective Portion and Amount Excluded from Effectiveness Testing)** | **Amount of Gain or (Loss) Recognized in Income on Derivative (ineffective Portion and Amount Excluded from Effectiveness Testing)** |
|---|---|---|---|---|---|
| | | Operating expenses | $ (1) | Operating expenses | $ — |
| Foreign currency forward contracts for the six months ended June 30, 2018 | $ (243) | Cost of revenues | $ (16) | Cost of revenues | — |
| | | Operating expenses | $ 129 | Operating expenses | $ — |
| Foreign currency forward contracts for the six months ended June 30, 2017 | $ 231 | Cost of revenues | $ 25 | Cost of revenues | — |

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

The Company has recorded a loss of less than $0.1 million upon settlement and a loss of less than $0.1 million for the change in fair value of outstanding contracts for the six months ended June 30, 2018, in the consolidated statement of operations and comprehensive income. The Company recorded a gain of less than $0.1 million upon settlement and a gain of less than $0.1 million for the change in fair value of the foreign currency forward contracts not designated as hedges for the six months ended June 30, 2017, in the consolidated statement of operations and comprehensive income.

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

**Goodwill**

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

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

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

Table of Contents

**Other Intangible Assets:**

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

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

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

| | **Surname domain names** | **Direct navigation domain names** | **Brand** | **Customer relationships** | **Technology** | **Network rights** | **Total** |
|---|---|---|---|---|---|---|---|
| **Amortization period** | **indefinite life** | **indefinite life** | **7 years** | **4 - 7 years** | **2 years** | **15 years** | |
| Balances March 31, 2018 | $ 11,205 | $ 1,519 | $ 10,342 | $ 30,806 | $ 1,625 | $ 550 | $ 56,047 |
| Additions to/(disposals from) domain portfolio, net | (4) | (24) | - | - | - | - | (28) |
| Amortization expense | - | - | (450) | (1,377) | (487) | (12) | (2,326) |
| Balances June 30, 2018 | $ 11,201 | $ 1,495 | $ 9,892 | $ 29,429 | $ 1,138 | $ 538 | $ 53,693 |

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

| | Surname domain names | Direct navigation domain names | Brand | Customer relationships | Technology | Network rights | Total |
|---|---|---|---|---|---|---|---|
| **Amortization period** | **indefinite life** | **indefinite life** | **7 years** | **4 - 7 years** | **2 years** | **15 years** | |
| Balances December 31, 2017 | $ 11,210 | $ 1,551 | $ 10,793 | $ 32,186 | $ 2,113 | $ 561 | $ 58,414 |
| Acquisition of customer relationships | - | - | - | 1 | - | - | 1 |
| Additions to/(disposals from) domain portfolio, net | (9 ) | (56 ) | - | - | - | - | (65 ) |
| Amortization expense | - | - | (901 ) | (2,758 ) | (975 ) | (23 ) | (4,657 ) |
| Balances June 30, 2018 | $ 11,201 | $ 1,495 | $ 9,892 | $ 29,429 | $ 1,138 | $ 538 | $ 53,693 |

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

| | Year ending December 31, |
|---|---|
| Remainder of 2018 | $ 4,579 |
| 2019 | 7,338 |
| 2020 | 7,171 |
| 2021 | 7,171 |
| 2022 | 7,171 |
| Thereafter | 7,567 |
| Total | $ 40,997 |

As of June 30, 2018, the accumulated amortization for the definite life intangible assets was $20.0 million.

**7. Loan payable:**

2017 *Amended Credit Facility*

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

Table of Contents

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

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

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

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

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

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

The 2017 Amended Credit Facility contains customary representations and warranties, affirmative and negative covenants, and events of default. The 2017 Amended Credit Facility requires that the Company to comply with the following financial covenants at all times, which are to be calculated on a rolling four quarter basis: (i) maximum Total Funded Debt to EBITDA Ratio of 2.50:1 until September 30, 2018 and 2.25:1 thereafter; and (ii) minimum

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

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

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

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

Table of Contents

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

| | June 30, 2018 | December 31, 2017 |
|---|---|---|
| Facility B | 2,500 | - |
| Facility C | 3,554 | 5,930 |
| Facility D | 63,373 | 71,823 |
| Less: unamortized debt discount and issuance costs | (694 ) | (829 ) |
| Total loan payable | 68,733 | 76,924 |
| Less: loan payable, current portion | 17,721 | 18,290 |
| Loan payable, long-term portion | 51,012 | 58,634 |

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

| | |
|---|---|
| Remainder of 2018 | 8,771 |
| 2019 | 17,900 |
| 2020 | 17,900 |
| 2021 | 17,900 |
| 2022 | 5,225 |
| Thereafter | 1,731 |
| | $69,427 |

*Other Credit Facilities*

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

The treasury risk management facility under the Amended Credit Facility provides for a $3.5 million settlement risk line to assist the Company with hedging Canadian dollar exposure through foreign exchange forward contracts and/or currency options. Under the terms of the Amended Credit Facility, the Company may enter into such agreements at market rates with terms not to exceed 18 months. As of June 30, 2018, the Company held contracts in the amount of

$21.6 million to trade U.S. dollars in exchange for Canadian dollars (note 5).

In Q4, 2017, the Company entered into a corporate credit card program with the Bank of Nova Scotia and the Lenders. The program provides that BMO and the Bank of Nova Scotia may establish corporate credit card facilities with the Company in an amount of up to $5 million.

**8. Income taxes**

For the three months ended June 30, 2018, we recorded an income tax expense of $1.2 million on income before income taxes of $4.8 million, using an estimated effective tax rate for the fiscal year ending December 31, 2018 (“Fiscal 2018”) adjusted for certain minimum state taxes as well as the inclusion of a $0.2 million tax recovery related to ASU 2016-09, which requires all excess tax benefits and tax deficiencies related to employee share-based payments to be recognized through income tax expense. Comparatively, for the three months ended June 30, 2017, the Company recorded an income tax expense of $1.1 million on income before taxes of $6.3 million, using an estimated effective tax rate for the 2017 fiscal year and adjusted for the $1.2 million tax recovery impact related to ASU 2016-09.

Table of Contents

For the six months ended June 30, 2018, we recorded an income tax expense of $2.4 million on income before income taxes of $9.8 million, using an estimated effective tax rate for Fiscal 2018 adjusted for certain minimum state taxes as well as the inclusion of a $0.3 million tax recovery related to ASU 2016-09, which requires all excess tax benefits and tax deficiencies related to employee share-based payments to be recognized through income tax expense. Comparatively, for the six months ended June 30, 2017, the Company recorded income tax expense of $1.0 million on income before taxes of $8.6 million, using an estimated effective tax rate for the 2017 fiscal year and adjusted for the $2.2 million tax recovery impact related to ASU 2016-09.

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

The Company recognizes accrued interest and penalties related to income taxes in income tax expense. The Company did not have significant interest and penalties accrued at June 30, 2018 and December 31, 2017, respectively.

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

Basic earnings per common share has been calculated on the basis of net income for the period divided by the weighted average number of common shares outstanding during each year. Diluted earnings per share gives effect to all dilutive potential common shares outstanding at the end of the year assuming that they had been issued, converted or exercised at the later of the beginning of the year or their date of issuance. In computing diluted earnings per share, the treasury stock method is used to determine the number of shares assumed to be purchased from the conversion of common share equivalents or the proceeds of the exercise of options.

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

| | **Three months ended June 30,** | | **Six months ended June 30,** | |
|---|---|---|---|---|
| | **2018** | **2017** | **2018** | **2017** |

| | | | | |
|---|---|---|---|---|
| Numerator for basic and diluted earnings per common share: | | | | |
| Net income for the period | $3,608 | $5,242 | $7,352 | $7,686 |
| Denominator for basic and diluted earnings per common share: | | | | |
| Basic weighted average number of common shares outstanding | 10,597,228 | 10,528,219 | 10,592,994 | 10,501,407 |
| Effect of outstanding stock options | 205,779 | 264,812 | 204,023 | 284,278 |
| Diluted weighted average number of shares outstanding | 10,803,007 | 10,793,031 | 10,797,017 | 10,785,685 |
| Basic earnings per common share | $0.34 | $0.50 | $0.69 | $0.73 |
| Diluted earnings per common share | $0.33 | $0.49 | $0.68 | $0.71 |

For the three months ended June 30, 2018, outstanding options to purchase 419,000 common shares were not included in the computation of diluted income per common share because all such options' exercise price was greater than the average market price of the common shares for the period as compared to the three months ended June 30, 2017, where 18,500 outstanding options were not included in the computation.

For the six months ended June 30, 2018, outstanding options to purchase 449,000 common shares were not included in the computation of diluted income per common share because all such options' exercise price was greater than the average market price of the common shares for the period as compared to the six months ended June 30, 2017, where 23,500 outstanding options were not included in the computation.

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

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

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

Table of Contents

**10. Revenue**

*Significant accounting policy*

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

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

*Nature of goods and services*

The following is a description of principal activities – separated by reportable segments – from which the Company generates its revenue. For more detailed information about reportable segments, see Note 12.

(a) Network Access Services

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

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

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

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

Our Roam Mobility brand also offers standard talk, text and data mobile services. Roam customers prepay for their usage through the Roam Mobility website. When prepayments are received the amount is deferred, and subsequently recognized as the Company satisfies its obligation to provide mobile services. In addition, revenues associated with the sale of SIM cards are recognized when title and risk of loss is transferred to the subscriber and shipment has occurred. Incentive marketing credits given to customers are recorded as a reduction of revenue.

In those cases, where payment is not received at the time of sale, revenue is not recognized at contract inception unless the collection of the related accounts receivable is reasonably assured. The Company records costs that reflect expected refunds, rebates and credit card charge-backs as a reduction of revenues at the time of the sale based on historical experiences and current expectations.

(b) Domain Services

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

Table of Contents

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

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

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

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

*Disaggregation of Revenue*

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

| | **Three months ended June 30,** | | **Six months ended June 30,** | |
|---|---|---|---|---|
| | **2018** | **2017** | **2018** | **2017** |
| Network Access Services: | | | | |

| | | | | |
|---|---|---|---|---|
| Mobile Services | $22,411 | $20,379 | $44,283 | $38,341 |
| Other Services | 1,895 | 1,248 | 3,631 | 2,535 |
| Total Network Access Services | 24,306 | 21,627 | 47,914 | 40,876 |
| | | | | |
| Domain Services: | | | | |
| Wholesale | | | | |
| Domain Services | 42,540 | 48,550 | 100,968 | 87,644 |
| Value Added Services | 4,601 | 5,415 | 9,035 | 9,322 |
| Total Wholesale | 47,141 | 53,965 | 110,003 | 96,966 |
| | | | | |
| Retail | 8,477 | 7,663 | 16,913 | 14,064 |
| Portfolio | 1,163 | 968 | 2,052 | 1,885 |
| Total Domain Services | 56,781 | 62,596 | 128,968 | 112,915 |
| | | | | |
| | $81,087 | $84,223 | $176,882 | $153,791 |

During the three months ended June 30, 2018, no customer accounted for more than 10% of total revenue. During the six months ended June 30, 2018, one customer accounted for 11% of total revenue, and for the three and six months ended June 30, 2017, no customer accounted for more than 10% of revenue. As at June 30, 2018 and December 31, 2017, no customer accounted for more than 10% of accounts receivable.

Table of Contents

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

| | **Three months ended June 30,** | | **Six months ended June 30,** | |
|---|---|---|---|---|
| | **2018** | **2017** | **2018** | **2017** |
| Network Access Services: | | | | |
| Mobile Services | $11,978 | $10,702 | $23,243 | $20,269 |
| Other Services | 1,290 | 946 | 2,230 | 1,771 |
| Total Network Access Services | 13,268 | 11,648 | 25,473 | 22,040 |
| Domain Services: | | | | |
| Wholesale | | | | |
| Domain Services | 35,844 | 42,449 | 87,161 | 76,913 |
| Value Added Services | 748 | 615 | 1,605 | 1,191 |
| Total Wholesale | 36,592 | 43,064 | 88,766 | 78,104 |
| Retail | 4,446 | 4,548 | 8,855 | 8,165 |
| Portfolio | 195 | 185 | 379 | 447 |
| Total Domain Services | 41,233 | 47,797 | 98,000 | 86,716 |
| Network Expenses: | | | | |
| Network, other costs | 2,701 | 2,261 | 5,275 | 4,604 |
| Network, depreciation and amortization costs | 1,727 | 1,169 | 3,357 | 2,141 |
| | 4,428 | 3,430 | 8,632 | 6,745 |
| | $58,929 | $62,875 | $132,105 | $115,501 |

*Contract Balances*

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

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

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

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

| | **Three months ended June 30, 2018** | **Six months ended June 30, 2018** |
|---|---|---|
| Balance, beginning of period | $150,983 | $160,582 |
| Deferral of revenue | 56,352 | 116,722 |
| Recognition of deferred revenue [1] | (55,284) | (125,253) |
| Balance, end of period | $152,051 | $152,051 |

[1]As a result of the bulk transfer of 2.65 million domain names to Namecheap on January 5, 2018, recognized revenue for the six months ended June 30, 2018 includes $14.6 million related to previously deferred revenue for these names.

Table of Contents

*Remaining Performance Obligations:*

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

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

| | **June 30, 2018** |
|---|---|
| Remainder of 2018 | $85,722 |
| 2019 | 45,546 |
| 2020 | 8,640 |
| 2021 | 4,616 |
| 2022 | 2,987 |
| Thereafter | 4,321 |
| Total | $151,832 |

**11. Contract Costs**

(a) Deferred costs of acquisition

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

Capitalized contract acquisition costs are amortized into operating expense based on the transfer of goods or services to which the assets relate which typically range 2 – 10 years. For the three months ended June 30, 2018, the Company capitalized $0.2 million and also amortized $0.3 million of contract costs, respectively, realizing net amortization of less than $0.1 million. For the six months ended June 30, 2018, the Company capitalized $0.4 million and also amortized $0.5 million of contract costs, respectively, realizing net amortization of less than $0.1 million. There was no impairment loss recognized in relation to the costs capitalized during the three or six months ending June 30, 2018. The breakdown of the movement in the contract costs balance for the three and six months ending June 30, 2018 is as follows (Dollar amounts in thousands of U.S. dollars):

| | **Three months ended June 30, 2018** | **Six months ended June 30, 2018 (1)** |
|---|---|---|
| Balance, beginning of period | $ 1,378 | $ 1,404 |
| Capitalization of costs | 244 | 439 |
| Amortization of costs | (268 ) | (489 ) |
| Balance, end of period | $ 1,354 | $ 1,354 |

(1)The beginning balance consists entirely of a cumulative adjustment recorded on January 1, 2018 as a result of the modified retrospective adoption of ASU 2014-09. See note 3 for additional information.

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

(b) Deferred costs of fulfillment

Deferred costs to fulfill contracts generally consist of domain registration costs which have been paid to a domain registry, and are capitalized as Prepaid domain name registry and ancillary services fees. These costs are deferred and amortized over the life of the domain which generally ranges from one to ten years. For the three months ended June 30, 2018, the Company capitalized $41.2 million and also amortized $41.4 million of contract costs, respectively, realizing a net change in prepaid domain name registry and ancillary services fees of $0.2 million. For the six months ended June 30, 2018, the Company capitalized $87.2 million and also amortized $98.7 million of contract costs, respectively, realizing a net change in prepaid domain name registry and ancillary services fees of $11.5 million. There was no impairment loss recognized in relation to the costs capitalized during the three or six months ending June 30, 2018. Amortization expense is primarily included in cost of revenue. The breakdown of the movement in the prepaid domain name registry and ancillary services fees balance for the three and six months ended June 30, 2018 is as follows (Dollar amounts in thousands of U.S. dollars).

| | Three months ended<br><br>June 30, 2018 | Six months ended<br><br>June 30, 2018 |
|---|---|---|
| Balance, beginning of period | $115,660 | $127,003 |
| Deferral of costs | 41,177 | 87,160 |
| Recognition of costs [1] | (41,380 ) | (98,708 ) |
| Balance, end of period | $115,456 | $115,456 |

[1]As a result of the bulk transfer of 2.65 million domain names to Namecheap on January 5th, 2018, recognized costs for the six months ended June 30, 2018 includes $14.5 million related to previously deferred revenue for these names.

Table of Contents

**12. Segment reporting:**

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

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

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

The Chief Executive Officer (the "CEO") is the chief operating decision maker and regularly reviews the operations and performance by segment. The CEO reviews gross profit as (a) key measure of performance for each segment and (b) to make decisions about the allocation of resources. Sales and marketing expenses, technical operations and development expenses, general and administrative expenses, depreciation of property and equipment, amortization of intangibles assets, impairment of indefinite life intangible assets, gain on currency forward contracts and other expense net are organized along functional lines and are not included in the measurement of segment profitability. Total assets and total liabilities are centrally managed and are not reviewed at the segment level by the CEO. The Company follows the same accounting policies for the segments as those described in Notes 2, 3 and 10 to these consolidated financial statements.

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

| | **Network Access Services** | **Domain Services** | **Consolidated Totals** |
|---|---|---|---|
| **Three months ended June 30, 2018** | | | |

| | | | |
|---|---|---|---|
| Net Revenues | $ 24,306 | $ 56,781 | $ 81,087 |
| | | | |
| Cost of revenues | | | |
| Cost of revenues | 13,268 | 41,233 | 54,501 |
| Network expenses | 640 | 2,061 | 2,701 |
| Depreciation of property and equipment | 903 | 325 | 1,228 |
| Amortization of intangible assets | 11 | 488 | 499 |
| Total cost of revenues | 14,822 | 44,107 | 58,929 |
| Gross Profit | 9,484 | 12,674 | 22,158 |
| | | | |
| Expenses: | | | |
| Sales and marketing | | | 7,852 |
| Technical operations and development | | | 2,355 |
| General and administrative | | | 4,256 |
| Depreciation of property and equipment | | | 102 |
| Amortization of intangible assets | | | 1,827 |
| Loss (gain) on currency forward contracts | | | 52 |
| Income from operations | | | 5,714 |
| Other income (expenses), net | | | (878 ) |
| Income before provision for income taxes | | | $ 4,836 |

20

Table of Contents

| **Three months ended June 30, 2017** | **Network Access Services** | **Domain Services** | **Consolidated Totals** |
|---|---|---|---|
| Net Revenues | $ 21,627 | $ 62,596 | $ 84,223 |
| Cost of revenues | | | |
| Cost of revenues | 11,648 | 47,797 | 59,445 |
| Network expenses | 410 | 1,851 | 2,261 |
| Depreciation of property and equipment | 489 | 225 | 714 |
| Amortization of intangible assets | 11 | 444 | 455 |
| Total cost of revenues | 12,558 | 50,317 | 62,875 |
| Gross Profit | 9,069 | 12,279 | 21,348 |
| Expenses: | | | |
| Sales and marketing | | | 7,447 |
| Technical operations and development | | | 1,798 |
| General and administrative | | | 3,285 |
| Depreciation of property and equipment | | | 165 |
| Loss on disposal of property and equipment | | | 2 |
| Amortization of intangible assets | | | 1,608 |
| Loss (gain) on currency forward contracts | | | (27) |
| Income from operations | | | 7,070 |
| Other income (expenses), net | | | (745) |
| Income before provision for income taxes | | | $ 6,325 |

| **Six months ended June 30, 2018** | **Network Access Services** | **Domain Services** | **Consolidated Totals** |
|---|---|---|---|
| Net Revenues | $ 47,914 | $ 128,968 | $ 176,882 |
| Cost of revenues | | | |
| Cost of revenues | 25,473 | 98,000 | 123,473 |
| Network expenses | 1,130 | 4,145 | 5,275 |
| Depreciation of property and equipment | 1,737 | 622 | 2,359 |
| Amortization of intangible assets | 23 | 975 | 998 |

| | | | |
|---|---|---|---|
| Total cost of revenues | 28,363 | 103,742 | 132,105 |
| Gross Profit | 19,551 | 25,226 | 44,777 |
| | | | |
| Expenses: | | | |
| Sales and marketing | | | 16,217 |
| Technical operations and development | | | 4,450 |
| General and administrative | | | 8,786 |
| Depreciation of property and equipment | | | 203 |
| Amortization of intangible assets | | | 3,659 |
| Loss (gain) on currency forward contracts | | | 49 |
| Income from operations | | | 11,413 |
| Other income (expenses), net | | | (1,650) |
| Income before provision for income taxes | | | $ 9,763 |

21

Table of Contents

| Six months ended June 30, 2017 | Network Access Services | Domain Services | Consolidated Totals |
|---|---|---|---|
| Net Revenues | $ 40,876 | $ 112,915 | $ 153,791 |
| Cost of revenues | | | |
| Cost of revenues | 22,040 | 86,716 | 108,756 |
| Network expenses | 951 | 3,653 | 4,604 |
| Depreciation of property and equipment | 916 | 389 | 1,305 |
| Amortization of intangible assets | 23 | 813 | 836 |
| Total cost of revenues | 23,930 | 91,571 | 115,501 |
| Gross Profit | 16,946 | 21,344 | 38,290 |
| Expenses: | | | |
| Sales and marketing | | | 14,667 |
| Technical operations and development | | | 3,492 |
| General and administrative | | | 6,742 |
| Depreciation of property and equipment | | | 331 |
| Loss on disposal of property and equipment | | | 2 |
| Amortization of intangible assets | | | 2,989 |
| Loss (gain) on currency forward contracts | | | (61) |
| Income from operations | | | 10,128 |
| Other income (expenses), net | | | (1,484) |
| Income before provision for income taxes | | | $ 8,644 |

Table of Contents

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

| | **June 30, 2018** | **December 31, 2017** |
|---|---|---|
| Canada | $1,518 | $ 1,176 |
| United States | 32,979 | 23,417 |
| Germany | 41 | 27 |
| | $34,538 | $ 24,620 |

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

| | **June 30, 2018** | **December 31, 2017** |
|---|---|---|
| Canada | $7,085 | $ 7,749 |
| United States | 33,895 | 37,783 |
| Germany | 17 | 120 |
| | $40,997 | $ 45,652 |

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

| **Allowance for doubtful accounts excluding provision for credit notes** | **Balance at beginning of period** | **Charged to costs and expenses** | **Write-offs during period** | **Balance at end of period** |
|---|---|---|---|---|
| Six months ended June 30, 2018 | $ 168 | $ (36 ) | $ - | $ 132 |
| Year ended December 31, 2017 | $ 164 | $ 4 | $ - | $ 168 |

Table of Contents

**13. Stockholders' Equity:**

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

| Common stock | Additional paid in | Retained earnings | Accumulated other comprehensive | Total |
|---|---|---|---|---|