

TUCOWS INC /PA/  
Form 10-Q  
May 14, 2010  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, DC 20549

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**FORM 10-Q**

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

**For the quarterly period ended March 31, 2010**

**OR**

**o 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.**

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(Exact Name of Registrant as Specified in Its Charter)

**Pennsylvania**  
(State or Other Jurisdiction of  
Incorporation or Organization)

**23-2707366**  
(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 May 14, 2010, there were 59,803,124 outstanding shares of common stock, no par value, of the registrant.



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**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)

	March 31, 2010 (unaudited)	December 31, 2009
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 5,181,896	\$ 9,632,394
Accounts receivable, net of allowance for doubtful accounts of \$110,000 as of March 31, 2010 and \$110,000 as of December 31, 2009	3,697,545	2,822,045
Prepaid expenses and deposits	2,860,624	2,498,922
Derivative instrument asset, current portion (note 6)	2,185,688	2,107,825
Prepaid domain name registry and ancillary services fees, current portion	33,750,000	31,596,236
Income taxes recoverable	358,000	674,000
Total current assets	48,033,753	49,331,422
Derivative instrument asset, long-term portion (note 6)	140,913	112,553
Prepaid domain name registry and ancillary services fees, long-term portion	12,588,320	12,126,515
Property and equipment	1,779,999	1,986,768
Deferred financing charges	33,600	41,000
Deferred tax asset, long-term portion (note 7)	4,102,929	3,907,476
Intangible assets (note 4)	18,213,439	18,656,353
Goodwill	17,990,807	17,990,807
Total assets	\$ 102,883,760	\$ 104,152,894
<b>Liabilities and Stockholders Equity</b>		
Current liabilities:		
Accounts payable	\$ 1,738,878	\$ 1,547,863
Accrued liabilities	1,763,176	1,889,980
Customer deposits	3,895,116	3,624,317
Loan payable, current portion (note 5)	2,741,564	3,220,125
Deferred revenue, current portion	42,837,249	40,211,766
Accreditation fees payable, current portion	594,968	530,656
Deferred tax liability, current portion (note 7)	1,102,929	907,476
Total current liabilities	54,673,880	51,932,183
Derivative instrument liability, long-term portion	7,958	15,708
Deferred revenue, long-term portion	16,677,922	16,098,812

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Accreditation fees payable, long-term portion	169,705	169,620
Deferred tax liability, long-term portion (note 7)	4,840,000	4,840,000
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; 59,792,816 shares issued and outstanding as of March 31, 2010 and 67,080,353 shares issued and outstanding as of December 31, 2009		
	12,579,210	14,030,384
Additional paid-in capital	43,587,383	47,287,351
Deficit	(29,652,298)	(30,221,164)
Total stockholders' equity	26,514,295	31,096,571
Total liabilities and stockholders' equity	\$ 102,883,760	\$ 104,152,894

See accompanying notes to unaudited consolidated financial statements

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**Tucows Inc.**

**Consolidated Statements of Operations**

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

**(unaudited)**

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	Three months ended March 31,	
	2010	2009
	(unaudited)	
Net revenues (note 9)	\$ 20,445,153	\$ 20,091,424
Cost of revenues:		
Cost of revenues (*)	14,924,874	13,785,398
Depreciation of property and equipment	310,058	392,947
Amortization of intangible assets (note 4)	74,802	29,199
Total cost of revenues (note 9)	15,309,734	14,207,544
Gross profit	5,135,419	5,883,880
Operating expenses:		
Sales and marketing (*)	1,862,336	1,353,176
Technical operations and development (*)	1,243,013	1,104,139
General and administrative (*)	815,580	1,869,896
Depreciation of property and equipment	43,889	82,453
Amortization of intangible assets (note 4)	360,540	360,540
Gain on change in fair value of forward exchange contracts	(113,973)	(85,343)
Total expenses	4,211,385	4,684,861
Income from operations	924,034	1,199,019
Other income :		
Interest income (expense), net	(39,168)	(63,462)
Total other income	(39,168)	(63,462)
Income before provision for income taxes	884,866	1,135,557
Provision for income taxes (note 7)	316,000	107,425
Net income for the period	\$ 568,866	\$ 1,028,132
Basic earnings per common share (note 8)	\$ 0.01	\$ 0.01
Shares used in computing basic earnings per common share (note 8)	61,265,903	72,655,213
Diluted earnings per common share (note 8)	\$ 0.01	\$ 0.01
Shares used in computing diluted earnings per common share (note 8)	63,338,084	72,657,604

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

Cost of revenues	\$ 3,628	\$ 5,000
Sales and marketing	15,686	14,900
Technical operations and development	14,581	10,600
General and administrative	22,734	18,700

See accompanying notes to unaudited consolidated financial statements





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

	<b>Three months ended March 31,</b>	
	<b>2010</b>	<b>2009</b>
	<b>(unaudited)</b>	
<b>Cash provided by (used in):</b>		
<b>Operating activities:</b>		
Net income for the period	\$ 568,866	\$ 1,028,132
<b>Items not involving cash:</b>		
Depreciation of property and equipment	353,947	475,400
Amortization of deferred financing charges	7,400	10,400
Amortization of intangible assets	435,342	389,739
Disposal of domain names	7,572	973
Unrealized gain in the fair value of forward exchange contracts	(113,973)	(85,343)
Stock-based compensation	56,629	49,200
<b>Change in non-cash operating working capital:</b>		
Accounts receivable	(875,500)	(516,993)
Prepaid expenses and deposits	(361,702)	(578,568)
Prepaid fees for domain name registry and ancillary services fees	(2,615,569)	(2,125,399)
Income tax recoverable	316,000	85,182
Accounts payable	186,569	(180,821)
Accrued liabilities	(126,804)	128,773
Customer deposits	270,799	(309,502)
Deferred revenue	3,204,593	2,463,376
Accreditation fees payable	64,397	78,607
<b>Net cash provided by operating activities</b>	<b>1,378,566</b>	<b>913,156</b>
<b>Financing activities:</b>		
Proceeds received on exercise of stock options	4,501	
Repurchase of common stock	(5,212,272)	(1,811,179)
Repayment of loan payable	(478,561)	(478,561)
<b>Net cash used in financing activities</b>	<b>(5,686,332)</b>	<b>(2,289,740)</b>
<b>Investing activities:</b>		
Cost of domain names acquired		(5,900)
Additions to property and equipment	(142,732)	(42,240)
<b>Net cash used in investing activities</b>	<b>(142,732)</b>	<b>(48,140)</b>
<b>Decrease in cash and cash equivalents</b>	<b>(4,450,498)</b>	<b>(1,424,724)</b>
Cash and cash equivalents, beginning of period	9,632,394	5,427,467
Cash and cash equivalents, end of period	\$ 5,181,896	\$ 4,002,743
<b>Supplemental cash flow information:</b>		

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Interest paid	\$	39,276	\$	65,521
Supplementary disclosure of non-cash investing activity:				
Property and equipment acquired during the period not yet paid for	\$	98,040	\$	2,784

See accompanying notes to unaudited consolidated financial statements

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**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**1. ORGANIZATION OF THE COMPANY:**

Tucows Inc., a Pennsylvania corporation (referred to throughout this report as the Company, Tucows, we, us or through similar expressions), together with our consolidated subsidiaries, is a global distributor of Internet services, including domain name registration, security and identity products through digital certificates and email through its distribution network of Internet Service Providers, web hosting companies and other providers of Internet services to end-users.

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 offices in the United Kingdom and the United States.

**2. BASIS OF PRESENTATION:**

The accompanying unaudited interim consolidated balance sheets, and the related consolidated statements of operations 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 March 31, 2010 and the results of operations and cash flows for the interim periods ended March 31, 2010 and 2009. 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, 2009 included in Tucows' 2009 Annual Report on Form 10-K filed with the SEC on March 22, 2010.

There have been no material changes to our significant accounting policies during the three months ended March 31, 2010 as compared to the significant accounting policies described in our Annual Report on Form 10-K for the fiscal year ended December 31, 2009.

During the first quarter of fiscal 2010, the Company recorded out-of-period adjustments relating to rent expense and the amortization of intangible assets. These immaterial corrections of errors reduced net income after taxes by \$0.1 million for the three months ended March 31, 2010.

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 to the notes to the unaudited interim consolidated financial statements.

### 3. NEW ACCOUNTING POLICIES:

#### *Recent Accounting Pronouncements Adopted*

In January 2010, the Financial Accounting Standards Board, or FASB, issued Accounting Standards Update 2010-06, Fair Value Measurements and Disclosures (Topic: 820): Improving Disclosures about Fair Value Measurements . Update 2010-06 requires additional fair value disclosures for significant transfers between levels of the fair value hierarchy and gross presentation of items within the Level 3 reconciliation. This guidance also clarifies that entities need to disclose fair value information for each class of asset and liability measured at fair value and that valuation techniques need to be provided for all non-market observable measurements. Our adoption of this guidance on January 1, 2010, did not impact our Consolidated Financial Statements as the Company does not have any such transfers and no items classified as Level 3.

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*Recent Accounting Pronouncements Not Yet Adopted*

In October 2009, the SEC announced that public companies with a public float below \$75 million must begin to comply with the final stage of Section 404 that requires auditor attestation of the effectiveness of internal control over financial reporting, beginning with annual reports for fiscal years ending on or after June 15, 2010. The previous effective date was for fiscal years ending on or after December 15, 2009. As a result, the Company will now be required to provide the attestation reports commencing for its fiscal year ending December 31, 2010.

In October 2009, the FASB issued Accounting Standards Update 2009-13, Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements (Update 2009-13). Update 2009-13 applies to multiple-deliverable revenue arrangements that are currently within the scope of FASB ASC Subtopic 605-25 (previously included in Emerging Issues Task Force Issue no. 00-21, Revenue Arrangements with Multiple Deliverables ). Update 2009-13 provides principles and application guidance on whether multiple deliverables exist, how the arrangement should be separated, and the consideration allocated. It also requires an entity to allocate revenue in an arrangement using estimated selling prices of deliverables if a vendor does not have vendor-specific objective evidence or third-party evidence of selling price. The guidance eliminates the use of the residual method, requires entities to allocate revenue using the relative-selling-price method, and significantly expands the disclosure requirements for multiple-deliverable revenue arrangements. Update 2009-13 is effective on a prospective basis for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. We are currently assessing the impact of Update 2009-13 on our future consolidated financial statements.

**4. INTANGIBLE ASSETS:**

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

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A summary of acquired intangible assets for the three months ended March 31, 2010 is as follows:

Amortization period	Technology 2 - 7 years	Brand 7 years	Customer relationships 4 - 7 years	Surname domain names indefinite life	Direct navigation domain names indefinite life	Total
Net book value, December 31, 2009	\$ 324,928	\$ 686,820	\$ 3,408,380	\$ 12,132,408	\$ 2,103,817	\$ 18,656,353
Sale of domain names				(649)	(6,923)	(7,572)
Amortization expense	(74,802)	(41,760)	(318,780)			(435,342)
Net book value, March 31, 2010	\$ 250,126	\$ 645,060	\$ 3,089,600	\$ 12,131,759	\$ 2,096,894	\$ 18,213,439

**5. LOAN PAYABLE:**

The Company entered into a non-revolving, reducing credit facility in the amount of \$9.6 million with a Canadian chartered bank (the credit facility) to finance the purchase of Innerwise, Inc. in July 2007. Effective February 23, 2009, the Company agreed to amend the interest rate payable from the bank's US Base rate plus 0.50% per annum to the bank's US Base rate plus 1.50% per annum. The principal and accrued interest on the loan is payable monthly over the term of the loan, which is five years. Tucows may prepay this loan in full or in part without any premium or penalty. The credit facility provides that we maintain certain financial and operating covenants which include, among other provisions, maintaining specific leverage and coverage ratios during the term of the loan. Certain covenants under the credit facility may limit the amount of our capital expenditures. The credit facility is collateralized by a first lien on, and pledge of, the majority of the Company and our subsidiaries present and future property and assets (subject to certain exclusions). As of March 31, 2010, the Company continued to comply with all covenants of the credit facility.

Pursuant to the terms of the credit facility, the Company is required to make an annual cash sweep payment based on excess cash flow as defined in the credit facility agreement, as well as monthly principal repayments of approximately \$160,000. Based on the assessment of the audited results for its 2008 fiscal year, the Company made a cash sweep payment for its 2008 fiscal year amounting to \$0.7 million, which was paid on May 1, 2009. As of March 31, 2010, The Company estimated that the cash sweep payment for its 2009 fiscal year, payable during the three months ending June 30, 2010, will repay in full the \$2,741,564 outstanding balance of our non-revolving, reducing credit facility.

To estimate the fair value of the Company's loan payable under the credit facility, the Company uses interest rates that are currently available to the Company for issuance of loans on similar terms and remaining maturities. The estimated fair value of the Company's loan payable at March 31, 2010 was \$2,749,897, compared to a carrying amount of \$2,741,564 at March 31, 2010.

**6. DERIVATIVE INSTRUMENT ASSETS AND LIABILITIES:**

The Company enters into foreign currency contracts to hedge a portion of the Company's expected Canadian dollar requirements. All derivative financial instruments are recorded at fair value on our consolidated balance sheet. The fair value of our foreign currency contracts at March 31, 2010 was a net unrealized gain of \$2.3 million as compared to a net unrealized gain of \$2.2 million at December 31, 2009. The net unrealized gain is a result of fluctuations in foreign exchange rates between the date the currency forward contracts were entered into and the valuation date.

at period end.



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At March 31, 2010, the Company had the following outstanding forward exchange contracts to trade U.S. dollars in exchange for Canadian dollars:

Maturity date	Notional amount of U.S. dollars	Weighted average exchange rate of U.S. dollars	Fair value
April - June 2010	\$ 4,939,000	0.8427	\$ 834,551
July - September 2010	5,400,000	0.8596	785,784
October - December 2010	5,400,000	0.9236	350,015
2010	15,739,000	0.8749	1,970,350
January - March, 2011	3,900,000	0.9302	215,338
April - June 2011	3,900,000	0.9635	64,335
July - September 2011	3,900,000	0.9604	68,620
2011	11,700,000	0.9511	348,293
Total	\$ 27,439,000	0.9058	\$ 2,318,643

During the three months ended March 31, 2010, the Company entered into a series of foreign exchange forward contracts to hedge a portion of our 2011 fiscal year expected Canadian dollar requirements. These contracts, collectively, have a notional value of US\$6.5 million, whereby US\$650,000 is converted into Canadian dollars on a semi-monthly basis from May 2011 to September 2011 at an average foreign exchange rate of US\$1.00: Cdn\$1.0390.

The Company does not apply hedge accounting and, therefore, for the three months ended March 31, 2010, the Company recorded a gain of \$113,973 in the fair value of forward contracts in its consolidated statements of operations. For the three months ended March 31, 2009, the Company recorded a gain on forward contracts of \$85,343.

## 7. INCOME TAXES

For the three months ended March 31, 2010, the Company recorded a provision for income taxes of \$316,000 on income before income taxes of \$885,000 using an estimated effective tax rate for its 2010 fiscal year. Comparatively, for the three months ended March 31, 2009, the Company recorded a current tax expense of \$107,000 on income before income taxes of \$1.1 million using an estimated effective tax rate for its 2009 fiscal year that accounts for the utilization of remaining net operating loss carry forwards and alternative minimum tax credits available to the Company.

As of December 31, 2009, the Company recorded a valuation allowance of \$4.3 million and a net deferred tax asset of \$3.0 million. As of March 31, 2010 the Company has recorded a non-current deferred tax asset of \$4.1 million and current deferred tax liabilities of \$1.1 million. As of March 31, 2010 and December 31, 2009, the Company has also recorded a non current deferred tax liability related to the temporary difference arising on indefinite life intangibles of \$4.8 million.

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The Company analyzes the carrying value of its deferred tax asset on a regular basis. In determining future taxable income, assumptions are made to forecast federal, state and international operating income, the reversal of temporary timing differences, and the implementation of any feasible and prudent tax planning strategies. The assumptions require significant judgment regarding the forecasts of future taxable income, and are consistent with other forecasts used to manage the business. During the three months ended March 31, 2010, there was no reversal of the valuation allowance. The valuation allowance will be maintained until sufficient evidence exists to support a reversal of, or decrease in, the valuation allowance.

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 has approximately \$107,000 of total gross unrecognized tax benefit as of March 31, 2010 and \$124,000 of total gross unrecognized tax benefit as of December 31, 2009, which if recognized would favorably affect our income tax rate in future periods. The unrecognized tax benefit relates to prior year Pennsylvania state franchise taxes, other US state taxes. The unrecognized tax benefit has decreased by \$17,000 when compared to the gross unrecognized tax benefits as of December 31, 2009 we have now settled the claim for the Pennsylvania franchise taxes for the years December 31, 1996 to December 31, 2000. The Company does not expect the unrecognized tax benefit for the 2009 and 2010 research and

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development claim to be significant. The Company recognizes accrued interest and penalties related to taxes in tax expense. The Company did not have significant interest and penalties accrued as of March 31, 2010 and March 31, 2009, respectively. The Company believes it is reasonably possible that \$107,000 of the unrecognized tax benefit will decrease in the next twelve months as it is anticipated that the U.S. tax authorities will finalize their review of prior taxes owing in Pennsylvania within the period and certain other prior year state tax returns will be filed.

**8. BASIC AND DILUTED EARNINGS (LOSS) 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 March 31, 2010	Three months ended March 31, 2009
Numerator for basic and diluted earnings per common share:		
Income for the period	\$ 568,866	\$ 1,028,132
Denominator for basic and diluted earnings per common share:		
Basic weighted average number of common shares outstanding	61,265,903	72,655,213
Effect of outstanding stock options	2,072,181	2,391
Diluted weighted average number of shares outstanding	63,338,084	72,657,604
Basic earnings per common share	\$ 0.01	\$ 0.01
Diluted earnings per common share	\$ 0.01	\$ 0.01

For the three months ended March 31, 2010, options to purchase 1,374,967 common shares that were outstanding, and 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 three months ended March 31, 2009, options to purchase 7,167,669 shares of common stock 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.

On January 13, 2010, 6,341,470 common shares were repurchased and cancelled under the terms of a modified Dutch auction tender offer.

During the three months ended March 31, 2010 an additional 956,000 common shares were repurchased and cancelled under the terms of our stock repurchase program announced in February 2010.

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These reductions in the number of shares outstanding have been included in the computation of earnings per share and diluted earnings per share for the three months ended March 31, 2010(see note 11).

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

	<b>Three months ended March 31,</b>	
	<b>2010</b>	<b>2009</b>
OpenSRS :		
Domain Services	\$ 15,403,010	\$ 14,202,023
Email Services	638,188	1,121,935
Other Services	1,093,711	1,094,460
Total OpenSRS Services	17,134,909	16,418,418
YummyNames	1,711,321	1,865,033
Hover	1,129,497	1,300,584
Butterscotch	469,426	507,389
	\$ 20,445,153	\$ 20,091,424

No customer accounted for more than 10% of revenue for the three months ended March 31, 2010 or the three months ended March 31, 2009. Significant management judgment is required at the time of recording of revenue to assess whether the collection of the resulting receivables is reasonably assured. On an ongoing basis, we assess the ability of our customers to make required payments. Based on this assessment, we expect the carrying amount of our outstanding receivables, net of allowance for doubtful accounts, to be fully collected.

As of March 31, 2010, two customers accounted for 32% of accounts receivable, all of which has been paid subsequent to March 31, 2010. As of March 31, 2009, no customer accounted for more than 10% of accounts receivable.

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

	<b>Three months ended March 31,</b>	
	<b>2010</b>	<b>2009</b>
OpenSRS :		
Domain Services	\$ 12,616,231	\$ 11,354,762
Email Services	107,138	179,918
Other Services	387,123	388,852
Total OpenSRS Services	13,110,492	11,923,532
YummyNames	202,754	185,554
Hover	399,445	513,210
Butterscotch	18,859	6,740
Network, other costs	1,193,324	1,156,362
Network, depreciation and amortization costs	384,860	422,146
	\$ 15,309,734	\$ 14,207,544

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

	March 31, 2010		December 31, 2009	
Canada	\$	1,348,232	\$	1,475,056
United States		428,314		506,533
United Kingdom		3,453		5,179
	\$	1,779,999	\$	1,986,768

**10. COMMITMENTS AND CONTINGENCIES:**

The Company is involved in various legal claims and lawsuits in connection with its ordinary business operations. The Company intends to vigorously defend these claims. While the final outcome with respect to any actions or claims outstanding or pending as of March 31, 2010 cannot be predicted with certainty, it is the opinion of management that their resolution will not have a material adverse effect on the Company's financial position.

Table of Contents**11. STOCKHOLDERS EQUITY:**

The following unaudited table summarizes stockholders' equity transactions for the period ended March 31, 2010:

	Number	Common stock Amount	Additional paid in capital	Deficit	Total stockholders equity
Balances, December 31, 2009	67,080,353	\$ 14,030,384	\$ 47,287,351	\$ (30,221,164)	\$ 31,096,571
Exercise of stock options	10,433	8,320	(3,819)		4,501
Repurchase and retirement of shares Dutch Auction	(6,341,470)	(1,268,294)	(3,222,692)		(4,490,986)
Repurchase and retirement of shares Normal course issuer bid	(956,000)	(191,200)	(530,086)		(721,286)
Stock-based compensation			56,629		56,629
Cancellation of restricted stock	(500)				
Net income for the period				568,866	568,866
Balances, March 31, 2010	59,792,816	\$ 12,579,210	\$ 43,587,383	\$ (29,652,298)	\$ 26,514,295

The following unaudited table summarizes stockholders' equity transactions for the period ended March 31, 2009:

	Number	Common stock Amount	Additional paid in capital	Deficit	Total stockholders equity
Balances, December 31, 2008	73,073,782	\$ 15,198,358	\$ 48,714,676	\$ (42,462,370)	\$ 21,450,664
Repurchase and retirement of shares	(4,185,690)	(837,138)	(974,041)		(1,811,179)
Stock-based compensation			49,200		49,200
Net income for the period				1,028,132	1,028,132
Balances, March 31, 2009	68,888,092	\$ 14,361,220	\$ 47,789,835	\$ (41,434,238)	\$ 20,716,817

On January 13, 2010, the Company announced that it successfully concluded a modified Dutch auction tender offer that was previously announced on December 14, 2009. Under the terms of the offer, the Company repurchased an aggregate of 6,341,470 shares of its common stock at a purchase price of \$0.70 per share, for a total of \$4,439,029, excluding transaction costs of \$51,957. The purchase price was funded from available cash. Of the 6,341,470 shares purchased, 5,000,000 were shares the Company offered to purchase in the offer and 1,341,470 were shares purchased pursuant to the Company's right to purchase up to an additional 2% of the shares outstanding immediately prior to the commencement of the tender offer. Due to over-subscription, the final proration factor for shares tendered at or below \$0.70 per share was approximately 99.9%. For this purpose, shares tendered at \$0.70 per share included shares tendered by those persons who indicated, in their letter of transmittal, that they were willing to accept the price determined in the offer. All shares purchased in the tender offer received the same price.

On February 16, 2010, the Company's Board of Directors authorized the repurchase of up to \$10 million of the Company's common stock at the Company's discretion. The Company has repurchased 956,000 shares under this repurchase program during the three months ended March 31, 2010.





Table of Contents**12. SHARE-BASED PAYMENTS**

## (a) Stock options

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

On November 22, 2006, the stockholders of the Company approved the implementation of the Company's 2006 Equity Compensation Plan (the "2006 Plan"), which serves as a successor to the 1996 Plan. The 2006 Plan has been established for the benefit of the employees, officers, directors and certain consultants of the Company. The 5,000,000 common shares that have been set aside for issuance under the 2006 Plan are to provide eligible persons with the opportunity to acquire a proprietary interest, or otherwise increase their proprietary interest, in Tucows. Generally, options issued under the 2006 Plan vest over a four-year period and have a term not exceeding seven years.

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

No stock options were granted during the periods ended March 31, 2010 or March 31, 2009.

Details of stock option transactions for the three months ended March 31, 2010 and March 31, 2009 are as follows:

	Three months ended March 31, 2010		Three months ended March 31, 2009	
	Number of shares	Weighted average exercise price per share	Number of shares	Weighted average exercise price per share
Outstanding, beginning of period	7,203,977	\$ 0.56	7,282,777	\$ 0.56
Granted				
Exercised	(10,433)	0.43		

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Forfeited	(15,000)		0.64	(155,718)		0.53
Expired	(383,374)		0.98	(1,500)		3.75
Outstanding, end of period	6,795,170	\$	0.53	7,125,559	\$	0.56
Options exercisable, end of period	5,942,169	\$	0.51	5,763,923	\$	0.52

The stock options expire on various dates through 2016.

As of March 31, 2010, the exercise prices, weighted average remaining contractual life of outstanding options and intrinsic values were as follows:

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Exercise price	Number outstanding	Options outstanding			Options exercisable		
		Weighted average exercise price per share	Weighted average remaining contractual life (years)	Aggregate intrinsic value	Number exercisable	Weighted average exercise price per share	Aggregate intrinsic value
\$0.31-\$0.49	3,717,249	\$ 0.38	3.3	\$ 1,218,892	3,717,249	\$ 0.38	\$ 1,218,892
\$0.56-\$0.69	1,806,704	\$ 0.59	4.7	210,927	1,189,704	\$ 0.59	147,557
\$0.80-\$0.99	1,262,500	\$ 0.86	3.5		1,026,500	\$ 0.86	
\$2.21-\$4.84	8,717	\$ 4.32	0.1		8,716	\$ 4.32	
	6,795,170	\$ 0.53		\$ 1,429,819	5,942,169	\$ 0.51	\$ 1,366,449

Total unrecognized compensation cost relating to unvested stock options at March 31, 2010, prior to the consideration of expected forfeitures, was approximately \$272,000 and is expected to be recognized over a weighted average period of 1.8 years.

The Company recorded stock-based compensation of \$56,436 and \$49,200 for the three months ended March 31, 2010 and 2009, respectively.

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

(b) Restricted stock awards

During the three months ended March 31, 2010, no restricted stock awards were granted to any employees of the Company.

Restricted stock awards generally vest annually over a four year period. Holders of restricted stock may not sell, assign, transfer, pledge or otherwise dispose of an unvested stock. Unvested shares of restricted stock are held in escrow by the Company until the holder's interest in such shares vests.

Holders of restricted stock shall have full shareholder rights with respect to any shares of Company stock issued to the participant under a stock award, whether or not the holder's interest in those shares is vested. Accordingly, the holder shall have the right to vote such shares and to receive any regular cash dividends paid on such shares.

Total unrecognized compensation cost relating to unvested restricted stock awards at March 31, 2010, prior to the consideration of expected forfeitures, was approximately \$3,000 and is expected to be recognized over a weighted average period of 3.0 years.

The Company recorded stock-based compensation associated with restricted stock awards of \$193 for the three months ended March 31, 2010.

**13. FAIR VALUE MEASUREMENT**

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

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The following table provides a summary of the fair values of the Company's derivative instrument assets and liabilities measured at fair value on a recurring basis at March 31, 2010:

	March 31, 2010			Assets at Fair Value
	Level 1	Fair Value Measurements Using Level 2	Level 3	
Derivative instrument asset	\$	\$ 2,326,601	\$	\$ 2,326,601
Total Assets	\$	\$ 2,326,601	\$	\$ 2,326,601
Derivative instrument liability	\$	\$ (7,958)	\$	\$ (7,958)
Total Liabilities	\$	\$ (7,958)	\$	\$ (7,958)

The following table provides a summary of the fair values of the Company's derivative instrument assets measured at fair value on a recurring basis as at December 31, 2009:

	December 31, 2009			Assets at Fair Value
	Level 1	Fair Value Measurements Using Level 2	Level 3	
Derivative instrument asset	\$	\$ 2,220,378	\$	\$ 2,220,378
Total Assets	\$	\$ 2,220,378	\$	\$ 2,220,378
Derivative instrument liability	\$	\$ (15,708)	\$	\$ (15,708)
Total Liabilities	\$	\$ (15,708)	\$	\$ (15,708)

**14. RECLASSIFICATION**

Certain of the prior periods' comparative figures have been reclassified to conform with the presentation adopted in the current period.

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

**SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS**

This Quarterly Report on Form 10-Q contains, in addition to historical information, forward-looking statements by us with regard to our expectations as to financial results and other aspects of our business that involve risks and uncertainties and may constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Words such as may, should, anticipate, believe, plan, estimate, expect and intend, and other similar expressions are intended to identify forward-looking statements. The forward-looking statements contained in this report include statements regarding, among other things, the Company's foreign currency requirements, specifically for the Canadian dollar; the estimated annual cash sweep payment due under the Company's credit facility; the number of new, renewed and transferred-in domain names, our valuations of certain deferred tax assets, our expectation to collect our outstanding receivables, net of our allowance for doubtful accounts; the potential impact of current and pending claims on our business; our expectation regarding fluctuations in certain expense and cost categories; our belief that the market for domain name registration will trend upward gradually and may be affected by market volatility; our belief that a slowing economy may lead to a decrease in advertising spending and the effect of changes in our contractual relationships on our revenue. These statements are based on management's current expectations and are subject to a number of uncertainties and risks that could cause actual results to differ materially from those described in the forward-looking statements. Many factors affect our ability to achieve our objectives and to successfully develop and commercialize our services including:

- Our ability to continue to generate sufficient working capital to meet our operating requirements;
- Our ability to maintain a good working relationship with our vendors and customers;
- The ability of vendors to continue to supply our needs;
- Actions by our competitors;
- Our ability to achieve gross profit margins at which we can be profitable;
- Our ability to attract and retain qualified personnel in our business;
- Our ability to effectively manage our business;

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- Our ability to obtain and maintain approvals from regulatory authorities on regulatory issues;
- Pending or new litigation; and
- Factors set forth under the caption "Item 1A Risk Factors" in our Annual Report on Form 10-K for the fiscal year ended December 31, 2009.

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

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

### OVERVIEW

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

Our primary distribution channel is a global network of more than 10,000 resellers in more than 100 countries who typically provide their customers, the end-users of the Internet, with a critical component for establishing and maintaining an online presence. Our primary focus is serving the needs of this network of resellers by providing superior services, easy-to-use interfaces, proactive and attentive customer service, reseller-oriented technology and agile design and development processes. We seek to provide superior customer service to our resellers by anticipating their business needs and technical

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requirements. This includes providing easy-to-use interfaces that enable resellers to quickly and easily integrate our services into their individual business processes, and offering brandable end-user interfaces that emphasize simplicity and visual appeal. We also provide second tier support to our resellers by email and phone in the event resellers experience issues or problems with our services. In addition, our Network Operating Center provides proactive support to our resellers by monitoring all services and network infrastructure to address deficiencies before customer services are impacted.

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

To assist us in forecasting growth and to help us monitor the effectiveness of our operational strategies, we categorize our revenue into the following services:

OpenSRS, our wholesale service, manages over ten million domain names, under its ICANN accreditation, as well as names Tucows manages for other registrars under their own accreditations, millions of mailboxes and tens of thousands of digital certificates through a network of over 10,000 web hosts, Internet service providers, or ISPs, and other resellers around the world.

Platypus, our billing service, provides ISPs with an industry-specific solution for billing, service provisioning and customer account management.

Hover, our retail service, offers services similar to those of OpenSRS to consumers and small businesses.

YummyNames, our domain portfolio service, manages tens of thousands of domain names, most of which generate advertising revenue and many of which we offer for resale via our reseller network and other channels. Included in the YummyNames domain portfolio are over 41,000 domains that allow over two-thirds of Americans to purchase a domain or email address based on their name.

Butterscotch, our content service, operates two advertising-supported websites, butterscotch.com and tucows.com, which provide content to help consumers overcome the complexity of modern technology and the Internet, in the form of over 2,600 videos and over 170,000 software and mobile listings and articles. Additionally, Butterscotch provides custom video production services for technology manufacturers and ISPs.

We periodically acquire companies or technology when we determine that the related products or technology are strategic or complementary to our current or future service offerings, as opportunities arise. For example:

- On July 25, 2007, we acquired Innerwise, Inc., or IYD, a privately held ICANN accredited registrar offering domain services through a worldwide wholesale affiliate network.



- On June 19, 2006, we acquired Mailbank.com, Inc. (doing business as NetIdentity). We use the assets from this acquisition to offer personalized Internet services directly to end-users through Hover and to resellers through OpenSRS Personal Names Service, as well as to generate income from the parked page of each domain address.
- On January 3, 2006, we acquired all of the Hosted Messaging assets of Critical Path, Inc. to expand our presence in the email market.

Our business model is characterized by non-refundable, up-front payments, which lead to recurring revenue and positive operating cash flow. We are an ICANN-accredited registrar and manage over ten million domains under our ICANN accreditation, as well as names we manage for other registrars under their own accreditations.

## **Net Revenues**

### *OpenSRS*

We derive revenue from our reseller network by providing them with reseller services that comprise (a) domain services, (b) email services and (c) other services. Other services primarily consist of secure sockets layer, or SSL, certificates and also include blogware and website building tools that are used by our resellers to create bundles of Internet services for their end-users along with billing solutions for ISPs.

### OpenSRS Domain Service

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Historically, our OpenSRS domain services has constituted the largest portion of our business and encompasses all of our services as an accredited registrar related to the registration, renewal, transfer and management of domain names. In addition, this service fuels other revenue categories as it often is the initial service for which a customer will engage us, enabling us to follow on with other services and allowing us to add to our domain portfolio by purchasing names registered through us upon their expiration. We also provide resellers with the ability to sell personal names. This service allows resellers the opportunity to sell email addresses based on our domain portfolio of surname domain names.

As of March 31, 2010, we offer registration services for the gTLDs .com, .net, .org, .info, .name, .biz, .tel, .mobi and .asia and for the country code top-level domains, or ccTLDs .at, .be, .bz, .ca, .cc, .ch, .cn, .de, .dk, .es, .eu, .fr, .in, .it, .li, .me, .mx, .nl, .tv, .uk, .ws, and .us.

With respect to the sale of domain registrations, we modified our pricing structure for domain names to provide greater visibility into the various fees that make up the cost of a domain name, by breaking out the cost of the registry and ICANN fees separately from our management fee. In October 2007 and October 2008, registry fees were increased by 7% respectively by the major gTLD registries. Effective July 2010, registry fees for the .com and .net registrations will increase by an additional 7%. The management fee provides our resellers with access to our provisioning and management tools to enable them to register and administer domain names and access to additional services like WHOIS privacy and DNS services, enhanced domain name suggestion tools and access to our Premium Domain name services. We earn fees in connection with each new, renewed and transferred-in registration and from providing provisioning services to resellers and registrars on a monthly basis. Domain registrations are generally purchased for terms of one to ten years, with a majority having a one-year term. Except for certain large customers with whom we have negotiated alternative arrangements, payments for the full term of service, or billed revenue, is received at the time of activation of service. All fees received in connection with domain name registration are non-refundable, and where appropriate, are recorded as deferred revenue and recognized as earned ratably over the term of provision of service. This accounting treatment reasonably approximates a recognition pattern that corresponds with the provision of the services during the quarters and the year.

OpenSRS Email Service

We derive revenue from our hosted email service through our global distribution network. Our email service is offered on a per account, per month basis, and provides resellers with a reliable, scalable white label hosted email solutions that can be customized to their branding and business model requirements. The email service also includes spam and virus filtering on all accounts. End-users can access the email service via a full-featured, multi-language AJAX-enabled web interface, a WAP mobile interface, or through traditional desktop email clients, such as Microsoft Outlook or Apple Mail, using IMAP or POP/SMTP and 2GB of email storage.

We earn fees for email services when such services are activated. Email services are generally purchased monthly and, at month-end, are either deducted on a pre-authorized basis from reseller's deposit account, or are invoiced.

Other OpenSRS Services

We derive revenue from other services primarily from provisioning SSL certificates. In addition, we provision blogware and website building tools that are used by our resellers to create bundles of Internet services for their end-users, as well as the provision of billing, provisioning and customer care software solutions to ISPs through our Platypus billing software.

We earn fees from such services when a service is activated. These services are generally purchased for terms of one month to three years. Platypus software is generally purchased for terms of one month to one year. Payments for services are for the full term of all services at the time of activation of service, are non-refundable and, where appropriate, are recorded as deferred revenue and recognized as earned ratably over the service term. This accounting treatment reasonably approximates a recognition pattern that corresponds with the provision of the services during the quarters and the year.

*YummyNames*

We derive revenue from our portfolio of domain names by displaying advertising on the domains and by making them available for sale or lease. In addition we display advertising on parked pages within OpenSRS. Parked pages are domain names registered with us that do not yet contain an active website. When a user types one of these domain names into a web browser, they are presented with dynamically generated links that are pay-per-click advertising. Every time a user clicks on one of these links, it generates revenue for us through our partnership with third-parties who provide syndicated pay-per-click advertising.

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

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

In addition, we also offer the same services to our customers, allowing them to make available names registered by them for monetization on a similar basis. For customer names, we earn a referral fee for premium names or names sold or leased, and participate on a revenue share basis for names offered through our pay-per-click advertising program.

We recognize revenue from these services, net of any fees payable to resellers or customers, immediately upon completion of the service, or in the case of advertising revenue, on a monthly basis once the advertising has been served.

*Hover*

We derive revenues from the providing and managing Internet services, on a retail basis, to consumers and small businesses through our Hover.com website. These services include domain registration and other Internet services such as email and personalized email through our portfolio of surname-based domain names, as well as an easy-to-use interface that allows users to connect domain names to websites and email addresses through a unique DNS forwarding system. Depending on the service offered, we typically receive fees for our services.

Our customers generally purchase services for terms of one to ten years, with a majority of services purchased for a one-year term. Certain services are also offered on a monthly basis. Payments for the full term of all services, or billed revenue, are received at the time of service activation and, where appropriate, are recorded as deferred revenue and recognized as earned ratably over the term of provision of service. This accounting treatment reasonably approximates a recognition pattern that corresponds with the provision of the services during quarterly and annual periods.

*Butterscotch*

We also generate advertising and other revenue through two ad-supported content sites, butterscotch.com and tu cows.com.

Butterscotch.com derives revenue from banner and text advertising on the site, as well as from video advertising and product placement within the videos that make up the bulk of the site. In addition, revenue is earned through custom video production for technology manufacturers and Internet services customers.

Tucows.com advertising revenue is generated from third-party advertisers and from software developers who rely on us as a primary source of distribution. Software developers use our Author Resource Center to submit their products for inclusion on our site and to purchase promotional placement of their software. Software developers may also purchase other promotional services on a cost-per-click or flat rate basis. Software developers are able to promote their software through advertising services including keyword search placements, banners, promotional placements, expedited reviews and premium data services. Revenue is also generated from companies that contract with us to provide them with co-branded content.

Advertising and other revenue is recognized ratably over the period in which it is presented. To the extent that we do not meet the minimum number of post-presentation impressions that we guarantee to customers, we defer recognition of the corresponding revenues until the guaranteed impressions are achieved. Custom video production revenue is recognized on acceptance of the completed video by the customer.

### **Critical Accounting Policies**

The following is a discussion of our critical accounting policies and methods. Critical accounting policies are defined as those that are both important to the portrayal of our financial condition and results of operations and are reflective of significant judgments and uncertainties made by management that may result in materially different results under different assumptions and conditions. Note 2 to the consolidated financial statements for the year ended December 31, 2009, or Fiscal

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2009, includes further information on the significant accounting policies and methods used in the preparation of our consolidated financial statements.

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

**Revenue recognition policy**

We earn revenues from the following services;

- OpenSRS (Domain, Email and Other Services);
  
- YummyNames;
  
- Hover; and
  
- Butterscotch.

With respect to the sale of domain registrations and other Internet services, we earn registration fees in connection with each new, renewed and transferred-in registration and from providing provisioning services to resellers and registrars on a monthly basis. We also enter into revenue arrangements in which a reseller may purchase a combination of services (multiple element arrangements). When fair value exists for all elements, we allocate revenue to each element based on the relative fair value of each of the elements. Fair value is established by the price charged when that element is sold separately. For arrangements where fair value exists only for the undelivered elements, we defer the fair value of the undelivered elements and recognize the difference between the total arrangement fee and the amount deferred for the undelivered items as revenue related to the delivered items, assuming all other criteria for revenue recognition have been met. Payments for the full term of all services, or billed revenue, are received at the time of activation of service and where appropriate are recorded as deferred revenue and are recognized as earned ratably over the term of provision of service. This accounting treatment reasonably approximates a recognition pattern that corresponds with the provision of the services during the quarters and the year.

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

We also generate advertising and other revenue through our online libraries of shareware, freeware and online services presented at our websites, [tucows.com](http://tucows.com) and [butterscotch.com](http://butterscotch.com). Advertising and other revenue is recognized ratably over the period in which it is presented. To the extent that the minimum number of post-presentation impressions we guarantee to customers is not met, we defer recognition of the corresponding revenues until the guaranteed impressions are achieved. Custom video production revenue is recognized on acceptance of the completed video by the customer.

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

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

We establish reserves for possible uncollectible accounts receivable and other contingent liabilities which may arise in the normal course of business. The allowance for doubtful accounts is calculated by taking into account factors such as our historical collection and write-off experience, the number of days the customer is past due and the status of the customer's

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account with respect to whether or not the customer is continuing to receive service. The contingent liability estimates are based on management's historical experience and various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the reported amounts of liabilities and expenses that are not readily apparent from other sources. Historically, credit losses have been within our expectations and the reserves we have established have been appropriate. However, we have, on occasion, experienced issues which have led to accounts receivable not being fully collected. Should these issues occur more frequently, additional reserves may be required.

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

Goodwill represents the excess of purchase price over the fair values assigned to the net assets acquired in business combinations. Intangible assets consist of acquired technology, brand, customer relationships, non-competition agreements, surname domain names and direct navigation domain names. Intangible assets, which include technology, brand value, customer relationships and non-competition arrangements related to the acquisition of Boardtown Corporation in April 2004, the acquisition of the Hosted Messaging Business of Critical Path, Inc. in January 2006, the acquisition of Mailbank.com Inc. in June 2006 and the acquisition of Innerwise, Inc. in July 2007, are being amortized on a straight-line basis over periods of two to seven years.

Goodwill and indefinite life intangibles are not be amortized, but are tested for impairment annually or more frequently if circumstances indicate potential impairment, through a comparison of fair value to carrying amount. Goodwill and indefinite life intangibles are tested for impairment annually at the same time every year, and when an event occurs or circumstances change such that it is reasonably possible that impairment may exist. We review goodwill and indefinite life intangibles at least annually for possible impairment in the fourth quarter of each year.

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

With regards to property, equipment and definite life intangible assets, we continually evaluate whether events or circumstances have occurred that indicate the remaining estimated useful lives of its definite-life intangible assets may warrant revision or that the remaining balance of such assets may not be recoverable. We use an estimate of the related undiscounted cash flows over the remaining life of the asset in measuring whether the asset is recoverable. There was no impairment recorded on definite-life intangible assets and property and equipment during the three months ended March 31, 2010 or during the three months ended March 31, 2009.

Determining the number of reporting units and the fair value of a reporting unit requires us to make judgments and involves the use of significant estimates and assumptions. These estimates and assumptions include revenue growth rates and operating margins used to calculate projected future cash flows, risk-adjusted discount rates, future economic and market conditions, and determination of appropriate market comparables. We base our fair value estimates on assumptions we believe to be reasonable but that are unpredictable and inherently uncertain. The long-term financial forecast represents the best estimate that we have at this time and we believe that its underlying assumptions are reasonable. However, actual performance in the near-term and longer-term could be materially different from these forecasts, which could impact future estimates of fair value of our reporting units and may result in a charge to earnings in future periods due to the potential for a write-down of goodwill in connection with such tests.



**Accounting for income taxes**

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

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

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

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

Table of Contents**RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED MARCH 31, 2010 AS COMPARED TO THE THREE MONTHS ENDED MARCH 31, 2009**

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

	<b>Three months ended March 31,</b>	
	<b>2010</b>	<b>2009</b>
OpenSRS :		
Domain Services	\$ 15,403,010	\$ 14,202,023
Email Services	638,188	1,121,935
Other Services	1,093,711	1,094,460
Total OpenSRS Services	17,134,909	16,418,418
YummyNames	1,711,321	1,865,033
Hover	1,129,497	1,300,584
Butterscotch	469,426	507,389
	\$ 20,445,153	\$ 20,091,424
Increase over comparative period	\$ 353,729	
Increase - percentage		2%

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

	<b>Three months ended March 31,</b>	
	<b>2010</b>	<b>2009</b>
OpenSRS :		
Domain Services	76%	71%
Email Services	3%	6%
Other Services	5%	5%
Total OpenSRS Services	84%	82%
YummyNames	8%	9%
Hover	6%	6%
Butterscotch	2%	3%
	100%	100%

Deferred revenue from domain name registrations and other services at March 31, 2010 increased to \$59.5 million from \$56.7 million at March 31, 2009.

No customer accounted for more than 10% of revenue during the three months ended March 31, 2010 and, at March 31, 2010, two customers accounted for 32% of accounts receivable. Significant management judgment is required at the time of recording of revenue to assess whether the collection of the resulting receivables is reasonably assured. On an ongoing basis we assess the ability of our customers to make required payments. Based on this assessment, we expect the carrying amount of our outstanding receivables, net of allowance for doubtful accounts, to be fully collected.

*OpenSRS*

Net revenues from OpenSRS services for the three months ended March 31, 2010 as compared to the three months ended March 31, 2009, increased by \$0.7 million to \$17.1 million.

This increase resulted from an increase in domain services of \$1.2 million to \$15.4 million, primarily the result of increased volumes of new clients and retention of existing customers. During the three months ended March 31, 2010, the total new, renewed and transferred-in domain name registrations that we processed increased by 0.2 million to 2.0 million as compared to the three months ended March 31, 2009.

While we anticipate that the number of new, renewed and transferred-in domain name registrations will continue to incrementally increase, the volatility in the market could affect the growth of domain names that we manage. As of March 31, 2010, the total domain names under our management increased by 0.4 million to 8.3 million, as compared to the total domain names under our management as of March 31, 2009. In additio