TUCOWS INC /PA/
Form 10-Q
May 13, 2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

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, 2011

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.
(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 x No o

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 o No o

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

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

As of May 12, 2011, there were 53,455,541 outstanding shares of common stock, no par value, of the registrant.

TUCOWS INC.
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TRADEMARKS, TRADE NAMES AND SERVICE MARKS

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

PART I.
FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements

Tucows Inc.
Consolidated Balance Sheets
(Dollar amounts in U.S. dollars)

	March 31, 2011 (unaudited)	December 31, 2010
Assets		
Current assets:		
Cash and cash equivalents	$4,164,166	$4,205,729
Accounts receivable, net of allowance for doubtful accounts of $65,000 as of March 31, 2011 and December 31, 2010	4,254,800	3,021,995
Prepaid expenses and deposits	2,885,523	2,363,876
Derivative instrument asset, current portion (note 6)	721,256	833,960
Prepaid domain name registry and ancillary services fees, current portion	39,029,239	37,016,871
Income taxes recoverable	485,000	620,000
Total current assets	51,539,984	48,062,431
Prepaid domain name registry and ancillary services fees, long-term portion	12,808,350	12,820,479
Property and equipment	1,430,242	1,552,349
Deferred financing charges	11,200	15,600
Deferred tax asset, long-term portion (note 7)	4,232,000	4,155,600
Intangible assets (note 4)	16,543,926	16,883,401
Goodwill	17,990,807	17,990,807
Total assets	$104,556,509	$101,480,667
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$1,778,092	$1,664,006
Accrued liabilities	1,634,522	1,346,436
Customer deposits	3,868,879	3,960,312
Loan payable, current portion (note 5)	827,322	1,305,883
Deferred revenue, current portion	48,141,934	45,832,374
Accreditation fees payable, current portion	586,290	547,810
Deferred tax liability, current portion (note 7)	1,232,000	1,155,600
Total current liabilities	58,069,039	55,812,421
Deferred revenue, long-term portion	16,747,268	16,738,429
Accreditation fees payable, long-term portion	166,283	168,580
Deferred rent, long-term portion	6,945	-

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; 53,455,691 shares issued and outstanding as of March 31, 2011 and 53,448,591 shares issued and outstanding as of December 31, 2010	11,331,134	11,324,866
Additional paid-in capital	40,772,110	40,700,587
Deficit	(27,376,270)	(28,104,216)
Total stockholders' equity	24,726,974	23,921,237
Total liabilities and stockholders' equity	$104,556,509	$101,480,667

See accompanying notes to unaudited consolidated financial statements

Subsequent events (note 14).

Tucows Inc.
Consolidated Statements of Operations
(Dollar amounts in U.S. dollars)

	Three months ended March 31,	
	2011	2010
	(unaudited)	
Net revenues (note 9)	$22,555,207	$20,445,153
Cost of revenues:		
Cost of revenues	15,695,140	13,731,550
Network expenses (*)	1,262,828	1,193,324
Depreciation of property and equipment	236,681	310,058
Amortization of intangible assets (note 4)	19,290	74,802
Total cost of revenues (note 9)	17,213,939	15,309,734
Gross profit	5,341,268	5,135,419
Operating expenses:		
Sales and marketing (*)	2,024,703	1,862,336
Technical operations and development (*)	1,199,236	1,243,013
General and administrative (*)	1,096,926	815,580
Depreciation of property and equipment	46,187	43,889
Amortization of intangible assets (note 4)	306,990	360,540
Loss (gain) on change in fair value of forward exchange contracts	112,704	(113,973)
Total expenses	4,786,746	4,211,385
Income from operations	554,522	924,034
Other income (expenses):		
Interest (expense) income, net	(11,540)	(39,168)
Other income	323,329	-
Total other income (expenses)	311,789	(39,168)
Income before provision for income taxes	866,311	884,866
Provision for income taxes (note 7)	138,365	316,000
Net income for the period	$727,946	$568,866
Basic earnings per common share (note 8)	$0.01	$0.01
Shares used in computing basic earnings per common share (note 8)	53,437,672	61,265,903
Diluted earnings per common share (note 8)	$0.01	$0.01
Shares used in computing diluted earnings per common share (note 8)	55,747,952	63,338,084

See accompanying notes to consolidated financial statements

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

Cost of revenues	$6,013	$3,628
Sales and marketing	25,333	15,686
Technical operations and development	15,708	14,581
General and administrative	27,277	22,734

See accompanying notes to unaudited consolidated financial statements

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

	Three months ended March 31,	
	2011	2010
Cash provided by (used in):	(unaudited)	
Operating activities:		
Net income for the period	$ 727,946	$ 568,866
Items not involving cash:		
Depreciation of property and equipment	282,868	353,947
Amortization of deferred financing charges	4,400	7,400
Amortization of intangible assets	326,280	435,342
Deferred rent	6,945	-
Disposal of domain names	13,195	7,572
Unrealized loss (gain) in the fair value of forward exchange contracts	112,704	(113,973)
Stock-based compensation	74,331	56,629
Changes in non-cash operating working capital:		
Accounts receivable	(1,232,805)	(875,500)
Prepaid expenses and deposits	(521,647)	(361,702)
Prepaid fees for domain name registry and ancillary services fees	(2,000,239)	(2,615,569)
Income taxes recoverable	135,000	316,000
Accounts payable	253,897	186,569
Accrued liabilities	316,472	(126,804)
Customer deposits	(91,433)	270,799
Deferred revenue	2,318,399	3,204,593
Accreditation fees payable	36,183	64,397
Net cash provided by operating activities	762,496	1,378,566
Financing activities:		
Proceeds received on exercise of stock options	3,460	4,501
Repurchase of common stock	-	(5,212,272)
Repayment of loan payable	(478,561)	(478,561)
Net cash used in financing activities	(475,101)	(5,686,332)
Investing activities:		
Additions to property and equipment	(328,958)	(142,732)
Net cash used in investing activities	(328,958)	(142,732)
Decrease in cash and cash equivalents	(41,563)	(4,450,498)
Cash and cash equivalents, beginning of period	4,205,729	9,632,394
Cash and cash equivalents, end of period	$ 4,164,166	$ 5,181,896
Supplemental cash flow information:		

Interest paid	$	11,589	$	39,276
Supplementary disclosure of non-cash investing activity:				
Property and equipment acquired during the period not yet paid for	$	105,136	$	98,040

See accompanying notes to unaudited consolidated financial statements

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. ORGANIZATION OF THE COMPANY:

Tucows Inc., a Pennsylvania corporation (referred to throughout this report as the “Company”, “Tucows”, “we”, “us” or through similar expressions), together with our consolidated subsidiaries, is a global distributor of Internet services, including domain name registration, security and identity products through digital certificates and email through its global Internet-based 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 other 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, 2011 and the results of operations and cash flows for the interim periods ended March 31, 2011 and 2010. 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, 2010 included in Tucows’ 2010 Annual Report on Form 10-K filed with the SEC on March 22, 2011.

There have been no material changes to our significant accounting policies during the three months ended March 31, 2011 as compared to the significant accounting policies described in our Annual Report on Form 10-K for the fiscal year ended December 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 October 2009, the Financial Accounting Standards Board (“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 have adopted these updates beginning January 1, 2011 and the adoption thereof is not expected to have a material impact on our 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.

A summary of acquired intangible assets for the three months ended March 31, 2011 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, 2010	$ 25,720	$ 519,780	$ 2,133,260	$ 12,125,918	$ 2,078,723	$ 16,883,401
Sale of domain names	—	—	—	(649)	(12,546)	(13,195)
Amortization expense	(19,290)	(41,760)	(265,230)	—	—	(326,280)
Net book value, March 31, 2011	$ 6,430	$ 478,020	$ 1,868,030	$ 12,125,269	$ 2,066,177	$ 16,543,926

5. LOAN PAYABLE:

The Company has credit agreements with the Bank of Montreal that provides it access to the following facilities:

1. a non-revolving, reducing demand loan facility that was used to fund the acquisition of Innerwise, Inc. during 2007, under which $0.8 million was owing as of March 31, 2011. This facility is repayable in equal monthly installments of $159,520 plus interest. The Company can elect to pay interest either at the Bank of Montreal (“BMO”) U.S. Base Rate plus 1.30% or at LIBOR plus 3.25%. The Company has elected to pay interest based on LIBOR plus 3.25%. All interest is payable monthly in arrears as incurred. The Company will continue to make annual cash sweep payments to the Bank based on certain metrics in the Company’s audited financial statements. Based on the anticipated annual cash sweep payment for Fiscal 2010, the Company expects that the remaining balance will be fully repaid by June 2011;

2. a non-revolving, reducing demand loan facility for $2.0 million which can be used to finance the repurchase of the Company’s common shares. As of March 31, 2011, the Company had no borrowings under this credit facility. Any advances under this facility are repayable in equal monthly installments over 60 months plus interest. This facility is subject, following the first draw, to an undrawn aggregate standby fee of 0.20% which is payable quarterly in arrears. The Company can elect to pay interest either at the Bank of Montreal (“BMO”) U.S. Base Rate plus 1.30% or at LIBOR plus 3.25%. All interest is payable monthly in arrears as incurred. This facility requires the Company to make annual cash sweep payments to the Bank based on the Company’s audited financial statements

3. an operating demand loan for $1.0 million to fund operational requirements. As of March 31, 2011, the Company had no borrowings under this credit facility. The Company has agreed to pay any outstanding principal amounts advanced under this facility, plus interest at a rate of BMO U.S. Base Rate plus 1.30%. Interest is payable monthly in arrears. Any borrowings under the facility are expected to fluctuate widely, with periodic clean-up at a minimum on an annual basis. The Company has also agreed to pay to the Bank a monthly monitoring fee of $500. The Operating Demand Loan Facility is payable on demand at any time, at the sole discretion of the Bank, with or without cause; and

4.

a Treasury Risk Management Facility for $3.5 million to be used as a line to fund any settlement risk exposure that may arise from foreign exchange contracts the Company enters into from time to time to mitigate the exchange rate risk on portions of its Canadian dollar exposure. At March 31, 2011, the Company had forward exchange contracts to trade $10.5 million U.S. dollars in exchange for Canadian dollars.

Pursuant to the credit agreements, the Company has agreed to comply with certain customary non-financial covenants regarding maintenance of insurance; payment of taxes; disposition of major assets; compliance with statutes and with environmental standards; reporting requirements; timely provision of notices of default; absence of material judgments; access to books and records; prohibition on assumption of additional debt or guarantee obligations by the Company, subject to certain exceptions for capital expenditures; and prohibition on the payment of dividends.

The non-revolving reducing demand loan facilities also require that the Company complies with the following financial covenants: (i) Maximum Senior Funded Debt to EBITDA of 2.00:1; (ii) Maximum Total Funded Debt to EBITDA of 2.50:1; and (iii) Minimum Fixed Charge Coverage of 1.25:1. Further, the Company’s Maximum Annual Capital Expenditures cannot exceed $3.6 million per year, which will be reviewed on an annual basis. As of and for the period ended March 31, 2011, the Company was in compliance with these covenants.

Principal loan repayments over the next five years are as follows:

Current portion:	
2011	$827,322

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, 2011 was a net unrealized gain of $0.7 million as compared to a net unrealized gain of $0.8 million at December 31, 2010. 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.

At March 31, 2011, 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 2011	$ 3,900,000	0.9635	$ 274,018
July - September 2011	3,900,000	0.9604	278,831
October - December 2011	2,700,000	0.9666	168,407
Total	$ 10,500,000	0.9631	$ 721,256

The Company does not apply hedge accounting and, therefore, for the three months ended March 31, 2011, the Company recorded a loss of $0.1 million in the fair value of forward contracts in its consolidated statements of operations. For the three months ended March 31, 2010, the Company recorded a gain on forward contracts of $0.1 million.

7. INCOME TAXES

For the three months ended March 31 2011, the Company recorded a provision for income taxes of $0.1 million on income before income taxes of $0.9 million, using an estimated effective tax rate for its 2011 fiscal year adjusted for certain foreign exchange losses for which the Company does not anticipate obtaining a current tax benefit. Comparatively, for the three months ended March 31, 2010, the Company recorded a current tax expense of $0.3 million on income before income taxes of $0.9 million, using an estimated effective tax rate for its 2010 fiscal year.

As of December 31, 2010, the Company recorded a valuation allowance of $3.7 million and a net deferred tax asset of $3.0 million. As of March 31, 2011 the Company has recorded a non-current deferred tax asset of $4.2 million and a current deferred tax liability of $1.2 million. As of March 31, 2011 and December 31, 2010, 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.

The Company analyzes the carrying value of its net deferred tax assets 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, 2011, there was no reversal of the valuation allowance. The valuation allowance will be maintained until sufficient evidence exists to support a reversal of 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 had approximately $0.2 million of total gross unrecognized tax benefit as of March 31, 2011and $0.2 million of total gross unrecognized tax benefit as of December 31, 2010, which if recognized would favorably affect our income tax rate in future periods. The unrecognized tax benefit relates primarily to prior year Pennsylvania state franchise taxes and other insignificant US state taxes as well as an estimate for unrecognized tax benefits for 2010 research and development tax credits. 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 as of March 31, 2011 and December 31, 2010, respectively. The Company believes it is reasonably possible that all 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, certain other prior year state tax returns will be filed and the 2010 Canadian research and development claim will be filed and assessed.

8. BASIC AND DILUTED EARNINGS PER COMMON SHARE:

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

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

		Three months ended March 31, 2011		Three months ended March 31, 2010
Numerator for basic and diluted earnings per common share:				
Net income for the period	$	727,946	$	568,866
Denominator for basic and diluted earnings per common share:				
Basic weighted average number of common shares outstanding		53,437,672		61,265,903
Effect of outstanding stock options		2,310,280		2,072,181
Diluted weighted average number of shares outstanding		55,747,952		63,338,084
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, 2011, outstanding options to purchase 2,572,500 shares were not included in the computation of diluted income per common share because all such options had exercise prices greater than the average market price of the common shares and as a result are considered anti-dilutive. During the three months ended March 31, 2010, outstanding options to purchase 1,374,967 common shares were not included in the computation of diluted income per common share because all such options had exercise prices greater than the average market price of the common shares

The computation of earnings per share and diluted earnings per share for the three months ended March 31, 2010 include reductions in the number of shares outstanding due to these purchases (see note 11).

9. SUPPLEMENTAL INFORMATION:

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

	Three months ended March 31,	
	2011	2010
OpenSRS :		
Domain Services	$ 17,540,380	$ 15,403,010
Email Services	685,267	638,188
Other Services	1,234,916	1,093,711
Total OpenSRS Services	19,460,563	17,134,909
YummyNames	1,392,381	1,711,321
Hover	1,195,056	1,129,497
Butterscotch	507,207	469,426
	$ 22,555,207	$ 20,445,153

No customer accounted for more than 10% of the Company's revenue for the three months ended March 31, 2011 or the three months ended March 31, 2010. Significant management judgment is required at the time revenue is recorded to assess whether the collection of the resulting receivables is reasonably assured. On an ongoing basis, we assess the ability of our customers to make required payments. Based on this assessment, we expect the carrying amount of our outstanding receivables, net of allowance for doubtful accounts, to be fully collected.

As of March 31, 2011, one customer accounted for 12% of accounts receivable. As of March 31, 2010, two customers accounted for 32% of accounts receivable.

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

	Three months ended March 31,	
	2011	2010
OpenSRS :		
Domain Services	$ 14,572,871	$ 12,616,231
Email Services	102,534	107,138
Other Services	399,644	387,123
Total OpenSRS Services	15,075,049	13,110,492
YummyNames	177,914	202,754
Hover	419,295	399,445
Butterscotch	22,882	18,859
Network, other costs	1,262,828	1,193,324
Network, depreciation and amortization costs	255,971	384,860
	$ 17,213,939	$ 15,309,734

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

	March 31, 2011	December 31, 2010
Canada	$ 980,701	$ 1,041,692

United States		449,541		510,657
	$	1,430,242	$	1,552,349

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, 2011 cannot be predicted with certainty, management believes that their resolution will not have a material adverse effect on the Company's financial position.

11. STOCKHOLDERS' EQUITY:

The following unaudited table summarizes stockholders' equity transactions for the three month period ended March 31, 2011:

	Common stock		Additional paid in capital	Deficit	Total stockholders' equity
	Shares	Amount			
Balances, December 31, 2010	53,448,591	$ 11,324,866	$ 40,700,587	$ (28,104,216)	$ 23,921,237
Exercise of stock options	7,250	6,268	(2,808)	—	3,460
Stock-based compensation	—	—	74,331	—	74,331
Cancellation of restricted stock	(150)	—	—	—	—
Net income for the period	—	—	—	727,946	727,946
Balances, March 31, 2011	53,455,691	$ 11,331,134	$ 40,772,110	$ (27,376,270)	$ 24,726,974

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

	Common stock		Additional paid in capital	Deficit	Total stockholders' equity
	Number	Amount			
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
Issuance of restricted stock	—	—	—	—	—
Cancellation of restricted stock	(500)	—	—	—	—
Net income for the period	—	—	—	568,866	568,866
	59,792,816	$ 12,579,210	$ 43,587,383	$ (29,652,298)	$ 26,514,295

Balances, March 31, 2010

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 where 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.

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.

The Company’s Amended and Restated 2006 Equity Compensation Plan (the “2006 Plan”), serves as a successor to the 1996 Plan. The 2006 Plan was established for the benefit of the employees, officers, directors and certain consultants of the Company. The Plan was amended and restated at the Annual General Meeting of the Stockholders on September 7, 2010 to extend the term thereof to September 6, 2020 and to increase the number of shares of common stock authorized for issuance thereunder from 5,000,000 to 6,900,000. The 6,900,000 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, 2011 or March 31, 2010

Details of stock option transactions for the three months ended March 31, 2011 and March 31, 2010 are as follows:

	Three months ended March 31, 2011		Three months ended March 31, 2010	
	Number of shares	Weighted average exercise price per share	Number of shares	Weighted average exercise price per share
Outstanding, beginning of period	8,272,249	$ 0.56	7,203,977	$ 0.56
Exercised	(7,250)	0.48	(10,433)	0.43
Forfeited	(10,250)	0.71	(15,000)	0.64
Expired	—	—	(383,374)	0.98
Outstanding, end of period	8,254,749	$ 0.56	6,795,170	$ 0.53
Options exercisable, end of period	6,436,499	$ 0.52	5,942,169	$ 0.51

As of March 31, 2011, the exercise prices, weighted average remaining contractual life and intrinsic values of outstanding options were as follows:

	Options outstanding				Options exercisable		
Exercise price	Number outstanding	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	3,680,295	$ 0.38	2.3	$ 1,722,356	3,680,295	$ 0.38	$ 1,722,356
$0.56-$0.71	3,446,954	$ 0.64	4.7	720,998	1,631,204	$ 0.60	412,710
$0.80-$0.99	1,127,500	$ 0.86	2.8	4,650	1,125,000	$ 0.86	4,650
	8,254,749	$ 0.56	3.4	$ 2,448,004	6,436,499	$ 0.52	$ 2,139,716

Total unrecognized compensation cost relating to unvested stock options at March 31, 2011, prior to the consideration of expected forfeitures, was approximately $519,000 and is expected to be recognized over a weighted average period of 2.7 years.

The Company recorded stock-based compensation of $74,172 and $56,436 for the three months ended March 31, 2011 and 2010, respectively.

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

(b) Restricted stock awards

During the three months ended March 31, 2011, 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 have full stockholder 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 has 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, 2011, prior to the consideration of expected forfeitures, was approximately $2,000 and is expected to be recognized over a weighted average period of 2.0 years.

The Company recorded stock-based compensation associated with restricted stock awards of $159 and $193 for the three months ended March 31, 2011 and 2010, respectively.

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.

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 at March 31, 2011:

	March 31, 2011			
	Fair Value Measurements Using			Assets at
	Level 1	Level 2	Level 3	Fair Value
Derivative instrument asset	$ —	$ 721,256	$ —	$ 721,256
Total Assets	$ —	$ 721,256	$ —	$ 721,256

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, 2010:

	December 31, 2010			
	Fair Value Measurements Using			Assets at
	Level 1	Level 2	Level 3	Fair Value
Derivative instrument asset	$ —	$ 833,960	$ —	$ 833,960
Total Assets	$ —	$ 833,960	$ —	$ 833,960

14. SUBSEQUENT EVENTS

During May 2011, the Company entered into foreign exchange forward contracts relating to a portion of its 2012 fiscal year expected Canadian dollar requirements. These contracts have a notional value of $2.4 million, whereby $0.3 million is converted into Canadian dollars during 2012 at an average foreign exchange rate of US$1.00: Cdn$0.9674.

15. 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 ot 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 number of new, renewed and transferred-in domain names we register as our business develops and competes; the effect of a potential gTLD expansion by the Internet Corporation for Assigned Names and Numbers ("ICANN") on the number of domains we register and the impact it may have on related revenues; our belief that the market for domain name registration will trend upward gradually and may be affected by market volatility; our belief that, by increasing the number of services we offer, we will be able to generate higher revenues; the revenue that our parked page vendor relationships may generate in the future, the effectiveness of our intellectual property protection, including our ability to license proprietary rights to network partners and to register additional trademarks and service marks; the potential impact of current and pending claims on our business; our valuations of certain deferred tax assets, our expectation to collect our outstanding receivables, net of our allowance for doubtful accounts; our expectation regarding fluctuations in certain expense and cost categories; our expectations regarding future revenue from our patent assignments; our expectations regarding our unrecognized tax benefit and the timing or completion of certain audits of our US tax returns; our expectations regarding cash from operations to fund our business; and our belief that a slowing economy may lead to a decrease in advertising spending. These statements are based on management's current expectations and are subject to a number of uncertainties and risks that could cause actual results to differ materially from those described in the forward-looking statements. Many factors affect our ability to achieve our objectives and to successfully develop and commercialize our services including:

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

Our ability to maintain a good working relationship with our vendors and customers;

The ability of vendors to continue to supply our needs;

Actions by our competitors;

Our ability to achieve gross profit margins at which we can be profitable;

Our ability to attract and retain qualified personnel in our business;

Our ability to effectively manage our business;

Our ability to obtain and maintain approvals from regulatory authorities on regulatory issues;

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, 2010.

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 11,000 resellers in over 100 countries who typically provide their customers, the end-users of the Internet, with a critical component for establishing and maintaining an online presence. Our primary focus is serving the needs of this network of resellers by providing superior services, easy-to-use interfaces, proactive and attentive customer service, reseller-oriented technology and agile design and development processes. We seek to provide superior customer service to our resellers by anticipating their business needs and technical requirements. This includes providing easy-to-use interfaces that enable resellers to quickly and easily integrate our services into their individual business processes, and offering brandable end-user interfaces that emphasize simplicity and visual appeal. We also provide “second tier” support to our resellers by email and phone in the event resellers experience issues or problems with our services. In addition, our Network Operations Center provides proactive support to our resellers by monitoring all services and network infrastructure to address deficiencies before customer services are impacted.

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

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

OpenSRS, our wholesale service, manages eleven million domain names, under its accreditation by the Internet Corporation for Assigned Names and Numbers, or ICANN, 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 11,000 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 42,000 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 4,500 videos and over 400,000 software and mobile listings and articles. Additionally, Butterscotch provides custom video production services for technology manufacturers and ISPs.

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 ten million domains under our ICANN accreditation, as well as names we manage for other registrars under their own accreditations.

For the three months ended March 31, 2011 and 2010, we reported revenue of $22.6 million and $20.4 million, respectively. For the three months ended March 31, 2011 and 2010, our OpenSRS domain service offering accounted

for 79% and 76% of our total revenue, respectively.

KEY BUSINESS METRICS

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

	Three months ended March 31,(1)	
	2011	2010
	(in 000's)	
Total new, renewed and transferred-in domain name registrations provisioned	2,062	1,950
Domain names under management		
Provisioned on behalf of Tucows	9,590	8,307
Provisioned on behalf of accredited registrars	1,403	1,699
Total domain names under management	10,993	10,006

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

OPPORTUNITIES, CHALLENGES AND RISKS

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

Our direct costs to register domain names on behalf of our customers are almost exclusively controlled by registries such as Verisign and by ICANN. Verisign provides all the registry services operations for the .com, .net, .cc, .tv, and .name domain names. ICANN is a private sector, not-for-profit corporation formed to oversee a number of Internet related tasks, including domain registrations for which it collects fees. The market for wholesale registrar services is both price sensitive and competitive, particularly for large volume customers, such as large web hosting companies and owners of large portfolios of domain names. We have a relatively limited ability to increase the pricing of domain name registrations without negatively impacting our ability to maintain or grow our customer base.

In 2007, we entered into contractual agreements with Verisign for the supply of domain names. These agreements expire in 2012. Under the agreements, Verisign charges a fee for .com and .net domain names of $7.34 and $5.40 respectively, for each year for which a domain name is registered. In addition, in terms of Verisign's agreement with ICANN, Verisign has the right to increase the fee it charges for a .com or .net domain name by up to an additional 7% once in either 2011 or 2012. Mandated registry price increases such as this will adversely increase our service costs as a percentage of our total revenue. To implement this price increase however, Verisign is required to give registrars six months' notice.

In 2009, our contractual agreement with ICANN was amended to extend the terms of the agreement through June 30, 2014. Under the agreement, ICANN charges a $0.18 fee for each year that a domain name is registered in the TLDs

that fall within its purview. In addition, ICANN is currently deliberating on the timing and framework for a potentially significant expansion of the number of generic TLDs, or gTLDs. Although there can be no assurance that any gTLD expansion will occur, we believe that such expansion, if any, should result in an increase in the number of domains we register and related revenues.

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

Display advertising from the desk-top software download site has historically been the largest source of Butterscotch revenue. This revenue stream has suffered from the secular shift away from desktop software. Recently, we have experienced an increase in video advertising and corporate video revenue as advertisers continue to migrate their advertising spend towards more content rich websites such as Butterscotch.com. A portion of this increase was from larger video contracts which may not be repeatable. In addition, to reach a wider audience of consumers, Butterscotch has refocused its efforts towards mobile technology. We believe that these initiatives present us with a potentially larger long-term revenue opportunity. However, if our marketing efforts with the above initiatives, together with other initiatives we take to grow our revenue and our page views, are not successful in offsetting any decline we experience in display advertising from the desk-top software download site, in the short term, may result in a decline in Butterscotch revenue.

Net Revenues

OpenSRS

We derive revenue from our reseller network by providing them with reseller services that comprise (a) domain service, (b) email service and (c) other services. From time to time we receive fees from vendors to expand or maintain the market position for their services. These market development funds are recognized as earned and are reflected under other services. In the case where these programs do not meet the criteria for revenue recognition under ASC 605-50 “Customer Payments and Incentives”, they are reflected as cost of goods sold. Additionally, other services include revenue from secure sockets layer, or SSL certificates sales, as well as revenue from the sale of 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

Historically, our OpenSRS domain service has constituted the largest portion of our business and encompasses all of our services as an accredited registrar related to the registration, renewal, transfer and management of domain names. In addition, this service fuels other revenue categories as it often is the initial service for which a 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, 2011, we offer registration services for the generic top-level domain (“gTLDs”) .com, .net, .org, .info, .name, .biz, .tel, .mobi and .asia and for the country code top-level domains (“ccTLDs”) .at, .au, .be, .bz, .ca, .co, .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, our pricing structure for domain names provides visibility into the various fees that make up the cost of a domain name by breaking out the cost of the registry and ICANN fees separately from our management fee. Effective July 2010, registry fees for the .com and .net registrations supplied by our largest registry supplier, Verisign, were increased by an additional 7%. This increase in registry fees, in accordance with our pricing policy, was passed on to our customers at cost. 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 are 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 solution 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. From time to time, we also receive fees from vendors to expand or maintain the market position for their services. These market development funds are earned as incurred and are reflected under other services revenue. Any accrued market development funds are offset against accounts receivable. 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 (“parked page vendors”).

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

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

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

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

Hover sells retail Internet domain name registration and email services to individuals and small businesses via its website at http://hover.com. These services include the sale of personalized email through Tucows' portfolio of surname-based domain names as well as simplified interfaces that allow customers to connect their domain names to websites and email addresses through a unique domain forwarding system.

Our customers purchase services in one to ten year terms, with a majority of services purchased for a one-year term. Payments for the full term of all services 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 tucows.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, 2010, or Fiscal 2010, includes further information on the significant accounting policies and methods used in the preparation of our consolidated financial statements.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate the application of these estimates, including those related to the 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 are received at the time of activation of service and where appropriate are recorded as deferred revenue and are recognized as earned ratably over the term of provision of service. This accounting treatment reasonably approximates a recognition pattern that corresponds with the provision of the services during the quarters and the year.

Revenue from the sale of domain names, through YummyNames, 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 and 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 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 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 as more fully described under the caption "Critical Accounting Policies" in our Annual Report on Form 10-K for the fiscal year ended December 31, 2010.

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, 2011 or during the three months ended March 31, 2010.

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 as more fully described under the caption “Critical Accounting Policies” in our Annual Report on Form 10-K for the fiscal year ended December 31, 2010. 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.

Any changes to our key assumptions about our businesses and our prospects, or changes in market conditions, could cause the fair value of our reporting unit to fall below its carrying value, resulting in a potential impairment charge. In addition, changes in our organizational structure or how our management allocates resources and assesses performance, could result in a change in our operating segments or reporting units, requiring a reallocation and updated impairment analysis of goodwill. A goodwill or intangible asset impairment charge could have a material effect on our consolidated financial statements because of the significance of goodwill and intangible assets to our consolidated balance sheet. As of March 31, 2011, we had $18.0 million and $16.5 million, respectively, in goodwill and intangible assets.

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.

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.

RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED MARCH 31, 2011 AS COMPARED TO THE THREE MONTHS ENDED MARCH 31, 2010

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

	Three months ended March 31,	
	2011	2010
OpenSRS :		
Domain Services	$ 17,540,380	$ 15,403,010
Email Services	685,267	638,188
Other Services	1,234,916	1,093,711
Total OpenSRS Services	19,460,563	17,134,909
YummyNames	1,392,381	1,711,321
Hover	1,195,056	1,129,497
Butterscotch	507,207	469,426
	$ 22,555,207	$ 20,445,153
Increase over comparative period	$ 2,110,054	
Increase - percentage	10 %	

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

	Three months ended March 31,	
	2011	2010
OpenSRS :		
Domain Services	79 %	76 %
Email Services	3 %	3 %
Other Services	5 %	5 %
Total OpenSRS Services	87 %	84 %
YummyNames	6 %	8 %
Hover	5 %	6 %
Butterscotch	2 %	2 %
	100 %	100 %

Deferred revenue from domain name registrations and other services at March 31, 2011 increased to $64.9 million from $59.5 million at March 31, 2010.

No customer accounted for more than 10% of revenue during the three months ended March 31, 2011 and, at March 31, 2011, one customer accounted for 12% of accounts receivable. Significant management judgment is required at the time revenue is recorded to assess whether the collection of the resulting receivables is reasonably assured. On an ongoing basis we assess the ability of our customers to make required payments. Based on this assessment, we expect the carrying amount of our outstanding receivables, net of allowance for doubtful accounts, to be fully collected.

OpenSRS

For the three months ended March 31, 2011, OpenSRS revenue increased by $2.3 million, or 14%, to $19.5 million when compared to the three months ended March 31, 2010, primarily as a result of OpenSRS domain revenue

increasing by $2.1 million or 14% to $17.5 million. This increase resulted primarily from the impact of passing on the 7% registration fee increase implemented in July 2010 for registration fees paid to certain registries and from our success in attracting customers with increased transaction volumes. In addition, email revenue increased by $0.1 million or 7% to $0.7 million and other services increased by $0.1 million or 13% to $1.2 million as a result of market development funds vendors have provided us to expand or maintain the market position for their services. Other service increases may not be repeatable as our vendor partners may elect to cancel or amend their marketing programs at any time.

During the three months ended March 31, 2011, the number of transactions from all new, renewed and transferred-in domain name registrations that we processed increased by 0.1 million transactions to 2.1 million transactions as compared to the three months ended March 31, 2010. While we anticipate that the number of new, renewed and transferred-in domain name registrations will continue to incrementally increase in the long term, the volatility in the market could affect the growth of domain names that we manage. In addition, new TLDs, including new IDN TLDs, ccTLDs and gTLDs, may be introduced by ICANN in 2011 and/or 2012. We cannot assess the impact, if any; the introduction of these new TLDs will have on our revenues and results of operations. See “Item 1A Risk Factors” in our Annual Report on Form 10-K for the fiscal year ended December 31, 2010.

As of March 31, 2011, the total domain names under our management increased by 1.3 million to 9.6 million, when compared to March 31, 2010. In addition, we provide provisioning services on a monthly basis to accredited registrars who use our technical systems to process domain registrations with their own accreditation. As of March 31, 2011, we managed 1.4 million domain names on behalf of other accredited registrars, a decrease of 0.3 million compared to the 1.7 million managed for accredited registrars as of March 31, 2010. The decrease is primarily attributable to the loss of an accredited registrar who had 0.3 million domains under management with us who have transferred their domain registration business to a competitive registrar with whom they have a reciprocal supply arrangement.

YummyNames

Net revenues from our YummyNames domain portfolio service for the three months ended March 31, 2011 as compared to the three months ended March 31, 2010 decreased by $0.3 million, or 19%, to $1.4 million.

During the three months ended March 31, 2011, we earned $1.1 million by making domain names in our portfolio available for sale or lease compared to $1.3 million during the three months ended March 31, 2010. In addition we earned $0.3 million from our pay-per-click advertising or parked pages program during the three months ended March 31, 2011 compared to $0.4 million for the three months ended March 31, 2010.

The decrease in portfolio sales primarily reflects the timing of portfolio domain names sales and the decreased contribution we receive from third-parties on the delivery of advertisements on parked pages as a result of changes parked page vendors have experienced from their advertising network partners.

The market for monetization of domain names is rapidly evolving and there is no guarantee that we will be able to continue to acquire the same caliber of names for our portfolio from future expiring domains or that names we acquire in future will provide the same revenue impact as we have experienced from past acquisitions. In addition, the revenue we derive from domain portfolio services is driven by general macroeconomic factors that affect internet advertising. Our advertising revenues are typically sensitive to economic conditions and tend to decline in recessionary periods and other periods of economic uncertainty.

Hover

Net revenues from Hover for the three months ended March 31, 2011 as compared to the three months ended March 31, 2010 increased by $0.1 million, or 6%, to $1.2 million. This increase reflects the success our marketing initiatives and improved website are having on our ability to attract new customers and retain existing ones.

This increase was offset in part by our de-emphasizing new customer acquisitions while we were undertaking the redevelopment of our website and the transition of our retail customers from our Domain Direct, NetIdentity and IYD services to Hover, which resulted in deferred revenue growth being muted. This quarter, however, Hover cash receipts have grown faster than revenue being recognized from prior periods by $0.4 million and is indicative of a return to a growth trend for Hover deferred revenue.

During the three months ended March 31, 2011, the success of our marketing programs have however resulted in cash receipts growing faster than revenue being recognized from prior periods. Consequently, Hover deferred revenue at March 31, 2011 has resumed a growth trend.

Butterscotch

Net revenues from Butterscotch for the three months ended March 31, 2011 were $0.5 million, unchanged from the three months ended March 31, 2010, as increases in revenue from video advertising and corporate video revenue were offset by decreases in revenue from display advertising from the Tucows.com desk-top software libraries (which historically has been the largest source of Butterscotch revenue) and our Author Resource Center. These decreases reflect what we believe is a current preference of advertisers for more content rich websites. In addition, Ad Sense revenues continue to decline as a result of Google's elimination of their enterprise level AdSense program. A portion of the increase in video advertising and corporate video revenues was generated by larger video contracts, which may not recur.

COST OF REVENUES

OpenSRS

OpenSRS Domain Service

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

OpenSRS Email Service

Cost of revenues for email services are payable to third-party providers for licensing and royalty costs related to the provision of certain components of our email services. Fees payable for these components are included in the cost of revenues in the month they are incurred.

Other OpenSRS Services

Costs of revenues for other reseller services include fees paid to third-party service providers, primarily for SSL certificates and for printing services in connection with Platypus. Fees payable for SSL certificates are amortized on a basis consistent with the provision of service, generally one year, while monthly printing fees are included in cost of revenues in the month they are incurred.

YummyNames

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

Hover

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

Butterscotch

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

General

As a significant portion of our expenses are incurred in Canadian dollars, the strengthening of the Canadian dollar relative to the U.S. dollar has negatively impacted operating expenses during the three months ended March 31, 2011 when compared to the three months ended March 31, 2010. Exchange rates are, however, subject to significant and rapid fluctuations, and therefore we cannot predict the prospective impact of exchange rate fluctuations on our business, results of operations and financial condition.

Network costs

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

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

	Three months ended March 31,	
	2011	2010
OpenSRS :		
Domain Services	$ 14,572,871	$ 12,616,231
Email Services	102,534	107,138
Other Services	399,644	387,123
Total OpenSRS Services	15,075,049	13,110,492
YummyNames	177,914	202,754
Hover	419,295	399,445
Butterscotch	22,882	18,859
Network, other costs	1,262,828	1,193,324
Network, depreciation and amortization costs	255,971	384,860
	$ 17,213,939	$ 15,309,734
Increase over comparative period	$ 1,904,205	
Increase - percentage	12 %	

The following table presents our cost of revenues, as a percentage of total revenues:

	Three months ended March 31,	
	2011	2010
OpenSRS :		
Domain Services	64 %	62 %
Email Services	0 %	0 %
Other Services	2 %	2 %
Total OpenSRS Services	66 %	64 %
YummyNames	1 %	1 %
Hover	2 %	2 %
Butterscotch	0 %	0 %
Network, other costs	6 %	6 %
Network, depreciation and amortization costs	1 %	2 %
	76 %	75 %
Percentage of net revenues	76 %	75 %

Total cost of revenues for the three months ended March 31, 2011 increased by $1.9 million, or 12%, to $17.2 million from $15.3 million for the three months ended March 31, 2010. We expect cost of sales to increase as a result of transactional volumes and the competitive and general business environment during Fiscal 2011. Prepaid domain registration and other Internet services fees as of March 31, 2011 increased by $5.5 million, or 12%, to $51.8 million from $46.3 million at March 31, 2010.

OpenSRS

Costs for OpenSRS for the three months ended March 31, 2011 increased by $2.0 million, or 15%, to $15.1 million, when compared to the three months ended March 31, 2010.

This increase was primarily the result of increased domain registration volumes and increases in registration fees paid to the registries that were implemented in July 2010 experienced during the three months ended March 31, 2011 when compared to the three months ended March 31, 2010. This increase was partially offset by an amount of $0.2 million being market development funds that we received from a vendor.

YummyNames

Costs for YummyNames for the three months ended March 31, 2011 as compared to the three months ended March 31, 2010 remained relatively flat at $0.2 million and primarily reflects the timing of portfolio domain names sales.

Hover

Costs for Hover for the three months ended March 31, 2011 as compared to the three months ended March 31, 2010 remained relatively flat at $0.4 million.

As more fully described under Hover revenue, the success that our marketing initiatives have had on our ability to attract new customers and retain existing ones has resulted in Hover deferred costs resuming a growth trend during the three months ended March 31, 2011. As part of our marketing initiatives, however, we have simplified our pricing model, which has resulted in a slight decline in our gross margin as a percentage of revenue. Deferred costs have thus grown at a slightly faster rate than deferred revenue which will negatively impact our gross margin in future periods as these costs are recognized from prior periods.

Network costs

Network costs before depreciation and amortization for the three months ended March 31, 2011 increased by $0.1 million, to $1.3 million, when compared to the three months ended March 31, 2010, despite the significant strengthening, on average, of the Canadian dollar relative to the U.S. dollar by approximately 6% as compared to the three months ended March 31, 2010, and reflects our improved efficiency in operating and managing our co-location facilities.

Network depreciation and amortization costs for the three months ended March 31, 2011 decreased by $0.1 million to $0.3 million primarily as a result of our being able to decrease our capital spend on network equipment.

A significant portion of our operating and network expenses are incurred in Canadian dollars. As a result, the strengthening of the Canadian dollar relative to the U.S. dollar has negatively impacted all of our operating costs, during the three months ended March 31, 2011 when compared to the three months ended March 31, 2010. Exchange rates are, however, subject to significant and rapid fluctuations, and we therefore cannot predict the prospective impact of exchange rate fluctuations on our business, results of operations and financial condition.

SALES AND MARKETING

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

	Three months ended March 31,			
	2011		2010	
Sales and marketing	$ 2,024,703		$ 1,862,336	
Increase over comparative period	$ 162,367			
Increase - percentage	9	%		
Percentage of net revenues	9	%	9	%

Sales and marketing expenses for the three months ended March 31, 2011 increased by $0.2 million or 9% $2.0 million when compared to the three months ended March 31, 2010. This increase was primarily due to higher

workforce costs that resulted from additional people employed in both our marketing and customer service areas, additional marketing expenses incurred in attending additional trade shows, as well as the negative impact of the approximately 6% strengthening, on average, in the Canadian dollar relative to the U.S. dollar compared to the three months ended March 31, 2010.

TECHNICAL OPERATIONS AND DEVELOPMENT

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

	Three months ended March 31,			
	2011		2010	
Technical operations and development	$ 1,199,236		$ 1,243,013	
(Decrease) increase over comparative period	$ (43,777)			
(Decrease) increase - percentage	(4)	%		
Percentage of net revenues	5	%	6	%

Technical operations and development expenses for the three months ended March 31, 2011 remained relatively flat at $1.2 million when compared to the three months ended March 31, 2010, primarily due to the productivity improvements that have resulted from our adoption of an agile development model, which deploys our development, quality assurance, product management and operations employees into smaller teams, offsetting the approximate 6% strengthening, on average, in the Canadian dollar relative to the U.S. dollar when compared to the three months ended March 31, 2010.

GENERAL AND ADMINISTRATIVE

General and administrative expenses consist primarily of compensation and related costs for managerial and administrative personnel, fees for professional services, public listing expenses, rent, foreign exchange and other general corporate expenses.

	Three months ended March 31,			
	2011		2010	
General and administrative	$ 1,096,926		$ 815,580	
Increase over comparative period	$ 281,346			
Increase - percentage	34	%		
Percentage of net revenues	5	%	4	%

General and administrative expenses for the three months ended March 31, 2011 increased by $0.3 million, or 34%, to $1.1 million as compared to the three months ended March 31, 2010. This was primarily as a result of our recording a foreign exchange gain of $0.5 million during the three months ended March 31, 2011 as compared to a foreign exchange gain of $0.6 million during the three months ended March 31, 2010. This gain in foreign exchange was primarily the result of the strengthening, on average, of the Canadian dollar relative to the U.S. dollar by approximately 6% from the three months ended March 31, 2010. This increase was also as a result of an increase in professional fees and workforce related costs of $0.2 million during the three months ended March 31, 2011, as compared to the three months ended March 31, 2010.

DEPRECIATION OF PROPERTY AND EQUIPMENT

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

	Three months ended March 31,			
	2011		2010	
Depreciation of property and equipment	$ 46,187		$ 43,889	
Increase over comparative period	$ 2,298			
Increase - percentage	5	%		
Percentage of net revenues	-	%	-	%

Depreciation costs for the three months ended March 31, 2011 increased by $2,000, or 5%, to $46,000.

During the remainder of Fiscal 2011 we are planning on reconfiguring our Toronto facility to better support our agile teams.

AMORTIZATION OF INTANGIBLE ASSETS

	Three months ended March 31,	
	2011	2010
Amortization of intangible assets	$ 306,990	$ 360,540
Decrease over comparative period	$ (53,550)	
Decrease - percentage	(15)%	
Percentage of net revenues	1%	2%

Amortization of intangible assets consists of amounts arising in connection with the acquisition of Boardtown in April 2004, the acquisition of the hosted messaging assets of Critical Path Inc. in January 2006, the acquisition of Mailbank.com Inc. in June 2006 and the acquisition of IYD in July 2007.

Brand and customer relationships acquired in connection with the acquisition of Boardtown Corporation and IYD are amortized on a straight-line basis over seven years.

Customer relationships acquired in connection with the acquisition of Mailbank.com Inc. and the hosted messaging assets of Critical Path Inc. are each amortized on a straight-line basis over five years.

LOSS (GAIN) ON CHANGE IN FAIR VALUE OF FORWARD EXCHANGE CONTRACTS

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

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

	Three months ended March 31,	
	2011	2010
Loss (gain) on change in fair value of forward contracts	$ 112,704	$ (113,973)
Decrease over comparative period	$ 226,677	
Decrease - percentage	(199)%	
Percentage of net revenues	0%	-1%

We have entered into forward exchange contracts to meet a portion of our future Canadian dollar requirements through November 2011. The impact of the fair value adjustment on unrealized foreign exchange on these contracts for the three months ended March 31, 2011 was a net loss of $0.1 million, as compared to a net gain of $0.1 million for the three months ended March 31, 2010. This net loss in fair value of forward contracts results from a combination of the impact from the change in foreign exchange rates over time, as well as from the impact of the settlement of forward exchange contracts as they mature.

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

OTHER INCOME AND EXPENSES

	Three months ended March 31,	
	2011	2010
Other income (expenses), net	$ 311,789	$ (39,168)
Increase over comparative period	$ 350,957	
Increase - percentage	(896) %	
Percentage of net revenues	1 %	- %

Other income increased by $0.4 million as compared to the three months ended March 31, 2010, to $0.3 million.

As a result of a routine audit undertaken by the third party who is commercializing the Infonautics patents that we assigned to them in 2002, we received an additional payment of $0.3 million in March 2011. As the costs of commercializing the patents have increased, we do not expect any future revenue received to be material.

Other expenses for the three months ended March 31, 2011 also decreased when compared to the three months ended March 31, 2010 as the interest payable pursuant to the terms of our Amended Credit Facility has continued to reduce as a result of the monthly principal payments we have made since March 31, 2010.

INCOME TAXES

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

	Three months ended March 31,	
	2011	2010
Provision for income taxes	$ 138,365	$ 316,000
Decrease over comparative period	$ (177,635)	
Decrease - percentage	(56) %	
Percentage of income before provision for income taxes	16 %	36 %

For the three months ended March 31 2011, we recorded a provision for income taxes of $0.1 million on income before income taxes of $0.9 million, using an estimated effective tax rate for its 2011 fiscal year adjusted for certain foreign exchange losses for which we do not anticipate obtaining a current tax benefit. Comparatively, for the three months ended March 31, 2010, we recorded a current tax expense of $0.3 million on income before income taxes of $0.9 million, using an estimated effective tax rate for its 2010 fiscal year.

As of December 31, 2010, we recorded a valuation allowance of $3.7 million and a net deferred tax asset of $3.0 million. As of March 31, 2011 we have recorded a non-current deferred tax asset of $4.2 million and a current deferred tax liability of $1.2 million. As of March 31, 2011 and December 31, 2010, we have also recorded a non-current deferred tax liability related to the temporary difference arising on indefinite life intangibles of $4.8 million.

We analyze the carrying value of our net deferred tax assets 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, 2011, there was no reversal of the valuation allowance. The valuation allowance will be maintained until sufficient evidence exists to support a reversal of the

valuation allowance.

We 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.

We had approximately $0.2 million of total gross unrecognized tax benefit as of March 31, 2011and $0.2 million of total gross unrecognized tax benefit as of December 31, 2010, which if recognized would favorably affect our income tax rate in future periods. The unrecognized tax benefit relates primarily to prior year Pennsylvania state franchise taxes and other insignificant US state taxes as well as an estimate for unrecognized tax benefits for 2010 research and development tax credits. We recognize accrued interest and penalties related to income taxes in income tax expense. We did not have significant interest and penalties accrued as of March 31, 2011 and December 31, 2010, respectively. We believe that it is reasonably possible that all 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, certain other prior year state tax returns will be filed and the 2010 Canadian research and development claim will be filed and assessed.

LIQUIDITY AND CAPITAL RESOURCES

As of March 31, 2011, our cash and cash equivalents balance remained flat at $4.2 million, when compared to December 31, 2010. Our principal source of liquidity during the three months ended March 31, 2011 was net cash provided by operating activities of $0.8 million. Fluctuations in foreign exchange rates had a material impact on the balances of our assets and liabilities year-over-year as reported in our consolidated balance sheets, which impacted amounts shown in our consolidated statement of cash flows.

We have credit agreements with the Bank of Montreal that provides us access to:

1. a non-revolving, reducing demand loan facility that was used to fund the acquisition of Innerwise, Inc. during 2007 under which $0.8 million was owing as of March 31, 2011. Based on the anticipated annual cash sweep payment for Fiscal 2010, we expect that this remaining balance will be fully repaid by June 2011;
2. a non-revolving, reducing demand loan facility for $2.0 million which can be used to finance the repurchase of our common shares. As of March 31, 2011, we had no borrowings under this credit facility;
3. an operating demand loan for $1.0 million to fund operational requirements. As of March 31, 2011, we had no borrowings under this credit facility; and
4. a Treasury Risk Management Facility for $3.5 million to be used as a line to fund any settlement risk exposure that may arise from foreign exchange contracts we enter into from time to time to mitigate the exchange rate risk on portions of our Canadian dollar exposure At March 31, 2011, we had forward exchange contracts to trade $10.5 million U.S. dollars in exchange for Canadian dollars.

Our credit agreement contains customary representations and warranties, affirmative and negative covenants, and events of default. Our credit agreement also requires us to make annual cash sweep payments on our non-revolving, reducing demand loans. They also require us to comply with certain customary non-financial covenants as well as certain financial covenants. As of and for the three months ended March 31, 2011, we were in compliance with these covenants.

Net cash provided by operating activities for the three months ended March 31, 2011 totaled $0.8 million, compared to $1.4 million for the three months ended March 31, 2010. Net cash provided by operating activities, before changes in non-cash operating working capital increased by $0.2 million to $1.5 million for the three months ended March 31, 2011 compared to $1.3 million for the three months ended March 31, 2010 primarily the result of the impact of the strengthening Canadian dollar and our forward exchange contracts have on our results. Net cash used in non-cash operating working capital increased by $0.9 million to $0.8 million for the three months ended March 31, 2011 compared to a decrease of $0.1 million for the three months ended March 31, 2010.

This additional investment of cash in non-cash working capital was primarily the result of increases totaling $1.3 million in accounts receivable and the deposits we maintain with our registry suppliers which reflect our increased sales volumes, a decrease in income taxes recoverable and a decrease in customer deposits during the three months ended March 31, 2011, as compared to the three months ended March 31, 2010. In addition, deferred revenue net of prepaid domain name registry and other Internet services fees, increased by $0.3 million, as compared to the three months ended March 31, 2010. These additional working capital needs were partially offset by an increase in accounts payable and accruals of $0.8 million, as compared to the three months ended March 31, 2010.

Net cash used in financing activities during the three months ended March 31, 2011 totaled $0.5 million as compared to $5.7 million for the three months ended March 31, 2010. Of the $5.7 million used during the three months ended March 31, 2010, $5.2 million was used to fund share repurchases as described in the following paragraph and in both the three months ended March 31, 2011 and 2010, $0.5 million was used for principal repayments under our Amended Credit Facility.

Under our share repurchase programs we used $4.5 million to repurchase 6.4 million shares pursuant to the terms of a Dutch auction tender offer completed during January 2010 and $0.7 million to repurchase 956,000 of our shares under the terms of our stock repurchase program announced in February 2010.

Investing activities used net cash of $0.3 million to acquire additional property and equipment during the three months ended March 31, 2011, as compared to the $0.1 million during the three months ended March 31, 2010.

Based on our operations, we believe that our cash flow from operations will be adequate to meet our anticipated requirements for working capital, capital expenditures and our loan repayments for at least the next 12 months.

We may choose to raise additional funds or seek other financing arrangements to facilitate more rapid expansion, develop new or enhance existing products or services, respond to competitive pressures or acquire or invest in complementary businesses, technologies, services or products.

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

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We develop products in Canada and sell these services in North America and Europe. Our sales are primarily made in U.S. dollars, while a major portion of expenses are incurred in Canadian dollars. Our financial results could be affected by factors such as changes in foreign currency exchange rates or weak economic conditions in foreign markets. Our interest income is sensitive to changes in the general level of Canadian and U.S. interest rates, particularly since the majority of our investments are in short-term instruments. Based on the nature of our short-term investments, we have concluded that there is no material interest rate risk exposure as of March 31, 2011. We are also subject to market risk exposure related to changes in interest rates under our Amended Credit Facility. We do not expect that any changes in interest rates will be material; however, fluctuations in interest rates are beyond our control. We will continue to monitor and assess the risks associated with interest expense exposure and may take additional actions in the future to mitigate these risks.

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

At March 31, 2011, 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 2011	$	3,900,000	0.9635	$	274,018
July - September 2011		3,900,000	0.9604		278,831
October - December 2011		2,700,000	0.9666		168,407
Total	$	10,500,000	0.9631	$	721,256

During May 2011, the Company entered into foreign exchange forward contracts to hedge a portion of its 2012 fiscal year expected Canadian dollar requirements. These contracts have a notional value of $2.4 million, whereby $0.3 million is converted into Canadian dollars during 2012 at an average foreign exchange rate of US$1.00: Cdn$0.9674.

The Company does not apply hedge accounting and, therefore, for the three months ended March 31, 2011, the Company recorded a loss of $0.1 million in the fair value of forward contracts in its consolidated statements of operations. For the three months ended March 31, 2010, the Company recorded a gain on forward contracts of $0.1 million.

We have performed a sensitivity analysis model for foreign exchange exposure over the three months ended March 31, 2011. The analysis used a modeling technique that compares the U.S. dollar equivalent of all expenses incurred in Canadian dollars, at the actual exchange rate, to a hypothetical 10% adverse movement in the foreign currency exchange rates against the U.S. dollar, with all other variables held constant. Foreign currency exchange

rates used were based on the market rates in effect during the three months ended March 31, 2011. The sensitivity analysis indicated that a hypothetical 10% adverse movement in foreign currency exchange rates would result in a decrease in net income for the three months ended March 31, 2011 of approximately $0.5 million. There can be no assurances that the above projected exchange rate decrease will materialize. Fluctuations of exchange rates are beyond our control. We will continue to monitor and assess the risk associated with these exposures and may take additional actions in the future to hedge or mitigate these risks.

Credit Risk

Financial instruments that potentially subject us to concentrations of credit risk consist principally of cash equivalents, marketable securities, foreign exchange contracts and accounts receivable. Our cash, cash equivalents and short-term investments are in high-quality securities placed with major banks and financial institutions whom we have evaluated as highly creditworthy and commercial paper. With respect to accounts receivable, we perform ongoing evaluations of our customers, generally granting uncollateralized credit terms to our customers, and maintaining an allowance for doubtful accounts based on historical experience and our expectation of future losses.

Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Based on that evaluation, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures as of the end of the period covered by this report have been designed and are functioning effectively to provide reasonable assurance that the information required to be disclosed by us in reports filed under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and is accumulated and communicated to our management, including our principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. We believe that a controls system, no matter how well designed and operated, cannot provide absolute assurance that the objectives of the controls system are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected.

(b) Change in Internal Control over Financial Reporting

No change in our internal control over financial reporting occurred during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II.
OTHER INFORMATION

Item 1. Legal Proceedings

We are involved in various investigations, claims and lawsuits arising in the normal conduct of our business, none of which, in our opinion, will harm our business. We cannot assure that we will prevail in any litigation. Regardless of the outcome, any litigation may require us to incur significant litigation expense and may result in significant diversion of our attention.

Item 1A. Risk factors

In addition to the other information set forth in this Quarterly Report, you should also carefully consider the risk factors discussed in Part I, “Item 1A. Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2010, all of which could materially affect our business, financial condition or operating results and should be considered before making an investment decision regarding our securities. The risks described in our Annual Report on Form 10-K are not the only risks facing the Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may adversely affect our business, financial condition or operating results.

Item 6. Exhibits

(a) Exhibits.

Exhibit No.	Description
3.1	Fourth Amended and Restated Articles of Incorporation of Tucows Inc. (Incorporated by reference to Exhibit 3.1 filed with Tucows’ current report on Form 8-K, as filed with the SEC on November 29, 2007)
3.2	Second Amended and Restated Bylaws of Tucows Inc. (Incorporated by reference to Exhibit 3.2 filed with Tucows’ annual report on Form 10-K for the year ended December 31, 2006, as filed with the SEC on March 29, 2007)
31.1	Chief Executive Officer’s Rule 13a-14(a)/15d-14(a) Certification *
31.2	Chief Financial Officer’s Rule 13a-14(a)/15d-14(a) Certification *
32.1	Chief Executive Officer’s Section 1350 Certification †
32.2	Chief Financial Officer’s Section 1350 Certification †

* Filed herewith.
† Furnished herewith.

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SIGNATURES

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

Date: May 13, 2011	TUCOWS INC.	
	By:	/s/ Elliot Noss Elliot Noss President and Chief Executive Officer
	By:	/s/ Michael Cooperman Michael Cooperman Chief Financial Officer (Principal Financial and Accounting Officer)

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31.2	Chief Financial Officer's Rule 13a-14(a)/15d-14(a) Certification *
32.1	Chief Executive Officer's Section 1350 Certification †
32.2	Chief Financial Officer's Section 1350 Certification †

* Filed herewith.
† Furnished herewith.