

TUCOWS INC /PA/
Form 10-Q
May 08, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2015

OR

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

For the transition period from to

Commission file number 1-32600

TUCOWS INC.

(Exact Name of Registrant as Specified in Its Charter)

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

96 Mowat Avenue,

Toronto, Ontario M6K 3M1, Canada

(Address of Principal Executive Offices) (Zip Code)

(416) 535-0123

(Registrant's Telephone Number, Including Area Code)

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

As of May 6, 2015, there were 11,019,983 outstanding shares of common stock, no par value, of the registrant.

TUCOWS INC.

Form 10-Q Quarterly Report

INDEX

PART I

FINANCIAL INFORMATION

Item 1.	Consolidated Financial Statements	1
	Consolidated Balance Sheets (unaudited) as of March 31, 2015 and December 31, 2014	1
	Consolidated Statements of Operations and Comprehensive Income (unaudited) for the three months ended March 31, 2015 and 2014	2
	Consolidated Statements of Cash Flows (unaudited) for the three months ended March 31, 2015 and 2014	3
	Notes to Consolidated Financial Statements (unaudited)	4
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	18
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	34
Item 4.	Controls and Procedures	35

PART II

OTHER INFORMATION

Item 1.	Legal Proceedings	36
Item 1A.	Risk Factors	36
Item 4.	Mine Safety Disclosures	36
Item 6.	Exhibits	37
	Signatures	38

TRADEMARKS, TRADE NAMES AND SERVICE MARKS

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PART I.**FINANCIAL INFORMATION****Item 1. Consolidated Financial Statements****Tucows Inc.****Consolidated Balance Sheets****(Dollar amounts in U.S. dollars)****(unaudited)**

	March 31, 2015 (unaudited)	December 31, 2014
Assets		
Current assets:		
Cash and cash equivalents	\$13,678,191	\$8,271,377
Accounts receivable, net of allowance for doubtful accounts of \$121,770 as of March 31, 2015 and \$125,766 as of December 31, 2014	7,119,785	6,789,685
Inventory	574,119	393,774
Prepaid expenses and deposits	5,085,514	3,697,292
Prepaid domain name registry and ancillary services fees, current portion	46,107,333	44,614,858
Other assets (note 5)	-	8,199,000
Deferred tax asset, current portion (note 9)	3,040,483	2,498,196
Income taxes recoverable	1,772	997
Total current assets	75,607,197	74,465,179
Prepaid domain name registry and ancillary services fees, long-term portion	11,735,134	11,764,765
Property and equipment	5,346,070	1,609,787
Deferred tax asset, long-term portion (note 9)	5,067,090	4,880,423
Intangible assets (note 7)	14,886,625	14,202,585
Goodwill (note 7)	21,055,143	18,873,127
Total assets	\$133,697,259	\$125,795,866
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$3,883,370	\$3,579,920

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Accrued liabilities	4,105,110	3,941,549
Customer deposits	4,325,284	4,461,727
Derivative instrument liability, (note 6)	2,139,268	1,115,805
Deferred rent, current portion	5,317	-
Loan payable (note 8)	3,500,000	-
Deferred revenue, current portion	57,630,217	55,495,566
Accreditation fees payable, current portion	519,432	466,201
Income taxes payable (note 9)	1,136,023	473,480
Total current liabilities	77,244,021	69,534,248
Deferred revenue, long-term portion	15,659,049	15,610,753
Accreditation fees payable, long-term portion	126,039	128,243
Deferred rent, long-term portion	85,069	92,878
Other liabilities (note 10)	1,545,832	-
Deferred tax liability, long-term portion (note 9)	5,032,177	4,787,351
Redeemable non-controlling interest (note 4)	3,000,000	-
Stockholders' equity (note 14)		
Preferred stock - no par value, 1,250,000 shares authorized; none issued and outstanding	-	-
Common stock - no par value, 250,000,000 shares authorized; 10,996,733 shares issued and outstanding as of March 31, 2015 and 11,329,732 shares issued and outstanding as of December 31, 2014	13,975,005	14,130,059
Additional paid-in capital	22,318,640	29,090,058
Deficit	(4,121,340)	(6,955,283)
Accumulated other comprehensive income (loss)	(1,167,233)	(622,441)
Total stockholders' equity	31,005,072	35,642,393
Total liabilities and stockholders' equity	\$ 133,697,259	\$ 125,795,866

Commitments and contingencies (note 13)

See accompanying notes to unaudited consolidated financial statements

Tucows Inc.**Consolidated Statements of Operations and Comprehensive Income****(Dollar amounts in U.S. dollars)****(unaudited)**

	Three months ended	
	March 31,	
	2015	2014
Net revenues (note 12)	\$40,467,833	\$34,402,394
Cost of revenues (note 12):		
Cost of revenues	26,821,374	24,316,639
Network expenses	1,222,096	1,143,644
Depreciation of property and equipment	199,642	182,974
Amortization of intangible assets (note 7)	3,924	-
Total cost of revenues	28,247,036	25,643,257
Gross profit	12,220,797	8,759,137
Expenses:		
Sales and marketing	3,799,175	4,021,774
Technical operations and development	1,114,195	1,089,898
General and administrative	1,815,188	1,767,800
Depreciation of property and equipment	59,262	56,304
Amortization of intangible assets (note 7)	53,215	219,030
Impairment of indefinite life intangible assets (note 7)	12,493	250,688
Loss on currency forward contracts (note 6)	956,858	551,371
Total expenses	7,810,386	7,956,865
Income from operations	4,410,411	802,272
Other income (expense):		
Interest expense, net	(24,775)	(73,833)
Total other income (expense)	(24,775)	(73,833)
Income before provision for income taxes	4,385,636	728,439
Provision for income taxes (note 9)	1,551,693	251,600
Net income	2,833,943	476,839

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Other comprehensive income (loss), net of tax		
Gain (loss) on hedging activities	(960,866)	(442,978)
Net amount reclassified to earnings	416,074	227,511
Other comprehensive income (loss) net of tax of \$319,878 and \$112,240 for the three months ended March 31, 2015 and March 31, 2014	(544,792)	(215,467)
Comprehensive income for the period	\$2,289,151	\$261,372
Basic earnings per common share (note 11)	\$0.25	\$0.04
Shares used in computing basic earnings per common share (note 11)	11,142,628	11,028,559
Diluted earnings per common share (note 11)	\$0.24	\$0.04
Shares used in computing diluted earnings per common share (note 11)	11,580,047	11,639,617

See accompanying notes to consolidated financial statements

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

	Three months ended	
	March 31,	
	2015	2014
Cash provided by:		
Operating activities:		
Net income for the period	\$2,833,943	\$476,839
Items not involving cash:		
Depreciation of property and equipment	258,904	239,278
Amortization of intangible assets	57,139	219,030
Impairment of indefinite life intangible asset	12,493	250,688
Deferred income taxes recovery	(164,250)	(343,231)
Excess tax benefits from share-based compensation expense	-	(1,013,800)
Amortization of deferred rent	(2,492)	3,212
Disposal of domain names	6,328	1,622
Loss (gain) on change in the fair value of forward contracts	158,793	87,146
Stock-based compensation	125,048	100,977
Change in non-cash operating working capital:		
Accounts receivable	(168,585)	(1,262,921)
Inventory	(113,150)	(199,747)
Prepaid expenses and deposits	(1,299,778)	(366,836)
Prepaid domain name registry and ancillary services fees	(1,462,844)	(1,815,683)
Income taxes recoverable	661,768	(433,301)
Accounts payable	117,566	1,670,415
Accrued liabilities	(59,220)	(422,398)
Customer deposits	(136,443)	(29,129)
Deferred revenue	2,061,510	2,748,933
Accreditation fees payable	51,027	50,087
Net cash (used in) / provided by operating activities	2,937,757	(38,819)
Financing activities:		
Proceeds received on exercise of stock options	247,983	911,081
Excess tax benefits from share-based compensation expense	412,642	1,013,800
Repurchase of common stock	(7,712,145)	(82,286)
Proceeds received on loan payable	3,500,000	-
Repayment of loan payable	-	(616,667)
Net cash provided by / (used in) financing activities	(3,551,520)	1,225,928
Investing activities:		

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Additions to property and equipment	(191,762)	(68,745)
Gross proceeds from the waiver of rights to .online registry	6,619,832	-
Additional cost of acquisition of Ting Virginia, LLC., net of cash of \$21,423	(407,493)	-
Net cash provided by (used in) investing activities	6,020,577	(68,745)
Increase in cash and cash equivalents	5,406,814	1,118,364
Cash and cash equivalents, beginning of period	8,271,377	12,418,888
Cash and cash equivalents, end of period	\$13,678,191	\$13,537,252
Supplemental cash flow information:		
Interest paid	\$38,893	\$73,949
Income taxes paid, net	\$564,139	\$669,624
Supplementary disclosure of non-cash investing and financing activities:		
Property and equipment acquired during the period not yet paid for	\$66,798	\$285,821

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”, “Tu cows”, “we”, “us” or through similar expressions), together with our consolidated subsidiaries, is a global distributor of Internet services, including domain name registration, security and identity products through digital certificates, email and mobile telephony and fixed Internet access services. The Company’s Internet Services are distributed 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 Netherlands, Germany and the United States. Our common stock is listed on NASDAQ under the symbol “TCX” and on the Toronto Stock Exchange under the symbol “TC”.

2. BASIS OF PRESENTATION:

The accompanying unaudited interim consolidated balance sheets, and the related consolidated statements of operations and comprehensive income and cash flows reflect all adjustments, consisting of normal recurring adjustments, that are, in the opinion of management, necessary for a fair presentation of the financial position of Tucows and its subsidiaries as at March 31, 2015 and the results of operations and cash flows for the interim periods ended March 31, 2015 and 2014. 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, 2014 included in Tucows' 2014 Annual Report on Form 10-K filed with the SEC on March 11, 2015.

There have been no material changes to our significant accounting policies during the three months ended March 31, 2015 as compared to the significant accounting policies described in our Annual Report on Form 10-K for the fiscal year ended December 31, 2014.

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

(a) Revenue recognition

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

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

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

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

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

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

The Company also generates advertising and other revenue through its online libraries of shareware, freeware and online services presented on its website. Advertising revenue includes revenue derived from cost-per action advertising links we display on third party websites who provide syndicated pay-per-click advertising on OpenSRS Domain Expiry Stream domains and the Company's Portfolio Domains. In addition, the Company uses third party partners to derive pay-per-click advertising on the Tucow.com website. Advertising revenue is recognized on a monthly basis based on the number of cost-per-action services that were provided in the month.

In those cases where payment is not received at the time of sale, additional conditions for recognition of revenue are that the collection of the related accounts receivable is reasonably assured and the Company has no further performance obligations. The Company records costs that reflect expected refunds, rebates and credit card charge-backs as a reduction of revenues at the time of the sale based on historical experiences and current expectations.

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

(b) Property and equipment

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

Asset	Rate
Computer equipment	30 %
Computer software	100 %
Furniture and equipment	20 %
Vehicles	20 %
Fiber network (years)	15
Customer equipment and installations (years)	3
Leasehold improvements	Over term of lease

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

Additions to the fiber network are recorded at cost, including all material, labour, vehicle and installation and construction costs and certain indirect costs associated with the construction of cable transmission and distribution facilities. While the Company's capitalization is based on specific activities, once capitalized, costs are tracked by fixed asset category at the fiber network level and not on a specific asset basis. For assets that are retired, the estimated historical cost and related accumulated depreciation is removed.

Costs associated with initial customer installation include materials, labour, vehicle and installation and construction costs and certain indirect costs. Indirect costs are associated with the activities of the Company's personnel who assist in connecting and activating the new service and consist of compensation and other costs associated with these support functions.

The costs of disconnecting service at a customer's dwelling or reconnecting service to a previously installed dwelling are charged to operating expense in the period incurred. Costs for repairs and maintenance are charged to operating expense as incurred, while plant and equipment replacement and betterments, including replacement of cable drops from pole to the dwelling, are capitalized.

(c) Derivative Financial Instruments

During the three months ended March 31, 2015 and the year ended December 31, 2014 ("Fiscal 2014"), we used derivative financial instruments to manage foreign currency exchange risk. We account for these instruments in accordance with Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 815, "Derivatives and Hedging" ("Topic 815"), which requires that every derivative instrument be recorded on the balance sheet as either an asset or liability measured at its fair value as of the reporting date. Topic 815 also requires that changes in our derivative financial instruments' fair values be recognized in earnings, unless specific hedge accounting and documentation criteria are met (i.e. the instruments are accounted for as hedges). We recorded the effective portions of the gain or loss on derivative financial instruments that were designated as cash flow hedges in accumulated other comprehensive income in our accompanying Consolidated Balance Sheets. Any ineffective or excluded portion of a designated cash flow hedge, if applicable, is recognized in net income.

For certain contracts, the Company has not complied with the documentation standards required for its forward foreign exchange contracts to be accounted for as hedges and has, therefore, accounted for such forward foreign exchange contracts at their fair values with the changes in fair value recorded in net income.

The fair value of the forward exchange contracts are determined using an estimated credit adjusted mark-to-market valuation which takes into consideration the Company's and the counterparty's credit risk. The valuation technique used to measure the fair values of the derivative instruments is a discounted cash flow technique, with all significant inputs derived from or corroborated by observable market data, as no quoted market prices exist for the derivative instruments. Our discounted cash flow techniques use observable market inputs, such as foreign currency spot and forward rates.

3. NEW ACCOUNTING POLICIES:

Recent Accounting Pronouncements Adopted

In May 2014, the FASB issued Accounting Standards Update ("ASU") No. 2014-09, *Revenue from Contracts with Customers* ("ASU 2014-09"), which is a comprehensive revenue recognition standard that will supersede nearly all existing revenue recognition guidance under U.S. GAAP. The new standard provides a single principles-based, five-step model to be applied to all contracts with customers, which steps are to (1) identify the contract(s) with the customer, (2) identify the performance obligations in the contract, (3) determine the transaction price, (4) allocate the transaction price to the performance obligations in the contract and (5) recognize revenue when each performance obligation is satisfied. More specifically, revenue will be recognized when promised goods or services are transferred to the customer in an amount that reflects the consideration expected in exchange for those goods or services. ASU 2014-09 will be effective, reflecting the one-year proposed deferral, for interim and annual periods beginning after December 15, 2017 (January 1, 2018 for the Company). Early adoption of the standard is permitted but not before the original effective date. Companies can transition to the standard either retrospectively or as a cumulative-effect adjustment as of the date of adoption. The Company is currently in the process of evaluating the impact that the adoption of ASU 2014-09 will have on its consolidated financial statements and the selected method of transition to the new standard.

In April 2015, the FASB issued ASU No. 2015-05, *Customer's Accounting for Fees Paid in a Cloud Computing Arrangement* ("ASU 2015-05"), which provides guidance in determining whether fees for purchasing cloud computing services (or hosted software solutions) are considered internal-use software or should be considered a service contract. The cloud computing agreement that includes a software license should be accounted for in the same manner as internal-use software if customer has contractual right to take possession of the software during the hosting period without significant penalty and it is feasible to either run the software on customer's hardware or contract with another vendor to host the software. Arrangements that don't meet the requirements for internal-use software should be accounted for as a service contract. ASU 2015-05 will be effective for interim and annual periods beginning after December 15, 2015 (January 1, 2016 for the Company). Early adoption of the standard is permitted. The Company is currently in the process of evaluating the impact that the adoption of ASU 2015-05 will have on its consolidated financial statements.

4. Acquisitions and Divestitures:

Acquisitions

On February 27, 2015, Ting Fiber, Inc., one of our wholly owned subsidiaries, acquired a 70% ownership interest in the newly formed Ting Virginia, LLC and its acquired subsidiaries, Blue Ridge Websoft, LLC (doing business as Blue Ridge InternetWorks), Fiber Roads, LLC and Navigator Network Services, LLC (the “BRI Group”) for a consideration of approximately \$3.6 million, subject to additional customary adjustments as anticipated in the purchase agreement, primarily related to estimated working capital levels at closing. The purchase price was satisfied through our releasing \$3.1 million from the escrow accounts established during Fiscal 2014 and an additional payment of \$0.4 million made at closing. Ting Virginia, LLC is an independent Internet service provider in Charlottesville, Virginia, doing business primarily as Blue Ridge InternetWorks. The BRI Group provides high speed internet access, Internet hosting and network consulting services to over 3,000 customers in central Virginia. The purchase price was primarily satisfied through an advance under our 2012 DLR Loan facility.

Ting Fiber Inc. and the selling shareholders (the “Minority Shareholders”) also agreed to certain put and call options with regard to the remaining 30% interest in Ting Virginia, LLC retained by the Minority Shareholders. On the second anniversary of the closing date, Ting Fiber, Inc. may exercise a call option to purchase an additional 20% ownership interest in Ting Virginia, LLC. Contingent upon the exercise of the call option by Ting Fiber, Inc. the Minority Shareholders may exercise a put option within 7 days following the exercise of the call option by Ting Fiber, Inc., to sell their remaining 10% ownership interest in Ting Virginia LLC. The consideration to be exchanged for the shares acquired or sold under the options shall be \$100,000 per percentage point of the equity interest acquired.

In addition, on the fourth anniversary of the closing date, the Minority Shareholders may exercise a put option under which the Ting Fiber Inc. shall be irrevocably obligated to purchase the Minority Shareholders’ remaining interest for \$120,000 per percentage point of the equity interest acquired for a total of \$3,600,000.

The Company has determined that the put options described above are embedded within the non-controlling interest shares that are subject to the put options. The redemption feature requires classification of the Minority Shareholders’ Interest in the Consolidated Balance Sheets outside of equity under the caption “Redeemable non-controlling interest”. The present value of the liability at the acquisition date is \$3,000,000.

The preliminary purchase consideration is comprised as follows:

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Cash	\$3,135,140
Assumption of debt	418,775
Redeemable non-controlling interest	3,000,000
	\$6,553,915

The following table represents the purchase price allocation based on the estimated fair values of the assets

Current assets (including cash of \$21,423)	\$338,577
Current liabilities	(529,702)
Property and equipment, including:	
Fiber network	3,456,024
Computer equipment	200,000
Furniture and equipment	5,000
Vehicles	92,000
Leasehold improvements	50,000
Intangible assets, including:	
Network rights	692,000
Customer relationships	68,000
Goodwill	2,182,016
Net assets acquired	\$6,553,915

The goodwill recorded on the acquisition is expected to be deductible for tax purposes.

The fair value of current assets acquired includes accounts receivable with a fair value of \$0.2 million. All accounts receivable acquired at acquisition are expected to be collectable.

The acquisition had no significant impact on revenues and net earnings for the three months ended March 31, 2015. There was also no significant impact on the Company's revenues and net income on a pro forma basis for all periods presented.

The Company acquired new classes of assets in this acquisition, namely fiber network and vehicles. The Company has accordingly, in connection with its depreciation policies, added additional disclosure in note 2 (b) above.

5. Other assets:

Other assets are comprised of the following:

	Year ended March 31, 2015	Year ended December 31, 2014
Amounts in escrow advanced to acquire a controlling ownership interest in Ting Virginia, LLC (see note 4)	\$	— \$3,125,000
Amounts advanced to the joint venture with Radix FZC and NameCheap Inc. which was terminated in February 2015 (note 10)		— 5,074,000
	\$	— \$8,199,000

6. Derivative instruments and hedging activities:*Foreign currency forward contracts*

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

The Company has designated these transactions as cash flow hedges of forecasted transactions under ASC Topic 815. As the critical terms of the hedging instrument, and of the entire hedged forecasted transaction, are the same, in accordance with ASC Topic 815, the Company has been able to conclude that changes in fair value or cash flows attributable to the risk of being hedged are expected to completely offset at inception and on an ongoing basis. Accordingly, unrealized gains or losses on the effective portion of these contracts have been included within other comprehensive income. The fair value of the contracts, as of March 31, 2015, is recorded as derivative instrument liabilities.

As of March 31, 2015, the notional amount of forward contracts that the Company held to sell U.S. dollars in exchange for Canadian dollars was \$19.5 million, of which \$16.5 million met the requirements of ASC Topic 815 and were designated as hedges (March 31, 2014 - \$20.1 million of which \$15.6 million were designated as hedges).

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

The effect of these derivative instruments on our consolidated financial statements as of, and for the three months ended March 31, 2015, were as follows (amounts presented do not include any income tax effects).

Fair value of derivative instruments in the consolidated balance sheets

Derivatives	Balance Sheet Location	As of	As of
		March 31, 2015	December 31, 2014
		Fair Value	Fair Value
		Asset	Asset
		(Liability)	(Liability)
Foreign currency forward contracts not designated as cash flow hedges	Derivative instruments	\$(327,922)	\$(169,129)
Foreign currency forward contracts designated as cash flow hedges	Derivative instruments	\$(1,811,346)	\$(946,676)
Total foreign currency forward contracts	Derivative instruments	\$(2,139,268)	\$(1,115,805)

Movement in Accumulated Other Comprehensive Income ("AOCI") balance for the three months ended March 31, 2015:

	Gains and losses on cash flow hedges	Tax impact	Total AOCI
Opening AOCI balance – December 31, 2014	\$(946,676)	\$324,235	\$(622,441)
Other comprehensive income (loss) before reclassifications	(1,510,346)	549,480	(960,866)
Amount reclassified from accumulated other comprehensive income	645,676	(229,602)	416,074
Other comprehensive income (loss) for the three months ended March 31, 2015	(864,670)	319,878	(544,792)
Ending AOCI balance – March 31, 2015	\$(1,811,346)	\$644,113	\$(1,167,233)

Effects of derivative instruments on income and other comprehensive income (OCI) for the three months ended March 31, 2015 and March 31, 2014 are as follows:

Derivatives in Cash Flow	Amount of Gain or (Loss) Recognized in OCI on Derivative (Effective Portion)	Location of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Amount of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Location of Gain or (Loss) Recognized in Income on Derivative (ineffective Portion and Amount Excluded from Effectiveness Testing)	Amount of Gain or (Loss) Recognized in Income on Derivative (ineffective Portion and Amount Excluded from Effectiveness Testing)
		Operating expenses	\$ (301,590)		
Foreign currency forward contracts for the three months ended March 31, 2015	\$ (544,792)	Cost of revenues	(114,484)	Operating expenses	\$ (15,419)

		Operating expenses	\$ (168,620)		
Foreign currency forward contracts for the three months ended March 31, 2014	\$ (215,467)	Cost of revenues	(58,891)	Operating expenses	\$ —

In addition to the above, for those foreign currency forward contracts not designated as hedges, the Company has recorded a loss of \$0.1 million upon settlement and a loss of \$0.2 million for the change in fair value of outstanding contracts for the three months ended March 31, 2015, in the consolidated statement of operations and comprehensive income. The Company has recorded a loss of \$0.1 million upon settlement and a loss of \$0.1 million for the change in fair value of outstanding contracts for the three months ended March 31, 2014, in the consolidated statement of operations and comprehensive income.

7. Goodwill and Other Intangible Assets:

Goodwill

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

Goodwill consists of the following:

	Boardtown Corporation	Hosted Messaging Assets of Critical Path	Innerwise Inc.	Mailbank.com Inc.	EPAG Domainservice GmbH	BRI Group	Total
Balances, December 31, 2014	\$ 2,044,847	\$ 4,072,297	\$ 5,801,040	\$ 6,072,623	\$ 882,320	\$ -	\$ 18,873,127
Acquisition of BRI Group, February 2015	-	-	-	-	-	2,182,016	2,182,016
Balances, March 31, 2015	\$ 2,044,847	\$ 4,072,297	\$ 5,801,040	\$ 6,072,623	\$ 882,320	\$ 2,182,016	\$ 21,055,143

The Company's goodwill relates predominantly to its Domain Services operating segment.

On February 27, 2015, Ting Fiber, Inc., one of our wholly owned subsidiaries, acquired a 70% ownership interest in the BRI Group. Goodwill is not amortized, but is subject to an annual impairment test.

Other Intangible Assets:

Intangible assets consist of network rights, brand, customer relationships, surname domain names, non-competition agreements 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, 2015 is as follows:

	Brand	Customer relationships	Network rights	Surname domain names	Direct navigation domain names	
	7 years	4 - 7 years	15 years	indefinite life	indefinite life	Total
Net book value, December 31, 2014	\$ 110,510	\$ 625,220	\$ -	\$ 11,525,624	\$ 1,941,231	\$ 14,202,585
Acquisition of BRI Group, February 2015	-	68,000	692,000	-	-	760,000
Sales of domain names	-	-	-	(1,623)	(4,705)	(6,328)
Impairment of domain names	-	-	-	-	-	-