

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

**SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS**

This Quarterly Report on Form 10-Q contains, in addition to historical information, forward-looking statements by us with regard to our expectations as to financial results and other aspects of our business that involve risks and uncertainties and may constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Words such as “may,” “should,” “anticipate,” “believe,” “plan,” “estimate,” “expect” and “intend,” and other similar expressions are intended to identify forward-looking statements. The forward-looking statements contained in this report include statements regarding, among other things: the competition we expect to encounter as our business develops and competes in a broader range of Internet services; our expectation regarding the acquisition of eNom, the Company's foreign currency requirements, specifically for the Canadian dollar; Ting mobile, Roam mobile and fixed Internet access subscriber growth and retention rates; our belief regarding the underlying platform for our domain services, our expectation regarding the trend of sales of domain names and advertising; 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; our expectation regarding litigation; 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 our unrecognized tax; our expectations regarding cash from operations to fund our business; the impact of cancellations of or amendments to market development fund programs under which we receive funds, our expectation regarding our ability to manage realized gains/losses from foreign currency contracts; and general business conditions and economic uncertainty. 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:

- Changes in the nature of key strategic relationships with our Mobile Virtual Network Operator ("MVNO") partners;
- The effects of vigorous competition on a highly penetrated mobile telephony market, including the impact of competition on the price we are able to charge subscribers for services and devices and on the geographic areas served by our MVNO partner wireless networks;
- Our ability to manage any potential increase in subscriber churn or bad debt expense;
- Our ability to continue to generate sufficient working capital to meet our operating requirements;
- Our ability to service our debt commitments;
- 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 attract and retain qualified personnel in our business;
- Our ability to effectively manage our business;
- The effects of any material impairment of our goodwill or other indefinite-lived intangible assets;
- Our ability to obtain and maintain approvals from regulatory authorities on regulatory issues;
- Our ability to invest in the build-out of fiber networks into selected towns and cities to provide Internet access services to residential and commercial customers while maintaining the development and sales of our established services;
- Adverse tax consequences such as those related to changes in tax laws or tax rates or their interpretations, including with respect to the impact of the Tax Cuts and Jobs Act of 2017;
- The application of judgment in determining our global provision for income taxes, deferred tax assets or liabilities or other tax liabilities given the ultimate tax determination is uncertain;

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- Our ability to effectively integrate acquisitions;
- Pending or new litigation; and
- Factors set forth herein under the caption “Item 1A Risk Factors” in our Annual Report on Form 10-K for the fiscal year ended December 31, 2017 filed with the SEC on March 6, 2018 (the “2017 Annual Report”).

As previously disclosed under the caption “Item 1A Risk Factors” in our 2017 Annual Report, data protection regulations may impose legal obligations on us that we cannot meet or that conflict with our ICANN contractual requirements.

Specifically, the European Commission has adopted the General Data Protection Regulation (the “GDPR”), which introduces numerous privacy-related changes for companies operating in the European Union, effective on May 25, 2018. The GDPR includes obligations around the procurement, processing, publication and sharing of personal data. Potential fines for violations of certain provisions of GDPR reach as high as 4% of a company’s annual total revenue, potentially including the revenue of its international affiliates. The interpretation and application of the GDPR is still unsettled for the industry. Our domain name registrar businesses, and the contracts we have with domain name registries and ICANN, require us to process and share personal data. The solutions we develop for GDPR-compliance may not be adequate in the views of regulatory authorities or ICANN, which may cause the loss of WHOIS privacy revenue or increase our costs of developing compliant solutions or subject us to litigation, liability, civil penalties, or loss of market share. As the privacy laws and regulations around the world continue to evolve, these changes could adversely affect our business operations in similar ways.

This list of factors that may affect our future performance and financial and competitive position and 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 as required by law. These statements are not guarantees of future performance.

We qualify all the forward-looking statements contained in this Quarterly Report on 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 of our customers’ experience as they access the Internet (at home or on the go) and while using Internet services such as domain name registration, email and other Internet services. We are organized, managed and report our financial results as two segments, Network Access Services and Domain Services, which are differentiated primarily by their services, the markets they serve and the regulatory environments in which they operate.

Our management 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 management 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 Network Access Services and Domain Services revenue separately.

For the three months ended September 30, 2018 and September 30, 2017, we reported revenue of \$83.5 million and \$85.0 million, respectively.

For the nine months ended September 30, 2018 and September 30, 2017, we reported revenue of \$260.4 million and \$238.8 million, respectively.

### ***Network Access Services***

Network Access Services includes mobile, fixed high-speed Internet access services and other revenues, including, billing solutions to small ISPs.

Our primary mobile service offering (“Ting Mobile”) is mainly distributed through the Ting website and to a lesser extent certain third-party retail stores and on-line retailers. We generate revenues from the sale of retail telephony services, mobile phone hardware and related accessories to individuals and small businesses through the Ting website. Ting Mobile’s primary focus is providing simple and easy to use services, including simple value pricing, in particular for multi-line accounts, and superior customer care. In the third quarter of 2017, the Company acquired the consumer-related assets of Otono- Networks Inc. (“Otono Networks”). The consumer assets relate to the mobile roaming and instant activation eSIM business under the Roam Mobility, Zipsim and Always Online Wireless brands (collectively “Roam Mobility brands”). The acquired portfolio operates as a MVNO on the same nationwide Global System for Mobile communications (“GSM”) network as Ting Mobile and distributes through third-party retail stores and product branded websites.

The Company also derives revenue from the sale of fixed high-speed Internet access (“Ting Internet”) in select towns including Holly Springs, North Carolina, Westminster, Maryland, Sandpoint, Idaho, Centennial, Colorado and Charlottesville, Virginia, with further expansion underway in existing Ting towns. Our primary sales channel of Ting Internet is through the Ting website. The primary focus of Ting Internet is to provide reliable Gigabit Internet services to consumer and business customers.

Revenues from Ting Mobile and Ting Internet are generated in the U.S. and are provided on a monthly basis with no fixed contract term. Revenues from Roam Mobility are generated in the U.S. and Canada on a prepaid usage basis with no fixed contract terms.

As of September 30, 2018, Ting managed mobile telephony services for approximately 295,000 subscribers and 162,000 accounts. For a discussion of subscribers and how they impacted our financial results, see the Net Revenue discussion below.

### ***Domain Services***

Domain Services includes wholesale and retail domain name registration services, value added services and portfolio services derived through our OpenSRS, eNom and Hover brands. We earn revenues primarily from the registration fees charged to resellers in connection with new, renewed and transferred domain name registrations. In addition, we earn revenues from the sale of retail domain name registration and email services to individuals and small businesses; and by making our portfolio of domain names available for sale or lease. Domain Services revenues are attributed to the country in which the contract originates, primarily Canada and the U.S.

Our primary distribution channel is a global network of approximately 37,000 resellers that operate in over 150 countries and who typically provide their customers, the end-users of Internet-based services, with solutions for establishing and maintaining an online presence. Our primary focus is serving the needs of this network of resellers by providing the broadest portfolio of generic top-level domain (“gTLD”) and the country code top-level domain (“ccTLD”) options and related services, a white-label platform that facilitates the provisioning and management of domain names, a powerful Application Program Interface, easy-to-use interfaces, comprehensive management and reporting tools, and proactive and attentive customer service. Our services are integral to the solutions that our resellers deliver to their customers. We provide “second tier” support to our resellers by email, chat and phone in the event resellers experience issues or problems with our services. In addition, our Network Operating Center proactively monitors all services and network infrastructure to address deficiencies before customer services are impacted.

We believe that the underlying platforms for our services are among the most mature, reliable and functional reseller-oriented provisioning and management platforms in our industry, and we continue to refine, evolve and improve these services for both resellers and end-users. Our business model is characterized primarily by non-refundable, up-front payments, which lead to recurring revenue and positive operating cash flow.

Wholesale, primarily branded as OpenSRS and eNom, derives revenue from its domain service and from providing value-added services. The OpenSRS and eNom domain services manage approximately 23.3 million domain names under the Tucows and eNom ICANN registrar accreditations and for other registrars under their own accreditations, which has decreased 5.0 million domain names since September 30, 2017. The reduction from prior year is primarily due to the bulk transfer of 2.89 million domain names to Namecheap’s credentials, which occurred in two bulk transfers. The first bulk transfer of 2.65 million names was completed by January 16, 2018, after King County Superior court (Washington) granted Namecheap Inc. a preliminary injunction on January 5, 2018, requiring the Company to bulk transfer the domain names under management. As a result of the bulk transfer that occurred in the first quarter of 2018, the Company recognized, on an accelerated basis, \$14.6 million of revenue and \$14.5 million of cost of revenues sold related to previously deferred revenue and deferred prepaid registry fees. Subsequent to the preliminary injunction noted above, on September 6, 2018, Tucows and Namecheap entered into an amicable settlement agreement to transfer the remaining 0.6 million domain names, of which 0.24 million domain names were transferred to Namecheap during the third quarter of 2018. As a result of the bulk transfer that occurred in the third quarter of 2018, the Company recognized, on an accelerated basis, an additional \$1.7 million of revenue and \$1.7 million of cost of revenues sold related to previously deferred revenue and deferred prepaid expenses. The remaining domain names as defined under the settlement agreement are expected to be transferred to Namecheap in the fourth quarter of 2018.

In addition, one of the resellers for which the Company registered domain names using the reseller’s accreditation, was acquired and the registrations were moved to the acquiring reseller, resulting in approximately 0.5 million domains being transferred in the first quarter of 2018. As the Company does not defer revenue associated with hosted registry services, there was no impact on deferred revenue as a result of the transfer.

Value-Added Services include hosted email which provides email delivery and webmail access to millions of mailboxes, Internet security services, Internet hosting, WHOIS privacy, publishing tools and other value-added services. All of these services are made available to end-users through a network of 37,000 web hosts, ISPs, and other resellers around the world. In addition, we also derive revenue by monetizing domain names which are near the end of their lifecycle through advertising revenue or auction sale.

Retail, primarily the Hover and eNom portfolio of websites, including eNom, eNom Central and Bulkregister, derive revenues from the sale of domain name registration and email services to individuals and small businesses. Retail also includes our Personal Names Service – based on over 36,000 surname domains – that allows roughly two-thirds of Americans to purchase an email address based on their last name.

Portfolio generates revenue by offering names in our domain portfolio for resale through a number of distribution channels including our reseller network. We also generate advertising revenue from our portfolio.

## KEY BUSINESS METRICS

We regularly review a number of business metrics, including the following key metrics and non-U.S. generally accepted accounting principles (“GAAP”) measures, to assist us in evaluating our business, measure the performance of our business model, identify trends impacting our business, determine resource allocations, manage our operational cash flow, formulate financial projections and make strategic business decisions. The following tables set forth the key business metrics which we believe are the primary indicators of our performance for the periods presented:

### Adjusted EBITDA

Tucows reports all financial information in accordance with U.S. GAAP. Along with this information, to assist financial statement users in an assessment of our historical performance, we typically disclose and discuss a non-GAAP financial measure, adjusted EBITDA, on investor conference calls and related events that exclude certain non-cash and other charges as we believe that the non-GAAP information enhances investors' overall understanding of our financial performance. Please see discussion of adjusted EBITDA in the Results of Operations section below.

### Network Access Services

	September 30,	
	2018 <sup>(1)</sup>	2017 <sup>(1,2)</sup>
	(in 000s)	
Ting mobile accounts under management	162	166
Ting mobile subscribers under management	295	281

- (1) For a discussion of these period to period changes in subscribers and devices under management and how they impacted our financial results, see the Net Revenue discussion below.
- (2) Subsequent to a review of our subscriber base in the first quarter of 2018, our comparative third quarter 2017 accounts under management were reduced by approximately 5,000.

### Domain Services

Total new, renewed and transferred-in domain name registrations:

	Three months ended September 30,	
	2018 <sup>(1)</sup>	2017 <sup>(1)</sup>
	(in 000's)	
Total new, renewed and transferred-in domain name registrations provisioned	4,170	4,839

	Nine months ended September 30,	
	2018 <sup>(1)</sup>	2017 <sup>(1)</sup>
	(in 000's)	
Total new, renewed and transferred-in domain name registrations provisioned	13,444	14,604

- (1) For a discussion of these period to period changes in the domain names provisioned and how they impacted our financial results, see the Net Revenues discussion below.

Domain names under management:

	September 30,	
	2018 <sup>(1)</sup>	2017 <sup>(1)</sup>
	(in 000's)	
Domain names under management:		
Registered using Registrar Accreditation belonging to the Tucows Group	18,990	22,708
Registered using Registrar Accreditations belonging to Resellers	4,344	5,597
Total domain names under management	23,334	28,305

- (1) For a discussion of these period to period changes in domain names under management and how they impacted our financial results, see the Net Revenue discussion below.

## OPPORTUNITIES, CHALLENGES AND RISKS

As a MVNO, our Ting and Roam services are reliant on our Mobile Network Operators ("MNOs") providing competitive networks. Our MNOs each continue to invest in network expansion and modernization to improve their competitive positions. Deployment of new and sophisticated technology on a very large-scale entails risks. Should they fail to implement, maintain and expand their network capacity and coverage, adapt to future changes in technologies and continued access to and deployment of adequate spectrum successfully, our ability to provide wireless services to our subscribers, to retain and attract subscribers and to maintain and grow our subscriber revenues could be adversely affected, which would negatively impact our operating margins.

Ting has also enjoyed rapid growth in its first six years of operation. During this growth phase, we have been able to continue to grow gross customer additions and maintain a consistent churn rate, which has allowed us to maintain net new customer additions despite the impact of churn on a fast-growing customer base. We expect price competition to grow more intense in the industry which could result in increased customer churn or reductions of customer acquisition rates either of which could result in slower growth rates or in certain cases, our ability to maintain growth.

The communications industry continues to compete on the basis of network reach and performance, types of services and devices offered, and price.

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

Substantially all of our Domain Services revenue is derived from domain name registrations and related value-added services from wholesale and retail customers using our provisioning and management platforms. The market for wholesale registrar services is both price sensitive and competitive and is evolving with the introduction of new gTLDs, 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. Growth in our Domain Services revenue is dependent upon our ability to continue to attract and retain customers by maintaining consistent domain name registration and value-added service renewal rates and to grow our customer relationships through refining, evolving and improving our provisioning platforms and customer service for both resellers and end-users. In addition, we also generate revenue through pay-per-click advertising and the sale of names from our portfolio of domain names and through the domain expiry stream. The revenue associated with names sales and advertising has recently experienced flat to declining trends due to lower traffic and advertising yields in the marketplace, which we expect to continue. Expanding data protection regulations may impose legal obligations on us that we cannot meet or that conflict with our ICANN contractual requirements. Specifically, the European Commission has adopted the GDPR, which introduces numerous privacy-related changes for companies operating in the European Union, effective on May 25, 2018. The solutions we develop for GDPR-compliance may not be adequate in the views of regulatory authorities or ICANN, which may cause the loss of WHOIS privacy revenue or increase our costs of developing compliant solutions or subject us to litigation, liability, civil penalties, or loss of market share. As the privacy laws and regulations around the world continue to evolve, these changes could adversely affect our business operations in similar ways.

From time-to-time certain of our vendors provide us with market development funds to expand or maintain the market position for their services. Any decision by these vendors to cancel or amend these programs for any reason may result in payments in future periods not being commensurate with what we have achieved during past periods.

Sales of domain names from our domain portfolio have a negative impact on our advertising revenue as these names are no longer available for advertising purposes. In addition, the timing of larger domain names portfolio sales is unpredictable and may lead to significant quarterly and annual fluctuations in our portfolio revenue.

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.

## **Net Revenues**

### **Network Access Services**

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

#### *Mobile*

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

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

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

#### *Other services*

Other services derive revenues from providing Ting Internet to individuals and small businesses in select cities. In addition, we provide billing, provisioning and customer care software solutions to ISPs through our Platypus billing software. Ting fixed Internet access contracts provide customers Internet access at their home or business through the installation and use of our fiber optic network. Ting Internet contracts are generally prepaid and grant customers with unlimited bandwidth based on a fixed price per month basis. Since consideration is collected before the service period, revenue is initially deferred and recognized as the Company performs its obligation to provide Internet access. Though the Company does not consider the installation of fixed Internet access to be a distinct performance obligation, the fees related to installation are immaterial and therefore revenue is recognized as billed.

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

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

## **Domain Services**

### *Wholesale*

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

Historically, our wholesale 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 reseller will engage us, enabling us to follow on with other services and allowing us to add to our portfolio by purchasing names registered through us upon their expiration. With the acquisition of eNom and its 24,000-reseller network, domain services will continue to be the largest portion of our business and will further fuel our ability to sell add-on services.

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

### *Wholesale – Value-Added Services*

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

We also derive revenue from other value-added services primarily from Internet hosting services, advertising from the OpenSRS and eNom domain expiry streams.

### *Retail*

We derive revenues from Hover and eNom's retail properties through the sale of retail domain name registration and email services to individuals and small businesses.

### *Portfolio*

We derive revenue from our portfolio of domain names parking monetization, whereby the Company contracts with third-party Internet advertising publishers to direct web traffic from the Company's domain expiry stream domains and Internet portfolio domains to advertising websites. Compensation from Internet advertising publishers is calculated variably on a cost-per-action basis based on the number of advertising links that have been visited in a given month.

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

## **Critical Accounting Policies**

The preparation of our consolidated financial statements in conformity with U.S. GAAP requires us to make estimates and judgements that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. There have been no material changes to the critical accounting policies and estimates as previously disclosed in Part II, Item 7 of our 2017 Annual Report, except for the adoption of Accounting Standard Update ("ASU") No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, which was adopted using the modified retrospective basis. Accordingly, comparative figures have not been restated. The adoption of ASU 2014-09 did not have a material impact on the timing of revenue recognition. For further information on our critical accounting policies and estimates, see note 3 – Recent accounting pronouncements to the consolidated financial statements of the Company in Part I, Item 1 in this Quarterly Report on Form 10-Q.

**RESULTS OF OPERATIONS FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2018 AS COMPARED TO THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2017**

During the preparation of these interim financial statements, the Company identified an immaterial error that affects the classification of expenses for the three and nine months ended September 30, 2017. This correction of the comparative periods resulted in a decrease in cost of revenues of \$0.3 million, a decrease in sales and marketing expense of \$0.2 million, and an increase in general and administrative expenses of \$0.5 million for both the three and nine months ended September 30, 2017 compared to the amounts previously reported.

**NET REVENUES**

The following table presents our net revenues, by revenue source (*Dollar amounts in thousands of U.S. dollars*):

	<b>Three months ended September 30,</b>		<b>Nine months ended September 30,</b>	
	<b>2018</b>	<b>2017*</b>	<b>2018</b>	<b>2017*</b>
<b>Network Access Services:</b>				
Mobile Services	\$ 22,546	\$ 21,749	\$ 66,829	\$ 60,090
Other Services	2,033	1,442	5,664	3,978
Total Network Access Services	24,579	23,191	72,493	64,068
<b>Domain Services:</b>				
<b>Wholesale</b>				
Domain Services	45,070	47,770	146,038	135,413
Value Added Services	4,541	4,203	13,576	13,526
Total Wholesale	49,611	51,973	159,614	148,939
Retail	8,731	8,873	25,644	22,937
Portfolio	598	971	2,650	2,856
Total Domain Services	58,940	61,817	187,908	174,732
	\$ 83,519	\$ 85,008	\$ 260,401	\$ 238,800
(Decrease) increase over prior period	\$ (1,489)		\$ 21,601	
(Decrease) increase - percentage	-2%		9%	

The following table presents our revenues, by revenue source, as a percentage of total revenues (*Dollar amounts in thousands of U.S. dollars*):

	<b>Three months ended September 30,</b>		<b>Nine months ended September 30,</b>	
	<b>2018</b>	<b>2017*</b>	<b>2018</b>	<b>2017*</b>
<b>Network Access Services:</b>				
Mobile Services	27%	26%	26%	25%
Other Services	2%	2%	2%	2%
Total Network Access Services	29%	28%	28%	27%
<b>Domain Services:</b>				
<b>Wholesale</b>				
Domain Services	55%	56%	56%	56%
Value Added Services	5%	5%	5%	6%
Total Wholesale	60%	61%	61%	62%
Retail	10%	10%	10%	10%
Portfolio	1%	1%	1%	1%
Total Domain Services	71%	72%	72%	73%
	100%	100%	100%	100%

Total net revenues for the three months ended September 30, 2018 decreased by \$1.5 million or 2% to \$83.5 million when compared to the three months ended September 30, 2017. The three-month decrease was primarily driven by the \$14.6 million acceleration of revenue related to the Namecheap bulk transfer of 2.65 million names in the first quarter of 2018, a portion of which would have otherwise been recognized in the third quarter of 2018. The decrease was partially offset by the \$1.7 million of revenue accelerated in the third quarter of 2018 related to 0.24 million of additional names transferred to Namecheap, a portion of which would have otherwise been recognized after the third quarter of 2018. The decrease was also offset by the impact of the acquisition of the mobile roaming assets of Otono Networks in September 2017.

Total net revenues for the nine months ended September 30, 2018 increased by \$21.6 million or 9% to \$260.4 million when compared to the nine months ended September 30, 2017. The nine-month increase was primarily driven by the acceleration of previously deferred revenue as a result of two bulk transfers of domain names to Namecheap. As a result of the Namecheap bulk transfer of 2.65 million domain names that occurred in the first quarter of 2018, the Company accelerated \$14.6 million of revenue, a portion of which would have otherwise been recognized after the third quarter of 2018. Likewise, as a result of the Namecheap bulk transfer of 0.24 million domain names that occurred in the third quarter of 2018, the Company accelerated \$1.7 million of revenue, a portion of which would have otherwise been recognized after the third quarter of 2018. In addition, revenues increased due to the January 20, 2017 acquisition of eNom and the impact the acquisition of the mobile roaming assets of Otono Networks in September 2017.

Deferred revenue from domain name registrations and other Internet services at September 30, 2018 decreased to \$148.5 million from \$160.6 million at December 31, 2017, primarily due to the bulk transfers discussed above.

During the three and nine months ended September 30, 2018, no customer accounted for more than 10% of total revenue. For the three and nine months ended September 30, 2017, no customer accounted for more than 10% of revenue. As at September 30, 2018 and December 31, 2017, no customer accounted for more than 10% of accounts receivable. Though a significant portion of the Company's domain services revenues are prepaid by our customers, where the Company does collect receivables, 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.

### ***Network Access Services***

Net revenues from mobile phone equipment and services for the three months ended September 30, 2018 increased by \$0.8 million or 4% to \$22.5 million as compared to the three months ended September 30, 2017. This increase primarily reflects the growth in service revenues by \$1.6 million to \$20.4 million as compared to the three months ended September 30, 2017, due to the impact of the larger Ting subscriber base is having on Ting mobile service revenue and acquisition of the roaming assets of Otono Networks in September of 2017. Revenues from the sale of mobile hardware and related accessories decreased by \$0.8 million to \$2.1 million as compared to the three months ended September 30, 2017. The decrease in device revenue was primarily driven by reduced demand for high-priced devices compared to the three months ended September 30, 2017.

Net revenues from mobile phone equipment and services for the nine months ended September 30, 2018 increased by \$6.7 million or 11% to \$66.8 million as compared to the nine months ended September 30, 2017. This increase primarily reflects the growth in service revenues by \$6.8 million to \$60.3 million as compared to the nine months ended September 30, 2017, due to the impact of the larger Ting subscriber base is having on Ting mobile service revenue and acquisition of the roaming assets of Otono Networks in September of 2017. Revenues from the sale of mobile hardware and related accessories decreased by \$0.1 million to \$6.5 million as compared to the nine months ended September 30, 2017. The decrease in device revenue was primarily driven by reduced demand for high-priced devices compared to the nine months ended September 30, 2017.

Other revenues from Ting Internet and billing solutions generated \$2.0 million in revenue during the three months ended September 30, 2018, up \$0.6 million from the three months ended September 30, 2017. Growth in Ting Internet revenues was as a result of the increased Ting Internet footprint in Charlottesville, VA, Westminster, MD and Holly Springs, NC. The Company began offering Ting Internet in Sandpoint, ID in the second quarter of 2018 and in Centennial, CO in the third quarter of 2018.

Other revenues from Internet and billing solutions generated \$5.7 million in revenue during the nine months ended September 30, 2018, up \$1.7 million from the nine months ended September 30, 2017. Growth in Ting Internet revenues was as a result of the increased Ting Internet footprint in Charlottesville, VA, Westminster, MD and Holly Springs, NC. The Company began offering Ting Internet in Sandpoint, ID in the second quarter of 2018 and in Centennial, CO in the third quarter of 2018.

As of September 30, 2018, Ting Mobile had 162,000 accounts under management and 295,000 subscribers under management compared to 166,000 accounts and 281,000 subscribers under management as of September 30, 2017.

### ***Wholesale***

During the three months ended September 30, 2018, domain services revenue decreased by \$2.7 million or 6% to \$45.1 million when compared to the three months ended September 30, 2017. The decrease was primarily driven by the accelerated recognition of domains revenue associated with the Namecheap bulk transfer of 2.65 million names in the first quarter of 2018 and partially offset by the \$1.7 million acceleration of an additional 0.24 million names in the third quarter of 2018. During the nine months ended September 30, 2018, domain services revenue increased by \$10.6 million or 8% to \$146.0 million when compared to the nine months ended September 30, 2017. This increase primarily resulted from \$14.6 million of accelerated recognition of wholesale domain revenue associated with the Namecheap bulk transfer of 2.65 million names that took place during the first quarter of 2018 and the \$1.7 million of accelerated recognition of wholesale domain revenue associated with the additional 0.24 million names transferred to Namecheap in the third quarter of 2018. The Company expects to transfer an additional 0.4 million domain names in the fourth quarter of 2018 related to Namecheap. In addition, revenues increased compared to the nine months ended September 30, 2017 due to the January 20, 2017 acquisition of eNom. eNom revenues and gross margins in 2017 were negatively impacted by amortizing into revenue, deferred revenue that was recorded at fair value at the acquisition date which was approximately 10% lower than the historical cost basis of eNom.

The increase in revenue from the acquisition of eNom has been offset by the continued and ongoing migration of a few large, low margin customers. These customers have been moving their domain management and domain transaction processing to their own accreditations and in-house systems. As previously discussed, in the first and third quarter of 2018 the Company completed bulk transfers of 2.65 million and 0.24 million domain names respectively to Namecheap's credentials, which are the most significant migrations of this nature. In addition, one of the resellers for which the Company registered domain names using the reseller's accreditation, was acquired by a third party and the registrations were moved to the acquiring reseller, resulting in approximately 0.5 million domains being transferred in the first quarter of 2018. Due to these factors, total domains that we manage decreased to 23.3 million as of September 30, 2018, when compared to 28.3 million at September 30, 2017. 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 of these factors could affect the growth of domain names that we manage.

During the three months ended September 30, 2018, value added services revenue increased by \$0.3 million to \$4.5 million when compared to the three months ended September 30, 2017. During the nine months ended September 30, 2018, value added services revenue increased by \$0.1 million to \$13.6 million when compared to the nine months ended September 30, 2017. Both the three and nine month increases were primarily driven by increased expiry stream revenue.

***Retail***

Net revenues from retail for the three months ended September 30, 2018, as compared to the three months ended September 30, 2017, decreased by \$0.1 million, or 2%, to \$8.7 million. Net revenues from retail for the nine months ended September 30, 2018, as compared to the nine months ended September 30, 2017, increased by \$2.7 million, or 12%, to \$25.6 million. The nine-month increase was largely due to the success that our retail marketing initiatives and improved websites are having on our ability to attract new customers and retain existing ones. In addition, our revenues and gross margins in 2017 were negatively impacted by amortizing into revenue, deferred revenue that was recorded at fair value at the acquisition date which was approximately 10% lower than the historical basis of eNom.

***Portfolio***

Net revenues from portfolio for the three months ended September 30, 2018, decreased by \$0.4 million to \$0.6 million, as compared to the three months ended September 30, 2017.

Net revenues from portfolio for the nine months ended September 30, 2018, decreased by \$0.2 million to \$2.7 million, as compared to the nine months ended September 30, 2017.

## **COST OF REVENUES**

### **Network Access Services**

#### *Mobile*

Cost of revenues for mobile services includes the costs of provisioning mobile services, which is primarily our customers' voice, messaging, data usage provided by our MNOs, and the costs of providing mobile phone hardware, which is the cost of mobile phone devices and SIM cards sold to our customers, order fulfillment related expenses, and inventory write-downs.

#### *Other Services*

Cost of revenues for other services includes the costs for provisioning high speed Internet access, comprised of network access fees and software licenses, the costs of providing hardware, comprised of the cost of network routers sold to our customers, order fulfillment related expenses, and inventory write-downs and fees paid to third-party service providers, primarily for printing services in connection with billing services to ISPs.

### **Wholesale**

#### *Domain Service*

Cost of revenues for domain registrations represents the amortization of registry and accreditation 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 represent a payment for distinct goods or services provided by the Company, and thus do not meet the criteria for revenue recognition under ASU 2014-09, are reflected as cost of goods sold and are recognized as earned.

#### *Value-Added Services*

Costs of revenues for value-added services include licensing and royalty costs related to the provisioning of certain components of related to hosted email, third-party hosting services. Fees payable for trust certificates are amortized on a basis consistent with the provision of service, generally one year, while email hosting fees and monthly printing fees are included in cost of revenues in the month they are incurred.

#### *Retail*

Costs of revenues for our provision and management of Internet services through our retail sites, Hover.com and the eNom branded sites, include the amortization of registry and accreditation 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 recorded as prepaid domain registry fees.

#### *Portfolio*

Costs of revenues for our portfolio 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.

### Network expenses

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

	Three months ended September 30,		Nine months ended September 30,	
	2018	2017*	2018	2017*
<b>Network Access Services:</b>				
Mobile Services	\$ 11,399	\$ 12,365	\$ 34,643	\$ 32,634
Other Services	872	595	3,103	2,366
Total Network Access Services	12,271	12,960	37,746	35,000
<b>Domain Services:</b>				
<b>Wholesale</b>				
Domain Services	37,414	42,293	124,572	119,207
Value Added Services	807	687	2,412	1,878
Total Wholesale	38,221	42,980	126,984	121,085
<b>Retail</b>				
Portfolio	4,465	4,611	13,320	12,776
Total Domain Services	42,834	47,771	140,832	134,488
<b>Network Expenses:</b>				
Network, other costs	2,315	2,461	7,590	7,064
Network, depreciation and amortization costs	1,838	1,322	5,195	3,463
	4,153	3,783	12,785	10,527
	\$ 59,258	\$ 64,514	\$ 191,363	\$ 180,015
(Decrease) increase over prior period	\$ (5,256)		\$ 11,348	
(Decrease) increase - percentage	-8%		6%	

The following table presents our cost of revenues, as a percentage of total of cost of revenues (*Dollar amounts in thousands of U.S. dollars*):

	Three months ended September 30,		Nine months ended September 30,	
	2018	2017*	2018	2017*
<b>Network Access Services:</b>				
Mobile Services	19%	19%	18%	18%
Other Services	1%	1%	2%	1%
Total Network Access Services	20%	20%	20%	19%
<b>Domain Services:</b>				
<b>Wholesale</b>				
Domain Services	64%	66%	65%	67%
Value Added Services	1%	1%	1%	1%
Total Wholesale	65%	67%	66%	68%
<b>Retail</b>				
Portfolio	8%	7%	7%	7%
Total Domain Services	73%	74%	73%	75%
<b>Network Expenses:</b>				
Network, other costs	4%	4%	4%	4%
Network, depreciation and amortization costs	3%	2%	3%	2%
	7%	6%	7%	6%
	100%	100%	100%	100%

Total cost of revenues for the three months ended September 30, 2018, decreased by \$5.3 million, or 8%, to \$59.3 million when compared to the three months ended September 30, 2017. The decrease was primarily driven by the Namecheap bulk transfer of 2.65 million names in the first quarter of 2018, resulting in the accelerated recognition of \$14.5 million prepaid domain registry fees, a portion of which would have otherwise been recognized in the third quarter of 2018. The decrease was offset by the transfer of 0.24 million domain names to Namecheap in the third quarter of 2018, which resulted in the accelerated recognition of \$1.7 million of prepaid domain registry fees, a portion of which otherwise would have been recognized after the third quarter of 2018.

Total cost of revenues for the nine months ended September 30, 2018, increased by \$11.3 million, or 6%, to \$191.4 million when compared to the nine months ended September 30, 2017. The increase was primarily driven by the Namecheap bulk transfer of 2.65 million names during the first quarter of 2018, resulting in the accelerated recognition of \$14.5 million of prepaid domain registry fees. The increase was also due to the Namecheap bulk transfer of 0.24 million domain names during the third quarter of 2018, resulting in the accelerated recognition of \$1.7 million of prepaid domain registry fees. A portion of the accelerated prepaid domain fees from both transfers would have otherwise been recognized after the third quarter of 2018. Additionally, the nine months ended September 30, 2017 were lower due to the January 20, 2017 acquisition of eNom and the impact the acquisition of the mobile roaming assets of Otono Networks in September 2017. Prepaid domain registration and other Internet services fees as of September 30, 2018, decreased to \$111.2 million from \$127.0 million as of December 31, 2017, primarily due to the bulk transfers discussed above.

## **Network Access Services**

### ***Mobile and Other Services***

Cost of revenues from mobile phone equipment and services for the three months ended September 30, 2018, as compared to the three months ended September 30, 2017, decreased by \$1.0 million or 8% to \$11.4 million. This decrease was driven by improved pricing with mobile carriers, which reduced mobile service cost of revenue by \$0.1 million to \$9.1 million as compared to the three months ended September 30, 2017. Mobile hardware and related accessories costs decreased \$0.9 million to \$2.3 million as compared to the three months ended September 30, 2017. The decrease was primarily driven by reduced demand for high-priced devices compared to the three months ended September 30, 2017.

In addition, during the three months ended September 30, 2018, we incurred costs of \$0.9 million in provisioning high speed Internet access and billing solutions as compared to \$0.6 million during the three months ended September 30, 2017. The increase in costs was primarily due primarily to the expansion of the Ting Internet foot print and increasing subscriber base.

Cost of revenues from mobile phone equipment and services for the nine months ended September 30, 2018, as compared to the nine months ended September 30, 2017, increased by \$2.0 million or 6% to \$34.6 million. This increase primarily reflects the impact the subscriber base had on Ting mobile service cost of revenue as well as the acquisition of the mobile roaming assets of Otono Networks in September 2017 which combined grew by \$2.1 million to \$27.6 million as compared to the nine months ended September 30, 2017. Mobile hardware and related accessories costs decreased by \$0.1 million compared to the nine months ended September 30, 2017, to \$7.0 million. The decrease was primarily driven by reduced demand for high-priced devices compared to the nine months ended September 30, 2017.

In addition, during the nine months ended September 30, 2018, we incurred costs of \$3.1 million in provisioning high speed Internet access and billing solutions as compared to \$2.4 million during the nine months ended September 30, 2017. The increase in costs was primarily due primarily to the expansion of the Ting Internet foot print and increasing subscriber base.

## **Domain Services**

### ***Wholesale***

Costs for wholesale and value-added services for the three months ended September 30, 2018 decreased by \$4.8 million, or 12%, to \$38.2 million when compared to the three months ended September 30, 2017. The three-month decrease resulted from \$14.5 million of accelerated recognition of prepaid domain registry fees associated with the Namecheap bulk transfer of 2.65 million names during the first quarter of 2018, a portion of which would have otherwise been recognized in the third quarter of 2018, and was offset by an acceleration of \$1.7 million of accelerated recognition of prepaid domain registry fees associated with the 0.24 million additional names transferred to Namecheap in the third quarter of 2018. Costs for wholesale and value-added services for the nine months ended September 30, 2018 increased by \$5.9 million, or 5%, to \$127.0 million when compared to the nine months ended September 30, 2017. The nine-month increase primarily resulted from \$14.5 million of accelerated recognition of prepaid domain registry fees associated with the Namecheap bulk transfer of 2.65 million names during the first quarter of 2018 and \$1.7 million of accelerated recognition of prepaid domain registry fees associated with the 0.24 million additional names transferred to Namecheap in the third quarter of 2018. In addition, cost of revenues increased due to the January 20, 2017 acquisition of eNom.

### ***Retail***

Costs for retail for the three months ended September 30, 2018 decreased by \$0.1 million, to \$4.5 million when compared to the three months ended September 30, 2017. Costs for Retail for the nine months ended September 30, 2018 increased by \$0.5 million, to \$13.3 million when compared to the nine months ended September 30, 2017. The nine-month increase was largely due to increased sales volumes associated with the success our retail marketing initiatives and improved websites are having on our ability to attract new customers and retain existing ones.

***Portfolio***

Costs for portfolio for the three months ended September 30, 2018 remained flat at \$0.1 million, when compared to the three months ended September 30, 2017. Costs for portfolio for the nine months ended September 30, 2018 decreased by \$0.1 million to \$0.5 million, when compared to the nine months ended September 30, 2017.

**Network Expenses**

Network costs for the three months ended September 30, 2018 increased by \$0.4 million to \$4.2 million when compared to the three months ended September 30, 2017. The three-month increase was driven by the expansion of the Company's network infrastructure. Costs for the nine months ended September 30, 2018 increased by \$2.3 million to \$12.8 million when compared to the nine months ended September 30, 2017. The nine-month increase is primarily due to the acquisition of eNom on January 20, 2017, including acquired developed platform technology.

## 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.

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

	<b>Three months ended September 30,</b>		<b>Nine months ended September 30,</b>	
	<b>2018</b>	<b>2017</b>	<b>2018</b>	<b>2017</b>
Sales and marketing	\$ 8,412	\$ 7,384	\$ 24,629	\$ 22,051
Increase over prior period	\$ 1,028		\$ 2,578	
Increase - percentage	14%		12%	
Percentage of net revenues	10%	9%	9%	9%

Sales and marketing expenses for the three months ended September 30, 2018 increased by \$1.0 million, or 14%, to \$8.4 million when compared to the three months ended September 30, 2017. This three-month increase related primarily to an increase of \$1.0 million in workforce and stock-based compensation related costs, which have primarily been driven by workforce increases to support mobile and network access related growth, as well as foreign exchange impacts.

Sales and marketing expenses for the nine months ended September 30, 2018 increased by \$2.6 million, or 12%, to \$24.6 million when compared to the nine months ended September 30, 2017. This nine-month increase related primarily to an increase of \$3.5 million increased workforce and stock-based compensation related costs, which have primarily been driven by workforce increases to support mobile and network access related growth, and foreign exchange impacts. The increase was offset by a \$0.9 million decrease in marketing costs, largely due to timing of expenditures.

## 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, network access services, email, retail, domain portfolio and other Internet services, as well as to distribute our digital content services. All technical operations and development costs are expensed as incurred.

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

	<b>Three months ended September 30,</b>		<b>Nine months ended September 30,</b>	
	<b>2018</b>	<b>2017</b>	<b>2018</b>	<b>2017</b>
Technical operations and development	\$ 2,207	\$ 1,910	\$ 6,657	\$ 5,402
Increase over prior period	\$ 297		\$ 1,255	
Increase - percentage	16%		23%	
Percentage of net revenues	3%	2%	3%	2%

Technical operations and development expenses for the three months ended September 30, 2018 increased by \$0.3 million, or 16%, to \$2.2 million when compared to the three months ended September 30, 2017. The increase in costs relates primarily to increased salaries and benefits driven by an expanding workforce and wage inflation.

Technical operations and development expenses for the nine months ended September 30, 2018 increased by \$1.3 million, or 23%, to \$6.7 million when compared to the nine months ended September 30, 2017. The increase in costs relate primarily to increased salaries and benefits driven by an expanding workforce and wage inflation, as well as the eNom technical operations and development workforce that were included as of January 20, 2017.

## 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.

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

	<b>Three months ended September 30,</b>		<b>Nine months ended September 30,</b>	
	<b>2018</b>	<b>2017</b>	<b>2018</b>	<b>2017</b>
General and administrative	\$ 4,120	\$ 3,381	\$ 12,906	\$ 10,124
Increase over prior period	\$ 739		\$ 2,782	
Increase - percentage	22%		27%	
Percentage of net revenues	5%	4%	5%	4%

General and administrative expenses for the three months ended September 30, 2018 increased by \$0.7 million, or 22%, to \$4.1 million when compared to the three months ended September 30, 2017. The increase was primarily driven by a rise in workforce, contract services, travel and stock-based compensation expenses of \$0.7 million. Other expenses including credit card processing fees related to growth of network access services and facilities costs decreased \$0.2 million, however the impact of foreign exchange revaluation on our monetary assets and liabilities had a \$0.2 million unfavourable impact, compared to the three months ended September 30, 2017.

General and administrative expenses for the nine months ended September 30, 2018 increased by \$2.8 million, or 27%, to \$12.9 million when compared to the nine months ended September 30, 2017. The increase was primarily driven by workforce, contract services, travel and stock-based compensation increased \$1.6 million. Other expenses including credit card processing fees related to growth of network access services and facilities costs increased \$0.2 million, while the impact of foreign exchanges revaluation of our monetary assets and liabilities had a \$1.0 million unfavourable impact, compared to the nine months ended September 30, 2017.

#### DEPRECIATION OF PROPERTY AND EQUIPMENT

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

	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
Depreciation of property and equipment	\$ 106	\$ 155	\$ 309	\$ 486
Decrease over prior period	\$ (49)		\$ (177)	
Decrease - percentage	(32%)		(36%)	
Percentage of net revenues	0%	0%	0%	0%

Depreciation costs decreased by less than \$0.1 million to \$0.1 million as compared to the three months ended September 30, 2017.

Depreciation costs decreased by \$0.2 million to \$0.3 million as compared to the nine months ended September 30, 2017.

#### AMORTIZATION OF INTANGIBLE ASSETS

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

	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
Amortization of intangible assets	\$ 1,797	\$ 1,746	\$ 5,456	\$ 4,735
Increase over prior period	\$ 51		\$ 721	
Increase - percentage	3%		15%	
Percentage of net revenues	2%	2%	2%	2%

Amortization of intangible assets for the three months ended September 30, 2018 increased \$0.1 million to \$1.8 million as compared to the three months ended September 30, 2017. The three-month increase is primarily due to the acquisition of the mobile roaming assets of Otono Networks in September 2017. Amortization of intangible assets for the nine months ended September 30, 2018 increased \$0.7 million to \$5.5 million as compared to the nine months ended September 30, 2017. The nine-month increase was due to the full three-quarter impact of the acquisition of eNom as well as acquisition of the mobile roaming assets of Otono Networks in September 2017.

#### LOSS (GAIN) ON CURRENCY FORWARD 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.

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

	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
Loss (gain) on currency forward contracts	\$ (27)	\$ (54)	\$ 22	\$ (115)
Increase over prior period	\$ 27		\$ 137	
Increase - percentage	50%		119%	
Percentage of net revenues	0%	0%	0%	0%

As of September 30, 2018, we have entered into certain forward exchange contracts that do not comply with the requirements of hedge accounting to meet a portion of our future Canadian dollar requirements through September 2019. The Company recorded a net gain of less than \$0.1 million on the change in fair value of outstanding contracts as well as realized gain on matured contracts, for the three months ended September 30, 2018, as compared to a net gain of \$0.1 million for the change in fair value of outstanding contracts and the settlement of contracts not designated as hedges for the three months ended September 30, 2017.

The Company recorded a net loss of less than \$0.1 million on the change in fair value of outstanding contracts as well as realized gain on matured contracts, compared to a net gain of \$0.1 million for the nine months ended September 30, 2017.

At September 30, 2018, our balance sheet reflects a net derivative instrument liability of \$0.1 million as a result of our existing foreign exchange contracts.

## OTHER INCOME AND EXPENSES

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

	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
Other income (expense), net	\$ (930)	\$ (707)	\$ (2,580)	\$ (2,191)
Increase over prior period	\$ (223)		\$ (389)	
Increase - percentage	32%		18%	
Percentage of net revenues	1%	1%	1%	1%

Other expenses during the three months ended September 30, 2018 was \$0.9 million and \$2.6 million for the nine months ended September 30, 2018, as compared to other expense of \$0.7 and \$2.2 million for the three and nine months ended September 30, 2017. Other expense consists primarily of the interest we incur in connection with our 2017 Amended Credit Facility (as discussed below), which was partially offset by income from the amortization of a \$1.5 million Joint Marketing Agreement commencing in November 2015. The interest incurred primarily relates to our loan balances related to the acquisition of eNom and funding for expenditures associated with the Company's Fiber to the Home program.

## INCOME TAXES

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

	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
Provision for income taxes	\$ 1,370	\$ 1,823	\$ 3,781	\$ 2,781
Increase (decrease) in provision over prior period	\$ (453)		\$ 1,000	
Increase (decrease) - percentage	(25%)		36%	
Effective tax rate	20%	35%	23%	20%

For the three months ended September 30, 2018, we recorded an income tax expense of \$1.4 million on income before income taxes of \$6.7 million, using an estimated effective tax rate for Fiscal 2018 adjusted for certain minimum state taxes as well as the inclusion of a \$0.2 million tax recovery related to ASU 2016-09, which requires all excess tax benefits and tax deficiencies related to employee share-based payments to be recognized through income tax expense. Comparatively, for the three months ended September 30, 2017, we recorded an income tax expense of \$1.8 million on income before taxes of \$5.3 million, using an estimated effective tax rate for the 2017 fiscal year and reflecting the \$0.4 million tax recovery impacted related to ASU 2016-09.

For the nine months ended September 30, 2018, we recorded an income tax expense of \$3.8 million on income before income taxes of \$16.5 million, using an estimated effective tax rate for Fiscal 2018 adjusted for certain minimum state taxes as well as the inclusion of a \$0.5 million tax recovery related to the adoption of ASU 2016-09, which requires all excess tax benefits and tax deficiencies related to employee share-based payments to be recognized through income tax expense on a prospective basis. Comparatively, for the nine months ended September 30, 2017, we recorded an income tax expense of \$2.8 million on income before income taxes of \$13.9 million, using an estimated effective tax rate for Fiscal 2017 adjusted for certain minimum state taxes as well as the inclusion of a \$2.6 million tax recovery related to the adoption of ASU 2016-09.

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

We recognize accrued interest and penalties related to income taxes in income tax expense. We did not have significant interest and penalties accrued at September 30, 2018 and December 31, 2017, respectively.

## ADJUSTED EBITDA

We believe that the provision of this supplemental non-GAAP measure allows investors to evaluate the operational and financial performance of our core business using similar evaluation measures to those used by management. We use adjusted EBITDA to measure our performance and prepare our budgets. Because adjusted EBITDA is a non-GAAP financial performance measure, our calculation of adjusted EBITDA may not be comparable to other similarly titled measures of other companies; and should not be considered in isolation, as a substitute for, or superior to measures of financial performance prepared in accordance with GAAP. Because adjusted EBITDA is calculated before recurring cash charges, including interest expense and taxes, and is not adjusted for capital expenditures or other recurring cash requirements of the business, it should not be considered as a liquidity measure. See the Consolidated Statements of Cash Flows included in the attached financial statements. Non-GAAP financial measures do not reflect a comprehensive system of accounting and may differ from non-GAAP financial measures with the same or similar captions that are used by other companies and/or analysts and may differ from period to period. We endeavor to compensate for these limitations by providing the relevant disclosure of the items excluded in the calculation of adjusted EBITDA to net income based on U.S. GAAP, which should be considered when evaluating the Company's results. Tucows strongly encourages investors to review its financial information in its entirety and not to rely on a single financial measure.

Our adjusted EBITDA definition excludes depreciation, amortization of intangible assets, income tax provision, interest expense (net), stock-based compensation, asset impairment, gains and losses from unrealized foreign currency transactions and infrequently occurring items. Gains and losses from unrealized foreign currency transactions removes the unrealized effect of the change in the mark-to-market values on outstanding unhedged foreign currency contracts, as well as the unrealized effect from the translation of monetary accounts denominated in non-U.S. dollars to U.S. dollars.

The following table reconciles net income to adjusted EBITDA (*Dollar amounts in thousands of U.S. dollars*):

**Reconciliation of Net income to Adjusted EBITDA**  
**(In Thousands of US Dollars)**  
**(unaudited)**

	Three months ended September 30,		Nine months ended September 30,	
	2018 (unaudited)	2017 (unaudited)	2018 (unaudited)	2017 (unaudited)
Net income for the period	\$ 5,346	\$ 3,440	12,698	\$ 11,128
Depreciation of property and equipment	1,445	978	4,007	2,614
Amortization of intangible assets	2,296	2,245	6,953	6,070
Impairment of intangible assets	-	2	-	2
Interest expense, net	914	864	2,761	2,703
Provision for income taxes	1,370	1,823	3,781	2,781
Stock-based compensation	711	203	1,904	834
Unrealized loss (gain) on change in fair value of forward contracts	(35)	1	7	(37)
Unrealized loss (gain) on foreign exchange revaluation of foreign denominated monetary assets and liabilities	(269)	(427)	191	(761)
Acquisition and other costs <sup>1</sup>	80	239	1,123	748
Adjusted EBITDA	<u>\$ 11,858</u>	<u>\$ 9,368</u>	<u>33,425</u>	<u>\$ 26,082</u>

<sup>1</sup> Acquisition and other costs represents transaction-related expenses, transitional expenses, such as duplicative post-acquisition expenses, primarily related to our acquisition of eNom in January 2017. Expenses include severance or transitional costs associated with department, operational or overall company restructuring efforts, including geographic alignments.

Adjusted EBITDA increased to \$11.9 million in the three months ended September 30, 2018 from \$9.4 million in the three months ended September 30, 2017. The increase in adjusted EBITDA from period-to-period was primarily driven an increased contribution by eNom and growth in Ting Mobile.

Adjusted EBITDA increased to \$33.4 million in the nine months ended September 30, 2018 from \$26.1 million in the nine months ended September 30, 2017. The increase in adjusted EBITDA from period to period was primarily driven by the acquisition of eNom on January 20, 2017, growth in domain services and Ting Mobile offset by the continued investment in the Company's Fiber to the Home program.

**OTHER COMPREHENSIVE INCOME (LOSS)**

To mitigate the impact of the change in fair value of our foreign exchange contracts on our financial results, in October 2012 we began applying hedge accounting for the majority of the contracts we need to meet our Canadian dollar requirements on a prospective basis.

The following table presents OCI for the periods presented:

	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017*
Other comprehensive income (loss)	\$ 207	\$ (9)	\$ (36)	\$ 222
Increase over prior period	\$ 216		\$ (258)	
Increase - percentage	(2,400%)		(116%)	
Percentage of net revenues	0%	(0%)	(0%)	0%

The impact of the fair value adjustments on outstanding hedged contracts for the three months ended September 30, 2018 was a gain in OCI of \$0.1 million as compared to a gain of \$0.3 million for the three months ended September 30, 2017. The impact of the fair value adjustment on outstanding hedged contracts for the nine months ended September 30, 2018 was a loss of \$0.1 million compared to a gain of \$0.6 million for the nine months ended September 30, 2017.

The net amount reclassified to earnings during the three months ended September 30, 2018 was a loss of \$0.1 million compared to a gain of \$0.3 million during the three months ended September 30, 2017. The net amount reclassified to earnings during the nine months ended September 30, 2018 was a loss of \$0.1 million compared to a gain of \$0.4 million during the nine months ended September 30, 2017.

## LIQUIDITY AND CAPITAL RESOURCES

As of September 30, 2018, our cash and cash equivalents balance decreased \$7.3 million when compared to December 31, 2017. Our principal uses of cash were \$15.2 million in loan repayments, \$1.2 million for the remaining 10% interest in Ting Virginia, LLC, \$0.5 million of other costs, including tax payment associated with stock option exercises and continued investment in property and equipment of \$19.4 million. These uses of cash were offset by proceeds from an advances of \$2.5 million from our 2017 Amended Credit Facility (defined below) to fund Fiber to the Home program (“FTTH”) and cash provided by operating activities of \$26.5 million for the nine months ended September 30, 2018.

### *2017 Amended Credit Facility*

On January 20, 2017, the Company and certain of its subsidiaries entered into a First Amended and Restated Secured Credit Agreement (the “2017 Amended Credit Agreement”) with Bank of Montreal (“BMO”), Royal Bank of Canada (“RBC”) and Bank of Nova Scotia (the “Lenders”) under which the Company increased its access to funds to an aggregate of \$140 million. The 2017 Amended Credit Agreement amends and restates the Company’s Credit Agreement, dated as of August 18, 2016, with BMO and RBC. The 2017 Amended Credit Agreement, among other things, reduced the existing Tucows non-revolving facility (such existing non-revolving facility, together with other existing facilities, the “Existing Facilities”) from \$40.0 million to \$35.5 million, and established a new non-revolving credit facility of \$85 million (the “New Facility”), and together with the Existing Facilities, the “2017 Amended Credit Facility”). The obligations of the Company under the 2017 Amended Credit Agreement are secured by a first priority lien on substantially all of the personal property and assets of the Company.

Borrowings under the 2017 Amended Credit Agreement accrue interest and standby fees at variable rates based on borrowing elections by the Company and the Company’s total funded debt to EBITDA as described as described more fully in note 7 – Loan payable of the unaudited Consolidated Financial Statements of the Company in Part I, Item 1 in this Quarterly Report on Form 10-Q.

The 2017 Amended Credit Agreement includes an additional repayment mechanism that is triggered based on the Company’s total funded debt to EBITDA calculation at the end of each fiscal year. If total funded debt to EBITDA exceeds 2.25:1 at December 31 of each year during the term, the Company is obligated to make a repayment of 50% of excess cash flow, all as set forth in the 2017 Amended Credit Agreement.

The 2017 Amended Credit Agreement contains customary events of default and affirmative and negative covenants and restrictions, including certain financial maintenance covenants such as a maximum total funded debt to EBITDA ratio and a minimum fixed charge ratio. As of September 30, 2018, we were in compliance with all our covenants.

For more information on the 2017 Amended Credit Agreement, see note 7 – Loan payable to the Consolidated Financial Statements of the Company in Part I, Item 1 in this Quarterly Report on Form 10-Q.

### *Other Credit Facilities*

In addition to the 2017 Amended Credit Agreement, the company is party to a Loan Agreement with BMO, as amended from time to time, most recently in June 2017 (the “2012 Amended Credit Agreement”), pursuant to which the Company currently maintains a treasury risk management facility and credit card facility.

The treasury risk management facility under the 2012 Amended Credit Agreement provides for a \$3.5 million settlement risk line to assist the Company with hedging Canadian dollar exposure through foreign exchange forward contracts and/or currency options. Under the terms of the 2012 Amended Credit Agreement, the Company may enter into such agreements at market rates with terms not to exceed 18 months. As of September 30, 2018, the Company held contracts in the amount of \$10.7 million to trade U.S. dollars in exchange for Canadian dollars.

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

### ***Cash Flow from Operating Activities***

Net cash provided by operating activities during the nine months ended September 30, 2018 was \$26.5 million, as compared to \$17.8 million during the nine months ended September 30, 2017.

Net income, after adjusting for non-cash charges, during the nine months ended September 30, 2018 was \$24.3 million. Net income included non-cash charges and recoveries of \$11.6 million such as depreciation, amortization, stock-based compensation, excess tax benefits on stock-based compensation, other income, unrealized gains on currency forward contracts, and disposal of domain names. In addition, changes in our working capital provided \$2.2 million. Positive contributions of \$18.4 million from movements in domain registry fees, accounts receivable, accounts payable, accrued liabilities, and income taxes recoverable were offset by \$16.2 million utilized in changes from prepaid expenses, inventory, customer deposits, accreditation fees payable and deferred revenue.

### ***Cash Flow from Financing Activities***

Net cash outflows from financing activities during the nine months ended September 30, 2018 totaled \$13.1 million as compared to cash inflows of \$69.7 million during the nine months ended September 30, 2017. Cash outflows of \$15.3 million related to principal repayments and loan costs relating to our 2017 Amended Credit Facility and a \$0.3 million outflow from the net impact of exercise of stock options, offset by cash inflows of \$2.5 million from advances from our 2017 Amended Credit Facility. During the nine months ended September 30, 2017, the net cash inflow of \$69.7 million was primarily related to the \$87.0 million draw on the 2017 Amended Credit Facility to fund the acquisition of eNom and to fund FTTH capital expenditures, offset by \$17.3 million in loan principal and cost payments as well as tax obligations related to the net exercise of stock options.

### ***Cash Flow from Investing Activities***

Investing activities during the nine months ended September 30, 2018 used net cash of \$20.8 million as compared to using \$90.1 million during the nine months ended September 30, 2017.

On February 14, 2018, the Company acquired the remaining 10% interest in Ting Virginia, LLC. for a consideration of \$1.2 million. The consideration was funded through cash flow from operations. For additional details, see note Acquisitions to the interim unaudited financial statements of the Company in Part I, Item 1 in this Quarterly Report on Form 10-Q.

In addition, the Company invested \$19.4 million in property and equipment, primarily to support the continued expansion of our fiber footprint. The Company continues to invest in our existing Ting Towns of Charlottesville, VA, Holly Springs, NC and Westminster, MD as well as ramping construction in Sandpoint, ID and Centennial, CO, as we seek to extend both our current network and expand to new towns. We expect our capital expenditures on building and expanding our fiber network to increase significantly during Fiscal 2018.

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 or need 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.

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

### **Off-Balance Sheet Arrangements**

As of September 30, 2018, we did not have any off-balance sheet arrangements, as defined in Item 303(a)(4)(ii) of SEC Regulation S-K.

### **Contractual Obligations**

In our Annual Report on Form 10-K for the year ended December 31, 2017, we disclosed our contractual obligations.

As of September 30, 2018, there have been no other material changes to those contractual obligations outside the ordinary course of business.