

TUCOWS INC /PA/
Form 10-K
March 28, 2008

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-K

**FOR ANNUAL AND TRANSITION REPORTS PURSUANT TO
SECTIONS 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

(Mark One)

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

For the fiscal year ended December 31, 2007

OR

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

Commission file number 0-28284

Tucows Inc.

(Exact Name of Registrant as Specified in Its Charter)

Pennsylvania
(State or Other Jurisdiction of
Incorporation or Organization)

23-2707366
(I.R.S. Employer
Identification No.)

96 Mowat Avenue
Toronto, Ontario, Canada
(Address of Principal Executive Offices)

M6K 3M1
(Zip Code)

Registrant's telephone number, including area code: **(416) 535-0123**

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class

Name of Each Exchange on Which Registered

Common Stock, no par value

American Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:

None

(Title of Class)

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Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by checkmark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the 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 Act). Yes No

As of June 30, 2007 (the last day of our most recently completed second quarter), the aggregate market value of the common stock held by non-affiliates of the registrant was \$67.2 million. Such aggregate market value was computed by reference to the closing sale price per share of \$1.19 as reported on the American Stock Exchange on such date. For purposes of making this calculation only, the registrant has defined affiliates as including all officers, directors, and beneficial owners of more than five percent of the common stock of the Company. In making such calculation, the registrant is not making a determination of the affiliate or non-affiliate status of any holders of shares of the registrant's common stock.

The number of shares outstanding of the registrant's common stock as of March 24, 2008 was 73,888,542.

TUCOWS INC.

ANNUAL REPORT ON FORM 10-K

For Fiscal Year Ended December 31, 2007

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Information Concerning Forward-Looking Statements

This Report on Form 10-K 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 number of new, renewed and transferred-in domain names, the competition we expect to encounter as our business develops and competes in a broad range of Internet services, the effectiveness of our intellectual property protection, including our ability to license proprietary rights to network partners and to register additional trademarks and service marks, our belief that the market for domain name registration will trend upward gradually, our belief that it is more likely than not that net deferred assets will be realized; our expectations regarding our acquisition of the assets of Critical Path, Inc. and the equity of Mailbank.com Inc.; our expectations regarding the cost of compliance with Sarbanes-Oxley and our belief that, by increasing the number of applications and services we offer, we will be able to generate higher revenues. These statements are based on management's current expectations and are subject to a number of uncertainties and risks that could cause actual results to differ materially from those described in the forward-looking statements. Many factors affect our ability to achieve our objectives and to successfully develop and commercialize our services including:

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

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

The ability of vendors to continue to supply our needs;

Actions by our competitors;

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

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

Our ability to effectively manage our business;

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

Pending or new litigation; and

Factors set forth herein under the caption "Item 1A Risk Factors".

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

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

PART I

ITEM 1. BUSINESS

Overview

Tucows, together with our consolidated subsidiaries provide domain names, email and other services through our extensive reseller network and directly to consumers and small businesses through our retail and content groups.

Our worldwide reseller network has grown to include more than 9,000 web-hosting companies, Internet Service Providers, or ISPs, and other resellers in more than 100 countries. Our primary focus is serving the needs of this network of resellers by providing superior services, easy-to-use interfaces, proactive and attentive customer service, reseller-oriented technology and agile design and development processes.

We seek to provide superior customer service to our resellers by anticipating their business needs and technical requirements. This includes providing easy-to-use interfaces to our services, so that resellers can quickly and easily integrate our services into their individual business processes, and offering brand-able end-user interfaces that emphasize simplicity and visual appeal. In the event resellers experience issues or problems with our services, we also provide "second tier" support to our resellers by email and phone. In addition, our Network Operating Center provides proactive support to our resellers by monitoring all services and network infrastructure to eliminate issues before they pose a problem for our resellers.

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

Our Company is organized into four service and product related groups, which are discussed below in more detail.

Our *Reseller Services* group manages over eight million domain names, millions of mailboxes and tens of thousands of Secure Socket Layer, or SSL, certificates through a network of over 9,000 web hosts, ISPs, and other resellers around the world.

Our *Retail Services* group offers these services to consumers and small businesses through our three consumer brands: Domain Direct (domaindirect.com), NetIdentity (netidentity.com), and IYD (ItsYourDomain.com).

As of February 20, 2008, our *Domain Portfolio* group oversees over 150,000 domain names, most of which generate advertising revenue and many of which we offer for resale via our reseller network and other channels. Included in the Domain Portfolio are over 30,000 domains that are the basis of our Personal Names Service that allows over two-thirds of Americans to purchase a domain or email address based on their name.

Additionally, our *Content* group generates advertising revenue through tucows.com, one of the oldest and most popular software download sites on the Internet.

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

On July 25, 2007, we acquired Innerwise Inc., a privately held, ICANN-accredited registrar offering domain services through a worldwide wholesale network of over 2,500 affiliates.

On June 19, 2006, we acquired Mailbank.com, Inc. (doing business as NetIdentity). We use these assets to offer personalized Internet services directly to end-users through Domain Direct and its channel of resellers, as well as to generate income from the parked page of each domain address.

To expand our presence in the email market, on January 3, 2006, we acquired all of the hosted messaging assets of Critical Path, Inc.

On April 27, 2004, we acquired Boardtown Corporation, a total billing and customer management solution created specifically for ISPs and web hosting companies.

Services

Our four main service and product related groups service our customers as set forth below.

Reseller Services

Our Reseller Services group provides six primary service offerings: Domain Services, Email Services, Personal Names Service, SSL Service, Platypus ISP Billing Solutions and Blogware and web site Builder Publishing Service.

Domain Service

Our Domain Service allows resellers to register domains on behalf of their end-users using Tucows' accreditations with eight gTLD (generic top-level domain) registries and seventeen ccTLD (country-code top-level domain) registries.

Our pricing for gTLD domains is based on a transparent "cost-plus" pricing model and is offered on a per domain, per year, basis. When a domain is purchased or renewed, resellers are charged registry and ICANN fees (at cost) plus a Tucows Management Fee. ccTLDs pricing is based on a set bundled price that allows us to provide for currency fluctuations and additional administrative overhead for some registries. We impose no restrictions on the prices resellers charge their end-users.

Our Management Fee and our ccTLD pricing, provides resellers with access to many relevant provisioning and management tools such as a domain name suggestions, a share of net parked domain advertising revenues, access to Premium Names (a domain resale marketplace for names held by large domain portfolio owners), domain registrant privacy and other domain management tools.

Our Domain Service is available via our web-based control panels or API (Application Programming Interface). Additionally, ICANN-accredited registrars can also use our Domain Service to process domain registrations with their accreditation. This fee-based option allows registrars to use a proven system without incurring the costs of building their own technical infrastructure.

Email Service

Our Email Service offers resellers the ability to outsource the often costly and problematic need to host email accounts for their end-users. It also allows email to become a strategic part of the resellers'

businesses, which can increase customer loyalty and satisfaction while reducing support and infrastructure costs.

The Email Service is offered on a per account per month basis, and provides resellers with a reliable, scalable "white label" email hosting solution that can be customized to their branding and business model requirements. The Email Service also includes spam and virus filtering on all accounts. End-users can access the Email Service via a full-featured multi-language AJAX-enabled web interface, a WAP mobile interface, or through traditional desktop email clients, such as Microsoft Outlook or Apple Mail, using IMAP or POP/SMTP.

Personal Names Service

Our Personal Names Service is based on our portfolio of over 30,000 domain names related to popular North American and international surnames. The Personal Names Service is offered on a per account per month basis, similar to our Email Service.

The Personal Names Service allows resellers to offer individual end-users domain names and email addresses based on their names. We estimate that two-thirds of Americans will find their name within our Personal Names Service, making it a unique service available only through our resellers. For example, Amy Smith could use amy.smith.net as the address of her personal web site and amy@smith.net as her email address.

SSL Service

We have a partnership with GeoTrust to provide resellers with wholesale pricing on an array of SSL certificate options that they can in turn sell to end-users, primarily businesses. SSL digital certificates allow web sites to provide secure transactions and restrict access to information, and are sold on a per certificate per year basis.

Other Services

Platypus ISP Billing Solution Platypus is a Windows software solution that ISPs install in-house and that provides ISPs with an industry-specific solution to billing, service provisioning, and customer account management. Platypus includes an integrated help desk system that automatically routes, tracks and maintains customer support email and phone calls to improve service desk performance.

Revenue is generated through licensing fees, support contracts, professional services, and fees related to an outsourced statement printing service offered within Platypus that allows ISPs to outsource the sending of physical invoices to Tucows.

Blogware and Web Site Builder Publishing Services Blogware is a hosted blogging solution that allows resellers to offer their end-users professional-looking blogs that are easy to create and update. Similarly, Web Site Builder allows resellers to provide their end-users with template-based web sites.

Both of our Platypus and Blogware services are sold on a per account per month basis.

Retail Services

We offer consumers and small businesses domain registration, email and other Internet services through our three retail brands: Domain Direct (domaindirect.com), NetIdentity (netidentity.com) and IYD (itsyourdomain.com). Our Net Identity brand also offers Personal Names Services to consumers.

Domain Portfolio

We have over 150,000 domain names in our private domain name portfolio. We purchase and renew names based on their ability to generate advertising revenue and their appeal for resale to consumers, businesses and other large portfolio owners.

The size of our domain name portfolio varies over time, as we acquire and sell domains on a regular basis to increase the overall value and revenue generation potential of our portfolio.

Our domain name portfolio is made up of four classes of domain names: Gems, Premium Names, Direct Navigation Names and Surnames.

Gems are considered to have the highest potential resale value in the portfolio. Many of the names in this class either generate significant advertising revenue or are highly brandable or both. Typically, these names are sold to strategic investors or businesses through auction or direct negotiation with potential acquiring parties.

Premium Names are domains that would be appropriate for websites and could potentially act as brands for the businesses operating at those domains. These domains generate small amounts of advertising revenue for Tucows but are primarily held for resale through the emerging aftermarket for domain names.

Direct Navigation Names generally have nominal "brand value", but do generate advertising revenue from pay-per-click advertising that we place on these sites. Such domains typically generate traffic from Internet users typing the domain name directly into their web browser in an attempt to find information on that particular topic. Advertisements placed on the web site then direct such users to advertisers' web sites.

Surnames are domain names related to last names found in the United States and Internationally. We do not typically sell these names as they are the basis of the Personal Names Service we offer to resellers through the NetIdentity retail brand.

Content

Since 1993, "tucows.com" has been one of the most popular directories of over 40,000 shareware, freeware and demo software packages available for download on the Internet. We redesigned the website in 2007 in order to place solutions to common technical problems in conspicuous locations on the homepage and throughout the site. The site is heavily community-centric offering visitors the ability to rate and review software and solutions found on the site. Visitors are also able to submit their own solutions and comment on those submitted by others. Since we launched the website, we have been committed to providing a quality experience for Internet users. Each title in our software directory is checked for spyware and viruses by a member of our editorial team. Advertisers and software developers of all sizes can reach Tucows' global readership through on-site ads or product placement within the directory.

Intellectual Property

We believe that we are well positioned in the wholesale domain registration and email markets due in part to our highly-recognized "Tucows" brand and the respect it confers on us as a defender of end-user rights and reseller friendly approaches to doing business. We were among the first group of thirty-four registrars to be accredited by the Internet Corporation for Assigned Names and Numbers (ICANN) in 1999 and we remain active in Internet governance issues.

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Our success and ability to compete depend on our ability to develop and maintain the proprietary aspects of our brand name and technology. We rely on a combination of trademark, trade secret and copyright laws, as well as contractual restrictions, to protect our intellectual property rights.

We registered the Tucows trademark in the United States, Canada and the European Union and we register additional service marks and trademarks as appropriate and where such protection is available.

We seek to limit disclosure of our intellectual property by requiring all employees and consultants with access to our proprietary information to commit to confidentiality, non-disclosure and work-for-hire agreements. All of our employees are required to sign confidentiality and non-use agreements, which provide that any rights they may have in copyrightable works or patentable technologies accrue to us. Before entering into discussions with potential vendors and partners about our business and technologies, we require them to enter into a non-disclosure agreement. If these discussions result in a license or other business relationship, we also generally require that the agreement containing the parties' rights and obligations include provisions for the protection of its intellectual property rights.

Customers

The majority of the customers to whom we provide Reseller Services are generally either web hosts or ISPs. A small number are consultants and designers providing our services to their business clients. Our Retail Services customers are a very broad mix of consumers, small businesses and corporations.

No single reseller represented more than 10% of our consolidated revenues in any of the last five fiscal years.

While web hosts and ISPs are capitalizing on the growth in Internet usage and the demand for new services, they also face significant competition from numerous other resellers with competitive or comparable offerings. This has led such web hosts and ISPs to focus on core competencies, as such resellers are increasingly seeking to outsource non-core services. Outsourcing enables these resellers to better focus on customer acquisition and retention efforts by eliminating the need to own, develop and support non-core applications in-house.

Seasonality

During the summer months and certain other times of the year, such as major holidays, Internet usage often declines. As a result, many of our services (reseller, retail and content) may experience reduced demand.

For example, our experience shows that new domain registrations and traffic on our download site decline during the summer months and around the year-end holidays. Seasonality may also affect advertising having a slight impact on both the content group and the domain name portfolio's advertisement-based revenue. These seasonal effects could cause fluctuations in our financial results as well as the content site's performance statistics reported and measured by leading Internet audience measurement services such as Media Metrix, Inc.

Competition

Our competition may be divided into the following groups:

Retail-oriented domain registrars such as GoDaddy, Network Solutions and Register.com who compete with our Resellers and our own Retail operations for end-users.

Wholesale-oriented domain registrars, such as eNom, Wild West Domains (a division of GoDaddy) and Melbourne IT, who market services to resellers such as our customers.

Wholesale Email Service providers such as Google, Yahoo!, Microsoft, Bluetie and Everyone.net.

ISP billing solution providers such as Rodopi.

Ad-supported content providers such as CNET's Download.com.

We expect to continue to experience significant competition from the competitors identified above and, as our business develops, we expect to encounter competition from other providers of Internet services. Service providers, Internet portals, web hosting companies, email hosting companies, outsourced application companies, country code registries and major telecommunication firms may broaden their services to include services we offer.

We believe the primary competitive factors in our Reseller Services are:

Providing superior customer service by anticipating the technical requirements and business objectives of resellers and providing them with technical advice to help them understand how our services can be customized to meet their particular needs.

Providing cost savings over in-house solutions by relieving resellers of the expense of acquiring and maintaining hardware and software and the associated administrative burden.

Enabling resellers to better manage their relationships with their end-users.

Facilitating scalability through an infrastructure designed to support millions of transactions across millions of end-users.

Providing superior technology and infrastructure, consisting of industry-leading software and hardware that allows resellers to provide these services to their customers without having to make substantial investments in their own software or hardware.

Although we encounter pricing pressure in many markets in which we compete, we believe the effects of that pressure are mitigated by the fact that we deliver a high degree of value to our resellers through our business and technical practices. We believe our status as a trusted supplier also allows us to mitigate the effects of this type of competition. We believe that the long-term relationships we have made with many resellers results in a sense of certainty that would not be available to those resellers through a competitor.

Employees

As of December 31, 2007, we had approximately 200 full-time employees. None of our employees are currently represented by a labor union. We consider our relations with our employees to be good.

Corporate Information

Tucows Inc. was 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 offices are located in Toronto, Ontario, Canada and we have offices in the United Kingdom and the United States.

Executive Officers of the Registrant

The following table sets forth the names, ages and titles of persons currently serving as our executive officers.

Name	Age	Title
Elliot Noss	45	President and Chief Executive Officer
Michael Cooperman	56	Chief Financial Officer
David Woroch	45	Vice President, Sales and Support
Kenneth Schafer	48	Vice President, Product Management and Marketing
Carla Goertz	50	Vice President, Human Resources

Elliot Noss has served as our President and Chief Executive Officer since May 1999 and served as Vice President of Corporate Services for Tucows Interactive Limited, which was acquired by Tucows in May 1999, from April 1997 to May 1999.

Michael Cooperman has served as our Chief Financial Officer since January 2000. From October 1997 to September 1999, Mr. Cooperman was the Chief Executive Officer of Archer Enterprise Systems Inc., a developer of sales force automation software.

David Woroch has served as our Vice President Sales and Support since July 2001. From March 2000 to July 2001, Mr. Woroch served as our Director of Sales for North America. Before joining us, Mr. Woroch spent 13 years at IBM Canada in a variety of roles including sales, marketing, finance and strategic planning.

Kenneth Schafer has served as our Vice President, Product Management and Marketing since April 2006. Before joining us, Mr. Schafer worked as an independent consultant from 1999 to 2006.

Carla Goertz has served as our Vice President, Human Resources since August 2005. Before joining us Ms. Goertz held the position of Director, Human Resources at TechData Canada from April 2004 to July 2005. From November 2001 to July 2003, she held the position of Vice President, Human Resources and Administration for Castek Inc.

Investor Information

The public may read and copy any materials we file with the Securities and Exchange Commission, or SEC, at the SEC's Public Reference Room at 100 F Street, NE, Washington, DC 20549 on official business days during the hours of 10:00 am to 3:00 pm. The public may obtain information on the operation of the Public Reference Room by calling 1-800-SEC-0330. The SEC maintains an internet site that contains reports, proxy and information statements and other information regarding issuers that file electronically at <http://sec.gov>.

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Our web site address is <http://about.tucows.com>. We make available through our web site, free of charge, copies of our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 as soon as reasonably practicable after filing such material electronically or otherwise furnishing it to the SEC.

The information on the web site listed above is not and should not be considered part of this Annual Report on Form 10-K and is not incorporated by reference in this document.

We were incorporated in the Commonwealth of Pennsylvania in November 1992. Our executive offices are located at 96 Mowat Avenue, Toronto, Ontario, Canada M6K 3M1. Our telephone number is (416) 535-0123.

ITEM 1A. RISK FACTORS

Our business faces significant risks. Some of the following risks relate principally to our business and the industry and statutory and regulatory environment in which we operate. Other risks relate principally to the securities markets and ownership of our stock. The risks described below may not be the only risks we face. Additional risks that we do not yet know of or that we currently think are immaterial may also impair our business operations. If any of the events or circumstances described in the following risk factors actually occur, our business, financial condition or results of operations could suffer, and the trading price of our common stock could decline.

Risks Related to Our Business and Industry

We may not be able to maintain or improve our competitive position and may be forced to reduce our prices because of strong competition in the market for Internet services generally and domain name registration in particular, which we expect will continue to intensify.

The market for Internet services generally and domain registrations in particular is intensely competitive and rapidly evolving as participants strive to protect their current market share and improve their competitive position. Most of our existing competitors are also expanding the variety of services that they offer. These competitors include, among others, domain name registrars, website design firms, website hosting companies, Internet service providers, Internet portals and search engine companies, including Google, Microsoft, Network Solutions, VeriSign and Yahoo!. Competitors like Microsoft, Google and Yahoo!, as well as other large Internet companies, have the ability to offer these services for free or at a reduced price as part of a bundle with other service offerings. If these companies decide to devote greater resources to the development, promotion and sale of these new products and services, greater numbers of individuals and businesses may choose to use these competitors as their starting point for creating an online presence and as a general platform for running their online business operations. In particular, VeriSign may in the future decide to offer additional services that compete with our domain name registration services or other services. If VeriSign were to become a competitor of ours in our core business areas, VeriSign would likely enjoy a number of competitive advantages, including its position as the largest registry, as well as superior financial and operational resources and customer awareness within our industry.

In addition, other large competitors, in an attempt to gain market share, may also offer aggressive price discounts on the services they offer. These pricing pressures may require us to match these discounts in order to remain competitive, which would reduce our margins, or potentially cause us to lose customers altogether who decide to purchase these discounted services.

We also face significant competition from other existing registrars and the continued introduction of new registrars in the domain registration industry. As of March 5, 2008, ICANN had accredited 925 competitive registrars, including our Company, to register domains in one or more of the gTLD's, though not all of these accredited registrars are operational. There are relatively few barriers to entry

in this market and the continued introduction of competitive registrars and Service Providers into the domain registration industry and the rapid growth of some competitive registrars and Service Providers who have already entered the industry may make it difficult for us to maintain our current market share. Some of these registrars may have longer operating histories, greater name recognition, particularly in international markets, or greater resources than us. We expect that competition will increase in the near term and that our primary long-term competitors may not yet have entered the market. As a result, we may not be able to compete effectively.

As our business model is premised upon selling multiple services through our resellers, we have competed aggressively to attract new clients and retain existing customers. As a result of these actions, our average selling prices have fallen and we may be required, by marketplace factors or otherwise, to reduce, perhaps significantly, the prices we charge for our domain registration and related products and services. The decline in our average selling price has partially offset the impact of increased transaction volume on our revenue and profitability. The likelihood of further declines in our selling price will increase if our competitors who charge these reduced fees are able to maintain customer service comparable to ours. We may face continued pricing pressure in order to remain competitive, which would adversely impact our revenues and profitability. While we anticipate that the number of new, renewed and transferred-in domain registrations will incrementally increase, volatility in the market could result in our customers turning to other registrars, thereby impairing growth in the number of domains under our management and our ability to sell multiple services to such customers. Since our strategy is to expand the services we provide our customers, if we are unable to maintain our domain registrations, our ability to expand our business may be adversely effected.

Each registry and the ICANN regulatory body impose a charge upon the registrar for the administration of each domain registration. If these fees increase, this may have an impact upon our profits.

Each registry typically imposes a fee in association with the registration of each domain. For example, the VeriSign registry presently charges a \$6.42 fee for each.com registration. ICANN charges a \$0.20 fee for each domain name registered in the TLDs that fall within its purview. We have no control over these agencies and cannot predict when they may increase their respective fees. In terms of the current registry agreement between ICANN and Verisign that was approved by the U.S. Department of Commerce on November 30, 2006, VeriSign will continue as the exclusive registry for the.com TLD and is entitled to increase the fee it receives for each.com domain name registration by 7% annually in any four of the six years through 2012, and potentially beyond that date. In terms of a pricing policy these increases will be passed through to our resellers, while other registrars may choose to absorb them. If such cost increases act as a deterrent to registration, we may find that our profits are adversely impacted by these third-party fees.

We rely on our network of resellers to renew their domain registrations through us and to distribute our applications and services, and if we are unable to maintain these relationships or establish new relationships, our revenues will decline.

The growth of our business depends on, among other things, our resellers' renewal of their customers' domain registrations through us. Resellers may choose to renew their domains with other registrars or their registrants may choose not to renew and pay for renewal of their domains. This may reduce our Resellers' number of domain name registration customers which in turn would drive up their customer acquisition costs and harm our operating results. If resellers decide, for any reason, not to renew their registrations through us, it may in turn reduce the market to which our resellers could market our other higher-margin services, thereby further impacting our revenue and profitability and harming our operating results. Since our strategy is to expand the number of services we provide to our customers, any decline in renewals of domain name registrations that are not offset by new domain name registrations would likely have an adverse effect on our business and results of operations.

We believe that companies operating on the Internet are facing a period of consolidation. In addition, some of our resellers may decide to seek ICANN accreditation. Both of these situations could reduce the number of our active resellers, in which case our revenues may suffer.

If any of our competitors merge with one another, they will present a stronger combined force in the market and may attract the business of both existing and prospective resellers. Resellers may opt to build their own technical systems and seek ICANN accreditation in order that they may process domain applications themselves. If a number of our customers decide to pursue this option, our sales will decrease.

Our failure to secure agreements with country code registries or our subsequent failure to comply with the regulations of the country code registries could cause customers to seek a registrar that offers these services.

The country code top-level domain, or ccTLD, registries require registrars to comply with specific regulations. Many of these regulations vary from ccTLD to ccTLD. If we fail to comply with the regulations imposed by ccTLD registries, these registries will likely prohibit us from registering or continuing to register domains in their ccTLD. Any failure on our part to offer domain registrations in a significant number of ccTLDs or in a popular ccTLD would cause us to lose a competitive advantage and could cause resellers to elect to take their business to a registrar that does offer these services.

Our standard agreements may not be enforceable, which could subject us to liability.

We operate on a global basis and all of our resellers must execute our standard agreements that govern the terms of the services we provide to our customers. These agreements contain provisions intended to limit our potential liability arising from the provision of services to our resellers and their customers, including liability resulting from our failure to register or maintain domains properly, from downtime or poor performance with respect to our Internet services, or for insecure or fraudulent transactions pursuant to which we have issued SSL certificates. As most of our customers purchase our services online, execution of our agreements by resellers occurs electronically or, in the case of our terms of use, is deemed to occur because of a user's continued use of the website following notice of those terms. We believe that our reliance on these agreements is consistent with the practices in our industry, but if a domestic, foreign or international court were to find that either one of these methods of execution is invalid or that key provisions of our services agreements are unenforceable, we could be subject to liability that has a material adverse effect on our business or we could be required to change our business practices in a way that increases our cost of doing business.

Regulation could reduce the value of Internet domain names or negatively impact the Internet domain acquisition process, which could significantly impair the value attributable to our acquisitions of Internet domain names.

The acquisition of expiring domain names for parked page commercialization, sale of names or acquisition of names for other uses, involves the registration of thousands of Internet domain names, both in the United States and internationally. We have and intend to continue to acquire previously-owned Internet domain names that have expired and have, following the period of permitted reclamation by their prior owners, been made available for sale. Furthermore, in addition to the names we acquired in our acquisition of Mailbank.com Inc., in June 2006, we have separately acquired and intend to continue to acquire in the future other previously-owned Internet domain names. The acquisition of Internet domain names generally is governed by federal or international regulatory bodies. The regulation of Internet domain names in the United States and in foreign countries is subject to change. Regulatory bodies could establish additional requirements for previously-owned Internet domain names or modify the requirements for holding Internet domain names. As a result, we might not acquire or maintain names that contribute to our financial results in the same manner as we currently do. Because certain Internet domain names are important assets, a failure to acquire or

maintain such Internet domain names could adversely affect our financial results and our growth. Any impairment in the value of these important assets could cause our stock price to decline.

If we cannot obtain or develop additional applications and services that are appealing to our customers, we may remain dependent on domain registrations as a primary source of revenue and our net revenues may fall below anticipated levels.

A key part of our long-term strategy is to diversify our revenue base by offering our resellers additional value-added products and services that address their evolving business needs. Although we have recently experienced increased sales for new products and services such as email and web certificates, our efforts to date have not resulted in substantial diversification. We cannot be sure that we will be able to license new applications and services at a commercially viable cost or at all, or that we will be able to cost-effectively develop the applications in-house. If we cannot obtain or develop these applications on a cost-effective basis and cannot expand the range of our service offerings, sales of our services may suffer as resellers turn to alternate providers that are able to more fully supply their business needs.

As part of our diversification strategy, in January 2006 we acquired the hosted messaging business of Critical Path, Inc., a leading email services provider. The acquisition expands our presence in the email market but also increases our exposure in this volatile business.

Factors that are likely to contribute to fluctuations in our operating results from provisioning hosted email services include:

the demand for outsourced messaging services;

our ability to attract and retain customers and provide customer satisfaction;

the ability to upgrade, develop and maintain our systems and infrastructure and to effectively respond to the rapid technological changes in the messaging market;

the budgeting and payment cycles of our existing and potential customers;

the amount and timing of operating costs and capital expenditures relating to expansion of the messaging business; and

the introduction of new or enhanced services by competitors.

In order to succeed in the hosted messaging business, our email product must remain competitive. We believe that some of the competitive factors affecting the market for hosted messaging services include:

breadth of platform features and functionality of our offering and the sophistication and innovation of our competitors;

scalability, reliability, performance and ease of expansion and upgrade;

ease of integration with customers' existing systems; and

flexibility to enable customers to manage certain aspects of their systems and leverage outsourced services in other cases when resources, costs and time to market reasons favor an outsourced offering.

We believe competition will continue to be strong and further increase as our market attracts new competition, current competitors aggressively pursue customers, increase the sophistication of their offerings and as new participants enter the market. Many of our current and potential customers have longer operating histories, larger customer bases, greater brand recognition in the business and greater financial, marketing and other resources than we do. Any delay in our development and delivery of new services or enhancement of existing services would allow our competitors additional time to

improve their product offerings and provide time for new competition to develop and market messaging services. Increased competition could result in pricing pressures, reduced operating margins and loss of market share, any of which could cause our financial results to decline.

If we fail to migrate customers to our new email platform, our services revenues may decline.

During Fiscal 2006, we began investing in the re-architecture of our email service due to inefficiencies in the older platform we had purchased from Critical Path. These inefficiencies were undermining our customer's experience and increasing our customer support incidences. During Fiscal 2007, we introduced our new email service and in January 2008, further extended the capabilities of our new email service by offering customers stand-alone spam and virus filtering functionality. We are in the process of migrating our customer base to our new email service. This migration entails significant technical and business risks, including the cooperation of our existing customers, and has required substantial expenditures and lead-time. Migration will be on a customer-by-customer basis and a poor migration will impact our ability to retain existing customers and may make it more challenging to attract new customers. We also expect some current customers will not want to migrate to our new email service. If sufficient existing customers decide not to migrate to our new email service, it will cause our revenues and financial results to suffer. In addition, if we are unable to attract new customers, our ability to grow our business in this area will be adversely impacted.

If we are unable to maintain our relationships with our customers, our revenue may decline.

Our network of resellers are our principal source for distributing services. We also rely on our resellers to market, promote and sell our services. Our ability to increase revenues in the future will depend significantly on our ability to maintain our customer network, to sell more services through existing resellers and to develop our relationships with existing resellers by providing customer and sales support and additional products. Resellers have no obligations to distribute our applications and services and may stop doing so at any time. If we are not able to maintain our relationships with resellers, our ability to distribute our applications and services will be harmed, and our revenue may decline.

With respect to our hosted eMail service, we rely on a limited number of customers for a high percentage of our revenues. The loss of one or several of these major customers, whether through termination of agreement, acquisition or bankruptcy, could have a significant impact on our revenues. Our agreements with our email customers typically have terms of one to three years often with automatic one-year renewals and can be terminated without cause upon certain notice periods that vary among our agreements and range from a period of 30 to 120 days notice.

The international nature of our business exposes us to certain business risks that could limit the effectiveness of our growth strategy and cause our results of operations to suffer.

Expansion into international markets is an element of our growth strategy. Introducing and marketing our services internationally, developing direct and indirect international sales and support channels and managing foreign personnel and operations will require significant management attention and financial resources. We face a number of risks associated with expanding our business internationally that could negatively impact our results of operations, including:

management, communication and integration problems resulting from cultural differences and geographic dispersion;

compliance with foreign laws, including laws regarding liability of online resellers for activities of customers and more stringent laws in foreign jurisdictions relating to the privacy and protection of third-party data;

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accreditation and other regulatory requirements to provide domain name registration, website hosting and other services in foreign jurisdictions;

competition from companies with international operations, including large international competitors and entrenched local companies;

to the extent we choose to make acquisitions to enable our international expansion efforts, the identification of suitable acquisition targets in the markets into which we want to expand;

difficulties in protecting intellectual property rights in international jurisdictions;

political and economic instability in some international markets;

sufficiency of qualified labor pools in various international markets;

currency fluctuations and exchange rates;

potentially adverse tax consequences or an inability to realize tax benefits; and

the lower level of adoption of the Internet in many international markets.

We may not succeed in our efforts to expand our international presence as a result of the factors described above or other factors that may have an adverse impact on our overall financial condition and results of operations.

We currently license many third party technologies and may need to license further technologies which could delay and increase the cost of product and service developments

We currently license certain technologies from third parties and incorporate them into certain of our services including email, anti-spam, anti-virus and web site publishing tools. The Internet services market is evolving and we may need to license additional technologies to remain competitive. We may not be able to license these technologies on commercially reasonable terms or at all. To the extent we cannot license necessary solutions, we may have to devote our resources to development of such technologies, which could delay and increase the cost of product and service developments overall.

In addition, we may fail to successfully integrate licensed technology into our services. These third party licenses may expose us to increased risks, including risks related to the integration of new technology and potential intellectual property infringement claims. In addition, an inability to obtain needed licenses could delay product and service development until equivalent technology can be identified, licensed and integrated. Any delays in services or integration problems could hinder our ability to attract and retain customers and cause our business and operating results to suffer.

We depend on third parties for free and low cost web-based content.

We access and provide web-based content for certain of our content notification and other sites. We access this content mainly by searching selected websites and then providing links to relevant content from the individual sites. Typically, we pay no fee, or a nominal fee, for accessing web-based content in this manner. Our ability to continue to use web-based content in this manner without cost, or for nominal fees, is fundamental to our goal of providing free, or low cost, content notification sites. If the market changes and owners begin to charge more significant fees for accessing material from their websites, we will incur additional expenses to provide the service or we may decide to no longer provide the service.

Our advertising revenues may be subject to fluctuations.

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We believe that Internet advertising spending, as in traditional media, fluctuates significantly with economic cycles and during any calendar year, with spending being weighted towards the end of the year to reflect trends in the retail industry. Our advertisers can generally terminate their contracts with us at any time. Advertising spending is particularly sensitive to changes in general economic conditions

and typically decreases when economic conditions are not favorable. A decrease in demand for Internet advertising could have a material adverse effect on our business, financial condition and results of operations.

We may acquire companies or make investments in, or enter into licensing arrangements with, other companies with technologies that are complementary to our business and these acquisitions or arrangements could disrupt our business, cause us to require additional financing and dilute your holdings in our company.

We may acquire companies, assets or the rights to technologies in the future in order to develop new or enhance existing services, to enhance our operating infrastructure, to fund expansion, to respond to competitive pressures or to acquire complementary businesses. Entering into these types of arrangements entails many risks, any of which could materially harm our business, including:

the diversion of management's attention from other business concerns;

the failure to effectively integrate the acquired technology or company into our business;

the incursion of significant acquisition costs;

the loss of key employees from either our current business or the acquired business; and

the assumption of significant liabilities of the acquired company.

In addition, absent sufficient cash flows from operations, we may need to engage in equity or debt financings to secure additional funds to meet our operating and capital needs. We may not be able to secure additional debt or equity financing on favorable terms, or at all, at the time when we need that funding. In addition, even though we may have sufficient cash flow, we may still elect to sell additional equity or debt securities or obtain credit facilities for other reasons. If we raise additional funds through further issuances of equity or convertible debt securities, our existing shareholders could suffer significant dilution in their percentage ownership of our company, and any new equity securities we issue could have rights, preferences and privileges senior to those of holders of our common stock. Any debt financing secured by us in the future could involve restrictive covenants relating to our capital raising activities and other financial and operational matters, which might make it more difficult for us to obtain additional capital, to pay dividends and to pursue business opportunities, including potential acquisitions. In addition, if we decide to raise funds through debt or convertible debt financings, we may be unable to meet our interest or principal payments.

Any of the foregoing or other factors could harm our ability to achieve anticipated levels of profitability from acquired businesses or to realize other anticipated benefits of acquisitions. We may not be able to identify or consummate any future acquisitions on favorable terms, or at all. If we do effect an acquisition, it is possible that the financial markets or investors will view the acquisition negatively. Even if we successfully complete an acquisition, it could adversely affect our business.

Our corporate culture has contributed to our success, and if we cannot maintain this culture as we grow, we could lose the innovation, creativity and teamwork fostered by our culture, and our business may be harmed.

We believe that a critical contributor to our success has been our corporate culture, which we believe fosters innovation, creativity and teamwork. As our organization grows and we are required to implement more complex organizational management structures, we may find it increasingly difficult to maintain the beneficial aspects of our corporate culture. This could negatively impact our future success.

Our business depends on a strong brand. If we are not able to maintain and enhance our brand, our ability to expand our customer base will be impaired and our business and operating results will be harmed.

We believe that the brand identity we have developed has significantly contributed to the success of our business. We also believe that maintaining and enhancing the "Tucows" brand is critical to

expanding our customer base. We anticipate that, as our market becomes increasingly competitive, maintaining and enhancing our brand may become increasingly difficult and expensive. Maintaining and enhancing our brand will depend largely on our ability to be a technology leader providing high quality products and services, which we may not do successfully. To date, we have engaged in relatively little direct brand promotion activities. This enhances the risk that we may not successfully implement brand enhancement efforts in the future.

If we fail to protect our proprietary rights, the value of those rights could be diminished.

We rely upon copyright, trade secret and trademark law, confidentiality and nondisclosure agreements, invention assignment agreements and work-for-hire agreements to protect our proprietary technology, all of which offer only limited protection. We cannot ensure that our efforts to protect our proprietary information will be adequate to protect against infringement and misappropriation by third parties, particularly in foreign countries where laws or law enforcement practices may not protect proprietary rights as fully as in the United States and Canada.

We have licensed, and may in the future license, some of our trademarks and other proprietary rights to others. Third parties may also reproduce or use our intellectual property rights without seeking a license and thus benefit from our technology without paying for it. Third parties could also independently develop technology, processes or other intellectual property that are similar to or superior to those used by us. Actions by licensees, misappropriation of the intellectual property rights or independent development by others of similar or superior technology might diminish the value of our proprietary rights or damage our reputation.

The unauthorized reproduction or other misappropriation of our intellectual property rights, including copying the look, feel and functionality of our website could enable third parties to benefit from our technology without us receiving any compensation. The enforcement of our intellectual property rights may depend on our taking legal action against these infringing parties, and we cannot be sure that these actions will be successful.

Because of the global nature of the Internet, our websites can be viewed worldwide. However, we do not have intellectual property protection in every jurisdiction. Furthermore, effective trademark, service mark, copyright and trade secret protection may not be available in every country in which our services become available over the Internet. In addition, the legal standards relating to the validity, enforceability and scope of protection of intellectual property rights in Internet-related industries are uncertain and still evolving.

We may not be able to realize the intended and anticipated benefits from our acquisitions of expiring domain names, which could affect the value of these acquisitions to our business and our ability to meet our financial obligations and targets.

We may not be able to realize the intended and anticipated benefits that we currently expect from our acquisitions of expiring domain names. These intended and anticipated benefits include increasing our cash flow from operations, broadening our Internet service offerings and delivering services that strengthen our reseller relationships.

Factors that could affect our ability to achieve these benefits include:

A significant amount of revenue attributed to our domain name assets comes from the provision of personalized email services and the generation of revenue from third party advertisements on parked pages. Some of our existing resellers who provide similar services may perceive this as a competitive threat and therefore may decide to terminate their agreements with us because of our recent acquisitions of a substantial number of expiring domain names.

We will need to continue to acquire commercially valuable expiring domain names to grow our presence in the field of direct navigation. We will need to continuously improve our technologies

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to acquire valuable expiring domain names as competition in the marketplace for appropriate expiring domain names intensifies. Our domain name acquisition efforts are subject to rules and guidelines established by registries which maintain Internet domain name registrations and other registrars who process and facilitate Internet domain name registrations. The registries and registrars may change the rules and guidelines for acquiring expiring domains in ways that may prove detrimental to our domain name acquisition efforts.

The business of direct navigation is dependent on current technologies and user practices. If browser or search technologies were to change significantly, the practice of direct navigation may be altered to our disadvantage.

If the acquired assets are not integrated into our business as we anticipate, we may not be able to achieve the benefits of these acquired assets or realize the value paid for the asset acquisitions, which could materially harm our business, financial condition and results of operations.

We may not be able to realize the intended and anticipated benefits from our acquisition of Mailbank.com Inc., which may impact the value of this acquisition to our business and our ability to meet our financial obligations and targets.

In June 2006, the Company acquired Mailbank.com Inc., a provider of personalized email services and the owner of a large collection of surname domain addresses. We plan to use these assets to offer personalized Internet services directly to end-users through Domain Direct and through our channel of resellers as well as to generate income from the parked page of each domain address.

Factors that could affect our ability to achieve the intended benefits include:

Our ability to market this new offering to our channel of resellers and their consequent interest in selling the personalized email service to their respective end users.

Our ability to acquire additional surname based domain names in order to expand the portfolio to attract the greatest number of potential end users.

If the acquired assets are not integrated into our business as anticipated, we may not be able to achieve the intended benefits of these acquired assets or realize the value paid for the assets acquired, which could materially harm our business, financial condition and results of operations.

We do not control the means by which end user access our web sites and material changes to current navigation practices or technologies or marketing practices could result in a material adverse effect on our business.

The success of our parked pages business depends in large part upon the current end user tendency to type desired destinations directly into the web browser. End users employ this practice of direct navigation to access our web sites primarily through the following methods: directly accessing our web sites by typing descriptive keywords or keyword strings into the uniform resource locator (URL) address box of an Internet browser, accessing our web sites by clicking on bookmarked web sites and accessing our web sites indirectly through search engines and directories.

Each of these methods requires the use of a third party product or service, such as an Internet browser or search engine or directory. Internet browsers may provide alternatives to the URL address box to locate web sites, and search engines may from time to time change and establish rules regarding the indexing and optimization of web sites. Product developments and market practices for these means of access to our web sites are not within our control. We may experience a decline in traffic to our web sites if third party browser technologies or search engine methodologies and rules, including those affecting marketing efforts, are changed to our disadvantage.

If the practice of direct navigation becomes less popular either as a result of evolving technologies or user practices, our ability to generate revenue from the practice of click through advertising may suffer.

A significant amount of revenue generated from the commercialization of domain names owned by the Company is dependent on our agreements with third party providers. The monetization of these domain names is currently largely dependent on the paid listings allocated by these providers to the websites associated with our domain names. This allocation may depend on each provider's advertiser base, internal policies and other factors and determinations that may or may not be controlled by or known to us.

We may experience unforeseen liabilities in connection with our domain name portfolio, including our acquisition of the Mailbank.com Inc. domain name portfolio, which could negatively impact our financial results.

The acquisition of Mailbank.com Inc. involved the acquisition of a portfolio of previously owned domain names. In addition, we are currently acquiring and intend to continue to acquire other previously owned domain names. In some cases, these acquired domain names may have trademark significance that is not apparent to us. As a result, we may face demands by third party trademark owners asserting infringement or dilution of their rights and seeking transfer of the domain names through the Uniform Domain Name Resolution Policy adopted by ICANN. We may also face actions from third-parties under national trademark or anti-competition legislation.

We review each claim or demand on its merits and we intend to transfer any such previously owned domain names acquired by us to parties that have demonstrated a valid prior right. We cannot guarantee that we will be able to resolve all such disputes without litigation. The potential violation of third party intellectual property rights may subject us to unforeseen liabilities, including injunctions and claims for monetary damages.

Once any infringement is detected, disputes concerning the ownership or rights to use intellectual property could be costly and time-consuming to litigate, may distract management from operating the business, and may result in us losing significant rights and our ability to operate all or a portion of our business.

Claims of infringement of intellectual property or other rights of third parties against us could result in substantial costs. Third parties may assert claims of infringement of patents or other intellectual property rights against us concerning past, current or future technologies.

Content obtained from third parties and distributed over the Internet by us may result in liability for defamation, negligence, intellectual property infringement, product or service liability and dissemination of computer viruses or other disruptive problems. We may also be subject to claims from third parties asserting trademark infringement, unfair competition and violation of publicity and privacy rights relating specifically to domains. These claims may include claims under the *Anti-cybersquatting Consumer Protection Act*, or ACPA, which was enacted in the United States to curtail the registration of a domain that is identical or similar to another party's trademark or the name of a living person with the bad faith intent to profit from use of the domain.

These claims and any related litigation could result in significant costs of defense, liability for damages and diversion of management's time and attention. Any claims from third parties may also result in limitations on our ability to use the intellectual property subject to these claims unless we are able to enter into agreements with the third parties making these claims. If a successful claim of infringement is brought against us and we fail to develop non-infringing technology or to license the infringed or similar technology on a timely basis, we may have to limit or discontinue the business operations which used the infringing technology.

We rely on technologies licensed from other parties. These third-party technology licenses may infringe on the proprietary rights of others and may not continue to be available on commercially

reasonable terms, if at all. The loss of this technology could require us to obtain substitute technology of lower quality or performance standards or at greater cost, which could increase our costs and make our products and services less attractive to customers.

The law relating to the liability of online services companies for data and content carried on or disseminated through their networks is currently unsettled and could expose us to unforeseen liabilities.

It is possible that claims could be made against online services companies under U.S., Canadian or foreign law for defamation, negligence, copyright or trademark infringement, or other theories based on data or content disseminated through their networks, even if a user independently originated this data or content. Several private lawsuits seeking to impose liability upon Internet service companies have been filed in U.S. and foreign courts. While the United States has passed laws protecting ISPs from liability for actions by independent users in limited circumstances, this protection may not apply in any particular case at issue. Our ability to monitor, censor or otherwise restrict the types of data or content distributed through our network is limited. Failure to comply with any applicable laws or regulations in particular jurisdictions could result in fines, penalties or the suspension or termination of our services in these jurisdictions. Our insurance may not be adequate to compensate or may not cover us at all in the event we incur liability for damages due to data and content carried on or disseminated through our network. Any costs not covered by insurance that are incurred as a result of this liability or alleged liability, including any damages awarded and costs of litigation, could harm our business and prospects.

Privacy concerns relating to our technology could damage our reputation and deter current and potential users from using our services.

From time to time, concerns have been expressed about whether our services compromise the privacy of our users and others. Concerns about our practices with regard to the collection, use, disclosure or security of personal information or other privacy-related matters, even if unfounded, could damage our reputation and operating results and expose us to litigation and possible liability, including claims for unauthorized purchases with credit card information, impersonation, or fraud claims and other claims relating to the misuse of personal information and unauthorized marketing purposes. While we strive to comply with all applicable data protection laws and regulations, as well as our own privacy policies, any failure or perceived failure to comply may result in proceedings or actions against us by government entities or others, which could potentially have an adverse effect on our business.

In addition, due to the fact that our services are web based, the amount of data we store for our users on our servers (including personal information) has been increasing. Any systems failure or compromise of our security that results in the release of our users' data could seriously limit the adoption of our services as well as harm our reputation and brand and, therefore, our business. We may also need to expend significant resources to protect against security breaches. The risk that these types of events could seriously harm our business is likely to increase as we expand the number of Internet services we offer.

A large number of legislative proposals pending before the United States Congress, various state legislative bodies and foreign governments concern data protection. In addition, the interpretation and application of data protection laws in Europe and elsewhere are still unsettled. We cannot guarantee that our current information-collection procedures and disclosure policies will be found to be in compliance with existing or future laws or regulations. If our policies and procedures are found not to be in compliance, in addition to the possibility of fines, this could result in an order requiring that we change our data practices, which could in turn have a material effect on our business. Complying with these various laws could cause us to incur substantial costs or require us to change our business practices in a manner adverse to our business.

Because we are required to recognize revenue for our services over the term of the applicable customer agreement, changes in our sales may not be immediately reflected in our operating results.

We recognize revenue from our customers ratably over the respective terms of their agreements with us as required by GAAP. Typically, our domain name registration agreements have terms that range from one to ten years, and our website hosting agreements have annual or month-to-month terms. Accordingly, increases in sales during a particular period do not translate into immediate, proportional increases in revenue during that period, and a substantial portion of the revenue that we recognize during a quarter is derived from deferred revenue from customer agreements that we entered into during previous quarters. As a result, we may not generate net earnings despite substantial sales activity during a particular period, since we are not permitted under GAAP to recognize all of the revenue from these sales immediately, and because we are required to reflect a significant portion of our related operating expenses in full during that period. Conversely, the existence of substantial deferred revenue may prevent deteriorating sales activity from becoming immediately observable in our consolidated statement of operations.

In addition, we may not be able to adjust spending in a timely manner to compensate for any unexpected revenue shortfall, and any significant shortfall in revenue relative to planned expenditures could negatively impact our business and results of operations.

Currency fluctuations may adversely affect us.

Our revenue is primarily realized in U.S. dollars and a significant portion of our operating expenses is 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. We do not account for these instruments as hedges in our consolidated financial statements.

If we do not maintain a low rate of credit card chargebacks, we will face the prospect of financial penalties and could lose our ability to accept credit card payments from customers, which would have a material adverse affect on our business, financial condition and results of operations.

A substantial majority of our revenues originates from online credit card transactions. Under current credit card industry practices, we are liable for fraudulent and disputed credit card transactions because we do not obtain the cardholder's signature at the time of the transaction, even though the financial institution issuing the credit card may have authorized the transaction. Under credit card association rules, penalties may be imposed at the discretion of the association. Any such potential penalties would be imposed on our credit card processor by the association. Under our contract with our processor, we are required to reimburse our processor for such penalties. Our current level of fraud protection, based on our fraudulent and disputed credit card transaction history, is within the gu