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# SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

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## FORM 10-Q

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

For the quarterly period ended March 31, 2004

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 0-28284

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## 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 M6K 3M1, Canada**  
(Address of Principal Executive Offices) (Zip Code)

**(416) 535-0123**  
(Registrant's Telephone Number, Including Area Code)

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

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| Class                      | Outstanding at April 28, 2004 |
|----------------------------|-------------------------------|
| Common Stock, no par value | 65,539,717                    |

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**TUCOWS INC.**  
**Form 10-Q Quarterly Report**  
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**PART I.  
FINANCIAL INFORMATION**

**Item 1. Financial Statements**

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

|   | <b>March 31,<br/>2004</b> | <b>December 31,<br/>2003</b> |
|---|---------------------------|------------------------------|
|   | <b>(unaudited)</b>        |                              |
| <b>Assets</b>   |                           |                              |
| Current assets:   |                           |                              |
| Cash and cash equivalents   | \$ 13,656,958             | \$ 12,912,811                |
| Restricted cash   | —                         | 132,500                      |
| Accounts receivable, net of allowance for doubtful accounts of \$50,000 as of<br>March 31, 2004 and December 31, 2003   | 548,957                   | 486,289                      |
| Prepaid expenses and deposits   | 2,007,943                 | 2,061,948                    |
| Prepaid domain name registry fees, current portion  | 14,564,254                | 13,204,566                   |
| Total current assets  | 30,778,112                | 28,798,114                   |
| Prepaid domain name registry fees, long-term portion  | 5,813,518                 | 5,136,194                    |
| Property and equipment  | 843,558                   | 1,048,400                    |
| Investments   | 353,737                   | 353,737                      |
| Total assets  | \$ 37,788,925             | \$ 35,336,445                |
| <b>Liabilities and Stockholders' Equity</b>   |                           |                              |
| Current liabilities:  |                           |                              |
| Accounts payable  | \$ 1,256,845              | \$ 1,632,294                 |
| Accrued liabilities   | 1,832,814                 | 2,088,235                    |
| Customer deposits   | 2,113,720                 | 2,160,601                    |
| Deferred revenue, current portion   | 22,595,093                | 20,715,191                   |
| Total current liabilities   | 27,798,472                | 26,596,321                   |
| Deferred revenue, long-term portion   | 8,801,562                 | 7,874,001                    |
| Stockholders' equity  |                           |                              |
| Preferred stock - no par value, 1,250,000 shares authorized; none issued and<br>outstanding   | —                         | —                            |
| Common stock - no par value, 250,000,000 shares authorized; 65,039,717 shares<br>issued and outstanding as of March 31, 2004 and 64,626,429 shares issued and<br>outsatnading as of December 31, 2003 | 8,693,749                 | 8,540,687                    |
| Additional paid-in capital  | 49,992,129                | 49,992,129                   |
| Deferred stock-based compensation   | —                         | (20,593)                     |
| Deficit   | (57,496,987)              | (57,646,100)                 |
| Total stockholders' equity  | 1,188,891                 | 866,123                      |
| Total liabilities and stockholders' equity  | \$ 37,788,925             | \$ 35,336,445                |
| Subsequent events (notes 5 (b) and 6)   |                           |                              |

See accompanying notes to consolidated financial statements

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

|  | <u>Three months ended March 31,</u> |                   |
|--|-------------------------------------|-------------------|
|  | <u>2004</u>                         | <u>2003</u>       |
| Net revenues   | \$ 10,174,909                       | \$ 8,996,914      |
| Cost of revenues   | 6,445,415                           | 5,576,643         |
| Gross profit   | <u>3,729,494</u>                    | <u>3,420,271</u>  |
| Operating expenses:  |                                     |                   |
| Sales and marketing (*)  | 1,220,534                           | 912,336           |
| Technical operations and development   | 1,011,422                           | 831,769           |
| General and administrative (*)   | 1,073,072                           | 622,980           |
| Depreciation of property and equipment   | 312,986                             | 434,965           |
| Total operating expenses   | <u>3,618,014</u>                    | <u>2,802,050</u>  |
| Income from operations   | 111,480                             | 618,221           |
| Other income:  |                                     |                   |
| Interest income, net   | 37,633                              | 26,449            |
| Gain on disposal of Liberty Registry Management Services Inc.                    | —                                   | 235,613           |
| Total other income   | <u>37,633</u>                       | <u>262,062</u>    |
| Income before provision for income taxes   | 149,113                             | 880,283           |
| Provision for income taxes   | —                                   | —                 |
| Net income for the period  | <u>\$ 149,113</u>                   | <u>\$ 880,283</u> |
| Basic and diluted earnings per share   | <u>\$ 0.00</u>                      | <u>\$ 0.01</u>    |
| Shares used in computing basic earnings per common share                         | <u>64,690,887</u>                   | <u>64,626,429</u> |
| Shares used in computing diluted earnings per common share                       | <u>72,098,757</u>                   | <u>64,626,429</u> |
| <br>   |                                     |                   |
| (*) Stock-based compensation has been included in operating expenses as follows: |                                     |                   |
| Sales and marketing  | \$ 16,834                           | \$ 27,105         |
| General and administrative   | \$ 3,759                            | \$ 13,013         |

See accompanying notes to consolidated financial statements

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

|   | <u>Three months ended March 31,</u> |                     |
|---|-------------------------------------|---------------------|
|   | <u>2004</u>                         | <u>2003</u>         |
| Cash provided by (used in):   |                                     |                     |
| Operating activities:   |                                     |                     |
| Net income for the period   | \$ 149,113                          | \$ 880,283          |
| Items not involving cash:   |                                     |                     |
| Depreciation of property and equipment  | 312,986                             | 434,965             |
| Gain on change in the fair value of forward contracts                                   | 18,885                              | (546,870)           |
| Stock-based compensation  | 20,593                              | 40,118              |
| Gain on disposal of Liberty Registry Management Services Inc.                           | —                                   | (235,613)           |
| Change in non-cash operating working capital:   |                                     |                     |
| Accounts receivable   | (62,668)                            | 72,374              |
| Prepaid expenses and deposits   | 35,120                              | (5,839)             |
| Prepaid domain name registry fees   | (2,037,012)                         | (959,424)           |
| Accounts payable  | (375,449)                           | (201,423)           |
| Accrued liabilities   | (255,421)                           | (182,772)           |
| Customer deposits   | (46,881)                            | (1,814)             |
| Deferred revenue  | 2,807,463                           | 1,415,702           |
|   | <u>566,729</u>                      | <u>709,687</u>      |
| Cash provided by operating activities   |                                     |                     |
| Financing activities:   |                                     |                     |
| Proceeds received on exercise of stock options  | 153,062                             | —                   |
|   | <u>153,062</u>                      | <u>—</u>            |
| Cash provided by financing activities   |                                     |                     |
| Investing activities:   |                                     |                     |
| Additions to property and equipment   | (108,144)                           | (468,197)           |
| Decrease in restricted cash - being margin security against forward exchange contracts  | 132,500                             | 225,000             |
| Proceeds on disposal of Liberty Registry Management Services Inc., net of cash disposed | —                                   | 235,613             |
|   | <u>24,356</u>                       | <u>(7,584)</u>      |
| Cash provided by (used in) investing activities   |                                     |                     |
| Increase in cash and cash equivalents   | 744,147                             | 702,103             |
| Cash and cash equivalents, beginning of period  | <u>12,912,811</u>                   | <u>8,844,829</u>    |
| Cash and cash equivalents, end of period  | <u>\$ 13,656,958</u>                | <u>\$ 9,546,932</u> |
| Supplemental cash flow information:   |                                     |                     |
| Interest paid   | \$ —                                | \$ 172              |

See accompanying notes to consolidated financial statements

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 1. BUSINESS AND BASIS OF PRESENTATION:

Tucows Inc., a Pennsylvania corporation (the “Company” or “Tucows”), is a global distributor of Internet services, including domain name registration, security and identity products through digital certificates and email, through its global Internet-based distribution network of Internet service providers, web hosting companies and other providers of Internet services to end-users.

The accompanying unaudited interim consolidated balance sheets, and the related statements of operations and cash flows reflect all adjustments, consisting of normal recurring adjustments, that are, in the opinion of management, necessary for a fair presentation of the financial position of Tucows and its subsidiaries at March 31, 2004 and the results of operations and cash flows for the interim periods ended March 31, 2004 and 2003.

The accompanying interim consolidated financial statements have been prepared by the Company without audit, in accordance with the rules and regulations of the Securities and Exchange Commission (the “SEC”) and do not include all information and notes normally provided in annual financial statements. These interim financial statements follow the same accounting policies and methods of application used in the annual financial statements and should be read in conjunction with the audited financial statements and notes thereto of the Company for the year ended December 31, 2003 included in the Company’s 2003 Annual Report on Form 10-K filed with the SEC on March 23, 2004.

The Company has elected to follow the intrinsic-value-based method of accounting as prescribed by Accounting Principles Board Opinion No. 25 (“APB 25”), “Accounting for Stock Issued to Employees”, and related interpretations, in accounting for its employee stock options. Under APB 25, deferred stock-based compensation is recorded at the option grant date in an amount equal to the difference between the market value of a common share and the exercise price of the option. Deferred stock-based compensation resulting from employee option grants is amortized over the vesting period of the individual options, generally four years, in accordance with the accelerated measurement method in Financial Accounting Standards Board Interpretation No. 28.

Stock options granted to consultants and other non-employees are accounted for using the fair value method under Statement of Financial Accounting Standards No. 123, “Accounting for Stock-based Compensation”. Under this method, the fair value of options granted is recognized as services are performed and options are earned.

The following table illustrates the effect on net income if the fair-value-based method had been applied to all outstanding and unvested awards in each period.

|   | <b>Three months ended March 31,</b> |                   |
|---|-------------------------------------|-------------------|
|   | <b>2004</b>                         | <b>2003</b>       |
|   | <b>(unaudited)</b>                  |                   |
| Net income, as reported   | \$ 149,113                          | \$ 880,283        |
| Add stock-based employee compensation expense included in reported net income, net of tax                                   | 20,593                              | 40,118            |
| Deduct total stock-based employee compensation expense determined under fair-value-based method for all rewards, net of tax | (184,671)                           | (106,995)         |
| Net income, pro forma   | <u>\$ (14,965)</u>                  | <u>\$ 813,406</u> |
| Earnings per common share, as reported  | \$ 0.00                             | \$ 0.01           |
| Earnings per common share, pro forma  | \$ 0.00                             | \$ 0.01           |

The results of operations for any interim period are not necessarily indicative of, nor are they comparable to, the results of operations for any other interim period or for the full fiscal year.

## 2. INVESTMENTS:

Investments over which the Company is unable to exercise significant influence are recorded at cost and written down only when there is evidence that a decline in value that is other than temporary has occurred.

The Company holds a 7.38% interest in a private company, Aflias, the registry for the .info generic top level domain.

## 3. BASIC AND DILUTED EARNINGS PER COMMON SHARE:

The Company's basic earnings per common share have been calculated by dividing net income by the weighted average number of common shares outstanding.

The diluted earnings per common share have been calculated using the weighted average number of common shares outstanding and potentially dilutive common shares outstanding during the periods. Potentially dilutive common shares assumes the exercising of all options, if dilutive, in the period. Potentially dilutive common shares are excluded in net loss periods, as their effect would be antidilutive.

## 4. SUPPLEMENTAL INFORMATION:

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

|                                    | <u>Three months ended March 31,</u> |                     |
|------------------------------------|-------------------------------------|---------------------|
|                                    | <u>2004</u>                         | <u>2003</u>         |
|                                    | <u>(unaudited)</u>                  |                     |
| Domain name and ancillary services | \$ 9,602,481                        | \$ 8,509,050        |
| Advertising and other revenue      | 572,428                             | 487,864             |
|                                    | <u>\$ 10,174,909</u>                | <u>\$ 8,996,914</u> |

## 5. COMMITMENTS AND CONTINGENCIES:

(a) At March 31, 2004, the Company had outstanding letters of credit totaling \$150,000 that expire on November 17, 2004.

(b) Subsequent to March 31, 2004, the Company entered into a series of forward foreign exchange contracts ("Contracts") to manage its exposure to foreign exchange rate fluctuations. On a semi-monthly basis, beginning on April 27, 2004, U.S.\$425,000 is converted into Canadian dollars until the end of December 2004 at foreign exchange rates varying from 1.3608 to 1.3663. The notional principal of the outstanding Contracts at April 27, 2004 was \$7,225,000. As margin security against these Contracts, the Company placed \$446,250 into secured term deposits, which will mature on a monthly basis in line with the Contracts and will be reflected as restricted cash on the balance sheet.

## 6. Subsequent events

On April 27, 2004, Tucows (Delaware) Inc., one of the Company's wholly owned subsidiaries, acquired 100% of the outstanding shares of capital stock Boardtown Corporation for total consideration of up to \$4.0 million depending on future performance milestones over the next 36 months. \$1.75 million of the purchase price is being held in escrow contingent upon performance of such milestones and to secure certain warranties, representations and covenants in the acquisition agreement. Boardtown is a leading provider of billing and customer care software solutions to Internet service providers and Application Service Providers worldwide. Tucows will satisfy the purchase price of up to \$4.0 million through the payment of up to \$3.0 million in cash and the issuance of up to 1,426,531 unregistered shares of Tucows common stock.

## **7. RECENT ACCOUNTING PRONOUNCEMENTS:**

In December 2003, the SEC issued Staff Accounting Bulletin No. 104 (“SAB 104”), “Revenue Recognition”, which supersedes Staff Accounting Bulletin No. 101 (“SAB 101”), “Revenue Recognition in Financial Statements.” The primary purpose of SAB 104 is to rescind accounting guidance contained in SAB 101 related to multiple element revenue arrangements, which was superseded as a result of the issuance of Emerging Issues Task Force 00-21 (“EITF 00-21”), “Accounting for Revenue Arrangements with Multiple Deliverables.” SAB 104 also incorporated certain sections of the SEC’s “Revenue Recognition in Financial Statements—Frequently Asked Questions and Answers” document. While the wording of SAB 104 has changed to reflect the issuance of EITF 00-21, the revenue recognition principles of SAB 101 remain largely unchanged by the issuance of SAB 104. The adoption of SAB 104 did not have a material impact on Tucows consolidated financial position, results of operations or cash flows.

In January 2003, the FASB issued Interpretation No. 46, “Consolidation of Variable Interest Entities” (FIN 46). In December 2003, the FASB issued FIN 46R which superseded FIN 46 and contains numerous exemptions. FIN 46R applies to financial statements of public entities that have or potentially have interests in entities considered special purpose entities for periods ended after December 15, 2003 and otherwise to interests in VIEs for periods ending after March 15, 2004. VIEs are entities that have insufficient equity and/or their equity investors lack one or more specified essential characteristics of a controlling financial interest. FIN 46R provides specific guidance for determining when an entity is a VIE and who, if anyone, should consolidate the VIE. The Company does not anticipate the adoption of this standard to have a material impact on the consolidated financial statements.

In April 2003, the FASB issued SFAS No. 149, “Amendment of Statement 133 on Derivative Instruments and Hedging”. SFAS No. 149 amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities under SFAS No. 133, “Accounting for Derivative Instruments and Hedging Activities”. The provisions of SFAS No. 149 will be effective for contracts entered into after June 30, 2003. The adoption of SFAS No. 149 did not have a material effect on the Company’s consolidated financial statements.

In May 2003, the FASB issued SFAS No. 150, “Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity”. SFAS No. 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances). Many of those instruments were previously classified as equity. The provisions of SFAS No. 150 are effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. The adoption of SFAS No. 150 did not have a material effect on the Company’s consolidated financial statements.

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

The following discussion of Tucows' financial condition and results of operations should be read with Tucows consolidated financial statements and notes contained in this Quarterly Report on Form 10-Q ("Form 10-Q"). This Form 10-Q contains, in addition to historical information, forward-looking statements by Tucows with regard to its expectations as to financial results and other aspects of its 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 Form 10-Q include statements regarding the following: Tucows expectations regarding its collections of accounts receivable; the expected increases in communication, personnel, sales and marketing expenses and general and administrative expenses; expected small increases in technical operations and development expenses; the number of new, renewed and transferred-in domain names; the future cost of Tucows revenues; the growth in domain name registration; Tucows beliefs concerning its future operating expenses; and Tucows' belief that its cash flow from operations will be adequate to meet its anticipated requirements for working capital and capital expenditures for at least the next 12 months. 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. Factors that may cause such a difference include the risks described under the caption "Risk Factors". This list of factors that may affect Tucows' 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 Form 10-Q are based on information available to Tucows as of the date of this Form 10-Q, and Tucows assumes no obligation to update these cautionary statements or any forward-looking statements. These statements are not guarantees of future performance.

### **OVERVIEW**

Tucows provides Internet services and digital software content to end-users worldwide through a global Internet-based distribution network of more than 6,000 resellers in over 100 countries. Tucows is an accredited registrar with the Internet Corporation for Assigned Names and Numbers, generally known as ICANN, and generates revenue primarily through the provision of domain name registration and other Internet services to resellers who offer such services to their own customers. These resellers are a heterogeneous group of companies, including Internet service providers, web hosting providers and telecommunications and cable companies (collectively referred to as "Service Providers") that typically provide a critical component of an end-user's Internet presence and have a very high level of interaction with the end-user. In addition to domain name registration services, Tucows currently provides security and identity services (through digital certificates), email services, managed domain name system or "DNS" and plans to introduce a number of additional Internet services in the future. Tucows' distributes its services to resellers using its Open Shared Reseller System, or "OpenSRS" platform, which provides the technical infrastructure that allows Service Providers to register and manage the provisioning of Tucows' services to their end-users. Tucows' provides its services on either a wholesale or private label basis, allowing Service Providers to deal directly with their own end-user customers. By using Tucows' services, Service Providers are able to avoid the costs and complexities of building in-house systems and to focus on their customer acquisition and retention strategies.

Tucows' goal is to leverage its global distribution channel, its expanding line of service offerings and its reputation for exemplary customer service and support to become the preferred supplier of a broad range of Internet services to the Service Provider channel on a global basis.

In addition to generating revenue through the provision of domain name registration and other Internet services, Tucows' generates advertising and other revenue through its online libraries of shareware, freeware and online services available at its web site, [www.tucows.com](http://www.tucows.com). Advertising revenue is generated from third party advertisers and from software developers who rely on Tucows as a primary source of distribution. Software developers use Tucows' Author Resource Center to submit their products for inclusion in the Tucows libraries and to purchase promotional placement of their software in the library categories as well as purchase other promotional services on a cost per click or flat rate basis. The libraries are available to end-users around the world via Tucows' Internet facilities and via a global network of Internet service companies who elect to mirror the Tucows libraries locally. Tucows also generates revenue from companies who contract with it to provide them with co-branded content and customized search agent services using Tucow's "Sleuth" technologies.

### **Net Revenues**

Tucows generates net revenues primarily through the provision of domain name registration and ancillary services. Other revenue sources include advertising and other revenue.

## **Domain name registration and ancillary services**

Tucows generates the majority of its net revenues from domain name registration services on both a wholesale and retail basis. Tucows earns registration fees in connection with new, renewed and transferred-in registrations. These services are generally purchased for terms of one to ten years. Payments for the full term of all registrations are received at the time of registration (“billed revenue”) but are recorded as deferred revenue and are recognized ratably on a monthly basis over the term of the registration.

On a wholesale basis, Tucows offers domain name registration and ancillary services, which currently consist of digital certificates, email services, and managed DNS to resellers, who provide these services to their end-users to facilitate their use of Internet services such as email or web-hosting. The domain name registration services offered by Tucows are for the generic top level domains, or gTLDs, .com, .net, .org, .info, .name and .biz and the country code domains .ca, .cc, .cn, .de, .uk, .tv and .us. Tucows receives revenues for each domain name, web certificate or email box registered through its system by resellers. Tucows charges standard fees for its services that are published on its web site. Tucows also extends volume based discounts and rebates to resellers.

On a retail basis, Tucows offers Internet services directly to end-users through its Domain Direct division. These services include domain name registration, email, hosting and web site creation. Depending on the service offered, Domain Direct receives standard fees for its services that are published on its web site. In addition, Domain Direct offers referral commissions based on a percentage of net registration revenues to participants in its affiliate program.

## **Advertising and other revenue**

Tucows’ also generates advertising and other revenue through its online libraries of shareware, freeware and online services presented at its web site, [www.tucows.com](http://www.tucows.com). Advertising revenue is generated from third party advertisers and from software developers who rely on Tucows as a primary source of distribution. Software developers use Tucows’ Author Resource Center to submit their products for inclusion in Tucows’ software libraries and to purchase promotional placement of their software in the library categories as well as purchase other promotional services on a cost per click or flat rate basis. Software developers are able to promote their software through advertising services including keyword search placements, banners, promotional placements, expedited reviews and premium data services. Revenue is also generated from companies who contract with Tucows to provide them with co-branded content and customized search agent services using Tucow’s “Sleuth” technologies. Advertising and other revenue is recognized ratably over the period in which it is presented.

## **Critical Accounting Policies**

The following is a brief discussion of Tucows’ critical accounting policies and methods. Critical accounting policies are defined as those that are both important to the portrayal of the company’s financial condition and results and are reflective of significant judgments and uncertainties made by management that may result in materially different results under different assumptions and conditions. Note 2 of Tucows audited financial statements for the year ended December 31, 2003 included in the Tucows Annual Report on Form 10-K filed with the SEC on March 23, 2004, includes a more complete summary of the significant accounting policies and methods used in the preparation of Tucows’ consolidated financial statements.

The preparation of financial statements in conformity with generally accepted accounting principles requires Tucows to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, Tucows evaluates its estimates, including those related to the recoverability of investments, prepaid domain name registry fees, product development costs, revenue recognition and deferred revenue, and contingencies and litigation. Tucows bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual amounts could differ significantly from these estimates.

## **Revenue recognition policy**

Tucows earns revenues from:

- Domain name registration fees on both a wholesale and retail basis and ancillary services; and
- Advertising and other revenue.

Tucows derives the vast majority of its net revenues from domain name registration fees and ancillary services. Service has been provided once Tucows has confirmation that the requested domain name has been appropriately recorded in the registry under contractual performance standards or the web certificate or email box has been activated. Payments for the full term of all registrations are received at the time of registration but are recorded as deferred revenue and are recognized ratably on a monthly basis over the term of the registration.

Tucows' also generates advertising and other revenue through its online libraries of shareware, freeware and online services presented at its web, site [www.tucows.com](http://www.tucows.com). Advertising and other revenue is recognized ratably over the period in which it is presented. To the extent that minimum guaranteed impressions are not met, Tucows defers recognition of the corresponding revenues until the guaranteed impressions are achieved.

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

In those cases where payment is not received at the time of sale, additional conditions for recognition of revenue are that the collection of sales proceeds is reasonably assured and Tucows has no further performance obligations. Tucows records 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.

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

## **Product development costs**

Tucows accounts for the costs of computer software developed or obtained for internal use in accordance with American Institute of Certified Public Accountants Statement of Position 98-1, Accounting for the Cost of Computer Software Developed or Obtained for Internal Use, as more fully described in Note 2 of Tucows audited financial statements for the year ended December 31, 2003 included in Tucows Annual Report on form 10-K filed with the SEC on March 23, 2004. Tucows' policy on capitalizing internally developed software costs determines the timing of its recognition of certain development costs. In addition, this policy determines whether the cost is classified as development expense or depreciation of property and equipment. Management is required to use its judgment in assessing technological feasibility in determining whether development costs meet the criteria for immediate expense or capitalization. Actual results may differ from these estimates under different assumptions or conditions.

## Valuation of long-lived assets

Tucows reviews the recoverability of long-lived assets based upon the existence of one or more of the following indicators of impairment:

- a significant underperformance relative to expected historical or projected future operating results;
- a significant change in the manner of Tucows' use of the acquired asset or the strategy for its overall business; or
- a significant negative industry or economic trend.

Tucows measures any impairment based on a projected discounted cash flow model using a discount rate determined by management to be commensurate with the risk inherent in Tucows' current business model. Management bases its estimates in preparing the discounted cash flows on historical experience and on various other assumptions, including current market trends and developments, ongoing customer developments and general economic factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily available from other sources. Actual results may differ from these estimates under different assumptions or conditions.

## RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED MARCH 31, 2004 AS COMPARED TO THE THREE MONTHS ENDED MARCH 31, 2003

### NET REVENUES

|                            | Three months ended March 31, |              |
|----------------------------|------------------------------|--------------|
|                            | 2004                         | 2003         |
| Net revenues               | \$ 10,174,909                | \$ 8,996,914 |
| Increase over prior period | \$ 1,177,995                 |              |
| Increase - percentage      |                              | 13%          |

Total net revenues for the three months ended March 31, 2004 increased to approximately \$10.2 million from approximately \$9.0 million for the three months ended March 31, 2003, and from approximately \$9.7 million for the three months ended December 31, 2003.

During the three months ended March 31, 2004, no customer accounted for more than 10% of billed revenue, and two customers accounted for 25% of accounts receivable at March 31, 2004. Subsequent to the quarter end, substantially all of the accounts receivable mentioned above was collected, and Tucows expects that the remaining amount will be collected.

### *Domain name and ancillary services*

Net revenues from domain name and ancillary services for the three months ended March 31, 2004 increased by \$1.1 million, or 12.9%, to \$9.6 million from \$8.5 million for the three months ended March 31, 2003, or increased by \$498,000, or 5.5%, from the \$9.1 million for the three months ended December 31, 2003.

During the three months ended March 31, 2004, the number of domain names processed by Tucows increased by approximately 165,000 to over 1.0 million new, renewed and transferred-in domain name registrations, compared to the three months ended December 31, 2003. This increase was due primarily to Tucows continuing to compete aggressively to attract new clients and retain existing customers to protect its current market share and improve its competitive position. These actions have resulted in Tucows average selling price declining, which has partially offset the impact of the increased transaction volume on Tucows revenue and profitability. Tucows may face continued pricing pressure in order to remain competitive, which would adversely impact its revenues and profitability. The renewal rate for domain name registrations increased to approximately 64% for the three months ended March 31, 2004 compared to approximately 63% for the three months ended December 31, 2003 and approximately 56% for the three months ended March 31, 2003.

While Tucows anticipates the number of new, renewed and transferred-in domain name registrations will incrementally increase, the volatility in the market could affect the growth of domain names under Tucows management. During the three months ended March 31, 2004, the total number of domain names under Tucows management increased by approximately 251,000 to approximately 4.1 million.

Deferred revenue from domain name registrations and ancillary services at March 31, 2004 increased to \$31.4 million from \$28.6 million at December 31, 2003.

#### *Advertising and other revenue*

Advertising and other revenue for the three months ended March 31, 2004 increased by approximately \$84,000, or 17.2%, to approximately \$572,000 compared to approximately \$488,000 for the three months ended March 31, 2003. The increase was predominantly the result of growth in revenue from Tucows' Author Resource Center.

#### **COST OF REVENUES**

Cost of revenues includes the costs associated with providing domain name registration and ancillary services, advertising and other revenue. Tucows has no direct cost of revenues relating to its advertising revenues. Cost of revenues for domain name registrations consist of registry fees and network costs. Network costs include personnel and related expenses, including bandwidth and co-location expenses to support the supply of products and services. Bandwidth and co-location expenses are composed primarily of communication and provisioning costs related to the management and support of Tucows' network.

|                            | <u>Three months ended March 31,</u> |              |
|----------------------------|-------------------------------------|--------------|
|                            | <u>2004</u>                         | <u>2003</u>  |
| Cost of revenues           | \$ 6,445,415                        | \$ 5,576,643 |
| Increase over prior period | \$ 868,772                          |              |
| Increase - percentage      | 16%                                 |              |
| Percentage of revenues     | 63%                                 | 62%          |

Cost of revenues for the three months ended March 31, 2004 increased by approximately \$869,000, or 15.6%, to approximately \$6.4 million from approximately \$5.6 million for the three months ended March 31, 2003, and increased by approximately \$522,000, or 8.8%, from the approximately \$5.9 million for the three months ended December 31, 2003. The increase was primarily the result of the increase in cost of revenues from increased volumes of domain names registered and digital certificates sold during the applicable periods. Tucows anticipates that cost of revenues will continue to increase in absolute dollars primarily as a result of continued growth in domain name registration and ancillary services.

Registry fees, the primary component of cost of revenues, are paid in full when the domain name is registered, and are recorded as prepaid domain name registry fees. These fees are recognized ratably over the term of the registration on a basis consistent with the recognition of revenues from Tucows' customers.

Cost of revenues of digital content distribution services includes the costs of network operations. The cost of network operations is composed primarily of communication costs, equipment maintenance, and employee and related costs directly associated with the management and maintenance of the network.

## SALES AND MARKETING

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

|                            | Three months ended March 31, |            |
|----------------------------|------------------------------|------------|
|                            | 2004                         | 2003       |
| Sales and marketing        | \$ 1,220,534                 | \$ 912,336 |
| Increase over prior period | \$ 308,198                   |            |
| Increase - percentage      | 34%                          |            |
| Percentage of revenues     | 12%                          | 10%        |

Sales and marketing expenses during the three months ended March 31, 2004 increased by approximately \$308,000, or 34%, to approximately \$1.2 million compared to approximately \$912,000 during the three months ended March 31, 2003. The increase was the result of increased costs related to ongoing initiatives to improve customer service and expand Tucows sales reach. Of these increased costs, approximately \$260,000 were a result of increased customer acquisition and people costs. Also included in this increased amount is an increase in fees to ICANN of approximately \$48,000 when compared to the three months ended March 31, 2003, reflecting the larger levy imposed on Tucows as a result of increases in the ICANN budget and the increased number of domain names Tucows has under management.

Tucows believes that sales and marketing expenses will increase, in absolute dollars, on a go forward basis as it adjusts its marketing programs and sales strategies to meet future opportunities in the market place.

## 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 Tucows uses to register domain names and to distribute its digital content services. Editorial costs relating to the rating and review of the software content libraries are included in the costs of product development. In accordance with the American Institute of Certified Public Accountants Statement of Position 98-1, Accounting for the Costs of Computer Software Developed or Obtained for Internal Use, costs incurred during the application development stage only are capitalized and primarily include personnel costs for employees directly related to the development project. All other costs incurred are expensed as incurred.

|                                      | Three months ended March 31, |            |
|--------------------------------------|------------------------------|------------|
|                                      | 2004                         | 2003       |
| Technical operations and development | \$ 1,011,422                 | \$ 831,769 |
| Increase over prior period           | \$ 179,653                   |            |
| Increase - percentage                | 22%                          |            |
| Percentage of revenues               | 10%                          | 9%         |

Technical operations and development expenses for the three months ended March 31, 2004 increased by approximately \$180,000, or 22%, to approximately \$1.0 million from approximately \$832,000 for the three months ended March 31, 2003. The increase was primarily the result of people related costs, including contract and outside service costs, net of capitalized research and development, which increased by approximately \$195,000. These increases were offset by decreases in bandwidth expenses, dues and subscriptions and other costs of approximately \$15,000.

Tucows expects technical operations and development expenses to increase slightly, in absolute dollars, on a go forward basis, as its business continues to grow and as it further develops its applications and services.

## 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 and other general corporate expenses.

|                            | <u>Three months ended March 31,</u> |             |
|----------------------------|-------------------------------------|-------------|
|                            | <u>2004</u>                         | <u>2003</u> |
| General and administrative | \$ 1,073,072                        | \$ 622,980  |
| Increase over prior period | \$ 450,092                          |             |
| Increase - percentage      | 72%                                 |             |
| Percentage of revenues     | 11%                                 | 7%          |

General and administrative expenses for the three months ended March 31, 2004 increased by approximately \$450,000, or 72%, to approximately \$1.1 million from approximately \$623,000 for the three months ended March 31, 2003.

The increase resulted primarily from Tucows recording a foreign exchange loss of approximately \$41,000 for the three months ended March 31, 2004 compared to a foreign exchange gain of approximately \$532,000 for the three months ended March 31, 2003. The gain from foreign exchange achieved in the three months ended March 31, 2003 arose primarily as a result of the effect of the foreign exchange forward contracts that Tucows entered into in June 2002 to hedge portions of its Canadian dollar exposure. Tucows entered into these forward exchange contracts as part of its policy to manage financial exposure to certain foreign exchange fluctuations with the objective of neutralizing some of the impact of foreign currency exchange movements. As a substantial portion of its fixed expenses continue to be incurred in Canadian dollars, Tucows financial results will remain subject to fluctuations in the foreign exchange on translation of its Canadian results into US dollars, its functional currency. Therefore, Tucows will continue to regularly assess if it should enter into additional forward exchange contracts to offset the risk associated with the effects of Canadian to US dollar transaction exposures. Tucows does not use forward contracts for trading purposes.

In addition, general and administrative expenses increased by approximately \$130,000 during the three months ended March 31, 2004 when compared to the three months ended March 31, 2003 as a result of additional credit card processing fees, people costs, including contractors and business taxes.

These increases were offset by decreases in professional fees by approximately \$231,000, largely as a result of lower legal fees as well as by a decrease in facility and other costs of approximately \$23,000.

Tucows expects general and administrative expenses to increase, in absolute dollars, on a go forward basis, as its business continues to grow and the impact of a higher Canadian dollar is recognized.

## DEPRECIATION OF PROPERTY AND EQUIPMENT

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

|  | <u>Three months ended March 31,</u> |             |
|--|-------------------------------------|-------------|
|  | <u>2004</u>                         | <u>2003</u> |
| Depreciation of property and equipment | \$ 312,986                          | \$ 434,965  |
| Decrease over prior period             | \$ (121,979)                        |             |
| Decrease - percentage                  | (28)%                               |             |
| Percentage of revenues                 | 3%                                  | 5%          |

The decrease in depreciation for the three months ended March 31, 2004 compared to the corresponding three month period in 2003 was primarily due to certain of Tucows older computer software being fully depreciated.

## OTHER INCOME (EXPENSES), NET

|                              | Three months ended March 31, |            |
|------------------------------|------------------------------|------------|
|                              | 2004                         | 2003       |
| Other income (expenses), net | \$ 37,633                    | \$ 262,062 |
| Decrease over prior period   | \$ (224,429)                 |            |
| Decrease - percentage        | (86)%                        |            |

In connection with the sale of its' back-end registry management service assets to Afilias, Tucows was entitled to earn contingent consideration of up to \$1.0 million based on each name registered or renewed in the .org registry. During the three months ended March 31, 2003, Tucows earned royalty payments of approximately \$236,000 from Afilias. As the full amount of the contingent consideration was fully paid by September 2003, no contingent consideration was received by Tucows during the quarter ended March 31, 2004.

Other income includes net interest income of approximately \$38,000 and \$26,000 for the three months ended March 31, 2004 and 2003, respectively.

## INCOME TAXES

No provision for income taxes was recorded for the three months ended March 31, 2004 and 2003 because Tucows had operating losses to offset against its operating income.

## LIQUIDITY AND CAPITAL RESOURCES

At March 31, 2004, Tucows principal source of liquidity was cash and cash equivalents of approximately \$13.7 million as compared to approximately \$12.9 million at December 31, 2003, an increase of approximately \$744,000. The cash and cash equivalents at March 31, 2004 represent an increase of approximately \$4.1 million over the approximately \$9.5 million at March 31, 2003.

Net cash provided by operating activities was approximately \$567,000 for the three months ended March 31, 2004, as compared to approximately \$710,000 for the three months ended March 31, 2003. Net cash provided by operating activities for the three months ended March 31, 2004 resulted primarily from net income for the period and increases in deferred revenue (representing cash received in advance of provision of the services). This was partially offset by an increase in prepaid domain name registry fees. Net cash provided by operating activities for the three months ended March 31, 2003 resulted primarily from net income for the period and a net increase in deferred revenue which was partially offset by the increases in prepaid domain name registry fees.

Net cash provided by financing activities during the three months ended March 31, 2004 comprised the net proceeds from the exercise of stock options of approximately \$153,000. During the three months ended March 31, 2003, no cash was provided by financing activities.

Net cash provided by investing activities was approximately \$24,000 for the three months ended March 31, 2004. This was primarily composed of approximately \$132,000 of term deposits, being margin security against forward foreign exchange contracts, maturing during the period. These proceeds were partially offset by cash used for the purchase of property and equipment of approximately \$108,000.

Based on Tucows' operations, Tucows believes that its cash and cash equivalents and cash flow from operations will be adequate to meet its anticipated requirements for working capital and capital expenditures for at least the next 12 months. Tucows may then need to, or before that time it may choose to, raise additional funds or seek other financing arrangements to facilitate more rapid expansion, including significant increases in personnel and office facilities, to develop new or enhance existing products or services, to respond to competitive pressures, or to acquire or invest in complementary businesses, technologies, services or products.

If additional financing is required, Tucows may not be able to raise it on acceptable terms, or at all, and additional financing may be dilutive to existing investors. Tucows may also evaluate potential acquisitions of other businesses, products and technologies. To complete potential acquisitions, Tucows may issue additional securities or need additional

equity or debt financing and any additional financing may be dilutive to existing investors. There are currently no understandings, commitments or agreements about any acquisition of other businesses, products or technologies other than the Boardtown Corporation acquisition more fully described in Note 6 to the consolidated financial statements contained in this Form 10-Q.

## RISK FACTORS

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

### **Risks Related to Tucows' Business and Industry**

**Tucows may not be able to maintain or improve its competitive position, and may be forced to reduce its prices, because of strong competition from other competitive registrars.**

Before the introduction of competition into the domain name registration industry in 1999, Network Solutions was the only entity authorized by the U.S. government to serve as the registrar for domain names in the .com, .net and .org domains. This position allowed Network Solutions to develop a substantial customer base, which gives it advantages in securing customer renewals and in developing and marketing ancillary products and services. In addition to Network Solutions, Tucows faces significant competition from other existing registrars and the continued introduction of new registrars in the domain name registration industry. As of March, 2004, ICANN had accredited 196 competitive registrars, including Tucows, to register domain names in one or more of the gTLDs, though not all of these accredited registrars are operational. The continued introduction of competitive registrars and resellers into the domain name registration industry and the rapid growth of some competitive registrars and resellers who have already entered the industry may make it difficult for Tucows to maintain its current market share. Some of these registrars may have longer operating histories, greater name recognition, particularly in international markets, or greater resources than Tucows. Tucows expects that competition will increase in the near term and that its primary long-term competitors may not yet have entered the market. As a result, Tucows may not be able to compete effectively.

The market for domain name registration continues to be extremely competitive as participants strive to protect their current market share and improve their competitive position. Verisign Global Registry Services charges registrars who use its shared registration system \$6 for each registration, which most users, including Tucows, pass on to their customers. Some of Tucows' competitors offer registration services at a price level minimally above the \$6 VeriSign registry fee for each domain name registered in the .com and .net registry. Other competitors have reduced and may continue to reduce their pricing for domain name registrations both for short-term promotions and on a permanent basis. Tucows' competitors have also offered domain name registrations free in a bundle of other products, deriving their revenues from other products and services. In addition, some of these competitors have experienced a significant increase in their registrations, suggesting that customers are becoming more price sensitive.

As Tucows' business model is premised upon selling multiple services through its reseller channel, Tucows has competed aggressively to attract new clients and retain existing customers. As a result of these actions, Tucows' average selling prices have fallen and Tucows may be required, by marketplace factors or otherwise, to reduce, perhaps significantly, the prices it charges for its core domain name registration and related products and services, especially if its competitors who charge these reduced fees are able to maintain customer service comparable to Tucows. Given the volatile nature of this market place, it is difficult to predict whether Tucows average selling prices will continue to decline. If Tucows continues to reduce its prices in order to remain competitive this could materially adversely affect Tucows' business, financial position and results of operations.

**If the growth rate of the market for new domain names remains flat or declines, Tucows' net revenue from registrations may fall below anticipated levels.**

Demand for renewals and new registrations under .com, .net, .org and other top level domains grew moderately in 2003. According to VeriSign, the total number of registrations under .com and .net grew by 4.6 million in 2003. While Tucows expects the market to continue to grow it does not expect demand for new domain name registrations to return to the high levels experienced in 2000 and 2001. If the market for new domain name registrations declines, it would restrict the growth of Tucows' domain name registration business and its revenues may decline.

**If Tucows is unable to improve its sales of existing gTLDs, improve its renewal rate or generate alternate revenue streams, its business, financial condition and results of operations could be materially adversely affected.**

Although the overall number of registrations in each new gTLD that has been launched has been significantly lower than the number of .com registrations, the introduction of new gTLDs has contributed to Tucows revenues. Tucows does not currently anticipate the introduction of any additional commercial gTLDs in the near future that would materially affect its revenues. As a result, in order to grow its revenues Tucows needs to increase sales of existing gTLDs, renewals, transfers or other products and services in lieu of the opportunities that were presented by the new gTLDs in 2001 and early 2002. Tucows business and results of operations could be materially adversely affected if the market for existing gTLDs does not develop, additional new top level domains are not introduced or if substantial numbers of its customers turn to other registrars for their registration needs.

**Tucows relies on its network of resellers to renew their domain name registrations through Tucows and to distribute its applications and services, and if Tucows is unable to maintain these relationships or establish new relationships, its revenue may decline.**

The growth of Tucows' business depends, among other things, on its resellers' renewal of their customers' domain name registrations through Tucows. Resellers may choose to renew their domain names with other registrars or they may choose not to renew and pay for renewal of their domain names. If resellers decide, for any reason, not to renew their registrations through Tucows, revenues from domain name registrations will decrease.

Tucows obtains revenues by distributing applications and services through its network of resellers. Tucows also relies on its resellers to market, promote and sell its services. Tucows' ability to increase revenues in the future will depend significantly on its ability to maintain its customer network, to sell more services through existing resellers and to develop its relationships with existing resellers by providing customer and sales support and additional products. Resellers have no obligations to distribute Tucows' applications and services and may stop doing so at any time. If Tucows is not able to maintain its relationships with resellers, its ability to distribute its applications and services will be harmed, and its revenue may decline.

**A significant portion of Tucows' bookings is obtained from a limited number of resellers, and the loss of any major customers could cause Tucows' bookings to decline.**

While no customer accounted for more than 10% of Tucows billed revenues in the three months ended March 31, 2004, approximately 40 resellers account for approximately 50% of Tucows' transaction volume and approximately 60 resellers account for approximately 50% of Tucows' billed revenue. Tucows does not expect any customer to account for more than 10% of billed revenues in 2004. If Tucows loses and is unable to replace any major customers, Tucows' billed revenues will decline.

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

If any of Tucows 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 name applications themselves. If a number of Tucows customers decide to pursue this option, Tucows sales will decrease.

**Failure by Tucows to secure agreements with country code registries or a subsequent failure by Tucows 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 (ccTLD) registries require registrars to comply with specific regulations. Many of these regulations vary from ccTLD to ccTLD. If Tucows fails to comply with the regulations imposed by ccTLD registries, these registries will likely prohibit Tucows from registering or continuing to register names in their ccTLD. Any failure on Tucows' part to offer domain name registrations in a significant number of ccTLDs, or in a popular ccTLD, would cause Tucows to lose a competitive advantage and could cause resellers to elect to take their business to a registrar that offers these services.

**Tucows operates on a global basis and clients around the world are required to execute its standard form agreements. Tucows' standard domain name registration agreement may not be enforceable, which could subject Tucows to liability.**

All of Tucows' resellers must execute Tucows' standard domain name registration agreement as part of the process of registering a domain name. This agreement contains provisions intended to limit Tucows' potential liability arising from its registration of domain names on behalf of its resellers and their customers, including liability resulting from its failure to register or maintain domain names. If a court were to find that the registration agreement is unenforceable, Tucows could be subject to liability.

**If Tucows' cannot obtain or develop additional applications and services or its customers do not find any expanded product and service offerings appealing, or if Tucows fails to establish itself as a reliable source for these products and services, Tucows may remain dependent on domain name registrations as a primary source of revenue and its net revenues may fall below anticipated levels.**

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

Tucows' primary business, domain name registration services, generated 94% of the company's net revenues during the three months ended March 31, 2004. Tucows cannot assure you that it will be able to attain the market's confidence as a reliable provider of products and services outside of its core business. If, over time, Tucows fails to offer products and services that meet its customers' needs and that are competitive with those offered in the marketplace, or its customers elect not to purchase its products and services, Tucows' anticipated net revenues may fall below expectations, it may not generate sufficient revenue to offset the related costs and it will remain dependent on domain name registrations as its primary source of revenue. Tucows' inability to diversify successfully its revenue base from domain name registrations could, together with a decline in that market, materially adversely affect its business, financial condition and results of operations.

**Tucows depends on third parties for free and low cost web-based content.**

Tucows accesses and provides web-based content for certain of its content notification and other sites. Tucows accesses this content mainly by searching selected web sites and then providing links to relevant content from the individual sites. Usually, Tucows pays no fee, or a small fee, for accessing web-based content in this manner. Tucows' ability to continue to use web-based content in this manner without cost, or for small fees, is fundamental to its goal of providing free, or low cost, content notification sites.

**If Tucows fails to protect its proprietary rights, the value of those rights could be diminished.**

Tucows relies upon copyright, trade secret and trademark law, confidentiality and nondisclosure agreements, invention assignment agreements and work for hire agreements to protect its proprietary technology. Tucows owns seven United States patents and has two pending United States patent applications. Tucows cannot ensure that its efforts to protect its 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.

Tucows has licensed, and may in the future license, some of its trademarks and other proprietary rights to others. Third parties may also reproduce or use intellectual property rights of Tucows without seeking a license and thus benefit from the technology of Tucows 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 Tucows. Actions by licensees, misappropriation of the intellectual property rights or independent development by others of similar or superior technology might diminish the value of the proprietary rights of Tucows or damage the reputation of Tucows.

The unauthorized reproduction or other misappropriation of Tucows' intellectual property rights, including copying the look, feel and functionality of its web site could enable third parties to benefit from Tucows' technology without Tucows receiving any compensation.

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 Tucows losing significant rights and its ability to operate all or a portion of its business.

**Claims of infringement of intellectual property or other rights of third parties against Tucows could result in substantial costs.**

Third parties may assert claims of infringement of patents or other intellectual property rights against Tucows concerning past, current or future technologies.

Content obtained from third parties and distributed over the Internet by Tucows may result in liability for defamation, negligence, intellectual property infringement, product or service liability and dissemination of computer viruses or other disruptive problems. Tucows may also be subject to claims from third parties asserting trademark infringement, unfair competition and violation of publicity and privacy rights relating specifically to domain names. These claims may include claims under the Anti-cybersquatting Consumer Protection Act, which was enacted to curtail the registration of a domain name 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 name.

These claims and any resultant 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 the ability of Tucows to use the intellectual property subject to these claims unless it is able to enter into agreements with the third parties making these claims. If a successful claim of infringement is brought against Tucows and it fails to develop non-infringing technology or to license the infringed or similar technology on a timely basis, it may have to limit or discontinue the business operations which used the infringing technology.

Tucows relies 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 Tucows to obtain substitute technology of lower quality or performance standards or at greater cost, which could make its products and services less attractive to customers or increase its costs.

**Tucows depends on key personnel to manage its business effectively.**

Tucows depends on the performance of its senior management team and other key employees. Tucows' success will also depend on its ability to attract, integrate, train, retain and motivate these individuals and additional highly skilled technical and sales and marketing personnel. In addition, Tucows does not maintain key person life insurance for any of its officers or key employees. The loss of the services of any of Tucows' senior management team or other key employees or failure to attract, integrate, train, retain and motivate additional key employees could harm Tucows' business.

**Currency fluctuations may adversely affect Tucows.**

Tucows revenue is primarily realized in United States dollars and a significant portion of Tucows' operating expenses is paid in Canadian dollars. Fluctuations in the exchange rate between the United States dollar and the Canadian dollar may have a material effect on Tucows' business, financial condition, and results from operations. In particular, Tucows may be adversely affected by a significant weakening of the United States dollar against the Canadian dollar on a quarterly and on an annual basis. Tucows' policy with respect to foreign currency exposure is to manage financial exposure to certain foreign exchange fluctuations with the objective of neutralizing some of the impact of foreign currency exchange movements by entering into foreign exchange forward contracts to hedge a portion of its Canadian dollar exposure. At March 31, 2004, Tucows had no forward foreign exchange contracts. Subsequent to March 31, 2004, Tucows entered into a series of forward exchange contracts more fully disclosed in Note 5 to the consolidated financial statements contained in this Form 10-Q.

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

A substantial majority of Tucows revenues originate from online credit card transactions. Under current credit card industry practices, Tucows is liable for fraudulent and disputed credit card transactions because Tucows does 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's rules, additional penalties may be imposed at the discretion of the association. Any such potential penalties would be imposed on Tucows credit card processor by the association, and under Tucows contract with its processor, Tucows is required to reimburse it for such penalties. Tucows current level of fraud protection is ranking its fraudulent and disputed credit card transaction history within the guidelines established by the credit card associations. However, Tucows faces the risk that one or more credit card associations may, at any time, assess penalties against it or terminate its ability to accept credit card payments from customers, which would have a material adverse affect on Tucows business, financial condition and results of operations.

**Tucows could suffer uninsured losses.**

Although Tucows maintains general liability insurance, claims could exceed the coverage obtained or might not be covered by Tucows' insurance. While Tucows typically obtains representations from its technology and content providers and contractual partners concerning the ownership of licensed technology and informational content and obtains indemnification to cover any breach of these representations, Tucows still may not receive accurate representations or adequate compensation for any breach of these representations. Tucows may have to pay a substantial amount of money for claims which are not covered by insurance or indemnification or for claims where the existing scope or adequacy of insurance or indemnification is disputed or insufficient.

**Current world events and economic trends may have a negative impact on Tucows' sales.**

Tucows' sales are subject to risks arising from adverse changes in domestic and global economic conditions and fluctuations in consumer confidence and spending. As a result, Tucows' sales may decline as a result of factors beyond its control, such as war and terrorism. These events include ongoing armed conflicts and retaliatory terrorist attacks. Any of these events could cause consumer confidence and spending to decrease or result in increased volatility in the global markets and economy. If any of the foregoing events occur, Tucows' sales may decline and its business may be adversely affected.

**Tucows' quarterly and annual operating results may fluctuate and its future revenues and profitability are uncertain.**

Tucows' quarterly operating results may fluctuate significantly in the future as a result of a variety of factors, many of which are outside of Tucows' control. Tucows' quarterly and annual operating results may be adversely affected by a wide variety of factors, including:

- Tucows' ability to maintain revenue growth at current levels or anticipate a decline in revenue from any of its services;
- Tucows' ability to identify and develop new technologies or services and to commercialize those technologies into new services in a timely manner;
- the mix of Tucows' services sold during the quarter or year;
- Tucows' ability to make appropriate decisions which will position it to achieve further growth;
- changes in Tucows' pricing policies or those of its competitors and other competitive pressures on selling prices;
- Tucows' ability to identify, hire, train, motivate, and retain highly qualified personnel, and to achieve targeted productivity levels;
- market acceptance of Internet services generally and of new and enhanced versions of Tucows services in particular;
- Tucows' ability to establish and maintain a competitive advantage;
- the continued development of Tucows' global distribution channel and its ability to compete successfully as part of Tucows' sales and marketing strategy;

- the number and significance of service enhancements and new service and technology announcements by Tucows' competitors;
- Tucows' ability to identify, develop, deliver, and introduce in a timely manner new and enhanced versions of its current service offerings which anticipate market demand and address customer needs;
- changes in foreign currency exchange rates and issues relating to the conversion to the Canadian dollar;
- interruptions in Tucows' services;
- seasonality of the markets and businesses of Tucows' customers;
- news relating to Tucows' industry as a whole; and
- Tucows' ability to enforce its intellectual property rights.

Tucows operating expenses may increase. Tucows bases its operating expense budgets on expected revenue trends that are more difficult to predict in periods of economic uncertainty. Tucows intends to continue its efforts to control discretionary spending; however, Tucows will continue to selectively incur expenditures in areas that it believes will strengthen its position in the marketplace. If Tucows does not meet revenue goals, it may not be able to meet reduced operating expense levels and its operating results will suffer. It is possible that in one or more future quarters, Tucows operating results may be below Tucows' expectations and the expectations of public market analysts and investors. In that event, the price of Tucows common stock may fall.

### **Risks Related to the Internet and Tucows' Technology**

**Tucows business could be materially harmed if the administration and operation of the Internet no longer relies upon the existing domain name system.**

The domain name registration industry continues to develop and adapt to changing technology. This development may include changes in the administration or operation of the Internet, including the creation and institution of alternate systems for directing Internet traffic without the use of the existing domain name system. Some of Tucows' competitors have begun registering domain names with extensions that rely on such alternate systems. These competitors are not subject to ICANN accreditation requirements and restrictions. Other competitors have attempted to introduce naming systems that use keywords rather than traditional domain names. The widespread acceptance of any alternative systems could eliminate the need to register a domain name to establish an online presence and could materially adversely affect Tucows' business, financial condition and results of operations.

**If Internet usage does not grow or if the Internet does not continue to expand as a medium for commerce, Tucows' business may suffer.**

Tucows' success depends upon the continued development and acceptance of the Internet as a widely used medium for commerce and communication. Rapid growth in the uses of and interest in the Internet is a relatively recent phenomenon and its continued growth cannot be assured. A number of factors could prevent continued growth, development and acceptance, including:

- the unwillingness of companies and consumers to shift their purchasing from traditional vendors to online vendors;
- the Internet infrastructure may not be able to support the demands placed on it, and its performance and reliability may decline as usage grows;
- security and authentication issues may create concerns with respect to the transmission over the Internet of confidential information, such as credit card numbers, and attempts by unauthorized computer users, so-called hackers, to penetrate online security systems; and
- privacy concerns, including those related to the ability of web sites to gather user information without the user's knowledge or consent, may impact consumers' willingness to interact online.

Any of these issues could slow the growth of the Internet, which could limit Tucows' growth and revenues.

**Tucows may be unable to respond to the rapid technological changes in the industry, and its attempts to respond may require significant capital expenditures.**

The Internet and electronic commerce are characterized by rapid technological change. Sudden changes in user and customer requirements and preferences, the frequent introduction of new applications and services embodying new technologies and the emergence of new industry standards and practices could make the applications, services and systems offered by Tucows obsolete. The emerging nature of applications and services in the e-business industry and their rapid evolution will require that Tucows continually improve the performance, features and reliability of its applications and services. The success of Tucows will depend, in part, on its ability:

- to develop and license new applications, services and technologies that address the increasingly sophisticated and varied needs of its current and prospective customers; and
- to respond to technological advances and emerging industry standards and practices on a cost-effective and timely basis.

The development of applications and services and other proprietary technology involves significant technological and business risks and requires substantial expenditures and lead-time. Tucows may be unable to use new technologies effectively or adapt its internally developed technology and transaction-processing systems to customer requirements or emerging industry standards. Updating technology internally and licensing new technology from third parties may require Tucows to incur significant additional capital expenditures.

**Tucows could experience system failures and capacity constraints which would cause interruptions in its services and ultimately cause it to lose customers.**

The ability of Tucows to maintain its computer hardware and software and telecommunications equipment in working order and to reasonably protect them from error and interruption is critical to its success. Failures and interruptions of, and the slowing of response times on, these systems could be caused by:

- an increase in the traffic on Tucows' web sites without any necessary increase in system capacity;
- natural disasters, power losses, telecommunications failures, break-ins and similar events;
- computer viruses and electronic break-ins;
- errors, defects and bugs in software; and
- failure or inability to upgrade technical infrastructure to handle unexpected surges in customer levels and increases in customers' usage of bandwidth.

Tucows' web site has experienced slower response times because of increased traffic and has occasionally suffered failures of the computer hardware and software and telecommunications systems that it uses to deliver its sites to customers. Substantial or persistent system failures could result in:

- loss of customers;
- loss of or delay in revenue; and
- failure to attract new customers or achieve market acceptance.

**Tucows' systems face security risks, and any compromise of the security of these systems could result in liability for damages and in lost customers.**

Tucows' security systems may be vulnerable to unauthorized access by hackers or others, computer viruses and other disruptive problems. Someone who is able to circumvent security measures could misappropriate customer or proprietary information or cause interruptions in Internet operations. Internet and online service providers have in the past

experienced, and may in the future experience, interruptions in service because of the accidental or intentional actions of Internet users, current and former employees or others. Tucows may need to expend significant capital or other resources to protect against the threat of security breaches or alleviate problems caused by breaches. Unauthorized persons may be able to circumvent the measures that are implemented in the future. Eliminating computer viruses and alleviating other security problems may require interruptions, delays or cessation of service to users accessing Tucows' web sites and the web pages that deliver Tucows' content services. Repeated or substantial interruptions could result in the loss of customers and reduced revenues.

Many users of online commerce services are highly concerned about the security of transmissions over public networks. Concerns over security and the privacy of users may inhibit the growth of the Internet and other online services generally, and the web in particular, especially as a means of conducting commercial transactions. Users might circumvent the measures Tucows takes to protect customers' private and confidential information, such as credit card numbers. Security breaches could damage Tucows' reputation and expose it to litigation and possible liability, including claims for unauthorized purchases with credit card information, impersonation or other similar fraud claims and for other misuses of personal information, including for unauthorized marketing purposes. Tucows may also incur significant costs to protect against security breaches or to alleviate problems caused by these breaches. In addition, the Federal Trade Commission and state agencies have investigated various Internet companies regarding their use of personal information. The federal government has enacted legislation protecting the privacy of consumers' nonpublic personal information. Tucows cannot guarantee that its current information-collection procedures and disclosure policies will be found to be in compliance with existing or future laws or regulations. Tucows' failure to comply with existing laws, including those of foreign countries, the adoption of new laws or regulations regarding the use of personal information that require Tucows to change the way it conducts business or an investigation of Tucows privacy practices could increase the costs of operating Tucows' business.

### **Governmental and Regulatory Risks**

**Governmental and regulatory policies or claims concerning the domain name registration system, and industry reactions to those policies or claims, may cause instability in the industry and disrupt Tucows' domain name registration business.**

Before 1999, Network Solutions managed the domain name registration system for the .com, .net and .org domains on an exclusive basis under a cooperative agreement with the U.S. government. In November 1998, the Department of Commerce authorized ICANN to oversee key aspects of the domain name registration system. ICANN has been subject to strict scrutiny by the public and by the government. For example, in the United States, Congress has held hearings to evaluate ICANN's selection process for new top level domains. In addition, ICANN faces significant questions regarding its financial viability and efficacy as a private sector entity. ICANN's may continue to evolve both its long term structure and mission to address perceived shortcomings such as a lack of accountability to the public and a failure to maintain a diverse representation of interests on its board of directors. Tucows continues to face the risks that:

- the U.S. or any other government may reassess its decision to introduce competition into, or ICANN's role in overseeing, the domain name registration market;
- the Internet community or the Department of Commerce or U.S. Congress may refuse to recognize ICANN's authority or support its policies, which could create instability in the domain name registration system;
- ICANN may lose any one of the several claims pending against it in both the U.S. and international courts, in which case its credibility may suffer and its policies may be discredited;
- ICANN may attempt to impose additional fees on registrars if it fails to obtain funding sufficient to run its operations;
- the terms of the registrar accreditation process could change in ways that are disadvantageous to Tucows; and
- International regulatory bodies, such as the International Telecommunications Union or the European Union, may gain increased influence over the management and regulation of the domain name registration system, leading to increased regulation in areas such as taxation and privacy.

In addition, ICANN has established policies and practices for itself and the companies it accredits to act as domain name registries and registrars. Some of ICANN's policies and practices, and the policies and practices adopted by registries and registrars in the domain name business, could be found to conflict with the laws of one or more jurisdictions.

If any of these risks occur, they could create instability in the domain name registration system business. These risks could also disrupt or suspend portions of Tucows' domain name registration business, which would result in reduced revenue.

**Tucows may be subject to government regulation and legal liabilities which may be costly and may interfere with its ability to conduct business.**

Although transmission of Tucows' sites primarily originates in Canada and the United States, the Internet is global in nature. Governments of foreign countries might try to regulate Tucows' transmissions or prosecute it for violations of their laws. Because of the increasing popularity and use of the Internet, federal, state and foreign governments may adopt laws or regulations in the future concerning commercial online services and the Internet, about:

- user privacy;
- children;
- copyrights and other intellectual property rights and infringement;
- domain names;
- pricing;
- content regulation;
- defamation;
- taxation; and
- the characteristics and quality of products and services.

Laws and regulations directly applicable to online commerce or Internet communications are becoming more prevalent. Laws and regulations such as those listed above or others could expose Tucows to substantial liability, if enacted, and increase its costs of compliance and doing business.

**The introduction of tax laws targeting companies engaged in electronic commerce could materially adversely affect Tucows business, financial condition and results of operations.**

Tucows files tax returns in such countries and states as required by law based on principles applicable to traditional businesses. However, one or more economic unions, countries and states could seek to impose additional income tax obligations or sales tax collection obligations on out-of-jurisdiction companies, such as Tucows, which engage in or facilitate electronic commerce. A number of proposals have been made at these different government levels that could impose such taxes on the sale of products and services through the Internet or the income derived from such sales. Such proposals, if adopted, could substantially impair the growth of electronic commerce and materially adversely affect Tucows business, financial condition and results of operations.

On November 28, 2001, President Bush signed the Internet Tax Non-discrimination Act, which limits the ability of the states to impose taxes on Internet-based transactions. While this legislation provided significant benefits to Internet-based businesses, it expired on November 1, 2003. As of this time, both the House of Representatives (H.R. 49) and the Senate (S. 150) have passed bills regarding the extension of the Internet tax moratorium. The House bill permanently extends the moratorium, but the Senate bill, passed on April 29, 2004, only approves a four-year extension. The House and Senate will now reconcile these bills in committee. It appears, therefore, that some form of moratorium will be presented to the President for his signature. If some form of moratorium legislation is not otherwise renewed, various states might be permitted to impose taxes on Internet-based commerce. The imposition of such taxes, which has been heavily lobbied for by states, many of which face increasing budget deficits, could materially adversely affect Tucows business, financial condition and results of operations.

**Compliance with new rules and regulations concerning corporate governance may be costly and could harm Tucows business.**

The Sarbanes-Oxley Act of 2002 mandates, among other things, that companies adopt new corporate governance measures and imposes comprehensive reporting and disclosure requirements, sets stricter independence and financial expertise standards for audit committee members and imposes increased civil and criminal penalties for companies, their chief executive officers and chief financial officers and directors for securities law violations. These laws, rules and regulations will increase the scope, complexity and cost of Tucows corporate governance, reporting and disclosure practices, which could harm Tucows results of operations and divert management's attention from business operations. Tucows also expects these developments to make it more difficult and more expensive for it to obtain director and officer liability insurance, and Tucows may be required to accept reduced coverage or incur substantially higher costs to obtain coverage. Further, Tucows' board members, chief executive officer and chief financial officer could face an increased risk of personal liability in connection with the performance of their duties. As a result, Tucows may have difficulty attracting and retaining qualified board members and executive officers, which could harm its business.

**Risk Related to Tucows' Stock**

**A limited number of principal shareholders control Tucows, which may limit your ability to influence corporate matters.**

Four principal shareholders beneficially own approximately 51% of Tucows voting stock. These shareholders could control the outcome of any corporate transaction or other matter submitted to Tucows shareholders for approval, including mergers, consolidations and the sale of all or substantially all of Tucows' assets, and also could prevent or cause a change in control. The interests of these shareholders may differ from the interests of Tucows' other shareholders.

Third parties may be discouraged from making a tender offer or bid to acquire Tucows because of this concentration of ownership.

**Tucows common stock has been delisted, and investors may find it more difficult to sell Tucows common stock.**

Tucows common stock was delisted from the Nasdaq SmallCap market in June 2001. Tucows common stock is now quoted on the OTC Bulletin Board maintained by Nasdaq. The fact that Tucows common stock is not listed is likely to make trading Tucows shares more difficult for broker-dealers, shareholders and investors, potentially leading to further declines in share price. It may also make it more difficult for Tucows to raise additional capital. An investor may find it more difficult to sell Tucows common stock or to obtain accurate quotations of the share price of Tucows common stock. Management has not determined when or whether it will apply again for listing on the Nasdaq SmallCap market.

Tucows is also subject to an SEC rule concerning the trading of so-called penny stocks. Under this rule, broker-dealers who sell securities governed by the rule to persons who are not established customers or accredited investors must make a special suitability determination and must receive the purchaser's written consent to the transaction prior to the sale. This rule may deter broker-dealers from recommending or selling Tucows' stock, which may negatively affect the liquidity of Tucows' stock.

**Tucows' stock price is highly volatile, which may make it difficult to resell your shares when you want to, at prices you find attractive.**

Tucows' stock price has varied recently and if it continues to vary, the price of its common stock may decrease in the future regardless of Tucows operating performance. Investors may be unable to resell their shares of common stock following periods of volatility because of the market's adverse reaction to this volatility.

The following factors may contribute to this volatility:

- actual or anticipated variations in Tucows' quarterly operating results;
- interruptions in Tucows' services;
- seasonality of the markets and businesses of Tucows' customers;

- announcements of new technologies or new services by Tucows or its competitors;
- Tucows' ability to accurately select appropriate business models and strategies;
- the impact that terrorist acts or military action may have on global economic conditions and the impact that this will have on Tucows' customers or business;
- the operating and stock price performance of other companies that investors may view as comparable to Tucows;
- news relating to Tucows' industry as a whole; and
- news relating to trends in Tucows' markets.

The stock market in general, and the market for Internet-related companies, including Tucows, in particular, has experienced extreme volatility. This volatility often has been unrelated to the operating performance of these companies. These broad market and industry fluctuations may cause the price of Tucows' stock to drop, regardless of Tucows' performance.

### **Item 3. Quantitative and Qualitative Disclosures about Market Risk**

Tucows services are developed in and are sold primarily from North America. Tucows' sales are primarily made in United States dollars, while a major portion of expenses are incurred in Canadian dollars. Tucows' financial results could be affected by factors such as changes in foreign currency exchange rates or weak economic conditions in foreign markets. Tucows' interest income is sensitive to changes in the general level of Canadian and U.S. interest rates, particularly since the majority of its investments are in short-term instruments. Based on the nature of its short-term investments, Tucows has concluded that there is no material interest rate risk exposure at March 31, 2004.

Although Tucows has a functional currency of U.S. dollars, a substantial portion of its fixed expenses are incurred in Canadian dollars. Tucows policy with respect to foreign currency exposure is to manage financial exposure to certain foreign exchange fluctuations with the objective of neutralizing some of the impact of foreign currency exchange movements. Accordingly, Tucows has in the past, entered into foreign exchange forward contracts to hedge portions of its Canadian dollar exposure and may do so in the future. At March 31, 2004 Tucows had no foreign exchange forward contracts outstanding. Subsequent to March 31, 2004, Tucows entered into a series of forward exchange contracts more fully disclosed in Note 5 to the consolidated financial statements contained in this Form 10-Q.

Foreign exchange forward contracts have not been treated as cash flow hedges for accounting purposes as Tucows has not complied with the documentation requirements. Tucows has accounted for the fair value of the derivative instruments within the consolidated balance sheet as a derivative financial asset or liability and the corresponding change in fair value is recorded in the consolidated statement of operations. Tucows has no other freestanding or embedded derivative instruments.

The impact of the foreign exchange forward contracts for the three months ended March 31, 2004 was a net loss of approximately \$19,000, and for the three months ended March 31, 2003, the impact was a net gain of approximately \$547,000, which is reflected on the consolidated statements of operations in general and administrative expenses.

Tucows has performed a sensitivity analysis model for foreign exchange exposure over the three months ended March 31, 2004. The analysis used a modeling technique that compares the US dollar equivalent of all expenses incurred in Canadian dollars, at the actual exchange rate, to a hypothetical 10% adverse movement in the foreign currency exchange rates, with all other variables held constant. Foreign currency exchange rates used were based on the market rates in effect during the three months ended March 31, 2004. The sensitivity analysis indicated that a hypothetical 10% adverse movement in foreign currency exchange rates would result in a decrease in net income for the three months ended March 31, 2004 of approximately \$301,000. There can be no assurances that the above projected exchange rate decrease will materialize. Fluctuations of exchange rates are beyond the control of Tucows. Tucows will continue to monitor and assess the risk associated with these exposures and may at some point in the future take actions to hedge or mitigate these risks. There is no assurance that any strategy will be successful in avoiding losses due to exchange fluctuations, or that the failure to manage currency risks effectively would not have a material effect on Tucow's results of operations.

### **Item 4. Controls and Procedures**

#### **(a) Evaluation of Disclosure Controls and Procedures**

Tucows' management, with the participation of its chief executive officer and chief financial officer, evaluated the effectiveness Tucows' disclosure controls and procedures as of the end of the period covered by this Form 10-Q. Based on that evaluation, Tucows' chief executive officer and chief financial officer concluded that Tucows' disclosure controls and procedures as of the end of the period covered by this Form 10-Q have been designed and are functioning effectively to provide reasonable assurance that the information required to be disclosed by Tucows in reports filed under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Tucows believes that a controls system, no matter how well designed and operated, cannot provide absolute assurance that the objectives of the controls system are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected.

#### **(b) Change in Internal Control over Financial Reporting**

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

**PART II.**  
**OTHER INFORMATION**

**Item 1. Legal Proceedings**

Since March 23, 2004, the date of the filing of Tu cows' Form 10-K for the year ending December 31, 2003, there have been no new material legal proceedings involving Tu cows. Tu cows cannot assure that it will prevail in any litigation. Regardless of the outcome, any litigation may require Tu cows to incur significant litigation expense and may result in significant diversion of management attention.

**Item 6. Exhibits and Reports on Form 8-K.**

(a) Exhibits.

| <u>Exhibit No.</u> | <u>Description</u>  |
|--------------------|---|
| 31.1               | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.                                     |
| 31.2               | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.                                     |
| 32                 | Certification by the Chief Executive Officer and Chief Financial Officer Relating to a Periodic Report Containing Financial Statements. |

(b) Reports on Form 8-K.

Form 8-K furnished on February 9, 2004 under Item 12, "Results of Operations and Financial Condition" (with respect to a press release relating to Tu cows' performance in the fourth quarter of 2003).

## **SIGNATURES**

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

Date: May 13, 2004

TUCOWS INC.

By: /s/ Elliot Noss  
Elliot Noss  
Chief Executive Officer

By: /s/ Michael Cooperman  
Michael Cooperman  
Chief Financial Officer  
(Principal Financial and Accounting Officer)

## EXHIBIT INDEX

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CERTIFICATION PURSUANT TO  
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Elliot Noss, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Tucows Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):
  - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 13, 2004

/s/ Elliot Noss  
Elliot Noss  
President and Chief Executive Officer

CERTIFICATION PURSUANT TO  
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Michael Cooperman, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Tucows Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures, and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):
  - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 13, 2004

/s/ Michael Cooperman  
Michael Cooperman  
Chief Financial Officer

CERTIFICATION BY THE CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER  
RELATING TO A PERIODIC REPORT CONTAINING FINANCIAL STATEMENTS

I, Elliot Noss, Chief Executive Officer and President of Tucows Inc., hereby certify to my knowledge, and I, Michael Cooperman, Chief Financial Officer, Tucows Inc., hereby certify to my knowledge, that:

- (a) The Company's quarterly report on Form 10-Q for the period ended March 31, 2004 (the "Form 10-Q"), fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934, as amended; and
- (b) The information contained in the Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of the Company.

CHIEF EXECUTIVE OFFICER

CHIEF FINANCIAL OFFICER

/s/ Elliot Noss  
Elliot Noss

/s/ Michael Cooperman  
Michael Cooperman

Date: May 13, 2004

Date: May 13, 2004

A signed original of this written statement required by Section 906 the Sarbanes-Oxley Act of 2002, or other document authenticating, acknowledging or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to Tucows Inc. and will be retained by Tucows Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

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