TUCOWS INC /PA/
Form 10-Q
August 13, 2002

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SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2002

OR

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

For the transition period from to

Commission file number 0-28284

TUCOWS INC.

(Exact Name of Registrant as Specified in Its Charter)

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

96 Mowat Avenue,
Toronto, Ontario M6K 3M1, Canada
(Address of Principal Executive Offices) (Zip Code)

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

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

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

Class	Outstanding at June 30, 2002
Common Stock, no par value	64,626,429

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Item 1. Financial Statements

Tucows Inc.

Consolidated Balance Sheets

(Dollar amounts in U.S. dollars)

	June 30, 2002 (unaudited)	December 31, 2001
Assets		
Current assets:		
Cash and cash equivalents	$ 5,870,965	$ 4,814,189
Restricted cash (note 8)	746,000	
Accounts receivable, net of allowance for doubtful accounts of $363,579 at June 30, 2002 and $276,579 at December 31, 2001	322,203	817,990
Prepaid expenses and deposits	2,095,362	2,041,927
Prepaid domain name registry fees, current portion	10,889,447	10,034,413
Total current assets	19,923,977	17,708,519
Restricted cash (note 8)	450,000	
Prepaid domain name registry fees, long-term portion	3,307,667	2,599,962
Property and equipment	2,098,427	3,691,390
Intangible assets		222,222
Investments	353,737	1,367,072

	June 30, 2002	December 31, 2001
Total assets	$ 26,133,808	$ 25,589,165
Liabilities and Stockholders' Deficiency		
Current liabilities:		
Accounts payable	$ 1,442,150	$ 1,958,744
Accrued liabilities	1,382,786	2,242,858
Customer deposits	2,245,958	1,951,336
Obligations under capital lease	27,495	58,772
Deferred revenue, current portion	18,925,874	18,444,280
Total current liabilities	24,024,263	24,655,990
Deferred revenue, long-term portion	5,495,257	4,270,341
Obligations under capital lease, net of current portion	38,093	52,387
Stockholders' deficiency:		
Capital stock	58,532,816	58,532,816
Deferred stock-based compensation	(265,317)	(346,000)
Deficit	(61,691,304)	(61,576,369)
Total stockholders' deficiency	(3,423,805)	(3,389,553)
Total liabilities and stockholders' deficiency	$ 26,133,808	$ 25,589,165

See accompanying notes to condensed consolidated financial statements

Tucows Inc.

Consolidated Statements of Operations

(Dollar amounts in U.S. dollars)

(unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2002	2001	2002	2001
Net revenues	$ 9,480,187	$ 7,187,394	$ 19,406,720	$ 13,579,042
Cost of revenues	5,636,988	4,653,170	12,231,513	8,570,470
Gross profit	3,843,199	2,534,224	7,175,207	5,008,572
Operating expenses:				
Sales and marketing(*)	800,897	1,819,352	1,905,753	3,770,430
Technical operations and development	958,780	1,396,797	2,017,709	2,642,881
General and administrative(*)	1,151,621	1,093,453	2,186,453	1,937,812

	Three months ended June 30,		Six months ended June 30,	
Depreciation of property and equipment	764,576	966,063	1,894,674	1,831,018
Amortization of intangible assets	55,556	937,586	222,222	1,863,446
Total operating expenses	3,731,430	6,213,251	8,226,811	12,045,587
Income (loss) from operations	111,769	(3,679,027)	(1,051,604)	(7,037,015)
Other income (expenses)				
Interest income	21,019	(27,193)	38,865	(756)
Write down of investment in bigchalk.com	(1,013,335)		(1,013,335)	
Gain on disposal of Liberty Registry Management Services Inc.			1,955,443	
Loss on disposal of Eklektix Inc.			(44,304)	
	(992,316)	(27,193)	936,669	(756)
Loss before provision for income taxes	(880,547)	(3,706,220)	(114,935)	(7,037,771)
Provision for income taxes				
Net loss for the period	$ (880,547)	$ (3,706,220)	$ (114,935)	$ (7,037,771)
Basic and diluted loss per share	$ (0.01)	$ (0.86)	$ (0.00)	$ (1.64)
Shares used in computing basic and diluted loss per common share	64,626,429	4,291,500	64,626,429	4,291,500
(*)Stock-based compensation has been included in operating expenses as follows:				
Sales and marketing	$ 27,406	$ 27,406	$ 54,511	$ 54,511
General and administrative	$ 13,159	$ 13,159	$ 26,172	$ 26,172

See accompanying notes to condensed consolidated financial statements

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Tucows Inc.

Consolidated Statements of Cash Flows

(Dollar amounts in U.S. dollars)

(unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2002	**2001**	**2002**	**2001**
Cash provided by (used in):				
Operating activities:				
Net Loss for the period	$ (880,547)	$ (3,706,220)	$ (114,935)	$ (7,037,771)
Items not involving cash:				
Depreciation of property and equipment	764,576	966,063	1,894,674	1,831,018

	Three months ended June 30,		Six months ended June 30,	
Amortization of intangible assets	55,556	937,586	222,222	1,863,446
Write down of investment in bigchalk.com	1,013,335		1,013,335	
Stock-based compensation	40,565	40,565	80,683	80,683
Gain on disposal of Liberty Registry Management Services Inc.			(1,955,443)	
Loss on write-off of Eklektix Inc.			44,304	
Change in non-cash operating working capital:				
Accounts receivable	115,049	62,989	322,883	206,093
Prepaid expenses and deposits	(221,508)	(271,661)	(192,858)	(714,781)
Prepaid domain name registry fees	(935,607)	(964,264)	(1,839,971)	(3,209,171)
Accounts payable	(134,651)	290,409	(179,149)	(734,313)
Accrued liabilities	(396,762)	86,533	(741,268)	684,487
Customer deposits	236,021	130,170	309,217	18,007
Deferred revenue	1,476,004	740,798	2,974,449	2,679,622
Cash provided by (used in) operating activities	1,132,031	(1,687,032)	1,838,143	(4,332,680)
Financing activities:				
Proceeds on rights issue				3,024,369
Loans payable		3,800,000		3,800,000
Repayments of obligations under capital leases	(25,795)		(45,571)	
Cash provided by (used in) financing activities	(25,795)	3,800,000	(45,571)	6,824,369
Investing activities:				
Additions to property and equipment	(242,683)	(816,455)	(448,057)	(1,971,214)
Increase in restricted cash being margin security against forward exchange contracts (note 8)	(1,196,000)		(1,196,000)	
Investment in Afilias Limited		(95,706)		(95,706)
Proceeds on disposal of Liberty Registry Management Services Inc., net of cash disposed			938,889	
Proceeds on disposal of Eklektix Inc., net of cash disposed			(30,628)	
Deferred acquisition costs				(313,098)
Cash used in investing activities	(1,438,683)	(912,161)	(735,796)	(2,380,018)
Increase (decrease) in cash and cash equivalents	(332,447)	1,200,807	1,056,776	111,671
Cash and cash equivalents, beginning of period	6,203,412	1,081,058	4,814,189	2,170,194
Cash and cash equivalents, end of period	$ 5,870,965	$ 2,281,865	$ 5,870,965	$ 2,281,865
Supplemental cash flow information:				
Interest paid	$ 7,130	$ 37,361	$ 11,628	$ 37,664

See accompanying notes to condensed consolidated financial statements

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. BUSINESS AND BASIS OF PRESENTATION:

Tucows Inc., a Pennsylvania corporation (the "Company" or "Tucows"), provides Internet domain name registration and other online products and services such as the delivery of private label applications, services and content through its global Internet-based distribution network to Internet service providers, web hosting companies, web designers, VARs and other providers of internet services to end users (sometimes collectively referred to as "MSP's").

The accompanying interim unaudited condensed consolidated balance sheets, statements of operations and statements of cash flows reflect all adjustments consisting of normal recurring adjustments and other adjustments appropriate in the circumstances that are, in the opinion of management, necessary for a fair presentation of the financial position of Tucows and its subsidiaries at June 30, 2002 and the results of operations and cash flows for the interim periods ended June 30, 2002 and 2001.

The accompanying interim condensed 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. Except for derivative financial instruments, which have been accounted for in the manner described in the following paragraph, 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, 2001 included in the Company's 2001 Annual Report on Form 10-K filed with the SEC on April 1, 2002.

The Company follows Statement of Financial Accounting Standard No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS No. 133"). SFAS No. 133 and Statement of Financial Accounting Standard No. 138, which amended SFAS No. 133, establishes accounting and reporting standards for derivative instruments and hedging activities. SFAS No. 133 requires that all derivatives, including foreign currency exchange contracts, be recognized in the statement of financial position at their fair value. Derivatives that are not hedges must be recorded at fair value through earnings. If a derivative is a hedge, depending on the nature of the hedge, changes in the fair value of the derivative are either offset against the change in fair value of underlying assets or liabilities through earnings or recognized in other comprehensive earnings until the underlying hedged item is recognized in earnings. The Company has not complied with the documentation standards for its derivative financial instruments to be accounted for as hedges and has therefore accounted for such derivative financial instruments at their fair value.

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. ACQUISITION OF INFONAUTICS, INC.:

On August 28, 2001, Tucows Inc., a Delaware corporation which later changed its name to Tucows (Delaware) Inc., finalized the acquisition of Infonautics, Inc., a Pennsylvania corporation ("Infonautics"). The acquisition was done as a merger of a subsidiary of Infonautics into Tucows (Delaware) Inc. so that after the merger, Tucows (Delaware) Inc. became a wholly owned subsidiary of Infonautics and Infonautics changed its name to Tucows Inc. In connection with the acquisition, for accounting purposes, all of the outstanding shares of Tucows (Delaware) Inc. were exchanged for 51,685,432 shares of Infonautics common stock. The acquisition of Infonautics has been accounted for as a reverse purchase acquisition as the former stockholders of Tucows (Delaware) Inc. acquired a majority of the outstanding shares of common stock of Infonautics and controlled the combined group of companies as a result of the acquisition. The accompanying condensed consolidated financial statements of the Company reflect the historical results of the predecessor entity, Tucows (Delaware) Inc., and the consolidated results of operations of the Company subsequent to the acquisition date of August 28, 2001.

The following supplemental pro-forma information is presented to illustrate the effects of the acquisition on the historical operating results for the three and six months ended June 30, 2001, as if the acquisition had occurred at the beginning of that period. No pro-forma information is required for the three and six months ended June 30, 2002 as all the relevant entities are included in these condensed consolidated financial statements for the full six months.

	Three months ended June 30, 2001	**Six months ended June 30, 2001**

	Three months ended June 30, 2001	Six months ended June 30, 2001
	(unaudited)	(unaudited)
Net revenues	$ 8,704,000	$ 16,935,000
Loss for the period	$ (5,083,000)	$ (9,405,000)
Loss per share	$ (0.08)	$ (0.15)

3. DISPOSITION OF LIBERTY REGISTRY MANAGEMENT SERVICES INC.:

On March 25, 2002, the Company sold all of the outstanding shares of Liberty Registry Management Services Inc. ("Liberty RMS"), which was a wholly owned subsidiary, and certain technology required to provide registry services, to Afilias Limited. Liberty RMS owned and operated the back-end registry services for the.info registry. Total consideration received consisted of cash proceeds of $977,000 and a receivable of $87,000. The Company has recorded a gain on the disposition of Liberty RMS of $1,955,443. The Company is also entitled to additional contingent consideration of up to $1 million based on certain future performance criteria. The amount the Company may earn from the future consideration cannot be estimated at this time and no amounts have been recognized. Any amounts receivable based on these criteria will be recorded when determinable.

4. 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 Afilias Limited ("Afilias"), a private company, which is a consortium of 18 domain name registrars.

The Company also holds an 11% interest in bigchalk.com, inc. ("bigchalk"), a private company. Tucows pays bigchalk content royalties and technical service fees for content provided to Tucows' Electric Library site, which amounted to approximately $378,000 for the three months ended June 30, 2002, and approximately $785,000 for the six months ended June 30, 2002. At June 30, 2002, approximately $246,000 is owed to bigchalk for these content royalties and technical service fees and is included within accrued liabilities. During the quarter ended June 30, 2002, the Company reviewed the carrying value of its investment in bigchalk. Based on this review, Tucows believes that a permanent decline in the value of this investment has occurred and has recorded a write down in the amount of $1,013,335 against the carrying value of this investment. The carrying value of this investment at June 30, 2002 was nil.

5. BASIC AND DILUTED (LOSS) EARNINGS PER SHARE:

The Company's basic (loss) earnings per common share for the three and six months ended June 30, 2002 and 2001 has been calculated by dividing net earnings by the weighted average number of common shares outstanding.

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The diluted earnings per common share exclude the effect of potentially dilutive shares when their effect is anti-dilutive. As all options to purchase common stock had exercise prices greater than the average market price of the common stock for all reported periods, they have been excluded from the computation of diluted earnings per share. Therefore, for all reported periods, basic and diluted loss per share is equal.

6. CAPITAL STOCK:

	June 30, 2002		December 31, 2001	
	shares	Amount	shares	Amount
	(unaudited)			
Capital stock				
Common stock, no par value:				

	June 30, 2002			December 31, 2001		
Authorized:						
250,000,000 at June 30, 2002 and December 31, 2001						
Issued and outstanding	64,626,429	$	8,525,131	64,626,429	$	8,525,131
Additional paid in capital			50,007,685			50,007,685
		$	58,532,816		$	58,532,816

7. SUPPLEMENTAL INFORMATION:

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

	Three months ended June 30,				Six months ended June 30,			
	2002		2001		2002		2001	
	(unaudited)				(unaudited)			
Advertising and other revenue	$	379,953	$	534,555	$	762,628	$	1,158,503
Domain name and ancillary services		8,054,774		6,652,839		16,479,668		12,420,539
Electric Library subscription		1,045,460				2,164,424		
	$	9,480,187	$	7,187,394	$	19,406,720	$	13,579,042

8. COMMITMENTS AND CONTINGENCIES:

The Company has been named as a defendant in a lawsuit filed in the Superior Court in the Province of Ontario, Canada. The lawsuit alleges that the Company defamed the plaintiff when the Company warned its customers about the plaintiff's business practices. Tucows does not believe that the lawsuit has merit and has retained local counsel to represent the Company in the proceedings. The Company does not believe it will be liable for any damages and accordingly has not accrued any amounts at June 30, 2002.

In addition, the Company has been named as a co-defendant with other entities in the industry in two class action lawsuits filed in the Superior Court, County of Los Angeles, U.S.A. The lawsuits allege that the defendants were engaged in unfair competition under state laws because they conducted an illegal lottery enterprise through the pre-registration of.biz generic top-level domains. The Company believes that the cases are without merit and has retained local counsel to represent the Company in the proceedings. The Company does not believe that it will be liable for any damages and, accordingly, has not accrued any amounts at June 30, 2002.

The Company has entered into a series of forward foreign exchange contracts ("Contracts") in the aggregate amount of $14.25 million, at an average foreign exchange rate of 1.5430, whereby an amount of U.S.$375,000 is converted into Canadian dollars on a semi-monthly basis from June 2002 until the end of December 2003. As margin security against these Contracts, the Company has placed $1,196,000 into secured term deposits, which mature on a monthly basis in line with the Contracts. The margin security in the amount of $1,196,000 is reflected as restricted cash on the balance sheet. As of June 30, 2002, notional amounts of $13.5 million were outstanding under these contracts.

9. RECENT ACCOUNTING PRONOUNCEMENTS:

In June 2001, the Financial Accounting Standards Board ("FASB") issued SFAS No. 141, "Business Combinations" ("SFAS No. 141") and SFAS No. 142, "Goodwill and Other Intangible Assets" ("SFAS No. 142"). The new statements mandate the purchase method of accounting be used for business combinations initiated on or after July 1, 2001. These new statements also establish criteria for identifying and measuring intangible assets acquired in business combinations that are recorded and reported apart from goodwill. Goodwill and intangible assets with indefinite useful lives are no longer amortized, but instead are tested for impairment at least annually by comparing their fair values with their book values. The new statements do not change the accounting for intangible assets with determinable lives; they continue to be amortized over their estimated useful lives and are tested for impairment by comparing their book values with undiscounted cash flows expected to be received from their use.

The Company adopted SFAS No. 141 and SFAS No. 142 beginning January 1, 2002. During the three and six months ended June 30, 2002, the Company has evaluated its intangible assets and has concluded that these intangible assets should continue to be accounted for apart from goodwill. Non-competition agreements are definite life intangible assets and continue to be amortized over the term of the non-competition agreements.

In August 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS No. 144"). SFAS No. 144 addresses financial accounting and reporting for the impairment or disposal of long-lived assets. This statement requires that long-lived assets be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. SFAS No. 144 also requires companies to separately report discontinued operations and extends that reporting to a component of an entity that either has been disposed of (by sale, abandonment, or in a distribution to owners) or is classified as held for sale. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell. The Company adopted SFAS No. 144 on January 1, 2002. The implementation of SFAS No. 144 did not have a material impact on the consolidated financial position of the Company.

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' condensed consolidated financial statements and notes contained in this Quarterly Report on Form 10-Q. Except for historical information, this report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These forward-looking statements involve risks and uncertainties, including, among other things, statements regarding Tucows' anticipated costs and expenses and revenue mix. Forward-looking statements include, among others, those statements including the words expects, anticipates, intends, believes and similar language. Tucows' actual results may differ significantly from those projected in the forward-looking statements. Factors that might cause or contribute to such differences include, but are not limited to, those discussed below under the caption "Risk Factors." You should carefully review the risks described in this Quarterly Report on Form 10-Q and in other documents Tucows files from time to time with the SEC. You are cautioned not to place undue reliance on the forward-looking statements, which speak only as of the date of this Quarterly Report on Form 10-Q. Tucows undertakes no obligation to publicly release any revisions to the forward-looking statements to reflect events or circumstances after the date of this document.

OVERVIEW

Tucows is a distributor of Internet services, including domain registration, to Internet service providers, web hosting companies and other providers of Internet services to end-users, with a network of more than 5,000 resellers in more than 100 countries. Tucows is a registrar accredited by the Internet Corporation for Assigned Names and Numbers, generally known as ICANN, and a provider of wholesale domain name registrations for country code and generic top-level domains and web certificates. The Tucows website offers more than 30,000 software titles in libraries located around the world, providing users with a fast local download. Tucows' other content properties include search and reference media sites such as of Electric Library, Sleuth Technology and Encyclopedia.com.

The three months ended June 30, 2002 represents the first quarter in which Tucows was both cash flow positive and profitable from operations. This has primarily been achieved by both revenue growth and continued cost savings. The cost savings are the result of Tucows' continued efforts to manage operating expenses prudently.

On August 28, 2001, Tucows concluded an acquisition of Infonautics, Inc., an unrelated provider of personalized information agents and websites. The acquisition was done as a merger of a subsidiary of Infonautics into Tucows (Delaware) Inc. (formerly, Tucows Inc.) so that after the merger, Tucows (Delaware) Inc. became a wholly owned subsidiary of Infonautics. In the acquisition, Infonautics issued 51,685,432 shares of common stock to Tucows (Delaware) Inc. stockholders, which amounted to an approximately 80% interest of the consolidated company. On completion of the acquisition, Infonautics changed its name to Tucows Inc.

In November 2000, ICANN selected Afilias to operate the registry for the .info top-level domains. Liberty RMS, which at that time was a wholly owned subsidiary of Tucows (Delaware) Inc., was granted a two-year contract by Afilias to provide technical registry management services for the registry operations. In August 2001, Liberty RMS began accepting registrations from registered trademark owners and in early September 2001 began accepting real-time registrations. The difficult economic environment that has existed since the launch has resulted in monthly registration volumes being well below those anticipated by Afilias and Tucows. As a result, Tucows believed that it would require a longer timeframe than its two-year contract to recover the high fixed cost component of implementing and maintaining the registry. Therefore, as a step in Tucows' effort to achieve profitability, Tucows sold the business of Liberty RMS and certain software technology required to provide registry services to Afilias in March 2002. Under the agreement, consideration for this sale was comprised of $977,000 in

cash, a receivable of $87,000 and up to a $1 million in future consideration based on future performance criteria. Tucows retains its 7.38% stake in Afilias and remains a registrar for the ..info registry.

Net Revenues

Tucows earns its net revenues primarily from three services: domain name registration and ancillary services, Electric Library subscription fees and advertising and other revenue. Digital content distribution services revenues accounted for only $23,000 and $28,000 of Tucows revenues for the three and six months ended June 30, 2002, respectively, and as this revenue stream is not considered significant, it has been included with 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. These services are purchased for terms of one to ten years. 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 into revenue on a monthly basis over the term of the registration.

On a wholesale basis, Tucows offers domain name registration and ancillary services, currently consisting of web certificates, to MSPs, or resellers, who provide these services to their end-users to assist them in creating their web presence. The domain name registration services offered by Tucows are for the gTLDs .com, .net, .org, .info and .biz and the country code domains .ca, .cc, .co, .uk, .us and .tv. Tucows receives revenues for each domain name registration passed through its system by resellers. Typically, Tucows receives $10 per year of registration, although some additional discounts and rebates are offered based upon volume or participation in other programs Tucows offers. Tucows receives between $13 and $100 for each country code domain name registration and $99 for each digital certificate sold. The average term for wholesale domain name registration services over the three and six months ended June 30, 2002 was 15 months (for the three and six months ended June 30, 2001, the average term was 14 months). If registrations are renewed, Tucows expects to produce ongoing revenues.

On a retail basis, Tucows offers domain registration services directly to end users through its DomainDirect division. Tucows receives revenues for the retail registration of domain names and the managing of other services relating to a domain name such as domain forwarding, Domain Name Service ("DNS"), web site creation and web site hosting, e-mail and e-mail forwarding. Tucows' registration fee for the full suite of services is approximately $32 per year. The average term for retail domain name registration services over the three and six months ended June 30, 2002, was 19 and 20 months, respectively (for the three and six months ended June 30, 2001, the average term was 17 months).

Prior to the sale of Liberty RMS in March 2002, Tucows provided technical back-end registry management services to Afilias, the .info registry. Tucows received from Afilias a service fee of $2.95 for each domain year registered. Payment for each registration under management was due annually in the anniversary month. Effective March 25, 2002, Tucows sold Liberty RMS to Afilias. Prior to the sale, Tucows held and it continues to hold a 7.38% interest in Afilias.

Electric Library subscriptions

Electric Library is a web-accessible online archive that aggregates content from hundreds of sources and contains over 13 million documents from books, magazines and newspapers. Potential individual subscribers are given a free trial period, after which Tucows typically charges a fee of approximately $15 per month for monthly subscriptions and approximately $80 per year for annual subscriptions, both for virtually unlimited usage.

Advertising and other revenue

Tucows generates advertising revenues through advertisements placed on its content properties. Advertising revenues are primarily received from short-term advertising agreements in which advertising banners are delivered at an agreed upon rate per thousand impressions delivered to traditional advertisers. In addition, in response to the decline in the online advertising marketplace, Tucows established an Author Resource Centre ("ARC"), whereby software developers, who rely on Tucows as a primary source of distribution, are able to promote their software through advertising services including keyword search placements, banners, promotional placements, expedited reviews and premium data services. Advertising revenues are recognized ratably over the period in which the advertisement is presented. Tucows also enters into barter transactions, which are a component of advertising revenues. Barter transactions are the exchange of advertising space on Tucows' website for reciprocal space or traffic on other websites. Revenues and expenses are recognized from advertising barter transactions when the value of the advertising surrendered is determinable based on Tucows' historical practice of receiving cash for similar advertising. Tucows recognized barter revenue of approximately $7,000 and $42,000 for the three and six months ended June 30, 2002, respectively, and nil for the three and six months ended June 30, 2001.

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 the audited financial statements of the Company for the year ended December 31, 2001, included in the Company's Annual Report on Form 10-K filed with the SEC on April 1, 2002, 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, intangible assets, 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;
- Advertising and other revenue; and
- Subscription fees from Tucows search and reference media sites, principally Electric Library.

Tucows derives the 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. 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.

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Tucows' search and reference media sites obtain revenue from subscription sales that are recognized ratably over the term of the subscription. Potential individual subscribers are given a free trial period, after which Tucows charges a subscription fee for the required monthly or annual period. Revenues are reduced at the time of sale to reflect expected refunds and credit card charge-backs that are estimated based on historical experience and current expectations.

Tucows also generates revenues from online advertising through advertisements placed on its content properties. Advertising revenues are primarily derived from short-term advertising agreements in which advertising banners are delivered at an agreed upon rate per thousand impressions delivered. Advertising revenues are recognized ratably over the period in which the advertisement 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.

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 costs that reflect expected refunds, rebates and credit card charge-backs as a reduction of revenues at the time of the sale based on historical experiences and current expectations.

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 to the audited financial statements of Tucows for the year ended December 31, 2001, included in Tucows' Annual Report on Form 10-K filed with the SEC on April 1, 2002. 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; and
- a significant negative industry or economic trend.

Tucows measures any impairment based on a projected discounted cash flow method 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 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 AND SIX MONTHS ENDED JUNE 30, 2002 AS COMPARED TO THE THREE AND SIX MONTHS ENDED JUNE 30, 2001

REVENUES

	Three months ended June 30,		Six months ended June 30,	
	2002	2001	2002	2001

	Three months ended June 30,		Six months ended June 30,	
	(unaudited)		(unaudited)	
Net revenues	$ 9,480,187	$ 7,187,394	$ 19,406,720	$ 13,579,042
Increase over prior period	$ 2,292,793		$ 5,827,678	
Increase percentage	32%		43%	

The increase in revenues primarily reflects growth in revenues from the Company's domain name registration business and acquisition of Infonautics in August 2001, as further described below.

During the quarter ended June 30, 2002, Tucows processed approximately 740,000 new, renewed and transferred-in domain name registrations bringing the number of registered domain names under Tucows' management at June 30, 2002 to approximately 3.3 million, up from approximately 2.8 million at June 30, 2001. In addition, during the quarter ended June 30, 2002, Tucows processed approximately 208,000 names on behalf of other registrars, bringing the total number of domain names processed on behalf of other registrars to approximately 734,000, up from approximately 592,000 at March 31, 2002 and approximately 152,000 at June 30, 2001. This revenue increase in domain name registrations resulted in Tucows' deferred revenue from domain name registrations and ancillary services increasing to approximately $23.5 million at June 30, 2002 from approximately $22.0 million at March 31, 2002 and approximately $18.5 million at June 30, 2001.

During the three and six months ended June 30, 2002, no customer accounted for more than 5% of net revenues. One customer accounted for approximately 17% of net revenues in the three and six months ended June 30, 2001. Tucows does not expect any one customer to account for more than 10% of net revenues in 2002.

In March 2002, Tucows sold its registry management services business to Afilias. Revenue from registry management services for the three months ended March 31, 2002 was approximately $522,000.

The Infonautics business, which consists primarily of the Electric Library subscription service, which was acquired on August 28, 2001, contributed revenue of approximately $1.0 and $2.2 million for the three and six months ended June 30, 2002 respectively. As a result of seasonality and the continued difficult direct marketing environment, Tucows' subscriber base for its Electric Library end user services continued to fall and dropped to approximately 47,000 at June 30, 2002 from approximately 51,000 at March 31, 2002. This decline in subscription revenue from Electric Library resulted in Tucows' deferred revenue, relating to Electric Library, decreasing to approximately $899,000 at June 30, 2002 from approximately $942,000 at March 31, 2002.

The increases in revenue were partially offset by declines in advertising and related services revenues to approximately $380,000 and approximately $763,000 for the three and six months ended June 30, 2002, respectively, from approximately $535,000 and $1.2 million for the three and six months ended June 30, 2001, respectively. This decline is primarily the result of the continued slowdown in the traditional online advertising market, which has been partially offset by revenue generated by the Tucows Author Resource Centre.

COST OF REVENUES

Cost of revenues includes the costs associated with providing domain name registration and ancillary services, Electric Library subscription services and digital content distribution services.

	Three months ended June 30,		Six months ended June 30,	
	2002	2001	2002	2001
	(unaudited)		(unaudited)	
Cost of revenues	$ 5,636,988	$ 4,653,170	$ 12,231,513	$ 8,570,470
Increase over prior period	$ 983,818		$ 3,661,043	
Increase percentage	21%		43%	
Percentage of revenues	59%	65%	63%	63%

Growth of revenues was the primary factor in the increase of cost of revenues in the three and six months ended June 30, 2002 compared to the same periods ended June 30, 2001. The decrease of approximately $1.0 million in cost of revenues for the quarter ended June 30, 2002 when compared to the quarter ended March 31, 2002 was primarily attributable to Tucows transferring its monthly contractual payments ranging from approximately $97,000 to approximately $335,000 to Afilias in March 2002, as part of the sale of its registry services business. Tucows anticipates that cost of revenues will continue to increase in absolute dollars primarily as a result of the continued growth of domain name registrations and ancillary services.

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 comprise primarily communication and provisioning costs related to the management and support of the network. The increase in cost of revenues for domain name registrations was primarily due to the growth in domain name registration revenues and the corresponding cost of registry fees for domain names registered during the three and six months ended June 30, 2002 and the full impact of the ratable portion of the cost of registry fees for domain names registered in prior periods.

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. Tucows pays a $6 per domain year registry fee for each .com, .net and .org domain name registration. Registration fees for each .info domain name registration are $5.75 per domain year, and registration fees for each .biz domain name registration are $5.30 per domain year. From October 2000 to February 2002, Tucows paid Cdn$20.00 per year registry fee for each .ca domain name registration. This was reduced to Cdn$15.00 in February 2002. These fees are payable on the anniversary date of each domain name registration. Domain name fees paid for future registrations are deferred as prepaid expenses and are then recognized on a straight-line basis over the registration period consistent with the recognition of revenues from Tucows' customers.

The acquisition of Infonautics in August 2001 has increased cost of revenues with the addition of the Electric Library subscriptions revenue stream. The principal elements of costs associated with the delivery of the Electric Library subscriptions are royalty and license fees on end-user revenues paid to bigchalk.com, inc. ("bigchalk"), amounting to approximately $381,000 and $792,000 for the three and six months ended June 30, 2002, respectively. bigchalk is currently the sole provider of content, hardware, software, and related costs to deliver the Electric Library subscriptions.

Cost of revenues of digital content distribution services includes the costs of network operations. Tucows expects communication costs to increase as its network expands geographically and network activity increases. The cost of network operations is comprised primarily of communication costs,

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equipment maintenance, and employee and related costs directly associated with the management and maintenance of the network.

Tucows has no direct cost of revenues relating to its advertising revenues.

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. Tucows also incurs advertising expenses, including barter advertising, trade show and other promotional costs.

	Three months ended June 30,		Six months ended June 30,	
	2002	2001	2002	2001
	(unaudited)		(unaudited)	
Sales and marketing	$ 800,897	$ 1,819,352	$ 1,905,753	$ 3,770,430
Decrease over prior period	$ (1,018,455)		$ (1,864,677)	
Decrease percentage	-56%		-49%	
Percentage of revenues	8%	25%	10%	28%

The decrease in sales and marketing expenses was primarily due to the headcount reductions and the reassessment of the Company's marketing strategies in 2001. These initiatives have resulted in an increased focus on targeted customer acquisition programs being undertaken in fiscal 2002, which has resulted in significantly lower amounts being spent on other traditional marketing activities including trade shows (approximately $100,000), advertising (approximately $500,000), and other marketing programs (approximately $100,000). In addition, marketing activities traditionally slows in the summer months which also contributed to the lower marketing expenses during the second quarter.

The Company believes that sales and marketing expenses (in absolute dollars) will increase 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. 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 expensed 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 are capitalized and primarily include personnel costs for employees directly related to the development project. All other costs are expensed as incurred.

	Three months ended June 30,		Six months ended June 30,	
	2002	**2001**	**2002**	**2001**
	(unaudited)		(unaudited)	
Technical operations and development expenses	$ 958,780	$ 1,396,797	$ 2,017,709	$ 2,642,881
Decrease over prior period	$ (438,017)		$ (625,172)	
Decrease percentage	-31%		-24%	
Percentage of revenues	10%	19%	10%	19%

The decrease in technical operations and development expenses was due to Tucows' cost cutting initiatives, primarily headcount reductions, undertaken in September 2001, which resulted in a decrease

in absolute dollars spent on technical operations and development (headcount at June 30, 2002 had decreased by 26 individuals from June 30, 2001). This decrease was offset by a reduction in the amount of capitalized research and development expenses. The amount of research and development expenses decreased from approximately $325,000 for the three months ended June 30, 2001 to approximately $142,000 for the three months ended June 30, 2002 and from approximately $765,000 for the six months ended June 30, 2001 to approximately $333,000 for the six months ended June 30, 2002. Tucows expects technical operations and development expenses (in absolute dollars) to increase 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.

	Three months ended June 30,		Six months ended June 30,	
	2002	**2001**	**2002**	**2001**
	(unaudited)		(unaudited)	
General and administrative	$ 1,151,621	$ 1,093,453	$ 2,186,453	$ 1,937,812
Increase over prior period	$ 58,168		$ 248,641	
Increase percentage	5%		13%	
Percentage of revenues	12%	15%	11%	14%

General and administrative expenses remained relatively consistant over the three and six months ended June 30, 2002 compared to the three and six months ended June 30, 2001. The increased costs for the three and six months ended June 30, 2002 compared to the corresponding periods in 2001 were primarily the result of public listing expenses and additional infrastructure costs as a result of the Infonautics acquisition. These increases were offset by a gain of approximately $130,000 relating to the accounting for the change in the fair value of the forward foreign exchange contracts on hand at June 30, 2002, which were entered into in June 2002.

Tucows expects general and administrative expenses to increase in absolute dollars as it incurs incremental expenses as a public company and adds infrastructure.

DEPRECIATION OF PROPERTY AND EQUIPMENT

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

	Three months ended June 30,		Six months ended June 30,	
	2002	2001	2002	2001
	(unaudited)		(unaudited)	
Depreciation of property and equipment	$ 764,576	$ 966,063	$ 1,894,674	$ 1,831,018
(Decrease) Increase over prior period	$ (201,487)		$ 63,656	
(Decrease) Increase percentage	-21%		3%	
Percentage of revenues	8%	13%	10%	13%

The decrease in depreciation for the three months ended June 30, 2002 compared to the three months ended June 30, 2001 was primarily due to some of the Company's older computer software being fully depreciated.

AMORTIZATION OF INTANGIBLE ASSETS

Intangible assets consist of amounts relating to the non-competition agreements entered into with the former owners of the Tucows Division of Tucows Interactive Limited which, in accordance with the provisions of SFAS No.142, are being amortized on a straight-line basis over three years. These agreements were fully amortized during the quarter ended June 30, 2002.

	Three months ended June 30,		Six months ended June 30,	
	2002	2001	2002	2001
	(unaudited)		(unaudited)	
Amortization of intangible assets	$ 55,556	$ 937,586	$ 222,222	$ 1,863,446
Decrease over prior period	$ (882,030)		$ (1,641,224)	
Decrease percentage	-94%		-88%	
Percentage of revenues	1%	13%	1%	14%

All goodwill pertaining to the purchase of any assets acquired in purchase business combinations was fully amortized as of December 31, 2001. Amortization of this goodwill amounted to approximately $771,000 for the three months ended June 30, 2001, and approximately $1.5 million for the six months ended June 30, 2001.

The decrease in amortization was primarily due to amortization and write-off of goodwill during 2001, which was fully amortized at December 31, 2001.

OTHER INCOME (EXPENSES), NET

	Three months ended June 30,		Six months ended June 30,	
	2002	2001	2002	2001
	(unaudited)		(unaudited)	
Other income (expenses)	$ (992,316)	$ (27,193)	$ 936,669	$ (756)

During the quarter ended June 30, 2002, Tucows reviewed the carrying value of its investment in bigchalk. Based on this review, Tucows believes that an other than temporary decline in the value of this investment has occurred and has recorded a loss on the write down of its investment in bigchalk in the amount of approximately $1.0 million.

For the three months ended March 31, 2002, Tucows showed a gain from disposition of Liberty RMS in the amount of approximately $2.0 million. In addition, during January 2002, Tucows concluded the sale of its subsidiary, Eklektix, Inc., and recorded a loss in the amount of approximately $44,000.

Other income includes net interest income of approximately $21,000 and approximately $(27,000) for the three months ended June 30, 2002 and 2001, respectively, and approximately $39,000 and approximately $(1,000) for the six months ended June 30, 2002 and 2001, respectively.

INCOME TAXES

No provision for income taxes has been recorded for the three and six months ended June 30, 2002 and 2001 because Tucows had operating losses for these periods.

LIQUIDITY AND CAPITAL RESOURCES

Tucows had cash and cash equivalents of approximately $7.1 million (including restricted cash in the amount of approximately $1.2 million) at June 30, 2002 as compared to $4.8 million at December 31, 2001, an increase of $2.3 million. The primary reasons for the increase were the disposition of Liberty RMS in March 2002 and the cash generated from operating activities for the six months ended June 30, 2002.

In order to manage its foreign exchange fluctuations, in June 2002, Tucows entered into a series of forward foreign exchange contracts with its bank in the aggregate amount of US$14.25 million. The forward foreign exchange contracts mature on a semi-monthly basis through December 2003. Pursuant to these forward foreign exchange contracts, twice each month US$375,000 will be converted into Canadian dollars at a predetermined foreign exchange rate equal to 1.5430 Canadian dollars per each US dollar. As margin security for the outstanding forward foreign exchange contracts, Tucows' bank required it to deposit an aggregate amount of US $1,196,000 into term deposits. The term deposits are released to Tucows on a monthly basis as the forward foreign exchange contracts mature. Tucows refers to the $1,196,000 as "restricted cash" on its balance sheet contained in this Quarterly Report on Form 10-Q. Tucows' cash and cash equivalents of approximately $7.1 million at June 30, 2002, include this approximately $1.2 million of restricted cash.

Tucows' operating activities provided cash of approximately $1.8 million during the six months ended June 30, 2002, as compared to using cash of approximately $4.7 million for the six months ended June 30, 2001. Net cash provided by operating activities for the six months ended June 30, 2002 resulted primarily from net income for the period and a net increase in deferred revenue (before the disposition of Liberty RMS). This was partially offset by the increases in prepaid domain name registry fees and decreases in accounts payable and accrued liabilities.

Net cash used in financing activities was approximately $46,000 for the six months ended June 30, 2002 relating to repayments of capital lease obligations and net cash provided by financing activities was approximately $6.8 million for the six months ended June 30, 2001 being proceeds on a rights issue and loans received in the amount of approximately $3.8 million.

Tucows does not anticipate that capital expenditures (in absolute dollars) will continue to increase. Based on Tucows' operations, Tucows believes 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. 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 reduce the ownership interest of existing investors. Tucows may also evaluate potential acquisitions of other businesses, products and technologies. There are currently no understandings, commitments or agreements about any acquisition of other businesses, products or technologies. To complete potential acquisitions, Tucows may issue additional securities or need additional equity or debt financing and any additional financing may reduce the ownership interest of existing investors.

RISK FACTORS

In addition to other information in this Form 10-Q, the following risk factors should be carefully considered in evaluating Tucows and its business because these factors currently have a significant impact or may have a significant impact on its business, operating results or financial condition. Actual

results could differ materially from those suggested in the forward-looking statements contained in this Form 10-Q as a result of the risk factors discussed below and elsewhere in this Form 10-Q.

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 may vary significantly, which may make it difficult to resell your shares when you want to at prices you find attractive.

Tucows' stock price has varied significantly recently and if it continues to vary, the price of its common stock may decrease in the future regardless of the company's 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;
- changes in financial estimates or recommendations by securities analysts;
- general economic and political conditions in the United States, Canada and globally;
- acts of war and terrorist activities;

news relating to high-profile corporate scandals and/or bankruptcies;

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.

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

Six principal shareholders beneficially own approximately 75% 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 has incurred losses and may incur losses in the future.

Tucows incurred net losses of approximately $115,000 for the six months ended June 30, 2002. Although these net losses are down significantly from net losses of approximately $7.0 million for the same period in 2001, Tucows believes it may incur losses in the future, and it may never become consistently profitable or consistently generate positive cash flow from operating activities.

Tucows has only been operating as a domain name registrar since January 2000 and because it operates in a new industry for private label Internet applications and services, it is exposed to risks that affect its ability to conduct its business.

Competition in the domain name registration industry was introduced in 1999. Tucows entered the domain name registration business in January 2000 by providing a wholesale service to customers with primary operations that involve direct dealings with registrants. Tucows' primary customers, which Tucows refers to as MSPs, have been Internet service providers, web hosting companies, web designers, VARs and other providers of Internet services to end users. Tucows has a limited operating history as a domain name registrar upon which its current business and prospects can be evaluated.

As a company operating in a newly competitive and rapidly evolving industry, Tucows faces risks and uncertainties relating to its ability to implement its business plan successfully. Tucows cannot assure you that it will adequately address these risks and uncertainties or that its business plans will be successful.

If Tucows cannot obtain or develop additional applications and services that meet the evolving business needs of its MSPs, the market for its services will not grow and may decline.

Part of Tucows' strategy is to expand its services by offering its MSPs additional applications and services that address their evolving business needs. Tucows cannot be sure that it will be able to license these 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 MSPs turn to alternate providers that are able to more fully supply their business needs. Tucows may not produce sufficient revenues to offset the related costs and will remain dependent on domain name registrations as a primary source of revenue, and revenue may fall below anticipated levels.

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 Inc., which is now a part of VeriSign, Inc., 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, the Internet Corporation for Assigned Names and Numbers, 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 U.S., Congress has held hearings to evaluate ICANN's selection process for new top-level domains.

Tucows faces 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; and

- the Internet community or the Department of Commerce or U.S. Congress may refuse to recognize ICANN's authority or support its policies.

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. Two class action lawsuits were filed in Superior Court in California against ICANN, NeuLevel, Inc., which is the registry for the .biz generic top-level domain, and over 60 other defendants including Tucows. The lawsuits claim that the defendants were engaged in unfair competition under state laws because they were pre-registering .biz generic top-level domains (which is alleged to constitute an illegal lottery enterprise). The lawsuits seek a refund of the fees paid to the defendants, additional damages, costs, attorneys' fees and an injunction to stop the pre-registrations. NeuLevel, Inc. decided to refund the fees paid by applications. Although Tucows, in turn, has implemented a plan designed to return fees to the applicants who came through the Tucows system, Tucows management believes the lawsuits to be without merit. Tucows intends to defend itself vigorously in the lawsuits and believes that it should not be subject to any liability or an injunction. The California Superior Court or other courts or governmental agencies may disagree.

If any of these risks occur or the class action lawsuits, or others like them, are maintained, they could create instability in the domain name registration system business. These risks and the class action lawsuits, or others like them, could also disrupt or suspend portions of Tucows' domain name registration business, which would result in reduced revenue. Any litigation or claims against Tucows could result in significant costs of defence, liability for damages and diversion of management's time and attention.

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 VeriSign and 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. On June 9, 2000, VeriSign, Inc., a provider of Internet trust services, acquired Network Solutions. The acquisition of Network Solutions by VeriSign has facilitated cross-marketing between the two companies and has strengthened VeriSign's competitive advantage by enabling it to couple registration services with an expanded range of products and services.

Based on VeriSign's quarterly press releases, the VeriSign registrar registered approximately 2.8 million, new, renewed and transferred registrations under all domains (including ccTLDs) for the six months ended June 30, 2002. This compares with the approximately 1.86 million new, renewed and transferred domain names that Tucows registered (including approximately 373,000 processed on behalf of other registrars) for the six months ended June 30, 2002. As of June 30, 2002, the VeriSign registrar supported approximately 9.6 million of the approximately 27.3 million active .com, .net and .org domain names, compared to approximately 4 million domain names that Tucows supported (including approximately 730,000 on behalf of other registrars).

Tucows faces significant competition from VeriSign as Tucows seeks to increase its revenue from domain name registration services. Tucows also faces competition from the continued introduction of registrars into the domain name registration industry. The growth of registrars who have entered the industry may make it difficult for Tucows to maintain its current market share. As of June 30, 2002, ICANN had accredited 110 competitive registrars, including Tucows, to register domain names in the .com, .net and .org domains. Some of these registrars may have longer operating histories, greater name recognition, particularly in international markets, or greater resources than Tucows.

In response to increasing competition in the domain name registration industry, Tucows may be required to reduce the prices it charges for its core domain name registration business. The VeriSign registry 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 and less than the basic $10 fee charged by Tucows for each domain name registered in the .com, .net and .org registry. During the years 2000 and 2001, other competitors, including VeriSign, reduced their pricing for domain name registrations both for short-term promotions and on a permanent basis. Some of Tucows' competitors have also offered domain name registrations free in a bundle of other products, deriving their revenues from other products and services. Although Tucows offers discounts and rebates based on volume or participation in other programs Tucows offers, Tucows does not presently intend to reduce its prices. If Tucows should reduce prices in order to remain competitive, Tucows' revenues may decline.

If the growth rate of the market for domain names continues to fall, Tucows' net revenue from registrations may fall below anticipated levels.

The .com, .net and .org domain name markets are now stabilizing and Tucows does not expect these markets to continue to experience the same high level of growth they experienced in the past. The VeriSign registry has reported a decline in the number of new registrations starting in the third quarter of 2000 until December 31, 2001. For the first two quarters of 2002, VeriSign has reported a slight increase in new registrations.

If a decline in the market for new domain names were to resume and continue, the growth of Tucows' domain name registration business would be restricted and its revenues may decline.

If Tucows' MSPs do not renew their domain name registrations through Tucows, its revenues may decline.

The growth of Tucows' business depends in part on its MSPs' renewal of their domain name registrations through Tucows. The renewal and transfer of existing domain registrations as a proportion of the total domain name market has increased and is expected to increase further in 2002. Tucows believes that a large number of the domain names registered in 1999 and 2000 were registered by speculators who registered names with the intention of reselling them rather than putting them to use. For this reason, Tucows believes that a significant number of the existing domain names will not be renewed and will be allowed to lapse. Over time, as the percentage of names held by speculators decreases, Tucows believes that renewals will become an increasingly important part of the business. If Tucows' MSP's do not renew their domain name registrations through Tucows, its revenues may decline. The first expirations for .com, .net and .org domain names occurred in January 2001, and Tucows has limited experience with registration renewals for generic top level and country code domain names.

Tucows anticipates that its renewal rate will be affected by the growing use of direct marketing practices by some competitors. If Tucows is unable to retain customers in the face of direct solicitation by competitors or for any other reason, revenues from renewals of domain name registrations will decrease.

If Tucows' MSPs do not choose to sell the recently introduced generic top-level domains Tucows' business may not grow, and its revenue from that business may decline.

In the fourth quarter of 2000, ICANN announced that the introduction of new generic top-level domains was scheduled for the first or second quarter of 2001. .info was launched to the public on September 12, 2001 and .biz on November 7, 2001. .name began to sell registrations in January 2002 and began its live registration service in June 2002. Although demand for these new registries has been below expectations, it is too early to determine the long-term success of these new top-level domains. If Tucows' MSP's do not elect to sell the new top level domains or if their customers do not respond positively to the new generic top level domains, Tucows may not be able to develop its domain name registration business as planned.

Tucows' revenue from domain name registration services is likely to decline if the administration and operation of the Internet no longer relies upon the existing domain name system or if VeriSign's shared registration system no longer functions.

Future developments in the domain name registration industry may include changes in the administration or operation of the Internet, including the creation and institution of alternative 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 these alternative systems. These competitors are not subject to ICANN accreditation requirements and restrictions. The widespread acceptance of any alternate systems could eliminate the need to register a domain name to establish an on-line presence and reduce Tucows' revenues from domain name registrations.

The success of Tucows' business as a competitive registrar depends upon the continued availability and functionality of the shared registration system, which is maintained by VeriSign. Because the shared registration system has been in general use only since 1999, Tucows cannot assure you that the system will be able to handle the growing traffic caused by the increasing number of registrars or registrations.

Tucows' ability to provide domain name registration services in the .com, .net and .org domains would be materially harmed, and its revenue from those services would decline, upon any failure of the shared registration system.

Tucows relies on its network of MSPs to distribute its applications and services, and if Tucows is unable to maintain these relationships or establish new relationships, its revenue may decline.

Tucows obtains revenues by distributing applications and services through its network of MSPs.

Tucows also relies on its MSPs 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 MSPs and to develop its relationships with existing MSPs by providing customer and sales support and additional products. MSPs 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 MSPs, its ability to distribute its applications and services will be harmed, and its revenue may decline.

If Tucows MSPs should choose to become accredited registrars of the new registries and choose not to utilize Tucows' hosted registrar service, Tucows' revenues could decline.

Tucows is a minority shareholder in the Afilias consortium that is responsible for the .info top level domain. The venture may cause Tucows to incur additional capital and operating expenses to develop the registry.

Afilias Limited, a consortium of 18 ICANN accredited registrars, including Tucows, is responsible for the .info top level domain. If Afilias is unable to operate with its existing capital or elects to expand its business, it may request additional investments by its shareholders. If Tucows decides not to make any further investments, its shareholdings in the venture may be diluted.

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 registries require registrars to comply with specific regulations. Many of these regulations vary from country code to country code.

If Tucows fails to comply with the regulations imposed by country code registries, these registries will likely prohibit Tucows from registering or continuing to register names in their country codes. Any failure on Tucows' part to offer domain name registrations in a significant number of country codes, or in a popular country code would cause Tucows to lose a competitive advantage and could cause MSPs 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 agreements. Tucows' standard domain name registration agreement may not be enforceable which could subject Tucows to liability.

All of Tucows' MSPs 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 MSPs 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.

Tucows relies on subscriptions for its revenue from the Electric Library site. If Tucows does not acquire new subscribers and retain existing subscribers or the cost of acquiring or retaining subscribers increases, Tucows' revenue from this site will decline and its ability to achieve profitability will be impaired.

Tucows obtains most of its subscription-based revenue from the fee-based Electric Library site.

The following factors affect Tucows' net revenue from Electric Library:

- Tucows pays fees to third party websites and services to obtain new subscribers to Electric Library. Tucows may be required to make payments even if the agreements don't result in revenues from new subscribers sufficient to cover Tucows' costs. One or more of these agreements may not be renewed, which could reduce Tucows' revenue from new subscribers.
- Tucows may choose to limit spending on subscriber acquisition, which will likely result in fewer new subscribers.
- Tucows' customers may not renew their subscriptions after their subscription period has ended.
- Tucows may reduce the selling price of Electric Library in response to increased competition or loss of customers.
- If Tucows' subscriber acquisition, retention and renewal rates or pricing decreases significantly, its net revenues from Electric Library will decline.

The competition Tucows faces from other providers of electronic information is intense, and Tucows may not be able to compete effectively or successfully attract and retain customers.

Competition in Tucows' business of providing electronic information is intense. Some of Tucows' competitors, such as Yahoo!, America Online, About.com, Britannica.com, and Northern Light, have greater resources and name recognition than Tucows. Many of these competitors have substantially greater experience and larger customer bases than Tucows. Tucows' competitors may succeed in:

- responding more quickly to new or emerging technologies and changes in customer requirements;
- devoting greater resources to the development, promotion and sale of their products or services than Tucows; and
- establishing relationships with affiliates, advertisers, content providers, and others who have not entered into agreements with Tucows.

Tucows' competitors may also succeed in developing services and products that are superior to those of Tucows and also may prove more successful in marketing their products or services to the same customers to which Tucows intends to market its products or services. Because of this competition, Tucows may not be successful in attracting and retaining customers which would cause revenues to decline.

Tucows depends on bigchalk.com and other third parties for published content, technology and technology services. Loss of these services could restrict Tucows' ability to do business and could result in reduced revenue.

Tucows relies on bigchalk.com for published content and technology and technology services. bigchalk.com is Tucows' preferred provider of published content for Electric Library. The loss of the bigchalk.com content license could require Tucows to change Electric Library and any other site using the content licensed from bigchalk.com. These changes may cause interruptions in Tucows' business and could cause it to incur substantial costs to replace any lost content.

Tucows also depends on licenses of additional content on a cost-effective basis from sources other than bigchalk.com. If Tucows is unable to maintain its existing relationships with its existing freeware and shareware providers and/or license content at a reasonable cost, its ability to deliver its sites could be impaired which could cause it to lose customers or fail to attract new customers.

bigchalk.com also licenses the Electric Library site and related software, technology, and systems to Tucows. The license is royalty free and perpetual, but bigchalk.com has a right to terminate the license on a change of control of Tucows. The loss of this license could hurt Tucows' business and cause its revenues to decline.

Tucows also depends on bigchalk.com to provide technical and data center support and services for Electric Library for individual end users. This agreement expires on December 15, 2002 and may be renewed by the mutual written agreement of the parties. The loss of this agreement could force Tucows to provide technical and data center support and services itself, or hire a third party to provide those services. This could cause Tucows' business to suffer interruptions and require it to incur substantial costs.

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 websites 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.

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

Tucows is not subject to direct regulation by any United States or state government agency other than the laws and regulations applicable to businesses generally. There are few laws or regulations directly applicable to access to or commerce on the Internet. Tucows believes these laws and regulations do not seriously affect its operations and that it is materially in compliance with them.

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.

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 obsolete the applications, services and systems offered by Tucows. The emerging nature of applications and services in the e-business industry and their rapid evolution will require that Tucows continually improves 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.

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 websites 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.

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.

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 website 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.

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.

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.

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

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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' websites 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' website 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.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Tucows develops products in Canada and sells these products in North America and Europe. Tucows' sales are primarily made in United States 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 market risk exposure.

Although Tucows has a functional currency of U.S. dollars, a substantial portion of its fixed expenses are derived from 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, the Company has entered into foreign exchange forward contracts to hedge portions of its Canadian dollar exposure with a maximum hedging period of 19 months.

Such foreign exchange forward contracts have not been treated as cash flow hedges for accounting purposes as Tucows has not complied with the documentation standards for these foreign exchange forward contracts to be accounted for as hedges. 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 gain or loss is recorded within general and administrative expenses. The Company has no other freestanding or embedded derivative instruments.

The impact of the foreign exchange forward contracts for the three months ended June 30, 2002 was a net gain of approximately $130,000 which is included in general and administrative expenses on the consolidated statements of operations. As of June 30, 2002, Tucows had outstanding foreign currency forward contracts totaling $13.5 million with an average exchange of US$1.00 to CDN$1.543.

PART II.
OTHER INFORMATION

Item 1. Legal Proceedings

In the Company's Annual Report on Form 10-K for the year ended December 31, 2001, Tucows reported that the Company had been named as a co-defendant with other entities in the industry in two class action lawsuits filed in the Superior Court, County of Los Angeles, U.S.A. The lawsuits allege that the defendants were engaged in unfair competition under state laws because they conducted an illegal lottery enterprise through the pre-registration of .biz generic top-level domains. The Company believes that the cases are without merit and has retained local counsel to represent the Company in the proceedings. The Company does not believe that it will be liable for any damages and, accordingly, has not accrued any amounts at June 30, 2002. There have been no material developments in those proceedings during the quarter ended June 30, 2002.

On July 2, 2002, a lawsuit was filed in the Superior Court in the Province of Ontario, Canada against Tucows. The title of the lawsuit is 1446513 Ontario Limited v. Tucows Inc. et al. The lawsuit alleges that the Company defamed the plaintiff when the Company warned its customers about the plaintiff's business practices. The lawsuit seeks damages in excess of $10 million. Tucows does not believe that the lawsuit has merit and has retained local counsel to represent the Company in the proceedings. The Company does not believe it will be liable for any damages and accordingly has not accrued any amounts at June 30, 2002.

Item 4. Submission of Matters to a Vote of Security Holders

Tucows Annual Meeting of Shareholders was held on June 13, 2002. Holders of an aggregate of 64,626,429 shares of Tucows common stock at the close of business on April 29, 2002 were entitled to vote at the meeting, of which 49,654,728 were present in person or represented by proxy. At such meeting, Tucows' shareholders voted as follows:

Proposal 1. To elect six directors to serve until the 2003 Annual Meeting of Shareholders or until their respective successors shall have been duly selected and qualified.

Nominee	**Votes For**	**Votes Witheld**
Stanley Stern	49,592,313	62,415
Elliot Noss	49,590,313	64,415
Erez Gissin	49,595,313	59,415
Robert F. Young	49,599,813	54,915
Alan Lipton	49,596,663	58,065
Lloyd Morisett	49,599,713	55,015

No other persons were nominated, or received votes, for election as directors of Tucows Inc. at the 2002 Annual Meeting of Shareholders. There were no abstentions or broker non-votes with respect to this proposal.

Proposal 2. To ratify the appointment of KPMG LLP as independent auditors of the Company for the fiscal year ending December 31, 2002.

	Votes For	**Votes Against**	**Votes Abstained**
Ratification of Appointment of KPMG LLP	49,622,184	22,224	10,320

There were no broker non-votes with respect to this proposal.

Item 6. Exhibits and Reports on Form 8-K

(a)

Exhibits:

Description

Exhibit No.	
99.1	Certification of Chief Executive Officer and Chief Financial Officer Relating to Periodic Report Containing Financial Statements

(b)

Reports on Form 8-K:

None.

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.

TUCOWS INC.

Dated August , 2002

By: /s/ ELLIOT NOSS

Elliot Noss
Chief Executive Officer

Dated August , 2002

By: /s/ MICHAEL COOPERMAN

Michael Cooperman
Chief Financial Officer
(Principal Financial and Accounting Officer)

EXHIBIT INDEX

Exhibit No.	Description
99.1	Certification of Chief Executive Officer and Chief Financial Officer Relating to a Periodic Report Containing Financial Statements

QuickLinks