TUCOWS INC /PA/
Form 10-Q
November 10, 2005

UNITED STATES

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 September 30, 2005

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

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

As of November 7, 2005, there were 71,878,822 outstanding shares of common stock, no par value, of the registrant, excluding 3,569 shares of common stock remaining in escrow as a result of an acquisition in April 2004.

TUCOWS INC.

Form 10-Q Quarterly Report

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PART I.

FINANCIAL INFORMATION

Item 1. Financial Statements

Tucows Inc.

Consolidated Balance Sheets

(Dollar amounts in U.S. dollars)

	September 30, 2005 (unaudited)	December 31, 2004
Assets		
Current assets:		
Cash and cash equivalents	$ 10,315,332	$ 13,914,988
Short-term investments	7,771,453	
Restricted cash	300,000	460,398
Interest receivable	115,739	
Accounts receivable, net of allowance for doubtful accounts of $93,500 as of September 30, 2005 and $25,000 as of December 31, 2004	1,362,887	1,111,082
Prepaid expenses and deposits	1,687,766	2,156,702
Prepaid domain name registry and ancillary services fees, current portion	18,001,418	15,601,786
Deferred tax asset, current portion	1,000,000	1,000,000
Total current assets	40,554,595	34,244,956
Prepaid domain name registry and ancillary services fees, long-term portion	7,445,536	6,471,916
Property and equipment	1,412,753	1,017,237
Deferred tax asset, long-term portion	2,000,000	2,000,000
Intangible assets	1,065,120	1,242,240
Goodwill	1,951,067	964,467
Investment	353,737	353,737
Cash held in escrow	619,082	1,009,650
Total assets	$ 55,401,890	$ 47,304,203
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 1,715,409	$ 1,483,543
Accrued liabilities	1,743,843	2,688,738
Customer deposits	2,169,890	2,247,262
Deferred revenue, current portion	26,561,381	23,648,381
Accreditation fees payable, current portion	366,143	144,483
Total current liabilities	32,556,666	30,212,407

Deferred revenue, long-term portion		10,758,080		9,602,599
Accreditation fees payable, long-term portion		78,212		31,816
Stockholders equity				
Preferred stock - no par value, 1,250,000 shares authorized; none issued and outstanding				
Common stock - no par value, 250,000,000 shares authorized; 71,840,267 shares issued and outstanding as of September 30, 2005 and 66,817,250 shares issued and outstanding as of December 31, 2004		12,354,168		9,541,277
Additional paid-in capital		50,061,866		50,061,866
Deficit		(50,407,102)		(52,145,762)
Total stockholders equity		12,008,932		7,457,381
Total liabilities and stockholders equity	$	55,401,890	$	47,304,203

See accompanying notes to unaudited consolidated financial statements

Tucows Inc.

Consolidated Statements of Operations

(Dollar amounts in U.S. dollars)

(unaudited)

	Three months ended September 30, 2005	2004	Nine months ended September 30, 2005	2004
Net revenues	$ 12,054,796	$ 12,381,326	$ 35,858,640	$ 33,195,200
Cost of revenues	7,676,713	7,654,475	22,484,530	20,658,290
Gross profit	4,378,083	4,726,851	13,374,110	12,536,910
Operating expenses:				
Sales and marketing (*)	1,150,674	1,370,932	3,669,185	3,716,192
Technical operations and development	1,468,624	1,107,590	4,147,467	3,259,882
General and administrative (*)	820,860	1,388,421	3,358,347	3,295,996
Depreciation of property and equipment	213,422	187,158	732,165	817,475
Amortization of intangible assets	59,040	59,040	177,120	98,720
Total operating expenses	3,712,620	4,113,141	12,084,284	11,188,265
Income from operations	665,463	613,710	1,289,826	1,348,645
Other income:				
Interest income, net	122,755	56,549	296,859	136,285
Total other income	122,755	56,549	296,859	136,285
Income before provision for income taxes	788,218	670,259	1,586,685	1,484,930
Provision for (recovery of) income taxes		(150,432)	(151,975)	(150,432)
Net income for the period	$ 788,218	$ 820,691	$ 1,738,660	$ 1,635,362
Basic earnings per common share	$ 0.01	$ 0.01	$ 0.03	$ 0.02
Shares used in computing basic earnings per common share	69,602,723	66,800,369	68,126,691	65,831,258
Diluted earnings per common share	$ 0.01	$ 0.01	$ 0.02	$ 0.02
Shares used in computing diluted earnings per common share	73,145,627	68,458,596	72,243,523	68,099,907

(*) Stock-based compensation has been included in operating expenses as follows:				
Sales and marketing	$	$	$	$ 16,834
General and administrative	$	$	$	$ 3,759

See accompanying notes to unaudited consolidated financial statements

Tucows Inc.

Consolidated Statements of Cash Flows

(Dollar amounts in U.S. dollars)

(unaudited)

	Three months ended September 30, 2005	Three months ended September 30, 2004	Nine months ended September 30, 2005	Nine months ended September 30, 2004
Cash provided by (used in):				
Operating activities:				
Net income for the period	$ 788,218	$ 820,691	$ 1,738,660	$ 1,635,362
Items not involving cash:				
Depreciation of property and equipment	213,422	187,158	732,165	817,475
Amortization of intangible assets	59,040	59,040	177,120	98,720
Unrealized change in the fair value of forward contracts	(290,177)	(97,512)	(182,549)	(188,775)
Stock-based compensation				20,593
Change in non-cash operating working capital:				
Interest receivable	(115,739)		(115,739)	
Accounts receivable	(91,828)	(382,631)	(251,805)	(456,915)
Prepaid expenses and deposits	240,682	68,578	651,485	179,193
Prepaid domain name registry and ancillary services fees	(535,643)	369,522	(3,373,252)	(2,926,678)
Accounts payable	292,579	61,324	231,866	(287,933)
Accrued liabilities	(269,556)	668,181	(944,895)	445,699
Customer deposits	31,497	(167,189)	(77,372)	(163,589)
Deferred revenue	674,016	(460,375)	4,068,481	3,916,585
Accreditation fees payable	(204,296)		268,056	
Cash provided by operating activities	792,215	1,126,787	2,922,221	3,089,737
Financing activities:				
Proceeds received on exercise of stock options	65,177	81,581	251,616	726,050
Net proceeds received on issuance of common stock, net of issue costs	2,024,025		1,574,675	
Cash provided by financing activities	2,089,202	81,581	1,826,291	726,050
Investing activities:				
Additions to property and equipment	(301,604)	(143,239)	(1,127,681)	(496,489)
Investment in short-term investments			(7,771,453)	
Decrease (increase) in restricted cash - being margin security against forward exchange contracts	(300,000)	148,750	160,398	(80,000)
Acquisition of Boardtown Corporation, net of cash acquired				(2,019,510)
Decrease (increase) in cash held in escrow	(2,320)		390,568	(1,000,000)
Cash (used in) provided by investing activities	(603,924)	5,511	(8,348,168)	(3,595,999)
Increase (decrease) in cash and cash equivalents	2,277,493	1,213,879	(3,599,656)	219,788
Cash and cash equivalents, beginning of period	8,037,839	11,918,720	13,914,988	12,912,811
Cash and cash equivalents, end of period	$ 10,315,332	$ 13,132,599	10,315,332	13,132,599

Supplemental cash flow information:								
Interest paid	$		$	113	$	300	$	166
Supplementary disclosure of non-cash investing and financing activities:								
Common stock issued on the acquisition of Boardtown Corporation	$	285,238	$		$	986,601	$	274,540

See accompanying notes to unaudited consolidated financial statements

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. BUSINESS AND BASIS OF PRESENTATION:

Tucows Inc., a Pennsylvania corporation (referred to throughout this report as the Company , Tucows , we , us or through similar expressions), provides Internet services and downloadable software through a global network of service providers, including web hosting companies and other providers of services over the Internet. Tucows services include domain registration services, digital certificates, billing, provisioning and customer care software solutions, email and anti-spam services, blogware and website building tools.

The accompanying unaudited interim consolidated balance sheets, and the related statements of operations and cash flows reflect all adjustments, consisting of normal recurring adjustments, that are, in the opinion of management, necessary for a fair presentation of the financial position of Tucows and its subsidiaries at September 30, 2005 and the results of operations and cash flows for the interim periods ended September 30, 2005 and 2004.

The accompanying interim consolidated financial statements have been prepared by the Company without audit, in accordance with the rules and regulations of the Securities and Exchange Commission (the SEC) and do not include all information and notes normally provided in annual financial statements. These interim financial statements follow the same accounting policies and methods of application used in the annual financial statements and should be read in conjunction with the audited financial statements and notes thereto of the Company for the year ended December 31, 2004 included in the Company s 2004 Annual Report on Form 10-K filed with the SEC on March 24, 2005.

We consider investments in highly liquid instruments purchased with an original maturity of 90 days or less to be cash equivalents. We maintain our cash balances in highly rated financial institutions. At times, such cash balances exceed the Federal Deposit Insurance Corporation limit.

Our short-term investments are invested in United States Treasury Bonds, Certificates of Deposit and Commercial Papers. These short-term investments are reported at cost, while any accrued interest on these investments is included in Other Income within Consolidated Statements of Operations, and under Accounts Receivable, on the Consolidated Balance Sheets.

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

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

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

	Three months ended September 30,				Nine months ended September 30,			
	2005		2004		2005		2004	
	(unaudited)				(unaudited)			
Net income, as reported	$	788,218	$	820,691	$	1,738,660	$	1,635,362
Add stock-based employee compensation expense included in reported net income, net of tax	$							20,593
Deduct total stock-based employee compensation expense determined under fair-value-based method for all rewards, net of tax		(67,102)		(77,996)		(279,085)		(296,706)
Net income, pro forma	$	721,116	$	742,695	$	1,459,575	$	1,359,249
Earnings per common share, as reported	$	0.01	$	0.01	$	0.03	$	0.02
Earnings per common share, pro forma	$	0.01	$	0.01	$	0.02	$	0.02

To determine the fair value of each option on the grant date in the three months ended September 30, 2005 and 2004 respectively, the following assumptions were used for the Company s stock option plan:

	Three months ended September 30,				Nine months ended September 30,			
	2005		2004		2005		2004	
	(unaudited)				(unaudited)			
Volatility		114.0%		132.8%		122.0%		132.4%
Risk-free interest rate		4.1%		3.2%		3.7%		3.2%
Expected life (in years)		4.0		4.0		4.0		4.0
Dividend yield		%		%		%		%
The weighted average grant date fair value for options issued, with the exercise price equal to market value on the date of grant	$	0.78	$	0.48	$	0.69	$	0.50

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. INVESTMENT:

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 not temporary has occurred.

The Company holds a 7% interest in Afilias, Limited (Afilias), a private company, which is a consortium of 18 domain name registrars.

3. BASIC AND DILUTED EARNINGS PER COMMON SHARE:

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

The diluted earnings per common share have been calculated using the weighted average number of common shares outstanding and potentially dilutive common shares outstanding during the periods.

Options to purchase 103,786 shares of common stock were outstanding during the three months ended September 30, 2005 (three months ended September 30, 2004: 1,634,698) but were not included in the computation of diluted income per common share because the options exercise price was greater than the average market price of the common shares during the period. Options to purchase 105,213 shares of common stock were outstanding during the nine months ended September

30, 2005 (nine months ended September 30, 2004: 1,065,438) but were not included in the computation of diluted income per common share because the options exercise price was greater than the average market price of the common shares. The options, which expire in years 2006 to 2015, were still outstanding at September 30, 2005.

4. SUPPLEMENTAL INFORMATION:

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

	Three months ended September 30,		Nine months ended September 30,	
	2005	2004	2005	2004
	(unaudited)		(unaudited)	
Domain name and ancillary services	$ 11,330,963	$ 11,401,460	$ 33,432,161	$ 30,976,960
Advertising and other revenue	723,833	979,866	2,426,479	2,218,240
	$ 12,054,796	$ 12,381,326	$ 35,858,640	$ 33,195,200

5. COMMITMENTS AND CONTINGENCIES:

Commitment obligations which existed at December 31, 2004 have been disclosed in the Company s 2004 Annual Report on Form 10-K filed with the SEC on March 24, 2005.

6. STOCKHOLDERS EQUITY:

The following table summarizes stockholders equity transactions for the nine months ended September 30, 2005:

	Common stock		Additional paid in capital	Deficit	Total stockholders equity
	Number	Amount			
Balances, December 31, 2004	66,817,250	$ 9,541,277	$ 50,061,866	$ (52,145,762)	$ 7,457,381
Exercise of stock options	666,519	251,616			251,616
Acquisition of Boardtown Corporation - shares released from escrow	1,066,075	986,600			986,600
Common stock issued on public offering in August 2005	3,290,423	1,574,675			1,574,675
Net income for the period				1,738,660	1,738,660
Balances, September 30, 2005	71,840,267	$ 12,354,168	$ 50,061,866	$ (50,407,102)	$ 12,008,932

On August 19, 2005, we sold 401,173 shares of common stock at $0.90 per share in a public offering. On August 31, 2005, the underwriters in the public offering exercised in full their over-allotment option to purchase an additional 2,889,250 shares of common stock at $0.90 per share. The public offering resulted in net proceeds, after underwriting, legal, accounting, printing and other costs, of $1,574,675.

7. RECENT ACCOUNTING PRONOUNCEMENTS:

In March 2005, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 47, Accounting for Conditional Asset Retirement Obligations (FIN 47), which is an interpretation of Statement of Financial Accounting Standards (SFAS) No. 143, Accounting for Asset Retirement Obligations. FIN47 clarifies terminology within SFAS 143 and requires an entity to recognize a liability for the fair value of a conditional asset retirement obligation when incurred if the liability s fair value can be reasonably estimated. FIN 47 is effective for fiscal years ending after December 15, 2005. We do not expect the adoption of this statement to have a material impact on our financial statements.

In May 2005, the FASB issued SFAS No. 154, Accounting Changes and Error Corrections. SFAS 154 replaces APB 20, Accounting Changes and SFAS 3, Reporting Accounting Changes in Interim Financial Statements and establishes retrospective application as the required method for reporting a change in accounting principle. SFAS 154 provides guidance for determining whether retrospective application of a change in accounting principle is impracticable and for reporting a change when retrospective application is impracticable. The reporting of a correction of an error by restating previously issued financial statements is also addressed. SFAS 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. We do not expect the adoption of this statement to have a material impact on our financial statements

In December 2004, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 123R, Share-Based Payment, which requires companies to expense the fair value of employee stock options and other forms of share-based compensation. Accordingly, SFAS 123R eliminates the use of the intrinsic value method to account for share-based compensation transactions as provided under APB Opinion No. 25. Under SFAS 123R, we are required to determine the appropriate fair value model to be used for valuing share-based payments, the amortization method for compensation cost and the transition method to be used at date of adoption. We currently use the Black-Scholes option-pricing model to value options for pro-forma financial statement disclosure purposes in note 1. The use of a different model to value options may result in a different fair value than the use of the Black-Scholes option-pricing model. We are required to adopt SFAS 123R in the first quarter of fiscal 2006. We are evaluating the requirements of SFAS 123R and anticipate that the adoption of FAS 123R will affect our results of operations to an extent similar to that as presented in its FAS 123 pro forma disclosure included in note 1.

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

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

Some of the statements under Management s Discussion and Analysis of Financial Condition and Results of Operations, Risk Factors and elsewhere in this Form 10-Q constitute forward-looking statements.

These statements involve known and unknown risks, uncertainties and other factors that may cause our or our industry s actual results, levels of activity, performance or achievements to be materially different from the information expressed or implied by these forward-looking statements. While we believe that we have a reasonable basis for each forward-looking statement contained in this Form 10-Q, we caution you that these statements are based on a combination of facts and factors currently known by us and projections of the future, about which we cannot be certain or even relatively certain. Many factors affect our ability to achieve our objectives and to successfully develop and commercialize our services including:

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

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

The ability of vendors to continue to supply our needs;

Actions by our competitors;

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

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

Our ability to effectively manage our business;

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

Pending or new litigation.

In addition, you should refer to the Risk Factors section of this Form 10-Q for a discussion of other factors that may cause our actual results to differ materially from those implied by our forward-looking statements. As a result of these factors, we cannot assure you that the forward-looking statements in this Form 10-Q will prove to be accurate. Furthermore, if our forward-looking statements prove to be inaccurate, the inaccuracy may be material. In light of the significant uncertainties in these forward-looking statements, you should not regard these statements as a representation or warranty by us or any other person that we will achieve our objectives and plans in any specified time frame, if at all.

You should read this Form 10-Q completely. In some cases, you can identify forward-looking statements by the following words: may, will, should, expect, intend, plan, anticipate, believe, estimate, predict, potential, continue or the negative of these terms or other co terminology. All forward-looking statements included in this Form 10-Q are based on information available to us as of the date of this Form 10-Q, and we assume no obligation to update these cautionary statements or any forward-looking statements. These statements are not guarantees of future performance.

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

OVERVIEW

We provide Internet services and downloadable software through a global distribution network of more than 6,000 customers, or Service Providers, in more than 100 countries. We are an accredited registrar with the Internet Corporations for Assigned Names and Numbers, or ICANN, and we generate revenue primarily through the provision of domain registration and other Internet services to Service Providers who offer such services to their own customers in a process known as wholesale distribution

Our distribution network of Service Providers is comprised primarily of web hosting companies, Internet Service Providers, or ISPs, and providers of other services over the Internet. These Service Providers typically provide their customers, the end-users of the Internet, with a critical component to enable their use of the Internet. End-users typically consist of individuals and businesses ranging from small businesses to large corporations.

Net Revenues

We generate net revenues primarily through the provision of domain registration and ancillary services. Additional revenue is generated from advertising and other services.

Domain registration and ancillary services

We generate revenues from the provision of Internet services on both a wholesale and retail basis. To date, the majority of net revenues has been derived from the sale of services provided as an accredited domain registrar. As of September 30, 2005, we offered registration services for the generic top-level domains, or gTLDs, .com, .net, .org, .info, .name and .biz and for the country code top-level domains, or ccTLDs .at, .be, .ca, .cc, .ch, .cn, .de, .fr, .it, .nl, .uk, .tv and .us.

We receive revenues for each domain registration or ancillary service processed through our system by Service Providers.

With respect to the sale of domain registrations, we earn registration fees in connection with each new, renewed and transferred-in registration and from providing provisioning services to Service Providers and registrars on a monthly basis. Domain registrations are generally purchased for terms of one to ten years. Payments for the full term of all services, or billed revenue, are received at the time of activation of service and where appropriate are recorded as deferred revenue and are recognized as earned ratably over the term of provision of service. This accounting treatment reasonably approximates a recognition pattern that corresponds with the provision of the services during the quarters and the year.

Ancillary services currently consist of digital certificates, billing, provisioning and customer care software solutions, email and anti-spam services, blogware and website building tools which are used by our Service Providers to create bundles of Internet services for their end-users. We earn fees when an ancillary service is activated. Ancillary services are generally purchased for terms of one month to three years. Payments for domain registrations and ancillary services are for the full term of all services at the time of activation of service and where appropriate are recorded as deferred revenue and are recognized as earned ratably over the term of provision of service. This accounting treatment reasonably approximates a recognition pattern that corresponds with the provision of the services during the quarters and the year.

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

Advertising and other revenue

We also generate advertising and other revenue through our online libraries of shareware, freeware and online services presented at our website, www.tucows.com. Advertising revenue is generated from third-party advertisers and from software developers who rely on us as a primary source of distribution. Software developers use our Author Resource Center, or ARC, to submit their products for inclusion in our software libraries and to purchase promotional placement of their software in the library categories, as well as purchase other promotional services on a cost-per-click through or flat rate basis. Software developers are able to promote their software through advertising services including keyword search placements, banners, promotional placements, expedited reviews and premium data services. Revenue is also generated from companies who contract with us to provide them with co-branded content. Advertising and other revenue is recognized ratably over the period in which it is presented. We have in the past also entered into barter transactions, which are a component of advertising revenues. Barter transactions are the exchange of advertising space on our 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 our historical practice of receiving cash for similar advertising. We did not undertake any barter transactions during the three or nine months ended September 30, 2005 or in the three or nine months ended September 30, 2004.

Critical Accounting Policies

The following is a discussion of our critical accounting policies and methods. Critical accounting policies are defined as those that are both important to the portrayal of our financial condition and results of operations and are reflective of significant judgments and uncertainties made by management that may result in materially different results under different assumptions and conditions. Notes 1 and 7 to the unaudited consolidated financial statements for the three and nine months ended September 30, 2005 includes further information on the significant accounting policies and methods used in the preparation of Tucows consolidated financial statements.

The preparation of financial statements in conformity with U.S. GAAP requires us 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, we evaluate the application of these estimates, including those related to the recoverability of investments, product development costs, revenue recognition and deferred revenue and accounting for income taxes. We base our 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

We earn revenues from:

Domain registration fees on both a wholesale and retail basis and ancillary services; and

Advertising and other revenue.

With respect to the sale of domain registrations, we earn registration fees in connection with each new, renewed and transferred-in registration and from providing provisioning services to Service Providers and registrars on a monthly basis. Domain registrations are generally purchased for terms of one to ten years. Payments for the full term of all services, or billed revenue, are received at the time of activation of service and where appropriate are recorded as deferred revenue and are recognized as earned ratably over the term of provision of service. This accounting treatment reasonably approximates a recognition pattern that corresponds with the provision of the services during the quarters and the year.

We also generate advertising and other revenue through our online libraries of shareware, freeware and online services presented at our website, www.tucows.com. Advertising and other revenue is recognized ratably over the period in which it is presented. To the extent that the minimum number of impressions we guarantee to customers is not met, we defer recognition of the corresponding revenues until the guaranteed impressions are achieved.

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

In those cases where payment is not received at the time of sale, additional conditions for recognition of revenue apply. The conditions are (i) that the collection of sales proceeds is reasonably assured and (ii) that we have no further performance obligations. We record 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. Should these expectations not be met, adjustments will be required in future periods.

We establish 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 our expectations and the reserves we have established have been appropriate. However, we have, 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

We account for the costs of computer software developed or obtained for internal use in accordance with the *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 our audited consolidated financial statements for the year ended December 31, 2004. Our 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 reassesses these judgments on an ongoing basis. Changes in management s assessment could impact the recognition of development costs in our accounts.

Valuation of intangible assets, goodwill and long-lived assets

Our business acquisitions typically result in goodwill and other intangible assets, which affect the amount of future period amortization expense and possible impairment expense that we may incur. The determination of the value of such intangible assets requires management to make estimates and assumptions that affect our consolidated financial statements. In addition to annual evaluation of the carrying value of goodwill, we review our identifiable intangibles, long-lived assets and goodwill whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Factors that we consider important that could trigger an impairment review include the following:

a significant underperformance relative to expected historical or projected future operating results;

a significant change in the manner of our use of the acquired asset or the strategy for our overall business; or

a significant negative industry or economic trend.

When we determine that the carrying value of intangibles, long-lived assets or goodwill may not be recoverable based upon the existence of one or more of the above indicators of impairment, we measure any impairment based on a projected discounted cash flow model using a discount rate determined by management to be commensurate with the risk inherent in our current business model. Management will base its estimates in preparing the discounted cash flows on historical experience and on various other assumptions, including current market trends and developments, ongoing customer developments and general economic factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily available from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Accounting for income taxes

We account for income taxes under the asset and liability method in accordance with Statement of Financial Accounting Standards No. 109. Under the asset and liability method, we recognize deferred tax assets or liabilities for the anticipated future tax effects of temporary differences between the financial statement basis and the tax basis of our assets and liabilities. We record a valuation allowance to reduce the net deferred tax assets when it is more likely than not that the benefit from the deferred tax assets will not be realized. In assessing the need for a valuation allowance, historical and future levels of income, expectations and risks associated with estimates of future taxable income and ongoing tax planning strategies are considered. In the event that it is determined that the deferred tax assets to be realized in the future would be in excess of the net recorded amount, an adjustment to the deferred tax asset valuation allowance would be recorded. This adjustment would increase income in the period such determination was made. Likewise, should it be determined that all or part of a recorded net deferred tax asset would not be realized in the future, an adjustment to increase the deferred tax asset valuation allowance would be charged to income in the period such determination would be made.

On a periodic basis, we evaluate the probability that our deferred tax asset balance will be recovered to assess its realizability. To the extent we believe it is more likely than not that some portion of our deferred tax assets will not be realized, we will increase the valuation allowance against the deferred tax assets. Realization of our deferred tax assets is dependent primarily upon future taxable income. Our judgments regarding future profitability may change due to future market conditions, changes in U.S. or international tax laws and other factors. These changes, if any, may require possible material adjustments to these deferred tax assets, resulting in a reduction in net income or an increase in net loss in the period when such determinations are made.

Accounting for stock based employee compensation

We account for stock based employee compensation arrangements in accordance with the provisions of Accounting Principles Board, or APB, Opinion No. 25, Accounting for Stock Issued to Employees and related interpretations, and comply with the disclosure requirements of Statement of Financial Accounting Standards No. 123, Accounting for Stock Based Compensation, or SFAS 123. Under APB Opinion No. 25, compensation cost, if any, is recognized over the respective vesting period based on the difference between the deemed fair value of our common stock and the exercise price on the date of grant. The determination of the volatility, expected term and other assumptions used to determine the fair value of stock options granted under SFAS 123 for footnote disclosure purposes involves subjective judgment and the consideration of a variety of factors, including our historical stock price and option exercise activity to date.

In December 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 123R, Share Based Payment, or SFAS 123R, which requires companies to expense the fair value of employee stock options and other forms of share based compensation. Accordingly, SFAS 123R eliminates the use of the intrinsic value method to account for share based compensation transactions as provided under APB Opinion No. 25. Under SFAS 123R, we are required to determine the appropriate fair value model to be used for valuing share based payments, the amortization method for compensation cost and the transition method to be used at date of adoption. We currently use the Black Scholes option pricing model to value options for pro-forma financial statement disclosure purposes. The use of a different model to value options may result in a different fair value than the use of the Black Scholes option pricing model. We are required to adopt SFAS 123R in the first quarter of fiscal 2006. We are evaluating the requirements of SFAS 123R to assess what impact its adoption will have on our financial position and results of operations.

RESULTS OF OPERATIONS FOR THE THREE MONTHS AND NINE MONTHS ENDED SEPTEMBER 30, 2005 AS COMPARED TO THE THREE MONTHS AND NINE MONTHS ENDED SEPTEMBER 30, 2004

NET REVENUES

	Three months ended September 30,		Nine months ended September 30,	
	2005	2004	2005	2004
Net revenues	$ 12,054,796	$ 12,381,326	$ 35,858,640	$ 33,195,200
(Decrease) increase over prior period	$ (326,530)		$ 2,663,440	
(Decrease) increase - percentage	(3)%		8%	

Total net revenues for the three months ended September 30, 2005 decreased to $12.1 million from $12.4 million for the three months ended September 30, 2004.

Total net revenues for the nine months ended September 30, 2005 increased to $35.9 million from $33.2 million for the nine months ended September 30, 2004.

During the three and nine months ended September 30, 2005, no customer accounted for more than 5% of billed revenue, and one customer accounted for 12.2% of accounts receivable at September 30, 2005. Subsequent to the quarter end, substantially all of the amounts, owed by this customer were collected. Significant management judgment is required at the time of recording of revenue to assess whether the collection of the resulting receivables is reasonably assured. On an ongoing basis we assess the ability of our customers to make required payments. Based on this assessment, we expect our outstanding receivables to be fully collected.

Domain name and ancillary services

Net revenues from domain name and ancillary services for the three months ended September 30, 2005 decreased by $100,000, or 0.6%, to $11.3 million from $11.4 million for the three months ended September 30, 2004 as a result of our reported revenue for the three and nine months ended September 30, 2004, which included the recognition of deferred domain name revenue of approximately $1.1 million that was recognized as a result of one of our resellers becoming an accredited registrar and transferring all of its domain names from our tag to its own tag. The impact of the transfer of these names, which included a large number of multiple year registrations, resulted on our having no future obligations in connection with these names. As a result, we recognized all deferred revenue previously recorded relating to these names during the quarter ended September 30, 2004. The customer continues to be a customer of ours, using our OpenHRS platform for its registration needs.

Net revenues from domain name and ancillary services for the nine months ended September 30, 2005 increased by $2.4 million, or 7.9%, to $33.4 million from $31.0 million for the nine months ended September 30, 2004, primarily as a result of increased volumes from new and existing customers, as well as the additional revenue earned as a result of the April 2004 acquisition of Boardtown Corporation.

During the three months ended September 30, 2005, the number of domain names that we processed increased by approximately 100,000 to approximately 1.0 million new, renewed and transferred-in domain name registrations, compared to the three months ended September 30, 2004. During the nine months ended September 30, 2005, the number of domain names that we processed increased by approximately 200,000 to approximately 3.0 million new, renewed and transferred-in domain name registrations, compared to the nine months ended September 30, 2004. These increases were due primarily to our continuing to compete aggressively to attract new clients and retain existing customers to protect our current market share and improve our competitive position. These actions have resulted in our average selling price declining, which has partially offset the impact of the increased transaction volume on our revenue and profitability. We may face continued pricing pressure in order to remain competitive, which would adversely impact our revenues and profitability.

The renewal rate for domain name registrations increased to approximately 69% for the three months ended September 30, 2005 compared to approximately 65% for the three months ended September 30, 2004.

During the three months ended September 30, 2005, revenue from domain names, including Domain Direct, comprised 86% of total revenue, compared to 87% for the three months ended September 30, 2004. During the three months ended September 30, 2005, revenue from ancillary products comprised 8% of total revenue, compared to 6% for the three months ended September 30, 2004.

During the nine months ended September 30, 2005, revenue from domain names, including Domain Direct, comprised 86% of total revenue, compared to 89% for the nine months ended September 30, 2004. During the nine months ended September 30, 2005, revenue from ancillary products comprised 8% of total revenue, compared to 5% for the nine months ended September 30, 2004.

While we anticipate that the number of new, renewed and transferred-in domain name registrations will incrementally increase, the volatility in the market could affect the growth of domain names under our management. During the three months ended September 30, 2005, the total number of domain names under our management increased by approximately 100,000 to approximately 4.7 million. In addition, as of September 30, 2005 we provided provisioning services to 6 registrars on a monthly basis (6 registrars at September 30, 2004) who use our technical systems to process domain registrations with their accreditation. As of September 30, 2005, we managed approximately 849,000 domain names (approximately 252,000 at September 30, 2004) on their behalf.

Deferred revenue from domain name registrations and ancillary services at September 30, 2005 increased to approximately $37.3 million from approximately $36.6 million at June 30, 2005.

Advertising and other revenue

Advertising and other revenue for the three months ended September 30, 2005 decreased by approximately $256,000, or 26%, to approximately $724,000 compared to approximately $980,000 for the three months ended September 30, 2004. This decline in revenue was primarily the result of the improved efficiency that users are experiencing as a result of the significant redesign of our software download website that we completed during the second quarter of 2005. While the improved navigability and usability of the website is enabling users to more readily find the software download that best addresses their needs and is resulting in a steadily improving ratio of downloads per visit, it has also enabled users to find their desired download more readily which has resulted in a decrease in the number of searches, the number of times users click on paid placements and the number of times users click on syndicated pay-per-click results. We expect the growth rate for advertising and other revenue to continue to be impacted over the short-term. However, over the long-term we expect that the improved navigability and usability will result in increased traffic to the website, which will generate additional advertising and other revenue that we believe will offset this decline in revenue.

Advertising and other revenue for the nine months ended September 2005 increased by approximately $200,000, or 9%, to approximately $2.4 million compared to approximately $2.2 million for the nine months ended September 30, 2004. The increase was predominantly the result of growth in advertising revenue from third party advertisers, which was partially offset by a decrease in advertising revenue as a result of the improved efficiency of the redesigned website described above.

During the three months ended September 30, 2005, revenue from advertising and other revenue comprised 6% of total revenue, compared to 8% for the three months ended September 30, 2004. During the nine months ended September 30, 2005, revenue from advertising and other revenue comprised 7% of total revenue, compared to 7% for the nine months ended September 30, 2004.

COST OF REVENUES

Cost of revenues includes the costs associated with providing domain registration and ancillary services, advertising and other revenue and network costs.

Cost of revenues for domain registrations represents the amortization of registry fees on a basis consistent with the recognition of revenues from our customers, namely ratably over the term of provision of the service. Registry fees, the primary component of cost of revenues, are paid in full when the domain is registered, and are recorded as prepaid domain registry fees. Costs of revenues for ancillary services consist of fees paid to third-party service providers and are recognized ratably over the periods in which the services are provided. We have minimal direct cost of revenues associated with our advertising and other revenues. Therefore, the gross profit margin on advertising revenue is approximately 100% and, accordingly, any increase or decrease in advertising and other revenue represents an increase or a reduction of our gross profit of the same amount. Network costs include personnel and related expenses, including bandwidth and co-location expenses to support the supply of all our services. Bandwidth and co-location expenses are composed primarily of communication and provisioning costs related to the management and support of our network.

	Three months ended September 30, 2005	2004	Nine months ended September 30, 2005	2004
Cost of revenues	$ 7,676,713	$ 7,654,475	$ 22,484,530	$ 20,658,290
Increase over prior period	$ 22,238		$ 1,826,240	
Increase - percentage	0%		9%	
Percentage of net revenues	64%	62%	63%	62%

Cost of revenues for the three months ended September 30, 2005 and the three months ended September 30, 2004 remained flat at approximately $7.7 million primarily as a result of the higher costs attributable to higher volumes of domain registrations and ancillary services and the November 2004 change in nature of the ICANN accreditation fee. Included in the cost of revenues for the three months ended September 30, 2004 is approximately $800,000 of non-cash prepaid cost of goods recorded during the quarter ended September 30, 2004 that arose as a result of one of our resellers, as more fully described under Net Revenue above, becoming an accredited registrar and transferring all of its domain names from our tag to its own tag with the result that we no longer have any future obligations in connection with these names.

Cost of revenues for the nine months ended September 30, 2005 increased by approximately $1.8 million, or 9%, to $22.5 million from $20.7 million for the nine months ended September 30, 2004. The increase was primarily the result of higher costs attributable to higher volumes of domain registrations and ancillary services, and as a result of the November 2004 change in nature of the ICANN accreditation fee. This increase was partly offset by the recognition of the non-cash prepaid cost of goods recorded during the quarter ended September 30, 2004 of approximately $800,000 that arose as a result of one of our resellers, as more fully described under Net Revenue above, becoming an accredited registrar and transferring all of its domain names from our tag to its own tag with the result that we no longer have any future obligations in connection with these names.

Registry fees, the primary component of cost of revenues, are paid in full when the domain is registered. Registry fees are recorded as prepaid domain registry fees and are recognized ratably over the term of provision of the service. Ancillary service costs and ICANN accreditation transaction fees are generally paid either monthly or quarterly. Services provided over periods longer than one month are recognized ratably over the term of provision of the service. Effective November 1, 2004, ICANN s members voted to change the basis whereby registrars pay their variable accreditation fee to a transaction based fee of $0.25 per domain year registered. As this fee is now being charged as a transaction fee, we are no longer expensing this fee to sales and marketing, but are allocating it to cost of goods sold and are recognizing it ratably over the term of provision of the service. We anticipate that cost of revenues will continue to increase in absolute dollars primarily as a result of continued growth in domain registration and ancillary services.

Prepaid domain registration and ancillary services fees at September 30, 2005 increased by approximately $0.5 million, to approximately $25.4 million from approximately $24.9 million at June 30, 2005.

Cost of revenues includes the costs of network operations. These costs for the three months ended September 30, 2005 increased by $100,000, or 17%, to $400,000 from $300,000 for the three months ended September 30, 2004, primarily as a result of additional bandwidth and people costs, primarily as a result of increased headcount and hours of operation.

Network operations for the nine months ended September 30, 2005 increased by $100,000, or 11%, to $1.0 million from $900,000 for the nine months ended September 30, 2004, primarily as a result of additional people costs, primarily as a result of increased headcount and hours of operation.

The cost of network operations is comprised primarily of communication costs, equipment maintenance, and employee and related costs directly associated with the management and maintenance of the network. We expect communication costs to increase as our network expands geographically and network activity increases.

SALES AND MARKETING

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

	Three months ended September 30, 2005	2004	Nine months ended September 30, 2005	2004
Sales and marketing	$ 1,150,674	$ 1,370,932	$ 3,669,185	$ 3,716,192
Decrease over prior period	$ (220,258)		$ (47,007)	
Decrease - percentage	(16)%		(1)%	
Percentage of net revenues	10%	11%	10%	11%

Sales and marketing expenses during the three months ended September 30, 2005 decreased by approximately $220,000, or 16%, to approximately $1.2 million compared to approximately $1.4 million during the three months ended September 30, 2004.

The decrease was primarily the result of a decrease in ICANN fees, which decreased by approximately $152,000 due to this expense now being included under cost of goods sold (as discussed under cost of revenues above).

In addition, personnel costs decreased by approximately $58,000 primarily as a result of no accrual being made for the 2005 at risk incentive compensation plan, or the 2005 At Risk Plan in the three months ended September 30, 2005. Under the 2005 At Risk Plan, the personal and net income performance bonus of each executive officer is paid partially in recognition of an individual s achievement of established objectives and partially in acknowledgement of our net income performance. During the three months ended September 30, 2004, we recorded a provision of approximately $162,000 in connection with the fiscal 2004 at risk incentive compensation plan, or the 2004 At Risk Plan, as management had assessed that it was more likely than not that we would exceed the performance thresholds that the compensation committee had set for fiscal 2004. No accrual has been recorded for fiscal 2005 as management has determined that at this point in time it is not likely that we will exceed the performance thresholds set by the compensation committee for senior managers and executive officers in our 2005 At Risk Plan. This decrease was largely offset by incremental personnel costs of approximately $104,000 during the quarter. Travel expenses for the three months ended September30, 2005 decreased by approximately $25,000 as a result of slightly less travel undertaken during the quarter.

Sales and marketing expenses during the nine months ended September 30, 2005 remained flat at approximately $3.7million compared to the nine months ended September 30, 2004. Included in these expenses was increased people costs, including contractors, of approximately $324,000 (includes a cost of approximately $62,000 relating to a severance payment), related to ongoing initiatives to improve customer service, product management and expand our sales reach. Also included in sales and marketing expenses is an increase of approximately $67,000 primarily related to travel incurred as a result of efforts to extend our sales reach. The increase was partly offset by a decrease in ICANN fees of approximately $438,000, which, effective November 2004, is included under cost of goods sold (as discussed under Cost of Revenues above) and by our not recording an accrual for senior managers and executive officers under the 2005 At Risk Plan.

We believe that sales and marketing expenses will continue to increase, in absolute dollars, as we adjust our marketing programs and sales strategies to meet future opportunities in the marketplace.

TECHNICAL OPERATIONS AND DEVELOPMENT

Technical operations and development expenses consist primarily of personnel costs and related expenses required to support the development of new or enhanced service offerings and the maintenance and upgrading of existing infrastructure. This includes expenses incurred in the research, design and development of technology that we use to register domain names and ancillary services and to distribute our digital content services. Editorial costs relating to the rating and review of the software content libraries are included in the costs of product development. In accordance with the American Institute of Certified Public Accountants Statement of Position 98-1, Accounting for the Costs of Computer Software Developed or Obtained for Internal Use, costs incurred during the application development stage 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 September 30,		Nine months ended September 30,	
	2005	**2004**	**2005**	**2004**
Technical operations and development	$ 1,468,624	$ 1,107,590	$ 4,147,467	$ 3,259,882
Increase over prior period	$ 361,034		$ 887,585	
Increase - percentage	33%		27%	
Percentage of net revenues	12%	9%	12%	10%

Technical operations and development expenses for the three months ended September 30, 2005 increased approximately $361,000, or 33%, to approximately $1.5 million from approximately $1.1 million for the three months ended September 30, 2004.

The increase was primarily the result of people related costs including contract and outside service costs, which increased by approximately $310,000 and reflects our ongoing commitment to enhance and extend our OpenSRS platform. No accrual was included under technical operations and development expenses during the three months ended September 30, 2005 for at risk compensation under the 2005 At Risk Plan compared to approximately $58,000 of at risk compensation under the 2004 At Risk Plan included under technical operations and development expenses during the three months ended September 30, 2004.

The amount of capitalized personnel costs for employees directly related to the application development stage of development projects decreased by approximately $26,000, which contributed to the increase in technical operations and development expenses. Also included in the increase in technical operations and development expenses is an increase of approximately $25,000 primarily related to travel expenses incurred in furthering the integration of our North American development teams.

Technical operations and development expenses for the nine months ended September 30, 2005 increased approximately $888,000, or 27%, to approximately $4.1 million from approximately $3.3 million for the nine months ended September 30, 2004.

The increase was primarily the result of people related costs including contract and outside service costs, which increased by approximately $835,000 (includes a cost of approximately $100,000 relating to a severance payment) and reflects our ongoing commitment to enhance and extend our OpenSRS platform. No accrual was included under technical operations and development expenses during the nine months ended September 30, 2005 for at risk compensation under the 2005 At Risk Plan compared to the approximately $58,000 of at risk compensation under the 2004 At Risk Plan included under technical operations and development expenses during the nine months ended September 30, 2004.

Also included in the increase in technical operations and development expenses is an increase of approximately $55,000 primarily related to travel expenses incurred in furthering the integration of our North American development teams.

The amount of capitalized personnel costs for employees directly related to the application development stage of development projects increased by approximately $2,000, which partly offset the increase in technical operations and development expenses. We expect technical operations and development expenses to increase slightly, in absolute dollars, going forward as our business continues to grow and as we further develop our 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 September 30,		Nine months ended September 30,	
	2005	2004	2005	2004
General and administrative	$ 820,860	$ 1,388,421	$ 3,358,347	$ 3,295,996
(Decrease) / Increase over prior period	$ (567,561)		$ 62,351	
(Decrease) / Increase - percentage	(41)%		2%	
Percentage of net revenues	7%	11%	9%	10%

General and administrative expenses for the three months ended September 30, 2005 decreased by approximately $568,000, or 41%, to $821,000 from $1.4 million for the three months ended September 30, 2004.

The decrease in general and administrative expenses resulted from in decreases in people related costs including contract and outside service costs, of approximately $281,000. These decreases were primarily due to no accrual being made for at risk compensation under the 2005 At Risk Plan during the period. During the three months ended September 30, 2004, approximately $286,000 of at risk compensation under the 2004 At Risk Plan was included under general and administrative expenses.

Professional fees accounted for approximately $190,000 of this decrease as costs for advice obtained in connection with the evaluation of cross border corporate structures and the protection of our intellectual property were incurred during three months ended September 30, 2004. In addition, directors and officers liability insurance, investor relations, conferences and seminars and other expenses accounted for an additional $43,000 of the decrease in general and administrative expenses.

These decreases were partially offset by an increase in provision for doubtful accounts of approximately $39,000 and increases in facility costs, business and state taxes and other miscellaneous expenses of approximately $46,000 during the three months ended September 30, 2005 compared to the three months ended September 30, 2004.

We also recorded a foreign exchange gain of approximately $294,000 for the three months ended September 30, 2005 compared to approximately $154,000 for the three months ended September 30, 2004.

General and administrative expenses for the nine months ended September 30, 2005 increased by approximately $62,000, or 2%, to $3.4 million from $3.3 million for the nine months ended September 30, 2004.

The increase in general and administrative expenses generally reflects the more sophisticated infrastructure needed to support the constantly evolving needs we experience as the size and scope of our business continues to grow. This resulted in increases in provision for doubtful accounts of approximately $98,000, increases in facility costs of approximately $94,000, and increases in public listing expenses, professional fees, telephone and supplies totaling approximately $97,000 (includes an incremental cost of $95,000 related to an outside management consultant).

These increases were partially offset by decreases in people costs, including contract and outside services of approximately $90,000. These decreases were primarily due to no accrual being made for at risk compensation under the 2005 At Risk Plan during the nine months ended September 30, 2005. During the nine months ended September 30, 2004, approximately $286,000 of at risk compensation under the 2004 At Risk Plan was included under general and administrative expenses.

Directors and officers liability insurance, business and state taxes travel and other miscellaneous expenses decreased by a total of approximately $124,000 during the nine months ended September 30, 2005 compared to the nine months ended September 30, 2004. We also recorded a foreign exchange loss of approximately $241,000 for the nine months ended September 30, 2005 compared to a foreign exchange gain of approximately $228,000 for the nine months ended September 30, 2004, reflecting the continued strengthening in the Canadian dollar.

We expect general and administrative expenses to continue to increase, in absolute dollars, as our business continues to grow and the impact of a higher Canadian dollar, more fully described in the risk factors above, is recognized.

DEPRECIATION OF PROPERTY AND EQUIPMENT

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

	Three months ended September 30,				Nine months ended September 30,			
	2005		2004		2005		2004	
Depreciation of property and equipment	$	213,422	$	187,158	$	732,165	$	817,475
Increase (decrease) over prior period	$	26,264			$	(85,310)		
Increase (decrease) - percentage		14%				(10)%		
Percentage of net revenues		2%		2%		2%		2%

The increase in depreciation for the three months ended September 30, 2005 compared to the three months ended September 30, 2004 was primarily due to the acquisition of additional computer hardware, purchased to increase production capacity to meet additional customer demands.

The decrease in depreciation for the nine months ended September 30, 2005 compared to the nine months ended September 30, 2004 was primarily due to certain of our older computer software being fully depreciated and not requiring replacement.

We expect that depreciation of property and equipment will increase, in absolute dollars, as we continue to enhance and add functionality to our service offerings.

AMORTIZATION OF INTANGIBLE ASSETS

Amortization of intangible assets consists of amounts arising in connection with the acquisition of Boardtown Corporation in April 2004. The technology, brand and customer relationships purchased are amortized on a straight-line basis over seven years, while the non-competition agreements entered into with the former owners of Boardtown Corporation are amortized on a straight-line basis over three years.

	Three months ended September 30,				Nine months ended September 30,			
	2005		2004		2005		2004	
Amortization of intangible assets	$	59,040	$	59,040	$	177,120	$	98,720
Increase over prior period	$				$	78,400		

OTHER INCOME

	Three months ended September 30,				Nine months ended September 30,			
	2005		2004		2005		2004	
Other income (expenses), net	$	122,755	$	56,549	$	296,859	$	136,285

Increase over prior period	$	66,206	$	160,574

Other income includes net interest income of approximately $123,000 for the three month period ended September 30, 2005 and approximately $56,000 for the three month period ended September 30, 2004, and approximately $297,000 for the nine month period ended September 30, 2005 and approximately $136,000 for the nine month period ended September 30, 2004.

INCOME TAXES

In preparing our financial statements, we make estimates of our current tax obligations and temporary differences resulting from differences in reporting items for financial statement and tax purposes. We recognize deferred taxes by the asset and liability method of accounting for income taxes. Under the asset and liability method, deferred taxes are recognized for differences between the financial statement and tax basis of assets and liabilities at enacted statutory tax rates in effect for the years in which the differences are expected to reverse. The effect on deferred taxes of a change in tax rates is recognized as income or expense in the period that includes the enactment date. Valuation allowances based on management s judgment are established when appropriate to reduce the carrying value of deferred tax assets to the amounts expected to be realized.

	Three months ended September 30,		Nine months ended September 30,	
	2005	2004	2005	2004
Provision for (recovery of) income taxes	$	$ (150,432)	$ (151,975)	$ (150,432)

We operate in various tax jurisdictions, and accordingly, our income is subject to varying rates of tax. Losses incurred in one jurisdiction cannot be used to offset income taxes payable in another. No provision for income taxes was recorded for the three or nine months ended September 30, 2005 and 2004 because we had net operating losses to offset against our operating income. Our ability to use income tax loss carryforwards and future income tax deductions is dependant upon our operations in the tax jurisdictions in which such losses or deductions arise.

We are entitled to certain Canadian investment tax credits for qualifying research and development activities performed in Canada. During the three months ended March 31, 2005, we recorded a tax recovery, net of Canadian provincial taxes otherwise payable, in the amount of approximately $152,000, representing the actual investment tax credit payment received from the Canadian authorities with respect to research and development undertaken in 2001, 2002 and 2003.

LIQUIDITY AND CAPITAL RESOURCES

At September 30, 2005, our principal source of liquidity was cash and cash equivalents, including short term investments, of approximately $18.1 million compared to approximately $13.9 million at December 31, 2004.

Net cash provided by operating activities was approximately $2.9 million for the nine months ended September 30, 2005, compared to approximately $3.1 for the nine months ended September 30, 2004. Net cash provided by operating activities for the nine months ended September 30, 2005 resulted primarily from net income and increases in deferred revenue and accreditation fees payable (representing cash received in advance of provision of the services). These increases were partially offset by an increase in prepaid domain name registry fees and accounts receivable and a decrease in accruals, primarily as a result of at risk compensation accruals and payment of other annual accruals.

Net cash used in investing activities was approximately $8.3 million for the nine months ended September 30, 2005. This was primarily as a result of an increase in short-term investments of approximately $7.7 million and by our purchasing of property and equipment, principally computers and related software of approximately $1.1 million during the nine months ended September 30, 2005 to meet our operational needs.

This was offset by a decrease in restricted cash of approximately $160,000 as a result of a release to us of margin security against forward exchange contracts that had matured during the quarter, as well as a release to us of approximately $400,000 that was held in escrow pursuant to the terms of the Boardtown purchase agreement.

Net cash provided by financing activities was approximately $1.8 million for the nine months ended September 30, 2005. On August 19, 2005, we sold 401,173 shares of common stock at $0.90 per share in a public offering. On August 31, 2005, the underwriters in the public offering exercised in full their over-allotment option to purchase an additional 2.9 million shares of common stock at $0.90 per share. The public offering resulted in net proceeds, after underwriting, legal, accounting, printing and other costs of approximately $1.6 million. In addition we received proceeds of approximately $252,000 on the exercise of stock options under our employee stock purchase plan.

Based on our operations, we believe that our cash flow from operations will be adequate to meet our anticipated requirements for working capital and capital expenditures for at least the next 12 months.

We may choose to raise additional funds or seek other financing arrangements to facilitate more rapid expansion 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, we may not be able to raise it on acceptable terms, or at all, and additional financing may be dilutive to existing investors. We may also evaluate potential acquisitions of other businesses, products and technologies. To complete potential acquisitions, we may issue additional securities or need additional equity or debt financing and any additional financing may be dilutive to existing investors. There are currently no material understandings, commitments or agreements about any acquisition of other businesses.

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RISK FACTORS

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

Risks Related to Our Business and Industry

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

Before the introduction of competition into the domain registration industry in 1999, Network Solutions LLC, or Network Solutions, was the only entity authorized by the U.S. government to serve as the registrar for domains in the .com, .net and .org domains. This position allowed Network Solutions to develop a substantial customer base, which gives it advantages in securing customer renewals and in developing and marketing ancillary products and services. In addition to Network Solutions, we face significant competition from other existing registrars and the continued introduction of new registrars in the domain registration industry. As of October 27, 2005, ICANN had accredited 528 competitive registrars, including our company, to register domains in one or more of the generic top level domains, or gTLD s, though not all of these accredited registrars are operational. The continued introduction of competitive registrars and Service Providers into the domain registration industry and the rapid growth of some competitive registrars and Service Providers who have already entered the industry may make it difficult for us to maintain our current market share. Some of these registrars may have longer operating histories, greater name recognition, particularly in international markets, or greater resources than us. We expect that competition will increase in the near term and that our primary long-term competitors may not yet have entered the market. As a result, we may not be able to compete effectively.

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

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

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

Each registry typically imposes a fee in association with the registration of each domain. For example, at present, the VeriSign registry charges a $6 fee. ICANN has recently imposed a $0.25 charge for each domain name registered in the TLDs that fall within its purview. We have no control over these agencies and cannot predict when they may increase their respective fees. Any increase in these fees must either be included in the prices we charge to our Service Providers or it must be imposed as a surcharge. If we absorb such cost increases or if surcharges act as a deterrent to registration, we may find that our profits are adversely impacted by these third-party fees.

If we are unable to protect our market share or improve our competitive position by maintaining or increasing the renewal of domain registrations, our business, financial condition and results of operations could be materially adversely affected.

We compete aggressively to attract new clients and retain existing customers to protect our current market share and improve our competitive position. These actions have resulted in our average selling price declining, which has partially offset the impact of the increased transaction volume on our revenue and profitability. We may face continued pricing pressure in order to remain competitive, which would adversely impact our revenues and profitability. While we anticipate that the number of new, renewed and transferred-in domain registrations will incrementally increase, volatility in the market could result in our customers turning to other registrars, thereby impairing growth in the number of domains under our management and our ability to sell multiple services to such customers. Since our strategy is to expand the services we provide our customers, if we are unable to maintain our domain registrations, our ability to expand our business may be adversely effected.

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

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

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

The growth of our business depends on, among other things, our Service Providers renewal of their customers domain registrations through us. Service Providers may choose to renew their domains with other registrars or their registrants may choose not to renew and pay for renewal of their domains. If Service Providers decide, for any reason, not to renew their registrations through us, our revenues from domain registrations will decrease.

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

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

We believe that part of our growth will be derived from Service Providers in international markets and may suffer if Internet usage does not continue to grow globally.

We believe that a major source of growth for Internet-based companies will come from individuals and businesses outside the United States where Internet access and use is less prevalent. A substantial number of our Service Providers are currently based outside the United States and we plan to grow our business in other countries. If Internet use in these jurisdictions does not increase as anticipated, our revenues may not grow as anticipated.

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

We believe that the brand identity we have developed has significantly contributed to the success of our business. We also believe that maintaining and enhancing the Tucows brand is critical to expanding our customer base. Maintaining and enhancing our brand may require us to make substantial investments and these investments may not be successful. We anticipate that, as our market becomes increasingly competitive, maintaining and enhancing our brand may become increasingly difficult and expensive. Maintaining and enhancing our brand will depend largely on our ability to be a technology leader providing high quality products and services, which we may not do successfully. To date, we have engaged in relatively little direct brand promotion activities. This enhances the risk that we may not successfully implement brand enhancement efforts in the future.

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

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

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

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

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

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

Our standard domain registration agreement may not be enforceable, which could subject us to liability.

We operate on a global basis and all of our Service Providers must execute our standard domain registration agreement as part of the process of registering a domain. This agreement contains provisions intended to limit our potential liability arising from our registration of domains on behalf of our Service Providers and their customers, including liability resulting from our failure to register or maintain domains. If a domestic, foreign or international court were to find that the registration agreement is unenforceable, we could be subject to liability.

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

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

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

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

Our advertising revenues may be subject to fluctuations.

We believe that Internet advertising spending, as in traditional media, fluctuates significantly with economic cycles and during any calendar year, with spending being weighted towards the end of the year to reflect trends in the retail industry. Our advertisers can generally terminate their contracts with us at any time. Advertising spending is particularly sensitive to changes in general economic conditions and typically decreases when economic conditions are not favorable. A decrease in demand for Internet advertising could have a material adverse affect on our business, financial condition and results of operations.

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

We may acquire companies or the rights to technologies in the future. Entering into these types of arrangements entails many risks, any of which could materially harm our business, including:

- diversion of management s attention from other business concerns;
- failure to effectively assimilate the acquired technology or company into our business;
- the loss of key employees from either our current business or the acquired business; and
- assumption of significant liabilities of the acquired company.

In addition, your holdings in our company will be diluted if we issue equity securities in connection with any acquisition or arrangement.

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

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

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

The unauthorized reproduction or other misappropriation of our intellectual property rights, including copying the look, feel and functionality of our website could enable third parties to benefit from our technology without us receiving any compensation.

The law relating to the use of and ownership in intellectual property on the Internet is currently unsettled and may expose us to unforeseen liabilities.

There have been ongoing legislative developments and judicial decisions concerning trademark infringement claims, unfair competition claims, and dispute resolution policies relating to the registration of domains. To help protect ourselves from liability in the face of these ongoing legal developments, we have taken the following precautions:

Our standard registration agreement requires that each registrant indemnify, defend and hold us harmless for any dispute arising from the registration or use of a domain registered in that person s name; and

Since December 1, 1999, we have required our Service Providers to ensure that all registrants are bound to the Uniform Domain Name Dispute Resolution Policy as approved by ICANN.

Despite these precautions, we cannot assure you that our indemnity and dispute resolution policies will be sufficient to protect us against claims asserted by various third parties, including claims of trademark infringement and unfair competition.

New laws or regulations concerning domains and registrars may be adopted at any time. Our responses to uncertainty in the industry or new regulations could increase our costs or prevent us from delivering our domain registration services over the Internet, which could delay growth in demand for our services and limit the growth of our revenues. New and existing laws may cover issues such as:

pricing controls;

the creation of additional generic top level domains and country code domains;

consumer protection;

cross-border domain registrations;

trademark, copyright and patent infringement;

domain dispute resolution; and

the nature or content of domains and domain registration.

An example of legislation passed in response to novel intellectual property concerns created by the Internet is the ACPA enacted by the United States government in November 1999. This law seeks to curtail a practice commonly known in the domain registration industry as cybersquatting. A cybersquatter is generally defined in the ACPA as one who registers a domain that is identical or similar to another party s trademark, or the name of another living person, with the bad faith intent to profit from use of the domain. The ACPA states that registrars may not be held liable for registration or maintenance of a domain for another person absent a showing of the registrar s bad faith intent to profit from the use of the domain. Registrars may be held liable, however, if they do not comply promptly with procedural provisions of the ACPA. For example, if there is litigation involving a domain, the registrar is required to deposit a certificate representing the domain registration with the court. If we are held liable under the ACPA, any liability could have a material adverse effect on our business, financial condition and results of operations.

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

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

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

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

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

We rely on technologies licensed from other parties. These third-party technology licenses may infringe on the proprietary rights of others and may not continue to be available on commercially reasonable terms, if at all. The loss of this technology could require us to obtain substitute technology of lower quality or performance standards or at greater cost, which could increase our costs and make our products and services less attractive to customers.

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

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

Currency fluctuations may adversely affect us.

Our revenue is primarily realized in U.S. dollars and a significant portion of our operating expenses is paid in Canadian dollars. Fluctuations in the exchange rate between the U.S. dollar and the Canadian dollar may have a material effect on our business, financial condition and results from operations. In particular, we may be adversely affected by a significant weakening of the U.S. dollar against the Canadian dollar on a quarterly and an annual basis. Our policy with respect to foreign currency exposure is to manage financial exposure to certain foreign exchange fluctuations with the objective of neutralizing some of the impact of foreign currency exchange movements by entering into foreign exchange forward contracts to mitigate the exchange risk on a portion of our Canadian dollar exposure. We may not always enter into such forward contracts and such contracts may not always be available and economical for us. We do not account for these instruments as hedges in our consolidated financial statements.

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

A substantial majority of our revenues originates from online credit card transactions. Under current credit card industry practices, we are liable for fraudulent and disputed credit card transactions because we do not obtain the cardholder s signature at the time of the transaction, even though the financial institution issuing the credit card may have authorized the transaction. Under credit card association rules, penalties may be imposed at the discretion of the association. Any such potential penalties would be imposed on our credit card processor by the association. Under our contract with our processor, we are required to reimburse our processor for such penalties. Our current level of fraud protection, based on our fraudulent and disputed credit card transaction history, is within the guidelines established by the credit card associations. However, we face the risk that one or more credit card associations may, at any time, assess penalties against us or terminate our ability to accept credit card payments from customers, which would have a material adverse affect on our business, financial condition and results of operations.

Forecasting our tax rate is complex and subject to uncertainty.

We are subject to income and other taxes in a number of jurisdictions and our tax structure is subject to review by both domestic and foreign tax authorities. We must make significant assumptions, judgments and estimates to determine our current provision for income taxes, deferred tax assets and liabilities and any valuation allowance that may be recorded against our deferred tax assets. Although we believe that our estimates are reasonable, the ultimate tax outcome may differ from the amounts recorded in our financial statements and may materially affect our financial results in the period or periods for which such determination is made. Our current and future tax liabilities could be adversely affected by:

international income tax authorities, including the Canada Revenue Agency and the U.S. Internal Revenue Service, challenging the validity of our arm s-length related party transfer pricing policies or the validity of our contemporaneous documentation. Currently, we are undergoing a transfer pricing audit by the Canada Revenue Agency with respect to our 2000 and 2001 taxation years.

changes in the valuation of our deferred tax assets; or

changes in tax laws or the interpretations of such laws.

While we believe we have adequate internal control over financial reporting, we are required to evaluate our internal controls under Section 404 of the Sarbanes-Oxley Act of 2002. Any adverse results from such evaluation could result in a loss of investor confidence in our financial reports and have an adverse effect on the price of our shares of common stock.

Pursuant to Section 404 of the Sarbanes-Oxley Act of 2002, we expect that beginning with our annual report on Form 10-K for the fiscal year ended December 31, 2007, we will be required to furnish a report by management on our internal control over financial reporting. Such report will contain among other matters, an assessment of the effectiveness of our internal control over financial reporting, including a statement as to whether or not our internal control over financial reporting is effective. This assessment must include disclosure of any material weaknesses in our internal control over financial reporting identified by our management. Such report must also contain a statement that our auditors have issued an attestation report on our management s assessment of such internal controls. Public Company Accounting Oversight Board Auditing Standard No. 2 provides the professional standards and related performance guidance for auditors to attest to, and report on, our management s assessment of the effectiveness of internal control over financial reporting under Section 404.

While we believe our internal control over financial reporting is effective, we are still compiling the system and processing documentation and performing the evaluation needed to comply with Section 404, which is both costly and challenging. We cannot be certain that we will be able to complete our evaluation, testing and any required remediation in a timely fashion. During the evaluation and testing process, if we identify one or more material weaknesses in our internal control over financial reporting, we will be unable to assert that such internal control is effective. If we are unable to assert that our internal control over financial reporting is effective as of December 31, 2007 (or if our auditors are unable to attest that our management s report is fairly stated or they are unable to express an opinion on the effectiveness of our internal controls), we could lose investor confidence in the accuracy and completeness of our financial reports, which would have a material adverse effect on our stock price.

Failure to comply with the new rules may make it more difficult for us to obtain certain types of insurance, including director and officer liability insurance, and we may be forced to accept reduced policy limits and coverage and/or incur substantially higher costs to obtain the same or similar coverage. The impact of these events could also make it more difficult for us to attract and retain qualified persons to serve on our board of directors, on committees of our board of directors, or as executive officers.

New accounting pronouncements may require us to change the way in which we account for our operational or business activities.

The Financial Accounting Standards Board, FASB, and other bodies that have jurisdiction over the form and content of our accounts are constantly discussing proposals designed to ensure that companies best display relevant and transparent information relating to their respective businesses. The effect of the pronouncements of FASB and other bodies may have the effect of requiring us to account for revenues and/or expenses in a different manner than at present. In particular, in fiscal 2006, FASB will require us to expense the fair value of stock options, resulting in increased expenses in our income statement and a reduction of our net income and earnings per share. The impact of applying a fair value method of accounting for stock options on a pro-forma basis in accordance with SFAS No. 123 is disclosed in Note 2 to the audited consolidated financial statements.

We could suffer uninsured losses.

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

Current world events and economic trends may have a negative impact on our sales.

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

Our quarterly and annual operating results may fluctuate and our future revenues and profitability are uncertain.

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

our ability to maintain revenue growth at current levels or anticipate a decline in revenue from any of our services;

our ability to identify and develop new technologies or services and to commercialize those technologies into new services in a timely manner;

the mix of our services sold during the quarter or year;

our ability to make appropriate decisions which will position us to achieve further growth;

changes in our pricing policies or those of our competitors and other competitive pressures on selling prices;

our ability to identify, hire, train, motivate and retain highly qualified personnel, and to achieve targeted productivity levels;

market acceptance of Internet services generally and of new and enhanced versions of our services in particular;

our ability to establish and maintain a competitive advantage;

the continued development of our global distribution channel and our ability to compete in multiple countries successfully as part of our sales and marketing strategy;

the number and significance of service enhancements and new service and technology announcements by our competitors;

our ability to identify, develop, deliver, and introduce in a timely manner new and enhanced versions of our current service offerings that anticipate market demand and address customer needs;

changes in foreign currency exchange rates and issues relating to the conversion to the Canadian dollar;

foreign, federal or state regulation affecting our business;

our ability to continue to attract users to our website;

our ability to attract software developers to participate in our Author Resource Center;

our ability to continue to attract advertisers to place content on our website

interruptions in our services;

seasonality of the markets and businesses of our customers;

news relating to our industry as a whole;

our ability to enforce our intellectual property rights;

our ability to manage internet fraud and information theft; and

changes in methods used for the accounting of stock options.

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

Risks Related To the Internet and Our Technology

Our business could be materially harmed if the administration and operation of the Internet no longer rely upon the existing domain system.

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

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

Our 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; 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 our growth and revenues.

We may be unable to respond to the rapid technological changes in the industry, and our 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 our applications, services and systems obsolete. The emerging nature of applications and services in the Internet application and services industry and their rapid evolution will require that we continually improve the performance, features and reliability of our applications and services. Our success will depend, in part, on our ability:

to develop and license new applications, services and technologies that address the increasingly sophisticated and varied needs of our 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. We may be unable to use new technologies effectively or adapt our 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 us to incur significant additional capital expenditures.

We could experience system failures and capacity constraints which would cause interruptions in our services and ultimately cause us to lose customers.

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

an increase in the traffic on our websites that outstrips our 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;

- failure or inability to upgrade technical infrastructure to handle unexpected surges in customer levels and increases in customers usage of bandwidth;

- failure of third-party bandwidth providers to maintain the services they supply to us; and

- failure of infrastructure providers such as electricity providers.

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.

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

Our 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. We may need to expend significant capital and 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 our websites and the web pages that deliver our content services. Repeated or substantial interruptions could result in the loss of customers and reduced revenues.

Users might circumvent the measures we take to protect customers private and confidential information, such as credit card numbers. Security breaches could damage our reputation and expose us 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. We may also incur significant costs to protect against security breaches or to alleviate problems caused by these breaches. In addition, the Federal Trade Commission in the United States and state agencies have investigated various Internet companies regarding their use of personal information. The federal government has enacted legislation protecting the privacy of consumers nonpublic personal information. We cannot guarantee that our current information-collection procedures and disclosure policies will be found to be in compliance with existing or future laws or regulations. Our failure to comply with existing laws, including those of foreign countries, the adoption of new laws or regulations regarding the use of personal information that require us to change the way we conduct business or an investigation of our privacy practices, could increase the costs of operating our business.

Lack of consumer confidence in the security of on-line financial transactions could negatively impact our business.

Consumers may not adopt online services if they are not confident that financial transactions over the Internet can be undertaken securely and confidentially. Although there is security technology currently available for online transactions, many Internet users may not use the Internet for commercial transactions because of security concerns. These concerns may be heightened by well-publicized security breaches of any Internet-related service, which could deter consumers from using our services provided by our solution. If consumers do not have confidence in the security for online services transactions that the current technologies provide, our revenue will not increase and may decrease.

We may be accused of intellectual property infringement of the technology we have employed to support both our back end platform and the products and services we offer to and through our Service Providers and may be sued for damages caused by actual use of the platforms or products and services and we may be required to pay substantial damage awards.

We seek to ensure that we have licensed or otherwise secured the necessary rights to use and offer for use all intellectual property relating to our platforms and the services we offer Service Providers through the platforms. Despite our efforts, we may be sued by third parties claiming rights in and to the technology we employ or by third parties who claim to have suffered as a result of any use, or inability to use, the platforms, products and services. If we are sued, defense of any such claims may require the resources of both our time and money. If a third-party is successful in its assertions, we may be required to pay damages that may have a material impact on our financial resources.

Governmental and Regulatory Risks

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

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

the U.S. or any other government may reassess its decision to introduce competition into, or ICANN s role in overseeing, the domain registration market;

the Internet community or the U.S. Department of Commerce or U.S. Congress may refuse to recognize ICANN s authority or support its policies, which could create instability in the domain registration system;

ICANN may lose any one of the several claims pending against it in both the U.S. and international courts, in which case its credibility may suffer and its policies may be discredited;

ICANN may attempt to impose additional fees on registrars if it fails to obtain funding sufficient to run its operations;

the terms of the registrar accreditation process could change in ways that are disadvantageous to us; and

international regulatory bodies, such as the International Telecommunications Union or the European Union, may gain increased influence over the management and regulation of the domain registration system, leading to increased regulation in areas such as taxation and privacy.

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

If any of these events occur, they could create instability in the domain registration system. These events could also disrupt or suspend portions of our domain registration solution, which would result in reduced revenue.

We may be subject to government regulation that may be costly and may interfere with our ability to conduct business.

Although transmission of our websites primarily originates in Canada and the United States, the Internet is global in nature. Governments of foreign countries might try to regulate our transmissions or prosecute us 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, with respect to:

- user privacy;
- children;
- copyrights and other intellectual property rights and infringement;
- domains;
- 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, if enacted, could expose us to substantial liability and increase our costs of compliance and doing business.

Risks Related to our Stock

We do not intend to declare dividends on our common stock in the foreseeable future.

We anticipate that for the foreseeable future, our earnings, if any, will be retained for use in the business and that no cash dividends will be paid on our common stock. Declaration of dividends on our common stock will depend upon, among other things, future earnings, our operating and financial condition, our capital requirements and general business conditions

We are controlled by a limited number of principal shareholders, which may limit your ability to influence corporate matters.

As of September 30, 2005, our five principal shareholders beneficially own approximately 39% of our shares of common stock. These shareholders could control the outcome of any corporate transaction or other matter submitted to our shareholders for approval, including mergers, consolidations and the sale of all or substantially all of our assets, and also could prevent or cause a change in control. The interests of these shareholders may conflict with the interests of our other shareholders.

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

Our share price is volatile, which may make it difficult for shareholders to sell their shares of common stock when they want to, at an attractive price.

Our share price has varied recently and the price of our common stock may decrease in the future, regardless of our operating performance. Investors may be unable to resell their 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 our quarterly operating results;

interruptions in our services;

seasonality of the markets and businesses of our customers;

announcements of new technologies or new services by our company or our competitors;

our ability to accurately select appropriate business models and strategies;

the impact that terrorist acts or military action may have on global economic conditions and the impact that this will have on our customers or business;

the operating and stock price performance of other companies that investors may view as comparable to us;

news relating to our industry as a whole; and

news relating to trends in our markets.

The stock market in general, and the market for Internet-related companies in particular, including our company, 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 our shares of common stock to drop, regardless of our performance.

Future sales of shares of common stock by our existing shareholders could cause our share price to fall.

If our shareholders sell substantial amounts of shares of common stock in the public market, the market price of the shares of common stock could fall. The perception among investors that these sales will occur could also produce this effect.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Our services are developed in and are sold primarily from North America. Our sales are primarily made in United States dollars, while a major portion of expenses are incurred in Canadian dollars. Our financial results could be affected by factors such as changes in foreign currency exchange rates or weak economic conditions in foreign markets. Our interest income is sensitive to changes in the general level of Canadian and U.S. interest rates, particularly since the majority of our investments are in short-term instruments. Based on the nature of its short-term investments, we have concluded that there is no material interest rate risk exposure at September 30, 2005.

Although we have a functional currency of U.S. dollars, a substantial portion of our fixed expenses are incurred in Canadian dollars. Our 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. We will continue to regularly assess if we should enter into additional forward exchange contracts to offset the risk associated with the effects of Canadian dollar to US dollar transaction exposures. We do not use forward contracts for trading purposes.

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

The impact of the foreign exchange forward contracts for the nine months ended September 30, 2005 was a net gain of approximately $183,000, and for the nine months ended September 30, 2004, the impact was a net gain of approximately $189,000, which is reflected on the consolidated statements of operations in general and administrative expenses.

We have performed a sensitivity analysis model for foreign exchange exposure over the three months ended September 30, 2005. The analysis used a modeling technique that compares the U.S. dollar equivalent of all expenses incurred in Canadian dollars, at the actual exchange rate, to a hypothetical 10% adverse movement in the foreign currency exchange rates, with all other variables held constant. Foreign currency exchange rates used were based on the market rates in effect during the three months ended September 30, 2005. The sensitivity analysis indicated that a hypothetical 10% adverse movement in foreign currency exchange rates would result in a decrease in net income for the three months ended September 30, 2005 of approximately $320,000. There can be no assurances that the above projected exchange rate decrease will materialize. Fluctuations of exchange rates are beyond our control. We will continue to monitor and assess the risk associated with these exposures and may at some point in the future take actions to hedge or mitigate these risks. There is no assurance that any strategy will be successful in avoiding losses due to exchange fluctuations, or that the failure to manage currency risks effectively would not have a material effect on our results of operations.

Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness our disclosure controls and procedures as of the end of the period covered by this report. Based on that evaluation, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures as of the end of the period covered by this report are functioning effectively to provide reasonable assurance that the information required to be disclosed by us in reports filed under the Securities Exchange Act of 1934 is (i) recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms and (ii) accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate, to allow timely decisions regarding disclosure. We believe that a controls system, no matter how well designed and operated, cannot provide absolute assurance that the objectives of the controls system are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected.

(b) Change in Internal Control over Financial Reporting

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

PART II.

OTHER INFORMATION

Item 1. Legal Proceedings

We are involved in various investigations, claims and lawsuits arising in the normal conduct of our business, none of which, in our opinion, will harm our business. We cannot assure that we will prevail in any litigation. Regardless of the outcome, any litigation may require us to incur significant litigation expense and may result in significant diversion of our attention.

Item 6. Exhibits

(a) Exhibits.

Exhibit No.	Description
10.1	Registrar Accreditation Agreement effective as of June 25, 2005 by and between the Internet Corporation for Assigned Names and Numbers and Tucows.com Co. (Incorporated by reference to Exhibit 10.12 filed with the registration statement on Form S-1 of Tucows Inc. (File No. 333-125843)).
10.2	Consulting Agreement, dated as of February 1, 2005, between Tucows.com Co. and Eugene Fiume (Incorporated by reference to Exhibit 10.1 filed with Tucows current report on Form 8-K, as filed with the SEC on September 27, 2005)
31.1	Chief Executive Officer s Rule 13a-14(a)/15d-14(a) Certification
31.2	Chief Financial Officer s Rule 13a-14(a)/15d-14(a) Certification
32.1	Chief Executive Officer s Section 1350 Certification
32.2	Chief Financial Officer s Section 1350 Certification

SIGNATURES

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

Date: November 10, 2005	TUCOWS INC.	
	By:	/s/ Elliot Noss Elliot Noss Chief Executive Officer
	By:	/s/ Michael Cooperman Michael Cooperman Chief Financial Officer (Principal Financial and Accounting Officer)

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