

PEER 1 NETWORK ENTERPRISES INC. MANAGEMENT DISCUSSION & ANALYSIS FOR THE SIX MONTHS ENDED DECEMBER 31, 2005

This Management Discussion and Analysis (“MD&A”), dated March 1, 2006, should be read in conjunction with Peer1’s unaudited first quarter statements, as well as the audited annual financial statements for the fiscal year ended June 30, 2005 and the notes thereto. All figures noted are in United States dollars.

FORWARD LOOKING STATEMENTS

This discussion includes certain forward looking statements in respect to various issues including upcoming events. These forward looking statements are based upon current expectations which involve risks and uncertainties that could cause actual outcomes and results to differ materially. Factors that could cause or contribute to such differences include, but are not limited to, general economic conditions, changes in technology, general sales risks, and limited intellectual property protection. Other risks and uncertainties are described in a subsequent section of this filing. Peer 1 Network Enterprises Inc. (“the company”) disclaims any obligation to revise any forward looking statements as a result of information received after the fact or regarding future events.

PEER 1 NETWORK ENTERPRISES OVERVIEW

Quarterly Highlights

- Effective October 1, 2005, the company changed its reporting currency to the U.S. dollar from the Canadian Dollar to better align its reporting currency with the currency of the majority of its revenue and expenses. After giving effect to the Interland acquisition, approximately 73% of the Company’s revenue and 68% of its expenses derive from the United States. All figures presented prior to October 1, 2005 for comparative purposes are also reported in U.S. dollars.
- Revenue of Peer 1 for the three months ended December 31, 2005 was \$16.29 million, compared to \$4.66 million for the three month period ended December 31, 2004, representing a 249% increase.
- Operating profit was \$1.31 million for the three months ended December 31, 2005 an increase of \$1.42 million from the operating loss of \$0.11 million for the three months ended December 31, 2004.
- Cash flow from operations for the three months ended December 31, 2005 was \$4.7 million, compared to \$1.9 million for the three month period ended December 31, 2004.
- Lance Tracey replaced Geoff Hampson as the company’s Chief Executive Office and President during the period, and a newly created position of Executive Vice President was added to help manage a significantly larger business the company now operates.

LINES OF BUSINESS

Peer 1 Network Enterprises Inc. ("Peer 1") is a Internet infrastructure solutions company, providing bandwidth, co-location, and dedicated hosting services to customers requiring 100% uptime for their online presence. Customers include hosting providers, online gaming companies and Internet phone (VoIP) companies. Building on a redundant, Cisco powered internal network, Peer 1 guarantees its customers internet access. The company has established local offices and data centres in Vancouver, Toronto, Montreal, New York, Seattle, San Jose, San Antonio, Los Angeles, Miami, Atlanta, Fremont, CA and Herndon VA and also has points of presence (POPs) in the USA in Ashburn VA, Chicago and in the UK in London.

Bandwidth

Peer 1's bandwidth service is provided by way of an expandable network which is connected to multiple globally based providers in Canada, the US and the UK and which utilizes hundreds of peering partners to ensure continuous internet connectivity, greater route diversity, and ultimately, enhanced internet performance. Traffic generated from and received by our customers is charged for on a per unit basis, except for those who have committed to minimum usage levels.

Colocation

The co-location service provided by Peer 1 involves the physical locating of a customer's switching gear or servers in one of the dedicated facilities operated by Peer 1, which is designed to provide the infrastructure necessary for the functioning of that equipment. Included in the required infrastructure would be such resources as a secured cage or cabinet, regulated power, emergency backup power, dedicated Internet connection, regulated air temperature and security.

The major benefits of co-location with Peer 1 are:

- Significantly reduced costs of staff, facilities and hardware
- Reduced configuration and management issues
- Access to a high bandwidth, high quality IP network
- 24 hours, 7 days a week monitoring
- An environmentally protected facility
- High level of physical security

Colocation customers are charged for the service provided by way of a monthly rental charge. Colocation sales are measured in units, with each unit equal to one eighth of a full cabinet.

Dedicated Servers

In addition to its colocation and bandwidth business, Peer 1 offers through its subsidiaries, ServerBeach and Peer 1 Dedicated Hosting, self-managed, competitively priced dedicated server solutions to small and mid-size businesses, and technology hobbyists. During the first quarter ended September 30, 2005 with the acquisition of the dedicated server assets of Interland (operated as Peer 1 Dedicated Hosting), the company has significantly increased its capacity in providing dedicated server solutions and product offerings to complement the company's colocation and bandwidth business.

STRATEGY

Peer 1's management is implementing a three-level growth strategy initiative. The three elements of the strategy initiative are organic growth, leveraged growth, and accelerated growth. The organic growth strategy seeks to add more customers and expand the network's reach into key peering points worldwide. The leveraged growth strategy seeks growth by introducing new products and services that leverage the infrastructure that Peer 1 already has. Peer 1's accelerated growth strategy focuses on actively pursuing acquisitions that are accretive to Peer 1.

Network

Peer 1 has built a series of dedicated links between all of Peer 1's facilities using multiple high-speed connections. Hundreds of peering relationships and traffic exchange agreements have been established with other networks. The peering arrangements are fundamental to the company's strategy. Peering is a relationship between two or more networks of any size in which the networks create a direct link between each other and agree to forward each other's packets directly across this link instead of using the standard Internet backbone. This has two main advantages: first, it reduces latency between the two networks; and secondly, it avoids additional costs associated with a third party network.

Colocation Facilities

Peer 1's strategy is to establish a point of presence in a new market by collocating in facilities owned by other suppliers, in order to gauge market demand, prior to making a decision to open up a new colocation facility. When a market is deemed to be viable, the company identifies suitable space for long term lease. Wherever possible, sites that have previously been operated as data centres are sought, since this reduces the initial capital investment required. All equipment is acquired and installed on a phased basis, again to reduce the capital investment required. As market share grows, additional equipment is acquired.

Dedicated Servers

The strategy for Peer 1's ServerBeach brand of unmanaged dedicated servers is to provide servers built with quality parts at the lowest possible cost. By using automated provisioning and billing processes and leveraging the existing network, the company has been able to maintain a quality, low cost structure that supports the price competitive

strategy. The company continues to build on its position in the dedicated server market and is currently integrating the dedicated server assets purchased through the recent Interland acquisition (Peer 1 Dedicated Hosting)..

SECOND QUARTER INFORMATION

Segmented Information

Due to the impact of the acquisition of ServerBeach and Peer 1 Dedicated Hosting on the results of operation and financial position, the following additional financial information is provided to facilitate comparisons to previous periods.

Peer 1 Network Enterprises, Inc. Segmented Balance Sheet As At December 31, 2005 (unaudited - prepared by management)					
	Peer 1 Network 12/31/2005 (US\$)	ServerBeach 12/31/2005 (US\$)	Peer 1 Dedicated* 12/31/2005 (US\$)	Total 12/31/2005 (US\$)	Peer 1 Network and ServerBeach 6/30/2005 (US\$)
Assets					
Current:					
Cash and cash equivalents	515,581	1,650,905	4,318,403	6,484,889	792,071
Accounts receivable	3,558,009	76,493	602,693	4,237,195	2,441,645
Inventory	-	193,281	-	193,281	83,901
Prepaid expenses	563,862	30,671	784,016	1,378,549	386,749
	4,637,452	1,951,350	5,705,112	12,293,914	3,704,366
Intercompany	23,448,494	(8,247,471)	(15,201,023)	-	-
Other assets	3,598,557	-	-	3,598,557	1,029,980
Property, plant and equipment	8,725,167	3,003,471	14,208,300	25,936,938	10,135,257
Goodwill, licences and other intangibles	-	4,214,261	1,059,845	5,274,106	4,686,915
	40,409,670	921,611	5,772,234	47,103,515	19,556,518
Liabilities					
Current Liabilities					
Accounts payable and accrued liabilities	3,618,854	805,386	2,960,729	7,384,969	4,594,231
Deferred revenue	855,180	512,461	1,728,292	3,095,933	1,139,387
Current portion of deferred lease inducements	65,524	-	-	65,524	48,941
Current portion of notes payable	3,486,064	-	-	3,486,064	10,992,067
Shareholder notes	-	-	-	-	2,249,629
	8,025,622	1,317,847	4,689,021	14,032,490	19,024,255
Deferred lease inducements	459,809	-	-	459,809	314,048
Notes Payable	19,334,784	-	-	19,334,784	94,701
Long Term Debt	7,403,113	-	-	7,403,113	-
	35,223,328	1,317,847	4,689,021	41,230,196	19,433,004
Shareholders' Equity (Deficiency)					
Common Shares	14,246,231	-	-	14,246,231	7,827,875
Warrants	975,183	-	-	975,183	-
Contributed Surplus	647,519	-	-	647,519	465,996
Equity component of convertible debt	-	-	-	-	325,595
Retained Earnings (Deficit)	(10,706,888)	(396,236)	1,083,213	(10,019,911)	(8,520,249)
Cumulative Translation Adjustment	24,297	-	-	24,297	24,297
	5,186,342	(396,236)	1,083,213	5,873,319	123,514
	40,409,670	921,611	5,772,234	47,103,515	19,556,518

* Refers to the dedicated server business acquired from Interland Inc.

Peer 1 Network Enterprises, Inc. Segmented Income Statement Three Months Ended December 31 (unaudited - prepared by management)					
	Three Months Ended December 31, 2005 Peer 1	Three Months Ended December 31, 2005 ServerBeach	Three Months Ended December 31, 2005 Peer1 Dedicated*	Three Months Ended December 31, 2005 Total	Three Months Ended December 31, 2004 Peer 1 & ServerBeach
Revenue	4,450,152	3,177,583	8,658,965	16,286,700	4,664,046
Cost of Sales	2,567,182	1,793,720	6,041,423	10,402,325	2,896,297
Gross Profit	1,882,970	1,383,863	2,617,542	5,884,375	1,767,749
Operating expenses	2,603,710	562,398	1,407,653	4,573,761	1,874,250
Operating profit (loss)	(720,740)	821,465	1,209,889	1,310,614	(106,501)
Amortization of licences	-	236,327	-	236,327	-
Amortization of preferred share discount	260,565	-	-	260,565	-
Interest expense	1,041,378	-	-	1,041,378	361,189
Interest accretion on convertible debt	63,836	-	-	63,836	75,874
Integration costs	-	-	365,125	365,125	-
Realized foreign exchange loss (gain)	(4,691)	-	-	(4,691)	5,757
Unrealized foreign exchange loss (gain)	(170,301)	-	-	(170,301)	(413,368)
Loss from equity accounted investment	-	-	-	-	-
Income (loss) before income taxes	(1,911,527)	585,138	844,764	(481,625)	(135,953)
Provision for income taxes	-	-	-	-	10,446
Income (loss) for the period	(1,911,527)	585,138	844,764	(481,625)	(146,399)
Deficit, beginning of period	(8,795,362)	(981,374)	238,449	(9,538,287)	(6,307,329)
Deficit, end of period	(10,706,889)	(396,236)	1,083,213	(10,019,912)	(6,453,728)
EBITDA	(182,644)	1,231,064	2,167,192	3,215,612	188,089
Normalized EBITDA	(182,644)	1,231,064	2,532,317	3,580,737	188,089

* Refers to the dedicated server business acquired from Interland Inc.

Peer 1 Network Enterprises, Inc. Segmented Income Statement Year To Date (unaudited - prepared by management)					
	Six Months Ended December 31, 2005 Peer 1	Six Months Ended December 31, 2005 ServerBeach	Six Months Ended December 31, 2005 Peer1 Dedicated*	Six Months Ended December 31, 2005 Total	Six Months Ended December 31, 2004 Peer 1 & ServerBeach
Revenue	8,550,512	5,853,895	11,560,572	25,964,979	7,555,823
Cost of Sales	5,066,676	3,200,602	8,094,903	16,362,181	4,698,330
Gross Profit	3,483,836	2,653,293	3,465,669	9,602,798	2,857,493
Operating expenses	3,941,167	1,069,613	1,949,768	6,960,547	3,013,971
Operating profit (loss)	(457,331)	1,583,680	1,515,901	2,642,251	(156,478)
Amortization of licences	-	472,654	-	472,654	-
Amortization of preferred share discount	404,792	-	-	404,792	-
Interest expense	1,458,318	610,411	-	2,068,729	484,167
Interest accretion on convertible debt	541,460	-	-	541,460	146,726
Integration of ServerBeach & Peer 1 Dedicated	-	-	432,688	432,688	-
Realized foreign exchange loss (gain)	(42,521)	-	-	(42,521)	381
Unrealized foreign exchange loss (gain)	250,997	-	-	250,997	(413,368)
Loss from investment accounted for on an equity basis	13,114	-	-	13,114	-
Income (loss) before income taxes	(3,083,491)	500,615	1,083,213	(1,499,662)	(374,384)
Provision for income taxes	-	-	-	-	10,446
Income (loss) for the period	(3,083,491)	500,615	1,083,213	(1,499,662)	(384,830)
Deficit, beginning of period	(7,623,398)	(896,851)	-	(8,520,249)	(6,068,898)
Deficit, end of period	(10,706,889)	(396,236)	1,083,213	(10,019,911)	(6,453,728)
EBITDA	485,852	2,378,094	2,883,683	5,747,629	867,650
Normalized EBITDA	485,852	2,378,094	3,316,371	6,180,317	867,650

* Refers to the dedicated server business acquired from Interland Inc.

Peer 1 Network Enterprises, Inc. EBITDA Reconciliation Three Months Ended December 31 (unaudited - prepared by management)					
	Three Months Ended December 31, 2005 Peer 1	Three Months Ended December 31, 2005 ServerBeach	Three Months Ended December 31, 2005 Peer1 Dedicated*	Three Months Ended December 31, 2005 Total	Three Months Ended December 31, 2004 Peer 1
Net Profit (Loss)	(1,911,527)	585,138	844,764	(481,625)	(146,399)
Interest Expense	1,105,214	-	-	1,105,214	290,337
Amortization - fixed assets and deferred network costs	379,266	409,599	1,322,428	2,111,293	457,519
Amortization - preferred share discount	260,565	-	-	260,565	-
Amortization - licence fees	-	236,327	-	236,327	-
Stock-based compensation expense	154,139	-	-	154,139	-
Loss from equity accounted investment	-	-	-	-	-
Unrealized FX gains/losses	(170,301)	-	-	(170,301)	(413,368)
EBITDA	(182,644)	1,231,064	2,167,192	3,215,612	188,089
Integration Costs	-	-	365,125	365,125	-
Normalized EBITDA	(182,644)	1,231,064	2,532,317	3,580,737	188,089

* Refers to the dedicated server business acquired from Interland Inc.

Peer 1 Network Enterprises, Inc. EBITDA Reconciliation Year To Date (unaudited - prepared by management)					
	Six Months Ended December 31, 2005 Peer 1	Six Months Ended December 31, 2005 ServerBeach	Six Months Ended December 31, 2005 Peer1 Dedicated*	Six Months Ended December 31, 2005 Total	Six Months Ended December 31, 2004 Peer 1
Net Profit (Loss)	(3,083,491)	500,615	1,083,213	(1,499,663)	(384,830)
Interest Expense	1,999,778	610,411	-	2,610,189	484,167
Amortization - fixed assets and deferred network costs	720,958	794,414	1,800,470	3,315,842	652,240
Amortization - preferred share discount	404,792	-	-	404,792	-
Amortization - licence fees	-	472,654	-	472,654	-
Stock-based compensation expense	179,704	-	-	179,704	-
Loss from equity accounted investment	13,114	-	-	13,114	-
Unrealized FX gains/losses	250,997	-	-	250,997	(413,368)
EBITDA	485,852	2,378,094	2,883,683	5,747,629	338,209
Integration Costs	-	-	432,688	432,688	-
Normalized EBITDA	485,852	2,378,094	3,316,371	6,180,317	338,209

* Refers to the dedicated server business acquired from Interland Inc.

Overall Performance

Selected Measures of Financial Position	December 2005	June 2005	June 2004
Cash (including restricted cash)	\$6,484,889	\$792,071	\$797,297
Total Assets	\$47,103,515	\$19,556,518	\$7,768,087
Working Capital	\$-1,738,576	\$-15,319,889	\$-969,663
Long Term Financial Liabilities	\$26,737,897	\$94,701	\$2,709,200
Share Capital	\$14,246,231	\$7,827,875	\$6,720,939
Shareholders' Equity	\$5,873,319	\$123,514	\$1,173,317

The company's revenue, operating profit and cash flow during its second quarter ended December 31, 2005 increased significantly to \$16.29 million, \$1.31 million and \$4.70 million respectively, attributable mostly to the acquisitions during the last year of the Dedicated Hosting business and the Server Beach dedicated hosting business.

Selected Measures of Operations	YTD Q2 FY2006	YTD Q2 FY2005	YTD Q2 FY2004
Total Revenue	\$25,964,979	\$7,555,823	\$2,858,437
Gross Margin	37.0%	37.9%	16.8%
Net Loss	\$1,499,662	\$384,830	\$1,176,446

RESULTS OF OPERATIONS

Revenues

The company's business model is primarily based on recurring revenue streams from its customer base. The recurring revenue is based on the premise that once a customer is obtained the revenue from services and product offerings which are invoiced monthly generally continue on a go forward basis. Customer's contracts range from a month-to-month to three year basis.

73% of the revenue this quarter was generated from dedicated servers, with revenues from colocation and bandwidth sales accounting for the balance. Revenue from dedicated servers has increased from 56% in the previous quarter, due to the full three months of Peer 1 Dedicated Hosting revenue.

Colocation and Bandwidth

Colocation revenues for the three months ended December 31, 2005 was \$1.93 million, compared to \$1.33 for the three months ended December 31, 2004 of an increase of 45%. The increase is directly attributable to growth in the customer base - the number of colocation customers increased from 734 at December 31, 2004 to 902 at December 31, 2005. Colocation revenues for the six months ended December 31, 2005 totaled \$3.67 million compared to \$2.50 million for the six months ended December 31, 2004, an increase of 47%

Bandwidth revenues for the three months ended December 31, 2005 was \$2.05 million, compared to \$1.75 for the three months ended December 31, 2004 of an increase of 17%. Bandwidth revenues for the six months ended December 31, 2005 totaled \$3.99 million compared to \$3.29 million for the the six months ended December 31, 2004, an increase of 21%

Canadian operations accounted for 25% of revenues (\$6.55 million of \$25.96 million) in the six month period ended December 31, 2005, compared to 87% of revenues (in the six month period ended December 31, 2004 (\$6.59 million of \$7.55 million) this significant change is the result of the impact of the two dedicated server businesses acquired in the US.

US colocation and bandwidth operations accounted for 23% of revenues (\$1.99 million of \$8.55 million) in the six month period ended December 31, 2005, compared to 17% of revenues (in the six month period ended December 31, 2004 (\$1.06 million of \$6.28 million) indicating that sales at the US locations continue to grow as a percentage of colocation and bandwidth line of business revenue..

The company continues to monitor capacity utilization closely, in order to ensure that anticipated growth is not adversely affected by a lack of available space.

Dedicated Servers

Revenue in the second quarter of fiscal 2006 attributable to the company's dedicated server business amounted to \$11.84 million, up from \$5.58 million in the previous quarter as indicated earlier this is largely due to a full quarter of revenue from Peer 1 Dedicated Hosting which accounts for \$8.66 million or 73% of the total dedicated server revenue.

The ServerBeach business continues to grow at a rapid pace, revenues increased 19% for the three month period ended December 31, 2005 when compared to the three month period ended September 30, 2005.

Cost of Sales

Cost of sales for the company are primarily are fixed due to the fact that most of the costs are related to infrastructure and staffing. These infrastructure costs consist of rent, maintenance, power, cooling, security, amortization of equipment and improvements, insurance, and supplies. Variable costs consist of power consumption, and incremental bandwidth from upstream carriers.

The cost of sales for colocation for the second quarter of fiscal 2006 has increased compared to the same period for fiscal 2005 as a result of the addition of new colocation facilities. As new facilities are added, cost of sales increases, largely as a result of fixed rental costs. The pattern of growth in revenues related to the new facilities does not match the pattern of growth in the related costs as the revenue increases are not fixed but rather result from capacity utilization increases.

Bandwidth cost of sales has increased only slightly for the current quarter compared to the same period last year as a result of the company's ability to reduce bandwidth cost per unit by committing to and using larger traffic volumes. Additionally, the company has increased its use of peering connections during the current quarter as compared to the same period last fiscal year.

The cost of sales related to the dedicated server line of business is primarily affected by the costs of facilities, costs of servers and bandwidth costs.

Operating Expenses

The largest component of operating expenses is salaries and wages which, in the second quarter of fiscal 2006 comprise approximately 34% of the total, compared with

43% of total operating expenses in the comparable quarter of the prior fiscal year. The decrease is due to efficiency of headcount required to operate the business.

Rent and administration costs make up the next most significant component at 17% of total operating costs for the second quarter of fiscal 2006 which is largely unchanged from the same period in fiscal 2005. Management continues to focus on administration costs to ensure that operations are as efficient as possible. No major changes are anticipated for the costs in this category and it is anticipated that they will be reduced over time as a percentage of revenue.

Travel costs are 6% of total operating expenses for the quarter compared to 11% for the same period in fiscal 2005.

Professional fees account for 8% of total costs this quarter, compared to 4% for the same period in FY2005, an increase which is attributable legal fees related to the Dedicated Hosting business. The company expects the costs in this category to decrease to around 5% in future quarters.

The company is currently incurring expenses related to the integration of Peer 1 Dedicated Hosting and anticipates expenses for these activities to recur through calendar year 2006 with a current forecast to December 2006 of \$1.45 million

The complexity of the accounting for the preferred shares merits some additional explanation as provided below, please note that the US \$7,000,000 preferred shares have been classified as debt since, under Canadian GAAP, the holders' option to redeem the shares for cash classifies the financial instruments issued as debt rather than equity. Consequently, the 8% dividend payable under the terms of the preferred share issue is considered to be interest expense, and not a distribution of income. The conversion provisions of the preferred shares have also been given value, as the instrument is considered to be debt rather than equity. Accordingly, because the redemption price is at twice the face value of the preferred shares, and because there is value ascribed to the conversion rights, the total terminal debt or redemption amount of 2 x \$7,000,000 or \$14,000,000 gets initially recorded on the balance sheet as a net amount, that is net of the \$7,000,000 discount, and net of the amount ascribed to the conversion feature (\$454,390). That is, since we received \$7,000,000 for a debt amount that will be worth \$14,000,000 in four years, we must record this discount and amortize it over 4 years.

SUMMARY OF QUARTERLY RESULTS

	Quarter Ended							
	March 31 2004 (US\$)	June 30 2004 (US\$)	September 30 2004 (US\$)	December 31 2004 (US\$)	March 31 2005 (US\$)	June 30 2005 (US\$)	Sept 30 2005 (US\$)	December 31 2005 (US\$)
Revenue	2,720,853	2,934,536	2,891,777	4,664,046	5,842,807	6,005,862	9,678,279	16,286,700
Operating Profit (Loss)	125,353	(51,580)	(49,971)	(106,500)	545,373	572,014	1,331,636	1,310,615
Net Income (Loss)	4,776	(195,978)	(238,431)	(146,399)	(947,000)	(692,813)	(1,018,038)	(481,623)
Pro forma basic and fully diluted income (loss) per share	-	-	(0.01)	-	(0.02)	(0.02)	(0.02)	(0.01)
EBITDA	337,573	99,648	150,120	188,089	1,248,986	1,038,989	2,599,580	3,580,737

LIQUIDITY AND CAPITAL RESOURCES

As of December 31, 2005 the company had cash and cash equivalents balance of \$6.5 million. As noted below in the OFF-BALANCE SHEET ARRANGEMENTS section this includes US\$500,000 of restricted funds which have been set aside as security for letters of credit. The company had a working capital deficit of \$1.7 million at the end of the quarter compared to a working capital deficit of \$15.3 million as at June 30, 2005. Included in the working capital deficit for the second quarter of fiscal 2006 is \$3.1 million for deferred revenue, this amount relates to the provision of services rather than the expected use of cash. If this item is excluded from the calculation, the working capital would be \$1.4 million.

Operating Activities

Operating activities, prior to consideration of the change in working capital balances, for the three and six months ended December 31, 2005 generated over twelve times more cash than in the same periods in FY 2005. This is primarily due to the increase in revenues exceeding the commensurate increase in cash based expenses

Investing Activities

Investing activities during the three and six months ended December 31, reflect the ongoing capital investment required in a rapidly growing business.

Continued investment in equipment and facilities for the colocation and bandwidth segment of the business, and for equipment for the dedicated server segment will be required to the end of the fiscal year.

Financing Activities

During the first quarter of fiscal 2006, a refinancing of the company was completed to address liquidity concerns and the need to increase the capitalization of the company. This process involved several steps, as outlined below:

- Extension of the maturity date of the loan that was used to finance the ServerBeach acquisition. The company exercised a six month renewal option,

and extended the maturity of the US\$7,500,000 bridge loan to December 31, 2005. The transaction fee associated with the renewal was US\$400,000, which was satisfied by issuing 1,538,625 shares at a price of \$0.32 per share. On September 2, 2005, this loan was repaid from the proceeds of the loan from Fortress Credit Corp. described below.

- On July 18, 2005 the Company closed a US\$2.0 million loan with companies controlled by directors. On September 2, 2005, this loan was repaid from the proceeds of the loan from Fortress Credit Corp. described below.

In connection with the Interland acquisition described below, the company completed on September 2, 2005 a US\$35 million loan agreement with Fortress Credit Corp., of which US\$24 million has been advanced. The loan agreement (the "LSA") is by and among Peer 1 (USA), Inc. and each of its subsidiaries that are signatories thereto as borrowers (the "Borrowers"), the company and each of its subsidiaries that are signatories thereto as guarantors (the "Guarantors"), and Fortress Credit Corp. ("Fortress") as the lender, arranger and administrative agent.

Pursuant to the LSA, Fortress agreed to make three loan facilities available to the Borrowers: a term loan which was advanced on September 2, 2005 in the amount of US\$24 million; a term loan (the "Incremental Term Loan") of up to US\$4 million (less if certain cash flow criteria specified in the LSA are not satisfied) and a revolving loan (the "Revolving Facility") of up to US\$7 million until September 2, 2008 and US\$10 million thereafter until September 2, 2010 if the maturity date is extended by the Company for two years in accordance with the terms of the LSA.

The obligation of the Lender to make the Incremental Term Loan is subject to certain conditions precedents which have not yet been satisfied, including the provision of additional security for the obligations of the Borrowers under the LSA and a requirement that the request for such loan is made on or before November 22, 2005.

The obligation of the lender to make the Revolving Facility is subject to certain conditions, including that no advance shall be made:

- (a) that would result in the aggregate borrowings under the LSA exceeding US\$24 million, such limit to increase to US\$28 million after the Incremental Term Loan is advanced;
- (b) if the aggregate amount advanced under the Revolving Facility in any 12 month period would exceed an amount determined with reference to the aggregate purchase price of certain equipment purchased by the Borrowers during such 12 month period; or
- (c) if the aggregate advances under the Revolving Facility during any 12 month period exceeds US\$2.5 million.

The interest rate on borrowings under the LSA is LIBOR plus 6.5% per annum, subject to adjustment in certain specified circumstances. The borrowings must be repaid in installments, commencing on October 1, 2005. A portion of the net proceeds received by any of the Borrowers from the sale of assets or the

issuance of equity securities must be used to prepay the loan. The maturity date of the loan is September 1, 2008, though the Company may extend the maturity date for two years by giving notice of such extension at least 90 days before September 1, 2008.

In connection with the LSA, the company issued warrants entitling the holders to acquire 2,306,571 common shares at a price per share of US\$0.23 for a period of 5 years.

- The company and its subsidiary, Peer 1 Network (USA) Inc. ("Peer 1 USA"), have entered into a Series A Preferred Stock Purchase Agreement (the "SPA") dated September 2, 2005 with several investors (the "Investors") pursuant to which Peer 1 USA issued on September 2, 2005 7,000 shares of Series A Preferred stock in its capital at a price per share of US\$1,000, for aggregate proceeds of US\$7,000,000.

The Series A Preferred stock carries one vote per share and a cumulative annual dividend of 8%. In the event of any liquidation, dissolution or winding up of Peer 1 (USA), the holders of the Series A Preferred stock are entitled to receive, in preference to any distribution of the assets of Peer 1 (USA), an amount per share equal to the Liquidation Value for each share of Series A Preferred stock. The Liquidation Value of a share of Series A Preferred stock is:

- (a) for the period beginning on September 2, 2005 (the "Closing Date") through but excluding the second anniversary of the Closing Date, US\$1,000 per share,
- (b) for the period beginning on such second anniversary through but excluding the third anniversary of the Closing Date, US\$1,500 per share and
- (c) for the period beginning on the third anniversary of the Closing Date and thereafter, US\$2,000, subject in each case to adjustments in certain circumstances.

At any time after the fourth anniversary of the Closing Date and provided that the amounts borrowed under the LSA have been repaid and the LSA has been terminated, any holder of shares of Series A Preferred stock may cause Peer 1 (USA) to redeem any or all of its outstanding shares of Series A Preferred stock at a price per share of US\$2000.

In connection with the SPA, the company and Peer 1 (USA) entered into an Investors' Rights Agreement (the "IRA") dated as of September 2, 2005 with the Investors. In addition to providing the Investors with rights to register their shares of Series A Preferred stock in the United States in certain circumstances, the IRA contains rights of put and call as follows:

- (a) Any Investor may require the Company to purchase for US\$2,000 per share any or all of its shares of Series A Preferred stock at any time after the fourth anniversary of the Closing Date, upon a liquidation, dissolution or winding up of the Company or upon a change of control.
- (b) At any time after the fourth anniversary of the Closing Date, the Company may require the Investors to sell all of their shares of Series A Preferred stock to the Company at a price per share of US\$2,000.

(c) Any investor may at any time require the Company to purchase any or all of its shares of Series A Preferred stock in exchange for the number of common shares in the capital of the Company determined by dividing \$1,000 per share of Series A Preferred stock being exchange by US0.2291, subject to adjustment in certain specified circumstances.

Pursuant to the IRA, the company has granted to each Investor a right of first offer with respect to future sales by the company of any of its shares or securities convertible into or exchangeable or exercisable for any shares in the capital of the company.

The preferred shares are classified as a liability as they are redeemable by the holders at US\$2,000 per share at anytime after four years. The \$US 14,000,000 redemption amount has been reduced by a discount on issuance of \$US 7,000,000 and is being amortized using the effective interest method over a period of four years.

The company, Peer 1 (USA), the Investors and certain shareholders of the company have entered into a Shareholder Agreement dated September 2, 2005 (the "Shareholder Agreement"). Pursuant to the Shareholder Agreement, the company has agreed to seek shareholder approval to increase its authorized share capital and cause its management to take all necessary actions so that a nominee of Celerity Partners SBIC, L.P. is a member of the Board of Directors of the company. On October 7, 2005 Mr. Mark Benham, a nominee of Celerity Partners SBIC, L.P. was appointed to the Board of directors of the company; and at the company's annual general meeting to be held on December 21 2005, the company's shareholders will be asked to approve the changes to the company's authorized capital required by the Shareholder Agreement.

Celerity Partners SBIC, L.P., of Menlo Park, California, acquired US\$4,090,000 and insiders of the company acquired US\$2,660,000 of the Series A Preferred stock.

- On September 2, 2005, US \$5,902,793 of the company's indebtedness was settled in exchange for the issuance of 25,274,588 common shares of the company, at a deemed price per share of Cdn \$0.2775 (approximately US \$0.2335)

OFF-BALANCE SHEET ARRANGEMENTS

The company has provided three letters of credit totaling US\$500,000 as security to a landlord for a facility lease and for two major suppliers. The security for the facility lease will be required for the term of the lease, whereas the security for the suppliers is dependant on whether the company continues to use the same suppliers, the extent to which a sufficient credit history is built up with the suppliers to reduce or negate the need for such security, and other similar discretionary factors. The letters of credit are secured by way of term deposits which are included in the reported cash balance. The year end financial statements classify the term deposits as restricted cash.

SENIOR MANAGEMENT CONTRACTS

During the quarter, a change in senior management was made. Geoffrey Hampson tendered his resignation as Chief Executive Officer and President. Concurrently, Lance Tracey, Peer 1 Network Enterprises, Inc.'s Chairman of the Board, was appointed Chief Executive Officer and President. The company also hired Fabio Banducci as Executive Vice President during the quarter.

Geoff Hampson and the company entered into an agreement pursuant to which the company will pay to Mr. Hampson in connection with his Cdn \$300,000 (approximately USD \$261,900) in accordance with the company's payroll procedures and Mr. Hampson will provide certain consulting services.

An oral management contract was entered into with Code Marketing, Ltd., a company controlled by Mr. Lance Tracey, to serve in the role of Chief Executive Officer and President. Under the terms of the contract, Code Marketing, Ltd. will be paid a monthly fee of Cdn \$25,000 (approximately USD \$21,700). The term on the agreement is month-to-month.

Fabio Banducci and the company entered into an employment agreement dated October 31, 2005. Under the employment agreement Mr. Banducci shall serve as the company's Executive Vice President, His salary is Cdn \$200,000 (approximately USD \$174,000) and he is entitled to and has received a grant of 500,000 incentive options. The agreement may be terminated by the company without cause as follows:

- if the termination occurs prior to the first anniversary of employment having commenced the company shall pay 50% of the annual salary for six months in accordance with the company payroll procedures
- if the termination occurs on or after the first anniversary employment having commenced but prior to the fourth anniversary, the company shall pay 100% of the annual salary for twelve months in accordance with the company payroll procedures
- if the termination occurs on or after the fourth anniversary, the company shall pay 150% of the annual salary for eighteen months in accordance with the company payroll procedures

TRANSACTIONS WITH RELATED PARTIES

During the second quarter of fiscal 2006, Peer 1 provided services in the normal course of business to companies either owned or subject to significant influence by the company's directors and principal shareholders.

As at December 31, 2005 and December 31, 2004, amounts due to and from related parties were as follows:

	12/31/2006	12/31/2005
Included in accounts receivable	\$91,208	\$109,469
Included in accounts payable and accrued liabilities	\$525	2,445

During the second quarter of fiscal 2006 and 2005, transactions with related parties were as follows:

	Q2-FY2006	Q2-FY2005
Revenues earned	\$56,563	\$74,621
Interest expensed	\$1,164,081	\$245,086
Other expenses incurred	\$1,083,902	76,376

These transactions are in the normal course of operations and are measured at their exchange amounts. Included in other expenses incurred is financing fees totaling \$1,083,902 relating to the Fortress loan and the Series A Preferred share issue.

SUBSEQUENT EVENTS AND PROPOSED TRANSACTIONS

None.

OUTSTANDING SHARE DATA

Peer 1 has authorized share capital of unlimited common shares without par value and unlimited preferred shares without par value. At December 31, 2005 76,437,580 common shares were issued and outstanding (44,369,367 as at December 31, 2004). A further 883,333 common shares have been issued as of the date of this MD&A, bringing the total number of common shares issued and outstanding to 77,320,913

5,406,571 warrants for the purchase of shares ranging in price from US \$0.23 to Cdn \$0.40 (approximately \$0.3475) were outstanding at December 31, 2005 end (2004 – 11,614,464). 833,333 additional warrants were issued subsequent to the quarter end; however nil warrants were exercised subsequent to the end of the quarter.

4,344,750 (2004 – 3,372,250) stock options were outstanding at quarter end under the company's stock option plan. 50,000 options were exercised after the quarter end; 240,000 additional options have been issued as of the date of this MD&A.

Under the preferred share financing described in the previous section, 7,000 preferred shares of Peer 1 Network (USA) Inc. were issued. By way of the Investor Rights

Agreement, the holders of the preferred shares may require the company to acquire any or all of their preferred shares in exchange for common shares of Peer 1. Subject to adjustment in specified circumstances, the conversion would be for 4,365 common shares of Peer 1 for each preferred share.

CRITICAL ACCOUNTING ESTIMATES

Management makes certain estimates in order to report the company's financial position and results of operations. Such estimates include the collectability of accounts receivable, the useful life of fixed assets, the likelihood of M&A projects being completed (see section below), valuation of the conversion features attached to debt instruments and warrants issued.

In estimating the allowance for doubtful accounts, management reviews the payment history of current customer as well as overall historical collection trends. Our allowance varies by line of business and ranges from approximately 2-2.5% of annual revenues in the Bandwidth and Colocation business and approximately 1% in the dedicated hosting lines of business.

Estimates as to the useful life of fixed assets are based upon experience and are in line with other companies in the industry.

Valuation of the debt conversion features and issue of warrants is based on estimates of dividend yield (Nil), expected volatility of the Peer 1 stock price (75%), risk-free interest rate (estimate changes over time as actual results change) and option term (varies depending on the warrants or options issued).

In all of the above cases, actual results may be different than the estimates made.

ACCOUNTING POLICIES

- The company prepares its financial statements on the basis of accounting principals generally acceptable in Canada. All accounting policies have been applied on a basis consistent with that of the previous year. Due to the most recent acquisition of the dedicated server assets of Interland Inc, the company's US dollar revenues account for approximately 75% of total company revenues. Effective October 1, 2005, the Company changed its functional currency to the U.S. dollar from the Canadian Dollar in order to more accurately represent the currency of the economic environment in which it operates as a result of increasing U.S. dollar denominated revenues and expenditures. Concurrent with the change in its functional currency, the Company has adopted the U.S. Dollar as its reporting currency. All figures presented prior to October 1, 2005 for comparative purposes are also reported in U.S. dollars.
- During the year, as part of its growth strategy, the company undertook a process of identifying and pursuing organizations for potential acquisition. As a result, costs directly related to acquisitions continue to be incurred. The company has adopted a policy of deferring such costs for proposed transactions where completion is considered to be more likely than not. These deferred costs will be added to the cost of purchase upon completion. Should the status of a project

change to become unlikely to complete, the costs associated with that project are expensed. As of the end of the second quarter, \$10,721 of costs had been deferred (\$358,734) at the end of the preceding quarter).

Non-GAAP Measures

The company reports Earnings Before Interest, Taxes, Depreciation and Amortization ("EBITDA"), which is an approximate measure of operating cash flow based on financial data from the company's income statement. EBITDA is not a recognized accounting measure nor is it defined by generally accepted accounting principles. This non-GAAP measure may not be an identical presentation when compared with other company reports, as the nature of amounts included in amortization varies. The disclosure of EBITDA is strictly presented for informational purposes and is not intended to replace financial results presented from operations or cash flow.

An EBITDA reconciliation is included in a previous section so that the components are clearly disclosed. It should be noted that the measure has been amended to reflect the impact of unrealized foreign exchange gains and losses. The EBITDA numbers in the quarterly information trend section have been amended accordingly.

OUTLOOK AND RISKS

Outlook

The demand for high-speed, IP-based network services is growing rapidly, as both businesses and individual users place greater reliance on web-based information and applications. As a result, the industry segment that Peer 1 operates in is expected to continue along an upward growth trend as the demand for the outsourcing of secure internet infrastructure also grows.

Revenues are expected to continue their growth trend, though the growth rate is likely to fall because of the larger base.

Risks

The company is subject to a number of business risks inherent in the industry, including competitive pressures, credit risk, foreign exchange risk and technological change.

Peer 1 operates in a competitive market. The company has differentiated itself from the competition by the high level of customer service we provide and the quality of the products we offer. Management intends to keep Peer 1's product offerings focused, so as to continue to deliver the high level of quality at a competitive price that the company has become known for. Our customer retention rate is one of the highest in the industry because of this customer and quality focus.

The company's bad debt rate has been reduced to 2-2.5% in the most recent fiscal year as a result of more sophisticated credit and collections procedures. This, together with the company's high retention rate of customers mitigates credit risk.

The company currently operates in Canada and the USA, and has recently established a POP in the UK, and is thereby subject to risks typical of an international business including, but not limited to, differing economic conditions, differing tax structures, other regulations and restrictions and foreign exchange rate volatility. The company has evaluated its exposure to these risks, and has determined that its only significant exposure is to exchange rate risk with respect to the US dollar. The company does not engage in hedging transactions, but anticipates that revenue growth in Peer 1's US locations, together with ServerBeach operations, will offset the exchange rate risk to a greater extent in 2005.

Technology is evolving rapidly, with the result that a major shift in communications technology away from the current IP based system could have a significant impact on all companies in the industry.

OTHER INFORMATION

Additional information relating to the company is available on SEDAR at www.sedar.com.