

peer1 | Fully scalable hosting solutions



**CONSOLIDATED FINANCIAL STATEMENTS
FOR THE FISCAL YEARS ENDED JUNE 30, 2009 AND 2008**



Cinnamon Jang Willoughby & Company

Chartered Accountants

A Partnership of Incorporated Professionals

AUDITORS' REPORT

To the Shareholders of **Peer 1 Network Enterprises, Inc.:**

We have audited the consolidated balance sheets of Peer 1 Network Enterprises, Inc. (the "Company") as at June 30, 2009 and 2008 and the consolidated statements of shareholders' equity, operations, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at June 30, 2009 and 2008, and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

"/s/ Cinnamon Jang Willoughby & Company"
Chartered Accountants

Burnaby BC, Canada
September 14, 2009


Comments by Independent Registered Chartered Accountants for U.S Readers on Canada-United States of America Reporting Differences

In the United States, the standards of the Public Company Accounting Oversight Board (United States) for auditors require the addition of an explanatory note when there are differences in accounting principles that have a material effect on the comparability of the Company's financial statements. Application of accounting principles generally accepted in the United States would have affected liabilities and shareholders' equity as at June 30, 2009 and 2008 and the results of operations for the years then ended to the extent summarized in Note 20 to the consolidated financial statements.

"/s/ Cinnamon Jang Willoughby & Company"
Chartered Accountants

Burnaby BC, Canada
September 14, 2009

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PEER 1 NETWORK ENTERPRISES, INC.
Consolidated Balance Sheet
June 30, 2009
(in thousands of United States dollars)

	2009	2008
Assets		
Current:		
Cash and cash equivalents	\$ 15,744	\$ 11,026
Accounts receivable	3,449	4,051
Future income tax asset (Note 12)	237	104
Prepaid expenses	1,130	801
	20,560	15,982
Other assets (Note 4)	2,692	3,075
Future income tax asset (Note 12)	1,042	1,841
Property and equipment (Note 5)	36,856	33,818
Equipment under capital lease (Note 6)	1,013	1,267
Goodwill	1,715	1,715
Intangible assets (Note 8)	2,552	2,500
	\$ 66,430	\$ 60,198
Liabilities		
Current:		
Accounts payable and accrued liabilities	\$ 7,936	\$ 8,810
Deferred revenue	2,886	3,553
Current portion of deferred gain (Note 7)	79	79
Current portion of deferred lease inducements (Note 9)	138	134
Current portion of derivative liabilities (Note 3)	89	-
Current portion of notes payable (Note 10)	2,250	3,286
Current portion of obligations under capital lease (Note 6)	211	226
Income taxes payable	2,200	1,435
	15,789	17,523
Deferred gain (Note 7)	493	571
Deferred lease inducements (Note 9)	664	739
Derivative liabilities (Note 3)	179	-
Notes payable (Note 10)	12,303	12,008
Obligation under capital lease (Note 6)	363	655
	29,791	31,496
Shareholders' equity (Note 11)	36,639	28,702
	\$ 66,430	\$ 60,198

Commitments and contingencies (Note 18)

On behalf of the Board of Directors

“Chris Theodoropoulos
Director

“David Harrison”
Director

PEER 1 NETWORK ENTERPRISES, INC.
Consolidated Statements of Shareholders' Equity
For the Year Ended June 30, 2009
(in thousands of United States dollars except number of shares)

	2009		2008	
	Number	Amount	Number	Amount
SHARE CAPITAL				
Common shares (Note 11)				
Balance at beginning of year	118,504,368	\$ 26,539	115,994,291	\$ 25,254
Stock options exercised	131,670	70	572,577	296
Warrants exercised	678,285	341	1,937,500	989
Balance at end of year	119,314,323	26,950	118,504,368	26,539
Warrants (Note 11)				
Balance at beginning of year	3,139,904	678	5,077,404	917
Warrants expired/exercised	(678,285)	(185)	(1,937,500)	(239)
Balance at end of year	2,461,619	493	3,139,904	678
Total – share capital		27,443		27,217
CONTRIBUTED SURPLUS				
Balance at beginning of year		2,509		1,092
Stock-based compensation		2,282		1,453
Options exercised and shares distributed under the stock option plan		(25)		(36)
Balance at end of year		4,766		2,509
RETAINED EARNINGS				
Balance at beginning of year		(1,013)		(8,077)
Net income		5,722		7,064
Balance at end of year		4,709		(1,013)
ACCUMULATED OTHER COMPREHENSIVE INCOME				
Balance at beginning of year		(11)		(11)
Other comprehensive income		(268)		-
Balance at end of year		(279)		(11)
Total - shareholders' equity		\$ 36,639		\$ 28,702

PEER 1 NETWORK ENTERPRISES, INC.
Consolidated Statement of Operations
For the Year Ended June 30, 2009
(in thousands of United States dollars, except per share amounts)

	2009	2008
Revenue		
Co-location Services	\$ 25,080	\$ 27,397
Hosting Services	67,229	61,950
	<u>92,309</u>	<u>89,347</u>
Cost of revenue	<u>52,560</u>	48,835
Gross profit	39,749	40,512
Operating expenses	<u>27,419</u>	25,824
Operating income before other items	12,330	14,688
Other items:		
Interest income	(70)	(328)
Integration costs	-	93
Gain on disposal of property and equipment	(47)	(12)
Foreign exchange loss (gain)	(130)	367
Interest expense – long term	2,194	2,267
	<u>1,947</u>	<u>2,387</u>
Income before income taxes	10,383	12,301
Income tax expense (Note 12)	4,661	5,237
Net income	\$ 5,722	\$ 7,064
Other comprehensive income:		
Change in unrealized fair value of derivatives designated as cash flow hedges	(268)	-
Comprehensive income	\$ 5,454	\$ 7,064
Net income attributable to:		
Common shares	\$ 5,722	\$ 7,064
Comprehensive income attributable to:		
Common shares	\$ 5,454	\$ 7,064
Basic and diluted earnings per share (Note 11)	\$ 0.05	\$ 0.06

PEER 1 NETWORK ENTERPRISES, INC.
Consolidated Statement of Cash Flows
For the Year Ended June 30, 2009
(in thousands of United States dollars)

	2009	2008
Operating Activities:		
Net income	\$ 5,722	\$ 7,064
Adjustments for non-cash items:		
Amortization of property and equipment	11,880	9,458
Amortization of intangible assets	1,363	1,590
Increase in accrued interest and accretion of convertible debt	82	18
Bad debt expense	650	494
Gain on disposal of property and equipment	(47)	(12)
Amortization of deferred gain	(79)	(79)
Amortization of deferred loan origination fees	774	648
Future income tax expense	655	2,040
Stock-based compensation included in income for the year	2,282	1,453
Decrease in deferred lease inducements	(71)	(236)
Changes in non-cash working capital:		
Change in accounts receivable	(47)	(122)
Increase in prepaid expenses	(329)	(112)
Increase (decrease) in accounts payable and accrued liabilities	(992)	341
Increase in income taxes payable	765	959
Decrease in deferred revenue	(667)	(683)
Cash flows from operating activities	21,941	22,821
Investing Activities:		
Investment in other assets	(56)	78
Acquisition of property and equipment	(14,451)	(17,017)
Acquisition of intangible assets	(1,511)	(975)
Proceeds on disposition of equipment	47	46
Cash flows used in investing activities	(15,971)	(17,868)
Financing Activities:		
Proceeds from notes payable	15,000	-
Repayments of notes payable	(16,158)	(3,554)
Payment of capital lease obligations	(199)	(91)
Issuance of capital stock	201	1,011
Cash flows used in financing activities	(1,156)	(2,634)
Foreign exchange gain (loss) on cash and cash equivalents	(96)	(47)
Increase in cash and cash equivalents	4,814	2,319
Cash and cash equivalents, beginning	11,026	8,754
Cash and cash equivalents, ending	\$ 15,744	\$ 11,026

Supplemental Disclosure of Cash Flow Information (Note 13)

PEER 1 NETWORK ENTERPRISES, INC.
Notes to Consolidated Financial Statements
June 30, 2009
(dollar amounts are presented in thousands of
United States dollars, except per share amounts)

1. Nature of Operations:

Peer 1 Network Enterprises, Inc. (the "Company") was incorporated under the laws of British Columbia. The Company is a provider of Internet infrastructure solutions and related managed services. The Company provides co-location facilities with high performance Internet bandwidth and hosting servers to web-centric and enterprise customers across North America. The Company has established local offices and data centers in Canada, the USA, and the UK and also has established points of presence in London, UK and Amsterdam in the Netherlands. The corporate headquarters are in Vancouver.

2. Significant Accounting Policies:

a) Basis of Consolidated Financial Statements -

These consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, Peer 1 Network (USA) Inc., Peer 1 Network (Seattle) Inc., Peer 1 Network (San Jose) Inc., Peer 1 Network (New York) Inc., Peer 1 Network (Nevada) GP, Inc., Peer 1 Network (Nevada) LP, Inc., ServerBeach Ltd., Data Center Technologies IP Inc., Peer 1 Dedicated Hosting Inc., Colobrokers.com Inc., 585065 B.C. Ltd., Peer 1 Network (Texas), LP, Peer 1 Network (LA), Inc. and Peer 1 (UK) Ltd.

b) Cash and Cash Equivalents -

Cash and cash equivalents consist of cash and highly liquid money market instruments.

c) Property and Equipment -

The following assets are recorded at cost. Amortization is provided on a declining balance basis at the following annual rates:

Data Centre equipment	20%
Computer equipment	30%
Furniture and fixtures	30%
Network equipment	20%
Equipment under capital lease	20%

Servers that are included as part of the hosting product line are amortized straight line over their expected useful life, which is 36 months. Inventory of parts held for server assembly are classified in this component of property and equipment, and are not subject to amortization until the assets are put into use.

Amortization of leasehold improvements is provided on a straight-line basis over the terms of the respective leases.

The carrying values of property and equipment are reviewed when indications of impairment exist. When the net carrying amount of the property and equipment exceeds the estimated net recoverable amount, the asset is written down to its estimated fair value and a charge is recorded in the consolidated statement of operations.

PEER 1 NETWORK ENTERPRISES, INC.
Notes to Consolidated Financial Statements
June 30, 2009
(dollar amounts are presented in thousands of
United States dollars, except per share amounts)

2. Significant Accounting Policies: (continued)

d) Leases -

Leases are classified as either capital or operating leases. A lease that transfers substantially all the benefits and risks incidental to the ownership of property is classified as a capital lease. All other leases are accounted for as operating leases wherein rental payments are expensed as incurred. At the inception of a capital lease, an asset and an obligation are recorded at an amount equal to the lesser of the present value of the future minimum lease payments or the property's fair value at the beginning of such lease.

e) Goodwill -

Goodwill is recorded at the amount originally recognized. Goodwill is tested for impairment in value on an annual basis. Fair value is determined based on the present value of discounted cash flows. Following the impairment test at year-end, management has concluded that there has been no impairment in the value of goodwill.

f) Intangible Assets –

Computer software comprising PC based software acquired for internal use is amortized on a straight line basis over three years. Computer software acquired as a component of revenue producing assets, or internal systems such as accounting or customer relations management systems is amortized over the expected useful life of the software. Amortization commences when the asset is put into service. Licenses are recorded at cost. Amortization is provided on a straight-line basis over the term of the licenses.

g) Deferred Lease Inducements -

Lease inducements, including rent free periods, are deferred and accounted for as a reduction of rent expense over the term of the related leases on a straight-line basis.

h) Debt Instruments –

Where the Company issues debt instruments with detachable warrants or conversion options in connection with a debt instrument, the estimated fair market value of the warrants and conversion feature are credited to shareholders' equity. The reduced liability component of the debt is accreted by a charge to interest expense.

PEER 1 NETWORK ENTERPRISES, INC.
Notes to Consolidated Financial Statements
June 30, 2009
(dollar amounts are presented in thousands of
United States dollars, except per share amounts)

2. Significant Accounting Policies: (continued)

i) Future Income Taxes -

Income taxes are calculated using the asset and liability method of tax allocation. Temporary differences arising from the difference between the tax basis of an asset or liability and its carrying amount on the balance sheet, and unutilized losses carried forward are used to calculate future income tax assets or liabilities. Future income tax assets or liabilities are calculated using tax rates anticipated to apply in the year that the temporary differences are expected to reverse. The carrying value of the future income tax asset is limited to the amount that is more likely than not to be realized.

j) Financing Costs -

Costs directly identifiable with the raising of capital are charged against the related capital stock. Costs incurred to obtain debt financing are netted against the related indebtedness, deferred and amortized by a charge to interest expense over the term of the related debt using the effective interest rate method. Financing costs expensed for 2009 are \$1,084 (2008: \$736).

k) Capitalization of Internally Developed Software -

Internally developed software is stated at cost less accumulated amortization and is amortized using the straight line method over its estimated useful life. Software assets are reviewed for impairment when events or circumstances indicate that the carrying value may not be recoverable over the remaining lives of the assets. Costs are capitalized during the software application development stage. Upgrades and enhancements are capitalized if they result in added functionality which enables the software to perform tasks it was previously incapable of performing.

Software maintenance, training, data conversion and business process reengineering costs are expensed in the period in which they are incurred.

l) Foreign Currency Translation -

Monetary assets and liabilities denominated in currencies other than United States dollars are translated at the rate of exchange in effect at the end of the year. Revenue and expense items are translated at the rate of exchange in effect on the dates they occur. Exchange gains or losses are recognized immediately in the consolidated statement of operations.

The Company's non-US subsidiaries are managed as integrated operations and accordingly are accounted for under the temporal method. Under this method, monetary assets and liabilities are translated at the exchange rate in effect at the balance sheet date. Non-monetary assets and liabilities are translated at historical rates. Revenues and expenses are translated at average rates for the year. Exchange gains or losses arising from the translation are included in operations.

PEER 1 NETWORK ENTERPRISES, INC.
Notes to Consolidated Financial Statements
June 30, 2009
(dollar amounts are presented in thousands of
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2. Significant Accounting Policies: (continued)

m) Revenue Recognition -

The two primary sources of revenue are from Co-location Services and Hosting Services. Co-location Services includes Co-location, Internet bandwidth connectivity, and other Co-location related services including, IP monitoring, tape back-up, technical support, additional access cards, additional power and DNS services. Hosting Services includes the provision of hosting servers and Internet bandwidth connectivity. Co-location Services and Hosting Services revenue is recognized once an agreement is in place, the price is fixed or determinable, the service is provided and there is probable assurance of cash collection. Revenue is earned through monthly charges at contractually agreed upon prices. Revenue is recognized ratably over the term of the contract as services are provided to the customer. One-time installation fees are deferred and recognized on a straight-line basis over the contractual period, which typically varies from six months to three years.

n) Stock-based Compensation -

The Company has a stock-based compensation plan for executives and other key employees. The stock-based compensation expense is recognized in accordance with CICA Handbook Section 3870 "Stock-Based Compensation and Other Stock-Based Payments". Compensation expense for stock or stock option grants to employees is based on the fair value of the stock or stock options issued. Consideration paid by employees on the purchase of shares under the employee share purchase plan and exercise of stock options is recorded as share capital. As of June 30, 2009, the Company has not made any stock grants.

o) Earnings per Share -

The diluted earnings per share is calculated based on the weighted-average number of common shares outstanding during the year, plus the effects of dilutive common share equivalents. This method requires that the dilutive effect of outstanding options issued should be calculated using the treasury stock method. This method assumes that all common share equivalents have been exercised at the beginning of the period (or at time of issuance, if later), and that the funds obtained thereby were used to purchase common shares of the Company at the average trading price of common shares during the period. The basic earnings per share is calculated based on the weighted-average number of common shares outstanding during the year.

p) Use of Estimates -

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying disclosures. Significant estimates are used in determining, but are not limited to, the valuation of accounts receivable, the estimated useful lives of property and equipment and intangible assets, the recoverability of long-lived assets, the measurement of accrued liabilities, the measurement of future income tax valuation allowances and stock-based compensation expense. Although these estimates are based on management's best knowledge of current events and actions the Company may undertake in the future, actual results may differ from these estimates.

PEER 1 NETWORK ENTERPRISES, INC.
Notes to Consolidated Financial Statements
June 30, 2009
(dollar amounts are presented in thousands of
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2. Significant Accounting Policies: (continued)

q) Derivative Financial Instruments

The Company uses derivative financial instruments in the management of its interest rate exposure. The Company's policy is not to use derivative financial instruments for trading or speculative purposes.

Determination of fair value

The fair value of a financial instrument is the amount of consideration that would be agreed upon in an arm's length transaction between knowledgeable willing parties who are under no compulsion to act. The fair value of a financial instrument on initial recognition is the transaction price, which is the fair value of the consideration given or received. Subsequent to initial recognition, the fair values of financial instruments that are quoted in active markets are based on bid prices for financial assets held and offer prices for financial liabilities. When independent prices are not available, fair values are determined by using valuation techniques which refer to observable market data. These include comparisons with similar instruments where observable market prices exist, discounted cash flow analyses, option pricing models and other valuation techniques commonly used by market participants. For certain derivatives, fair values may be determined in whole or in part from valuation techniques using non-observable market data or transaction prices. A number of factors such as bid-offer spread, credit profile and model uncertainty are taken into account, as appropriate, when values are calculated using valuations techniques.

Hedges

When the Company uses derivatives in hedge accounting relationships, the Company formally documents all relationships between hedging instruments and hedged item, as well as its risk management objective and strategy for undertaking various hedge transactions. This process includes linking derivatives to specific assets and liabilities on the balance sheet or to specific firm commitments or forecasted transactions. The Company also assesses whether the derivatives that are used in hedging transactions are effective in offsetting changes in fair values or cash flows of hedged items. When hedging instruments become ineffective before their maturity or the hedging relationship is terminated, deferred gains or losses on such instruments continue to be deferred and charged to earnings in the same period as the corresponding gains or losses for the hedged items; gains and losses realized subsequently as a result of marking to market are charged directly to earnings. If the hedged item ceases to exist due to its maturity, expiry, cancellation or exercise before the hedging instrument expires, deferred gains or losses are charged to earnings.

Derivative financial instruments are classified as HFT. The Company may choose to designate derivative financial instruments as hedging instruments for which hedge accounting is applied (see below).

Cash flow hedges – The Company has designated its interest-rate swap agreement as a cash flow hedge. In a cash flow hedge relationship, the portion of gains or losses on the hedging item that is determined to be an effective hedge is recognized in OCI, while the ineffective portion is recorded in net income. The amounts recognized in OCI are reclassified in net income when the hedged item affects net income. Hedge accounting is discontinued prospectively when it is determined that the hedging instrument is no longer effective as a hedge, the hedging instrument is terminated or sold, or upon the sale or early termination of the hedged item.

PEER 1 NETWORK ENTERPRISES, INC.
Notes to Consolidated Financial Statements
June 30, 2009
(dollar amounts are presented in thousands of
United States dollars, except per share amounts)

2. Significant Accounting Policies: (continued)

r) Comparative Numbers –

The 2008 comparative figures have been reclassified, where applicable, in order to conform with the presentation used in the current year.

s) Financial Instruments –

Financial instruments are classified into one of these five categories: held-for-trading, held-to-maturity, loans and receivables, available-for-sale financial assets or other financial liabilities. All financial instruments, including derivatives, are measured in the balance sheet at fair value except for loans and receivables, held-to-maturity investments and other financial liabilities which are measured at amortized cost. Subsequent measurement and changes in fair value will depend on their initial classification, as follows: held-for-trading financial assets are measured at fair value and changes in fair value are recognized in net income; available-for-sale financial instruments are measured at fair value with changes in fair value recorded in other comprehensive income until the investment is derecognized or impaired at which time the amounts would be recorded in net income.

The Company has designated its cash, cash equivalents, restricted cash and derivative financial instruments as held-for-trading, which are measured at fair value. Accounts receivable are classified as loans and receivables, which are measured at amortized cost. Accounts payable, accrued liabilities, obligations under capital lease and notes payable are classified as other financial liabilities.

The Company had neither available-for-sale, nor held-to-maturity instruments during the year ended June 30, 2009.

t) Changes in Accounting Policies –

i) In December 2006, the CICA released new Handbook Section 1535; this standard requires that an entity disclose information that enables users of its financial statements to evaluate an entity's objectives, policies and processes for managing capital, including disclosures of any externally imposed capital requirements and the consequences of non-compliance. As a result of adopting this standard, new or enhanced disclosure is provided in Note 17 – Capital risk management.

ii) In January 2009, the CICA issued EIC Abstract 173, "Credit Risk and the Fair Value of Financial Assets and Financial Liabilities". The EIC requires the Company to take into account the Company's own credit risk and the credit risk of the counterparty in determining the fair value of financial assets and financial liabilities, including derivative instruments. EIC 173 is to be applied retrospectively without restatement of prior periods to all financial assets and liabilities measured at fair value in the interim and annual financial statements for periods ending on or after the date of issuance of the Abstract. The Company has evaluated the impact of adopting this standard on our consolidated financial statements and no changes were made.

PEER 1 NETWORK ENTERPRISES, INC.
Notes to Consolidated Financial Statements
June 30, 2009
(dollar amounts are presented in thousands of
United States dollars, except per share amounts)

2. Significant Accounting Policies: (continued)

u) Recent Accounting Pronouncements –

i) In February 2008, the CICA issued Handbook Section 3064, “Goodwill and Intangible Assets”, effective for interim and annual periods on or after Oct 1, 2008. Section 3064, which replaces Section 3062, “Goodwill and Other Intangible Assets”, and Section 3450, “Research and Development Costs”, establishes standards for the recognition, measurement and disclosure of goodwill and intangible assets. The provisions relating the definition and initial recognition of intangible assets, including internally generated intangible assets, are equivalent to the corresponding provisions of International Financial Reporting Standards (“IFRS”) IAS 38, “Intangible Assets”. This new standard is effective for the Company’s interim and annual financial statements commencing July 1, 2009. The Company is assessing the impact of the new standard on its financial statements.

ii) Convergence with International Financial Reporting Standards (IFRS)

In 2006, Canada’s Accounting Standards Board announced that International Financial Reporting Standards (“IFRS”) will replace Canadian GAAP for publicly accountable enterprises for financial periods beginning on or after January 1, 2011. The Company will commence reporting under IFRS in the first quarter of fiscal year 2012 with comparative figures for the transitional period.

The International Accounting Standards Board’s work plan has projects underway that are expected to result in new pronouncements that continue to evolve IFRS. As a result, IFRS as at the transition date may be different from its current form.

The Company is in the process of assessing the impact of the convergence initiative and developing a plan for the implementation of IFRS. Such considerations include:

- Assessment of significant differences between Canadian GAAP and IFRS and their impacts on the Company’s Consolidated Financial Statements.
- Identification, evaluation and selection of continuing IFRS policies.
- Evaluation of IT and financial systems’ data capture and reporting functionality.
- Impact on disclosure controls and procedures, including changes in note disclosures, and communication with internal and external stakeholders.
- Identification of impact on internal control over financial reporting and training.
- Assessment of impact on other business activities such as compensation structure and financial covenants.

The Company has commenced the initial impact assessment and scoping phase which utilizes a diagnostic approach to identify a modest number of topics that may impact either the Company’s financial results or conversion efforts to IFRS. It is not practically possible at this time to quantify the impact of these differences. The Company expects to implement changes to processes and systems before the 2011 fiscal year to enable compliance and reporting under IFRS.

Initial training of key personnel started during the current reporting period and personnel have been identified to lead the transition effort. The Company has also engaged the services of external consultants to assist with the comparative analysis between Canadian GAAP and IFRS and other technical elements. Continued progress is necessary before the Company can prudently develop a timeline schedule of major implementation activities and key deliverables.

PEER 1 NETWORK ENTERPRISES, INC.
Notes to Consolidated Financial Statements
June 30, 2009
(dollar amounts are presented in thousands of
United States dollars, except per share amounts)

2. Significant Accounting Policies: (continued)

u) Recent Accounting Pronouncements (continued) –

iii) In January 2009, the CICA issued Section 1582, “Business Combinations”, which replaces former guidance on business combinations. Section 1582 establishes principles and requirements of the acquisition method for business combination and related disclosures. The Section applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2011 with earlier adoption permitted. The Company is currently evaluating the impact of this standard on its financial statements.

iv) In January 2009, the CICA issued Handbook Section 1601, “Consolidated Financial Statements”, which replaces the existing standard. This Section carries forward existing Canadian guidance for preparing consolidated financial statements other than non-controlling interests. The Section is effective for interim and annual financial statements beginning on January 1, 2011 and earlier adoption is permitted. The Company is currently evaluating the impact of adopting this standard on its consolidated financial statements.

v) In January 2009, the CICA issued Section 1602, “Non-controlling Interests”, which replaces existing guidance. Section 1602 provides guidance on accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. These standards are effective on or after the beginning of the first annual reporting period on or after January 1, 2011 with earlier adoption permitted. As of June 30, 2009 the Company has no non-controlling interests, and accordingly there is no currently expected impact as a result of the standard.

vi) In June 2009, the CICA amended Handbook Section 3855, "Financial Instruments - Recognition and Measurement", to clarify the application of the effective interest method after a debt instrument has been impaired. The Section has also been amended to clarify when an embedded prepayment option is separated from its host instrument for accounting purposes. The amendments apply to interim and annual financial statements relating to fiscal years beginning on or after May 1, 2009 for the amendments relating to the effective interest method and January 1, 2011 for the amendment relating to embedded prepayment options. The Company is currently evaluating the impact of the amendments.

3. Derivative Liabilities

The carrying amount of the derivative financial instrument in a hedge relationship was as follows:

	2009	2008
Derivative financial instruments designated as cash flow hedges		
Interest – rate swap agreement	\$ 268	-

The interest rate swap matures at the same time with the notes payable under Facility B.

PEER 1 NETWORK ENTERPRISES, INC.
Notes to Consolidated Financial Statements
June 30, 2009
(dollar amounts are presented in thousands of
United States dollars, except per share amounts)

4. Other Assets:

	2009	2008
Network installation fees	\$ 36	\$ 82
Restricted cash ^(a)	250	250
Security deposits	2,397	2,729
Sublease rent incentive	9	14
	\$ 2,692	\$ 3,075

(a) The Company has issued a letter of credit of \$250 (2008: \$250) to a landlord in lieu of deposit requirements. The letter of credit has a term of one year, with annual renewal provisions. A Certificate of deposit for the full amount of the issued letter of credit has been pledged as security, and is disclosed on the balance sheet under the caption of other assets

5. Property and Equipment:

	2009		
	Cost	Accumulated amortization	Net
Computer equipment	\$ 1,869	\$ 892	\$ 977
Data centre equipment	7,346	3,290	4,056
Hosting servers	36,508	23,937	12,571
Furniture and fixtures	720	243	477
Leasehold improvements	16,296	5,853	10,443
Network equipment	13,688	5,356	8,332
	\$ 76,427	\$ 39,571	\$ 36,856

	2008		
	Cost	Accumulated amortization	Net
Computer equipment	\$ 1,326	\$ 566	\$ 760
Data centre equipment	6,216	2,439	3,777
Hosting servers	29,213	17,373	11,840
Furniture and fixtures	493	134	359
Leasehold improvements	13,464	4,225	9,239
Network equipment	11,379	3,536	7,843
	\$ 62,091	\$ 28,273	\$ 33,818

Included in 2009 total cost is \$1,285 for projects which have not yet been put into use and have therefore not incurred amortization during the year. In 2009, expenditures for property and equipment were \$14,664 (2008: \$16,609).

PEER 1 NETWORK ENTERPRISES, INC.
Notes to Consolidated Financial Statements
June 30, 2009
(dollar amounts are presented in thousands of
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6. Equipment under Capital Lease:

In February 2008, the Company entered into a master capital lease agreement to acquire the right of use of certain network equipment. The leases under the master capital lease carry an interest rate of 6.3% and expire in January 2012. There are 5 separate leases under the master lease agreement with a term of 4 years and a one dollar purchase option per lease at expiry.

	2009		
	Cost	Accumulated amortization	Net
Network equipment	\$ 1,357	\$ 344	\$ 1,013

	2008		
	Cost	Accumulated amortization	Net
Network equipment	\$ 1,357	\$ 90	\$ 1,267

	2009		2008	
Total minimum lease payments payable	\$	620	\$	982
Portion representing interest to be expensed over the remaining term of the leases		46		101
Principal outstanding		574		881
Less: Current portion		211		226
Non-current portion	\$	363	\$	655

In aggregate the future minimum lease payments are \$620. The following is a schedule of future minimum lease payments under the capital lease expiring January 31, 2012:

2010	\$ 240
2011	240
2012	140

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7. Deferred Gain:

On August 9, 2006 the Company exercised its option to purchase its leased data centre property located at 2300 NW Place, Miami, Florida. The gross purchase price was \$4.6 million and was subject to closing adjustments. On September 26, 2006 the Company subsequently entered into a sale and leaseback arrangement for this property. The gross sale price was \$5.6 million. The Company leased the premises back from the purchaser for an initial term of 10 years with the option to renew for a further two 5 year periods. After adjustments, the Company recorded a deferred gain of \$788 on this transaction which is being amortized over the term of the lease. The unamortized balance of the deferred gain is \$572 (2008: \$650).

8. Intangible Assets:

	2009		
	Cost	Accumulated amortization	Net
Licenses	\$ 4,726	\$ 4,411	\$ 315
Computer software	4,450	2,254	2,196
Other Intangibles	41	-	41
	\$ 9,217	\$ 6,665	\$ 2,552

	2008		
	Cost	Accumulated amortization	Net
Licenses	\$ 4,727	\$ 3,466	\$ 1,261
Computer software	3,076	1,837	1,239
	\$ 7,803	\$ 5,303	\$ 2,500

Included in computer software for 2009 is \$1,290 relating to system integration software which has not yet been put into service and therefore was not amortized during the year. During the year ended June 30, 2009, \$150 was amortized in respect of internally developed software.

In 2009, expenditures for intangible assets were \$1,416 (2008: \$1,059).

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9. Deferred Lease Inducements:

	2009	2008
Deferred lease inducements	\$ 802	\$ 873
Less: Current portion	138	134
	\$ 664	\$ 739

10. Notes Payable:

Notes payable as of June 30, 2009 include amounts payable to National Bank of Canada. Pursuant to the adoption of CICA Handbook Section 3855, amounts are shown net of related transaction and financing costs. Details are as follows:

	2009	2008
Notes payable	\$ 15,000	\$ 16,243
Unamortized deferred loan origination fees	447	781
Unamortized proceeds allocated to warrants	-	168
Notes payable, net of related transaction and financing costs	14,553	15,294
Less: Current portion	2,250	3,286
	\$ 12,303	\$ 12,008

i) National Bank of Canada

On May 29, 2009, the Company entered into credit agreement (the "CA") with National Bank of Canada ("National") under which National agreed to provide the Company with two credit facilities (the "Facilities"). Facility A is a three year revolving facility for a term of three years, for up to US\$25,000,000 (or the Canadian dollar equivalent). Facility B is a three year revolving facility for a term of three years but up to US\$15,000,000 (or the Canadian equivalent). Loans ("Loans") made under either Facility may be, at the Company's option, made in Canadian dollars pursuant to Prime Rate Loans or Banker's Acceptances or in US dollars pursuant to US Base Rate Loans or LIBO Rate Loans, all as defined in the CA. In addition, Letters of Credit in either Canadian or US dollars are available under Facility A. At the Company's option, the Company can convert Loans from one type to another.

Both Facilities mature on May 29, 2012. The Company may request that the maturity date of either Facility be extended for a further 364 days by giving notice to National at least 365 days before the maturity date. National may then offer to extend on terms set out in its offer. If the Company declines the offer, the maturity date will not be extended. The Facilities may not be extended for more than two 364 day periods.

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10. Notes Payable: (continued)

Interest is payable on each Loan at the rate for that type of Loan plus a margin of 1.75% to 3.5% depending on the type of Loan and the Company's financial performance. Standby fees are payable on the portions of the Facilities that are not advanced of 0.50% to 0.65% depending on the Company's performance. There is also a standby fee on Letters of Credit issued of 2.75% to 3.50% depending on the Company's performance. In addition, there is an annual fee payable in Canadian dollars of .25% calculated on the maximum available amount of each Facility at such time (including all outstanding Loans). When the Company entered into the CA, the Company paid National a structuring fee of US\$200,000.

Facility B will be permanently reduced by 10 quarterly reductions of US\$750,000, the first reduction to be made on December 31, 2009. The Company may permanently reduce the amount available under each Facility without penalty by an amount of not less than \$1,000,000 (US or Canadian dollars, as applicable). The Company may also cancel the Facilities and repay the Loans without penalty if the repayment is made from operating cash flow or from the proceeds of an issuance of shares. If payment is made from another source a penalty will be payable on the repayment of the Loans made under Facility B of 0.75% if payment is made in the first year, 0.50% if payment is made in the second year and 0.25% if payment is made in the third year.

During the term of the Facilities the Company must meet certain financial conditions. The failure to meet such financial conditions will result in an event of default for which, among other things, National may declare all outstanding Loans to be due and payable. The Facilities are secured by first ranking charges on all of the Company's presently held and after acquired property and on all of the presently held and after acquired property of its subsidiaries. In addition, all of the shares of its subsidiaries are pledged to National as security for the Facilities. The amounts advanced to the Company under the Loans are to be used for working capital, financing Capital Expenditures and Investments, as defined in the CA.

On June 25, 2009 Credit Facility B was fully advanced in the amount of US\$15 million. At the same time that the Company was advanced \$US15 million under Facility B, the Company entered into a three year interest rate swap arrangement which locks in the interest rate at 5.36% over the three year term of this loan.

As of June 30, 2009, the Company has not made any drawdown on Facility A.

ii) Fortress Credit Corp.

On May 25, 2007 Peer 1 entered into a US\$40 million amended and restated loan agreement with Fortress Credit Corp., of which US\$20 million has been advanced. The loan agreement (the "amended and restated LSA") was by and among Peer 1 Network (USA), Inc. and each of its subsidiaries that were signatories thereto as borrowers (the "Borrowers"), the Company and each of its subsidiaries that were 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 two senior secured credit facilities (the "Credit Facilities") available to the Borrowers: a term loan (the "Term Loan") in the amount of US\$20 million; and a line of credit facility (the "Line"), in the maximum amount of US\$20 million.

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10. Notes Payable: (continued)

The Term Loan

On May 29, 2007 (the "Closing Date"), the Term Loan was fully advanced in the amount of US\$20 million. The advances were comprised of the aggregate principal outstanding under previous term loan facilities with Fortress totaling approximately \$18.1 million as at the Closing Date (initially advanced in

2005), together with such additional principal as is necessary to bring the total principal amount outstanding as at the Closing Date to US\$20 million. The Term Loan had a term of three years and was repayable in payments of approximately two hundred sixty-seven thousand dollars per month. The credit facility was to terminate and all loans and other obligations outstanding were to be payable in full on the third anniversary of the Closing Date (the "Maturity Date"), subject to the option for Peer 1 to extend the credit facility for an additional two years upon giving no less than 90 days' notice to Fortress before the Maturity Date.

The Line

The Line was made available to the Borrowers in order to finance future acquisitions and growth capital expenditures. Borrowings under the Line could be made up to US\$20 million provided that as of the date of any borrowing, after giving effect to the requested borrowing, the Borrowers' total funded debt outstanding under the Term Loan and the Line did not exceed 2.5 times actual trailing twelve month EBITDA ("TTM EBITDA") as defined under the terms of the agreement. There was an annual standby fee of one-half of one percent of the difference between the monthly balance of the Line commitment amount and the outstanding borrowings under the Line, payable 1/12th monthly. Draws under the Line were to amortize monthly based upon the following schedule:

Year 1: 1.25% of the outstanding balance;
Year 2: 2.0% of the outstanding balance; and
Year 3: 2.0% of the outstanding balance.

The Borrowers were required to repay the entire unpaid principal balance of the credit facility, including amounts owing under the Line, on the Maturity Date. The Borrowers had the ability, at their option, to terminate the Line on the first anniversary of the Closing Date if no advances have been made under the Line during that period. The Line was to automatically terminate on the second anniversary of the Closing Date if no advances had been made under the facility during that time.

Security

The Credit Facilities were secured by a first priority lien on all assets of the Borrowers including, but not limited to, capital, stock, accounts receivable, inventory, property, plant and equipment and all real and personal property owned and used by the Borrowers in connection therewith, intangible assets, trademarks, brands and all products and proceeds thereof.

Loan Prepayments

A portion of the net proceeds received by any of the Borrowers from the issuance of equity securities was required to be used to prepay the loan. Additionally, the proceeds from the sale of any assets in excess of two hundred fifty thousand dollars in a fiscal year were to be used to prepay the loan.

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10. Notes Payable: (continued)

Interest Rate

Obligations under the Credit Facilities accrued interest at the rate equal to the greater of (a) 30-day LIBOR, or (b) three percent, plus the percent per annum equal to the Applicable Margin set forth below:

Total Debt / actual TTM EBITDA	Applicable Margin
> 2.00x, <= 2.50x	4.25%
> 1.00x, <= 2.00x	3.25%
<= 1.00x	3.00%

In connection with the original Loan and security Agreement (prior to the amendment) the Company issued warrants entitling the holders to acquire 2,306,570 common shares at \$0.23 per share for a period of five years.

On June 25, 2009, the amount outstanding under the loan had been paid in full.

11. Shareholders' Equity:

Capital Stock:

The Company is authorized to issue unlimited common shares without par value and unlimited preferred shares without par value.

Shares Held released from Escrow

On August 11, 2008, the remaining balance of 1,841,401 common shares held in escrow was released.

Warrants -

The following non-transferable share purchase warrants are outstanding:

Exercise Price	2008	Issued	Expired/ Exercised	2009	Expiry Date
USD\$0.23	2,306,571	-	678,285	1,628,286	September 2, 2010
CDN\$0.40	833,333	-	-	833,333	January 31, 2011
	3,139,904	-	678,285	2,461,619	

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11. Shareholders' Equity: (continued)

Stock Options -

	2009		2008	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding, beginning	9,151,054	\$0.85	9,547,004	\$0.78
Granted	7,222,350	\$1.06	230,000	\$1.32
Exercised	133,888	\$0.35	581,503	\$0.47
Expired	125,000	\$0.42	-	-
Forfeited	86,666	\$1.01	44,447	\$0.99
Outstanding, ending	16,027,850	\$0.89	9,151,054	\$0.85
Options exercisable, ending	8,378,464	\$0.74	5,329,210	\$0.74

The following table summarizes stock options outstanding and exercisable:

	Range of Exercise Prices	Number Outstanding 2009	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price
Outstanding, ending	\$0.21 – \$0.50	887,000	1.17 Years	\$0.37
Outstanding, ending	\$0.51 – \$0.80	4,251,400	2.14 Years	\$0.54
Outstanding, ending	\$0.81 – \$1.10	7,292,850	3.98 Years	\$1.03
Outstanding, ending	\$1.11 – \$1.39	3,596,600	3.96 Years	\$1.15
Options exercisable, ending	\$0.21 – \$0.50	887,000	1.17 Years	\$0.37
Options exercisable, ending	\$0.51 – \$0.80	3,981,731	2.11 Years	\$0.54
Options exercisable, ending	\$0.81 – \$1.10	2,709,733	3.11 Years	\$1.02
Options exercisable, ending	\$1.11 – \$1.39	800,000	3.75 Years	\$1.14

During the fiscal year ended June 30, 2009, directors and officers of the Company were granted aggregate 2,955,750 options with an exercise price of \$0.98 expiring June 25, 2014.

New Stock Option Plan

During the quarter ended December 31, 2008 the Company's Board of Directors approved the adoption of a 2008 Combined Incentive and Nonqualified Stock Option Plan (the "New Plan") to replace the Company's 2006 Combined Incentive and Nonqualified Stock Option Plan. The New Plan received conditional TSX approval on November 14, 2008 and shareholder approval on December 4, 2008. Under the new plan 23,850,530 common shares have been reserved for the issuance of options. In accordance with the adoption of the New Plan, all existing stock options become outstanding under and governed by the New Plan. This number of shares represents 20% of the Company's outstanding share capital as at September 25, 2008. Under the new plan as under the 2006 plan which it replaced, the exercise price of each option equals the market price of the stock on the date of the grant. Outstanding options as at June 30, 2009, vest on varying terms from the date granted to over 36 months. Upon a change of control of the Company, 7,083,200 options would vest immediately

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11. Shareholders' Equity (continued)

Stock Options – (continued)

The fair value of each option is estimated as at the date of grant using the Black-Scholes Option Pricing Model with the following weighted average assumptions:

	2009	2008
Dividend yield	-	-
Expected volatility	61%	60%
Risk-free interest rate	2.9%	4.0%
Expected average option term	5 years	4.5 years

The weighted average fair value of the options granted to employees and directors of the Company during the year was \$0.57 (\$0.74 in 2008) per option. The 2009 stock based compensation expense is \$2,282 (2008: \$1,453).

Earnings Per Share -

Basic earnings per share

	2009	2008
Net earnings available to common shareholders	\$ 5,722	\$ 7,064
Weighted average number of common shares outstanding	119,139,925	118,255,679
Basic earnings per share	\$ 0.05	\$ 0.06

Diluted earnings per share

Net earnings available to common shareholders	\$ 5,722	\$ 7,064
Weighted average number of common shares outstanding	119,139,925	118,255,679
Dilutive effect of warrants	1,866,293	2,522,696
Dilutive effect of stock options	808,705	1,672,013
Adjusted weighted average number of common shares	121,814,923	122,450,388
	\$ 0.05	\$ 0.06

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12. Income Taxes:

Income tax expense consists of:

	2009	2008
Current tax expense	\$ 4,006	\$ 3,197
Future tax expense	655	2,040
	\$ 4,661	\$ 5,237

Income taxes vary from the amount that would be computed by applying the estimated combined statutory income tax rate 37.05% (2008: 36.47%) for the following reasons:

	2009	2008
Expected income tax expense	\$ 3,847	\$ 4,486
Non-deductible expenses	717	807
Other	97	(56)
Income tax expense	\$ 4,661	\$ 5,237

Significant components of the future tax assets are shown below:

	2009	2008
Non-capital losses carried forward	\$ 152	\$ -
Accounting depreciation in excess of tax depreciation	57	1,154
Deferred lease inducements	303	345
Deferred gain	217	247
Other	550	199
Total future tax assets	\$ 1,279	\$ 1,945

The Company's management evaluates the likelihood that future income tax assets will be realized based on projected future earnings and tax planning strategies.

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13. Supplemental Disclosure of Cash Flow Information:

a) Supplemental Disclosure –

	2009	2008
Interest paid	\$ 1,318	\$ 1,594
Income taxes paid	3,182	2,293
Interest received	70	316
Effect of acquisition of property and equipment in accounts payable	212	(370)

b) Non-cash Transactions –

Nil during the year ended June 30, 2009.

During the year ended June 30, 2008 as follows:

- i) In February 2008, the Company entered into a master capital lease agreement to acquire the right of use of certain network equipment. In connection with the lease the Company incurred an obligation under the capital lease in the amount of \$ 1,006,246. See Note 6.
- ii) During the year ended June 30 2008, fixed assets were disposed of as a trade in for deemed proceeds of \$553,036.

14. Related Party Balances and Transactions:

The Company has entered into a number of related party transactions with companies either owned or subject to significant influence by management, directors, and principal shareholders.

The significant transactions with related parties are as follows:

	2009	2008
Transaction during the year -		
Revenue earned from companies owned or subject to significant influence by directors and principal shareholders	\$ 100	\$ 99
Other expenses from companies owned or subject to significant influence by directors and principal shareholders	\$ 104	\$ 162

These transactions are in the normal course of operations and are measured at their exchange amounts, which is the amount of consideration established and agreed to by the related parties.

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14. Related Party Balances and Transactions: (continued)

	2009	2008
Balances at year end -		
Accounts receivable from companies owned or subject to significant influence by directors and principal shareholders	\$ -	\$ 4
Accounts payable to companies owned or subject to significant influence by directors and principal shareholders	\$ -	\$ 21

The balances are payable on demand and have arisen from the sale of products and provision of services referred to above.

15. Correction of Error in Prior Period:

During the quarter ended December 31, 2008 it was determined that as at June 30, 2008, included in the balance sheet captions accounts receivable and deferred revenue were amounts for invoices that had been issued but were not yet due. Accordingly, at June 30, 2008, the asset financial statement caption accounts receivable was overstated by \$653 and correspondingly, the liability caption deferred revenue was overstated by \$653.

At June 30, 2008, the effect of the correction of this error is to reduce accounts receivable presented on the balance sheet at June 30, 2008 by \$653 to \$4,051 and to reduce deferred revenue presented on the balance sheet at June 30, 2008 by \$653 to \$3,553.

The correction did not have any impact on net income or earnings per share.

The June 30, 2008 comparative numbers relating to accounts receivable and deferred revenue have been corrected to reflect these adjusted amounts.

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16. Capital Risk Management:

The Company manages its capital to maintain its ability to continue as a going concern and to provide returns to shareholders and benefits to other stakeholders. The capital structure of the Company consists of cash and cash equivalents, notes payable and equity comprising of issued capital, contributed surplus and retained earnings.

The Company manages its capital structure and makes adjustments to it in light of economic conditions. The Company, upon approval from its board of directors, will balance its overall capital structure through new share issues, share repurchases, the payment of dividends, the issue of debt or by undertaking other activities as deemed appropriate under the specific circumstances. The Company is subject to externally imposed capital requirements as required under the terms of its loan agreement. The Company's overall strategy with respect to capital risk management remains unchanged from the year ended June 30, 2008.

17. Financial Risk Management:

a) Overview:

The Company has exposure to credit risk, liquidity risk and market risk. The Company's Management has overall responsibility for the oversight of the Company's risk management within parameters established by the board of directors.

b) Credit risk:

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Company's accounts receivable. The carrying amount of financial assets represents the maximum credit exposure. The Company has adopted a credit policy which includes a requirement for payment in advance of service for dedicated hosting customers. The Company's exposure to credit risk with its customers is influenced mainly by the individual characteristics of each customer. The Company's customers are primarily located in the United States and Canada and represent various industries. At June 30, 2009, no single customer represented more than 5% of accounts receivable. The Company establishes an allowance for doubtful accounts that represents its estimate of incurred losses in respect of trade receivables. The main components of this allowance is a specific loss component that relates to individually significant exposures, and an overall loss component established based on historical trends and other information. Trade accounts receivable are written off against the allowance account after management has determined that the loss is probable. As at June 30, 2009, the Company had an allowance for doubtful accounts of \$922. At June 30, 2009, the Company had no individually material past due trade accounts receivables.

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17. Financial Risk Management: (continued)

b) Credit risk: (continued)

	As of June 30, 2009	
Total Accounts receivable	\$	4,371
Less: Allowance for doubtful accounts		922
Total Accounts receivable, net	\$	3,449
Of which:		
Not overdue	\$	52
1-30 days		1,615
31-60 days		628
61-90 days		252
91 days and over		610
Less: Allowance for doubtful accounts		(922)
Accounts receivable – other		1,214
Accounts receivable, net	\$	3,449

The Company invests its excess cash in overnight bank commercial paper with the objective of maintaining safety of principal and providing adequate liquidity to meet all current payment obligations and future planned capital expenditures and with the secondary objective of adding to the overall yield generated by excess cash balances. Excess cash balances are transferred to U.S. Bank commercial Paper sweep accounts which mature overnight. The U.S. Bank commercial paper is a short term promissory note issued by U.S. Bank N.A. and is rated at least investment grade by the recognized rating agencies. Given the high credit ratings and overnight duration, the Company does not expect the counterparties to these bank promissory notes to fail to meet their obligations.

c) Liquidity risk:

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Company's reputation. As at June 30, 2009, the Company had financial assets held for trading of \$15,744, loans and receivables of \$3,449 and other financial liabilities of \$23,064. As at June 30, 2008, the Company had financial assets held for trading of \$11,026, loans and receivables of \$4,051 and other financial liabilities of \$24,985. All of the Company's financial liabilities have contracted maturities of less than 3 years. The Company manages its liquidity risk by continuously monitoring forecast and actual gross profit and cash flows from operations.

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17. Financial Risk Management: (continued)

d) Market risk:

Market risk is the risk that changes in market prices, such as foreign exchange rates, interest rates and equity prices will affect the Company's income or the value of its financial instruments. The Company provides its services in the United States and Canada substantially all of the Company's financial assets and liabilities originate in United States and Canadian dollars. The Company is exposed to currency risk for sales and purchases that are denominated in Canadian dollars. The Company believes that changes in exchange rates would not have a significant impact on net income and has not entered into any currency hedging transactions. The Company is subject to interest rate risk on its cash and cash equivalents. The Company believes that interest rate risk is low as excess cash is invested overnight only.

A change of 1% in interest rates for the three months ended June 30, 2009 would have increased or decreased net income by \$26, and a change of 1% in interest rates for the twelve months ended June 30, 2009 would have increased or decreased net income by \$114.

On June 25, 2009 the Company entered into a interest rate swap agreement which fixed the interest rate on the Facility B notes payable at 5.36% (see note 10).

e) Fair value of financial instruments:

The fair values of financial assets and financial liabilities are determined as follows:

- (i) For cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities carrying amounts approximate fair value due to their short-term maturity;
- (ii) The fair value of notes payable and obligations under capital lease approximate their carrying value as their effective interest rates approximate current market rates.
- (iii) The fair value of derivative financial instruments is determined based on fair market valuation methods.

18. Commitments and Contingencies:

a) Premises leases -

The Company has entered into agreements to lease premises which expire between fiscal 2010 and 2020. The future minimum lease payments for the next five fiscal years are as follows:

2010	\$ 6,469
2011	6,752
2012	6,091
2013	6,046
2014	4,984

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18. Commitments and Contingencies: (continued)

b) Services agreements -

The Company has entered into a series of agreements to obtain bandwidth, backbone, peering, local loop/cross connect and points of presence services. These agreements expire between fiscal 2010 and 2012. Minimum payments for the next three fiscal years under the contracts are as follows:

	2010	2011	2012
Bandwidth	\$ 880	\$ 223	\$ -
Backbone	1,907	308	-
Peering	125	36	-
Local loop/cross connect	375	66	24
Points of presence	75	15	-
	\$ 3,362	\$ 648	\$ 24

c) Other commitments -

The Company has entered into agreements to purchase certain software licenses. These agreements expire between fiscal 2010 and 2012. Minimum payments for the next three fiscal years under the contracts are as follows:

2010	\$ 950
2011	360
2012	60

d) Legal contingencies -

In March 2007, the Company was served with a Writ of Summons and Statement of Claim (subsequently amended) issued in the Supreme Court of British Columbia. The plaintiffs, Aidan Stretch and James Walsh, claim that they are the assignees of an alleged right to receive 745,000 warrants, each warrant entitling them to acquire one of our common shares at a price of CDN \$0.40 for a period of two years, and they seek a declaration that the Company be obliged to issue those warrants. The plaintiffs also seek any losses suffered due to any delay in issuing the warrants, and costs. The Company filed a Statement of Defence on June 28, 2007 which led to the plaintiffs amending the claim by, among other things, adding WindyPoint Capital Inc. and WindyPoint Capital Holdings Inc. as plaintiffs in the action, being the parties from whom Stretch and Walsh allege they received the assignment of right. The Company responded with an amended Statement of Defence as well as with a Counterclaim seeking judgment against WindyPoint Capital Inc. for US\$668,750. On August 29, 2008, the plaintiffs filed a Reply to the amended Statement of Defence, and a Statement of Defence to the Counterclaim. Although the trial of the proceedings is scheduled to commence on December 7, 2009, no examinations for discovery have yet been conducted. As a result, while the Company has and continues to defend the claim vigorously on reasonable grounds, there can be no assurance that the Company will be successful in its efforts. A contingent loss has not been recorded with respect to this claim and an estimate of the contingent loss if any cannot be made.

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19. Segmented Information:

During the prior year, management of the Company completed integration initiatives including the implementation of reporting systems which allow for the management and allocation of resources of the Company on the basis of a re-aligned, integrated operating structure. Prior to the completion of these initiatives, the Company was managed on the basis of separate lines of business comprising two reporting segments. Following the completion of these integration initiatives and re-alignment, management has determined that the Company operates in a single reportable operating segment which involves the provision of outsourced data center infrastructure services. The Company's service offerings include the provision of physical space within its data centers, a complete suite of managed and dedicated hosting services and high availability bandwidth connectivity.

Geographic segment information is shown on the basis of the geographic location of the permanent establishment that derived the results. The geographic segments in operation are as follows:

	Canada	US	UK	2009 Total
Revenue	\$ 17,604	\$ 74,690	\$ 15	\$ 92,309
Property and equipment	8,864	28,338	667	37,869
Goodwill	-	1,715	-	1,715
Intangible assets	339	2,213	-	2,552
Amortization of property and equipment	1,628	10,184	68	11,880
Amortization of intangible assets	17	1,346	-	1,363

	Canada	US	UK	2008 Total
Revenue	\$ 20,083	\$ 69,264	\$ -	\$ 89,347
Property and equipment	6,877	28,208	-	35,085
Goodwill	-	1,715	-	1,715
Intangible assets	391	2,109	-	2,500
Amortization of property and equipment	1,080	8,378	-	9,458
Amortization of intangible assets	35	1,555	-	1,590

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20. Differences between Canadian and United States Generally Accepted Accounting Principles:

These financial statements are expressed in United States dollars and are prepared in accordance with Canadian GAAP which conforms, in all material respects, with US GAAP except as described below:

Convertible Debt and Debt Issued with Stock Purchase Warrants -

The interest on convertible debt includes an accretion charge to reflect the increase in the equity component of the convertible debt. Under US GAAP APB No. 14 "Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants", no portion of the security should be attributable to the conversion feature, so the accretion charge should be added back to net income (loss).

Employee Stock Options -

The Company accounts for all its employee stock options with the fair value method "FAS 123R". Under this method, compensation cost is measured at the grant date based on the fair value of the options granted. FAS 123R requires that the option be valued using a fair value option pricing model.

The Company adopted the fair value method for Canadian purposes effective January 1, 2004. As a result there is no adjustment to net income for 2005, but there is an adjustment to share capital and deficit to reflect the different dates of adoption.

Non-employee Stock Options -

The Company accounts for its non-employee stock options with the fair value method "FAS 123R". Under this method, compensation cost is measured at the grant date based on the fair value of the options granted. FAS 123R requires that the option be valued using the Black-Scholes Option Pricing Model.

Share Purchase Warrants -

Under FAS 133 as amended by FAS 149 and 150, beneficial detachable warrants issued as a component of debt have been reclassified as equity. As Canadian GAAP conforms to US GAAP, this has no material impact on the Company.

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20. Differences between Canadian and United States Generally Accepted Accounting Principles: (continued)

Net Income Per Share -

On February 1997, SFAS No. 128 "Earnings per Share" was issued. SFAS 128 redefines earnings per share under US GAAP and replaces primary earnings per share with basic earnings per share. The net income per share, as reported, is different from basic income per share prescribed by SFAS 128 as follows:

Weighted Average Number of Shares Outstanding -	2009	2008
Canadian	119,135,925	118,255,679
Less: Escrow shares	-	1,841,401
US GAAP	119,135,925	116,414,278
Basic Income per share under US GAAP	\$0.05	\$0.06

Application of US GAAP -

In June 1997, FASB issued SFAS No. 130 "Reporting Comprehensive Income", which was effective for fiscal years beginning after December 15, 1997. The Company has determined that comprehensive income consists of its net income (loss) and foreign currency translation adjustments, and is shown net of tax in the statement of changes in shareholders' equity.

The application of US GAAP would have the following effects on the balance sheet items as reported under Canadian GAAP:

Balance Sheet

Shareholders' Equity	2009	2008
Deficit / (Retained Earnings) - Canadian GAAP	\$ (4,709)	\$ 1,013
Cumulative effect of prior years' adjustments:		
Accretion interest charge on preferred shares	(2,450)	(2,450)
Stock based compensation	(422)	(422)
Accretion interest charge on convertible debt	(101)	(101)
Deficit/(Retained Earnings) - US GAAP	(1,736)	(1,960)
Capital - Canadian GAAP	32,198	29,715
Deduct: Stock based compensation	(422)	(422)
Capital - US GAAP	31,776	29,293
Shareholders' Equity – US GAAP	\$ 33,512	\$ 31,253

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20. Differences between Canadian and United States Generally Accepted Accounting Principles: (continued)

Convertible Promissory Debentures -

Under US GAAP, in accordance with APB No. 14 "Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants", no portion of the proceeds from the issuance of convertible debt securities should be accounted for as attributable to the conversion feature. Canadian GAAP requires the separate presentation of the liability and equity component of the convertible debentures.

Adopted Accounting Policies:

a) Fair Value Option for Financial Assets and Financial Liabilities

In February 2007, the Financial Accounting Standards Board ("FASB") issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities – Including an Amendment of FASB Statement No. 115". This statement permits entities to choose to measure many financial instruments and certain other items at fair value. Most of the provisions of SFAS No. 159 apply only to entities that elect the fair value option. However, the amendment to SFAS No. 115 "Accounting for Certain Investments in Debt and Equity Securities" applies to all entities with available-for-sale and trading securities. SFAS No. 159 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. Adoption of SFAS 159 on July 1, 2008 did not have a material impact on the Company's financial position, results of operations or cash flows.

b) Fair Value Measurements

In September 2006, FASB issued SFAS No. 157, "Fair Value Measurements". The objective of SFAS No. 157 is to increase consistency and comparability in fair value measurements and to expand disclosures about fair value measurements. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS No. 157 applies under other accounting pronouncements that require or permit fair value measurements and does not require any new fair value measurements. In February 2008, FASB issued FASB Staff Position No. FAS 157-2, "Effective Date of FASB Statement No. 157", which delays the effective date of SFAS No. 157 until fiscal years beginning after November 15, 2008 for nonfinancial assets and nonfinancial liabilities except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). The provisions of SFAS No. 157 are effective for fair value measurements made in fiscal years beginning after November 15, 2007. Adoption of SFAS 159 on July 1, 2008 did not have a material impact on the Company's financial position, results of operations or cash flows.

c) Accounting for uncertainty in income taxes

In June 2006, the Financial Accounting Standards Board ("FASB") issued Interpretation No. 48 ("FIN 48"). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109 "Accounting for Income Taxes" ("SFAS 109"). The interpretation prescribes a recognition threshold and measurement attribute to the financial statement recognition and measurement of tax position taken or expected to be taken in a tax return. FIN 48 also provides accounting guidance on derecognition, classification, interest and

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20. Differences between Canadian and United States Generally Accepted Accounting Principles: (continued)

Adopted Accounting Policies: (continued)

c) Accounting for uncertainty in income taxes (continued)

penalties, accounting in interim periods, disclosure and transition. The Company adopted the provisions of FIN 48 on July 1, 2008 which had no effect on its results of operations and financial condition.

Recent Accounting Pronouncements:

a) Non-controlling Interests in Consolidated Financial Statements

In December 2007, the FASB issued SFAS No. 160, “Non-controlling Interests in Consolidated Financial Statements – an amendment of Accounting Research Bulletin No. 51” (“SFAS 160”), which establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent, the amount of consolidated net income attributable to the parent and to the non-controlling interest, changes in a parent’s ownership interest and the valuation of retained non-controlling equity investments when a subsidiary is deconsolidated. The Statement also establishes reporting requirements that provide sufficient disclosures that clearly identify and distinguish between the interests of the parent and the interests of the non-controlling owners. SFAS 160 is effective for fiscal years beginning after December 15, 2008. The Company is assessing the impact of SFAS 160 on its results of operations and financial conditions.

b) Disclosures about Derivative Instruments and Hedging Activities – an amendment of FASB Statement No. 133

In March 2008, the FASB issued SFAS No. 161 “Disclosures about Derivative Instruments and Hedging Activities – an amendment of FASB Statement No. 133”. SFAS 161 changes the disclosure requirements for derivative instruments and hedging activities. Entities are required to provide enhanced disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are account for under FAS 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity’s financial position, financial performance, and cash flows. The guidance in SFAS 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008 with early adoption encouraged. The Company is assessing the impact of SFAS 161 on its results of operations and financial conditions.

c) The Hierarchy of Generally Accepted Accounting Principles

In May 2008, FASB issued SFAS 162, “The Hierarchy of Generally Accepted Accounting Principles”. The Statement identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements. This Statement is effective 60 days following the SEC’s approval of the Public Company Accounting Oversight Board amendments to AU Section 411, “The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles”. The adoption of this statement is not expected to have a material effect on the Company’s financial statements.

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20. Differences between Canadian and United States Generally Accepted Accounting Principles: (continued)

Recent Accounting Pronouncements: (continued)

d) Business Combinations

In December 2007, the FASB issued SFAS 141 (revised 2007), Business Combinations (SFAS 141R). SFAS 141R significantly changes the accounting for business combinations in a number of areas including the treatment of contingent consideration, pre-acquisition contingencies, transaction costs, in-process research and development, and restructuring costs. In addition, under SFAS 141R, changes in an acquired entity's deferred tax assets and uncertain tax positions after the measurement period will impact income tax expense. SFAS 141R is effective for fiscal years beginning after December 15, 2008. Adoption of this standard did not have a material impact on the Company's financial position, results of operations or cash flows.

e) Accounting for Financial Guarantee Insurance Contracts – an Interpretation of FASB Statement No. 60

In May 2008, the FASB issued SFAS No. 163, "Accounting for Financial Guarantee Insurance Contracts - an interpretation of FASB Statement No. 60." SFAS 163 requires that an insurance enterprise recognize a claim liability prior to an event of default (insured event) when there is evidence that credit deterioration has occurred in an insured financial obligation. This Statement also clarifies how Statement 60 applies to financial guarantee insurance contracts, including the recognition and measurement to be used to account for premium revenue and claim liabilities. Those clarifications will increase comparability in financial reporting of financial guarantee insurance contracts by insurance enterprises. This Statement requires expanded disclosures about financial guarantee insurance contracts. The accounting and disclosure requirements of the Statement will improve the quality of information provided to users of financial statements. SFAS 163 will be effective for financial statements issued for fiscal years beginning after December 15, 2008. The Company does not expect the adoption of SFAS 163 will have a material impact on its financial condition or results of operation.

f) Not for Profit Entities: Mergers and Acquisitions

In April 2009, the FASB issued SFAS 164 "Not for Profit Entities; Mergers and Acquisitions-Including an amendment of FASB Statement No. 142". SFAS 164 establishes principles and requirements for when a not-for-profit agency entity combines with one or more other not-for profit entities, businesses, or nonprofit activities. This Statement improves the relevance, representational faithfulness, and comparability of the information a not-for-profit entity provides about goodwill and other intangible assets after an acquisition. This Statement is effective for mergers for which the merger date is on or after the beginning of an initial reporting period beginning on or after December 15, 2009, and acquisitions for which the acquisition date is on or after the beginning of the first annual reporting period on or after December 15, 2009. The Company does not expect SFAS 164 to have a material effect on its financial statements.

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20. Differences between Canadian and United States Generally Accepted Accounting Principles: (continued)

Recent Accounting Pronouncements: (continued)

g) Subsequent Events

In May 2008, the FASB issued SFAS No. 165, Subsequent Events. SFAS No. 165 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued. SFAS No. 165 is effective for interim or annual financial periods ending after June 15, 2009. The adoption of SFAS No. 165 is not expected to have a material impact on the Company's results of operations, financial position and cash flows.

h) Accounting for Transfers of Financial Instruments

In June 2009, the FASB issued SFAS No. 166, "Accounting for Transfers of Financial Assets—an amendment of FASB Statement" ("SFAS 166"). SFAS No. 166 is intended to establish standards of financial reporting for the transfer of assets and transferred assets to improve the relevance, representational faithfulness, and comparability. SFAS 166 was established to clarify de-recognition of assets under FASB Statement No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. SFAS No. 166 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2009. The Company expects that the adoption of SFAS No. 166 will have no impact will have on its consolidated financial statements.

i) Amendments to FASB Interpretation No. 46(R)

In June 2009, the FASB issued SFAS No. 167, "Amendments to FASB Interpretation No. 46(R)" ("SFAS No. 167"). SFAS No. 167 eliminates the exception to consolidate a qualifying special-purpose entity, changes the approach to determining the primary beneficiary of a variable interest entity and requires companies to more frequently re-assess whether they must consolidate variable interest entities. Under the new guidance, the primary beneficiary of a variable interest entity is identified qualitatively as the enterprise that has both (a) the power to direct the activities of a variable interest entity that most significantly impact the entity's economic performance, and (b) the obligation to absorb losses of the entity that could potentially be significant to the variable interest entity or the right to receive benefits from the entity that could potentially be significant to the variable interest entity. SFAS No. 167 becomes effective for the Company's fiscal 2011 year-end and interim reporting periods thereafter. The Company does not expect SFAS No. 167 to have a material impact on its financial statements.

j) FASB Accounting Standards Certification and the Hierarchy of Generally Accepted Accounting Principles

In June 2009, the FASB issued SFAS No. 168, "The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles," ("Codification"), which supersedes all existing accounting standard documents and will become the single source of authoritative non-governmental U.S. GAAP. All other accounting literature not included in the Codification will be considered non-authoritative. The Codification was implemented on July 1, 2009 and will be effective for interim and annual periods ending after September 15, 2009.