

SEPTEMBER 30, 2005  
QUARTERLY REPORT

NOTICE TO READER:

The attached financial statements have been prepared by management of Peer 1 Network Enterprises, Inc. and have not been reviewed by the auditor of Peer 1 Network Enterprises, Inc.

**Peer 1 Network Enterprises, Inc.**  
**Consolidated Balance Sheet**  
**As At September 30, 2005**  
**(unaudited - prepared by management)**

	September 2005 \$	June 2005 \$
<b>Assets</b>		
<b>Current:</b>		
Cash and cash equivalents	6,776,087	357,738
Restricted Cash	585,650	612,800
Accounts receivable	4,558,218	2,991,503
Inventory	111,771	102,829
Prepaid expenses	2,083,880	460,586
	<u>14,115,606</u>	<u>4,525,456</u>
<b>Other assets</b>	4,611,882	1,273,573
<b>Property, plant and equipment</b>	30,649,491	12,489,163
<b>Goodwill, licences and other intangibles</b>	6,660,141	5,865,724
	<u>56,037,120</u>	<u>24,153,916</u>
<b>Liabilities</b>		
<b>Current Liabilities</b>		
Accounts payable and accrued liabilities	7,452,123	5,629,157
Deferred revenue	3,486,440	1,396,154
Current portion of deferred lease inducements	65,460	59,962
Current portion of notes payable	4,285,845	13,467,480
Shareholder notes	-	2,756,245
	<u>15,289,868</u>	<u>23,308,998</u>
<b>Deferred lease inducements</b>	451,274	384,772
<b>Notes payable</b>	23,741,731	119,228
<b>Long Term Debt</b>	7,962,021	-
	<u>47,444,894</u>	<u>23,812,998</u>
<b>Shareholders' Deficiency</b>		
<b>Common Shares</b>	18,713,823	11,245,992
<b>Warrants</b>	1,360,657	-
<b>Equity component of convertible debt</b>	539,906	435,638
<b>Contributed Surplus</b>	666,271	636,056
<b>Deficit</b>	(12,688,431)	(11,976,768)
	<u>8,592,226</u>	<u>340,918</u>
	<u>56,037,120</u>	<u>24,153,916</u>

**Peer 1 Network Enterprises, Inc.**  
**Consolidated Income Statement**  
**Three Months Ended September 30**  
(unaudited - prepared by management)

	Three Months Ended September 2005	Three Months Ended September 2004
Revenue	11,569,507	3,780,131
Cost of Sales	7,117,279	2,355,617
<b>Gross Profit</b>	<b>4,452,228</b>	<b>1,424,514</b>
Operating expenses	2,826,675	1,489,836
<b>Operating profit (loss)</b>	<b>1,625,553</b>	<b>(65,322)</b>
Amortization of licences	898,168	-
Amortization of preferred share discount	173,279	-
Interest expense	756,636	160,757
Interest accretion on convertible debt	573,833	92,618
Integration costs	79,677	-
Realized foreign exchange loss (gain)	(200,158)	(7,028)
Unrealized foreign exchange loss (gain)	40,026	-
Loss from equity accounted investment	15,755	-
<b>Loss before income taxes</b>	<b>(711,663)</b>	<b>(311,669)</b>
(Provision for) recovery of corporate taxes	-	-
<b>Loss for the period</b>	<b>(711,663)</b>	<b>(311,669)</b>
Deficit, beginning of period	(11,976,768)	(9,132,877)
<b>Deficit, end of period</b>	<b>(12,688,431)</b>	<b>(9,444,546)</b>
<b>Basic and diluted loss per share</b>	<b>(0.01)</b>	<b>(0.01)</b>

**Peer 1 Network Enterprises, Inc.**  
**Consolidated Statement of Cash Flows**  
**Three Months Ended September 30**  
**(unaudited - prepared by management)**

	<b>Three Months Ended September 2005</b>	<b>Three Months Ended September 2004</b>
<b>Cash flows from operating activities</b>		
Loss for the period	(711,663)	(311,669)
Amortization	1,721,231	264,223
Amortization of preferred share discount	173,279	-
Stock-based compensation included in loss for period	30,715	-
Increase (decrease) in deferred lease inducements	72,000	(2,951)
Increase in accrued interest and accretion of convertible debt	1,330,469	253,375
	2,616,031	202,978
Change in non-cash working capital items		
Increase in accounts receivable	(1,566,715)	(43,656)
Increase in inventory	(8,942)	-
Increase in prepaid expenses	(1,623,294)	(167,130)
Increase in accounts payable and accrued liabilities	1,822,966	389,372
Increase in deferred revenue	2,090,286	(7,004)
	3,330,332	374,561
<b>Cash flows from investing activities</b>		
Acquisition of property and equipment	(19,597,047)	(621,305)
Investment in goodwill, licences and other intangibles	(1,078,929)	-
Investment in other assets	(2,738,245)	(413,426)
	(23,414,221)	(1,034,731)
<b>Cash flows from financing activities</b>		
Change in restricted cash	27,150	-
Proceeds from notes payable, long term debt and affiliated companies	29,230,133	(224,426)
Share capital issued	1,200	1,560
Proceeds from (repayment of) shareholder notes	(2,756,245)	-
	26,502,238	(222,866)
Decrease in cash and cash equivalents	6,418,349	(883,037)
Cash and cash equivalents - beginning of period	357,738	976,848
Cash and cash equivalents - end of period	6,776,087	93,812

## **Notes to Unaudited Consolidated Financial Statements**

### **1. Nature of Operations and Basis of Presentation:**

Peer 1 Network Enterprises, Inc. (the "Company") was incorporated under the laws of British Columbia. The company provides high performance internet bandwidth and co-location facilities to web-centric and enterprise customers across North America. Building on a redundant, 100% Cisco powered internal network, the Company guarantees 100% uptime internet access for companies with mission-critical applications. The Company has established local offices and data centres throughout Canada and the USA, and also has established a point of presence in London, UK. The corporate headquarters are in Vancouver.

The accompanying unaudited consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles for interim financial information and, accordingly do not include all information and note disclosures required for the annual financial statements under Canadian generally accepted accounting principles. It is management's opinion that all adjustments considered necessary for fair presentation of the financial position, results of operations and cash flow for the nine month period have been made. These financial statements have been prepared in accordance with the same accounting principles applied in the preparation of the annual audited consolidated financial statements filed with the British Columbia Securities Commission for the fiscal year ended June 30, 2005. The annual financial statements should be referenced in conjunction with this interim report.

### **2. Basis of Consolidation:**

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

### **3. Interland, Inc. Asset Acquisition**

On September 2, 2005 the company, through a wholly owned subsidiary, completed the asset purchase pursuant to the asset purchase agreement dated August 31, 2005 with Interland, Inc. ("Interland"). Pursuant to the agreement, Interland agreed to sell, and the company agreed to purchase, all of the assets of Interland that are necessary for the daily operation of Interland's dedicated server business. The company has also agreed to assume certain liabilities of Interland. In addition, Interland has granted to the company a royalty-free non-

exclusive license to the intellectual property owned by Interland and access to property licensed by Interland from third parties. The purchase price for the assets and the obligations of Interland was US\$14,000,000, subject to adjustment in accordance with the asset purchase agreement. 20% of the purchase price prior to adjustment was placed in escrow as security for the obligations of Interland under the agreement. Peer 1 and Interland have also entered into an administrative services agreement dated as of August 31, 2005. As a result of the transaction, Interland has become a significant co-location, bandwidth and managed services customer of the company.

The allocation of the purchase price is preliminary and the final allocation may be subject to refinement in the next 12 months. The purchase price and related organizational costs were allocated to the assets acquired based on the fair market value, with the excess recorded as goodwill, as follows

	<b>US</b>	<b>CDN</b>
Accounts receivable, net	473,018	562,040
Prepaid expenses	538,000	639,252
Other assets – deposits	289,000	343,390
Tangible capital assets	15,029,509	17,858,063
Goodwill	239,635	284,733
Deferred revenue	(1,800,000)	(2,138,760)
Accounts payable	<u>(165,000)</u>	<u>(196,053)</u>
	<b>\$ <u>14,604,162</u></b>	<b>\$ <u>17,352,665</u></b>

#### 4. Share Capital

a) Authorized :  
100,000,000 Common shares without par value

b) Issued and Fully Paid:

	<b>Number</b>	<b>Amount</b>
Balance at beginning of year	49,119,367	\$ 11,245,993
Changes in share capital	<u>26,818,213</u>	<u>\$ 7,467,830</u>
Balance at September 30, 2005	<u>75,937,580</u>	<u>\$ 18,713,823</u>

c) Preferred Shares Series A

On September 2, 2005 7,000 preferred shares with a par value of \$US 1,000 per share were issued for cash proceeds of \$8,317,400 (\$US 7,000,000). The preferred shares are classified as long term debt as they are redeemable by the holders at US\$2,000 per share at anytime after four years. The \$16,634,000 (\$US 14,000,000) redemption amount has been reduced by a discount on issuance of \$8,317,400 (\$US 7,000,000) and is being amortized using the effective interest method over a period of four years.

d) Warrants Outstanding

The following non-transferable share purchase warrants are outstanding:

<i><b>Expiry Date</b></i>	<i><b>Exercise Price</b></i>	<i><b>Outstanding 06/30/2005</b></i>	<i><b>Issued</b></i>	<i><b>Expired/ Exercised</b></i>	<i><b>Outstanding 09/30/2005</b></i>
Jul 18, 2007	\$0.40		3,100,000		3,100,000
Sept 2, 2007	\$0.40		745,000		745,000
Oct 23, 2005	\$0.32	1,834,215			1,834,215
Nov 6, 2005	\$0.28	500,000			500,000
Sept 2, 2010	US\$0.23		2,306,571		2,306,571
		2,334,215	6,151,571		8,485,786

e) Shares held in escrow:

As of September 30, 2005, 11,048,401 shares of the company are subject to an escrow agreement and may not be transferred, assigned, or otherwise dealt with without the consent of the regulatory body that has jurisdiction.

f) Stock Options

The company has the following stock options outstanding:

<i><b>Expiry Date</b></i>	<i><b>Exercise Price</b></i>	<i><b>Outstanding 06/30/2005</b></i>	<i><b>Issued</b></i>	<i><b>Expired/ Exercised</b></i>	<i><b>Outstanding 09/30/2005</b></i>
May 30, 2009	\$0.46	15,000			15,000
July 24, 2007	\$0.45	2,138,250			2,138,250
Nov 7, 2007	\$0.45	300,000			300,000
June 30, 2009	\$0.45	60,000			60,000
Sept 30, 2010	\$0.45		2,500		2,500
March 8, 2009	\$0.44	300,000			300,000
Jan 29, 2009	\$0.42	15,000			15,000
Nov 7, 2007	\$0.39	105,000			105,000
July 29, 2010	\$0.39		110,000		110,000
Oct 20, 2009	\$0.38	195,000			195,000
Aug 31, 2010	\$0.36		10,000		10,000
May 31, 2005	\$0.35	35,000			35,000

Sept 9, 2008	\$0.32	337,000		337,000
Sept 30, 2009	\$0.31	10,000		10,000
Mar 1, 2010	\$0.30	30,000		30,000
Feb 28, 2010	\$0.30	15,000		15,000
Apr 30, 2010	\$0.30	25,000		25,000
Nov 30, 2009	\$0.28	37,000		37,000
Dec 31, 2009	\$0.28	10,000		10,000
Jan 31, 2010	\$0.24	20,000	5,000	15,000
		3,647,250	122,500	5,000
				3,764,750

The options and warrants are not included in diluted per share calculations.

## 5. Related Party Transactions

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

At September 30, 2005 amounts due to and from related parties were as follows:

	<b>FY2006</b>	<b>FY2005</b>
Included in accounts receivable	\$26,178	\$112,602
Included in accounts payable and accrued liabilities	\$5,118	2,996

During the period, transactions with related parties were as follows:

	<b>FY2006</b>	<b>FY2005</b>
Revenues earned	\$28,963	\$54,896
Interest expensed	\$697,707	\$140,684
Other expenses incurred	\$2,047,105	74,907

These transactions are in the normal course of operations and are measured at their exchange amounts. Included in other expenses incurred is \$52,185 in accounts receivable from related parties that was written off, Interest and loan origination fees of \$526,960 and financing fees of \$1,467,960.

## 6. Segmented Information

Prior to the second quarter of FY2005, the Company operated one reporting segment and four geographic segments. Following the acquisition of Server Beach assets on October 20, 2004 and commencement of the provision of dedicated servers, two reporting segments are now in operation.

	<i>Quarter ended 9/30/05 Colocation &amp; Bandwidth</i>	<i>Quarter ended 9/30/05 Dedicated Servers</i>	<i>Quarter ended 9/30/05 Total</i>	<i>Quarter ended 9/30/04 Colocation &amp; Bandwidth Total</i>
Revenue	\$ 4,926,309	\$6,643,198	\$11,569,507	\$3,780,131
Income (loss)	\$(833,402)	\$121,739	\$(711,663)	\$(311,669)
Total Assets	\$21,873,022	\$34,164,098	\$56,037,120	\$9,615,718

### Segmented Information (continued)

During the quarter ended September 30, 2005 the company began reporting on two additional geographic segments, Georgia and Florida.

#### **Three months ended September 30, 2005**

	<i>British Columbia</i>	<i>Ontario</i>	<i>Quebec</i>	<i>Virginia</i>	<i>Texas</i>	<i>Georgia</i>	<i>Florida</i>	<i>Other USA</i>	<i>Total</i>
Revenue	\$1,640,431	\$1,441,268	\$760,288	\$2,101,166	\$1,120,167	\$2,015,487	\$1,175,294	\$1,315,406	\$11,569,507
Income (loss)	\$562,715	\$ 138,516	\$ (95,671)	\$ 59,112	\$ 31,513	\$ 18,290	\$ 10,722	\$(1,436,860)	\$ (711,663)
Total Assets	\$16,042,836	\$2,028,188	\$949,290	\$ 6,912,982	\$6,573,892	\$13,702,047	\$ 7,891,421	\$1,936,464	\$56,037,120

#### **Three months ended September 30, 2004**

	<i>British Columbia</i>	<i>Ontario</i>	<i>Quebec</i>	<i>Virginia</i>	<i>Texas</i>	<i>Georgia</i>	<i>Florida</i>	<i>Other USA</i>	<i>Total</i>
Revenue	\$1,444,030	\$927,321	\$763,705	\$-	\$-	\$-	\$-	\$645,075	\$3,780,131
Income (loss)	\$569,779	\$ 150,154	\$ 58,192	\$-	\$-	\$-	\$-	\$(1,089,794)	\$ (311,669)
Total Assets	\$6,000,630	\$802,461	\$680,950	\$-	\$-	\$-	\$-	\$2,131,677	\$9,615,718