

peer1 | Fully scalable hosting solutions



FOR THE THREE AND SIX MONTHS ENDED DECEMBER 31, 2008 AND 2007
MANAGEMENT'S DISCUSSION & ANALYSIS

**MANAGEMENT'S DISCUSSION AND ANALYSIS
OF FINANCIAL RESULTS
FOR THE THREE AND SIX MONTHS ENDED DECEMBER 31, 2008**

This Management Discussion and Analysis ("MD&A") of Peer 1 Network Enterprises, Inc. ("Peer 1" or "the Company"), dated February 5, 2009, should be read in conjunction with Peer 1's unaudited second quarter financial statements, as well as the audited annual financial statements for the fiscal year ended June 30, 2008 and the notes thereto, all of which can be found on www.sedar.com. Unless otherwise noted, all figures noted are in United States dollars.

FORWARD LOOKING STATEMENTS

This MD&A may include or incorporate by reference certain statements that are "forward-looking statements". All statements, other than statements of historical fact, included or incorporated by reference in this MD&A that address activities, events or developments that the Company or its management expects or anticipates will or may occur in the future, including such things as future capital expenditures (including the amounts and nature thereof), business strategies and measures to implement strategies, goals, expansion and growth of the Company's business and operations, plans and references to the Company's future success, and other such matters, are forward-looking statements. These forward-looking statements are based on certain assumptions and analyses made by the Company's management in light of their experience and perception of historical trends, current conditions and expected future developments, as well as other factors the Company's management believes is appropriate in the circumstances. However, whether actual results and developments will conform to the expectations and predictions of the Company's management is subject to a number of risks and uncertainties, including those risk factors discussed under "Risk Factors" and elsewhere in this MD&A and the documents incorporated by reference. Consequently, all of the forward-looking statements made in this MD&A and the documents incorporated herein by reference are qualified by these cautionary statements and other cautionary statements or factors contained herein or in documents incorporated by reference herein, and there can be no assurance that the actual results or developments anticipated by the Company and its management will be realized or, even if substantially realized, that they will have the expected consequences for, or effects on, the Company.

The forward-looking statements set forth herein reflect the Company's expectations as at the date of this MD&A and are subject to change after that date. Unless otherwise required by applicable securities laws, the Company and its management expressly disclaim any intention, and assume no obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

COMMENT ON CURRENT GLOBAL ECONOMIC CONDITIONS

The current global financial market downturn has resulted in some of the world's well known financial institutions to have experienced severe negative economic consequences. Additionally it has resulted in significant erosion of stock market values, and severe restrictions on credit availability. The volatile and uncertain economic environment presents many companies with new business challenges.

Although Peer 1 has experienced some economic effects including some instances of lengthened sales cycles and competitive pricing, it has not seen a significant impact on its operations thus far as a result of the global financial crisis.

While it is possible that a prolonged economic downturn could negatively impact the demand for the Company's service solutions, we have not seen significant evidence of this to date. Unlike many other industries, where there is significant discretion in the purchase decision, consumers of internet infrastructure solutions are increasingly reliant on sophisticated internet infrastructure in order to compete and maintain effective business presence. Further, the Company believes there is a growing trend to outsource internet infrastructure and related managed services to third-party providers given the significant costs associated with attempting to deliver high quality internet infrastructure solutions through an in house approach. While this does not make participants in the internet infrastructure industry immune to the effects of the current economic crisis, these factors may have perhaps at least partly lessened any impact in our industry to date. Management will continue to monitor market activity and trends in our industry, in order to be able to react in a timely fashion should we see a decline in the level of business activity.

For an analysis of other risks faced by the Company, please refer to the section "Risk Factors", included later in this MD&A.

OVERVIEW

Quarterly Financial Highlights

- Peer 1's revenue increased 6.37 % to \$23.64 million for the three months ended December 31, 2008, compared to \$22.22 million for the three months ended December 31, 2007. When adjusted for the effect of the differing exchange rates between the Canadian and US dollars for the comparative periods, the Company's increase in revenue was 10.80%.
- Gross profit increased 6.4% to \$10.77 million for the three months ended December 31, 2008, compared to \$10.13 million for the three months ended December 31, 2007.
- Operating income decreased 5.24% to \$3.7 million for the three months ended December 31, 2008, compared to \$3.91 million for the three months ended December 31, 2007.
- Income before income taxes was \$3.39 Million for the three months ended December 31, 2008 compared to \$3.27 million for the three months ended December 31, 2007.
- Net income was \$2.01 million for the three months ended December 31, 2008, compared to \$1.88 million for the three months ended December 31, 2007.

Quarterly Key Developments

- October 21, 2008 – PEER 1 Network Enterprises, Inc., announced that it expanded its SAN-based backup offerings to co-location and ServerBeach dedicated hosting customers. Leveraging IBM's Tivoli Storage Manager software in each of its three product lines, PEER 1's co-location customers now have a hosted backup option, a feature that is not common in the co-location space. ServerBeach customers can also now take advantage of this enterprise-class backup offering, regardless of their business size, for a higher level of protection and to avoid critical downtime and revenue loss.
- On October 15, 2008, the Company announced that it had partnered with Absolute Performance to offer a suite of advanced monitoring solutions that will serve the growing needs of PEER 1's customers. The new advanced solutions available in the third quarter of fiscal 2009, will expand current offerings and provide a 360 degree view of system and application health. Monitoring also offers in-depth analysis to help both customers and PEER 1 better understand and meet IT needs in order to reduce risks and costs, as well as create more efficient, profitable systems.

- On October 2, 2008, the Company announced that it has launched the PEER 1 Partner Network, an integrated Referral and Reseller Program targeted towards web developers, system integrators and IT consultants. These programs are designed to provide PEER 1 partners with an opportunity to strengthen their relationships with existing clients, offer revenue incentives to refer business and in turn increase revenue for both PEER 1 and its partners. The Referral Program provides partners with a variety of choices for business and revenue growth opportunities without having to close the sale themselves or support the client afterwards. Referral partners can either receive a one-time commission or participate in a revenue sharing plan that pays a monthly commission (monthly recurring revenue)
- Effective October 1, 2008, the Company fixed for a period of twelve months, the LIBOR Rate (as defined in the loan and security agreement - the “LSA”, with Fortress Credit Opportunities 1 LP) at a rate of 3.84%. Accordingly for the twelve month period commencing October 1, 2008, the loan balance under the LSA will accrue interest at the rate equal to i) the LIBOR Rate of 3.84% plus ii), an additional amount of between 3% and 4.25% per annum, the actual amount to be determined based on the Company’s financial performance. As at the date of this MD&A the interest rate accruing on the loan balance is 6.84%. In the event of default, the interest rate will increase by 2% per annum.

OUR BUSINESS

Peer 1 is a premier Internet infrastructure provider, delivering managed hosting, dedicated hosting, co-location and network services through 15 datacenters located in 12 cities across North America, all connected together by its own IP (“Internet Protocol”) backbone network. Peer 1 is a full solution provider and the Company’s services are designed to enable its customers to focus on their businesses rather than the complexities of maintaining or expanding their Internet infrastructure. Peer 1’s principal target market is those small and medium-sized businesses whose activities are increasingly dependent upon the Internet.

INDUSTRY

An increasing number of business critical applications are now delivered over the Internet. As a result, businesses of all sizes are evolving to depend on 24 hours a day, seven days a week, or 24-7, connectivity, availability and security of their IT systems. In addition, community and social based web applications, such as YouTube, Facebook or MySpace are revolutionizing the ways that users interact over the Internet. These dynamics are spurring the demand for increased Internet infrastructure availability.

Modern data centers must be designed and operated at a level approaching 100% of system availability. To achieve this, multiple redundant layers of power, bandwidth, network connectivity and cooling systems are now mandatory. The economic resources and technical expertise required to build and operate facilities of this kind are well beyond the capabilities of a typical small and medium-sized business.

The increasing capabilities and sophistication of web applications is driving small and medium-sized businesses to develop and deploy system architectures that are increasingly complex, creating a sense of urgency and demand for specialized Internet infrastructure solutions and services.

The Company has chosen to focus on small and medium-sized businesses worldwide. To effectively compete, this target market has become reliant on sophisticated Internet infrastructure that, in the past, has been typically deployed at larger enterprises. However, managing, monitoring,

administering, and maintaining a sophisticated Internet infrastructure can rapidly deplete the limited resources of small and medium-sized businesses which need to be directed at core business activities. These complex and growing demands necessitate a closer relationship with a value-added, solutions oriented Internet infrastructure service provider such as Peer 1.

The Company views the North American market for Internet infrastructure as highly fragmented, with no single dominant player focused on the small and medium-sized business marketplace. Specifically, the Company believes the industry includes many small, regional providers that are limited in their ability to scale their service offerings or data center infrastructure.

The Company believes that there is a growing trend to outsource Internet infrastructure and related managed services to third-party providers. The Company expects this trend to remain healthy for the foreseeable future given the significant costs associated with attempting to deliver high quality Internet infrastructure solutions through an in-house approach. In particular, the Company believes that small and medium-sized businesses face significant challenges in trying to deliver these services on their own because of constraints related to technical expertise and cost. The Company believes that outsourcing these functions will allow organizations to focus capital and personnel resources on their core business operations, as opposed to Internet infrastructure.

SERVICES AND SOLUTIONS

Peer 1 is a full solution provider and its services are designed to enable its customers to focus on their businesses rather than the complexities of maintaining or expanding their Internet infrastructure. The Company's four core services are: managed hosting, dedicated hosting, co-location and network services.

MANAGED HOSTING

Managed hosting is an arrangement with a customer in which Peer1 provides them with the use of server and related technology and a collection of services designed to ensure the proper management of that technology in the light of the customer's objectives. These services and technology include the following:

- Peer 1 provides data backup and recovery solutions designed to make backups and restorations faster and more flexible with minimal customer impact.
- Peer 1 provides firewall technology to protect servers against online exploitation. Peer 1 customizes firewall rule sets in accordance with customer objectives with a view to balancing the need for protection from illegitimate access against the need to allow unimpeded legitimate access.
- Peer 1 provides dedicated switches and devices that provide a private communication link between servers and assist its customers in managing their bandwidth consumption.
- Peer 1 provides vulnerability scanning services to satisfy customer demands for periodic server security audits.
- Peer 1 provides advance system monitoring services to enable its customers to address potential problems before they become actual problems.
- Peer 1 provides load balancing services that enables customers to better handle high traffic loads by, among other things, adding more servers to server farms as they are needed and removing them when they are no longer needed. Load balancing services are ideal for customers that have

clusters of servers in multiple locations, as it enables them to direct internet traffic between server nodes in Peer 1's different datacenters.

- Peer 1 provides a caching system that directs the customers' clients to the nearest caching server or node, allowing for faster delivery of web content than is possible without caching. This system is also made available as part of all of the Company's other services offerings.

DEDICATED HOSTING

Dedicated hosting arrangements are substantially similar to managed hosting arrangements except that in the former case the customer manages and administers the server, not the Company. The services made available to Dedicated hosting customers take the form of automated tools to facilitate the provisioning of server solutions. They include the following:

- Peer 1 provides RapidReboot™ to enable customers to remotely restart their servers, eliminating the need for an on-site technician to manually re-start them.
- Peer 1 provides RapidRescue™ to enable servers running the Linux operating system to be rescued by the Company's customers from potentially fatal errors. Customers can recover and repair corrupted file systems, gain immediate access to the server, and boot the server into rescue mode without the help of an on-site technician.
- Peer 1 provides remote backup technology to enable customers to back-up their critical data on a separate device. Storage amounts can be increased and decreased by the customer via Peer 1's web portal, and any changes occur automatically.
- Peer 1 provides control panel technology designed to simplify and automate, and thereby reduce the costs associated with the management and administration of web sites.
- Peer 1 provides a variety of options for port speed and bandwidth allotment that can be tailored to meet the requirements of each customer.
- Peer 1 provides technology that allows customers to communicate between their web, database and other servers internally without going over the public Internet.

CO-LOCATION AND RELATED SERVICES

Co-location arrangements are substantially similar to dedicated hosting except that co-location customers own the server hardware and technology which they house on Peer 1's premises in order to access Peer 1's high quality Internet infrastructure, large bandwidth capacity, redundant power supply, security and technical support. This type of arrangement also enables customers to easily increase the Internet-related aspects of their business with minimal disruption. Peer 1's co-location services include the following:

- Peer 1 hosts customer domain names on a fully redundant distributed environment providing the customer with fast performance and reliable uptime over the Internet.
- Peer 1's port monitoring service enables its customers to define their minimum and maximum thresholds for bandwidth and packets per second usage, and alerts them by email once the threshold has been reached. This service also enables Peer 1 customers to better manage network costs and alerts customers of reductions in traffic to their sites due to server crash, hardware failure or web site configuration issues.
- Peer 1 provides co-location customers with convenient, secure, browser-based access to servers located on its premises, allowing customers to remotely repair server problems. This device allows the remote installation of operating systems and server troubleshooting.

- Peer 1 provides load balancing services that enables customers to better handle high traffic loads by, among other things, adding more servers to server farms as they are needed and removing them when they are no longer needed. Load balancing services are ideal for customers that have clusters of servers in multiple locations, as it enables them to direct internet traffic between server nodes in different Peer 1 datacenters.
- Peer 1 offers a service that protects its customers' online presence by distributing an incoming Distributed Denial of Service Attack, minimizing the impact on their normal functioning.

IP BACKBONE NETWORK SERVICES

Peer 1 has engineered one of the fastest and most reliable IP backbone networks in North America. Peer 1 has established 20 network points-of-presence, in some cases with multiple points-of-presence in a single city.

Peer 1 bundles network connectivity with all of its core service offerings and also attracts select customers wishing to have access to the benefits and security of the Peer 1 network without subscribing to other Peer 1 services. Peer 1 network operations are managed and serviced on a continuous basis.

The network is based on a series of dedicated links between Peer1 datacenters using multiple high speed connections and best-in-class network hardware. It is fully redundant, without any single point of failure, and makes use of strategic peering relationships with over 500 other network providers. These relationships improve performance by reducing network latency, and they reduce the Company's telecommunications carrier costs.

GROWTH STRATEGY

Peer 1 is pursuing a growth strategy that is focused on (1) organic growth, (2) leveraging Peer 1's automation capabilities and (3) pursuing additional growth opportunities through strategic acquisitions.

ORGANIC GROWTH

Peer 1 seeks to increase its customer base and revenue by a continued focus on service excellence, the introduction of new service solutions, the cross selling of its service solutions to existing customers, the expansion of its geographical presence in North America and Europe, and the continuation and improvement of its sales and marketing activities. Peer 1 will also continue using its relative financial strength and size to secure strategic arrangements with other service providers and vendors that might not be available to its smaller competitors due to their size.

LEVERAGING AUTOMATION

Peer 1 pursues an operational strategy aimed at increasing the use of automation in respect of the manner in which the Company provisions and delivers its service solutions. This benefits its customers through more effective and faster deployment of its service solutions and reduces the Company's costs and commensurately increases its margins in comparison with an operational strategy that does not accommodate automation.

STRATEGIC ACQUISITIONS

Peer 1 will seek to exploit the opportunities presented by fragmented industry in which it operates in order to accelerate its growth through strategic acquisitions. The Company's senior management team and Board of Directors have considerable acquisition experience and have completed and integrated two major acquisitions during the past five years.

RESULTS OF OPERATIONS

Peer 1 Network Enterprises, Inc.
Consolidated Statement of Operations, Comprehensive Income and Retained Earnings (Deficit)
Six Months Ended December 31, 2008
(unaudited - prepared by management)
(in thousands of United States Dollars, except per share amounts)

	Three Months Ended December 31, 2008 US\$	Three Months Ended December 31, 2007 US\$	Six Months Ended December 31, 2008 US\$	Six Months Ended December 31, 2007 US\$
Revenue:				
Co-location Services	6,124	7,006	12,839	13,332
Dedicated Hosting Services	17,515	15,218	34,305	29,851
	<u>23,639</u>	<u>22,224</u>	<u>47,144</u>	<u>43,183</u>
Cost of Sales	<u>12,866</u>	<u>12,099</u>	<u>25,902</u>	<u>24,082</u>
Gross Profit	10,773	10,125	21,242	19,101
Operating expenses	<u>7,069</u>	<u>6,216</u>	<u>14,035</u>	<u>12,367</u>
Operating Income before other items	3,704	3,909	7,207	6,734
Other Items:				
Interest Income	(17)	(108)	(54)	(226)
Integration costs	-	-	-	93
(Gain) / loss on disposal of fixed assets	(18)	7	(20)	(7)
Foreign exchange (gain) / loss	(91)	157	(84)	256
Interest expense - long term	437	586	861	1,204
Income before income taxes	<u>3,393</u>	<u>3,267</u>	<u>6,504</u>	<u>5,414</u>
Future income tax expense (recovery)	(52)	663	237	990
Current income tax expense	1,440	722	2,536	1,296
Income tax expense	<u>1,388</u>	<u>1,385</u>	<u>2,773</u>	<u>2,286</u>
Net income and comprehensive income	2,005	1,882	3,731	3,128
Retained Earnings (Deficit), beginning of period	713	(6,831)	(1,013)	(8,077)
Retained Earnings (Deficit), end of period	<u>2,718</u>	<u>(4,949)</u>	<u>2,718</u>	<u>(4,949)</u>

Revenues

The Company's business model is based on recurring revenue streams for all of its main offerings. Customer revenue from services and product offerings, which are invoiced monthly, generally continue on a go forward basis with a manageable level of customer churn. Customer contracts range from month-to-month to three year terms.

Services revenue includes additional charges for power and setup fees for initial configuration and installation of services. Setup fees are typically billed once and only upon completion of configuration and installation.

	Three Month ended December 31				Six Months ended December 31			
	2008	%	2007	%	2008	%	2007	%
Revenue:								
Colocation	2,952,669	12.49%	3,254,097	14.64%	6,096,062	12.93%	6,155,653	14.25%
Bandwidth	2,047,020	8.66%	2,540,191	11.43%	4,425,890	9.39%	4,872,077	11.28%
Services	1,124,483	4.76%	1,211,588	5.45%	2,317,138	4.92%	2,304,457	5.34%
Colocation Services	6,124,172	25.91%	7,005,876	31.52%	12,839,090	27.23%	13,332,187	30.87%
Dedicated Hosting Services	17,515,446	74.09%	15,218,149	68.48%	34,304,593	72.77%	29,851,017	69.13%
Total Revenue	\$ 23,639,618	100%	\$ 22,224,025	100%	\$ 47,143,683	100%	\$ 43,183,204	100%

Revenue increased to \$23.64 million and \$47.14 million for the three and six months ended December 31, 2008 respectively compared to \$22.22 million and \$43.18 million for the same periods in the prior fiscal year. The increases in revenue are attributable to organic growth offset in part by the decreased value of the Canadian dollar against the US dollar for Canadian dollar denominated sales. When adjusted for the exchange rates in effect in the prior year periods, revenue for the three and six months ended December 31, 2008 was \$24.62 million and \$48.09 million respectively. Taking into account the effect of the differing exchange rates between the Canadian and US dollars for the comparative periods, revenue grew 10.8% and 11.3% for the three and six months ended December 31, 2008.

Colocation revenue decreased to \$2.95 million and \$6.1 million for the three and six months ended December 31, 2008 respectively compared to \$3.25 million and \$6.16 million for the same periods in the prior fiscal year. The decreases in revenue are attributable to the decreased value of the Canadian dollar against the US dollar offset in part by organic growth which will be constrained until new facilities are found in key markets. Peer 1's efforts to secure additional data centre space are ongoing. The effect on revenue of the decrease in value of the Canadian dollar against the US dollar was \$.44 million and \$.43 million for the three and six month periods ended December 31, 2008 and 2007 respectively.

Bandwidth revenue decreased to \$2.05 million and \$4.4 million for the three and six months ended December 31, 2008 respectively compared to \$2.5 million and \$4.9 million for the same periods in the prior fiscal year. The decreases in revenue are primarily attributable to the decreased value of the Canadian dollar against the US dollar and periodic expected fluctuations in bandwidth usage. The effect on revenue of the decrease in value of the Canadian dollar against the US dollar was \$.38 million and \$.36 million for the three and six month periods ended December 31, 2008 and 2007 respectively.

Dedicated hosting revenues increased to \$17.52 million for the three months ended December 31, 2008 from \$15.22 million for the three months ended December 31, 2007. Dedicated hosting revenues increased to \$34.30 million for the six months ended December 31, 2008 from \$29.85 million for the six months ended December 31, 2007. The increase for the three and six months ended December 31, 2008 is attributable to organic growth. Dedicated Hosting revenues are not impacted by foreign exchange effects as all Dedicated Hosting sales are denominated in United States Dollars.

Peer 1's Canadian operations accounted for \$4.23 million of revenues for the three months ended December 31, 2008 compared to \$5.16 million of revenues for the three months ended December 31, 2007. The Company's Canadian operations accounted for \$9.16 million of revenues for the six months ended December 31, 2008 compared to \$9.75 million of revenues for the six months ended December 31, 2007. These changes are related to increased co-location revenues in the Canadian operations offset by unfavorable foreign exchange effects of \$0.98 million and \$0.95 million respectively for the three and six months ended December 31, 2008.

Cost of Sales

Cost of sales relating to the Company's infrastructure and staffing are primarily fixed with changes primarily in connection with expansion. Infrastructure costs consist of rent, maintenance, power, cooling, security, leasing and/or amortization of equipment and improvements, insurance, software licenses and supplies. Variable costs consist of power consumption, and incremental bandwidth from upstream carriers.

Cost of sales increased to \$12.87 million for the three months ended December 31, 2008 from \$12.1 million for the three months ended December 31, 2007. Cost of sales as a percentage of revenue was 54.4% for both the three months ended December 31, 2008 and three months ended December 31, 2007. Cost of sales increased to \$25.90 million for the six months ended December 31, 2008 from \$24.08 million for the six months ended December 31, 2007. Cost of sales as a percentage of revenue decreased to 54.94% for the six months ended December 31, 2008 from 55.77% for the six months ended December 31, 2007. The decrease in cost of sales as a percentage of revenue for the six month period ended December 31, 2008 is attributable to the effect of certain costs including staffing costs remaining relatively stable during the three and six months ended December 31, 2008 and December 31, 2007 in addition to growth in revenue. The cost of sales increase for the three months ended December 31, 2008 compared to the three months ended December 31, 2007 is mainly attributable to added server and network equipment depreciation of \$.79 million and added rent expense in connection with Toronto expansion of \$.11 million during the current quarter as compared to the same period in the prior year. The cost of sales increase for the six months ended December 31, 2008 compared to the six months ended December 31, 2007 is mainly attributable to added server and network equipment depreciation of \$1.13 million and additional software license costs of \$0.4 million.

Total cost of sales is expected to increase as revenues increase. The pattern of growth in revenues does not generally match the pattern of growth in the related costs due to the relatively large fixed cost component of the operating infrastructure. The cost of sales related to co-location is primarily affected by the cost of facilities. The cost of sales related to bandwidth is primarily affected by cost for bandwidth, transport and infrastructure. The cost of sales related to the dedicated hosting services is primarily affected by the costs of facilities, costs of servers and bandwidth costs.

Operating Expenses

The following table presents operating expenses consisting of sales and marketing, general and administrative and technology and customer relations, as a percentage of revenue.

	Three Month ended December 31				Six Months ended December 31			
	2008	%	2007	%	2008	%	2007	%
Total Operating Expenses	\$ 7,068,625	29.90%	\$ 6,215,385	27.97%	\$ 14,035,230	29.77%	\$ 12,366,697	28.64%

Total operating expenses increased to \$7.07 million for the three months ended December 31, 2008 from \$6.22 million for the three months ended December 31, 2007. Operating expenses as a percentage of revenue increased to 29.9% for the three months ended December 31, 2008 from 27.97% for the three months ended December 31, 2007. The increase in operating expenses for the three months ended December 31, 2008 is primarily due to approximately \$0.46 million related to increased staff and training costs \$0.24 million in higher advertising and marketing expenses, \$0.16 million higher stock based compensation, and \$0.1 million in bad debt expense. Total operating expenses increased to \$14.04 million for the six months ended December 31, 2008 from \$12.37

million for the six months ended December 31, 2007. Operating expenses as a percentage of revenue increased to 29.77% for the six months ended December 31, 2008 from 28.64% for the six months ended December 31, 2007. The increase in operating expenses for the six months ended December 31, 2008 is attributable to \$0.61 million higher stock based compensation, approximately \$0.66 million related to increased staff and training costs, \$0.62 million higher advertising and marketing expense and \$0.15 million in increased bad debt expense. The increase in bad debt expense reflects a higher estimated expense for doubtful accounts that is based on management's review of specific customer payment history, the age of the accounts receivable and collection trends. The Company has experienced some increase in the age of receivables and increased bad debt expense, which reflects prevailing economic conditions. The Company will continue to monitor receivables and bad debts given the recent economic downturn.

General and administrative expenses accounted for 59.27% of total operating expenses for the three months ended December 31, 2008 compared to 56.71% for the three months ended December 31, 2007. General and administrative expenses accounted for 55.27% of total operating expenses for the six months ended December 31, 2008 compared to 60.13% for the six months ended December 31, 2007. Total general and administrative expense was higher for the three and six months ended December 31, 2008 compared to the same period in the prior year primarily due to increased stock based compensation and bad debt expense.

Sales and marketing expenses accounted for 34.33% of total operating expenses for the three months ended December 31, 2008 compared to 35.06% for the three months ended December 31, 2007. Sales and marketing expenses accounted for 38.5% of total operating expenses for the six months ended December 31, 2008 compared to 30.99% for the six months ended December 31, 2007. Sales and marketing expenses increased during the three months ended December 31, 2008 compared to the same period in the prior year primarily due to higher advertising expenses. The increase in sales and marketing expenses as a percentage of operating expenses for the six months ended December 31, 2008 is primarily attributable to higher advertising and marketing, salary and sales costs related to Peer 1's marketing initiatives to support organic growth.

As the Company continues to pursue its growth strategy, operating expenses may increase to support marketing, promotional opportunities and general and administration requirements.

Other income and expenses:

Interest income for the three months ended December 31, 2008 was \$0.02 million compared to \$0.11 million for the three months ended December 31, 2007. Interest income for the six months ended December 31, 2008 was \$0.05 million compared to \$0.23 million for the six months ended December 31, 2007

Interest Expense

Interest expense decreased to \$0.44 million for the three months ended December 31, 2008 compared to \$0.58 million for the three months ended December 31, 2007. Interest expense decreased to \$0.86 million for the six months ended December 31, 2008 compared to \$1.20 million for the six months ended December 31, 2007. The decreases are primarily due to lower interest rates applied to decreased principal amounts of term debt outstanding.

Income Tax Expense

For the three months ended December 31, 2008, Peer 1 recorded total income tax expense of \$1.39 million compared to \$1.38 million for the three months ended December 31, 2007. For the six months ended December 31, 2008, Peer 1 recorded total income tax expense of \$2.77 million compared to \$2.29 million for the six months ended December 31, 2007.

The Company's effective tax rate of 40.91% and 42.64% for the three months and six months ended December 31, 2008 respectively differs from the combined federal, provincial and state tax rates due to the effect of non-deductible expenditures primarily related to stock based compensation.

Liquidity and Capital Resources

Peer 1 has historically financed operations through cash generated from operations, sale of common and preferred shares and issuance of debt. As at December 31, 2008, the Company had cash and cash equivalents of \$9.58 million, compared to \$11.03 million as at June 30, 2008. The current portion of the Company's notes payable as at December 31, 2008 was \$3.30 million.

The Company had a working capital deficit of \$1 million at December 31, 2008 compared to a working capital deficit of \$1.54 million as the end of June 30, 2008. The working capital deficit of \$1 million at December 31, 2008 includes deferred revenue of \$3.61 million and current portion of notes payable of \$3.30 million. The Company anticipates current liquidity and cash generated from operations to be sufficient to fund existing operations for the foreseeable future.

Operating Activities

Cash flow from operating activities for the three months ended December 31, 2008 and 2007 was \$7.74 million and \$3.72 million respectively. Cash flow from operating activities for the six months ended December 31, 2008 and 2007 was \$9.93 million and \$9.05 million respectively. The increase in cash provided by operations for the three and six months ended December 31, 2008 compared to the same period in the prior year is primarily due to changes in non-cash working capital items.

Investing Activities

Cash used for investing activities for the three months ended December 31, 2008 and 2007 was \$5.5 million and \$6.48 million, respectively. Cash used for investing activities for the six months ended December 31, 2008 and 2007 was \$9.87 million and \$9.92 million, respectively. The decrease in use of cash for the three months ended December 31, 2008 compared to the same period in the prior year is due to less capital expenditure incurred in the current year.

Financing Activities

Net cash outflows from financing activities for the three months ended December 31, 2008 was \$0.83 million compared to cash outflows from financing of \$0.99 million for the three months ended December 31, 2007. The decrease in cash outflow from financing activities for the three months ended December 31, 2008 compared to the three months ended December 31, 2007 is a result of lower principal repayment on notes payable in the three months ended December 31, 2008 than for the three months ended December 31, 2007. Net cash outflow from financing activities for the six months ended December 31, 2008 was \$1.5 million compared to cash outflow from financing of \$0.93 million for the six months ended December 31, 2007. The increase in cash outflow from financing activities for the six months ended December 31, 2008 compared to the six months ended

December 31, 2007 is a result of \$1 million received from the issuance of share capital in the prior year.

OFF-BALANCE SHEET ARRANGEMENTS

As at December 31, 2008 Peer 1 has provided one letter of credit totaling US\$0.25 Million as security to a landlord for a facility lease. The security for the facility lease will be required for the term of the lease. The letter of credit is secured by way of a term deposit which is included in the other assets balance as restricted cash

TRANSACTIONS WITH RELATED PARTIES

Peer 1 entered into a number of related party transactions with companies either owned or subject to significant influence by management, directors and principal shareholders.

At December 31 amounts due to and from related parties were as follows:

	FY2009	FY2008
Accounts receivable from related companies	\$17,095	\$687
Accounts payable to related party	\$122	\$-

During the six months ended December 31, 2008 transactions with related parties were as follows:

	FY2009	FY2008
Revenues earned	\$58,137	\$32,369
Other expenses incurred	\$53,372	\$101,657

These transactions are in the normal course of operations and are measured at their exchange amounts. Other expenses incurred include management and consulting fees of \$29 (in thousands of dollars).

Details of related party transactions for the three months ended December 31, 2008								
Related person or entity	Related person	A/R	A/P	USD				
				Revenue	Interest	Other Exp		
Code Marketing Ltd.	Lance Tracey	-	-			24,301 Management fees		
E-Xact Transactions Ltd.	Scott Shaw, Lance Tracey	-	122	14,378		553 E-Xact provides Peer 1 with credit card gateway processing services		
Fatport	Michael Cytrynbaum	2,028	-	1,805		Revenue from contract to provide colocation and bandwidth in Vancouver.		
Something Simpler Systems Inc. (formerly called "Pubsub Concepts Inc.")	Lance Tracey	15,066	-	6,787		Revenue from contract to provide colocation and bandwidth in New York.		
Sutton Group Realty Services Ltd.	Scott Shaw, Lance Tracey	-	-	3,957		Revenue from contract to provide colocation service, expenses are for consulting services		
				17,095	122	26,927	-	24,854

SUMMARY OF QUARTERLY RESULTS

The following table sets out certain operating results of the Company for the past eight quarters.

(In \$000's except per share data)

Quarter Ended (in thousands \$)	31-Mar 2007 (US\$)	30-Jun 2007 (US\$)	30-Sep 2007 (US\$)	31-Dec 2007 (US\$)	31-Mar 2008 (US\$)	30-Jun 2008 (US\$)	30-Sep 2008 (US\$)	31-Dec 2008 (US\$)
Revenue	18,755	19,828	20,959	22,224	22,772	23,392	23,504	23,640
Operating Profit	1,915	1,482	2,825	3,910	4,108	3,844	3,501	3,705
Net Income	230	2,303	1,246	1,882	2,201	1,733	1,726	2,005
Basic earnings per share	0.00	0.02	0.01	0.02	0.02	0.01	0.01	0.02
Fully diluted earnings per share	0.00	0.02	0.01	0.02	0.02	0.01	0.01	0.02

SUBSEQUENT EVENTS AND PROPOSED TRANSACTIONS

N/A

OUTSTANDING SHARE DATA

Peer 1 has authorized share capital of unlimited common shares without par value and unlimited preferred shares without par value. At December 31, 2008 119,294,323 common shares were issued and outstanding. As of the date of this MD&A 119,294,323 common shares were issued and outstanding.

At December 31, 2008 2,461,619 warrants for the purchase of shares ranging in price from US\$0.23 to CAD\$0.40 (approximately US\$0.33) were outstanding. As the date of this MD&A, no warrants have been exercised or issued subsequent to the end of the quarter.

As at December 31, 2008 and the date of this MD&A, 12,537,100 stock options were outstanding under the Company's stock option plan. If all warrants and options were exercised there would be a total of 134,293,042 shares outstanding as of the date of this MD&A.

CRITICAL ACCOUNTING ESTIMATES

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

In estimating the allowance for doubtful accounts, management reviews the payment history of current customers as well as overall historical collection trends.

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

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

The measurement of income tax assets and any income tax valuation allowance is based upon estimates of future taxable income and the expected timing of reversals of temporary differences.

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

CONTROLS AND PROCEDURES

Management is responsible for the design of internal controls over financial reporting (“ICOFR”) within the Company in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the financial statements for external purposes in accordance with Canadian GAAP. The control framework used by management to design the Company’s ICOFR is the Integrated Framework issued by the Committee of sponsoring Organisation of the Treadway Commission (“COSO”). Management has evaluated whether there were changes to its ICOFR during the three months ended December 31, 2008 that have materially affected, or are reasonably expected to materially affect, its ICOFR. No such changes were identified.

CHANGES IN ACCOUNTING POLICIES

i) Capital disclosures:

Effective July 1, 2008, the Company adopted the new recommendations of the Canadian Institute of Chartered Accountants (“CICA”) Handbook section 1535, Capital Disclosures. This new Handbook section establishes standards for disclosing information about an entity’s capital and how it is managed. The required disclosure and presentation of information pursuant to these standards has been provided in the interim financial statements for the three and six months ended December 31, 2008 and the notes thereto.

ii) Financial instruments:

Effective July 1, 2008, the Company adopted the new recommendations of CICA Handbook Section 3862, Financial Instruments - Disclosures and Handbook Section 3863, Financial Instruments – Presentation. Section 3862 requires entities to provide disclosures in their financial statements that enable users to evaluate the significance of financial instruments on the entity’s financial position and its performance and the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the balance sheet date, and how the entity manages those risks. Section 3863 establishes standards for presentation of financial instruments and non-financial derivatives. It deals with the classification of financial instruments, from the perspective of the issuer, between liabilities and equities, the classification of related interest, dividends, losses and gains, and circumstances in which financial assets and financial liabilities are offset. The required disclosure and presentation of information pursuant to these standards has been provided in the interim financial statements for the three and six months ended December 31, 2008.

RECENT ACCOUNTING PRONOUNCEMENTS

In February 2008, the CICA issued Handbook Section 3064, Goodwill and Intangible Assets which applies to annual and interim financial statements relating to fiscal years beginning on or after October 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 to 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.

In February 2008, the CICA's Accounting Standards Board confirmed its strategy of replacing Canadian generally accepted accounting principles with IFRS for Canadian publicly accountable enterprises. These new standards will be effective for the Company's interim and annual financial statements commencing July 1, 2011. The Company is assessing the impact of the transition to IFRS on its financial statements.

ACCOUNTING POLICIES

The Company prepares its financial statements on the basis of accounting principles generally acceptable in Canada. All accounting policies have been applied on a basis consistent with that of the previous year except as noted in changes in accounting policies.

RISK FACTORS

The Company and its shareholders are subject to the following risks, in addition to the risks mentioned elsewhere in this MD&A:

Future Capital Needs

The Company may require additional working capital in the future to finance the ongoing operation, development and expansion of its business. If additional funds are raised from the issuance of equity or equity linked debt securities, the percentage ownership of the Company's shareholders will be reduced, and the newly issued securities may have rights, preferences or privileges senior to those of the holders of its common shares. No assurance can be given that additional funding will be available or that, if available, it will be available on terms favourable to the Company or its shareholders. Failure to secure adequate funds on reasonable terms may have a material adverse effect on the Company's business, results of operations and financial condition.

Competition

The Company operates in an intensely competitive market. Some of its competitors have longer operating histories, significantly greater financial, technical, marketing and other resources, greater brand recognition and as the Company management believe, a larger base of customers. In addition, competitors may operate more successfully than Peer 1 or form alliances to acquire significant market share from Peer 1. These competitors may be able to adapt more quickly to new or emerging technologies and changes in customer requirements. They may also be able to devote more resources to the promotion, sale and development of their services and solutions than Peer 1 and there can be no assurance that Peer 1's competitors will not be able to develop services comparable or superior to those offered by Peer 1 at more competitive prices. As a result, in the future Peer 1 may suffer from an inability to offer competitive services or be subject to negative pricing pressure that would adversely affect its ability to generate revenue and adversely affect its operating results.

Price Sensitive Market

The competitive market in which the Company conducts its business could require it to reduce its prices. If the Company's competitors offer discounts on certain products or services in an effort to recapture or gain market share or to sell other products, the Company may be required to lower its

prices or offer other favorable terms to compete successfully. Any of these changes would likely reduce the Company's margins and could adversely affect its operating results. In addition, many of the services and solutions that the Company provides and market are not unique to the Company and its customers and target customers may not distinguish the Company's services and solutions from those of its competitors. All of these factors could, over time, limit or reduce the prices that the Company can charge for its services and solutions. If the Company cannot offset price reductions with a corresponding increase in the number of sales or with lower spending, then the reduced revenue resulting from lower prices would adversely affect the Company's margins and operating results.

Limited Operating History

The Company has a limited operating history upon which to evaluate its business and prospects, having commenced operations in 1999. Fiscal 2008 is the Company's second year of profitable operations. There can be no assurance that the Company will continue to be profitable. In view of the rapidly evolving nature of the Company's business, its limited operating history and the risks discussed elsewhere in these risk factors, period to period comparisons of operating results are not meaningful and should not be relied upon as an indication of future performance.

Dependence on Personnel

The Company's continued success is largely dependant on the personal efforts and abilities of its executive officers and senior management. The Company's success also depends on its continued ability to attract, retain, and motivate its employees. In particular, the Company is dependent on its skilled technical employees and its sales and customer service employees, the competition for which is intense. There can be no assurance that the Company will be able to continue to attract, integrate or retain additional highly qualified personnel in the future. Any failure in this regard will adversely affect the Company's business.

Management of Growth

Significant expansion is required in order to maintain and extend the Company's position in the market. Expansions place pressure on the Company's management, operational and financial resources and there can be no assurance that management will be able to manage them effectively. If management does not manage them effectively, the Company's growth objectives will be prejudiced and its business, financial condition and results of operations will be adversely impacted.

Risk of Damage to Peer 1 Data Centers

Hurricanes, fire, floods, power loss, telecommunications failures, earthquakes, break-ins, acts of war or terrorism, computer sabotage and similar events could damage or destroy the Company's data centers as well as the systems and information housed in those facilities. These problems could temporarily or permanently prevent the Company from fulfilling existing service obligations and from securing new customers. These events could also cause loss of service and data to customers. The Company's business could be seriously harmed even if these disruptions are temporary, its revenue could decline and its existing and prospective customers may lose confidence in its systems. The Company could also be required to make significant expenditures if its systems were damaged or destroyed, or pay damages if the delivery of its services to its customers were delayed or stopped by any of these occurrences. Disruptions in the Company's business caused by these events could have a material adverse effect on the Company's business, operating results and financial position.

Risk of Security Breach

The Company's business involves the storage, management, and transmission of the proprietary information of customers. Although the Company employs control procedures to protect the security of this information, it cannot guarantee that these measures will be sufficient for this purpose. Breaches of the Company's security could result in misappropriation of personal information, suspension of hosting operations or interruptions in its services. If the Company's security measures are breached as a result of a third-party action, employee error or otherwise, and as a result customers' information becomes available to unauthorized parties, the Company could incur liability and its reputation would be damaged. This could lead to the loss of current and potential customers. If the Company experiences any breaches of its network security due to unauthorized access, sabotage, or human error, it may be required to expend significant capital and other resources to remedy, protect against or alleviate these and related problems. The Company also may not be able to remedy these problems in a timely manner, or at all. The Company's systems are also exposed to computer viruses, denial of service attacks and bulk unsolicited commercial email, or spam. Being subject to these events and items could cause a loss of service and data to customers, even if the resulting disruption is temporary. The Company could be required to make significant expenditures to repair its systems in the event that they are damaged or destroyed, or if the delivery of its services to its customers is delayed and its business could be harmed.

Electrical Power Outages

The Company's data centers are susceptible to regional variations in the cost of power, electrical power outages, planned or unplanned power outages such as those that occurred in California during 2001 and the U.S. Northeast in 2003, natural disasters such as the tornados on the U.S. East Coast in 2004 and limitations on availability of adequate power resources. Power outages could harm the Company's customers and its business including the loss of its customers' data and extended service interruptions. While the Company attempts to limit exposure to system downtime by using backup generators and power supplies, it may not be able to limit its exposure entirely even with these protections in place. With respect to any increase in energy costs, the Company may not be able to pass these increased costs on to its customers which could have a material adverse effect on its business, results of operations and financial condition.

Potential Service Level Credits and Litigation

The Company's revenue and profit depend on the reliability and performance of its services and solutions. The Company has contractual obligations to provide service level credits to almost all of its customers against future invoices if certain service disruptions occur. Although the Company's service agreements limit its liability for damages arising in those instances, there can be no assurance that they will function as the Company anticipates. Furthermore, litigation could result in substantial cost to the Company, divert management's attention and resources from the Company's operations and result in negative publicity that may impair its ongoing marketing efforts. There is no assurance that the Company's insurance will cover the claims or that the claims will not exceed the insurance limit under its current policies. There can be no assurance that the result of the litigation described under "Legal Proceedings" will not be materially adverse to the Company.

Economic Conditions

Many of the Company's existing and target customers include small and medium-sized businesses. These businesses are more likely to be significantly affected by economic downturns than larger, more established businesses. Additionally, these businesses often have limited funds, which they

may choose to spend on items other than the Company's services and solutions. If a material portion of the small and medium-sized businesses that the Company services, or is looking to service, experience economic hardship, these small and medium-sized businesses may be unwilling or unable to expend resources on the services and solutions the Company provides, which would negatively affect the overall demand for the Company's services and could cause its revenue to decline.

Leased Data Centre Facilities

The Company's data centers are located in leased premises, and there can be no assurance that the Company will remain in compliance with its leases and that they will not be terminated. Termination of a lease could have a material adverse effect on the Company's business, results of operations and financial condition.

Reliance on Third Parties

The Company purchases bandwidth from, or enter into interconnection arrangements with, several Internet service providers. The Company cannot provide any assurance that these Internet service providers will continue to provide service to it on competitive terms, if at all, or that it will be able to acquire additional network capacity to adequately meet future customer demand. If the Company is not able to maintain direct connections to multiple IP backbone networks, this could have a material adverse effect on the Company's operating results.

Regulatory Developments

The Company operates in a largely unregulated environment, though various laws and governmental regulations govern other Internet related services. The adoption of new laws or extension of existing laws to any aspect of the Company's business could have a material adverse effect on its business, operating results and financial condition.

Adequate Intellectual Property Protection

The Company relies upon trade secrets, proprietary know-how, and continuing technological innovation to develop new data center and IT infrastructure services and solutions and to remain competitive. If the Company's competitors learn of its proprietary technology or processes, they may use this information to produce data center and IT infrastructure services and solutions that are equivalent or superior to its services and solutions, and this could materially adversely affect its business, operations and financial position. The Company's employees and consultants may breach their obligations not to reveal the Company's confidential information, and any remedies available to the Company may be insufficient to compensate it. Even in the absence of such breaches, the Company's trade secrets and proprietary know-how may otherwise become known to its competitors, or be independently discovered by its competitors, which could adversely affect its competitive position.

Technological Change

The markets in which the Company operates are characterized by rapidly changing technology and evolving industry standards. Failure or delays by the Company to develop products and services to respond to industry or user trends could have a material adverse effect on its business, results of operations and financial condition. The Company's ability to anticipate changes in technology, technical standards and product offerings will be a significant factor in its success in expanding into new markets.

Excess Capacity

The Company has excess capacity in some of its data centers and is in the process of adding additional capacity. There can be no assurance that the Company will be able to fill this capacity. Any failure in this regard may have a material adverse effect on the Company's business, results of operation and financial condition.

Acquisitions

One part of the Company's growth strategy involves the acquisition of suitable businesses and technologies. A multitude of risks are inherent in all acquisitions, including risks relating to integration, financing and the impact of such financing on the Company's financial condition. There can be no assurance that the Company will be able to manage these risks adequately. Any failure in this regard could have a material adverse effect on the Company's business, results of operation and financial condition.

Currency Fluctuations

The Company's revenues and costs are affected by fluctuations in the rate of exchange between the Canadian dollar and the US dollar. Exposure to exchange rate fluctuations exists because a portion of the Company's revenues, trade receivable and trade payables are in Canadian and US dollars depending on the location of business. The Company expects that Canadian and US dollar sales and expenses will continue to account for a material portion of operations for the foreseeable future. As a result, exchange rate fluctuations may affect the Company's revenue and earnings growth materially in the future.

OTHER INFORMATION

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