

**PEER 1 NETWORK ENTERPRISES INC.
MANAGEMENT DISCUSSION & ANALYSIS
FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2005**

This Management Discussion and Analysis ("MD&A"), dated November 28 2005, should be read in conjunction with Peer1's unaudited first quarter statements, as well as the audited annual financial statements for the fiscal year ended June 30, 2005 and the notes thereto. All figures noted are in Canadian dollars.

FORWARD LOOKING STATEMENTS

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

PEER 1 NETWORK ENTERPRISES OVERVIEW

Quarterly Highlights

- 205% increase in quarterly revenues (three months ended September 30, 2005 vs. three months ended September 30, 2004) from \$3.8 million to \$11.6 million as a result of the acquisition of ServerBeach and Interland, as well as growth in the base business.
- Completed the acquisition of assets of Interland, Inc., a dedicated server provider. The assets acquired include data centers in Atlanta, Georgia; Fremont, California; and Miami, Florida, totaling over 115,000 square feet and approximately 8,300 dedicated servers.
- Completion of a major refinancing in connection with the acquisition of Interland, Inc. assets and the recapitalization of the company.
- 25,000 square foot data center established in Los Angeles.
- EBITDA of \$3.0 million this quarter, compared to \$0.2 million for the same quarter last year.

Core Business

Peer 1 Network Enterprises Inc. (“Peer 1”) provides high performance internet bandwidth and co-location facilities to web-centric customers across North America. Building on a redundant, 100% Cisco powered internal network, Peer 1 guarantees 100% uptime internet access for companies with mission-critical applications. The company has established local offices and data centres in Vancouver, Toronto, Montreal, New York, Seattle, San Jose, San Antonio and Herndon VA and also has points of presence (POPs) in the USA in Ashburn VA, Chicago and Los Angeles, and in the UK in London.

Bandwidth

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

Colocation

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

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

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

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

Dedicated Servers

In addition to its colocation and bandwidth business, Peer 1 offers through its subsidiaries, ServerBeach and Peer 1 Dedicated Hosting, self-managed, competitively price dedicated server solutions to small and mid-size businesses, and technology hobbyists. During the quarter with the acquisition of the dedicated server assets of Interland (operated as part of Peer 1 Dedicated Hosting), the company has significantly increased its capacity in providing dedicated server solutions.

STRATEGY

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

Network

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

Colocation Facilities

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

Dedicated Servers

The strategy for Peer 1's ServerBeach brand of unmanaged dedicated servers is to provide servers built with quality parts at the lowest possible cost. By using automated provisioning and billing processes and leveraging the existing network, the company has been able to maintain a low cost structure that supports the price-driven strategy. The company continues to build on its position in the dedicated server market and is currently integrating the dedicated server assets purchased through the recent Interland acquisition.

FIRST QUARTER INFORMATION

Segmented Information

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

Peer 1 Network Enterprises, Inc. Segmented Balance Sheet As At September 30, 2005 (unaudited - prepared by management)					
	Peer 1 Network 9/30/2005	ServerBeach 9/30/2005	Peer 1 Dedicated* 9/30/2005	Total 9/30/2005	Peer 1 Network and ServerBeach 6/30/2005
Assets					
Current:					
Cash and cash equivalents	3,456,107	1,038,751	2,866,879	7,361,737	970,538
Accounts receivable	3,963,601	-	594,617	4,558,218	2,991,503
Inventory	-	111,771	-	111,771	102,829
Prepaid expenses	778,273	58,143	1,247,464	2,083,880	460,586
	<u>8,197,981</u>	<u>1,208,665</u>	<u>4,708,960</u>	<u>14,115,606</u>	<u>4,525,456</u>
Intercompany	28,691,871	(10,210,545)	(18,481,326)	-	-
Other assets	4,611,882	-	-	4,611,882	1,273,573
Property, plant and equipment	9,063,159	3,844,290	17,742,042	30,649,491	12,489,163
Goodwill, licences and other intangibles	-	5,581,211	1,078,930	6,660,141	5,865,724
	<u>50,564,893</u>	<u>423,621</u>	<u>5,048,606</u>	<u>56,037,120</u>	<u>24,153,916</u>
Liabilities					
Current Liabilities					
Accounts payable and accrued liabilities	3,773,012	673,588	3,005,523	7,452,123	5,629,157
Deferred revenue	905,829	568,642	2,011,969	3,486,440	1,396,154
Current portion of deferred lease inducements	65,460	-	-	65,460	59,962
Current portion of notes payable	4,285,845	-	-	4,285,845	13,467,480
Shareholder notes	-	-	-	-	2,756,245
	<u>9,030,146</u>	<u>1,242,230</u>	<u>5,017,492</u>	<u>15,289,868</u>	<u>23,308,998</u>
Deferred lease inducements	451,274	-	-	451,274	384,772
Notes Payable	23,741,731	-	-	23,741,731	119,228
Long Term Debt	7,962,021	-	-	7,962,021	-
	<u>41,185,172</u>	<u>1,242,230</u>	<u>5,017,492</u>	<u>47,444,894</u>	<u>23,812,998</u>
Shareholders' Equity (Deficiency)					
Common Shares	18,713,823	-	-	18,713,823	11,245,992
Warrants	1,360,657	-	-	1,360,657	-
Contributed Surplus	666,271	-	-	666,271	435,638
Equity component of convertible debt	539,906	-	-	539,906	636,056
Retained Earnings (Deficit)	(11,900,936)	(818,609)	31,114	(12,688,431)	(11,976,768)
	<u>9,379,721</u>	<u>(818,609)</u>	<u>31,114</u>	<u>8,592,226</u>	<u>340,918</u>
	<u>50,564,893</u>	<u>423,621</u>	<u>5,048,606</u>	<u>56,037,120</u>	<u>24,153,916</u>

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

Peer 1 Network Enterprises, Inc. Segmented Income Statement Three Months Ended September 30 (unaudited - prepared by management)					
	Three Months Ended September 30, 2005 Peer 1	Three Months Ended September 30, 2005 ServerBeach	One Month Ended September 30, 2005 Peer1 Dedicated*	Three Months Ended September 30, 2005 Total	Three Months Ended September 30, 2004 Peer 1
Revenue	4,926,309	3,221,333	3,421,865	11,569,507	3,780,131
Cost of Sales	3,002,975	1,692,635	2,421,669	7,117,279	2,355,617
Gross Profit	1,923,334	1,528,698	1,000,196	4,452,228	1,424,514
Operating expenses	1,576,670	610,689	639,316	2,826,675	1,482,480
Operating profit (loss)	346,664	918,009	360,880	1,625,553	(57,966)
Amortization of licences	30,196	867,972	-	898,168	-
Amortization of preferred share discount	173,279	-	-	173,279	-
Interest expense	500,926	255,710	-	756,636	160,757
Interest accretion on convertible debt	573,833	-	-	573,833	92,618
Integration costs	-	-	79,677	79,677	-
Realized foreign exchange loss (gain)	40,026	-	-	40,026	-
Unrealized foreign exchange loss (gain)	(153,949)	(296,298)	250,089	(200,158)	(7,028)
Loss from equity accounted investment	15,755	-	-	15,755	-
Income (loss) before income taxes	(833,402)	90,625	31,114	(711,663)	(304,313)
Provision for income taxes	-	-	-	-	7,356
Income (loss) for the period	(833,402)	90,625	31,114	(711,663)	(311,669)
Deficit, beginning of period	(11,067,534)	(909,234)	-	(11,976,768)	(9,132,877)
Adjustment for prior years' stock based compensation	-	-	-	-	-
Deficit, end of period	(11,900,936)	(818,609)	31,114	(12,688,431)	(9,444,546)
EBITDA	717,677	1,396,848	903,923	3,018,448	213,285
Normalized EBITDA	717,677	1,396,848	983,600	3,098,125	213,285

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

Peer 1 Network Enterprises, Inc. EBITDA Reconciliation Three Months Ended September 30 (unaudited - prepared by management)					
	Three Months Ended September 30, 2005 Peer 1	Three Months Ended September 30, 2005 ServerBeach	One Month Ended September 30, 2005 Peer1 Dedicated*	Three Months Ended September 30, 2005 Total	Three Months Ended September 30, 2004 Peer 1
Net Profit (Loss)	(833,402)	90,625	31,114	(711,663)	(311,669)
Interest Expense	1,074,759	255,710	-	1,330,469	253,375
Amortization - fixed assets and deferred network costs	410,520	462,444	563,755	1,436,719	254,539
Amortization - preferred share discount	173,279	-	-	173,279	-
Amortization - startup costs	-	-	-	-	9,684
Amortization - loan origination fees	-	583,460	-	583,460	-
Amortization - licence fees	-	284,512	-	284,512	-
Taxes	-	16,395	58,965	75,360	7,356
Stock-based compensation expense	30,715	-	-	30,715	-
Loss from equity accounted investment	15,755	-	-	15,755	-
Unrealized FX gains/losses	(153,949)	(296,298)	250,089	(200,158)	-
EBITDA	717,677	1,396,848	903,923	3,018,448	213,285
Integration Costs	-	-	79,677	79,677	-
Normalized EBITDA	717,677	1,396,848	983,600	3,098,125	213,285

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

Overall Performance

Selected Measures of Financial Position	September 2005	June 2005	June 2004
Cash (including restricted cash)	\$7,361,737	\$970,538	\$976,848
Total Assets	\$56,037,120	\$24,153,916	\$9,517,460
Working Capital	\$-1,174,262	\$-18,783,542	\$-1,188,031
Long Term Financial Liabilities	\$31,703,752	\$119,228	\$3,319,312
Share Capital	\$18,713,823	\$11,245,992	\$9,914,432
Shareholders' Equity	\$8,592,226	\$340,918	\$1,437,548

During the quarter, the company completed two major transactions, both on September 2, 2005: first, the acquisition of certain assets of Interland, Inc., and second, a debt reorganization and re-financing. The former has, together with the ServerBeach acquisition which completed after the comparable quarter in the prior year, significantly contributed to an improvement in the company's operational results and capabilities, and the latter has

resulted in a material improvement in the company's financial condition and liquidity. Revenue and EBITDA for the quarter ending September 2005 increased to \$11.6 million and \$3.0 million, respectively, as compared to \$3.8 million and \$0.2 million, respectively, in the comparable quarter of the prior year. Approximately 70% of the increase in revenue during the quarter ending September 30, 2005 is attributable to the Interland and ServerBeach acquisitions.

Liquidity concerns and the need to increase the capitalization of the company have been areas that management has spent significant time and effort on. During the first quarter of fiscal 2006, a refinancing of the company was completed. This process involved several steps, as outlined below in **LIQUIDITY AND CAPITAL RESOURCES – Financing Activities**, culminating in the company raising \$43.8 million on September 2, 2005 from a combination of debt, issuance of preferred shares, and conversion of existing shareholder debt (\$7.0 million). The company's working capital deficit of \$1.2 million as at September 30, 2005 is substantially the same as the working capital deficit as at September 30, 2004, but it is materially less than the working capital deficit of \$19 million as at June 30, 2005. Approximately \$0.5 million of the cash held by the company as at September 30, 2005 is unavailable for general use, as it is held as security for letters of credit required for operating purposes.

The large increase in total assets during the quarter ended September 30, 2005 is a result of the acquisition of the dedicated server assets of Interland, Inc. (see above), further investment in property and equipment and other assets for the network and data centres which required the use of \$24.0 million of the cash generated from operations and financing activities. The company continues to invest in assets for the Peer 1 Network operating companies as well as for Server Beach and Interland, Inc. Also during the quarter a 25,000 square foot data center facility was established in Los Angeles, California.

Selected Measures of Operations	YTD Q1 FY2006	YTD Q1 FY2005	YTD Q1 FY2004
Total Revenue	\$11,569,507	\$3,780,131	\$3,113,210
Gross Margin	38.4%	37.7%	34.1%
Net Loss	\$711,663	\$311,669	\$504,767

RESULTS OF OPERATIONS

With the decision to refocus management efforts onto the two principal business segments, the provision of colocation & bandwidth services and the rental of dedicated servers, this quarter's operating results do not include any revenues or costs related to Symmetric Broadband Inc. The company's share of the loss incurred by Symmetric Broadband this quarter is included on the income statement as a separate line item.

The colocation and bandwidth segment is the area of business that Peer 1 has historically provided services in. The ServerBeach and Interland acquisitions have facilitated entry into the dedicated server segment.

Revenues

56% of the revenue this quarter was generated from dedicated servers with revenues from colocation and bandwidth sales accounting for the balance. Revenue from dedicated servers has increased from 39% in the previous quarter, due to the acquisition of Interland. There was no revenue from dedicated servers during the first quarter of fiscal 2005.

Colocation and Bandwidth

Colocation revenues increased from \$1.5 million in the first quarter of fiscal 2005 to \$2.3 million in the first quarter of fiscal 2006 (53% growth). The increase is directly attributable to growth in the customer base - the number of colocation customers increased from 689 at the end of the first quarter of fiscal 2005 to 896 by the end of the first current quarter of fiscal 2006. Associated with this increase has been a 33% increase in the number of units sold each month. The average selling price of \$781 per customer, and average per-unit price of \$104, has increased 5% and 3%, respectively, in the first quarter of fiscal 2006 compared to the same period in fiscal 2005.

Bandwidth revenues have increased 16% to \$2.3 million during the first quarter of fiscal 2006 compared to the same period in fiscal 2005, though compared to the fourth quarter of fiscal 2005 bandwidth revenue has decreased slightly. Although the trend of falling bandwidth prices resulting from a highly competitive market continued during the most recent quarter, traffic was 28% higher in that quarter as compared with the quarter ending June 30, 2005. The ratio of colocation to bandwidth revenues was 47%:53% as at September 30, 2005 (substantially unchanged from the last quarter), compared to 43%:57% at September 30, 2004.

78% of revenues earned in the first quarter of fiscal 2006 were from the company's Canadian operations, compared to 81% in the comparable period in fiscal 2005. Sales at the US locations continue to grow, with Seattle and New York recording the majority of the increase. Management expects that the US locations will continue their sales growth, as Peer 1 brand recognition increases.

The company continues to monitor capacity utilization closely, in order to ensure that anticipated growth is not adversely affected by a lack of available space. Additional space has been purchased in Los Angeles and will contribute to revenue growth.

Dedicated Servers

Revenue in the first quarter of fiscal 2006 attributable to the company's dedicated server business amounted to \$6.5 million, up from \$2.9 million in the previous quarter. There was no revenue from dedicated servers during the first quarter of fiscal 2005. The \$6.5 million is comprised of \$3.2 million from ServerBeach and \$3.3 million from Interland. As at September 30, 2005, the company had 13,091 servers compared to 5,594 as at June 30, 2005.

Gross Profit

Gross profit margins have remained stable compared to the same period last year and compared to fiscal 2005 as unutilized capacity that would have negatively impacted margins has been offset by customers purchasing higher margin products.

Cost of Sales

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

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

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

Operating Expenses

Colocation and Bandwidth

The largest component of operating expenses is salaries and wages which, in the first quarter of fiscal 2006 comprise approximately 56% of the total, unchanged as a percentage of total operating expenses in the comparable quarter of the prior fiscal year.

Rent and administration costs make up the next most significant component at 22% of total operating costs for the first quarter of fiscal 2006 which is largely unchanged from the same period in fiscal 2005. Management continues to focus on administration costs to ensure that operations are as efficient as possible. No major changes are anticipated for the costs in this category.

Travel costs are 8% of total operating expenses for the quarter compared to 11% for the same period in fiscal 2005.

Professional fees account for 9% of total costs this quarter, unchanged from FY2005. No major changes are anticipated for the costs in this category.

SUMMARY OF QUARTERLY RESULTS

	Quarter Ended							
	December 31 2003	March 31 2004	June 30 2004	September 30 2004	December 31 2004	March 31 2005	June 30 2005	Sept 30 2005
Revenue	3,407,164	3,400,250	3,667,290	3,780,131	5,693,401	7,169,124	7,470,692	11,569,507
Operating Profit (Loss)	66,585	156,654	(64,459)	(57,966)	51,591	669,173	522,577	1,625,553
Net Income (Loss)	(248,638)	5,969	(244,914)	(311,669)	(178,709)	(1,162,000)	(861,790)	(711,663)
Pro forma basic and fully diluted income (loss) per share	(0.01)	-	(0.01)	(0.01)	-	(0.03)	(0.02)	(0.01)
EBITDA	277,177	421,865	124,530	213,285	653,734	1,532,506	1,292,399	3,098,125

LIQUIDITY AND CAPITAL RESOURCES

On September 2, 2005 the company secured additional financing and reorganized certain existing debts resulting in the improved liquidity of the company which management expects will be sufficient to fund existing operations for FY2006. The details of the financing are discussed below.

As of September 30, 2005 the company had a cash and cash equivalents balance of \$7.4 million. As noted in a previous section, this includes US\$500,000 of restricted funds which have been set aside as security for letters of credit. The company had a working capital deficit of \$1.2 million at the end of the quarter compared to a working capital deficit of \$18.8 million as at June 30, 2005. Included in the working capital deficit for the first quarter of fiscal 2006 is \$3.5 million for deferred revenue, this amount relates to the provision of services rather than the expected use of cash. If this item is excluded from the calculation, the working capital would be \$2.3 million.

Other assets on the balance sheet is comprised of \$3.3 million of loan origination fees, \$.4 million in deferred mergers and acquisitions costs and \$.9 million in other deposits and long term prepaid amounts.

Operating Activities

Operating activities, prior to consideration of the change in working capital balances, in the first quarter of FY2006 generated almost thirteen times more cash than in the same quarter last year. This is primarily because the increase in revenues was greater than the commensurate increase in cash based expenses. Future revenue growth is also expected to follow this trend, with the result that cash flows are anticipated to continue increasing.

Investing Activities

Investing activities during the quarter reflect the ongoing capital investment required in a rapidly growing business. Significant investing activities during the quarter included the build out of the Los Angeles data center and the acquisition of the dedicated server assets of Interland. The details of the Interland acquisition are discussed below.

- 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.

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

Financing Activities

Liquidity concerns and the need to increase the capitalization of the company have been areas that management has spent significant time and effort on. During the first quarter of fiscal 2006, a refinancing of the company was completed. This process involved several steps, as outlined below:

- Extension of the maturity date of the loan that was used to finance the ServerBeach acquisition. The company exercised a six month renewal option, and extended the maturity of the US\$7,500,000 bridge loan to December 31, 2005. The transaction fee associated with the renewal was US\$400,000, which was satisfied by issuing 1,538,625 shares at a price of \$0.32 per share. On September 2, 2005, this loan was repaid from the proceeds of the loan from Fortress Credit Corp. described below.
- On July 18, 2005 the Company closed a US\$2.0 million loan with companies controlled by directors. On September 2, 2005, this loan was repaid from the proceeds of the loan from Fortress Credit Corp. described below.

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

Pursuant to the LSA, Fortress agreed to make three loan facilities available to the Borrowers: a term loan which was advanced on September 2, 2005 in the amount of US\$24 million; a term loan (the "Incremental Term Loan") of up to US\$4 million (less if certain cash flow criteria specified in the LSA are not satisfied) and a revolving loan (the "Revolving Facility") of up to US\$7 million until

September 2, 2008 and US\$10 million thereafter until September 2, 2010 if the maturity date is extended by the Company for two years in accordance with the terms of the LSA.

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

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

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

The interest rate on borrowings under the LSA is LIBOR plus 6.5% per annum, subject to adjustment in certain specified circumstances. The borrowings must be repaid in installments, commencing on October 1, 2005. A portion of the net proceeds received by any of the Borrowers from the sale of assets or the issuance of equity securities must be used to prepay the loan. The maturity date of the loan is September 1, 2008, though the Company may extend the maturity date for two years by giving notice of such extension at least 90 days before September 1, 2008.

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

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

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

- (a) for the period beginning on September 2, 2005 (the "Closing Date") through but excluding the second anniversary of the Closing Date, US\$1,000 per share,
- (b) for the period beginning on such second anniversary through but excluding the third anniversary of the Closing Date, US\$1500 per share and
- (c) for the period beginning on the third anniversary of the Closing Date and thereafter, US\$2000, subject in each case to adjustments in certain circumstances.

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

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

- (a) Any Investor may require the Company to purchase for US\$2,000 per share any or all of its shares of Series A Preferred stock at any time after the fourth anniversary of the Closing Date, upon a liquidation, dissolution or winding up of the Company or upon a change of control.
- (b) At any time after the fourth anniversary of the Closing Date, the Company may require the Investors to sell all of their shares of Series A Preferred stock to the Company at a price per share of US\$2000.
- (c) Any investor may at any time require the Company to purchase any or all of its shares of Series A Preferred stock in exchange for the number of common shares in the capital of the Company determined by dividing \$1,000 per share of Series A Preferred stock being exchange by US0.2291, subject to adjustment in certain specified circumstances.

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

The preferred shares are classified as a liability as they are redeemable by the holders at US\$2,000 per share at anytime after four years. The \$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.

The conversion feature of the preferred shares has been separately valued at \$.5 million and recorded as equity and the resulting discount is being accreted to interest also over 4 years.

The company, Peer 1 (USA), the Investors and certain shareholders of the company have entered into a Shareholder Agreement dated September 2, 2005

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

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

- On September 2, 2005, \$7,013,698.25 of the company's indebtedness was settled in exchange for the issuance of 25,274,588 common shares of the company, at a deemed price per share of \$0.2775.

OFF-BALANCE SHEET ARRANGEMENTS

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

TRANSACTIONS WITH RELATED PARTIES

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

As at September 30, 2005 and September 30, 2004, amounts due to and from related parties were as follows:

	9/30/2005	9/30/2004
Included in accounts receivable	\$26,178	\$112,602
Included in accounts payable and accrued liabilities	\$5,118	2,996

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

	Q1-FY2006	Q1-FY2005
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 financing fees totaling \$1,994,920 relating to the Fortress loan and the Series A Preferred share issue.

SUBSEQUENT EVENTS AND PROPOSED TRANSACTIONS

The company continues to proceed with due diligence work in connection with the Board approved letter of intent for an acquisition target in the USA. The target is in a similar business segment, and would enhance Peer 1's market presence and network infrastructure. The due diligence process will continue in the next quarter, prior to any further decisions being made by the Board.

OUTSTANDING SHARE DATA

Peer 1 has authorized share capital of 100,000,000 common shares without par value. At September 30, 2005 75,937,580 common shares were issued and outstanding (44,369,367 as at September 30, 2004). A further 500,000 common shares have been issued as of the date of this MD&A, bringing the total number of common shares issued and outstanding to 76,437,580

8,485,786 warrants for the purchase of shares ranging in price from \$0.27 to \$0.40 were outstanding at September 30, 2005 end (2004 – 16,319,880). No additional warrants were issued subsequent to the quarter end, however 500,000 warrants were exercised subsequent to the end of the quarter.

3,764,750 (2004 – 3,433,250) stock options were outstanding at quarter end under the company's stock option plan. No options were exercised after the quarter end; no additional options have been issued as of the date of this MD&A.

Under the preferred share financing described in the previous section, 7,000 preferred shares of Peer 1 Network (USA) Inc. were issued. By way of the Investor Rights Agreement, the holders of the preferred shares may require the company to acquire any or all of their preferred shares in exchange for common shares of Peer 1. Subject to adjustment in specified circumstances, the conversion would be for 4,365 common shares of Peer 1 for each preferred share.

CRITICAL ACCOUNTING ESTIMATES

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

In estimating the allowance for doubtful accounts, management reviews the payment history of current customer as well as overall historical collection trends. Our allowance is in the range of 2-2.5% of annual revenues.

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

The likelihood of M&A projects being completed are based on the facts involved in each particular case.

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

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

ACCOUNTING POLICIES

The company prepares its financial statements on the basis of accounting principals generally acceptable in Canada. All accounting policies have been applied on a basis consistent with that of the previous year. Due to the most recent acquisition of the dedicated server assets of Interland Inc, the company's US dollar revenues account for approximately 67% of total company revenues. Accordingly, the company's management believe that in order to more accurately reflect the current nature of the operations, it would be desirable to report the results of the company in US dollars and US GAAP prior to the end of the current fiscal year. The company is currently evaluating the impact of converting the reporting to US dollars and US GAAP.

During the year, as part of its growth strategy, the company undertook a process of identifying and pursuing organizations for potential acquisition. As a result, costs directly related to acquisitions continue to be incurred. The company has adopted a policy of deferring such costs for proposed transactions where completion is considered to be more likely than not. These deferred costs will be added to the cost of purchase upon completion. Should the status of a project change to become unlikely to complete, the costs associated with that project are expensed. As of the end of the first quarter, \$420,000 of costs had been deferred (\$338,000 at the end of the preceding quarter).

Non-GAAP Measures

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

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

OUTLOOK AND RISKS

Outlook

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

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

Risks

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

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

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

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

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

OTHER INFORMATION

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