peer1 NETWORK | CO-LOCATION | DEDICATED HOSTING

Consolidated Financial Statements
For The Fiscal Years Ended June 30, 2007 and 2006

PEER 1 NETWORK ENTERPRISES, INC.

CONSOLIDATED FINANCIAL STATEMENTS

For the Years Ended June 30, 2007 and 2006

PEER 1 NETWORK ENTERPRISES, INC.

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HLB
Cinnamon Jang Willoughby & Company

Chartered Accountants
A Partnership of Incorporated Professionals

AUDITORS' REPORT

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

We have audited the consolidated balance sheets of Peer 1 Network Enterprises, Inc. (the "Company") as at June 30, 2007 and 2006, and the consolidated statements of operations and deficit, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at June 30, 2007 and 2006, and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

"Cinnamon Jang Willoughby & Company"

Chartered Accountants

Burnaby, BC, Canada
August 31, 2007

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

In the United States, the standards of the Public Company Accounting Oversight Board (United States) for auditors require the addition of an explanatory note when there are differences in accounting principles that have a material effect on the comparability of the Company's financial statements. Application of accounting principles generally accepted in the United States would have affected liabilities and shareholders' deficiency as at June 30, 2007, 2006 and the results of operations for the years then ended to the extent summarized in Note 22 to the consolidated financial statements.

"Cinnamon Jang Willoughby & Company"

Chartered Accountants

Burnaby, BC, Canada
August 31, 2007

MetroTower II - Suite 900 - 4720 Kingsway, Burnaby, BC Canada V5H 4N2. Telephone: +1 604 435 4317. Fax: +1 604 435 4319.
HLB Cinnamon Jang Willoughby & Company is a member of HLB International. A world-wide organization of accounting firms and business advisors.

Exhibit "A"

PEER 1 NETWORK ENTERPRISES, INC.
Consolidated Balance Sheet
June 30, 2007
(in thousands of United States dollars)

Assets	**2007**	2006
Current:		
Cash and cash equivalents	**$ 8,754**	$ 5,666
Restricted cash (Note 4)	**505**	505
Accounts receivable	**4,424**	5,242
Future income tax asset (Note 16)	**1,392**	-
Prepaid expenses	**689**	720
	15,764	12,133
Other assets (Note 6)	**4,079**	3,951
Future income tax asset (Note 16)	**2,574**	-
Property and equipment (Note 7)	**26,924**	24,520
Goodwill	**1,715**	1,715
Intangible Assets (Note 10)	**3,030**	5,964
	$ 54,086	$48,283
Liabilities		
Current:		
Accounts payable and accrued liabilities	**$ 8,754**	$ 10,039
Deferred revenue	**4,236**	3,749
Current portion of deferred gain	**79**	-
Current portion of deferred lease inducements	**144**	84
Current portion of notes payable	**3,350**	3,664
Income taxes payable (Note 16)	**476**	402
	17,039	17,938
Deferred gain (Note 8)	**650**	-
Deferred lease inducements (Note 12)	**965**	423
Notes payable (Note 13)	**16,257**	17,388
Long-term debt (Note 14)	-	8,087
	34,911	43,836
Shareholders' Equity		
Capital stock (Note 15)	**25,254**	14,327
Warrants (Note 15)	**917**	1,061
Contributed surplus (Note 15)	**1,092**	778
Deficit, per Exhibit "B"	**(8,077)**	(11,708)
Cumulative translation adjustment	**(11)**	(11)
	19,175	4,447
	$ 54,086	$48,283

Commitments and contingencies (Note 20)

On behalf of the Board:

Director Director

Exhibit "B"

PEER 1 NETWORK ENTERPRISES, INC.
Consolidated Statement of Operations and Deficit
For the Year Ended June 30, 2007
(in thousands of United States dollars, except per share amounts)

	2007	2006
Revenue	**$ 74,361**	$60,726
Cost of sales	**45,594**	38,266
Gross Profit	**28,767**	22,460
Operating expenses	**21,153**	18,430
Operating Income before other items	**7,614**	4,030
Other Items:		
Amortization of preferred share discount	**1,361**	1,089
Integration costs	**650**	1,187
Loss from investment accounted for on an equity basis	**-**	13
Loss on disposal of property plant & equipment	**138**	61
Foreign exchange loss (gain)	**(33)**	305
Impairment of intangible assets (Note 10)	**1,185**	-
Interest expense – long term	**3,360**	4,136
Interest expense – short term	**-**	37
	6,661	6,828
Income (Loss) before income taxes	**953**	(2,798)
Income tax expense (recovery) (Note 16)	**(2,678)**	390
Net Income (Loss)	**3,631**	(3,188)
Deficit, beginning	**11,708**	8,520
Deficit, ending, to Exhibit "A"	**$ 8,077**	$ 11,708
Basic and diluted income (loss) per share (Note 15)	**$ 0.04**	($ 0.04)

PEER 1 NETWORK ENTERPRISES, INC.
Consolidated Statement of Cash Flows
For the Year Ended June 30, 2007
(in thousands of United States dollars)

	2007	2006
Operating Activities:		
Net Income (Loss), per Exhibit "B"	**$ 3,631**	$ (3,188)
Adjustments for -		
Amortization of preferred share discount	**1,361**	1,089
Amortization of property and equipment	**9,415**	7,072
Amortization of intangible assets	**1,530**	1,442
Increase in accrued interest and accretion of convertible debt	**142**	2,337
Settlement of loan renewal fee	**-**	400
Bad debt expense	**628**	859
Loss on disposal of property and equipment	**138**	61
Impairment of intangible assets	**1,185**	-
Amortization of deferred gain	**(59)**	-
Amortization of deferred loan origination fees	**946**	762
Future income tax expense (recovery)	**(3,962)**	-
Stock-based compensation included in income (loss) for the year	**449**	289
	15,404	11,123
Changes in non-cash working capital -		
Decrease (Increase) in accounts receivable	**189**	(3,658)
Decrease (Increase) in prepaid expenses	**31**	(333)
Increase (Decrease) in accounts payable and accrued liabilities	**(1,852)**	5,853
Increase in income taxes payable	**74**	402
Increase in deferred revenue	**487**	2,610
Cash flows from operating activities	**14,333**	15,997
Investing Activities:		
Increase in restricted cash	**-**	(5)
Investment in other assets	**(1,310)**	(3,683)
Acquisition of property and equipment	**(11,165)**	(22,168)
Acquisition of intangible assets	**(1,017)**	(3,001)
Acquisition of goodwill	-	(1,125)
Proceeds on disposition of equipment	**51**	16
Increase in deferred lease inducements	**602**	144
Cash flows (used in) investing activities	**(12,839)**	(29,822)
Financing Activities:		
Net Proceeds on sale leaseback	**1,750**	-
Proceeds from notes payable and long - term debt, net of repayments	**(1,587)**	18,890
Issuance of capital stock	**1,431**	309
Cash flows from financing activities	**1,594**	19,199
Increase (Decrease) in Cash and Equivalents	**3,088**	5,374
Cash and Equivalents, beginning	**5,666**	292
Cash and Equivalent, ending	**$ 8,754**	$ 5,666

Supplemental Disclosure of Cash Flow Information (Note 17)

PEER 1 NETWORK ENTERPRISES, INC.
Notes to Consolidated Financial Statements
June 30, 2007
(tabular dollar amounts are presented in thousands of United States dollars, except number of shares and per share amounts)

1. Nature of Operations:

Peer 1 Network Enterprises, Inc. ("the Company" or "Peer 1") was incorporated under the laws of British Columbia. The Company provides high performance Internet bandwidth, co-location facilities and dedicated servers to web-centric and enterprise customers across North America. Building on an internal network with built in redundancy, the company guarantees 100% uptime Internet access for companies with mission-critical applications. The Company has established local offices and data centres throughout Canada and the USA, and also has established points of presence in London, UK and Amsterdam in the Netherlands.

The Company, through the ServerBeach division, based in San Antonio, Texas, specializes in offering self-managed dedicated servers providing firewalls, SAN, security and support to augment the clients' applications and custom hosting solutions for clients with unique requirements. The corporate headquarters are in Vancouver.

2. Significant Accounting Policies:

a) Basis of Consolidated Financial Statements -

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

b) Cash and Cash Equivalents -

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

c) Property and Equipment -

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

Co-location equipment	20%
Computer equipment	30%
Furniture and fixtures	20%
Network equipment	20%

Dedicated servers rented to customers as part of the dedicated server business unit are amortized straight line over their expected useful life, which varies from 24 to 36 months. Inventory of parts held for server assembly are classified in this component of property and equipment, and are not subject to amortization until the assets are put into use.

PEER 1 NETWORK ENTERPRISES, INC.
Notes to Consolidated Financial Statements
June 30, 2007
(tabular dollar amounts are presented in thousands of United States dollars, except number of shares and per share amounts)

2. Significant Accounting Policies (Continued):

c) Property and Equipment (Continued) -

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

When the net carrying amount of the property and equipment exceeds the estimated net recoverable amount, the asset is written down to its estimated fair value and a charge is recorded in the consolidated statement of operations.

d) Goodwill -

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

e) Intangible assets –

Computer software comprising PC based software acquired for internal use is amortized at an annual rate of 100%. Computer software acquired as a component of revenue producing assets, or internal systems such as accounting or customer relations management systems is amortized over the expected useful life of the software. Amortization commences when the asset is put into service. Licences are recorded at cost. Amortization is provided on a straight-line basis over the term of the licences. The lease purchase option is not amortized.

f) Deferred Lease Inducements -

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

g) Debt Instruments -

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

h) Future Income Taxes -

Income taxes are calculated using the asset and liability method of tax allocation. Temporary differences arising from the difference between the tax basis of an asset or liability and its carrying amount on the balance sheet, and unutilized losses carried forward are used to calculate future income tax assets or liabilities. Future income tax assets or liabilities are calculated using tax rates anticipated to apply in the year that the temporary differences are expected to reverse. The carrying value of the future income tax asset is limited to the amount that is more likely to be realized.

PEER 1 NETWORK ENTERPRISES, INC.
Notes to Consolidated Financial Statements
June 30, 2007
(tabular dollar amounts are presented in thousands of United States dollars, except number of shares and per share amounts)

2. Significant Accounting Policies: (Continued)

i) Financing Costs -

Costs directly identifiable with the raising of capital are charged against the related capital stock. Costs incurred to obtain debt financing are deferred and amortized by a charge to interest expense over the term of the related debt. Debt financing fees are amortized and included as part of interest expense. Financing costs expensed for 2007 are $946,382 ($762,315 in 2006).

j) Capitalization of Internally Developed Software –

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

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

k) Organizational Costs -

Organizational costs, direct or incremental costs directly related to acquisitions, are deferred and added to the cost of the purchase. Only costs that are directly related to proposed transactions, where completion is considered more likely than not, are deferred. Once the Company ceases to be engaged on a regular ongoing basis and it is not likely that activities will resume, the costs are expensed.

l) Foreign Currency Transactions -

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

The Company's non-US subsidiaries are managed as integrated operations and accordingly are accounted for under the temporal method. Under this method, monetary assets and liabilities are translated at the exchange rate in effect at the balance sheet date. Non-monetary assets and liabilities are translated at historical rates. Revenues and expenses are translated at average rates for the year. Exchange gains or losses arising from the translation are included in operations. See also Note 3.

m) Revenue Recognition -

The four sources of revenue are co-location, Internet traffic, provision of dedicated hosting servers and general services. General services include installation, IP monitoring, tape back-up, technical support, additional access cards, and DNS services. Co-location, Internet traffic, dedicated hosting servers and general services revenue is recognized once an agreement is in place, the price is fixed or determinable, the service is provided and there is reasonable assurance of cash collection

PEER 1 NETWORK ENTERPRISES, INC.
Notes to Consolidated Financial Statements
June 30, 2007
(tabular dollar amounts are presented in thousands of United States dollars, except number of shares and per share amounts)

2. Significant Accounting Policies: (Continued)

m) Revenue Recognition – (Continued)

Revenue is earned through monthly charges at contractually agreed upon prices. Revenue is recognized ratably over the term of the contract as services are provided to the customer. One-time installation fees are deferred and recognized on a straight-line basis over the contractual period, which typically varies from six months to three years.

n) Stock-based Compensation -

The Company has a stock-based compensation plan for executives and other key employees. The stock-based compensation expense is recognized in accordance with CICA Handbook Section 3870 "Stock-Based Compensation and Other Stock-Based Payments". Beginning January 1, 2004, the Company changed its accounting policy related to employee stock options, and began to recognize compensation expense for stock or stock option grants to employees, based on the fair value of the stock or stock options issued. Consideration paid by employees on the purchase of shares under the employee share purchase plan and exercise of stock options is recorded as share capital.

o) Earnings Per Share -

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

p) Use of Estimates -

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying disclosures. Although these estimates are based on management's best knowledge of current events and actions the Company may undertake in the future, actual results may differ from these estimates.

q) Comparative Numbers –

The 2006 comparative figures have been reclassified, where applicable, in order to conform with the presentation used in the current year.

PEER 1 NETWORK ENTERPRISES, INC.
Notes to Consolidated Financial Statements
June 30, 2007
(tabular dollar amounts are presented in thousands of United States dollars, except number of shares and per share amounts)

3. Functional And Reporting Currency Change:

Effective October 1, 2005, the Company changed its functional currency to the US dollar from the Canadian dollar in order to more accurately represent the currency of the economic environment in which it operates as a result of increasing US dollar denominated revenues and expenditures. Concurrent with the change in its functional currency, the Company has adopted the US dollar as its reporting currency.

The consolidated financial statements of the Company for the periods ended on or before June 30, 2005 which were based on the Canadian functional currency were translated into the US reporting currency using the current rate method as follows: assets and liabilities using the rate of exchange prevailing at the balance sheet date; shareholders' equity using the applicable historic rate; and revenue and expenses using a monthly average rate of exchange. Translation adjustments have been included as part of the cumulative translation adjustment.

For periods commencing July 1, 2005 monetary assets and liabilities denominated in foreign currencies are translated into US dollars using exchange rates in effect at the balance sheet date. All other assets and liabilities are translated at the exchange rates prevailing at the dates the assets were acquired or liabilities incurred. Revenue and expense items are translated at the average exchange rate for the period. Foreign exchange gains and losses are included in the determination of the income for the period.

4. Restricted Cash:

The Company has issued letters of credit totaling $505,000 ($505,000 in 2006) to landlords and other vendors in the normal course of business in lieu of deposit requirements. The letters of credit have a term of one year, with annual renewal provisions. Certificates of deposit for the full amount of the issued letters of credit have been pledged as security, and are disclosed on the balance sheet as restricted cash.

5. Investment in Symmetric:

Symmetric was a provider of voice services over the Internet. This service was not offered by PEER 1, and it entered into an agreement with a joint venturer who would provide the required expertise.

In January 2005 the Company amended the agreement with the joint venturer. Under the terms of the revised agreement, the Company is no longer responsible for continuing to fund Symmetric's operations, with all current funding being made available by the other party to the agreement. As a result, the Company's ownership interest has declined from 50% at December 31, 2004 to 28% at June 30, 2005, and the basis of accounting was changed from proportionate consolidation to equity accounting during the June 30, 2005 fiscal year end.

After reflecting the Company's share of the losses incurred by Symmetric during 2006 on the equity basis, the net investment in Symmetric is $Nil ($Nil in 2006)
.
The Company has retained the right to increase its interest in Symmetric back to the 50% level by providing funding equivalent to twice the amount that would otherwise be required to match the contributions made by the other party to the agreement.

PEER 1 NETWORK ENTERPRISES, INC.
Notes to Consolidated Financial Statements
June 30, 2007
(tabular dollar amounts are presented in thousands of United States dollars, except number of shares and per share amounts)

6. Other Assets:

	2007	2006
Financing costs	**$1,515**	$ 1,995
Network installation fees	**94**	14
Security deposits	**2,456**	1,942
Sublease rent incentive	**14**	-
	$4,079	$3,951

7. Property and Equipment:

	Cost	**2007 Accumulated Amortization**	**Net**
Co-location equipment	$ 4,975	$1,793	$ 3,182
Computer equipment	949	369	580
Dedicated servers	20,360	11,909	8,451
Furniture and fixtures	303	68	235
Leasehold improvements	12,670	2,909	9,761
Network equipment	7,658	2,943	4,715
	$46,915	$19,991	$26,924

	Cost	**2006 Accumulated Amortization**	**Net**
Co-location equipment	$3,248	$ 1,238	$ 2,010
Computer equipment	720	257	463
Dedicated servers	14,431	5,485	8,946
Furniture and fixtures	178	63	115
Leasehold improvements	10,836	1,593	9,243
Network equipment	5,814	2,071	3,743
	$35,227	$10,707	$24,520

There are no assets under capital lease in the current year ($Nil in 2006).

Included in computer equipment is $252,072 ($191,516 in 2006) relating to a system integration project. This has not yet been put into use and has therefore not incurred amortization during the year.

Included in dedicated servers is inventory of parts held for server assembly at a cost of $Nil ($544,160 in 2006).

In 2007, expenditures for property & equipment were $12,008,061 ($21,478,962 in 2006).

PEER 1 NETWORK ENTERPRISES, INC.
Notes to Consolidated Financial Statements
June 30, 2007
(tabular dollar amounts are presented in thousands of United States dollars, except number of shares and per share amounts)

8. Sales and Leaseback:

On August 9, 2006 the Company exercised its option to purchase its leased data centre property located at 2300 NW Place, Miami, Florida. The gross purchase price was $4,617,266 and was subject to closing adjustments. On September 26, 2006 the Company subsequently entered into a sale and leaseback arrangement for this property. The gross sale price was $5,600,000. The Company leased the premises back from the purchaser for an initial term of 10 years with the option to renew for a further two 5 year periods. After adjustments, the Company recorded a deferred gain of $788,135 on this transaction which is being amortized into the statements of operations over the term of the lease.

9. Interland Inc. Asset Acquisition:

On September 2, 2005 the Company, through its wholly-owned subsidiary, Peer 1 Dedicated Hosting, Inc., completed an asset acquisition pursuant to the asset purchase agreement dated August 31, 2005 with Interland, Inc. ("Interland"). The Interland Inc. asset acquisition is being accounted for under the purchase method. The results of the acquisition are included in the consolidated company results from September 2, 2005. 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 to Interland from third parties. The purchase price for the assets and the obligations of Interland was $14,000,000 plus an adjustment of $604,162 relating to a working capital adjustment due to the Company having assumed reduced net liabilities of Interland, plus legal and consulting costs of $709,054, 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 which was amended December 31, 2005.

The purchase price and related organizational costs were allocated to the assets acquired based on the fair market value, with the excess recorded as goodwill, as follows:

Accounts Receivable, net	$ 457
Prepaid Expenses	538
Other Assets – deposits	289
Tangible Assets	12,610
Software	1,391
Lease purchase option	962
Goodwill	1,125
Deferred Revenue	(1,894)
Accounts Payable	(165)
	$15,313

PEER 1 NETWORK ENTERPRISES, INC.
Notes to Consolidated Financial Statements
June 30, 2007
(tabular dollar amounts are presented in thousands of United States dollars, except number of shares and per share amounts)

10. Intangible Assets:

	Cost	2007 Accumulated Amortization	Net
Licences	$4,727	$2,521	$2,206
Computer software	2,017	1,193	824
	$6,744	$3,714	$3,030

During the year, the Company recorded an amount of $1,185,000 with respect to an impairment provision on capitalized internally developed software. Events and circumstances indicated that the carrying value of these assets was not recoverable over their remaining lives and the assets were considered to have no future benefit to the Company. The impairment provision is shown on the income statement on the line caption *Impairment of intangible assets* and is included in the operating segments *Co-location and Bandwidth* and *Dedicated Servers* in the amounts of $423,000 and $762,000 respectively for the fiscal year ended June 30, 2007.

	Cost	2006 Accumulated Amortization	Net
Licences	$4,727	$1,576	$3,151
Computer software	1,699	609	1,090
Internally developed software	761	-	761
Lease purchase option	962	-	962
	$8,149	$2,185	$5,964

Computer software totaling $1,699,680 ($576,483 in 2006) has been fully amortized and remains in service.

In 2007, expenditures for intangible assets were $741,625 ($4,406,521 in 2006).

11. Shareholder Notes Payable:

The shareholder notes payables were unsecured, payable on demand and carried an interest rate of prime plus 7%.

On August 31, 2005 the Company entered into agreements with the respective holders of the shareholder notes payable whereby the respective parties agreed that if and when an advance was made under the Fortress Credit Corp. Loan (Note 13(f)), the Company would repay the total amount owing under the shareholder notes in full by issuing to the Lender common shares of the Company at a price of CDN$0.2775 per share.

PEER 1 NETWORK ENTERPRISES, INC.
Notes to Consolidated Financial Statements
June 30, 2007
(tabular dollar amounts are presented in thousands of United States dollars, except number of shares and per share amounts)

11. Shareholder Notes Payable: (Continued)

On September 2, 2005 the shareholder notes were converted to 10,056,436 shares, at CDN$0.2775.

12. Deferred Lease Inducements:

	2007	2006
Deferred lease inducements	**$1,109**	$507
Less: Current portion	**144**	84
	$965	$423

13. Notes Payable:

	Principal and Interest	Unamortized Accretion	**2007 Total**	2006 Total
Secured Loans -				
a) Sutton Group Financial Services Limited	$ -	$ -	**$ -**	$ -
b) Sutton Group Financial Services Limited	-	-	-	-
c) Polygon Financial, Inc.	-	-	-	-
d) Polygon Financial Investments Inc.	-	-	-	-
e) Code Capital Limited	-	-	-	-
f) Fortress Credit Corp.	-	-	-	21,052
g) Fortress Credit Opportunities I LP	19,862	255	**19,607**	-
h) Polygon Financial Investments Inc.	-	-	-	-
	19,862	255	**19,607**	21,052
Unsecured Loans -				
i) ACACIA Management Services Inc.	-	-	-	-
j) Cyber Pacific Holdings Limited	-	-	-	-
k) Code Marketing Limited	-	-	-	-
	-	-	-	-
	$19,862	$255	**19,607**	21,052
Less: Current portion			**3,350**	3,664
			$ 16,257	$ 17,388

PEER 1 NETWORK ENTERPRISES, INC.
Notes to Consolidated Financial Statements
June 30, 2007
(tabular dollar amounts are presented in thousands of United States dollars, except number of shares and per share amounts)

13. Notes Payable: (Continued)

a) Sutton Group Financial Services Limited -

On July 1, 2003, the Company amended the terms of a convertible, secured 10% note dated May 10, 2002 held by a significant shareholder, Sutton Group Financial Services Limited. The amended note accelerated the maturity date from January 2008 to July 2006. It also reduced the share price at which the outstanding principal and interest could be converted to common shares of the Company, from a range of CDN$0.45 to CDN$0.65 during the term of the note to CDN$0.32 until September 30, 2005, and CDN$0.352 thereafter. The terms of the note were further amended on August 31, 2005.

As consideration for the acceptance of the terms as amended July 1, 2003, the Company issued warrants to purchase 2,502,900 common shares at CDN$0.32 per share until October 22, 2005. The warrants were exercised in March 2004. The shares of Peer 1 Network Inc., the Canadian operating subsidiary, were registered under a pledge agreement to secure the note. On August 31, 2005 the Company amended the note by entering into an agreement with Sutton Group Financial Services Limited whereby the parties agreed that if and when an advance was made under the Fortress Credit Corp. Loan (Note 13(f)), the Company would repay the total amount owing under the note in full by issuing the Lender common shares at a price of CDN$0.2775 per share.

On September 2, 2005 the debt was converted to 3,585,328 shares at CDN$0.2775 per share.

b) Sutton Group Financial Services Limited -

An unsecured, demand promissory note bearing interest at prime plus 7% was issued to a significant shareholder of the Company, Sutton Group Financial Services Limited, in September 2002 and the terms of the note were amended effective July 1, 2003. The amended terms provided that the principal and interest accrued at prime plus 7% would be due June 30, 2006 and that the note could have been converted to common shares of the Company at CDN$0.32 per share until June 30, 2005, and thereafter at CDN$0.352 per share.

The Company had also agreed that the holders could have exchanged the amended note to the Company for shares in the capital of Peer 1 Network Enterprises Inc. Prior to September 30, 2005, the number of shares issued were based on CDN$0.32 per share, thereafter, CDN$0.352 per share. The terms of the note were further amended on August 31, 2005.

As partial consideration for agreeing to renegotiate the terms of the existing debt as per the amendment dated July 1, 2003, the creditors were granted warrants to purchase 3,013,821 common shares at CDN$0.32 per share expiring on October 22, 2005. The warrants were exercised in March 2004.

The Company had pledged the assets of Peer 1 Network Enterprises, Inc. as security for the loan, subject to the security interest of the Code Capital Limited loan (Note 13(e)), and a postponement agreement. Code Capital Limited is a Company owned by a shareholder and director of the Company.

On August 31, 2005 the Company entered into an agreement with Sutton Group Financial Services Limited (the “Lender”) whereby the parties agreed that if and when an advance was made under the Fortress Loan, the Lender would assign the Indebtedness to the Company in exchange for common shares of the Company at a price of CDN$0.2775 per share.

On September 2, 2005 the debt was converted to 4,565,328 shares at CDN$0.2775 per share.

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13 Notes Payable: (Continued)

c) Polygon Financial, Inc. -

Under an April 4, 2003 line of credit agreement with Polygon Financial, Inc., a lender controlled by a director of the Company, the lender advanced $900,000, the full amount of the agreement, in four draws.

Interest was charged at 10% per annum compounded monthly (increasing to 15% in the event of default). Principal and interest were payable in quarterly installments commencing October 31, 2003 and ending on January 31, 2008. The unused portion of the facility bore a standby fee of 7.5%.

The aggregate principal amount under the line of credit could have been converted into common shares at the option of the lender. During the first two years of the line of credit, the conversion price was CDN$0.32 per share. The conversion price was to be increased by 10% per year thereafter. If the conversion resulted in the lender holding more than 20% of the issued common shares, shareholder approval was to be obtained. On August 31, 2005 the conversion price was amended to CDN$0.2775 per share.

In connection with the April 4, 2003 line of credit agreement, the Company issued to the lender, a non-transferable share purchase warrant entitling it to purchase up to 4,145,906 common shares at CDN$0.32 per share, for two years. The warrants, issued in lieu of additional interest and fees, expired on July 24, 2005.

The assets of Peer 1 Network (USA) Inc. had been pledged as security for the facility.

On August 31, 2005 the Company entered into an agreement with Polygon Financial, Inc., whereby the parties agreed that if and when an advance is made under the Fortress Credit Corp Loan (Note 13(f)), the Lender will assign the total amount owing under the promissory note – the "Indebtedness" to the Company in exchange for common shares of the Company at a price of CDN$0.2775 per share and that the Company will then forgive the Indebtedness.

On September 2, 2005 the debt of CDN$728,049 was converted to 2,623,600 shares at CDN$0.2775 per share.

d) Polygon Financial Investments Inc. -

On October 18, 2004 a senior secured promissory note agreement was entered into with Polygon Financial Investments Inc., a Company owned by a shareholder and a director of the Company, in the amount of $7,500,000. Under the terms of the note, interest accrued at a rate of 6% per annum, compounded monthly, from the date of issue to December 31, 2004 at which time the accrued interest was payable. The interest rate then increased to 15% per annum, compounded monthly, with accrued interest payable monthly commencing January 31, 2005.

A $500,000 transaction fee was charged as additional compensation for the making of the loan. On April 1, 2005 the agreement was amended to add the $500,000 fee to the principal amount of the note. The transaction fee has been charged to income over the term of the note.

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13. Notes Payable: (Continued)

d) Polygon Financial Investments Inc. – (Continued)

The maturity date of the note was June 30, 2005, with provisions for extension at the discretion of the borrower. The note extension periods varied from three to six months, with renewal fees equivalent to 2.5% of the outstanding principal for each three month period. The Company exercised a six month renewal option, and extended the maturity date of the note to December 31, 2005. The transaction fee associated with the renewal was $400,000, which was settled on July 1, 2005 by issuing 1,538,625 shares at CDN$0.32 per share.

The shares of ServerBeach GP Inc., ServerBeach LP Inc., ServerBeach Ltd., and Data Centre Technologies IP Inc. had been pledged as security for the note.

On September 2, 2005 the note was repaid.

e) Code Capital Limited -

In October 2003, a promissory note agreement was entered into with Code Capital Limited, a Company owned by a shareholder and a director of the Company, in the amount of CDN$500,000. Under the terms of the note, interest accrued at a rate of prime plus 4%. Principal and interest were payable in 60 equal installments of CDN$10,359 commencing October 15, 2003.

Under the agreement, the Company issued 500,000 warrants to purchase 500,000 common shares at CDN$0.28 per share if exercised before November 6, 2005. The warrants were exercised on October 14, 2005.

The loan had first security over the assets of the Company, except for the security interest in the shares of Peer 1 Network (USA) Inc., a wholly-owned subsidiary of the Company.

On August 31, 2005 the Company entered into an agreement with Code Capital Limited whereby the parties agreed that if and when an advance was made under the Fortress Credit Corp. Loan (Note 13 f), the Company would repay the total amount owing under the promissory note in full by issuing to the Lender common shares of the Company at a price of CDN$0.2775 per share.

On September 2, 2005 the note was converted to 1,254,176 shares, at CDN$0.2775.

f) Fortress Credit Corp.-

In connection with the Interland acquisition, the Company entered into a Loan and Security Agreement (the "LSA") dated September 2, 2005 by and among Peer 1 (USA), Inc. and each of its subsidiaries that were signatories thereto as borrowers (the "Borrowers"), the Company and each of its subsidiaries that were signatories thereto as guarantors (the "Guarantors"), and Fortress Credit Corp. as the lender, arranger and administrative agent.

Pursuant to the LSA, Fortress Credit Corp. agreed to make three loan facilities available to the Borrowers after they met the terms of the contract: a term loan which was advanced on September 2, 2005 in the amount of $24,000,000; a term loan (the "Incremental Term Loan") of up to $4,000,000 (less if certain cash flow criteria specified in the LSA were not satisfied) and a revolving loan

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13. Notes Payable: (Continued)

f) Fortress Credit Corp.. – (Continued)

(the"Revolving Facility") of up to $7,000,000 until September 2, 2008 and $10,000,000 thereafter until September 2, 2010 if the maturity date was extended by the Company for two years in accordance with the terms of the LSA.

The interest rate on borrowings under the LSA was LIBOR plus 6.5% per annum, subject to adjustment in certain specified circumstances. The amounts borrowed had to be repaid in monthly installments of $288,000, 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 had to be used to prepay the loan. The maturity date of the loan was September 1, 2008, though the Company could have extended the maturity date for two years by giving notice of such extension at least 90 days before September 1, 2008.

The Company pledged 100% of the shares of Peer 1 Network Enterprises Inc and its subsidiaries Peer 1 Network Inc. (and its subsidiaries), and Peer1 Network (USA) Inc. (and its subsidiaries) as security for the loan with Fortress Credit Corp.

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

On May 25, 2007 Peer 1 entered into a US$40 million amended and restated loan agreement with Fortress Credit Opportunities I LP, whereby the LSA was renegotiated and replaced with “the amended and restated LSA”. (Note 13g).

g) Fortress Credit Opportunities I LP

On May 25, 2007 Peer 1 entered into a US$40 million amended and restated loan agreement with Fortress Credit Opportunities I LP (“Fortress”), of which US$20 million has been advanced. The loan agreement (the “amended and restated LSA”) is by and among Peer 1 Network (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”), Fortress as the lender, and Fortress Credit Corp. as the arranger and administrative agent. Pursuant to the LSA, Fortress agreed to make two senior secured credit facilities (the “Credit Facilities”) available to the Borrowers: a term loan (the “Term Loan”) in the amount of US$20 million; and a line of credit facility (the “Line”), in the maximum amount of US$20 million.

The Term Loan

On May 29, 2007 (the “Closing Date”), the Term Loan was fully advanced in the amount of US$20 million. The advances were comprised of the aggregate principal outstanding under previous term loan facilities with Fortress Credit Corp. totaling approximately $18,130,943.99 as at the Closing Date (initially advanced in 2005), together with such additional principal as is necessary to bring the total principal amount outstanding as at the Closing Date to US$20 million. The Term Loan has a term of three years and is repayable in payments of $266,667 per month. The credit facility shall terminate and all loans and other obligations outstanding shall be payable in full on the third anniversary of the Closing Date (the “Maturity Date”), subject to the option for Peer 1 to extend the credit facility for an additional two years upon giving no less than 90 days’ notice to Fortress before the Maturity Date.

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13. Notes Payable: (Continued)

g) Fortress Credit Opportunities I LP.- (Continued)

The Line

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

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

The Borrowers will repay the entire unpaid principal balance of the credit facility, including amounts owing under the Line, on the Maturity Date. The Borrowers shall have the ability, at their option, to terminate the Line on the first anniversary of the Closing Date if no advances have been made under the Line during that period. The Line will automatically terminate on the second anniversary of the Closing Date if no advances have been made under the facility during that time. As of June 30, 2007, no advances have been made under the Line.

Security

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

Loan Prepayments

A portion of the net proceeds received by any of the Borrowers from the issuance of equity securities must be used to prepay the loan. Additionally, the proceeds from the sale of any assets in excess of $250,000 in a fiscal year must be used to prepay the loan.

Interest Rate

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

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

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13. Notes Payable: (Continued)

h) Polygon Financial Investments Inc. -

On July 18, 2005 the Company closed a $2,000,000 loan, the proceeds of which were used to build a data centre in Los Angeles and to complete the build out of the new facility in Toronto. The lenders are companies which are controlled by directors of the Company.

The loan carried an interest rate of 10% per annum, compounded monthly, plus contingent interest in certain circumstances equal to 50% of the aggregate operating profit generated from the new locations during the period ending June 30, 2010. Interest only was payable monthly effective July 31, 2005 and blended payments of principal and interest were payable effective July 31, 2006. The loan had a stated maturity date of June 30, 2008.

At the option of the lender, the loan was convertible into common shares at CDN$0.40 per share if exercised by July 18, 2007 and CDN$0.46 per share if exercised thereafter. The loan was convertible only until 90 days after the lender received any payment of contingent interest. As further consideration for the loan, the Company issued 3,100,000 warrants to the lenders, pro rata to their respective percentage of the loan. Each warrant entitles the holder to purchase one common share of the Company at CDN$0.40 per share until July 18, 2007.

The loan was secured by the assets of the new Los Angeles and Toronto facilities.

On September 2, 2005 the note was repaid.

i) ACACIA Management Services Inc. -

An unsecured, convertible note agreement was entered into with ACACIA Management Services Inc., and amended the terms of the agreement effective July 1, 2003. The loan bore interest at 10%. As amended, CDN$500,000 could be converted to common shares of the Company at CDN$0.38 per share. Upon conversion, the balance of the loan was repayable without interest in quarterly payments of CDN$75,000.

The lender exercised its right to convert debt of CDN$500,000 and received 1,315,789 common shares of the Company on November 6, 2003.

The loan was repaid in January 2006.

j) Cyber Pacific Holdings Limited -

An unsecured, demand promissory note bearing interest at prime plus 7% was issued to a lender, Cyber Pacific Holdings Limited, whose director is also a shareholder of the Company, in November 2002 and amended the terms of the note effective July 1, 2003. The amendments provided that the note could be converted to common shares of the Company at CDN$0.32 per share until June 30, 2005 and at CDN$0.352 until June 30, 2006, when the note was to be repaid. The terms of the note were further amended on August 31, 2005.

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13. Notes Payable: (Continued)

j) Cyber Pacific Holdings Limited – (Continued)

In consideration of the amendment effective July 1, 2003, the Company issued 1,834,215 warrants to purchase common shares of the Company at CDN$0.32 per share if exercised before October 23, 2005. The warrants were not exercised and expired.

On August 31, 2005 the Company entered into an agreement with Cyber Pacific Holdings Limited whereby the parties agreed that if and when an advance was made under the Fortress Credit Corp. Loan (Note 13(f)), the Company would repay the total amount owing under the promissory note in full by issuing to the Lender common shares of the Company at a price of CDN$0.2775 per share.

On September 2, 2005 the note was converted to 2,697,897 shares, at CDN$0.2775.

k) Code Marketing Limited –

An unsecured, demand promissory note without interest was issued to a lender, Code Marketing Limited, controlled by a shareholder and director of the Company in May 2002 and amended the note effective July 1, 2003. Under the amended terms, the note could be converted to common shares at CDN$0.32 per share until June 30, 2005 and CDN$0.352 per share thereafter. If the note was not converted by June 30, 2006, the principal plus all accrued and unpaid interest, calculated at prime plus 7%, would be payable immediately. The terms of the note were further amended on August 31, 2005.

In consideration for the lender's acceptance of the amendments effective July 1, 2003, the Company issued 334,375 share purchase warrants. The warrants entitled the lender to purchase common shares at CDN$0.32 per share if exercised before October 22, 2005. The warrants were exercised in March 2004.

On August 31, 2005 the Company entered into an agreement with Code Marketing Limited whereby the parties agreed that if and when an advance was made under the Fortress Credit Corp Loan (Note 13(f)), the Company would repay the total amount owing under the promissory note in full by issuing to the Lender common shares of the Company at a price of CDN$0.2775 per share.

On September 2, 2005 the note was converted to 491,823 shares, at CDN$0.2775.

14. Long Term Debt:

a) Preferred Shares Series A -

The Company and its subsidiary, Peer 1 Network (USA Inc.) ("Peer 1 USA"), 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 7,000 shares of Series A preferred stock in its capital at $1,000 per share, for aggregate proceeds of $7,000,000. The preferred shares were classified

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14. Long Term Debt: (Continued)

a) Preferred Shares Series A – (Continued)

as long term debt as they were redeemable by the holders at $2,000 per share anytime after four years. The $14,000,000 redemption amount was reduced by a discount on issuance of $7,000,000 and was being amortized using the effective interest method over a period of four years.

The Series A preferred stock carried 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 were 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 was:

(i) for the period beginning on September 2, 2005 (the "Closing Date") through but excluding the second anniversary of the Closing Date, $1,000 per share;

(ii) for the period beginning on such second anniversary through but excluding the third anniversary of the Closing Date, $1,500 per share; and

(iii) for the period beginning on the third anniversary of the Closing Date and thereafter, $2,000 per share, 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 had been repaid and the LSA had been terminated, any holder of shares of Series A preferred stock could cause Peer 1 USA to redeem any or all of its outstanding shares of Series A preferred stock at $2,000 per share.

In connection with the SPA, the Company and Peer 1 USA entered into an Investors' Rights Agreement (the "IRA") dated 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:

(i) any Investor could require the Company to purchase for $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.

(ii) at any time after the fourth anniversary of the Closing Date, the Company could require the Investors to sell all of their shares of Series A preferred stock to the Company at $2,000 per share.

(iii) any investor could 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 plus cumulative but unpaid dividends being exchanged by $0.2291, subject to adjustment in certain specified circumstances.

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14. Long Term Debt: (Continued)

a) Preferred Shares Series A – (Continued)

Pursuant to the IRA, the Company 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 Company, Peer 1 USA, the Investors and certain shareholders of the Company entered into a Shareholder Agreement dated September 2, 2005 (the "Shareholder Agreement"). Pursuant to the Shareholder Agreement, the Company 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.

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

In May 2007 in accordance with the pre-existing terms of the Preferred Shares Series A, the holders of the 7,000 Preferred Shares Series A converted all 7,000 shares and cumulative compound unpaid dividends into 34,869,628 Common Shares of the Company. See Note 15(b).

15. Shareholders' Equity: -

Capital Stock:

a) Authorized –

Unlimited Common shares without par value

Unlimited Preferred shares without par value

On December 21, 2005 a resolution was passed altering the notice of articles to change the authorized share capital to an unlimited number of shares for the Common and Preferred shares.

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15. Shareholders' Equity: - (Continued)

Capital Stock: (Continued)

b) Issued and Fully Paid -

	Number of Common Shares	Amount
Balance, June 30, 2005	49,119,367	7,828
Debt for equity conversion	25,274,588	5,825
Share issuance costs	-	(50)
Stock options exercised	60,000	35
Settlement of loan renewal fee	1,538,625	400
Warrants exercised	500,000	156
Private placement	833,333	133
Balance, June 30, 2006	77,325,913	14,327
Preferred Share Series A conversion	34,869,628	9,453
Share issuance costs	-	(236)
Stock options exercised	2,636,250	1,130
Warrants exercised	1,162,500	580
Balance, June 30, 2007	115,994,291	$ 25,254

Debt for Equity Conversion

On September 2, 2005, the Company converted approximately CDN$7,013,698 of its aggregate indebtedness into 25,274,588 common shares of the Company, at CDN$0.2775 per share.

Settlement of Loan Renewal Fee

On July 1, 2005, the Company and Polygon Financial Investments Inc. settled a $400,000 transaction fee associated with the renewal of a senior promissory note agreement by issuing 1,538,625 shares at CDN$0.32 per share.

Private Placement -

The Company completed a private placement on January 30, 2006 for 833,333 units, each unit consisting of one common share and one share purchase warrant at a price of CDN$0.30 per unit. Proceeds attributable to the common shares shown above were $132,456.

Preferred Share Series A Conversion

In May 2007 in accordance with the pre-existing terms of the Preferred Shares Series A, the holders of the 7,000 Preferred Shares Series A converted all 7,000 shares and cumulative compound unpaid dividends into 34,869,628 Common Shares of the Company. The conversion of the Preferred Shares Series A was

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15. Shareholders' Equity: – (Continued)

Preferred Shares Series A Conversion: (Continued)

calculated based on dividing the face value of $1,000 for each preferred share plus the cumulative compound unpaid dividends totaling $988,631 by $0.2291. As a result of the conversion, the carrying value of the Preferred Shares Series A classified as long term debt has, following the conversion, been classified to Common Shares.

Shares Held in Escrow -

Shares in the amount of 5,524,201 (9,207,001 in 2006) are subject to an escrow agreement and may not be transferred, assigned or otherwise dealt with without regulatory approval.

Warrants –

Balance, June 30, 2005	-
Warrants issued	1,099
Warrants exercised	(38)
Balance, June 30, 2006	1,061
Warrants exercised	(144)
Balance, June 30, 2007	$ 917

Warrants -

The following non-transferable share purchase warrants are outstanding:

Exercise Price	2006	Issued	Expired/ Exercised	**2007**	Expiry Date
CDN$0.40	3,100,000	-	1,162,500	1,937,500	July 18, 2007
$0.23	2,306,571	-	-	2,306,571	September 2, 2010
CDN$0.40	833,333	-	-	833,333	January 31, 2011
	6,239,904	-	1,162,500	5,077,404	

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15. Shareholders' Equity: – (Continued)

Contributed Surplus –

Balance, June 30, 2005	502
Stock options exercised	(13)
Stock based compensation	289
Balance, June 30, 2006	778
Stock options exercised	(135)
Stock based compensation	449
Balance, June 30, 2007	$ 1,092

Stock Options -

	2007		**2006**	
	Shares	**Weighted Average Exercise Price**	Shares	Weighted Average Exercise Price
Outstanding, beginning	5,024,750	$0.41	3,647,250	$0.34
Granted	7,395,200	0.87	1,515,000	0.49
Exercised	2,636,250	0.41	60,000	0.36
Expired	45,000	0.35	77,500	0.32
Forfeited	191,696	0.61	-	-
Outstanding, ending	9,547,004	$0.78	5,024,750	$0.41
Options exercisable, ending	2,238,778	$0.46	4,540,583	$0.39

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15. Shareholders' Equity: – (Continued)

Stock Options - (Continued)

The following table summarizes stock options outstanding and exercisable:

	Range of Exercise Prices	Number Outstanding 2007	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price
Outstanding, ending	0.23 – 0.55	1,803,500	2.23 Years	$0.42
Outstanding, ending	0.56 – 0.89	4,181,400	4.17 Years	$0.60
Outstanding, ending	0.90 – 1.21	3,562,100	4.97 Years	$1.17
Options exercisable, ending	0.23 – 0.55	1,803,500	2.23 Years	$0.42
Options exercisable, ending	0.56 – 0.89	424,167	3.83 Years	$0.62
Options exercisable, ending	0.90 – 1.17	11,111	4.98 Years	$1.17

During the fiscal year ended June 30, 2007, directors and officers of the Company were granted aggregate 6,035,200 options with exercise prices within a range of $0.59 - $1.21 expiring between September 6, 2011 and June 20, 2012.

New Stock Option Plan

On September 6th, 2006 the Company announced that its Board of Directors had approved the adoption of a 2006 Combined Incentive and Nonqualified Stock Option Plan ("New Plan") to replace the Company's 2002 Incentive Stock Option Plan. The new plan received shareholder and TSX Venture Exchange approval.

Under the new plan 15,468,382 common shares have been reserved for the issuance of options. This number of shares represents 20% of the Company's outstanding share capital as at September 6th, 2006. The previous plan had a reserve of 10% of the outstanding share capital from time to time. Under the new plan as under the 2002 plan which it replaced, the exercise price of each option equals the market price of the stock on the date of the grant. Outstanding options as at June 30, 2007, vest on varying terms from the date granted to over 36 months. Upon a change of control of the Company, 3,293,400 options would vest immediately.

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

	2007	2006
Dividend yield	-	-
Expected volatility	60%	75%
Risk-free interest rate	4.3 %	4.5 %
Expected average option term	5 years	5 years

The weighted average fair value of the options granted to employees and directors of the Company during the year was $0.87 ($0.28 in 2006) per option. The 2007 stock based compensation expense is $449,000 ($289,000 in 2006).

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15. Shareholders' Equity: – (Continued)

Earnings (loss) Per Share:

	2007	2006
Basic earnings (loss) per share		
Net earnings (loss) available to common shareholders	**$ 3,631**	$(3,188)
Weighted average number of common shares outstanding	**81,906,473**	72,198,492
Basic earnings (loss) per share	**$ 0.04**	$ (0.04)
Diluted earnings (loss) per share		
Net earnings (loss) available to common shareholders	**$ 3,631**	$ (3,188)
Weighted average number of common shares outstanding	**81,906,473**	72,198,492
Dilutive effect of Series A Preferred shares (*1)	**-**	-
Dilutive effect of warrants (*2)	**3,816,146**	-
Dilutive effect of stock options (*2)	**2,266,738**	-
Adjusted weighted average number of common shares outstanding	**87,989,358**	72,198,492
Diluted earnings (loss) per share	**$ 0.04**	$ (0.04)

(*1) The Series A preferred shares, the warrants and stock options are anti-dilutive for the purposes of calculating diluted earnings per share for the twelve months ended June 30, 2007 and June 30, 2006.
(*2) The warrants and stock options are anti-dilutive for the purpose of calculating diluted earnings per share for the twelve months ended June 30, 2006.

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16. Income Taxes:

Income tax (recovery) expense consists of:

	2007	2006
Current tax expense	**$ 1,263**	$ 390
Future tax credit	**(3,941)**	-
	$(2,678)	$ 390

Income taxes vary from the amount that would be computed by applying the estimated combined statutory income tax rate 36.56% (2006:35.5%) for the following reasons:

Significant components of the future tax assets are shown below:

	2007	2006
Expected income tax expense (recovery)	**$348**	$ (993)
Change in valuation allowance	**(3,684)**	496
Non-deductible expenses	**720**	749
Change in future income taxes resulting from a change in the estimated combined statutory rate	**(62)**	138
Income tax (recovery) expense	**$(2,678)**	$390

Significant components of the future tax assets are shown below:

	2007	2006
Non-capital losses carried forward	**$1,099**	$ 2,503
Accounting depreciation in excess of tax depreciation	**2,006**	932
Deferred lease inducements	**424**	186
Deferred gain	**277**	-
Other	**160**	63
Total future tax assets	**3,966**	3,684
Valuation allowance	-	(3,684)
	$ 3,966	$ -

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16. Income Taxes – (Continued):

Peer 1 management evaluates the likelihood that future income tax assets will be realized based on projected future earnings and tax planning strategies. During 2007 management estimated that it is more likely than not that all future income tax assets will be realized and therefore the valuation allowance was reduced to $nil.

Accumulated non-capital losses of approximately $3,231,000 ($7,345,000 in 2006) are available to be carried forward to apply against future years' income for tax purposes. These losses expire as follows:

2025	$ 2,837,000
2026	394,000

17. Supplemental Disclosure of Cash Flow Information:

a) Supplemental Disclosure -

	2007	2006
Interest paid	**$ 2,347**	$ 1,836
Income taxes paid	**$ 1,301**	$ -

b) Non-cash Transactions -

i) On September 2, 2005, there was an issuance of 2,306,571 warrants with a fair value of $630,215 as additional consideration for a note payable. The unamortized accretion is $455,161. See Note 13(f).

ii) On July 18, 2005, there was an issuance of 3,100,000 warrants with a fair value of $382,923 as additional consideration for a note payable. See Note 13(h).

iii) On September 2, 2005, there was a conversion of CDN$7,013,698 into 25,274,588 common shares. See Note 15(b).

iv) On July 1, 2005, there was a conversion of a $400,000 loan renewal fee into 1,538,625 common shares. See Note 15(b).

v) In May 2007 in accordance with the pre-existing terms of the Preferred Shares Series A, the holders of the 7,000 Preferred Shares Series A converted all 7,000 shares and cumulative compound unpaid dividends into 34,869,628 Common Shares of the Company. See Note 15(b).

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18. Related Party Balances and Transactions:

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

The significant transactions with related parties are as follows:

	2007	2006
Transactions During the Year -		
Revenue earned	**$ 98**	$ 169
Interest expensed	**-**	322
Other expenses	**454**	365

These transactions are in the normal course of operations and are measured at their exchange amounts, which is the amount of consideration established and agreed to by the related parties. Included in other expenses is $12,869 ($139 in 2006) in accounts receivable that has been written off.

	2007	2006
Balances at Year-End -		
Accounts receivable from related companies	**$ 10**	$59
Accounts payable to a related party	**35**	26

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

Also see Notes 13 and 14 for details of additional related party transactions and balances.

19. Financial Instruments:

a) Fair Values -

Cash and cash equivalents, restricted cash, accounts receivable, accounts payable and accrued liabilities, deferred revenue, and shareholder notes payable are stated at amounts approximating fair value due to their short-term nature. The fair values of notes payable and long-term debt are stated at amounts that approximate their fair value.

b) Foreign Currency Risk -

The Company has cash, accounts receivable and accounts payable denominated in Canadian dollars.
The carrying value of these items may change due to fluctuations in foreign exchange rates. The Company currently does not enter into hedging transactions.

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19. Financial Instruments: (Continued)

c) Credit Risk -

The accounts receivable are subject to credit risk as several customers operate in a volatile segment of the economy. The Company mitigates this risk through receipt and review of credit applications, diligent collection procedures and encouraging customers to pay via credit cards or pre-authorized payment. A deposit at the onset for installation charges may also be required.

d) Interest Rate Risk -

The Company is exposed to interest rate risk as the obligations under the Credit Facilities will accrue interest at the rate equal to the greater of (a)30-day LIBOR, or (b) three percent, plus the percent per annum equal to the Applicable Margin set forth in note 13(g)

e) Liquidity Risk -

The Company has significant financial liabilities outstanding including accounts payable and notes payable. The Company is exposed to the risk that it may not have sufficient liquid assets readily convertible to meet its commitments associated with these financial liabilities.

20. Commitments and contingencies:

a) Premises Leases -

The Company has entered into agreements to lease premises which expire between fiscal 2008 and 2017. The future minimum lease payments for the next five fiscal years are as follows:

2008	$5,762
2009	5,807
2010	5,474
2011	5,315
2012	4,826

b) Services Agreements -

The Company has entered into a series of agreements to obtain bandwidth, backbone, peering, local loop/cross connect and points of presence services. These agreements expire between fiscal 2008 and 2010. Minimum lease payments for the next three fiscal years under the contracts are as follows:

	2008	2009	2010
Bandwidth	$1,945	$ 963	$ -
Backbone	1,655	1,052	29
Peering	40	-	-
Local loop/cross connect	561	376	11
Points of presence	100	50	8
	$4,301	$2,441	$48

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20. Commitments and contingencies: (Continued)

c) Legal contingencies -

In March 2007, the Company was served with a Writ of Summons and Statement of Claim issued in the Supreme Court of British Columbia. The plaintiffs claim that they are the assignees of an alleged right to receive 745,000 warrants of PEER 1 Network Enterprises, Inc. and they seek a declaration that PEER 1 Network Enterprises, Inc. be obliged to issue those warrants. The plaintiffs also seek any losses suffered due to any delay in issuing the said warrants, and costs. The Company has delivered a response to the Writ and Statement of Claim and the parties have delivered initial Lists of Documents. At this early stage of the action, although the Company is of the belief that it has a meritorious defense in this claim and intends to vigorously defend the action, no assurance can be given that an adverse outcome in this case cannot occur. A contingent loss has not been recorded with respect to this claim and an estimate of the contingent loss if any cannot be made.

d) Outstanding legal matters -

The Company is involved in certain legal actions and claims. It is the opinion of management that all legal matters will be resolved without material effect on the Company's consolidated financial statements.

21. Segmented Information:

The reporting segments are as follows:

	Co-location & Bandwidth	Dedicated Servers	**2007 Total**
Revenue	$ 21,401	$ 52,960	**$ 74,361**
Income (Loss)	(1,338)	4,969	**3,631**
Interest Income	72	264	**336**
Impairment of Intangible Assets	423	762	**1,185**
Provision for Sales/Use Taxes	844	71	**915**
Income taxes	801	(3,479)	**(2,678)**
Interest Expense	538	2,822	**3,360**
Amortization of property & equipment	1,821	7,594	**9,415**
Amortization of intangible assets	29	1,501	**1,530**
Expenditures for Capital and Goodwill	3,453	9,297	**12,750**
Total Assets	18,341	35,745	**54,086**

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21. Segmented Information: (Continued)

	Co-location & Bandwidth	Dedicated Servers	**2006 Total**
Revenue	$18,391	$42,335	**$60,726**
Income (Loss)	(3,219)	31	**(3,188)**
Interest Income	292	17	**309**
Income taxes	274	116	**390**
Interest Expense	568	3,605	**4,173**
Amortization of property & equipment	1,562	5,510	**7,072**
Amortization of intangible assets	48	1,394	**1,442**
Expenditures for Capital and Goodwill	2,816	23,039	**25,885**
Total Assets	19,734	28,549	**48,283**

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

	Canada	US	**2007 Total**
Revenue	$ 15,770	$ 58,591	**$ 74,361**
Property and equipment	8,539	18,385	**26,924**
Goodwill	-	1,715	**1,715**
Intangible assets	40	2,990	**3,030**
Amortization of property and equipment	1,143	8,272	**9,415**
Amortization of intangible assets	29	1,501	**1,530**

	Canada	US	**2006 Total**
Revenue	$14,160	$46,566	**$60,726**
Property and equipment	5,479	19,041	**24,520**
Goodwill	-	1,715	**1,715**
Intangible assets	51	5,913	**5,964**
Amortization of property and equipment	1,075	5,997	**7,072**
Amortization of intangible assets	48	1,394	**1,442**

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22. Differences Between Canadian and United States Generally Accepted Accounting Principles:

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

Statement of Operations -	**2007**	2006
Net income (loss) - Canadian GAAP	**$3,631**	($3,188)
Add: Accretion interest charge on preferred shares	**1,361**	1,089
Net income (loss) and comprehensive income (loss) - US GAAP	**4,992**	(2,099)

Convertible Debt and Debt Issued with Stock Purchase Warrants -

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

Employee Stock Options -

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

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

Non-employee Stock Options -

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

Share Purchase Warrants -

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

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22. Differences Between Canadian and United States Generally Accepted Accounting Principles: (Continued)

Net Income (Loss) Per Share -

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

Weighted Average Number of Shares Outstanding –	**2007**	2006
Canadian	**81,906,473**	77,325,913
Less: Escrow shares	**5,524,201**	9,207,001
US GAAP	**76,382,272**	68,118,912
Basic Income (loss) per share under US GAAP	**$0.07**	$(0.03)

Application of US GAAP -

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

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

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22. Differences Between Canadian and United States Generally Accepted Accounting Principles: (Continued)

Balance Sheet

Liabilities	**2007**	2006
Canadian GAAP	**$34,575**	$43,836
Effect of equity portion of preferred shares	**-**	(8,087)
US GAAP	**$ 34,575**	$35,749

Shareholders' Deficiency		
Deficit - Canadian GAAP	**$8,077**	$ 11,708
Add: Accretion interest charge on preferred shares	**(1,361)**	(1,087)
Cumulative effect of prior years' adjustments:		
Stock based compensation	**(422)**	(422)
Accretion interest charge on convertible debt	**(101)**	(101)
Deficit - US GAAP	**6,193**	10,098
Capital - Canadian GAAP	**27,252**	16,155
Deduct: Stock based compensation	**(422)**	(422)
Add: Equity component of convertible debt	**-**	6,899
Capital - US GAAP	**26,830**	22,632
Shareholders' Equity (Deficiency) – US GAAP	**$20,637**	$ 12,534

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22. Differences Between Canadian and United States Generally Accepted Accounting Principles: (Continued)

Convertible Promissory Debentures -

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

Recent Accounting Pronouncements:

a) The Fair Value Option for Financial Assets and Financial Liabilities –

In February 2007, the Financial Accounting Standards Board ("FASB") issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities – Including an Amendment of FASB Statement No. 115. This statement permits entities to choose to measure many financial instruments and certain other items at fair value. Most of the provisions of SFAS No. 159 apply only to entities that elect the fair value option. However, the amendment to SFAS No. 115 "Accounting for Certain Investments in Debt and Equity Securities" applies to all entities with available-for-sale and trading securities. SFAS No. 159 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. Early adoption is permitted as of the beginning of a fiscal year that begins on or before November 15, 2007, provided the entity also elects to apply the provision of SFAS No. 157, "Fair Value Measurements". The adoption of this statement is not expected to have a material effect on the Company's financial statements.

b) Fair Value Measurements –

In September 2006, the Financial Accounting Standards Board ("FASB") issued SFAS No. 157, "Fair Value Measurements". The objective of SFAS No. 157 is to increase consistency and comparability in fair value measurements and to expand disclosures about fair value measurements. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS No. 157 applies under other accounting pronouncements that require or permit fair value measurements and does not require any new fair value measurements. The provisions of SFAS No. 157 are effective for fair value measurements made in fiscal years beginning after November 15, 2007. The adoption of this statement is not expected to have a material effect on the Company's future reported financial position or results of operations.

c) Accounting for Uncertainty in Income taxes –

In June 2006, the Financial Accounting Standards Board ("FASB") issued Interpretation No. 48 ("FIN 48"). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109 "Accounting for Income Taxes" ("SFAS 109"). The interpretation prescribes a recognition threshold and measurement attribute to the financial statement recognition and measurement of tax position taken or expected to be taken in a tax return. FIN 48 also provides accounting guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. We will adopt the provisions of FIN 48 on July 1, 2007. The Company is assessing the impact of FIN 48 on its results of operations and financial condition

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22. Differences Between Canadian and United States Generally Accepted Accounting Principles: (Continued)

Recent Accounting Pronouncements: (Continued)

d) Accounting Changes and Error Corrections –

In May 2005, FASB issued SFAS Statement No. 154 "Accounting Changes and Error Corrections" requiring retrospective application to prior periods' financial statements of a change in an accounting policy. The Company believes that the adoption of this standard will have no material impact on its consolidated financial statements.

e) Accounting Changes and Error Corrections –

In March 2005, FASB issued interpretation No. 47, "Accounting for Conditional Asset Retirement Obligations—an interpretation of FASB Statement No. 143". This Interpretation clarifies that the term conditional asset retirement obligation as used in FASB Statement No. 143, Accounting for Asset Retirement Obligations, refers to a legal obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. The obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and (or) method of settlement. Thus, the timing and (or) method of settlement may be conditional on a future event. Accordingly, an entity is required to recognize a liability for the fair value of a conditional asset retirement obligation if the fair value of the liability can be reasonably estimated. The fair value of a liability for the conditional asset retirement obligation should be recognized when incurred—generally upon acquisition, construction, or development and (or) through the normal operation of the asset. Uncertainty about the timing and (or) method of settlement of a conditional asset retirement obligation should be factored into the measurement of the liability when sufficient information exists. Statement 143 acknowledges that in some cases, sufficient information may not be available to reasonably estimate the fair value of an asset retirement obligation. This Interpretation also clarifies when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation. There is no impact to the company's consolidated financial position, results of operations or cash flows.