peer1 hosting

PING & PEOPLE

UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
THREE AND NINE MONTHS ENDED MARCH 31, 2011 AND 2010

PEER 1 NETWORK ENTERPRISES, INC.
Consolidated Balance Sheet
March 31, 2011
(in thousands of United States dollars)

	March 31, 2011	June 30, 2010
Assets		
Current:		
Cash and cash equivalents	**$ 23,503**	$ 2,321
Accounts receivable	**4,919**	3,249
Income tax receivable	**1,088**	623
Future income tax asset	**228**	97
Prepaid expenses	**2,415**	1,655
	32,153	7,945
Other assets	**2,321**	2,688
Future income tax asset	**2,684**	1,900
Property and equipment	**71,078**	53,237
Equipment under capital lease	**789**	986
Goodwill	**2,363**	2,363
Intangible assets	**4,123**	3,527
	$ 115,511	$ 72,646
Liabilities		
Current:		
Accounts payable and accrued liabilities	**$ 9,517**	$ 9,114
Deferred revenue	**2,707**	2,216
Current portion of deferred gain	**79**	79
Current portion of deferred lease inducements	**126**	126
Current portion of derivative liabilities (Note 2)	**111**	170
Current portion of notes payable (Note 3)	**3,333**	3,000
Current portion of obligations under capital lease	**328**	376
	16,201	15,081
Deferred gain	**355**	414
Deferred lease inducements	**502**	557
Derivative liabilities (Note 2)	**424**	170
Notes payable (Note 3)	**57,780**	16,404
Obligation under capital lease	**17**	232
	75,279	32,858
Shareholders' equity (Note 4)	**40,232**	39,788
	$ 115,511	$ 72,646

PEER 1 NETWORK ENTERPRISES, INC.
Consolidated Statements of Shareholders' Equity
For the Three and Nine Months Ended March 31, 2011
(in thousands of United States dollars except number of shares)

	Three months ended				Nine months ended			
	March 31, 2011		March 31, 2010		March 31, 2011		March 31, 2010	
	Number	**Amount**	**Number**	**Amount**	**Number**	**Amount**	**Number**	**Amount**
SHARE CAPITAL (Note 4)								
Common shares								
Balance at beginning of period	**119,645,665**	**$ 27,693**	121,260,741	$ 27,942	**119,721,834**	**$ 27,631**	119,314,323	$ 26,950
Stock options exercised	**56,972**	**67**	33,879	14	**170,303**	**173**	352,011	225
Warrants exercised	**833,333**	**422**	-	-	**833,333**	**422**	1,628,286	781
Purchase of shares for cancellation pursuant to normal course issuer bid	-	-	-	-	**(189,500)**	**(44)**	-	-
Balance at end of period	**120,535,970**	**28,182**	121,294,620	27,956	**120,535,970**	**28,182**	121,294,620	27,956
CONTRIBUTED SURPLUS								
Balance at beginning of period		**7,877**		5,709		**6,804**		4,766
Stock-based compensation		**482**		619		**1,598**		1,684
Stock options exercised		**(51)**		(5)		**(94)**		(127)
Balance at end of period		**8,308**		6,323		**8,308**		6,323
Warrants								
Balance at beginning of period	**833,333**	**86**	833,333	86	**833,333**	**86**	2,461,619	493
Warrants exercised	**(833,333)**	**(86)**	-	-	**(833,333)**	**(86)**	(1,628,286)	(407)
Balance at end of period	**-**	**-**	833,333	86	**-**	**-**	833,333	86
RETAINED EARNINGS								
Balance at beginning of period		**5,592**		6,862		**5,619**		4,709
Net income		**(1, 311)**		459		**(1,127)**		2,612
Purchase of shares for cancellation pursuant to normal course issuer bid		**-**		-		**(211)**		-
Balance at end of period		**4,281**		7,321		**4,281**		7,321
ACCUMULATED OTHER COMPREHENSIVE INCOME								
Balance at beginning of period		**(11)**		(315)		**(352)**		(279)
Other comprehensive income (loss)		**(528)**		(38)		**(187)**		(74)
Balance at end of period		**(539)**		(353)		**(539)**		(353)
Total - shareholders' equity		**$ 40,232**		$ 41,333		**$ 40,232**		$ 41,333

PEER 1 NETWORK ENTERPRISES, INC.
Consolidated Statement of Operations
For the Three and Nine Months Ended March 31, 2011
(in thousands of United States dollars, except per share amounts)

	Three months ended		Nine months ended	
	March 31, 2011	March 31, 2010	**March 31, 2011**	March 31, 2010
Revenue				
Colocation Services	**$ 8,067**	$ 7,143	**$ 22,501**	$ 20,616
Hosting Services	**20,662**	17,923	**60,442**	51,721
	28,729	25,066	**82,943**	72,337
Cost of revenue	**17,906**	14,852	**51,094**	42,670
Gross profit	**10,823**	10,214	**31,849**	29,667
Operating expenses	**10,401**	8,047	**28,959**	22,761
Operating income before other items	**422**	2,167	**2,890**	6,906
Other items:				
Interest income	**(3)**	(2)	**(17)**	(8)
Gain on insurance recovery	**-**	-	**-**	(93)
Gain on disposal of property and	**(8)**	(29)	**(36)**	(71)
Loss on legal settlement		440	**24**	440
Loss on derivative	**-**	111	**-**	111
Foreign exchange loss	**325**	75	**531**	264
Interest expense – long term	**721**	338	**1,950**	987
	1,035	933	**2,452**	1,630
Income before income taxes	**(613)**	1,234	**438**	5,276
Future income tax recovery	**(35)**	(212)	**(883)**	(712)
Current income tax expense	**733**	987	**2,448**	3,376
Income tax expense	**698**	775	**1,565**	2,664
Net income (loss)	**$ (1,311)**	$ 459	**$ (1,127)**	$ 2,612
Other comprehensive income:				
Change in unrealized fair value of derivatives designated as cash flow hedges	**(528)**	(38)	**(187)**	(74)
Comprehensive income	**$ (1,839)**	$ 421	**$(1,314)**	$ 2,538
Net income (loss) attributable to:				
Common shares	**$ (1,311)**	$ 459	**$ (1,127)**	$ 2,612
Comprehensive income attributable to:				
Common shares	**(1,839)**	421	**(1,314)**	2,538
Basic and diluted earnings (loss) per share	**$ (0.01)**	$ 0.00	**$ (0.01)**	$ 0.02
Weighted average number of shares outstanding:				
Basic	**120,042,547**	121,274,770	**119,938,894**	120,653,339
Diluted	**120,042,547**	124,338,272	**119,938,894**	124,316,811

PEER 1 NETWORK ENTERPRISES, INC.
Consolidated Statement of Cash Flows
For the Three and Nine Months Ended March 31, 2011
(in thousands of United States dollars)

	Three months ended		Nine months ended	
	March 31, 2011	**March 31, 2010**	**March 31, 2011**	**March 31, 2010**
Operating Activities:				
Net income (loss)	**$ (1,311)**	$ 459	**$ (1,127)**	$ 2,612
Adjustments for non-cash items:				
Amortization of property and equipment	**5,042**	3,560	**13,685**	10,055
Amortization of intangible assets	**246**	82	**472**	569
Ineffective portion of cash flow hedge		-	**283**	-
Bad debt expense	**89**	174	**271**	388
Gain on disposal of property and equipment	**(8)**	(29)	**(36)**	(71)
Gain on insurance	**-**	-	**-**	(93)
Amortization of deferred gain	**(20)**	(20)	**(59)**	(59)
Amortization of deferred loan origination fees	**61**	74	**408**	191
Future income tax recovery	**(35)**	(212)	**(883)**	(712)
Stock-based compensation included in income	**482**	620	**1,598**	1,684
Decrease in deferred lease inducements	**(18)**	(37)	**(54)**	(110)
Changes in non-cash working capital:				
Increase in accounts receivable	**(193)**	405	**(1,941)**	(458)
Decrease (increase) in prepaid expenses	**894**	(81)	**(763)**	(657)
Increase in accounts payable and accrued liabilities	**669**	490	**287**	1,147
Increase (decrease) in income taxes payable	**1,216**	54	**(465)**	(2,122)
Decrease (increase) in deferred revenue	**476**	(314)	**491**	(200)
Cash flows from operating activities	**7,590**	5,225	**12,167**	12,164
Investing Activities:				
Acquisition of subsidiary, net of cash acquired	**-**	(534)	**-**	(534)
Investment in other assets	**45**	(135)	**(625)**	(362)
Acquisition of property and equipment	**(10,973)**	(9,390)	**(31,228)**	(22,992)
Acquisition of intangible assets	**(507)**	(389)	**(1,064)**	(1,325)
Proceeds on disposition of equipment	**18**	29	**46**	71
Cash flows used in investing activities	**(11,417)**	(10,419)	**(32,871)**	(25,142)
Financing Activities:				
Proceeds from notes payable	**25,035**	2,000	**74,172**	2,000
Repayments of notes payable	**(1,000)**	(750)	**(32,726)**	(1,500)
Payment of capital lease obligations	**(94)**	(66)	**(291)**	(178)
Payment of derivative liabilities	**(283)**		**(283)**	
Issuance of capital stock	**352**	9	**415**	471
Purchase of shares for cancellation pursuant to normal course issuer bid	**-**	-	**(255)**	-
Cash flows from (used in) financing activities	**24,010**	1,193	**41,032**	793
Foreign exchange gain (loss) on cash and cash equivalents	**804**	75	**854**	137
Increase (decrease) in cash and cash equivalents	**20,987**	(3,926)	**21,182**	(12,048)
Cash and cash equivalents, beginning	**2,516**	7,622	**2,321**	15,744
Cash and cash equivalents, ending	**$ 23,503**	$ 3,696	**$ 23,503**	$ 3,696
Supplemental Disclosure of Cash Flow Information (Note 5)				

1. Significant Accounting Policies:

a) Nature of Operations:

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

The accompanying unaudited consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles for interim financial information and, accordingly do not include all information and note disclosures required for the annual financial statements under Canadian generally accepted accounting principles. It is management's opinion that all adjustments considered necessary for fair presentation of the financial position, results of operations and cash flow for the interim periods presented have been made. These financial statements have been prepared in accordance with the same accounting principles applied in the preparation of the annual audited consolidated financial statements filed with the British Columbia Securities Commission for the fiscal year ended June 30, 2010. The annual financial statements should be referenced in conjunction with this interim report. Certain comparative amounts have been reclassified to correspond to the presentation in the current period.

b) Basis of Consolidation:

These consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, Peer 1 Network (USA) Inc., Colobrokers.com Inc., 585065 B.C. Ltd., Inc. Peer 1 (UK) Ltd., and VIA Net.Works USA, Inc. As at June 30, 2010, the following companies were merged into 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., Peer 1 Network (Texas), LP, Peer 1 Network (LA).

c) Recent Accounting Pronouncements:

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

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

(dollar amounts are presented in thousands of
United States dollars, except per share amounts)

1. Significant Accounting Policies: (continued)

c) Recent Accounting Pronouncements: (continued)

iii) In January 2009, the CICA issued Section 1602, “Non-controlling Interests”, which replaces existing guidance. Section 1602 provides guidance on accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. These standards are effective on or after the beginning of the first annual reporting period on or after January 1, 2011 with earlier adoption permitted. As of March 31, 2011 the Company has no non-controlling interests, and accordingly there is no currently expected impact as a result of the standard.

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

2. Derivative Liabilities:

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

	March 31, 2011	June 30, 2010
Derivative financial instruments designated as cash flow hedges		
Interest – rate swap agreement	**$ 535**	$ 341

3. Notes Payable:

On November 9, 2010, the Company entered into credit agreement (the “CA”) with National Bank of Canada as Agent (the “Agent”) under which the Agent and other lenders (the “Lenders”) agreed to provide the Company with two credit facilities (the “Facilities”) a revolving facility (the “Revolving Facility”) for a term of five years, for up to $30,000,000 (or the Canadian dollar equivalent) and a non-revolving facility (the “Non-Revolving Facility”) for a term of five years for up to $45,000,000 (or the Canadian equivalent). Loans (“Loans”) made under either Facility may be, at the Company’s option, made in Canadian dollars pursuant to Prime Rate Loans or Banker’s Acceptances or in US dollars pursuant to US Base Rate Loans or LIBO Rate Loans, all as defined in the CA. In addition, Letters of Credit in either Canadian or US dollars are available under the Revolving Facility. At the Company’s option, the Company can convert Loans from one type to another. Both Facilities mature five years after the closing date which is expected to be several weeks following November 9, 2010. The Revolving Facility has an accordion feature (the “Accordion Feature”), which allows the Company to borrow up to an additional $25,000,000. The Accordion Feature must be drawn in multiples of $5,000,000 and is available to be drawn down up to 90 days preceding the Maturity Date. Repayment terms of the Accordion Feature are the same of those under the Revolving Facility.

(dollar amounts are presented in thousands of
United States dollars, except per share amounts)

3. Notes Payable: (continued)

Notes payable as of March 31, 2011 include amounts payable to National Bank of Canada. Pursuant to the adoption of CICA Handbook Section 3855, amounts are shown net of related transaction and financing costs. Details are as follows:

		March 31, 2011		June 30, 2010
Notes payable under non-revolving term facility	**$**	**44,439**	$	7,000
Notes payable under revolving term facility		**17,605**		12,750
Less: unamortized deferred loan origination fees		**(931)**		(346)
Notes payable, net of related transaction and financing costs		**61,113**		19,404
Less: current portion		**(3,333)**		(3,000)
	$	**57,780**	$	16,404

4. Shareholders' Equity:

Capital Stock:

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

Warrants:

The following non-transferable share purchase warrants are outstanding:

Exercise Price	Outstanding at June 30, 2010	Issued	Exercised	Outstanding at March 31, 2011	Expiry Date
CDN$0.40	833,333	-	(833,333)	-	January 31, 2011

Stock Options:

As at March 31, 2011, the Company had 18,613,700 stock options outstanding. During the nine months ended March 31, 2011, the term on 3,912,400 stock options was extended to December 31, 2011. Stock based compensation recognized as a result of this extension was $18.

Normal Course Issuer Bid

Pursuant to the Company's normal course issuer bid (NCIB), as approved by the Toronto Stock Exchange, the Company is entitled to acquire from April 16, 2010 to April 15, 2011 up to 6,064,731 common shares of the Company's issued and outstanding shares as at April 12, 2010. For the three and nine months ended March 31, 2011, the Company has purchased for cancellation a total of Nil and 189,500 common shares under this program for Nil and $255 respectively.

The Company has purchased for cancellation a total of 1,832,286 common shares under the NCIB. The excess of the purchase price over the average stated value of shares purchased for cancellation was charged to retained earnings.

(dollar amounts are presented in thousands of United States dollars, except per share amounts)

4. Shareholders' Equity: (continued)

Normal Course Issuer Bid (continued)

	Common shares purchased for cancellation	Charged to share capital	Charged to retained earnings	Paid
Balance, June 30, 2010	1,642,786	$ 379	$ 1,331	$ 1,710
Purchased during the quarter:				
September 30, 2010	189,500	44	211	255
December 31, 2010	-	-	-	-
March 31, 2011	-	-	-	-
Balance, March 31, 2011	1,832,286	$ 423	$ 1,542	$ 1,965

5. Supplemental Disclosure of Cash Flow Information:

	Three months ended March 31,		Nine months ended March 31,	
	2011	2010	**2011**	2010
Interest paid	**$ 728**	$ 203	**$1,321**	$ 675
Income taxes paid	**(525)**	890	**2,768**	5,446
Interest received	**3**	2	**17**	8
Effect of acquisition of property and equipment in accounts payable	**(2,109)**	(3,677)	**111**	366

6. 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:

	Three months ended March 31,		Nine months ended March 31,	
	2011	2010	**2011**	2010
Transaction during the period:				
Revenue earned from companies owned or subject to significant influence by directors and principal shareholders	**$ 40**	$ 36	**$ 115**	$ 94
Other expenses from companies owned or subject to significant influence by directors and principal shareholders	**1**	-	**1**	1

6. Related Party Balances and Transactions: (continued)

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.

	March 31, 2011	March 31, 2010
Balances at the end of the period:		
Accounts receivable from companies owned or subject to significant influence by directors and principal shareholders	**$ 1**	$ 96

The balances are payable on demand and have arisen from the sale of products, provision of services and invoice payments.

7. Capital Risk Management:

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

The Company manages its capital structure and makes adjustments to it in light of economic conditions. The Company, upon approval from its board of directors, will balance its overall capital structure through new share issues, share repurchases, the payment of dividends, the issue of debt or by undertaking other activities as deemed appropriate under the specific circumstances. The Company is subject to externally imposed capital requirements as required under the terms of its loan agreement, which includes the maintenance of financial ratios. The Company's overall strategy with respect to capital risk management remains unchanged from the year ended June 30, 2010.

8. Financial Risk Management:

a) Overview:

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

b) Credit risk:

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Company's accounts receivable. The carrying amount of financial assets represents the maximum credit exposure. The Company has adopted a credit policy which includes a requirement for payment at commencement of service for dedicated hosting and colocation customers.

(dollar amounts are presented in thousands of
United States dollars, except per share amounts)

8. Financial Risk Management: (continued)

b) Credit risk: (continued)

The Company's exposure to credit risk with its customers is influenced mainly by the individual characteristics of each customer. The Company's customers are primarily located in the United States, Canada and the UK and represent various industries. At March 31, 2011, no single customer represented more than 5% of accounts receivable. The Company establishes an allowance for doubtful accounts that represents its estimate of incurred losses in respect of trade receivables. The main components of this allowance is a specific loss component that relates to individually significant exposures, and an overall loss component established based on historical trends and other information. Trade accounts receivable are written off against the allowance account after management has determined that the loss is probable. As at March 31, 2011, the Company had an allowance for doubtful accounts of $539. At March 31, 2011, the Company had no individually material past due trade accounts receivables.

		March 31, 2011
Total Accounts receivable	$	5,458
Less: Allowance for doubtful accounts		(539)
Accounts receivable, net	$	4,919
Of which:		
Not overdue	$	1,126
1-30 days		2,908
31-60 days		376
61-90 days		5
91 days and over		504
Less: Allowance for doubtful accounts		(539)
Accounts receivable – other		539
Accounts receivable, net	$	4,919

		March 31, 2011
Allowance for doubtful accounts, beginning	$	585
Foreign exchange effect on opening balance		7
Bad debt expense		271
Write-off of uncollectible accounts		(324)
Allowance for doubtful accounts, ending	$	539

8. Financial Risk Management: (continued)

c) Liquidity risk:

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Company's reputation.

As at March 31, 2011, the Company had financial assets held for trading of $23,503, loans and receivables of $4,919 and other financial liabilities of $70,974. All of the Company's financial liabilities have contracted maturities of less than 5 years. The Company manages its liquidity risk by continuously monitoring forecast and actual gross profit and cash flows from operations.

d) Market risk:

Market risk is the risk that changes in market prices, such as foreign exchange rates, interest rates and equity prices will affect the Company's income or the value of its financial instruments. The Company provides its services in the United States, Canada and the UK, substantially all of the Company's financial assets and liabilities originate in United States dollars, Canadian dollars and UK Pound Sterling. The Company is exposed to currency risk for sales and purchases that are denominated in Canadian dollars, Euros and UK Pound Sterling and may enter into derivative contracts to limit its exposure to foreign exchange risk. The Company is subject to interest rate risk on its cash and cash equivalents. A change of 1% in interest rates for the three months ended March 31, 2011 would have changed net income by $155. A change of 1% in interest rates for the nine months ended March 31, 2011 would have changed net income by $311.

e) Fair value of financial instruments:

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

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

9. Segmented Information:

Management has determined that the Company operates in a single reportable operating segment which involves the provision of outsourced data center infrastructure services. The Company provides its services in the United States, Canada and the UK and substantially all of the Company's identifiable assets as at March 31, 2011 are located in the United States, Canada and the UK.

The Company's service offerings include the provision of physical space within its data centres, a complete suite of managed and unmanaged dedicated hosting services and high availability bandwidth connectivity. The Company makes decisions and evaluates financial performance primarily based on these service offerings.