



NETWORK | CO-LOCATION | MANAGED HOSTING

**Consolidated Financial Statements
For The Three Months Ended September 30, 2008 and 2007**



Peer 1 Network Enterprises, Inc.
Consolidated Balance Sheet
September 30, 2008
(unaudited - prepared by management)
(in thousands of United States Dollars)

	September 30,	June 30,
	2008	2008
	US\$	US\$
Assets		
Current:		
Cash and cash equivalents	8,167	11,026
Restricted Cash	250	250
Accounts receivable (note 10b)	7,422	4,704
Future income tax asset	97	104
Prepaid expenses	900	801
	<hr/>	<hr/>
	16,836	16,885
Other assets	2,804	2,825
Future income tax asset	1,555	1,841
Property, plant and equipment	36,418	33,818
Equipment under capital lease	1,203	1,267
Goodwill	1,716	1,715
Intangible assets	2,479	2,500
	<hr/>	<hr/>
	63,011	60,851
	<hr/>	<hr/>
Liabilities		
Current:		
Accounts payable and accrued liabilities	8,465	8,810
Deferred revenue	5,558	4,206
Current portion of deferred gain	79	79
Current portion of deferred lease inducements	133	134
Current portion of notes payable (note 4)	3,282	3,286
Current portion of obligations under capital lease	220	226
Income taxes payable	684	1,435
	<hr/>	<hr/>
	18,421	18,176
Deferred gain	552	571
Deferred lease inducements	704	739
Notes payable (note 4)	11,354	12,008
Obligations under Capital Lease	571	655
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	31,602	32,149
	<hr/>	<hr/>
Shareholders' Equity		
Capital stock (note 5b)	26,911	26,539
Warrants (note 5c)	493	678
Contributed Surplus (note 5d)	3,303	2,509
Retained Earnings (Deficit)	713	(1,013)
Accumulated other comprehensive loss	(11)	(11)
	<hr/>	<hr/>
	31,409	28,702
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	63,011	60,851
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Peer 1 Network Enterprises, Inc.
Consolidated Statement of Operations, Comprehensive Income and Retained Earnings (Deficit)
Three Months Ended September 30, 2008
(unaudited - prepared by management)
(in thousands of United States Dollars, except per share amounts)

	Three Months Ended September 30, 2008 US\$	Three Months Ended September 30, 2007 US\$
Revenue:		
Co-location Services	6,715	6,326
Dedicated Hosting Services	16,789	14,633
	23,504	20,959
Cost of Sales	13,036	11,983
	10,468	8,976
Gross Profit		
Operating expenses	6,967	6,151
	3,501	2,825
Operating Income before other items		
Other Items:		
Interest Income	(38)	(118)
Integration costs	-	93
(Gain) on disposal of fixed assets	(3)	(14)
Foreign exchange loss	7	99
Interest expense - long term	424	618
	3,111	2,147
Income before income taxes		
Future income tax expense	289	327
Current Income tax expense	1,096	574
	1,385	901
Income tax expense		
Net income and comprehensive income	1,726	1,246
Deficit, beginning of period	(1,013)	(8,077)
Retained Earnings (Deficit), end of period	713	(6,831)
Earnings per Share:		
Basic	.01	.01
Diluted	.01	.01
Weighted average number of shares outstanding:		
Basic	118,703,525	117,722,895
Diluted	123,344,996	122,314,114

Peer 1 Network Enterprises, Inc.
Consolidated Statement of Cash Flows
For the three months ended September 30, 2008
(unaudited - prepared by management)
(in thousands of United States Dollars)

	Thee Months Ended	Thee Months Ended
	September 30, 2008	September 30, 2007
	US\$	US\$
Cash flows from operating activities		
Net Income	1,726	1,246
Amortization of property and equipment	2,654	2,322
Amortization of intangible assets	390	389
Increase in accrued interest and accretion on notes payable	18	20
Bad debt expense	136	83
Gain on disposal of property and equipment	(3)	(16)
Amortization of deferred gain	(20)	(20)
Amortization of deferred loan origination fees	123	146
Future income tax expense	289	327
Stock-based compensation included in income for period	805	352
Decrease in deferred lease inducements	(36)	(173)
Change in non-cash working capital items		
Increase in accounts receivable	(2,854)	(348)
Decrease (increase) in prepaid expenses	(100)	86
Increase (decrease) in accounts payable and accrued liabilities	(1,509)	188
Increase (decrease) in income taxes payable	(781)	590
Increase in deferred revenue	1,352	137
	<u>2,190</u>	<u>5,329</u>
Cash flows from investing activities		
Investment in other assets	22	(65)
Acquisition of property and equipment	(3,997)	(3,224)
Investment in goodwill, licences and other intangibles	(399)	(171)
Proceeds on disposition of equipment	3	18
	<u>(4,371)</u>	<u>(3,442)</u>
Cash flows from financing activities		
Repayment of notes payable	(800)	(800)
Payment of capital lease obligations	(54)	-
Issuance of capital stock	176	853
	<u>(678)</u>	<u>53</u>
(Decrease) Increase in cash and cash equivalents	(2,859)	1,940
Cash and cash equivalents - beginning of period	11,026	8,754
Cash and cash equivalents - end of period	<u>8,167</u>	<u>10,694</u>
Supplemental cash flow information:		
Interest paid	282	453
Income tax paid	1,817	-
Interest received	38	118
Effect of acquisition of property and equipment in accounts payable and accrued liabilities	1,193	2,406

Notes to Unaudited Consolidated Financial Statements
(in thousands, except for share and per share amounts)

1. Significant accounting policies:

a) Nature of Operations and Basis of Presentation:

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 co-location facilities with high performance Internet bandwidth and dedicated servers to web-centric and enterprise customers across North America. 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 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, 2008 except as described in note 1b). 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) Changes in accounting policies:

i) Capital disclosures:

Effective July 1, 2008, the Company adopted the new recommendations of the Canadian Institute of Chartered Accountants ("CICA") Handbook section 1535, Capital Disclosures. This new Handbook section establishes standards for disclosing information about an entity's capital and how it is managed. It requires the disclosure of information about an entities objectives, policies and processes for managing capital. These new disclosures are included in note 8.

ii) Financial instruments:

Effective July 1, 2008, the Company adopted the new recommendations of CICA Handbook Section 3862, Financial Instruments - Disclosures and Handbook Section 3863, Financial Instruments – Presentation. Section 3862 requires entities to provide disclosures in their financial statements that enable users to evaluate the significance of financial instruments on the entity's financial position and its performance and the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the balance sheet date, and how

Notes to Unaudited Consolidated Financial Statements

(in thousands, except for share and per share amounts)

the entity manages those risks. Section 3863 establishes standards for presentation of financial instruments and nonfinancial derivatives. It deals with the classification of financial instruments, from the perspective of the issuer, between liabilities and equities, the classification of related interest, dividends, losses and gains, and circumstances in which financial assets and financial liabilities are offset. The adoption of these standards did not have any impact on the classification and valuation of the Company's financial instruments.

Under section 3862, the carrying amounts of financial instruments are to be disclosed as classified into one of these five categories as defined in CICA Handbook section 3855, Financial Instruments – Recognition and Measurement: held for trading, held-to-maturity, loans and receivables, available for sale financial assets or other financial liabilities. All financial instruments, including derivatives, are measured in the balance sheet at fair value except for loans and receivables, held-to-maturity investments and other financial liabilities which are measured at amortized cost. Subsequent measurement and changes in fair value will depend on their initial classification, as follows: held-for-trading financial assets are measured at fair value and changes in fair value are recognized in net income; available-for-sale financial instruments are measured at fair value with changes in fair value recorded in other comprehensive income until the investment is derecognized or impaired at which time the amounts would be recorded in net income. The new disclosures pursuant to these new Handbook Sections are included in notes 3 and 10.

c) Recent accounting pronouncements:

In February 2008, the CICA issued Handbook Section 3064, Goodwill and Intangible Assets which applies to annual and interim financial statements relating to fiscal years beginning on or after October 1, 2008. Section 3064, which replaces Section 3062, Goodwill and Other Intangible Assets, and Section 3450, Research and Development Costs, establishes standards for the recognition, measurement and disclosure of goodwill and intangible assets. The provisions relating to the definition and initial recognition of intangible assets, including internally generated intangible assets, are equivalent to the corresponding provisions of International Financial Reporting Standards ("IFRS") IAS 38, Intangible Assets. This new standard is effective for the Company's interim and annual financial statements commencing July 1, 2009. The Company is assessing the impact of the new standard on its financial statements.

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

Notes to Unaudited Consolidated Financial Statements

(in thousands, except for share and per share amounts)

2. Basis of Consolidation:

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.

3. Financial Instruments:

a) Classification of financial instruments:

Upon adoption of CICA 3855, the Company designated its cash, cash equivalents and restricted cash as held-for-trading, which are measured at fair value. Accounts receivable are classified as loans and receivables, which are measured at amortized cost. Accounts payable and accrued liabilities, notes payable and obligations under capital lease, are classified as other financial liabilities. The Company had neither available for sale, nor held-to-maturity instruments during the three months ended September 30, 2008.

b) Interest Income:

The Company has recorded interest income in relation to the following financial instruments:

	Three Months Ended September 30,	
	2008	2007
Financial assets held for trading:		
Interest income earned on:		
Cash and cash equivalents	38	118

4. Notes Payable

Notes payable include amounts payable to Fortress Credit Corp. Pursuant to the adoption of CICA Handbook Section 3855, amounts are shown net of related transaction and financing costs. Details are as follows:

	September 30,	June 30,
	2008	2008
Notes payable	\$15,440	\$16,243
Unamortized deferred loan origination fees	658	781
Unamortized proceeds allocated to warrants	146	168
Notes payable, net of related transaction and financing costs	\$14,636	\$15,294
Less: Current portion	(3,282)	(3,286)
	\$11,354	\$12,008

Notes to Unaudited Consolidated Financial Statements
(in thousands, except for share and per share amounts)

5. Share Capital

a) Authorized :

Unlimited Common shares without par value

Unlimited Preferred shares without par value

b) Issued and Fully Paid:

	Number	Amount
Balance, June 30, 2008	118,504,368	\$ 26,539
Stock Option Exercise	70,004	31
Warrants exercised	<u>678,285</u>	<u>341</u>
Balance, September 30, 2008	<u>119,252,657</u>	<u>\$ 26,911</u>

c) Warrants Outstanding:

	Number	Amount
Balance, June 30, 2008	3,139,904	\$ 678
Warrants exercised	<u>678,285</u>	<u>185</u>
Balance, September 30, 2008	<u>2,461,619</u>	<u>\$ 493</u>

The following non-transferable share purchase warrants are outstanding:

Expiry Date	Exercise Price	Outstanding 6/30/2008	Issued	Expired/ Exercised	Outstanding 9/30/2008
Sept 2, 2010	US\$0.23	2,306,571	-	678,285	1,628,286
Jan 31, 2011	Cdn\$0.40	833,333	-	-	833,333
		3,139,904	-	678,285	2,461,619

d) Contributed Surplus:

	Amount
Balance, June 30, 2008	\$ 2,509
Stock options exercised	(11)
Stock based compensation	<u>805</u>
Balance, September 30, 2008	<u>\$ 3,303</u>

e) Escrow shares release:

On August 11, 2008, the remaining balance of 1,841,401 common shares held in escrow was released.

Notes to Unaudited Consolidated Financial Statements
(in thousands, except for share and per share amounts)

f) Stock Options:

The company has the following stock options outstanding:

Expiry Date	Exercise Price	Outstanding 6/30/2008	Issued	Expired/ Forfeited/ Exercised	Outstanding 9/30/2008
Sept 2, 2013	Cdn\$1.62	-	125,000		125,000
Aug 18, 2009	Cdn\$1.45	-	25,000		25,000
Jul 8, 2013	Cdn\$1.30	-	600,000		600,000
Jul 8, 2013	Cdn\$1.30	-	1,007,400		1,007,400
Jul 3, 2013	Cdn\$1.34	-	1,654,200		1,654,200
May 15, 2013	Cdn\$1.44	40,000			40,000
Feb 14, 2013	Cdn\$1.17	20,000			20,000
Dec 12, 2012	Cdn\$1.40	125,000			125,000
Feb 28, 2012	Cdn\$1.29	40,000			40,000
June 20, 2012	Cdn\$1.25	2,007,400			2,007,400
June 18, 2012	Cdn\$1.25	1,508,032		13,332	1,494,700
July 19, 2008	Cdn\$1.15	25,000		25,000	-
Jan 17, 2012	Cdn\$0.65	100,000			100,000
April 3, 2011	Cdn\$0.65	465,000			465,000
Oct 26, 2011	Cdn\$0.64	642,222		2,222	640,000
Sept 6, 2011	Cdn\$0.63	2,886,400			2,886,400
Jan 16, 2011	Cdn\$0.59	200,000			200,000
Jan 31, 2011	Cdn\$0.55	40,000			40,000
Dec 1, 2010	Cdn\$0.47	500,000			500,000
Nov 30, 2010	Cdn\$0.47	10,000			10,000
May 30, 2009	Cdn\$0.46	5,000			5,000
June 30, 2009	Cdn\$0.45	10,000			10,000
Jan 29, 2009	Cdn\$0.42	5,000			5,000
Oct 6, 2010	Cdn\$0.41	100,000			100,000
Oct 31, 2010	Cdn\$0.40	2,500			2,500
July 29, 2010	Cdn\$0.39	10,000			10,000
Oct 20, 2009	Cdn\$0.38	140,000			140,000
Aug 31, 2010	Cdn\$0.36	7,500			7,500
May 31, 2010	Cdn\$0.35	30,000			30,000
Sept 9, 2008	Cdn\$0.32	160,000		160,000	-
Mar 1, 2010	Cdn\$0.30	30,000			30,000
Feb 28, 2010	Cdn\$0.30	5,000			5,000
Apr 30, 2010	Cdn\$0.30	10,000		5,000	5,000
Nov 30, 2009	Cdn\$0.28	12,000		5,000	7,000
Dec 31, 2009	Cdn\$0.28	5,000			5,000
Jan 31, 2010	Cdn\$0.24	10,000			10,000
		9,151,054	3,411,600	210,554	12,352,100

Notes to Unaudited Consolidated Financial Statements

(in thousands, except for share and per share amounts)

6. Related Party 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 for the three month period ended September 30 are as follows:

	FY 2009	FY 2008
Revenue earned	\$31	\$19
Interest expensed	-	-
Other expenses	\$29	\$71

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.

	FY 2009	FY 2008
Balances at September 30		
Accounts receivable from related companies	\$11	\$8
Accounts payable to a related party	-	\$27

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

7. Contingencies

a) 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.

b) 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.

Notes to Unaudited Consolidated Financial Statements

(in thousands, except for share and per share amounts)

8. 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. The Company's overall strategy with respect to capital risk management remains unchanged from the year ended June 30, 2008.

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 Canada and the United States and substantially all of the Company's identifiable assets as at September 30, 2008 are located in Canada and the United States. 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.

10. Financial Risk Management

a) Overview:

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

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 in advance of service for dedicated hosting customers. 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 and Canada and represent various industries. At September 30, 2008, 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. As

Notes to Unaudited Consolidated Financial Statements

(in thousands, except for share and per share amounts)

at September 30, 2008, the Company had an allowance for doubtful accounts of \$1,039. At September 30, 2008, the Company had no individually material past due trade accounts receivables.

As of September 30, 2008	
Total Accounts receivable	8,461
Less: Allowance for doubtful accounts	(1,039)
Total Accounts receivable, net	7,422
Of which:	
Not overdue	2,281
1-30 days	2,585
31-60 days	1,499
61-90 days	592
91 days and over	671
Less: Allowance for doubtful accounts	(1,039)
Accounts receivable – other	833
Accounts receivable, net	7,422

The Company invests its excess cash in overnight bank commercial paper with the objective of maintaining safety of principal and providing adequate liquidity to meet all current payment obligations and future planned capital expenditures and with the secondary objective of adding to the overall yield generated by excess cash balances. Excess cash balances are transferred to U.S. Bank commercial Paper sweep accounts which mature overnight. The U.S. Bank commercial paper is a short term promissory note issued by U.S. Bank N.A. and is rated at least investment grade by the recognized rating agencies. Given the high credit ratings and overnight duration, the Company does not expect the counterparties to these bank promissory notes to fail to meet their obligations.

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 September 30, 2008, the Company had financial assets held for trading of \$8,417, loans and receivables of \$7,422 and other financial liabilities of \$23,892. As at June 30, 2008, the Company had financial assets held for trading of \$11,276, loans and receivables of \$4,704 and other financial liabilities of \$24,985. All of the Company's financial liabilities have contracted maturities of less than 4 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 and Canada substantially all of the Company's financial assets and liabilities originate in United States and Canadian dollars. The Company is exposed to currency risk for sales

Notes to Unaudited Consolidated Financial Statements

(in thousands, except for share and per share amounts)

and purchases that are denominated in Canadian dollars. The Company believes that changes in exchange rates would not have a significant impact on net income and has not entered into any currency hedging transactions. The Company is subject to interest rate risk on its cash and cash equivalents and notes payable. The Company believes that interest rate risk is low as excess cash is invested overnight only. A change of 1% in interest rates for the three months ended September 30, 2008 would have increased or decreased net income by \$29.

Subsequent to the quarter ended September 30, 2008, effective October 1, 2008, the Company fixed for a period of twelve months, the LIBOR Rate (as defined in the loan and security agreement - the "LSA", with Fortress Credit Opportunities 1 LP) at a rate of 3.84%. Accordingly for the twelve month period commencing October 1, 2008, the loan balance under the LSA will accrue interest at the rate equal to i) the LIBOR Rate of 3.84% plus ii), an additional amount of between 3% and 4.25% per annum, the actual amount to be determined based on the Company's financial performance. In the event of default, the interest rate will increase by 2% per annum. The additional monthly standby fee of one half of one per cent payable on the un-advanced portion of the commitment for the Acquisition Term Loans is unchanged.

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