



PEER 1 NETWORK

**DECEMBER 31, 2005
QUARTERLY REPORT**

Peer 1 Network Enterprises, Inc.
Consolidated Balance Sheet
As At December 31, 2005
(unaudited - prepared by management)

	December 2005 US\$	June 2005 US\$
Assets		
Current:		
Cash and cash equivalents	5,984,889	292,071
Restricted Cash	500,000	500,000
Accounts receivable	4,237,195	2,441,645
Inventory	193,281	83,901
Prepaid expenses	1,378,549	386,749
	<u>12,293,914</u>	<u>3,704,366</u>
Other assets	3,598,557	1,029,980
Property, plant and equipment	25,936,938	10,135,257
Goodwill, licences and other intangibles	5,274,106	4,686,915
	<u>47,103,515</u>	<u>19,556,518</u>
Liabilities		
Current Liabilities		
Accounts payable and accrued liabilities	7,384,969	4,594,231
Deferred revenue	3,095,933	1,139,387
Current portion of deferred lease inducements	65,524	48,941
Current portion of notes payable	3,486,064	10,992,067
Shareholder notes	-	2,249,629
	<u>14,032,490</u>	<u>19,024,255</u>
Deferred lease inducements	459,809	314,048
Notes payable	19,334,784	94,701
Long Term Debt	7,403,113	-
	<u>41,230,196</u>	<u>19,433,004</u>
Shareholders' Deficiency		
Common Shares	14,246,231	7,827,875
Warrants	975,183	-
Equity component of convertible debt	-	325,595
Contributed Surplus	647,519	465,996
Deficit	(10,019,911)	(8,520,249)
Cumulative Translation Adjustment	24,297	24,297
	<u>5,873,319</u>	<u>123,514</u>
	<u>47,103,515</u>	<u>19,556,518</u>

Peer 1 Network Enterprises, Inc.
Consolidated Income Statement
Three Months Ended December 31, and Year To Date
(unaudited - prepared by management)

	Three Months Ended December 2005 US\$	Three Months Ended December 2004 US\$	Six Months Ended December 2005 US\$	Six Months Ended December 2004 US\$
Revenue	16,286,700	4,664,046	25,964,979	7,555,823
Cost of Sales	10,402,326	2,896,297	16,362,182	4,698,330
Gross Profit	5,884,374	1,767,749	9,602,797	2,857,493
Operating expenses	4,573,759	1,874,250	6,960,546	3,013,971
Operating profit (loss)	1,310,615	(106,501)	2,642,251	(156,478)
Amortization of licences	236,327	-	472,654	-
Amortization of preferred share discount	260,565	-	404,792	-
Interest expense	1,041,378	361,189	2,068,729	484,167
Interest accretion on convertible debt	63,836	75,874	541,460	146,726
Integration costs	365,125	-	432,688	-
Realized foreign exchange loss (gain)	(4,691)	5,757	(42,521)	381
Unrealized foreign exchange loss (gain)	(170,302)	(413,368)	250,997	(413,368)
Loss from equity accounted investment	-	-	13,114	-
Loss before income taxes	(481,623)	(135,953)	(1,499,662)	(374,384)
(Provision for) recovery of corporate taxes	-	10,446	-	10,446
Loss for the period	(481,623)	(146,399)	(1,499,662)	(384,830)
Deficit, beginning of period	(9,538,288)	(6,307,329)	(8,520,249)	(6,068,898)
Deficit, end of period	(10,019,911)	(6,453,728)	(10,019,911)	(6,453,728)
Basic and diluted loss per share	(0.01)	0.00	(0.02)	(0.01)

Peer 1 Network Enterprises, Inc.
Consolidated Statement of Cash Flows
Three Months Ended December 31, and Year To Date
(unaudited - prepared by management)

	Three Months Ended December 2005 US\$	Three Months Ended December 2004 US\$	Six Months Ended December 2005 US\$	Six Months Ended December 2004 US\$
Cash flows from operating activities				
Loss for the period	(481,624)	(146,399)	(1,499,662)	(384,830)
Amortization	2,347,620	14,323	3,788,496	216,452
Amortization of preferred share discount	260,565	-	404,792	-
Foreign exchange translation adjustment	-	540	-	(15,323)
Stock-based compensation included in loss for period	154,139	-	179,704	-
Increase (decrease) in deferred lease inducements	101,203	(2,408)	162,344	(4,816)
Increase in accrued interest and accretion of convertible debt	1,105,214	437,063	2,610,189	630,893
	<u>3,487,117</u>	<u>303,119</u>	<u>5,645,863</u>	<u>442,376</u>
Change in non-cash working capital items				
Increase in accounts receivable	(352,710)	(97,787)	(1,795,550)	(133,418)
Increase in inventory	(97,856)	(44,164)	(109,380)	(44,164)
Increase in prepaid expenses	435,502	(337,049)	(991,800)	(473,459)
Increase in accounts payable and accrued liabilities	1,043,364	1,692,400	2,790,738	2,010,203
Increase in deferred revenue	151,695	408,373	1,956,546	402,656
	<u>4,667,112</u>	<u>1,924,892</u>	<u>7,496,417</u>	<u>2,204,194</u>
Cash flows from investing activities				
Change in restricted cash	-	-	-	-
Acquisition of property and equipment	(2,633,296)	(3,011,270)	(19,117,523)	(3,504,847)
Investment in goodwill, licences and other intangibles	(151,808)	(5,131,123)	(1,059,845)	(5,131,123)
Investment in other assets	361,560	(298,075)	(2,083,167)	(635,510)
	<u>(2,423,544)</u>	<u>(8,440,468)</u>	<u>(22,260,535)</u>	<u>(9,271,480)</u>
Cash flows from financing activities				
Proceeds from notes payable, long term debt and affiliated companies	(2,014,298)	6,819,156	22,550,344	6,648,955
Share capital issued	68,581	-	156,221	1,183
Proceeds from (repayment of) shareholder notes	-	974,505	(2,249,629)	974,505
	<u>(1,945,717)</u>	<u>7,793,661</u>	<u>20,456,936</u>	<u>7,624,643</u>
Decrease in cash and cash equivalents	297,851	1,278,085	5,692,818	557,357
Cash and cash equivalents - beginning of period	5,687,038	76,569	292,071	797,297
Cash and cash equivalents - end of period	<u>5,984,889</u>	<u>1,354,654</u>	<u>5,984,889</u>	<u>1,354,654</u>

Notes to Unaudited Consolidated Financial Statements

1. Nature of Operations and Basis of Presentation:

Peer 1 Network Enterprises, Inc. (the "Company") was incorporated under the laws of British Columbia. The company provides high performance internet bandwidth and co-location facilities to web-centric and enterprise customers across North America. Building on a redundant, 100% Cisco powered internal network, 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 a point of presence in London, UK. 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 six month period 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, 2005. The annual financial statements should be referenced in conjunction with this interim report.

2. Basis of Consolidation:

These consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, Peer 1 Network Inc., Peer 1 Network (USA) Inc., Peer 1 Network (Seattle) Inc., Peer 1 Network (San Jose) Inc., Peer 1 Network (New York) Inc., ServerBeach GP Inc., ServerBeach 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. Functional And Reporting Currency Change:

Effective October 1, 2005, the Company changed its functional currency to the U.S. 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 U.S. dollar denominated revenues and expenditures. Concurrent with the change in its functional currency, the Company has adopted the U.S. Dollar as its reporting currency. For comparative purposes, the results for the three and six months ended December 31, 2005 have been presented in US dollars. The consolidated financial statements of the Company for the comparative periods ended on or before June 30, 2005 which were based on the Canadian functional currency have been translated into the U.S. 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 revenues 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, monetary assets and liabilities denominated in foreign currencies are translated into U.S. 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. Interland, Inc. Asset Acquisition

On September 2, 2005 the company, through a wholly owned subsidiary, completed the asset purchase pursuant to the asset purchase agreement dated August 31, 2005 with Interland, Inc. ("Interland"). Pursuant to the agreement, Interland agreed to sell, and the company agreed to purchase, all of the assets of Interland that are necessary for the daily operation of Interland's dedicated server business. The company has also agreed to assume certain liabilities of Interland. In addition, Interland has granted to the company a royalty-free non-exclusive license to the intellectual property owned by Interland and access to property licensed by Interland from third parties. The purchase price for the assets and the obligations of Interland was US\$14,000,000, subject to adjustment in accordance with the asset purchase agreement. 20% of the purchase price prior to adjustment was placed in escrow as security for the obligations of Interland under the agreement. Peer 1 and Interland have also entered into an administrative services agreement dated as of August 31, 2005 which was amended December 31, 2005..

The allocation of the purchase price is preliminary and the final allocation may be subject to refinement in the next 9 months. 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

	US
Accounts receivable, net	473,018
Prepaid expenses	538,000
Other assets – deposits	289,000
Tangible capital assets	15,029,509
Goodwill	1,059,845
Deferred revenue	(1,893,850)
Accounts payable	<u>(165,000)</u>
	\$ <u>15,330,522</u>

5. Share Capital

- 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.

- b) Issued and Fully Paid:

	Number	Amount
Balance at beginning of year	49,119,367	\$ 7,827,875
Changes in share capital	<u>27,318,213</u>	<u>\$ 6,418,356</u>
Balance at December 31, 2005	<u>76,437,580</u>	<u>\$ 14,246,231</u>

- c) Preferred Shares Series A

On September 2, 2005 7,000 preferred shares with a par value of \$1,000 per share were issued for cash proceeds of \$7,000,000. The preferred shares are classified as long term debt as they are redeemable by the holders at \$2,000 per share at anytime after four years. The \$14,000,000 redemption amount has been reduced by a discount on issuance of \$7,000,000 and is being amortized using the effective interest method over a period of four years.

d) Warrants Outstanding

The following non-transferable share purchase warrants are outstanding:

Expiry Date	Exercise Price	Outstanding 09/30/2005	Issued	Expired/ Exercised	Outstanding 12/31/2005
Jul 18, 2007	Cdn\$0.40	3,100,000			3,100,000
Oct 23, 2005	Cdn\$0.32	1,834,215		1,834,215	-
Nov 6, 2005	Cdn\$0.28	500,000		500,000	-
Sept 2, 2010	US\$0.23	2,306,571			2,306,571
		7,740,786		2,334,215	5,406,571

Warrants outstanding in the amount of 745,000 have been removed from the table presented previously in the quarter ended September 30, 2005 as final board approval was not obtained.

e) Shares held in escrow:

As of December 31, 2005, 11,048,401 shares of the company are subject to an escrow agreement and may not be transferred, assigned, or otherwise dealt with without the consent of the regulatory body that has jurisdiction.

f) Stock Options

The company has the following stock options outstanding:

Expiry Date	Exercise Price	Outstanding 09/30/2005	Issued	Expired/ Exercised	Outstanding 12/31/2005
Dec 1, 2010	Cdn\$0.47		500,000		500,000
May 30, 2009	Cdn\$0.46	15,000			15,000
July 24, 2007	Cdn\$0.45	2,138,250			2,138,250
Nov 7, 2007	Cdn\$0.45	300,000			300,000
June 30, 2009	Cdn\$0.45	60,000			60,000
Sept 30, 2010	Cdn\$0.45	2,500			2,500
March 8, 2009	Cdn\$0.44	300,000			300,000
Jan 29, 2009	Cdn\$0.42	15,000			15,000
Oct 6, 2010	Cdn\$0.41		100,000		100,000
Nov 7, 2007	Cdn\$0.39	105,000			105,000
July 29, 2010	Cdn\$0.39	110,000			110,000
Oct 20, 2009	Cdn\$0.38	195,000		15,000	180,000
Aug 31, 2010	Cdn\$0.36	10,000			10,000
May 31, 2005	Cdn\$0.35	35,000			35,000
Sept 9, 2008	Cdn\$0.32	337,000			337,000
Sept 30, 2009	Cdn\$0.31	10,000			10,000
Mar 1, 2010	Cdn\$0.30	30,000			30,000
Feb 28, 2010	Cdn\$0.30	15,000			15,000
Apr 30, 2010	Cdn\$0.30	25,000		5,000	20,000
Nov 30, 2009	Cdn\$0.28	37,000			37,000
Dec 31, 2009	Cdn\$0.28	10,000			10,000
Jan 31, 2010	Cdn\$0.24	15,000			15,000
		3,764,750	600,000	20,000	4,344,750

The options and warrants are not included in diluted per share calculations.

6. Related Party Transactions

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

At December 31, 2005 amounts due to and from related parties were as follows:

	FY2006	FY2005
Included in accounts receivable	\$91,208	\$109,469
Included in accounts payable and accrued liabilities	\$525	2,445

During the period, transactions with related parties were as follows:

	FY2006	FY2005
Revenues earned	\$56,563	\$74,621
Interest expensed	\$1,164,081	\$245,086
Other expenses incurred	\$1,083,902	76,376

These transactions are in the normal course of operations and are measured at their exchange amounts. Included in other expenses incurred is financing fees of \$1,083,902.

7. Segmented Information

Prior to the second quarter of FY2005, the Company operated one reporting segment and four geographic segments. Following the acquisition of Server Beach assets on October 20, 2004 and commencement of the provision of dedicated servers, two reporting segments are now in operation.

	<i>Quarter ended 12/31/05 Colocation & Bandwidth</i>	<i>Quarter ended 12/31/05 Dedicated Servers</i>	<i>Quarter ended 12/31/05 Total</i>	<i>Quarter ended 12/31/04 Total</i>
Revenue	\$4,450,152	\$11,836,548	\$16,286,700	\$ 4,664,046
Income (loss)	\$(1,911,527)	\$1,429,902	\$(481,625)	\$ (146,399)
	<i>Year To Date 12/31/05 Colocation & Bandwidth</i>	<i>Year To Date 12/31/05 Dedicated Servers</i>	<i>Year To Date 12/31/05 Total</i>	<i>Year To Date 12/31/04 Total</i>
Revenue	\$9,130,964	\$16,834,015	\$25,964,979	\$7,555,823
Income (loss)	\$(3,083,491)	\$1,583,828	\$(1,499,663)	\$(384,830)
Total Assets	\$16,961,176	\$30,142,339	\$47,103,515	\$18,031,513

Segmented Information (continued)

During the quarter ended September 30, 2005 the company began reporting on two additional geographic segments, Georgia and Florida.

Three months ended December 31, 2005

	<i>British Columbia</i>	<i>Ontario</i>	<i>Quebec</i>	<i>Virginia</i>	<i>Texas</i>	<i>Georgia</i>	<i>Florida</i>	<i>Other USA</i>	<i>Total</i>
Revenue	\$1,481,874	\$1,301,961	\$686,802	\$2,072,630	\$1,104,953	\$5,337,523	\$2,089,798	\$2,211,159	\$16,286,700
Income (loss)	\$1,290,668	\$317,706	\$ (219,435)	\$381,666	\$203,472	\$520,726	\$203,880	\$(3,180,308)	\$ (481,625)

Three months ended December 31, 2004

	<i>British Columbia</i>	<i>Ontario</i>	<i>Quebec</i>	<i>Virginia</i>	<i>Texas</i>	<i>Georgia</i>	<i>Florida</i>	<i>Other USA</i>	<i>Total</i>
Revenue	\$1,370,195	\$797,280	\$647,930	\$548,724	\$726,967	\$-	\$-	\$572,949	\$4,664,046
Income (loss)	\$566,365	\$ 120,556	\$ 88,819	\$44,563	\$59,039	\$-	\$-	\$(1,025,741)	\$ (146,399)

Year to Date December 31, 2005

	<i>British Columbia</i>	<i>Ontario</i>	<i>Quebec</i>	<i>Virginia</i>	<i>Texas</i>	<i>Georgia</i>	<i>Florida</i>	<i>Other USA</i>	<i>Total</i>
Revenue	\$2,726,516	\$2,511,938	\$1,314,907	\$3,673,045	\$1,958,162	\$7,034,194	\$2,864,860	\$3,881,357	\$25,964,979
Income (loss)	\$979,614	\$171,915	\$ (412,393)	\$330,574	\$176,235	\$659,096	\$268,434	\$(3,673,137)	\$ (1,499,662)
Total Assets	\$15,395,000	\$1,811,892	\$840,782	\$5,801,434	\$3,092, 839	\$12,761,476	\$5,197,446	\$2,202,646	\$47,103,515

Year to Date December 31, 2004

	<i>British Columbia</i>	<i>Ontario</i>	<i>Quebec</i>	<i>Virginia</i>	<i>Texas</i>	<i>Georgia</i>	<i>Florida</i>	<i>Other USA</i>	<i>Total</i>
Revenue	\$2,482,775	\$1,503,668	\$1,229,980	\$548,724	\$726,967	\$-	\$-	\$1,063,708	\$7,555,823
Income (loss)	\$997,777	\$ 235,228	\$ 131,820	\$44,563	\$59,038	\$-	\$-	\$(1,852,854)	\$ (384,830)
Total Assets	\$4,032,297	\$1,322,386	\$950,774	\$3,806,693	\$5,043,227	\$-	\$-	\$2,876,137	\$18,031,513