peer1 NETWORK | CO-LOCATION | DEDICATED HOSTING

# Management's Discussion & Analysis for the Three and Nine Months Ended March 31, 2007

**MANAGEMENT'S DISCUSSION AND ANALYSIS**
**OF INTERIM FINANCIAL RESULTS**
**FOR THE THREE AND NINE MONTHS ENDED MARCH 31, 2007**

*This Management Discussion and Analysis ("MD&A"), dated May 25, 2007, should be read in conjunction with Peer 1's unaudited first, second and third quarter financial statements, as well as the audited annual financial statements for the fiscal year ended June 30, 2006 and the notes thereto, all of which can be found on www.sedar.com. Unless otherwise noted, all figures noted are in United States dollars.*

## FORWARD LOOKING STATEMENTS

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

## OVERVIEW

### Quarterly Financial Highlights

- Peer 1's revenue increased 7% to $18.81 million for the three months ended March 31, 2007, compared to $17.63 million for the three month period ended March 31, 2006.

- Gross profit increased 8.12% to $7.06 million for the three months ended March 31, 2007, compared to $6.53 million for the three months ended March 31, 2006.

- Operating income increased 61.47% to $1.97 million for the three months ended March 31, 2007, compared to $1.22 million for the three months ended March 31, 2006.

- Income before income taxes was $541,180 for the quarter ended March 31, 2007, compared to a loss before income taxes of $354,910 for the three months ended March 31, 2006.

- Net profit was $0.23 million for the three months ended March 31, 2007, compared to a net loss of $0.35 million for the three months ended March 31, 2006.

### Quarterly Key Developments

- On February 1, 2007 the Company announced that its previously announced data center expansion in Vancouver is complete, increasing the Company's co-location capacity by over 140 cabinet equivalents. Additionally the Company announced an expansion of its Toronto data center that will accommodate a further 125 cabinets, with completion scheduled before the end of June 2007.

- On February 1, 2007 the Company announced that recent expansions in current Peer 1 data centers across North America have given the Company the capacity to add approximately 65% more dedicated servers to its current base of over 16,000 dedicated servers and approximately 40% more co-location cabinet equivalents to its current base of over 1,100 cabinet equivalents. This enables Peer 1 to significantly grow its customer base with modest incremental capital expenditures relative to building a new data center. The data center expansions and increased capacity supports management's strategy for continued growth and margin improvement.

## OUR BUSINESS

Peer 1 is a provider of Internet infrastructure solutions and related managed services. Peer 1's service offerings include bandwidth, co-location, and dedicated hosting services. Customers include hosting providers, online gaming companies, Internet phone (VoIP) companies and small and medium-sized businesses across North America. Peer 1 has established data centers and points of presence ("POPs") in 17 cities across North America and Europe including: Vancouver, Toronto, Montreal, New York, Seattle, San Jose, San Antonio, Los Angeles, Miami, Atlanta, Fremont, Herndon, Ashburn, Chicago, Dallas, Amsterdam and London, England.

Management of Peer 1 believes that the Company has been successful in attracting and generating business as a result of:

- Access to a high bandwidth, high quality IP network
- 24 hours, 7 days a week monitoring
- Environmentally protected facilities
- High level of physical security
- Customer support

### Dedicated Hosting

Peer 1 provides competitively priced, managed and unmanaged dedicated server solutions to small and mid-size businesses. Managed dedicated hosting is a comprehensive web hosting service whereby the client is provided the ability to utilize a Peer 1 server housed in one of the Company's data centers, and receives professional managed support. The server is dedicated to the customer's use only. Unmanaged dedicated hosting is the same, but the customer performs all management activities on the server. The acquisition of ServerBeach, Ltd. on October 20, 2004 and the dedicated server assets of Interland, Inc. on September 2, 2005 significantly increased the Company's capacity to provide dedicated server solutions and product offerings that complement the Company's co-location and bandwidth service offerings.

### Co-location

Peer 1's co-location service involves the physical locating of a customer's switching gear and/or servers in one of the Company's data center facilities that provides the infrastructure necessary for effective functioning of their equipment. The infrastructure resources include a secured cage or cabinet, regulated power, emergency backup power, dedicated Internet connection, regulated air temperature and physical security. Co-location customers are charged for the service provided by way of a monthly rental charge.

### Bandwidth (Network)

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

## STRATEGY

Peer 1's growth strategy includes organic, leveraged, and accelerated growth. Organic growth focuses on the addition of new customers and the expansion of the network's reach into key peering points worldwide. Leveraged growth focuses on the introduction of new products and services that leverage and complement Peer 1's current infrastructure. Accelerated growth is based on pursuing investments and acquisitions complementary to existing lines of business.

### Dedicated Servers

Peer 1's strategy for dedicated servers is to provide servers built with quality parts within a low cost infrastructure that supports a price competitive strategy. The Company, through its ServerBeach division, specializes in offering self-managed dedicated servers where the client retains control of the functionality and performance of the server. Peer 1 Dedicated Hosting specializes in managed dedicated servers providing firewalls, storage area networks, security and support to augment the client's applications, as well as custom hosting solutions for clients with unique requirements.

### Bandwidth (Network)

Peer 1's strategy is to continue to build a series of dedicated links, peering relationships and establish traffic exchange agreements with other networks between the Company's facilities using multiple high-speed connections. Peering arrangements are fundamental to the Company's strategy, and create two advantages: first, they reduce latency between networks; and second, they avoid additional costs associated with a third party network. Peering is a relationship between two or more networks of any size in which the networks create a direct link between each other and agree to forward each other's packets directly across this link instead of using the standard Internet backbone.

### Co-location Facilities

Peer 1 establishes a point of presence in new markets by co-locating in facilities owned by other suppliers. This allows Peer 1 to gauge market demand prior to establishing a new co-location facility. When a market is considered viable, the Company identifies suitable space for long term lease. Wherever possible, sites that have previously been operated as data centers are sought to reduce initial capital investment requirements. Equipment is acquired and installed on a phased basis based on demand. As market share grows, additional space and equipment are acquired.

## RESULTS OF OPERATIONS

The table below presents, for the periods indicated, the statement of operations.

**Peer 1 Network Enterprises, Inc.**
**Consolidated Income Statement**
**Three and Nine Months Ended March 31**
**(unaudited - prepared by management)**

| | Three Months Ended March 2007 US$ | Three Months Ended March 2006 US$ | Nine Months Ended March 2007 US$ | Nine Months Ended March 2006 US$ |
|---|---|---|---|---|
| Revenue | 18,812,108 | 17,626,782 | 54,429,496 | 43,591,761 |
| Cost of Sales | 11,747,092 | 11,092,270 | 33,711,409 | 27,110,969 |
| Gross Profit | 7,065,016 | 6,534,512 | 20,718,087 | 16,480,792 |
| Operating expenses | 5,092,622 | 5,311,064 | 14,689,971 | 13,087,747 |
| Operating Income before other items | 1,972,394 | 1,223,448 | 6,028,116 | 3,393,045 |
| Other Items: | | | | |
| Amortization of preferred share discount | 389,013 | 341,683 | 1,120,367 | 746,475 |
| Interest expense - long term | 803,062 | 628,804 | 2,464,551 | 2,662,679 |
| Interest expense - short term | - | 1,848 | - | 36,702 |
| Interest accretion on notes payable | 53,261 | 76,649 | 163,692 | 618,109 |
| Integration costs | 90,650 | 405,467 | 608,192 | 838,155 |
| Foreign exchange loss (gain) | 13,819 | 123,907 | (23,950) | 332,383 |
| Loss on disposal of fixed assets | 81,409 | - | 127,540 | - |
| Loss from equity accounted investment | - | - | - | 13,114 |
| Income (Loss) before income taxes | 541,180 | (354,910) | 1,567,724 | (1,854,572) |
| Future income tax expense (recovery) | 266,120 | - | (358,799) | - |
| Current Income tax expense | 45,358 | - | 598,519 | - |
| Income tax expense | 311,478 | - | 239,720 | - |
| Income (Loss) for the period | 229,702 | (354,910) | 1,328,004 | (1,854,572) |
| Deficit, beginning of period | (10,609,427) | (10,019,911) | (11,707,729) | (8,520,249) |
| Deficit, end of period | (10,379,725) | (10,374,821) | (10,379,725) | (10,374,821) |
| Basic earnings (loss) per share | 0.00 | (0.01) | 0.02 | (0.03) |
| Diluted earnings (loss) per share | 0.00 | (0.01) | 0.02 | (0.03) |

## Acquisitions

Over the past three years, Peer 1's strategic focus has expanded through the execution of our three-pronged growth strategy to grow and diversify the Company's sources of revenue.

In FY2004, Peer 1's primary focus was on providing bandwidth and co-location services, which represented over 94% of the Company's consolidated revenue. In FY2006, bandwidth and co-location revenues represented 27% of consolidated revenues, while dedicated server revenue accounted for 70% of consolidated revenues. The shift in sources of revenue is attributable to the FY2005 acquisition of ServerBeach Ltd. and the FY2006 acquisition of dedicated hosting assets from Interland, Inc. (the "Dedicated Hosting" acquisition) as described below.

On September 2, 2005, the Company acquired the dedicated server assets of Interland, Inc. for $14.0 million. Included in the operating assets were existing customer contracts and data centers in Atlanta, GA; Fremont, CA; and Miami, FL, totaling over 115,000 square feet and 8,300 servers. Interland has since been renamed Web.com.

For the quarter ended March 31, 2007 dedicated server revenue accounted for 71% of total revenue, compared to 72% for the quarter ended March 31, 2006.

## Revenues

The Company's business model is based on recurring revenue streams for all of its main offerings. Once a customer is obtained, the revenue from services and product offerings, which are invoiced monthly, generally continues on a go forward basis with a manageable level of customer churn. Customer contracts range from month-to-month to three year terms.

Set-up fees are charges customers pay for initial configuration and installation of services. These services are typically billed once and only upon completion of such configuration and installation.

| | Three months ended March 31 | | | | Nine Months ended March 31 | | | |
|---|---|---|---|---|---|---|---|---|
| | 2007 | % | 2006 | % | 2007 | % | 2006 | % |
| Revenue: | | | | | | | | |
| Colocation | 2,518,137 | 13% | 2,036,108 | 12% | 7,226,090 | 13% | 5,709,073 | 13% |
| Bandwidth | 2,029,581 | 11% | 2,258,517 | 13% | 6,192,176 | 11% | 6,254,562 | 14% |
| Services (Set up fees) | 853,832 | 5% | 559,163 | 3% | 2,082,772 | 4% | 1,440,665 | 3% |
| Dedicated Servers | 13,410,558 | 71% | 12,772,994 | 72% | 38,928,458 | 72% | 30,187,461 | 69% |
| **Total Revenue** | 18,812,108 | 100% | 17,626,782 | 100% | 54,429,496 | 100% | 43,591,761 | 100% |

Consolidated revenue increased to $18.81 million for the three months ended March 31, 2007 from $17.63 million for the three months ended March 31, 2006. The increase in revenue for the quarter is attributable to organic growth. Consolidated revenue increased to $54.43 million for the nine months ended March 31, 2007 from $43.59 million for the nine months ended March 31, 2006. The increase in revenue is primarily attributable to nine months of revenue from Dedicated Hosting during the nine month period ended March 31, 2007 compared to seven months of revenue from Dedicated Hosting during the same period last fiscal year, as well as to organic growth.

Co-location revenues increased to $2.52 million in the three months ended March 31, 2007 from $2.04 million for the three months ended March 31, 2006. Co-location revenues increased to $7.2 million for the nine months ended March 31, 2007 from $5.71 million for the nine months ended March 31, 2006. The increase is attributable to improved pricing and increased sales volume. As Peer 1 continues to pursue its organic growth strategy, the Company expects the data center expansion in Vancouver and Toronto and the resultant increase in co-location capacity to generate revenue in future periods.

Bandwidth revenues were $2.03 million in the three months ended March 31, 2007 compared to $2.26 million in the three months ended March 31, 2006. Bandwidth revenues were $6.19 million for the nine months ended March 31, 2007 compared to $6.25 million for the nine months ended March 31, 2006. The bandwidth business line continues to operate in a competitive price sensitive market.

Dedicated server revenues increased to $13.41 million for the three months ended March 31, 2007 from $12.77 million for the three months ended March 31, 2006. Dedicated server revenues increased to $38.93 million in the nine months ended March 31, 2007 from $30.19 million for the nine months ended March 31, 2006. The increase for the three and nine month period ended March 31, 2007 is attributable to increased sales, addition of new customers, an overall decrease in customer churn rates and nine months of revenue from Dedicated Hosting for the nine month period ended March 31, 2007, compared to seven months of revenue from Dedicated Hosting during the same period last fiscal year.

The Company's Canadian operations accounted for $3.93 million of revenues in the three month period ended March 31, 2007 compared to $3.77 million of revenues in the three months ended March 31, 2006. The Company's Canadian operations accounted for $11.48 million of revenues in the nine month period ended March 31, 2007 compared to $10.32 million of revenues in the nine months ended March 31, 2006. This change is the result of increased co-location revenues in the Canadian operations for the current quarter compared to the same period last year.

**Cost of Sales**

Cost of sales for the Company are primarily fixed and relate to infrastructure and staffing. Infrastructure costs consist of rent, maintenance, power, cooling, security, leasing and/or amortization of equipment and improvements, insurance, and supplies. Variable costs consist of power consumption, and incremental bandwidth from upstream carriers.

Consolidated cost of sales increased to $11.75 million for the three months ended March 31, 2007 from $11.09 million for the three months ended March 31, 2006. Cost of sales for the current quarter includes approximately $0.30 million of one time supplemental facilities charges. Cost of sales as a percentage of revenue decreased to 62% in the quarter ended March 31, 2007 from 63% for the quarter ended March 31, 2006. Consolidated cost of sales increased to $33.71 million for the nine months ended March 31, 2007 from $27.11 million for the nine months ended March 31, 2006. Cost of sales as a percentage of revenue remained unchanged at 62% for the nine months ended March 31, 2007 and for the same period in 2006. The cost of sales dollar increase for the nine month period ended March 31, 2007 is primarily a result of the inclusion of the operations relating to the acquired assets from Interland, Inc. for an additional two months compared to the same period in the prior fiscal year.

In the three months ended March 31, 2007, in order to better reflect their functional contribution to the Company, costs associated with certain technical staff at Dedicated Hosting were reclassified from cost of sales to operating expenses, specifically technology and customer relations. Accordingly, cost of sales figures for three and nine months ended 2007 and 2006, discussed above, have been reclassified on a comparative basis.

For the quarter ended March 31, 2007, cost of $0.04 million was reclassified from cost of sales to operating expenses compared to $0.03 million for the same period last year. For the nine months ended March 31, 2007, cost of $1.01 million was reclassified from cost of sales to operating expenses compared to $0.68 million for the nine months ended March 31, 2006.

Total cost of sales is expected to increase as revenues increase. The pattern of growth in revenues related to the new facilities does not generally match the pattern of growth in the related costs. Revenue increases are a function of capacity utilization. The cost of sales related to co-location is primarily affected by the cost of facilities. The cost of sales related to bandwidth is primarily affected by cost for bandwidth, transport and infrastructure. The cost of sales related to the dedicated server line of business is primarily affected by the cost of facilities, servers and bandwidth.

**Operating Expenses**

The following table presents operating expenses consisting of sales and marketing, general and administrative, and technology and customer relations, as a percentage of revenue.

| | Three months ended March 31 | | | | Nine Months ended March 31 | | | |
|---|---|---|---|---|---|---|---|---|
| | 2007 | % | 2006 | % | 2007 | % | 2006 | % |
| Total Operating Expenses | 5,092,622 | 27% | 5,311,064 | 30% | 14,689,971 | 27% | 13,087,747 | 30% |

Total operating expenses decreased to $5.09 million for the three months ended March 31, 2007 from $5.31 million for the three months ended March 31, 2006, as a result of efficiencies attributable to the integration of the Dedicated Hosting assets. Operating expenses as a percentage of revenue decreased to 27% in the quarter ended March 31, 2007 from 30% for the quarter ended March 31, 2006. Total operating expenses increased to $14.69 million for the nine months ended March 31, 2007 from $13.09 million for the nine months ended March 31, 2006. Operating expenses as a percentage of revenue decreased to 27% in the nine months ended March 31, 2007 from 30% for the nine months ended March 31, 2006. The significant increase in operating expenses for the nine month period ended March 31, 2007 compared to the same period in the prior fiscal year is a result of nine months of operating expenses from Dedicated Hosting for the nine month period ended March 31, 2007, compared to seven months of operating expenses from Dedicated Hosting during the same period last fiscal year.

As discussed in cost of sales above, costs associated with certain technical staff at Dedicated Hosting were reclassified from cost of sales to operating expenses. Please refer to the discussion of cost of sales above on this reclassification of costs related to certain technical staff from cost of sales to operating expenses. Operating expenses for the three and nine months ended March 31, 2007 and March 31, 2006 are presented on the basis of having reclassified the same amounts for respective periods as has been done for cost of sales.

The largest component of operating expenses is general and administrative which accounted for 58% and 59% for the three and nine months ended March 31, 2007 respectively compared to 63% and 65% for the three and nine months ended March 31, 2006 respectively. The decrease in general and administrative expenses as a percentage of operating expenses for the three and nine month period is attributable to increased expenses in sales and marketing and technology and customer relations to support growth and the effect of having decreased the allowance for doubtful accounts during the quarter ended March 31, 2007 to reflect a more current customer accounts receivable aging primarily as a result of sustained collection efforts. Management continues to focus on administration costs to ensure that operations are as efficient as possible and it is anticipated that they will be reduced as a percentage of revenue over time.

Sales and marketing costs accounted for 28% and 26% for the three and nine months ended March 31, 2007 compared to 26% and 24% for the three and nine months ended March 31, 2006 respectively. The increase for the three and nine month period is a result of increased marketing efforts to support growth.

As the Company continues to pursue its growth strategy, operating expenses may increase to support marketing, promotional opportunities and general and administration requirements.

**Other income and expenses:**

The Company is currently incurring expenses related to the integration of the Dedicated Hosting acquisition. The Company incurred $0.01 million in integration costs in the quarter ended March 31, 2007, of which $0.09 million was expensed, $0.08 million was capital cost recovery for internally developed software and $Nil was capitalized as computer equipment. The Company was able to negotiate a credit from a vendor for cost previously invoiced and capitalized as software. For the nine month period ended March 31, 2007 the Company incurred $1.09 million in integration costs, of which $0.61 million was expensed, $0.42 million was capitalized as internally developed software and $0.06 million was capitalized as computer equipment. The Company anticipates expenses for these activities to continue through the balance of this fiscal year. Integration costs include the cost of a new billing, ticketing and customer support system in addition to separation of business operations.

## SUMMARY OF QUARTERLY RESULTS

The following table sets out certain operating results and balance sheet items of the Company for the past eight quarters.

| | Quarter Ended (in thousands $) | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | June 30 2005 (US$) | 30-Sep 2005 (US$) | 31-Dec 2005 (US$) | March 31 2006 (US$) | June 30 2006 (US$) | 30-Sep 2006 (US$) | 31-Dec 2006 (US$) | 31-Mar 2007 (US$) |
| Revenue | 6,019 | 9,678 | 16,287 | 17,627 | 17,134 | 17,486 | 18,131 | 18,812 |
| Operating Profit (Loss) | 500 | 1,095 | 1,074 | 1,224 | 638 | 1,772 | 2,284 | 1,972 |
| Net Income (Loss) | (654) | (1,018) | (481) | (355) | (1,333) | 249 | 849 | 230 |
| Basic income (loss) per share | (0.02) | (0.02) | (0.01) | (0.01) | (0.01) | 0.00 | 0.01 | 0.00 |
| Fully diluted income (loss) per share | (0.02) | (0.02) | (0.01) | (0.01) | (0.01) | 0.00 | 0.01 | 0.00 |

## Liquidity and Capital Resources

Peer 1 has historically financed its operations through cash generated from operations, sale of common and preferred shares and issuance of debt. As at March 31, 2007, the Company had cash and cash equivalents of $7.22 million (including $0.5 million in restricted cash – see Off-Balance Sheet Arrangements section), compared to $6.17 million (including $0.5 million in restricted cash) as at June 30, 2006. The Company had long term debt (in the form of Preferred Shares Series A, please refer to Peer 1's 2006 annual report for more information) of $9.21 million and notes payable of $18.61 million as at March 31, 2007 compared to $8.1 million long term debt and notes payable of $21 million as at June 30, 2006.

The Company had a working capital deficit of $3.72 million at March 31, 2007 compared to a working capital deficit of $4.2 million as the end of December 31, 2006.

The working capital deficit of $3.72 million at March 31, 2007 includes deferred revenue of $4.07 million and current portion of notes payable of $3.66 million. The Company anticipates current liquidity and cash generated from operations to be sufficient to fund existing operations for the foreseeable future.

## Operating Activities

Cash flow from operating activities for the three months ended March 31, 2007 and 2006 was $4.71 million and $3.28 million, respectively. Cash flow from operating activities for the nine months ended March 31, 2007 and 2006 was $9.59 million and $10.70 million, respectively. The increase in cash provided by operations for the three months ended March 31, 2007 compared to the same period last year is primarily due to Peer 1 having net income and reduction of bad debt expense during the current quarter. The decrease in cash provided by operations for the nine months ended March 31, 2007 compared to the same period last year is attributable to decreased cash flow from working capital items as a result of payment of accounts payable and other accrued liabilities. Excluding changes in non-cash working capital items, cash flow from operating activities for the three months ended March 31, 2007 and 2006 was $4.06 million and $2.29 million, respectively. Cash flow from operating activities for the nine months ended March 31, 2007 and 2006 was $12.37 million and $9.07 million, respectively.

Implementation of one or more of the Company's growth strategies, combined with the continued integration of Peer 1 Dedicated Hosting, may have short-term negative impact on its expenses and cash flow from operations.

### Investing Activities

Cash used by investing activities for the three months ended March 31, 2007 and 2006 was $2.70 million and $2.15 million, respectively. The increase in use of cash for the three month period ended March 31, 2007 compared to the same period last year is a result of capital expenditures to fund the Company's operations and growth strategy, which includes purchases of cabinets/cages, computer software and equipment, such as servers, routers and firewalls. Cash used by investing activities for the nine months ended March 31, 2007 and 2006 was $8.51 million and $24.43 million, respectively. The decrease in use of cash for the nine month period ended March 31, 2007 compared to the same period last year was a result of the purchase of Interland's dedicated server assets on September 2, 2005.

### Financing Activities

Cash used by financing activities for the three months ended March 31, 2007 was $0.13 million compared to $0.47 million for the three months ended March 31, 2006 as a result of an increase in share capital issued during the current quarter. Cash used by financing activities for the nine months ended March 31, 2007 was $0.03 million compared to cash provided by financing activities for the same period last year of $20.07 million. The decrease in cash from financing activities for the nine months ended March 31, 2007 compared to the same period ended March 31, 2006 is a result of the financings and re-capitalization undertaken in conjunction with the acquisition of the dedicated server assets from Interland in September 2005, as discussed in the Company's first and second quarter fiscal 2006 financial statements and MD&A.

## OFF-BALANCE SHEET ARRANGEMENTS

As of March 31, 2007 the Company has provided two letters of credit totaling $0.5 million as security to a landlord for a facility lease and for a major supplier. The security for the facility lease will be required for the term of the lease, whereas the security for the suppliers is dependant on whether the Company continues to use the same suppliers, the extent to which a sufficient credit history is established with the suppliers to reduce or negate the need for such security, and other similar discretionary factors. The letters of credit are secured by way of term deposits which are included in the reported cash balance. The financial statements classify these term deposits as restricted cash.

## TRANSACTIONS WITH RELATED PARTIES

Peer 1 has 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 March 31, 2007 amounts due to and from related parties were as follows:

| | FY2007 | FY2006 |
|---|---|---|
| Accounts receivable from related companies | $8,538 | $80,391 |
| Accounts payable to related party | $11,186 | $30,477 |

During the nine month period ending March 31, 2007 transactions with related parties were as follows:

| | FY2007 | FY2006 |
|---|---|---|
| Revenues earned by the Company from related parties | $72,669 | $76,739 |
| Interest expensed by the Company | - | $334,287 |
| Other expenses incurred by the Company | $360,698 | $224,314 |

These transactions are in the normal course of operations and are measured at their exchange amounts. Other expenses incurred include fees in the amount of $342,973 for management and consulting services provided by related parties.

**Details of related party transactions for the three months ended March 31, 2007**

| Related person or entity | Related person | A/R | A/P | USD Revenue | Interest | Other | |
|---|---|---|---|---|---|---|---|
| Celerity Partners | Mark Benham | - | 2,005 | - | - | 2,005 | Expense chargeback $2,005 |
| Code Marketing Ltd. | Lance Tracey | - | - | - | - | 65,558 | Management fees $65,558 |
| E-Xact Transactions Ltd. | Scott Shaw, Lance Tracey | 5,524 | - | 14,556 | - | 149 | 1) Revenue from contract to provide colocation and bandwidth in Vancouver C$17,054.17…2) E-Xact provides Peer 1 with credit card gateway processing services C$174.87 |
| Fatport | Michael Cytrynbaum | 744 | - | 1,890 | - | - | Revenue from contract to provide colocation and bandwidth in Vancouver. |
| Pubsub Concepts Inc. | Lance Tracey | - | - | - | | 1,000 | Revenue from contract to provide colocation and bandwidth in New York. Other expenses due to written off account receivable. |
| Sutton Group Realty Services Ltd. | Scott Shaw, Lance Tracey | 2,271 | 9,181 | - | - | 26,573 | Consulting expenses CDN$10,000 per month |
| | | 8,538 | 11,186 | 16,446 | - | 95,285 | |

## SUBSEQUENT EVENTS AND PROPOSED TRANSACTIONS

- On April 12, 2007 the Company announced its partnership with ControlScan, a market leader in e-commerce security and marketing services. This partnership allows Peer 1 to offer its dedicated hosting customers an affordable solution for scanning their servers for the latest vulnerabilities. It also satisfies the rigorous payment card industry (PCI) compliance scan requirements. Peer 1 utilizes ControlScan's award-winning, PCI-approved scanning solution to provide a safe platform from which their customers can perform online business. Peer 1 customers will be actively scanned for over 14,000 known vulnerabilities with a database that is updated twice daily. This will ensure their servers are safe and protected from recent threats. This system will also allow Peer 1 customers to gain greater insight and management of their hosted server's security.

- On April 18, 2007 Peer 1 announced that it has completed the installation of the IBM Tivoli Storage Manager software, and is offering its managed dedicated hosting (www.dedicatedhosting.com) customers world-class enterprise data backup services. The new Tivoli data backup solution is built on Peer 1's SAN technology, and gives customers storage management efficiencies by reducing file recovery time and disk consumption. The solution also allows Peer 1 to manage thousands of servers at one time, regardless of their geographical location. This is especially beneficial to the Company, which supports over 16,000 servers in 15 data centers across North America.

- Following the quarter ended March 31, 2007 and as of the date of this MD&A, in accordance with the pre-existing terms of the Preferred Shares Series A, the holders of the 7,000 Preferred Shares Series A have converted all 7,000 shares and cumulative compounded unpaid dividends into 34,869,628 common shares of Peer 1. The conversion of the Preferred Shares Series A is calculated based on multiplying the face value of $1,000 for each preferred share by the number of preferred shares (7,000), adding the cumulative compounded unpaid dividends totaling $988,631, and then dividing this total 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.

- On May 25, 2007 Peer 1 entered into a $40 million amended and restated loan agreement with Fortress Opportunities I LP ("Fortress"), of which $20 million will be outstanding as of May 29, 2007 ("the Closing Date") . The loan agreement (the "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 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 $20 million; and a line of credit facility (the "Line"), in the maximum amount of $20 million.

  The Term Loan

  On the Closing Date, the Closing Date Outstanding Principal ("Principal Balance") will be $20 million. The Principal Balance will be comprised of the aggregate principal outstanding under previous term loan facilities with Fortress 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 $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 notice to Fortress no less than 90 days before the Maturity Date.

  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 $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 the date of this MD&A, 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, trademarks, 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% |

## OUTSTANDING SHARE DATA

Peer 1 has authorized share capital of unlimited common shares without par value and unlimited preferred shares without par value. At March 31, 2007 79,524,163 common shares were issued and outstanding. As of the date of this MD&A 114,610,791 common shares were issued and outstanding.

At March 31, 2007 6,239,904 warrants for the purchase of shares ranging in price from $0.23 to CAD$0.40 (approximately US$0.3432) were outstanding. As of the date of this MD&A nil warrants have been issued or exercised subsequent to the end of the quarter.

As at March 31, 2007 6,674,600 stock options were outstanding under the Company's stock option plan. Subsequent to the quarter ended March 31, 2007 and as of the date of this MD&A, 217,000 options were exercised and nil additional options have been granted. Stock options outstanding as of the date of this MD&A are 6,457,600

If all warrants and options were exercised there would be a total of 127,308,295 shares outstanding as of the date of this MD&A.

## CRITICAL ACCOUNTING ESTIMATES

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

In estimating the allowance for doubtful accounts, management reviews the payment history of current customers as well as overall historical collection trends. Our allowance varies by line of business and ranges from approximately 1-2.5% of annual revenues in the bandwidth and co-location business and approximately 1% in the dedicated hosting lines of business.

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

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

The Company recognized future income tax assets in the amount of $0.36 million for the three and nine months ended March 31, 2007 relating to accumulated non-capital tax losses and temporary differences. There are also additional temporary differences between accounting income and income for tax purposes in the amount of approximately $6.2 million as well as non-capital losses in the amount of approximately $3.4 million. Management believes there is sufficient uncertainty regarding the realization of additional future tax assets relating to these items such that a valuation allowance has been provided. Management evaluates the taxable position of the Company quarterly and considers factors including estimated taxable income, the history of losses for tax purposes, and growth of the Company.

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

## ACCOUNTING POLICIES

The Company prepares its financial statements on the basis of accounting principles generally acceptable in Canada. All accounting policies have been applied on a basis consistent with that of the previous year.

## RISKS

### Operating Results are Expected to Fluctuate

The company has experienced fluctuations in its operating results on a quarterly and on an annual basis. In view of the rapidly evolving nature of the Company's business, and the risk explained herein and those that are included in filings with regulatory authorities, the Company believes that period-to-period comparisons should not be relied upon as an indication of future performance. The Company expects that operating results will continue to fluctuate in the foreseeable future due to a variety of factors, including but not limited to:

- changes in general economic conditions and specific market conditions in the telecommunications and Internet industries;
- the timing and magnitude of operating expenses, capital expenditures and expenses relating to the expansion of sales, marketing, operations and acquisitions, if any, of related or complementary businesses and assets;
- the cost and availability of adequate public utilities, including power; and
- certainty that customer contracts will be renewed upon expiry.

Any of the foregoing factors could have material adverse effect on the Company's business, results of operations or financial condition.

**Competition**

The Company operates in a competitive market. The company competes on the basis of certain factors including the ability to provide its customers with scalable Internet operations and infrastructure, the use of private backbone connections and the ability to provide redundant, high-speed connectivity to the Internet. There is no assurance the Company's current and future competitors will not be able to develop co-location services, dedicated servers or other infrastructure expertise comparable or superior to those developed by the Company or to adapt more quickly than the Company to new technologies, evolving industry standards or customer requirements. Certain of Peer 1's competitors or potential competitors have or may have far greater financial resources, brand recognition and established business relationships with enterprises in Peer 1's target market than Peer 1 at the present time.

**Price Sensitive Market**

Peer 1's offerings are currently priced on a value basis. However, the competitive market in which Peer 1 conducts its business could require the Company to reduce its prices. If Peer 1's competitors offer discounts on certain products or services in an effort to recapture or gain market share or to sell other products, the Company may be required to lower prices or offer other favorable terms to compete successfully. Any such changes would likely reduce Peer 1's margins and could adversely affect operating results.

**Currency Fluctuations**

The Company's revenues and costs are affected by fluctuations in the rate of exchange between the Canadian dollar and the US dollar. Exposure to exchange rate fluctuations exists because a portion of the Company's revenues, trade receivable and trade payables are in Canadian and US dollars depending on the location of business. The Company expects that Canadian and US dollar sales and expenses will continue to account for a material portion of operations for the foreseeable future. As a result, exchange rate fluctuations may affect the Company's revenue and earnings growth materially in the future.

**Dependence on Key Suppliers**

The Company's operations are dependent on the timely delivery of materials by outside suppliers. While the Company enters into purchase agreements with a few of its suppliers, the Company cannot be sure that materials, components, and subsystems will be available in quantities required, if at all. If any of the suppliers fail to meet the Company's needs, it may not have readily available alternatives. The Company's inability to fill its supply needs would jeopardize its ability to satisfactorily complete the Company's obligations under its contracts on a timely basis. This might result in reduced sales, contractually imposed penalties for delay of services, termination of one or more of these contracts or damage to the Company's reputation and relationships with its customers. All of these events could have negative impact on the Company's financial condition.

**Integration Risk of Acquisitions**

The Company may pursue strategic relationships, investments and acquisitions. The Company may not be able to successfully manage its operations if it fails to successfully integrate the acquired technologies and/or businesses. The risks commonly encountered in the creation and execution of strategic relationships, investment in or acquisition of businesses would accompany any future investments or acquisitions by the Company. Such risks may include the following:

- issues related to product transition (such as development, distribution and customer support);
- the substantial management time devoted to such activities;
- the potential disruption of the Company's on-going business;
- undisclosed liabilities;
- failure to realize anticipated benefits (such as synergies and costs savings);
- the difficulty in integrating potentially distinct businesses into one business unit; and
- technological uncertainty regarding the current and future functionality of products and services.

## OTHER INFORMATION

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