



NETWORK | CO-LOCATION | DEDICATED HOSTING

Management's Discussion & Analysis
For The Fiscal Year Ended June 30, 2006



**MANAGEMENT'S DISCUSSION AND ANALYSIS
OF FINANCIAL RESULTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

This Management Discussion and Analysis ("MD&A"), dated October 27, 2006, should be read in conjunction with Peer 1's unaudited first, second and third quarter 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 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

Fiscal Year Financial Highlights

- Peer 1's revenue increased 212.4% to \$60.7 million for the year ended June 30, 2006, compared to \$19.4 million for the year ended June 30, 2005;
- Gross profit was \$21.4 million for the year ended June 30, 2006, an increase of \$13.8 million from \$7.6 million for the year ended June 30, 2005;
- Operating income was \$4.0 million for the year ended June 30, 2006 an increase of \$3.7 million from the operating income of \$0.3 million for the year ended June 30, 2005.
- Net loss was \$3.2 million for the year ended June 30, 2006, compared to a net loss of \$2.2 million for the year ended June 30, 2005.
- Cash flow from operating activities for the year ended June 30, 2006 was \$13.6 million, compared to \$3.7 million for the year ended June 30, 2005.

Fiscal Year Key Developments

- On September 2, 2005 Peer 1 closed a \$14.0 million acquisition of the dedicated server assets of Interland, Inc. The assets included data centers in Atlanta, GA; Fremont, CA; and Miami, FL, totaling over 115,000 square feet and 8,300 servers.
- Peer 1 completed a \$36 million re-capitalization to fund the acquisition of Interland, Inc.'s dedicated server assets and to improve liquidity and working capital.
- As of October 1, 2005 the Company changed its functional and reporting currency to US dollars.
- In October 2005, Peer 1 established a 25,000 square-foot data center in Los Angeles to better serve the city's online entertainment and gaming industries.

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 datacenters 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 Servers

Peer 1 provides competitively priced, unmanaged and managed dedicated server solutions to small and mid-size businesses, and technology hobbyists. The acquisition of ServerBeach on October 20, 2004 and the dedicated server assets of Interland, Ltd. 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.

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.

Co-location

Peer 1's co-location service involves the physical locating of a customer's switching gear and/or servers in one of our datacenter facilities that provide 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 security. Co-location customers are charged for the service provided by way of a monthly rental charge.

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, SAN, 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 secondly, 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.

SELECTED ANNUAL INFORMATION

(in \$ thousands, except per share items)	Year Ended June 30,		
	2006	2005	2004
Statement of Operations Data			
Dedicated Servers	42,335	5,811	-
Bandwidth	8,588	7,094	6,645
Colocation	7,919	5,556	3,601
Services	1,884	977	624
Total Revenue	60,726	19,438	10,870
Total Cost of Sales	39,295	11,889	6,900
Gross Profit	21,431	7,549	3,971
Total Operating Expenses	17,401	7,225	4,004
Operating Income (Loss)	4,030	324	(33)
Non-Operating expenses:	6,828	2,506	761
Income Taxes	390	-	-
Net Loss	3,188	2,182	794
Net Income per share (basic & diluted)	(0.04)	(0.04)	(0.02)
Balance Sheet Data			
Cash (including Restricted cash)	6,171	792	797
Current Assets	12,133	3,621	2,793
Total Assets	48,283	19,557	7,768
Current portion of notes payable	3,664	10,992	1,490
Current Liabilities	17,938	19,023	3,763
Deferred lease inducements	423	314	123
Notes Payable	17,388	95	2,709
Long Term Debt	8,087	-	-
Total Liabilities	43,836	19,432	6,595
Shareholders Equity	4,447	125	1,173
Total Liabilities & Shareholders Equity	48,283	19,557	7,768

RESULTS OF OPERATIONS

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 2004, Peer 1's primary focus was on providing bandwidth and co-location services, which represented over 94% of the Company's consolidated revenue. In 2006, 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 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.

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 continue 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.

(in \$ thousands, except per share items)	Year Ended June 30,			
	2006	%	2005	%
Dedicated Servers	42,335	70%	5,811	30%
Bandwidth	8,588	14%	7,094	36%
Colocation	7,919	13%	5,556	29%
Services	1,884	3%	977	5%
Total Revenue	60,726	100%	19,438	100%

Consolidated revenue increased 212.4% to \$60.7 million for the year ended June 30, 2006 from \$19.4 million for the year ended June 30, 2005. The increase in revenue for the year is attributable to the addition of ten months revenue from the Dedicated Hosting acquisition and 12 months of revenue from ServerBeach compared to nil revenue from Dedicated Hosting and eight months of revenue from ServerBeach in the prior year.

Bandwidth revenues increased 21.1% to \$8.6 million in the year ended June 30, 2006 from \$7.1 million in the year ended June 30, 2005. The increase is a result of organic growth and the addition of new customers – a large percentage of growth was related to increased bandwidth usage by one of the Company's largest customers.

Co-location revenues increased 42.5% to \$8.0 million in the year ended June 30, 2006 from \$5.6 million for the year ended June 30, 2005. The increase is directly attributable to growth in the customer base - the number of co-location customers increased to 867 at the end of the year of fiscal 2006 from 817 from the end of the 2005 fiscal year.

Dedicated server revenues increased 628.5 % to \$42.3 million for the year ended June 30, 2006 from \$5.8 million for the year ended June 30, 2005. The increase is attributable to ten months of revenue recognition from the Dedicated Hosting acquisition and 12 months of revenue recognition from the ServerBeach acquisition, increased customer usage, addition of new customers and an overall decrease in customer churn rates.

The Company's Canadian operations accounted for 23% of revenues in the year ended June 30, 2006 compared to 57% of revenues in the year ended June 30, 2005. This significant change is the result of the ServerBeach and the Dedicated Hosting acquisitions.

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, software licenses and supplies. Variable costs consist of power consumption, and incremental bandwidth from upstream carriers.

Consolidated cost of sales increased 230.5 % to \$39.3 million for the year ended June 30, 2006 from \$11.9 million for the year ended June 30, 2005. Cost of sales as a percentage of revenue increased to 64.7% in the year ended June 30, 2006 from 61.2% for the year ended June 30, 2005. The cost of sales increase is as a result of the ServerBeach and the Dedicated Hosting acquisitions.

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 are primarily affected by the cost of facilities. The cost of sales related to bandwidth are 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 costs of facilities, costs of servers and bandwidth costs.

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.

(in \$ thousands)	Year Ended June 30,			
	2006	%	2005	%
Operating Expenses	17,401	29%	7,225	37%

Total operating expenses increased 140.8 % to \$17.4 million for the year ended June 30, 2006 from \$7.2 million for the year ended June 30, 2005, as a result of the ServerBeach and the Dedicated Hosting acquisitions. Operating expenses as a percentage of revenue decreased to 29% in the year ended June 30, 2006 from 37% for the year ended June 30, 2005.

The largest component of operating expenses is general and administrative which for Fiscal year 2006 accounted for 69% of total operating expenses compared to 58% in the same period of the prior fiscal year. The increase in general and administration costs as a percentage of total operating expenses is a result of the acquisition of Dedicated Hosting and increased staffing and overhead costs to manage larger business operations compared to the same period a year ago. 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 over time as a percentage of revenue.

Sales and marketing decreased to 25% of total operating expenses in 2006 compared to 32% in the same period of the prior fiscal year. The decrease in sales and marketing expenses as a percentage of revenue is a result of increased efficiency and scale of a larger business base.

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 \$2.14 million in integration costs in the year ended June 30, 2006, of which \$1.19 million were expensed \$0.76 million was capitalized as internally developed software and \$0.19 million was capitalized as computer equipment. The Company anticipates expenses for these to activities continue through April 2007. Integration costs include cost of new billing, ticketing and customer support systems in addition to separation of business operations.

Liquidity and Capital Resources

Peer 1 has historically financed operations through cash generated from operations, sale of common and preferred shares and issuance of debt. As at June 30, 2006, the Company had cash, cash equivalents and short term investments of \$6.1 million (including \$0.5 million in restricted cash – see Off-Balance Sheet Arrangements section), compared to \$0.8 million (including \$0.5 million in restricted cash) as at June 30, 2005. The Company had long term debt (in the form of Preferred Shares Series A, please refer to the Company’s 2005 annual report for more information) of \$8.1 million and notes payable of \$21.0 million as at June 30, 2006 compared to nil long term debt and notes payable (including shareholder notes) of \$13.3 million as at June 30, 2005.

The Company had a working capital deficit of \$5.8 million at June 30, 2006 compared to a working capital deficit of \$15.4 million as at June 30, 2005. The improvement in working capital is a result of the Company’s 2005 re-capitalization in conjunction with the Dedicated Hosting acquisition, as described below.

The working capital deficit of \$5.8 million at June 30, 2006 includes deferred revenue of \$3.7 million and current portion of notes payable of \$3.7 million. The Company anticipates current liquidity and cash generated from operations to be sufficient to fund existing operations for the foreseeable future.

Re-capitalization

On September 2, 2005 Peer 1 entered into a US\$36 million loan agreement with Fortress Credit Corp., of which US\$24 million has been advanced. The loan agreement (the “LSA”) is by and among Peer 1 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”), and Fortress Credit Corp. (“Fortress”) as the lender, arranger and administrative agent.

Pursuant to the LSA, Fortress agreed to make three loan facilities available to the Borrowers: a term loan which was advanced on September 2, 2005 in the amount of US\$24 million; a term loan (the “Incremental Term Loan”) of up to US\$4 million (less if certain cash flow criteria specified in the LSA are not satisfied) and a revolving loan (the “Revolving Facility”) of up to US\$7 million until September 2, 2008 and US\$10 million thereafter until September 2, 2010 if the maturity date is extended by the Company for two years in accordance with the terms of the LSA.

The obligation of the Lender to make the Incremental Term Loan is subject to certain conditions precedents which have not yet been satisfied, including the provision of additional security for the obligations of the Borrowers under the LSA and a requirement that the request for such loan is made on or before November 22, 2005. The Company did not exercise the option to utilize the Incremental Term Loan, and no additional borrowings have been advanced under this loan facility.

The obligation of the lender to make the Revolving Facility is subject to certain conditions, including that no advance shall be made:

- (a) that would result in the aggregate borrowings under the LSA exceeding US\$24 million, such limit to increase to US\$28 million after the Incremental Term Loan is advanced;
- (b) if the aggregate amount advanced under the Revolving Facility in any 12 month period would exceed an amount determined with reference to the aggregate purchase price of certain equipment purchased by the Borrowers during such 12 month period; or
- (c) if the aggregate advances under the Revolving Facility during any 12 month period exceeds US\$2.5 million.

As of June 30, 2006 no borrowings have been advanced under the Revolving Facility.

The interest rate on borrowings under the LSA is LIBOR plus 6.5% per annum, subject to adjustment in certain specified circumstances. The borrowings must be repaid in installments, commencing on October 1, 2005. A portion of the net proceeds received by any of the Borrowers from the sale of assets or the issuance of equity securities must be used to prepay the loan. The maturity date of the loan is September 1, 2008, though the Company may extend the maturity date for two years by giving notice of such extension at least 90 days before September 1, 2008.

In connection with the LSA, the company issued warrants entitling the holders to acquire 2,306,571 common shares at a price per share of US\$0.23 for a period of 5 years.

The Company and its subsidiary, Peer 1 Network (USA) Inc. ("Peer 1 USA"), entered into a Series A Preferred Stock Purchase Agreement (the "SPA") dated September 2, 2005 with several investors (the "Investors") pursuant to which Peer 1 USA issued 7,000 shares of Series A Preferred stock in its capital at a price per share of US\$1,000, for aggregate proceeds of US\$7,000,000.

The Series A Preferred stock carries one vote per share and a cumulative annual dividend of 8%. In the event of any liquidation, dissolution or winding up of Peer 1 (USA), the holders of the Series A Preferred stock are entitled to receive, in preference to any distribution of the assets of Peer 1 (USA), an amount per share equal to the Liquidation Value for each share of Series A Preferred stock. The Liquidation Value of a share of Series A Preferred stock is:

- (a) for the period beginning on September 2, 2005 (the "Closing Date") through but excluding the second anniversary of the Closing Date, US\$1,000 per share,
- (b) for the period beginning on such second anniversary through but excluding the third anniversary of the Closing Date, US\$1,500 per share and
- (c) for the period beginning on the third anniversary of the Closing Date and thereafter, US\$2000, subject in each case to adjustments in certain circumstances.

At any time after the fourth anniversary of the Closing Date and provided that the amounts borrowed under the LSA have been repaid and the LSA has been terminated, any holder of shares of Series A Preferred stock may cause Peer 1 (USA) to redeem any or all of its outstanding shares of Series A Preferred stock at a price per share of US\$2000.

In connection with the SPA, the company and Peer 1 (USA) entered into an Investors' Rights Agreement (the "IRA") dated as of September 2, 2005 with the Investors. In addition to providing the Investors with rights to register their shares of Series A Preferred stock in the United States in certain circumstances, the IRA contains rights of put and call as follows:

- (a) Any Investor may require the Company to purchase for US\$2,000 per share any or all of its shares of Series A Preferred stock at any time after the fourth anniversary of the Closing Date, upon a liquidation, dissolution or winding up of the Company or upon a change of control.
- (b) At any time after the fourth anniversary of the Closing Date, the Company may require the Investors to sell all of their shares of Series A Preferred stock to the Company at a price per share of US\$2,000.
- (c) Any investor may at any time require the Company to purchase any or all of its shares of Series A Preferred stock in exchange for the number of common shares in the capital of the Company determined by dividing \$1,000 per share of Series A Preferred stock being exchange by US0.2291, subject to adjustment in certain specified circumstances.

Pursuant to the IRA, the company has granted to each Investor a right of first offer with respect to future sales by the company of any of its shares or securities convertible into or exchangeable or exercisable for any shares in the capital of the Company.

The preferred shares are classified as a liability as they are redeemable by the holders at US\$2,000 per share at anytime after four years. The \$US 14,000,000 redemption amount has been reduced by a discount on issuance of \$US 7,000,000 and is being accreted using the effective interest method over a period of four years.

The Company, Peer 1 (USA), the Investors and certain shareholders of the Company have entered into a Shareholder Agreement dated September 2, 2005 (the "Shareholder Agreement"). Pursuant to the Shareholder Agreement, Peer 1 has agreed to seek shareholder approval to increase its authorized share capital and cause its management to take all necessary actions so that a nominee of Celerity Partners SBIC, L.P. is a member of the board of directors of the Company.

Celerity Partners SBIC, L.P., of Menlo Park, California, acquired US\$4,090,000 and insiders of Peer 1 acquired US\$2,660,000 of the Series A Preferred stock.

On September 2, 2005, US \$5,902,793 of the Peer 1's indebtedness was settled in exchange for the issuance of 25,274,588 common shares of the Company, at a deemed price per share of Cdn \$0.2775 (approximately US \$0.2335).

Operating Activities

Cash flow from operating activities for the year ended June 30, 2006 and 2005 was \$13.6 million and \$3.7 million, respectively. The increase in cash provided by operations in the year ended June 30, 2006 resulted primarily from improvement in the Company's operating results as well as overall improvement in its working capital balances.

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

Investing Activities

Cash used for investing activities for the year ended June 30, 2006 and 2005 was \$27.5 million and \$13.6 million, respectively. The increase in use of cash is a result of capital expenditures to fund the Peer 1's operations and growth strategy, which includes cabinets/cages and computer equipment, such as servers, routers and firewalls. The increase in use of cash was also a result of the Dedicated Hosting acquisition on September 2, 2005.

Financing Activities

Net cash inflows from financing activities for the year ended June 30, 2006 was \$19.2 million compared to cash inflows from financing of \$9.5 million for the year ended June 30, 2005. The increase in cash from financing activities for the year ended June 30, 2006 is a result of the financings and re-capitalization undertaken in conjunction with the Dedicated Hosting acquisition - see "Acquisitions" and "Re-capitalization".

The gross proceeds from the \$7.0 million preferred share offering and the \$24 million debt facility (see "Re-capitalization") were used as follows: \$7.5 million used to repay bridge loans, \$2.0 million used to repay loans to related parties, \$14.6 million used to fund the Dedicated Hosting acquisition, \$0.7 million used for acquisition related costs, and the balance was added to working capital.

OFF-BALANCE SHEET ARRANGEMENTS

As of June 30, 2006 Peer 1 has provided two letters of credit totaling US\$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

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.

During the year ended June 30, 2006 transactions with related parties were as follows:

	FY2006	FY2005
Revenues earned	\$169	\$87
Interest expensed	\$322	\$1,205

Other expenses incurred \$365 \$60

These transactions were 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.

At June 30, 2006 amounts due to and from related parties were as follows (in \$000's):

	FY2006	FY2005
Included in accounts receivable	\$59	\$50
Included in accounts payable and accrued liabilities	\$26	\$(4)

The balances are payable on demand and have arisen from the sale of products and provisions of services as described in detail below for the year ended June 30, 2006.

Details of Related Party Transactions for year ending June 30, 2006

Related person or entity:	Related Person	A/R	A/P	Revenue	Interest	Other	Description
Caliber Management Ltd.	Scott Shaw	-	-	-	-	21	Consulting services
Celerity Partners	Mark Benham	-	-	-	-	11	Financing costs
Code Capital Ltd.	Lance Tracey	-	-	-	4	-	Interest
Code Marketing Ltd.	Lance Tracey	-	24	-	2	185	Interest and Management fees
DA Harrison & Associates	David Harrison	-	2	-	-	33	Consulting services
E-Xact Transactions Ltd.	Scott Shaw, Lance Tracey	12	0.2	65	-	1	Revenue from co-location and bandwidth services, other expenses of payment processing services
Fatport	Michael Cytrynbaum	2	-	9	-	-	Revenue for co-location and bandwidth services
Geoff Hampson	Geoff Hampson	-	-	-	5	-	Interest
Look Communications Inc.	Michael Cytrynbaum	-	-	-	-	0.1	Other expenses
Pubsub Concepts Inc.	Lance Tracey	44	-	73	-	-	Revenue for co-location and bandwidth services
Polygon Financial	Werner Paulus	-	-	-	236	-	Interest
Sutton Group Financial Services Ltd.	Scott Shaw, Lance Tracey	-	-	-	57	114	Interest and Consulting services
Sutton Group Realty Services Ltd.	Scott Shaw, Lance Tracey	-	-	-	-	0.1	Expense
Symmetric Broadband	50% Peer 1 Joint Venture	-	-	23	-	-	Revenue for co-location and bandwidth services
Werner Paulus	Werner Paulus	-	-	-	19	-	Interest
Total		59	26	169	322	365	

SUMMARY OF QUARTERLY RESULTS

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

	Quarter Ended (in thousands \$)							
	September 30	December 31	March 31	June 30	September 30	December 31	March 31	June 30
	2004 (US\$)	2004 (US\$)	2005 (US\$)	2005 (US\$)	2005 (US\$)	2005 (US\$)	2006 (US\$)	2006 (US\$)
Revenue	2,891	4,685	5,843	6,019	9,678	16,287	17,627	17,134
Operating Profit (Loss)	(50)	(114)	(12)	500	1,280	1,014	1,097	638
Net Income (Loss)	(238)	(529)	(762)	(654)	(1,018)	(481)	(355)	(1,333)
Pro forma basic and fully diluted income (loss) per share	(0.01)	(0.01)	(0.02)	(0.02)	(0.02)	(0.01)	(0.01)	(0.01)

FOURTH QUARTER RESULTS

Revenues for the fourth quarter of 2006 increased \$11.1 million to \$17.1 million, from \$6.0 million in the same quarter a year ago. The increase in revenue is primarily attributable to a full quarter of revenue from Dedicated Hosting as compared to nil revenue in the same quarter a year ago. Revenue mix for the quarter was 70% dedicated hosting, 13% co-location, 14% bandwidth and 3% from services.

Gross margin in the fourth quarter of 2006 was 32.8% compared to 40.2% in the same quarter a year ago. Gross margins in the managed dedicating hosting are lower than those in unmanaged dedicated hosting, co-location and bandwidth, with the result of overall lower gross margin percentage while overall gross profit increased \$3.2 million in the fourth quarter compared to the same period a year ago.

Operating expenses as a percentage of revenue decreased to 29.1% compared to 31.9% in the same quarter a year ago primarily due to increased operational efficiencies. During the quarter the Company had a number of one-time costs that include: severance expenses of \$0.3 million, legal, accounting and regulatory expenses of \$0.2 million.

The Company generated \$2.9 million in cash from operations in the fourth quarter. The Company used \$3.1 million of cash for investing activities, of which \$1.3 million was used for capital expenditures in the fourth quarter.

SUBSEQUENT EVENTS AND PROPOSED TRANSACTIONS

- On July 27, 2006 Peer 1 filed the Business Acquisition Report related to the Dedicated Hosting acquisition with the British Columbia Securities Commission. The Company is compliant with all securities regulations.
- On August 9, 2006 the Company exercised its option to purchase its leased Data Centre property located at 2300 NW Place, Miami, Florida.

The gross purchase price was \$4,617,266 and was subject to closing adjustments.

On September 26, 2006 the Company subsequently entered into a sale and leaseback arrangement for this property. The gross sales price was \$5,600,000. The Company leased the premises back from the purchaser for an initial term of 10 years with the option to renew for a further two 5 year periods.

After adjustments, the Company recorded a deferred gain of \$788,135 on this transaction.

- On September 7, 2006 the Company opened a new data center at 8500 Vicar Drive in San Antonio, TX with 12,000 square feet of raised floor space and an adjoining 6,000 square feet of office space.
- The Company committed to a lease for a 3,500 square foot expansion of its co-location facilities in Vancouver.

- On September 6, 2006 the Company announced that its Board of Directors had approved the adoption of a 2006 Combined Incentive and Nonqualified Stock Option Plan (“New Plan”) to replace the Company’s 2002 Incentive Stock Option Plan.

Under the new plan 15,468,382 common shares have been reserved for the issuance of options. This number of shares represents 20% of the Company’s outstanding share capital as at September 6th, 2006. The previous plan had a reserve of 10% of the outstanding share capital from time to time.

The new plan is subject to shareholder and TSX Venture Exchange approval. Approval is required on or before February 28, 2007 or the New Plan will terminate.

On September 6, 2006 the Company’s Board of Directors granted options to certain non-director officers of the Company to acquire 2,973,100 shares. These options are exercisable at a price of \$0.63 per share, and have a term of five years, expiring on September 6th, 2011.

The options vest, subject to adjustment in certain circumstances, as to one third on September 6th, 2007 and two thirds monthly in equal amounts over the 24 months ending September 6th, 2009.

In addition 828,000 of the options granted, included in the above total, are exercisable only after all requisite approvals of the new plan have been obtained.

OUTSTANDING SHARE DATA

Peer 1 has authorized share capital of unlimited common shares without par value and unlimited preferred shares without par value. At June 30, 2006 77,325,913 common shares were issued and outstanding compared to 49,119,367 as at June 30, 2005.

At June 30, 2006 there were 6,239,904 warrants for the purchase of shares ranging in price from US\$0.23 to CAD\$0.40 (approximately US\$0.36) were outstanding compared to 2,334,215 as at June 30, 2005. As the date of this MD&A nil warrants have been exercised subsequent to the end of the fiscal year.

As at June 30, 2006 there were 5,024,750 stock options outstanding under the Company’s stock option plan compared to 3,647,250 stock options outstanding at June 30, 2005. 100,000 options were exercised after the fiscal year end; 2,973,100 additional options have been granted as of the date of this MD&A.

Under the preferred share financing described in the previous section, 7,000 preferred shares of Peer 1 Network (USA) Inc. were issued. By way of the Investor Rights Agreement, the holders of the preferred shares may require the Company to acquire any or all of their preferred shares in exchange for common shares of Peer 1. Subject to adjustment in specified circumstances, the conversion would be for 4,365 common shares of Peer 1 for each preferred share having a face value of \$1,000.

CRITICAL ACCOUNTING ESTIMATES

Management makes certain estimates in order to report the Company's financial position and results of operations. Such estimates include the collectability 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. The allowance for doubtful accounts is equal to 1.5% of revenue.

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 debt conversion features and issue of warrants is based on estimates of dividend yield (nil), expected volatility of the Peer 1 stock price (75%), risk-free interest rate (estimate changes over time as actual results change) and option term (varies depending on the warrants or options issued).

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

ACCOUNTING POLICIES

- Peer 1 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. Due to the Dedicated Hosting acquisition, the Company's US dollar revenues account for approximately 76% of total company revenues. Effective October 1, 2005, the Company changed its functional currency to the US dollar from the Canadian Dollar in order to more accurately represent the currency of the economic environment in which it operates as a result of increasing U.S. dollar denominated revenues and expenditures. Concurrent with the change in its functional currency, Peer 1 has adopted the U.S. Dollar as its reporting currency. All figures presented prior to October 1, 2005 for comparative purposes are also reported in U.S. dollars.
- Following the Dedicated Hosting acquisition, the Company's investment in software licences has materially increased. As a result, the Company has expanded its accounting policy with respect to classification of software and licenses. The expanded policy distinguishes personal computer software and licenses for internal use from software acquired for revenue-generating assets and higher value software with expected life that exceeds one year. Personal computer software licensed for internal use continues to be amortized over one year, whereas the new categories of software licences are amortized over their expected useful lives. In addition, all software licences are now classified as intangible assets instead of fixed assets. Comparative information has been restated to reflect this presentation.

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 U.S. 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 (execution) of a strategic relationship, 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 Peer 1 is available on SEDAR at www.sedar.com.