

Financial Statements of

Q9 NETWORKS INC.

Years ended October 31, 2006 and 2005



KPMG LLP
Chartered Accountants
Yonge Corporate Centre
4100 Yonge Street Suite 200
Toronto ON M2P 2H3
Canada

Telephone (416) 228-7000
Fax (416) 228-7123
Internet www.kpmg.ca

AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the balance sheets of Q9 Networks Inc. as at October 31, 2006 and 2005 and the statements of operations, cash flows and shareholders' equity for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at October 31, 2006 and 2005 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

A handwritten signature in black ink that reads 'KPMG LLP' in a cursive, stylized font. A horizontal line is drawn underneath the signature.

Chartered Accountants

Toronto, Canada

December 11, 2006

Q9 NETWORKS INC.

Balance Sheets
(In thousands)

October 31, 2006 and 2005

	2006	2005
Assets		
Current assets:		
Cash and cash equivalents	\$ 5,961	\$ 7,843
Short-term investments (note 2)	61,448	67,610
Accounts receivable	4,330	3,208
Unbilled revenue	345	752
Future tax asset (note 11)	667	–
Prepaid expenses	866	676
	<hr/>	<hr/>
	73,617	80,089
Restricted cash (note 3)	230	410
Other assets (note 4)	766	801
Future tax asset (note 11)	6,393	–
Property and equipment (note 5)	58,592	36,757
	<hr/>	<hr/>
	\$ 139,598	\$ 118,057
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 11,830	\$ 3,041
Deferred revenue	4,731	3,912
Notes payable (note 7)	434	542
	<hr/>	<hr/>
	16,995	7,495
Deferred revenue	755	646
Deferred gain on sale of property (note 5)	1,128	1,207
Leasehold inducements (note 8)	1,378	1,099
Asset retirement obligation (note 6)	930	631
Other long-term liabilities	1,158	701
Shareholders' equity (note 9):		
Capital Stock:		
Common shares	139,427	139,276
Contributed surplus	3,949	3,092
Deficit	(26,122)	(36,090)
	<hr/>	<hr/>
	117,254	106,278
Commitments and contingencies (note 13)		
	<hr/>	<hr/>
	\$ 139,598	\$ 118,057

See accompanying notes to financial statements.

On behalf of the Board:

_____ Director

_____ Director

Q9 NETWORKS INC.

Statements of Operations
(In thousands, except per share amounts)

Years ended October 31, 2006 and 2005

	2006	2005
Revenue:		
Co-location	\$ 22,779	\$ 16,296
Managed services	15,868	13,917
Managed bandwidth	6,651	6,591
Set-up fees	1,169	1,025
	<u>46,467</u>	<u>37,829</u>
Cost of revenue	<u>31,199</u>	<u>25,840</u>
Gross margin	15,268	11,989
Expenses:		
Sales and marketing	4,766	4,007
General and administrative	8,322	7,156
Amortization of property and equipment	1,008	535
	<u>14,096</u>	<u>11,698</u>
Income from operations	1,172	291
Interest income, net	2,543	1,670
Income before income taxes	3,715	1,961
Income tax expense (benefit) (note 11):		
Current	11	-
Future	(7,060)	-
Net income	<u>\$ 10,764</u>	<u>\$ 1,961</u>
Earnings per share (notes 9(a) and 12)		
Basic	\$ 0.53	\$ 0.10
Diluted	\$ 0.52	\$ 0.10
Weighted average number of shares outstanding (notes 9(a) and 12)		
Basic	20,299	20,204
Diluted	20,887	20,556

See accompanying notes to financial statements.

Q9 NETWORKS INC.

Statements of Cash Flows
(In thousands)

Years ended October 31, 2006 and 2005

	2006	2005
Cash provided by (used in):		
Operating activities:		
Net income	\$ 10,764	\$ 1,961
Items not involving cash:		
Amortization of property and equipment	9,112	8,294
Amortization of other assets (note 4)	46	32
Gain on sale of property	(79)	(79)
Accretion expense (note 6)	65	68
Net non-cash rent expense	736	471
Stock-based compensation expense	2,153	2,244
Future income taxes	(7,060)	-
Change in non-cash operating working capital (note 16)	1,318	(1,250)
	17,055	11,741
Financing activities:		
Issuance of notes payable	830	951
Repayment of notes payable	(938)	(1,198)
Repurchase of shares (note 9 (c))	(2,691)	(585)
Issuance of shares	610	1,002
	(2,189)	170
Investing activities:		
Purchase of property and equipment	(23,145)	(6,639)
Purchase of short-term investments	(243,776)	(107,845)
Sale of short-term investments	250,004	104,384
Increase in other assets	(11)	(833)
Decrease in restricted cash	180	730
	(16,748)	(10,203)
Increase (decrease) in cash and cash equivalents	(1,882)	1,708
Cash and cash equivalents, beginning of year	7,843	6,135
Cash and cash equivalents, end of year	\$ 5,961	\$ 7,843
Supplemental cash flow information:		
Interest received	\$ 2,506	\$ 1,544
Income taxes (received) paid	10	(77)
Supplemental disclosure of non-cash financing and investing activities:		
Effect of acquisition of property and equipment in accounts payable and accrued liabilities	(7,568)	121
Effect of repurchase of shares in accounts payable and accrued liabilities	140	(140)
Reduction of share capital (note 9(b))	-	39,275

See accompanying notes to financial statements.

Q9 NETWORKS INC.

Statements of Shareholders' Equity (In thousands)

Years ended October 31, 2006 and 2005

	Common shares Number	Amount	Contributed surplus	Deficit	Total
Balance, October 31, 2004	20,135	\$ 177,750	\$ 1,149	\$ (77,103)	\$ 101,796
Issuance of shares upon exercise of stock options (note 10)	200	1,002	–	–	1,002
Stock-based compensation (note 10)	–	–	2,244	–	2,244
Compensation cost of options exercised	–	301	(301)	–	–
Repurchase of shares (note 9 (c))	(73)	(502)	–	(223)	(725)
Reduction of deficit (note 9 (b))	–	(39,275)	–	39,275	–
Net income	–	–	–	1,961	1,961
Balance, October 31, 2005	20,262	\$ 139,276	\$ 3,092	\$ (36,090)	\$ 106,278
Issuance of shares upon exercise of stock options (note 10)	251	610	–	–	610
Stock-based compensation (note 10)	–	–	2,153	–	2,153
Compensation cost of options exercised	–	1,296	(1,296)	–	–
Repurchase of shares (note 9 (c))	(255)	(1,755)	–	(796)	(2,551)
Net income	–	–	–	10,764	10,764
Balance, October 31, 2006	20,258	\$ 139,427	\$ 3,949	\$ (26,122)	\$ 117,254

See accompanying notes to financial statements.

Q9 NETWORKS INC.

Notes to Financial Statements
(In thousands, except per share amounts)

Years ended October 31, 2006 and 2005

Q9 Networks Inc. (the "Company") is a leading Canadian provider of outsourced data centre infrastructure for organizations with mission-critical IT operations. The Company's common shares are listed on the Toronto Stock Exchange under the symbol "Q".

1. Significant accounting policies:

(a) Basis of presentation:

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP").

(b) Use of estimates:

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the year. Significant estimates are used in determining, but are not limited to, the valuation of accounts receivable, the estimated useful lives of property and equipment, the recoverability of long-lived assets, asset retirement obligation costs, the measurement of income tax valuation allowances and stock-based compensation expense. Actual results could differ from those estimates.

(c) Revenue recognition:

The Company's service offerings include the provision of physical space within its high security data centres ("co-location"), a comprehensive suite of managed services ("managed services"), and high availability Internet connectivity ("managed bandwidth"). Co-location is available in two basic configurations: secure cabinets and secure custom cages. Managed services include those related to the installation and maintenance of servers, firewalls, data backup, load balancing, Virtual Private Networks ("VPN") and remote links. Managed bandwidth involves the provision of bandwidth and Internet connectivity to the Company's highly redundant network.

Q9 NETWORKS INC.

Notes to Financial Statements (continued)
(In thousands, except per share amounts)

Years ended October 31, 2006 and 2005

1. Significant accounting policies (continued):

Revenue is earned from monthly charges for server co-location, managed services and managed bandwidth as contractually agreed upon between the Company and its customers for the various services provided and from one-time set-up fees. Revenue is generally recognized ratably over the term of the contract as the related services are provided to customers if evidence of an arrangement exists and collection is deemed probable by management. The one-time set-up fees are deferred and recognized in a systematic and rational manner over the longer of the contractual period, which typically varies from one to three years, or the expected customer relationship. Amounts billed but not yet earned are recorded as deferred revenue. Unbilled revenue is recorded for services delivered but not yet billed.

(d) Cash and cash equivalents:

Cash and cash equivalents consist of bank balances, net of outstanding cheques, and highly liquid money market instruments.

(e) Short-term investments:

Short-term investments consist of investment-grade fixed income securities, such as corporate and government notes. Short-term investments are recorded at lower of cost or market value and include accrued interest for interest-bearing instruments.

(f) Property and equipment:

Property and equipment are recorded at cost less accumulated amortization and any impairment losses recognized in accordance with note 1(h). Cost includes the direct cost to acquire or construct the asset and excludes interest. Amortization is provided on the straight-line basis over the estimated useful lives of the assets, beginning in the period in which the asset is put into use, as follows:

Computer hardware	2 - 3 years
Computer software	1 year
Furniture and equipment	5 years
Leasehold improvements	5 – 15 years

(lesser of useful life and expected term of lease)

Q9 NETWORKS INC.

Notes to Financial Statements (continued)
(In thousands, except per share amounts)

Years ended October 31, 2006 and 2005

1. Significant accounting policies (continued):

(g) Other assets:

Other assets consist of the prepaid acquired rights to use certain dark fibres and associated property. Acquired rights are recorded at cost and amortized on a straight-line basis over the period of benefit, generally 20 years.

(h) Impairment of long-lived assets:

The Company reviews long-lived assets for impairment when events or changes in circumstances indicate that the carrying amount may not be recoverable. If the sum of the undiscounted future cash flows expected to result from the use and eventual disposition of a group of assets is less than its carrying amount, it is considered to be impaired. An impairment loss is measured as the amount by which the carrying amount of the group of assets exceeds its fair value.

(i) Leases and leasehold inducements:

The total lease payments over the term of premises leases with future contractual increases are expensed on a straight-line basis over the expected term of the lease. Lease costs related to the pre-operating phase of new facilities are expensed as incurred.

Leasehold inducements received in connection with the leasing of premises are amortized on a straight-line basis over the expected term of the lease. Such amortization is recorded as a reduction of rent expense.

(j) Income taxes:

The Company uses the asset and liability method of accounting for income taxes. Future income tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. When necessary, a valuation allowance is recorded to reduce income tax assets to an amount where realization is more likely than not. Future tax assets and liabilities are measured using enacted or substantively enacted tax laws and rates in effect for the year in which those temporary differences are expected to be recovered or settled. The effect on future tax assets and liabilities of a change in tax laws and rates is recognized as part of the provision for income taxes in the year that includes the enactment date (or the year in which the changes in rates are substantively enacted).

Q9 NETWORKS INC.

Notes to Financial Statements (continued)
(In thousands, except per share amounts)

Years ended October 31, 2006 and 2005

1. Significant accounting policies (continued):

(k) Stock-based compensation:

The Company has prospectively applied the fair value method of accounting for stock option awards to employees granted after November 1, 2003 and, accordingly, has recorded compensation expense for such awards. The fair value of option grants is recognized as compensation expense over the service period. Forfeitures are accounted for as they occur. The Company's stock option plan is described in note 10.

Prior to November 1, 2003, the Company accounted for its employee stock options using the settlement method and no compensation expense was recognized. For awards granted to employees from November 1, 2002 to October 31, 2003, accounting standards require the disclosure of pro forma net income and earnings per share information as if the Company had accounted for employee stock options under the fair value method. The pro forma effect of awards granted to employees prior to November 1, 2002 has not been included in the pro forma net income and earnings per share information.

Pro forma disclosures giving effect to the fair value for awards granted to employees from November 1, 2002 to October 31, 2003 are as follows:

	2006	2005
Net income	\$ 10,764	\$ 1,961
Pro forma stock-based compensation expense	–	(10)
Pro forma net income	\$ 10,764	\$ 1,951
Earnings per share, as reported:		
Basic	\$ 0.53	\$ 0.10
Diluted	0.52	0.10
Pro forma earnings per share:		
Basic	0.53	0.10
Diluted	0.52	0.10

The weighted average estimated fair value at the date of grant for options granted for the years ended October 31, 2006 and 2005 was \$3.71 and \$3.89, respectively.

Q9 NETWORKS INC.

Notes to Financial Statements (continued)
(In thousands, except per share amounts)

Years ended October 31, 2006 and 2005

1. Significant accounting policies (continued):

The estimated fair value of each option granted to employees and directors in the years above was estimated on the date of the grant using the Black-Scholes option-pricing model with the following assumptions:

	2006	2005
Weighted average risk-free interest rate	4.00%	3.40%
Dividend yield	0%	0%
Weighted average expected life of the options	5 years	5 years
Weighted average volatility	38%	47%

(l) Earnings per share:

Basic earnings per share has been computed by dividing the net income for the year by the weighted average number of common shares outstanding for the year. Diluted earnings per share is computed based on the weighted average number of common shares outstanding for the year plus common share equivalents consisting of shares subject to stock options, if dilutive. The number of additional shares is calculated using the treasury stock method, which assumes that outstanding stock options are exercised and that proceeds from such exercises are used to acquire shares of common stock at the average market price during the year.

(m) Financial instruments:

(i) Fair value:

The carrying amounts of cash and cash equivalents, short-term investments, accounts receivable, unbilled revenue, restricted cash, and accounts payable and accrued liabilities approximate their fair values due to the short-term nature of these instruments.

The fair value of the Company's notes payable approximates its carrying value, as they are due within one year.

Q9 NETWORKS INC.

Notes to Financial Statements (continued)
(In thousands, except per share amounts)

Years ended October 31, 2006 and 2005

1. Significant accounting policies (continued):

(ii) Concentration of credit risk:

Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of cash and cash equivalents, short-term investments and accounts receivable. Cash and cash equivalents consist of deposits with, or guaranteed by, major commercial banks. Short-term investments consist of investment-grade fixed income securities. With respect to accounts receivable, the Company performs periodic credit evaluations of the financial condition of its customers and, in certain instances, requires collateral from them. Management assesses the need for allowances for potential credit losses by considering the credit risk of specific customers, historical trends and other information.

At October 31, 2006, two customers represented 10% and 9% of accounts receivable, respectively. At October 31, 2005, two customers represented 18% and 12% of accounts receivable, respectively.

(n) Asset retirement obligations:

The Company recognizes the fair value of a liability for an asset retirement obligation in the period in which it is incurred or when a reasonable estimate of fair value can be made. Fair value is based on the present value of future cash flows discounted at a credit-adjusted risk-free rate of interest. The corresponding increase in property and equipment is amortized into income on the same basis as the related asset. The accretion expense and corresponding increase to the liability are recognized each period. Subsequent to the initial measurement, period-to-period changes in the liability are recognized for revisions to either the timing or the amount of the original estimate of undiscounted cash flows. Actual costs incurred upon settlement are charged against the asset retirement obligation. Any difference between the actual costs and the recorded liability is recognized as a gain or loss in earnings in the period in which the settlement occurs.

Q9 NETWORKS INC.

Notes to Financial Statements (continued)
(In thousands, except per share amounts)

Years ended October 31, 2006 and 2005

1. Significant accounting policies (continued):

(o) Recent pronouncements:

- (i) In January 2005, the CICA released new Handbook Section 3855, Financial Instruments, Recognition and Measurement, effective for annual and interim periods beginning on or after October 1, 2006. This new section establishes standards for the recognition and measurement of all financial instruments, provides a characteristics – based definition of a derivative financial instrument, provides criteria to be used to determine when a financial instrument should be recognized, and provides criteria to be used when a financial instrument is to be extinguished. As a result, effective November 1, 2006 the Company will record all financial instruments on the balance sheet at fair value, with changes in fair value recognized in income or other comprehensive income, as appropriate, each period.
- (ii) In January 2005, the CICA released new Handbook Section 1530, Comprehensive Income and Section 3251, Equity, effective for annual and interim periods beginning on or after October 1, 2006. Section 1530 establishes standards for reporting comprehensive income. It defines other comprehensive income to include revenues, expenses, gains and losses that, in accordance with primary sources of GAAP, are recognized in comprehensive income, but excluded from net income. Section 1530 does not address issues of recognition or measurement for comprehensive income and its components. Section 3251 establishes standards for the presentation of equity and changes in equity during the reporting period. The requirements in Section 3251 are in addition to Section 1530 and recommend that an enterprise should present separately the following components of equity: retained earnings, accumulated other comprehensive income, the total of retained earnings and accumulated other comprehensive income, contributed surplus, share capital and reserves. The adoption of these standards effective November 1, 2006 is not expected to have a significant impact on the Company's financial statements.
- (iii) In January 2005, the CICA released new Handbook Section 3865, Hedges, effective for annual and interim periods beginning on or after October 1, 2006. This new section establishes standards for when and how hedge accounting may be applied. The adoption of this standard effective November 1, 2006 is not expected to have any impact on the Company's financial statements.

Q9 NETWORKS INC.

Notes to Financial Statements (continued)
(In thousands, except per share amounts)

Years ended October 31, 2006 and 2005

1. Significant accounting policies (continued):

(iv) In June 2005, the CICA released new Handbook Section 3831, Non-monetary Transactions, effective for fiscal periods beginning on or after January 1, 2006. This standard requires all non-monetary transactions to be measured at fair value unless they meet one of four very specific criteria. Commercial substance replaces culmination of the earnings process as the test for fair value measurement. A transaction has commercial substance if it causes an identifiable and measurable change in the economic circumstances of the entity. The Company is currently evaluating the impact of this standard on its financial statements.

2. Short-term investments:

	2006		2005	
	Market Value	Carrying Value	Market Value	Carrying Value
Guaranteed Investment Certificates	\$ 782	\$ 782	\$ 4,928	\$ 4,928
Government and Crown Corporation Bonds	8,336	8,336	—	—
Corporate Bonds	52,330	52,330	62,585	62,682
	\$ 61,448	\$ 61,448	\$ 67,513	\$ 67,610

3. Restricted cash:

The restricted cash represents cash on deposit and letters of credit, which have been provided as security to certain property owners. The letters of credit expire on various dates ending June 2007.

Q9 NETWORKS INC.

Notes to Financial Statements (continued)
(In thousands, except per share amounts)

Years ended October 31, 2006 and 2005

4. Other assets:

The Company acquired the rights to use certain dark fibres and associated property. The rights are amortized ratably over the agreements, generally 20 years. Cost and accumulated amortization of these rights as at the end of each year were as follows:

	2006	2005
Cost	\$ 844	\$ 833
Accumulated amortization	78	32
Net book value	\$ 766	\$ 801

5. Property and equipment:

2006	Cost	Accumulated amortization	Net book value
Computer hardware	\$ 15,676	\$ 12,956	\$ 2,720
Computer software	1,700	1,551	149
Furniture and equipment	5,118	501	4,617
Leasehold improvements	77,316	26,210	51,106
	\$ 99,810	\$ 41,218	\$ 58,592

2005	Cost	Accumulated amortization	Net book value
Computer hardware	\$ 13,144	\$ 10,777	\$ 2,367
Computer software	1,421	1,327	94
Furniture and equipment	1,394	750	644
Leasehold improvements	54,370	20,718	33,652
	\$ 70,329	\$ 33,572	\$ 36,757

Amortization of property and equipment related to data centres in the amount of \$8,071 and \$7,712 for the years ended October 31, 2006 and 2005, respectively, is included in cost of revenue in the statements of operations. The net carrying amount of leasehold improvements and equipment related to data centres not yet in use and therefore not being amortized as at October 31, 2006 was \$24,800.

Q9 NETWORKS INC.

Notes to Financial Statements (continued)
(In thousands, except per share amounts)

Years ended October 31, 2006 and 2005

5. Property and equipment (continued):

Leasehold improvements primarily consist of expenditures related to data centre builds.

On November 19, 2002, the Company signed a purchase and sale agreement for the land and building at its Brampton facility as part of a sale-leaseback transaction. The transaction closed in March 2003 for total consideration of \$12,500. The gain on the sale of \$1,417, based on the net book value at the time of closing, has been deferred and is being amortized into the statements of operations over the term of the lease.

6. Asset retirement obligation:

Asset retirement obligations are legal obligations associated with the retirement of long-lived tangible assets that result from their acquisition, lease, construction, development or normal operations. The asset retirement obligation relates to future site restoration costs related to the Company's leased facilities. Significant assumptions are required to estimate the fair value of asset retirement obligations, primarily related to the amount and timing of cash flows required to satisfy the Company's future legal obligation including labour costs based on current marketplace wages and the rate of inflation over expected years to settlement; the length of facility lease renewal periods and probability of such renewals; and, the appropriate discount rate to present value the future cash flows. The asset retirement obligation was determined using a discount rate of 12% over a range of periods from 2035 to 2051. As at October 31, 2006 and 2005, the amount of undiscounted cash flows required to settle this liability was \$32,235 and \$21,173, respectively.

The Company's asset retirement obligations at the end of each year were as follows:

	2006	2005
Obligation, beginning of year	\$ 631	\$ 563
Obligation incurred during the year	330	—
Revision in estimated cash flows	(96)	—
Accretion expense	65	68
Obligation, end of year	\$ 930	\$ 631

The accretion and amortization expense is included in cost of revenue in the Company's statement of operations. The Company recorded a total of \$82 and \$114 in accretion and amortization expense for 2006 and 2005, respectively.

Q9 NETWORKS INC.

Notes to Financial Statements (continued)
(In thousands, except per share amounts)

Years ended October 31, 2006 and 2005

6. Asset retirement obligation (continued):

During the year, the Company re-evaluated the timing of the original estimate of future cash flows based on current information, which resulted in a decrease in the asset retirement obligation of \$96.

7. Notes payable:

The Company has entered into a vendor-finance agreement with an equipment provider. In exchange for computer hardware, the Company issues non-interest bearing promissory notes that are repayable in equal monthly instalments over an eleven month period commencing one month after issuance and execution. These notes have not been discounted since the term to maturity is less than one year and the related imputed interest expense is not material. The notes are secured by the related equipment.

8. Leasehold inducements:

Leasehold inducements are as follows:

	2006	2005
Opening balance	\$ 1,099	\$ 1,013
Additions	524	252
Amortization	(245)	(166)
	<u>\$ 1,378</u>	<u>\$ 1,099</u>

9. Shareholders' equity:

(a) Authorized:

The Company's authorized capital stock includes an unlimited number of common shares.

(b) Deficit reduction:

On March 18, 2005, at the Company's Annual General and Special Meeting of Shareholders, shareholders approved a special resolution authorizing the reduction in stated capital by \$39,275, which also resulted in the reduction of the Company's deficit by the same amount.

Q9 NETWORKS INC.

Notes to Financial Statements (continued)
(In thousands, except per share amounts)

Years ended October 31, 2006 and 2005

9. Shareholders' equity (continued):

(c) Repurchase of shares:

Pursuant to the Company's Normal Course Issuer Bid ("NCIB"), as approved by the Toronto Stock Exchange, the Company was entitled to acquire up to a maximum of 1,015 or 5% of the issued and outstanding common shares from October 4, 2005 to October 3, 2006. During the year ended October 31, 2006, the Company purchased and cancelled a total of 255 shares under the NCIB, at an average cost of \$9.97 per share and a total cost, including commissions, of \$2,551, of which \$796 was charged to deficit and \$1,755 was charged to common shares.

On October 30, 2006, the Company renewed its NCIB. Under the terms of the NCIB, the Company may, during the twelve month period ending October 31, 2007, purchase on the Toronto Stock Exchange, up to a maximum of 1,013 or 5% of the issued and outstanding common shares. Common shares purchased under the NCIB will be cancelled.

(d) Warrants:

During fiscal 2001, the Company issued 8 warrants with a value of \$62 to a financial institution for no cash consideration. The warrants entitled the holder to acquire common shares of the Company at \$6.40 per share. During fiscal 2005, these warrants were exercised for no additional consideration in accordance with the original terms of the warrant agreement. As a result, the Company issued 3 shares for the exercise of these warrants. No warrants were outstanding at October 31, 2006 and 2005.

10. Stock-based compensation:

There are 2,300 common shares reserved for issuance under the Company's stock option plan. For those options granted prior to the closing of the initial public offering on April 29, 2004, with the exception of those options granted with a nominal exercise price, one-third of such options vest one year after the date of grant of the option and 1/24 of the remaining two-thirds vest each month thereafter. These options expire seven years after the date of the grant. For all options granted subsequent to the closing of the initial public offering on April 29, 2004, the exercise price of these options is based on the weighted average trading price of each of the five trading days immediately preceding the date of grant and will expire eight years after the date of grant. One-quarter of the option grants will vest one year after the date of grant and the remaining three-quarters of the options will vest evenly over the next 12 quarters. All options vest immediately upon a change of control of the Company. During the fiscal years ended October 31, 2006 and 2005, all option grants were to employees and directors of the Company.

Q9 NETWORKS INC.

Notes to Financial Statements (continued)
(In thousands, except per share amounts)

Years ended October 31, 2006 and 2005

10. Stock-based compensation (continued):

On April 28, 2004, the Company issued 813 employee stock options at an exercise price of \$0.05 per share. As these options have a nominal exercise price, they were accounted for as a direct award of shares. The fair value of these options at the date of issue, of \$8.50 less the exercise price, is being recorded as compensation cost, in the Company's statement of operations over the vesting period of such options. One-third of such options vest on each of the first, second and third anniversary of their date of grant. For the years ended October 31, 2006 and 2005, stock-based compensation expense related to these stock options was \$1,897 and \$2,174, respectively.

The Company's total stock-based compensation expense for the years ended October 31, 2006 and 2005 was \$2,153 and \$2,244, respectively with the corresponding increase to contributed surplus. Such compensation expense is included in the Company's statement of operations as follows: \$263 in cost of revenue, \$435 in sales and marketing expense and \$1,455 in general and administrative expense, for the year ended October 31, 2006, and \$236 in cost of revenue, \$416 in sales and marketing expense and \$1,592 in general and administrative for the year ended October 31, 2005.

Details of stock option transactions are as follows:

	2006		2005	
	Number	Weighted average exercise price	Number	Weighted average exercise price
Outstanding, beginning of year	1,769	\$ 4.30	1,815	\$ 3.89
Granted	138	9.92	193	8.51
Exercised	(251)	2.43	(197)	5.08
Cancelled	(64)	4.32	(42)	2.20
Outstanding, end of year	1,592	\$ 5.07	1,769	\$ 4.30

Range of exercise prices	Number outstanding	Weighted average exercise price	Weighted average remaining life (years)	Number exercisable	Weighted average exercise price
\$ 0.05	544	\$ 0.05	4.49	310	\$ 0.05
\$ 5.35 to \$6.96	637	6.28	1.28	625	6.27
\$ 7.96 to \$10.37	308	9.13	7.02	53	8.49
\$ 12.00	103	12.00	2.66	103	12.00
	1,592	\$ 5.07	3.58	1,091	\$ 5.15

Q9 NETWORKS INC.

Notes to Financial Statements (continued)
(In thousands, except per share amounts)

Years ended October 31, 2006 and 2005

11. Income taxes:

Income tax expense (benefit) in the statements of operations differs from the amount that would be computed by applying the federal and provincial statutory income tax rate of 36.12% for the years ended October 31, 2006 and 2005 to the net income before income taxes. These differences result from the following items:

	2006	2005
Computed tax expense	\$ 1,341	\$ 708
Increase (decrease) resulting from:		
Adjustment to future tax assets for substantially enacted changes in tax laws and tax rates	806	–
Effect of non-deductible expenditures	808	845
Large Corporations tax	11	–
Decrease in valuation allowance	(10,015)	(1,553)
Net provision for income tax benefit	\$ (7,049)	\$ –

The income tax effects of temporary differences at October 31, 2006 and 2005 that give rise to significant portions of future income tax assets are as follows:

	2006	2005
Future income tax assets:		
Non-capital income tax loss carryforwards	\$ 6,554	\$ 9,171
Property and equipment	4,008	4,153
Financing costs	506	773
Deferred gain on sale of property	34	63
Non-cash deferred rent	365	253
Leasehold inducements	473	397
Asset retirement obligation (note 6)	143	228
	12,083	15,038
Valuation allowance	(5,023)	(15,038)
Net future tax assets	\$ 7,060	\$ –

Q9 NETWORKS INC.

Notes to Financial Statements (continued)
(In thousands, except per share amounts)

Years ended October 31, 2006 and 2005

11. Income taxes (continued):

As at October 31, 2006, the Company has approximately \$19,002 of non-capital losses available that may be used to reduce future years' taxable income. The deductibility of these losses expires as follows:

2008	\$	856
2009		8,072
2010		10,074

In assessing the realizability of future income tax assets, management considers whether it is more likely than not that some portion or all of the future income tax assets will be realized. The ultimate realization of future income tax assets is dependent upon the generation of future taxable income during the years in which the temporary differences are deductible. Management considers the character of the income tax assets and the tax planning strategies in place when making this assessment. To the extent that management believes that the realization of future income tax assets does not meet the more likely than not realization criterion, a valuation allowance is recorded against the future tax assets.

In making an assessment of whether future income taxes are more likely than not to be realized, management regularly prepares information regarding the expected use of such assets by reference to its internal income forecasts. Based on management's estimates of the expected realization of future income tax assets, during 2006 the Company reduced the valuation allowance to reflect that it is more likely than not that certain future income tax assets will be realized.

Q9 NETWORKS INC.

Notes to Financial Statements (continued)
(In thousands, except per share amounts)

Years ended October 31, 2006 and 2005

12. Earnings per share:

The following table sets forth the calculation of basic and diluted earnings per share:

	2006	2005
Net income	\$ 10,764	\$ 1,961
Weighted average number of common shares	20,299	20,204
Stock options	588	352
	20,887	20,556
Basic earnings per share	\$ 0.53	\$ 0.10
Diluted earnings per share	0.52	0.10

The calculation of diluted earnings per share for the years ended October 31, 2006 and 2005 excludes the effect of the potential exercise of 171 and 297 stock options, respectively, because the effect would be anti-dilutive.

13. Commitments and contingencies:

(a) Future minimum obligations for contracts related to operating leases for premises and bandwidth and carrier circuits commitments as at October 31, 2006 are as follows:

2007	\$ 6,061
2008	5,165
2009	5,208
2010	5,220
2011	5,004
Thereafter	27,271
	\$ 53,929

In addition, the Company is contractually obligated to capital expenditures of \$4,889 as at October 31, 2006, related to the expansion of its data centre facilities.

Rent expense under operating leases for the years ended October 31, 2006 and 2005 was \$8,465 and \$6,314, respectively.

Q9 NETWORKS INC.

Notes to Financial Statements (continued)
(In thousands, except per share amounts)

Years ended October 31, 2006 and 2005

13. Commitments and contingencies (continued):

- (b) The Company has provided standard indemnifications to its landlords under certain property lease agreements for claims by third parties in connection with the Company's use of the premises. In addition, the Company may from time to time in the normal course of business provide indemnifications with respect to the procurement and provision of services. The maximum amount of these indemnifications cannot be reasonably estimated due to their nature. Historically, the Company has not made any payments relating to such indemnifications.
- (c) Subsequent to October 31, 2006, the Company has agreed to enter into separate indemnification agreements with its directors and certain officers to supplement the current indemnity provisions contained in the Company's by-laws.

14. Related party transactions:

The Company provides services in the normal course of business to customers that are affiliates of certain directors and officers of the Company. Revenue from these customers for the years ended October 31, 2006 and 2005 was \$2,957 and \$5,266, respectively. Accounts receivable from such customers as at October 31, 2006 and 2005 was \$62 and \$442, respectively. These transactions have been recorded at the exchange amount which is the amount agreed upon between the parties.

15. Segmented information:

Management has determined that the Company operates in a single reportable operating segment, which involves the provision of outsourced data centre infrastructure and managed services to organizations with mission-critical IT operations.

The Company markets its products primarily in Canada.

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

Substantially all of the Company's identifiable assets as at October 31, 2006 and 2005 are located in Canada.

Q9 NETWORKS INC.

Notes to Financial Statements (continued)
(In thousands, except per share amounts)

Years ended October 31, 2006 and 2005

15. Segmented information (continued):

During the year ended October 31, 2006, two customers accounted for 13% and 10% of revenue, respectively. The combined accounts receivable balance for these customers as at October 31, 2006 was \$755. For the year ended October 31, 2005, one customer accounted for 12% of revenue and two customers accounted for approximately 10% each of revenue. The combined accounts receivable for these customers, as at October 31, 2005, was \$987.

16. Change in non-cash operating working capital:

	2006	2005
Interest receivable on short-term investments	\$ (66)	\$ (126)
Accounts receivable	(1,122)	(1,362)
Unbilled revenue	407	(598)
Prepaid expenses	(190)	(30)
Accounts payable and accrued liabilities	1,361	(53)
Deferred revenue	928	919
	<hr/>	<hr/>
	\$ 1,318	\$ (1,250)

17. Comparative figures:

Certain comparative figures have been reclassified to conform with the financial statement presentation adopted in the current year.