SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 8-K/A

CURRENT REPORT

PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

JULY 31, 2000
Date of Report
(Date of earliest event
reported)

INTERNAP NETWORK SERVICES CORPORATION
(Exact name of registrant as specified in its charter)

WASHINGTON	000-27265	91-1896926
(State or other jurisdiction of incorporation)	(Commission File No.)	(IRS Employer Identification No.)

601 Union St., Suite 1000
SEATTLE, WASHINGTON 98101
(Address of principal executive offices, including zip code)

(206) 441-8800
(Registrant's telephone number, including area code)

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ITEM 2. ACQUISITION OR DISPOSITION OF ASSETS

The undersigned Registrant hereby amends in the manner set forth below and in the pages attached hereto Item 7 and the exhibits of its Current Report on Form 8-K, filed on August 14, 2000, relating to the Registrant's acquisition of VPNX.com, Inc. on July 31, 2000 as described in such Current Report.

ITEM 7. FINANCIAL STATEMENTS, PRO FORMA FINANCIAL INFORMATION AND EXHIBITS

(a) FINANCIAL STATEMENTS OF BUSINESS ACQUIRED

See Exhibit 99.3 for the audited financial statements of VPNX.com, Inc.

(b) PRO FORMA FINANCIAL INFORMATION

UNAUDITED PRO FORMA COMBINED CONDENSED FINANCIAL INFORMATION

On July 31, 2000, InterNAP Network Services Corporation ("InterNAP") completed the acquisition of certain assets and liabilities of VPNX.com, Inc. ("VPNX"). The acquisition was recorded by InterNAP using the purchase method of accounting under APB Opinion No. 16. InterNAP issued 2,027,092 shares of common stock, assumed options to purchase 278,963 shares of common stock, and incurred certain costs of acquisition, resulting in an aggregate purchase price of $88.0 million.

CO Space, Inc. ("CO Space") was acquired on June 20, 2000 for 6,881,018 shares of common stock, $200,000 in cash and assumption of options and the results of its operations since that date are included with those of InterNAP. Financial information for CO Space is included in Form 8-K/A filed September 5, 2000. InterNAP's balance sheet as of June 30, 2000 on Form 10-Q as filed with the Securities and Exchange Commission on August 11, 2000 reflects the acquisition of CO Space.

The unaudited pro forma combined condensed balance sheet is based on the individual historical balance sheets of InterNAP and VPNX and has been prepared to reflect the acquisition by InterNAP of VPNX as if the transaction had occurred on June 30, 2000.

The unaudited pro forma combined condensed statements of operations are based on individual historical results of operations of InterNAP, CO Space and VPNX for the year ended December 31, 1999 and for the six months ended June 30, 2000, as if the acquisitions of CO Space and VPNX had occurred on January 1, 1999.

The unaudited pro forma condensed statements of operations should be read in conjunction with the historical financial statements and notes thereto of InterNAP included in its 1999 annual report on Form 10-K and VPNX included herein. The pro forma adjustments and assumptions described in the accompanying notes to the unaudited pro forma combined condensed statements of operations are based on estimates, evaluations, and other data currently available. The unaudited pro forma combined condensed statements of operations are presented for illustrative purposes only and are not necessarily indicative of results of operations that would have actually occurred had the acquisitions CO Space and VPNX been effected on the dates assumed.

Unaudited Pro Forma Combined Condensed Balance Sheet
June 30, 2000
(in thousands)

	InterNAP	VPNX	Pro Forma Adjustments		Pro Forma Combined
ASSETS					
Current assets:					
Cash and cash equivalents	$ 123,266	$ 3,946			$ 127,212
Short-term investments and investment income receivable	125,097				125,097
Accounts receivable, net	10,527	10			10,537
Prepaid expenses and other assets	1,614	60			1,674
Total current assets	260,504	4,016			264,520
Property and equipment, net	91,001	856			91,857
Patents and trademarks, net	194				194
Restricted cash	4,620				4,620
Investments	52,355				52,355
Goodwill and other intangible assets, net	256,691		$ 70,489	(A)	327,180
Deposits and other assets, net	3,986	116			4,102
Total assets	$ 669,351	$ 4,988	$ 70,489		$ 744,828
LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIT)					
Current liabilities:					
Accounts payable and accrued liabilities	$ 43,820	$ 679	$ 950	(A),(B)	$ 45,449
Deferred revenue	545	4,156	(2,224)	(F)	2,477
Notes payable, current portion	1,723	2,531			4,254
Line of credit	1,525				1,525
Capital lease obligations, current portion	11,269				11,269
Total current liabilities	58,882	7,366	(1,274)		64,974
Deferred revenue	8,870				8,870
Notes payable, less current portion	2,724	291			3,015
Capital lease obligations, less current portion	19,367				19,367
Total liabilities	89,843	7,657	(1,274)		96,226
Commitments and contingencies					
Shareholders' equity (deficit)					
Convertible preferred stock		6	(6)	(D)	
Common stock	145	10	(10)	(D)	147
			2	(C)	

Additional paid-in capital........................	688,023	9,539	(9,539)	(D)	780,253
			92,230	(A),(C)	
Full recourse notes receivable....................		(3)			(3)
Deferred stock compensation.......................	(11,604)	(1,707)	(5,135)	(E)	(16,739)
			1,707	(D)	
Accumulated deficit...............................	(102,878)	(10,514)	10,514	(D)	(120,878)
			(18,000)	(A)	
Accumulated items of other comprehensive income....	5,822				5,822
Total shareholders' equity (deficit).........	579,508	(2,669)	71,763		648,602
Total liabilities and shareholders' equity (deficit).................................	$ 669,351	$ 4,988	$ 70,489		$ 744,828

See accompanying notes to the unaudited pro forma combined condensed financial information

Unaudited Pro Forma Combined Condensed Income Statement
(in thousands)

	Six Months ended June 30, 2000					
	InterNAP	CO Space	VPNX	Pro Forma Adjustments		Pro Forma Combined
Revenues.................	$ 22,538	$ 994	$ 1,215			$ 24,747
Costs and expenses						
Cost of network and customer support....	35,801	6,622				42,423
Product development...	3,441		3,033			6,474
Sales and marketing...	15,689	2,480	738			18,907
General and administrative......	9,694	4,384	727			14,805
Amortization of deferred stock compensation........	5,624	1,412	83	$ 1,284	(E)	8,403
Amortization of goodwill and other intangibles.........	2,157			52,732	(A)	54,889
Total operating costs and expenses........	72,406	14,898	4,581	54,016		145,901
Loss from operations.....	(49,868)	(13,904)	(3,366)	(54,016)		(121,154)
Other income (expense)						
Interest income.......	7,338	122	205			7,665
Interest and financing expense...	(890)		(113)			(1,003)
Net loss...........	$(43,420)	$ (13,782)	$ (3,274)	$ (54,016)		$(114,492)
Basic and diluted net loss per share........	$ (0.32)					$ (0.79)
Weighted average shares used in computing basic and diluted net loss per share........	135,406			8,908	(G)	144,314

Twelve Months ended December 31, 1999

	InterNAP	CO Space	VPNX	Pro Forma Adjustments	Pro Forma Combined
Revenues	$ 12,520	$ 258	$ 3,867		$ 16,645
Costs and expenses					
Cost of network and customer support	27,412	2,706			30,118
Product development	3,919		6,128		10,047
Sales and marketing	17,523	488	1,283		19,294
General and administrative	8,328	2,970	1,201		12,499
Amortization of deferred stock compensation	7,569	89		$ 2,568 (E)	10,226
Amortization of goodwill and other intangibles				109,779 (A)	109,779
Total operating costs and expenses	64,751	6,253	8,612	112,347	191,963
Loss from operations	(52,231)	(5,995)	(4,745)	(112,347)	(175,318)
Other income (expense)					
Interest income	3,388	38	330		3,756
Interest and financing expense	(1,074)		(86)		(1,160)
Net loss	$(49,917)	$ (5,957)	$ (4,501)	$ (112,347)	$(172,722)
Basic and diluted net loss per share	$ (1.31)				$ (3.68)
Weighted average shares used in computing basic and diluted net loss per share	37,994			8,908 (G)	46,902

See accompanying notes to the unaudited pro forma combined condensed financial information

NOTES TO UNAUDITED PRO FORMA COMBINED CONDENSED FINANCIAL INFORMATION

PRO FORMA ADJUSTMENTS TO PRO FORMA COMBINED CONDENSED FINANCIAL INFORMATION

(A) InterNAP estimates the purchase price for CO Space and VPNX to be approximately $275.3 million and $88.0 million, respectively, based on the consideration to be paid to shareholders including common stock issued, assumption of options, plus acquisition related expenses incurred.

For purposes of estimating the value of the CO Space purchase consideration for the pro forma presentation, the value of the InterNAP common stock to be issued for the acquisition of CO Space was based on the closing price of InterNAP's common stock on June 16, 2000, the date the total number of shares to be issued was determined per the merger agreement, multiplied by the InterNAP shares to be issued based upon the exchange ratio set forth in the merger agreement. The fair value of options to be assumed was estimated using the Black Scholes valuation model assuming no expected dividends and the following weighted average assumptions: risk-free interest rate of 6%; volatility of 100%; and an expected life of three years.

For purposes of estimating the value of the VPNX purchase consideration for the pro forma presentation, the value of the InterNAP common stock to be issued for the acquisition of VPNX was based on the average closing price of InterNAP's common stock over the three day periods before and after July 6, 2000, the date the acquisition was announced, multiplied by the InterNAP shares to be issued based upon the exchange ratio set forth in the merger agreement. The fair value of options to be assumed was estimated using the Black Scholes valuation model assuming no expected dividends and the following weighted average assumptions: risk-free interest rate of 6%; volatility of 100%; and an expected life of three years.

InterNAP is currently in the process of finalizing its assessment of the fair value of the net assets acquired. For purposes of the preparation of the pro form combined condensed financial information, InterNAP has allocated \$16.5 million and \$(0.4) million of the purchase prices of CO Space and VPNX, respectively, to the tangible assets acquired from each of these respective companies net of liabilities assumed, based on the book value as of June 30, 2000. In addition, InterNAP has allocated \$18.0 million of the VPNX purchase price to in-process research and development which, for purposes of the pro forma presentation, has been excluded from expense. The remainder of the purchase price has been allocated to intangible assets acquired from CO Space and VPNX, which include:

	CO Space	VPNX
	(in thousands)	
Completed real estate leases........	\$ 19,300	
Customer relationships.............	1,800	
Workforce in place including covenants not to compete..........	2,000	\$ 15,100
Trademarks.........................	2,800	
Developed technologies.............		3,400
Goodwill...........................	232,948	51,989
	\$ 258,848	\$ 70,489

Based on an estimated useful life of three years for such intangible assets, the unaudited pro forma combined condensed financial information includes adjustments of \$54.9 million and \$109.8 million for amortization expense for the six months ended June 30, 2000 and year ended December 31, 1999, respectively. The allocation of the purchase prices to tangible and intangible assets, as well as the related amortization expense may change materially as a result of the completion of InterNAP's evaluation of the fair value or the net assets acquired and changes in purchase consideration.

(B) Increase in accrued expenses for estimated acquisition related expenses.

(C) Increase in shareholders' equity for the issuance of shares of InterNAP common stock.

(D) Elimination of VPNX shareholder equity accounts.

(E) The Financial Accounting Standards Board has issued Financial Interpretation No. 44 which is effective for acquisitions after June 30, 2000, and requires that the portion of the intrinsic value of unvested options assumed in purchase business combination be recognized as deferred stock compensation and amortized to deferred stock compensation expense over the remaining vesting period. Accordingly, InterNAP has estimated the intrinsic

value of the unvested options assumed in the VPNX acquisition to be \$5.1 million, and has included related pro forma adjustments of \$1.3 million and \$2.5 million for the six months ended June 30, 2000 and year ended December 31, 1999, respectively. The intrinsic value associated with unvested options was deducted from the fair value of the awards for purposes of the allocation of the purchase price to the other assets acquired.

(F) The deferred revenue balance recorded by VPNX at the date of acquisition has been reduced by a pro forma adjustment to reflect the cost of services to be provided subsequent to the acquisition date plus an allowance for normal profit on those services.

(G) The unaudited pro forma combined per share amounts are based on the pro forma combined weighted average number of shares of InterNAP common stock, which equals InterNAP's weighted average number of shares of InterNAP common stock outstanding for the period plus shares of InterNAP common stock that were issued at the completion of the acquisitions of CO Space and VPNX. All potential common stock equivalents of InterNAP, CO Space and VPNX have been excluded from the calculation of pro forma net loss from operations per common share as their inclusion would be anti-dilutive.

(c) EXHIBITS

The following exhibits are filed as part of this report:

Exhibit NUMBER	DESCRIPTION
2.1*	Agreement and Plan of Merger and Reorganization, dated as of July 6, 2000, by and among Registrant, Virginia Acquisition Corp., a Delaware corporation, and VPNX.com, Inc., a Delaware corporation.
4.1*	Form of Registration Rights Agreement by and among Registrant and the stockholders of VPNX.com, Inc., a Delaware corporation.
99.1*	Press Release entitled "InterNAP to Add VPN Technology Expertise to Its Ranks through the Planned Acquisition of VPNX.com," issued July 6, 2000.
99.2*	Press Release entitled "InterNAP Completes Acquisition of VPNX.com," issued July 31, 2000.
99.3	VPNX.com, Inc. Financial Statements (Audited).

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* - Previously filed.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

INTERNAP NETWORK SERVICES CORPORATION

Dated: October 4, 2000

By: /s/ Paul E. McBride

Paul E. McBride
Senior Vice President and
Chief Financial Officer

INDEX TO EXHIBITS

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FINANCIAL STATEMENTS

VPNX.com, INC. (a development stage company)
YEARS ENDED DECEMBER 31, 1998 AND 1999 AND THE PERIOD FROM
JUNE 19, 1996 (INCEPTION) TO DECEMBER 31, 1999
WITH REPORT OF INDEPENDENT AUDITORS

VPNX.com, Inc.
(a development stage company)

INDEX TO FINANCIAL STATEMENTS

REPORT OF ERNST & YOUNG LLP, INDEPENDENT AUDITORS

The Board of Directors and Stockholders
VPNX.com, Inc.

We have audited the accompanying balance sheets of VPNX.com, Inc. (a development stage company) as of December 31, 1998 and 1999, and the related statements of operations, stockholders' equity (deficit), and cash flows for each of the three years in the period ended December 31, 1999 and for the period from June 19, 1996 (inception) to December 31, 1999. 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 auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about 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. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of VPNX.com, Inc. at December 31, 1998 and 1999, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 1999 and for the period from June 19, 1996 (inception) to December 31, 1999, in conformity with accounting principles generally accepted in the United States.

The accompanying financial statements have been prepared assuming that VPNX.com, Inc. will continue as a going concern. As more fully described in Note 1, the Company has incurred operating losses since inception and has an accumulated deficit at December 31, 1999 of $7,239,909. These conditions raise substantial doubt about the Company's ability to continue as a going concern. The financial statements of VPNX.com, Inc. do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of liabilities that may result from the outcome of this uncertainty.

/s/ ERNST & YOUNG LLP

February 4, 2000

VPNX.com, Inc.
(a development stage company)

Balance Sheets

	DECEMBER 31, 1998	DECEMBER 31, 1999	JUNE 30, 2000
			(Unaudited)
ASSETS			
Current assets:			
Cash and cash equivalents	$ 4,146,036	$ 3,390,454	$ 3,946,009
Short-term investments	498,663	-	-
Accounts receivable	851,853	-	10,021
Prepaid expenses and other current assets	61,028	137,857	60,136
Total current assets	5,557,580	3,528,311	4,016,166
Property and equipment:			
Computer equipment	578,542	916,776	899,819
Furniture and office equipment	805,803	823,174	823,174
Leasehold improvements	187,275	194,665	202,639
	1,571,620	1,934,615	1,925,632
Accumulated depreciation and amortization	388,698	834,668	1,069,793
	1,182,922	1,099,947	855,839
Deposits and other assets	80,460	116,400	116,400
Total assets	$ 6,820,962	$ 4,744,658	$ 4,988,405
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)			
Current liabilities:			
Accounts payable	$53,749	$196,390	$92,170
Accrued payroll and related expenses	240,072	377,683	241,828
Other accrued liabilities	149,273	205,348	345,362
Notes payable, current portion	580,933	528,057	531,430
Deferred revenue	183,333	374,257	4,155,695
Bridge loans	-	2,000,000	2,000,000
Total current liabilities	1,207,360	3,681,735	7,366,485
Notes payable, less current portion	603,716	548,194	290,739
Commitments			
Stockholders' equity (deficit):			
Series A preferred stock, $0.001 par value: Authorized shares - 3,131,341 Issued and outstanding shares - 3,131,341 Liquidation preference of $2,600,000	3,131	3,131	3,131
Series B preferred stock, $0.001 par value: Authorized shares - 3,140,987 Issued and outstanding shares - 3,140,987 Liquidation preference of $3,999,995	3,141	3,141	3,141
Common stock, $0.001 par value: Authorized shares - 20,000,000 Issued and outstanding shares - 9,966,116 in 1998 and 1999 and 9,990,306 in 2000	9,966	9,966	9,990
Additional paid-in capital	7,741,372	7,741,372	9,538,604
Notes receivable	(8,917)	(2,972)	(2,972)
Deferred compensation	-	-	(1,707,000)
Deficit accumulated during the development stage	(2,738,807)	(7,239,909)	(10,513,713)
Total stockholders' equity (deficit)	5,009,886	514,729	(2,668,819)
Total liabilities and stockholders' equity (deficit)	$ 6,820,962	$ 4,744,658	$ 4,988,405

See accompanying notes.

VPNX.com, Inc.
(a development stage company)
Statements of Operations

	YEARS ENDED DECEMBER 31, 1997	1998	1999	PERIOD FROM JUNE 19, 1996 (INCEPTION) TO DECEMBER 31, 1999	SIX MONTHS ENDED JUNE 30, 1999	2000
					(Unaudited)	(Unaudited)
Net revenues	$ 1,604,098	$3,866,795	$ 3,866,627	$ 9,337,520	$ 300,050	$ 1,215,214
Operating expenses:						
Research and development	1,846,389	2,949,755	6,128,003	11,425,744	2,713,577	3,033,155
General and administrative	646,852	873,779	1,200,870	3,010,778	552,700	726,993
Sales and marketing	396,384	763,599	1,282,618	2,551,899	556,508	738,134
Amortization of deferred compensation	-	-	-	-	-	83,000
Total operating expenses	2,889,625	4,587,133	8,611,491	16,988,421	3,822,785	4,581,282
Operating loss	(1,285,527)	(720,338)	(4,744,864)	(7,650,901)	(3,522,735)	(3,366,068)
Interest and other income	51,576	173,518	330,251	546,866	174,169	205,686
Interest expense	(7,842)	(41,543)	(86,489)	(135,874)	(46,655)	(113,422)
Net loss	$(1,241,793)	$(588,363)	$(4,501,102)	$(7,239,909)	$(3,395,221)	$(3,273,804)
Basic and diluted net loss per share	$ (0.15)	$ (0.07)	$ (0.46)		$ (0.35)	$ (0.33)
Shares used to compute basic and diluted net loss per share	8,319,357	8,977,842	9,719,583		9,701,276	9,951,128

See accompanying notes.

VPNX.com, Inc.
(a development stage company)
Statements of Stockholders' Equity (Deficit)
Period from June 19, 1996 (inception) to December 31, 1999

	PREFERRED STOCK SHARES	AMOUNT	COMMON STOCK SHARES	AMOUNT	ADDITIONAL PAID-IN CAPITAL
Issuance of common stock in July for business plan	-	$ -	5,635,035	$5,635	$50,715
Sale of common stock in July and August at $0.24 per share	-	-	1,934,415	1,934	458,066
Sale of common stock in September at $0.24 per share	-	-	50,000	50	11,840
Sale of common stock in November at $0.30 per share	-	-	1,333,333	1,334	398,666
Stock issuance costs	-	-	-	-	(7,607)
Net loss	-	-	-	-	-
Balance at December 31, 1996	-	-	8,952,783	8,953	911,680
Sale of common stock in March at $0.30 per share	-	-	833,333	833	249,167
Sale of Series A preferred stock in April at $0.83 per share, less issuance costs of $30,856	3,010,905	3,011	-	-	2,466,133
Sale of Series A preferred stock in September at $0.83 per share	120,436	120	-	-	99,880
Issuance of common stock due to exercise of stock options at $0.30 per share	-	-	100,000	100	29,900
Net loss	-	-	-	-	-
Balance at December 31, 1997	3,131,341	3,131	9,886,116	9,886	3,756,760
Sale of Series B preferred stock in March at $1.27 per share, less issuance costs of $35,527	3,140,987	3,141	-	-	3,961,327
Issuance of common stock due to exercise of stock options at $0.24 per share	-	-	10,208	10	2,417
Issuance of common stock due to exercise of stock options at $0.30 per share	-	-	80,000	80	23,920
Repurchase of common stock from employee in March at $0.30 per share	-	-	(10,208)	(10)	(3,052)
Payment by stockholder on note	-	-	-	-	-
Net loss	-	-	-	-	-

Balance at December 31, 1998	6,272,328	6,272	9,966,116	9,966	7,741,372

	NOTES RECEIVABLE	DEFICIT ACCUMULATED DURING THE DEVELOPMENT STAGE	TOTAL STOCKHOLDERS' EQUITY (DEFICIT)
Issuance of common stock in July for business plan	$ -	$ -	$56,350
Sale of common stock in July and August at $0.24 per share	-	-	460,000
Sale of common stock in September at $0.24 per share	(11,890)	-	-
Sale of common stock in November at $0.30 per share	-	-	400,000
Stock issuance costs	-	-	(7,607)
Net loss	-	(908,651)	(908,651)
Balance at December 31, 1996	(11,890)	(908,651)	92
Sale of common stock in March at $0.30 per share	-	-	250,000
Sale of Series A preferred stock in April at $0.83 per share, less issuance costs of $30,856	-	-	2,469,144
Sale of Series A preferred stock in September at $0.83 per share	-	-	100,000
Issuance of common stock due to exercise of stock options at $0.30 per share	-	-	30,000
Net loss	-	(1,241,793)	(1,241,793)
Balance at December 31, 1997	(11,890)	(2,150,444)	1,607,443
Sale of Series B preferred stock in March at $1.27 per share, less issuance costs of $35,527	-	-	3,964,468
Issuance of common stock due to exercise of stock options at $0.24 per share	-	-	2,427
Issuance of common stock due to exercise of stock options at $0.30 per share	-	-	24,000
Repurchase of common stock from employee in March at $0.30 per share	-	-	(3,062)
Payment by stockholder on note	2,973	-	2,973
Net loss	-	(588,363)	(588,363)
Balance at December 31, 1998	(8,917)	(2,738,807)	5,009,886

See accompanying notes.

VPNX.com, Inc.
(a development stage company)
Statements of Stockholders' Equity (Deficit) (continued)

Period from June 19, 1996 (inception) to December 31, 1999

	PREFERRED STOCK		COMMON STOCK		ADDITIONAL PAID-IN CAPITAL	NOTES RECEIVABLE
	SHARES	AMOUNT	SHARES	AMOUNT		
Balance at December 31, 1998	6,272,328	$6,272	9,966,116	$9,966	$7,741,372	$(8,917)
Payment by stockholder on note	-	-	-	-	-	5,945
Net loss	-	-	-	-	-	-
Balance at December 31, 1999	6,272,328	6,272	9,966,116	9,966	7,741,372	(2,972)
Exercise of Stock options/warrants (unaudited)	-	-	24,190	24	7,232	-
Deferred compensation (unaudited)	-	-	-	-	1,790,000	-
Amortization of deferred compensation (unaudited)	-	-	-	-	-	-
Net loss (unaudited)	-	-	-	-	-	-
Balance at June 30, 2000 (unaudited)	6,272,328	$6,272	9,990,306	$9,990	$9,538,604	$(2,972)

	DEFERRED COMPENSATION	DEFICIT ACCUMULATED DURING THE DEVELOPMENT STAGE	TOTAL STOCKHOLDERS' EQUITY (DEFICIT)
Balance at December 31, 1998	$ -	$(2,738,807)	$5,009,886
Payment by stockholder on note	-	-	5,945
Net loss	-	(4,501,102)	(4,501,102)
Balance at December 31, 1999	-	(7,239,909)	514,729
Exercise of Stock options/warrants (unaudited)	-	-	7,256
Deferred compensation (unaudited)	(1,790,000)	-	-
Amortization of deferred compensation			

(unaudited)	83,000	-	83,000
Net loss (unaudited)	-	(3,273,804)	(3,273,804)
Balance at June 30, 2000 (unaudited)	$(1,707,00)	$(10,513,713)	$(2,668,819)

See accompanying notes.

VPNX.com, Inc.
(a development stage company)
Statements of Cash Flows

	YEARS ENDED DECEMBER 31,			PERIOD FROM JUNE 19, 1996 (INCEPTION) TO DECEMBER 31,	SIX MONTHS ENDED JUNE 30,	
	1997	1998	1999	1999	1999	2000
					(Unaudited)	
OPERATING ACTIVITIES						
Net loss	$(1,241,793)	$(588,363)	$(4,501,102)	$(7,239,909)	$(3,395,221)	$(3,273,804)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:						
Depreciation and amortization	169,558	155,628	445,970	834,668	220,421	235,125
Write-off of technology and licensing agreement	85,000	-	-	149,754	-	-
Amortization of deferred compensation	-	-	-	-	-	83,000
Changes in assets and liabilities:						
Accounts receivable-trade	(833,138)	(1,853)	851,853	-	851,853	(10,021)
Prepaid expenses and other current assets	(42,052)	(8,756)	(76,829)	(81,507)	(61,832)	77,721
Account payable	10,412	26,642	142,641	196,390	(38,602)	(104,220)
Accrued payroll and related expenses	43,010	112,073	137,611	377,683	24,907	(135,855)
Other accrued liabilities	25,084	110,189	56,075	214,115	(15,005)	140,014
Deferred revenue	(76,000)	183,333	190,924	374,257	3,150,000	3,781,438
Net cash provided by (used in) operating activities	(1,859,919)	(11,107)	(2,752,857)	(5,174,549)	736,521	793,398
INVESTING ACTIVITIES						
Acquisition of property, plant, and equipment	(177,946)	(1,193,272)	(362,995)	(1,749,369)	(225,084)	-
Proceeds from (purchases of) short-term investments	-	(498,663)	498,663	-	498,663	-
Proceeds from sales of equipment	-	-	-	-	-	$ 8,983
Other assets	(34,133)	(44,890)	(35,940)	(116,400)	(30,417)	-
Net cash provided by (used in) investing activities	(212,079)	(1,736,825)	99,728	(1,865,769)	243,162	8,983
FINANCING ACTIVITIES						
Proceeds from issuance of Series A preferred stock	2,569,144	-	-	2,569,144	-	-
Proceeds from issuance of Series B preferred stock	-	3,964,468	-	3,964,468	-	-
Proceeds from issuance of common stock, net of repurchases	280,000	23,365	-	1,155,758	-	7,256
Proceeds from payment of stockholder notes	-	2,973	5,945	8,918	-	-
Proceeds from issuance of notes payable, net	483,572	753,788	621,832	1,859,192	306,764	-
Repayments of notes payable	(280,000)	(116,478)	(730,230)	(1,126,708)	(345,286)	(254,082)
Proceeds from bridge loans	-	-	2,000,000	2,000,000	-	-
Net cash provided by (used in) financing activities	3,052,716	4,628,116	1,897,547	10,430,772	(38,522)	(246,826)
Net increase (decrease) in cash and cash equivalents	980,718	2,880,184	(755,582)	3,390,454	941,161	555,555
Cash and cash equivalents at beginning of period	285,134	1,265,852	4,146,036	-	4,146,036	3,390,454
Cash and cash equivalents at end of period	$1,265,852	$4,146,036	$3,390,454	$3,390,454	$5,087,197	$3,946,009
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION						
Note payable issued in exchange for technology, royalty considerations, and fixed assets	$85,000	$ -	$ -	$ 335,000	$ -	$ -
Common stock issued in exchange for note	$ -	$ -	$ -	$ 11,890	$ -	$ -
Common stock issued in exchange for business plan	$ -	$ -	$ -	$ 56,350	$ -	$ -
Interest paid	$ -	$ 41,543	$86,489	$ 135,874	$ 46,655	$ 113,422

See accompanying notes.

VPNX.com, Inc.
(a development stage company)
Notes to Financial Statements
(Information as of June 30, 2000 and for the six months ended
June 30, 1999 and 2000 is unaudited)

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

ORGANIZATION AND BUSINESS

VPNX.com, Inc. (VPNX or the Company) was incorporated on June 19, 1996 in the state of Delaware. The Company conducts its business within one industry segment and was formed for the purpose of developing and marketing policy software for controlling network infrastructure. In the later part of 1999, the Company began shifting its focus to the virtual private network market. In 1999, the product was in the development stage with a product launch scheduled for 2000. Since inception, the Company has primarily been involved in performing research and development activities, establishing development contracts, and raising capital. Accordingly, the Company is in the development stage.

GOING CONCERN

The Company has incurred losses since inception and will require additional financing in order for the Company to continue its operations. Management believes it will be able to secure additional sources of funding through a private stock offering and intends to pursue this course of action. There can be no assurance that the Company will be able to secure the necessary financing to continue operations. These facts raise substantial doubt about the Company's ability to continue as a going concern. The financial statements do not include any adjustments relating to the recoverability of recorded asset amounts or the amount and classification of liabilities that might be necessary should the Company be unable to raise sufficient capital to continue operations.

USE OF ESTIMATES

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results may differ from these estimates.

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

CASH EQUIVALENTS AND SHORT-TERM INVESTMENTS

The Company considers as a cash equivalent any highly liquid investment that matures within three months of its purchase date. At December 31, 1999 and June 30, 2000, cash equivalents consisted of money market funds. The Company considers as a short-term investment any highly liquid investment with an original maturity greater than three months but less than one year. The Company considers all short-term investments as "available-for-sale." No adjustments have been made to the carrying value of short-term investments as the carrying value at December 31, 1998 approximated fair market value. In addition, no realized gains or losses were recognized from the sale of short-term investments in 1997, 1998, or 1999.

Estimated fair values of financial instruments are based on quoted market prices. The following is a summary of available-for-sale securities (in thousands) at December 31, 1998. At December 31, 1998, the fair value of securities approximated cost.

	DECEMBER 31, 1998
Money market fund	$3,043,018
Commercial paper	979,893
Corporate bonds	500,000

	$4,522,911
Classified as:	
Cash equivalents	$4,024,248
Short-term investments	498,663
	$4,522,911

PROPERTY AND EQUIPMENT

Property and equipment are stated at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the assets, which are generally two to five years. Leasehold improvements are amortized over the shorter of their useful lives or the term of the lease.

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

REVENUE RECOGNITION

Substantially all of the Company's revenue relates to research and development work performed under development contracts. The Company recognizes this revenue when earned, which generally occurs when agreed upon deliverables are provided or milestones are met and confirmed by customers, and in any case not in excess of the amount that would be recognized using the percentage of completion method. Due to technological risk factors, the costs of these contracts are expensed as incurred. Costs incurred under development contracts of $483,000, $1,265,000, $4,242,000 and $6,095,000 in 1997, 1998, 1999 and for the period from June 19, 1996 (inception) to December 31, 1999 respectively are included in research and developments in the statements of operations.

INTERIM FINANCIAL INFORMATION

The interim financial information at June 30, 2000 and for the six-month periods ended June 30, 1999 and 2000 is unaudited but, in the opinion of management, includes all adjustments, consisting only of normal recurring accruals, which the Company considers necessary for a fair presentation of the financial position and results of operations for the interim periods. The results of operations for the six-month period ended June 30, 2000 are not necessarily indicative of the results to be expected for the full fiscal year.

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

CONCENTRATION OF CREDIT RISK

A limited number of customers have historically accounted for a substantial portion of the Company's revenue. The following table summarizes the Company's significant customers:

CUSTOMER	YEARS ENDED DECEMBER 31, 1997	1998	1999	SIX MONTHS ENDED JUNE 30, 1999	2000
A	-%	65%	10%	33%	83%
B	87%	35%	16%	67%	-%
C	-%	-%	80%	-%	-%

The Company performs ongoing credit evaluations of its customers and considers reserves for potential credit losses, and such losses have been within management's expectations. The Company generally does not require collateral from its customers.

RESEARCH AND DEVELOPMENT

Research and development expenditures are generally charged to operations as incurred. Statement of Financial Accounting Standards No. 86, "Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed," requires the capitalization of certain software development costs subsequent to the establishment of technological feasibility. Based on the Company's product development process, technological feasibility is established upon the completion of a working model. To date, no costs have qualified for capitalization, and accordingly, the Company has charged all such costs to research and development expense in the accompanying statements of operations.

COMPREHENSIVE INCOME

Effective January 1, 1998, the Company adopted Statement of Financial Accounting Standards No. 130, "Reporting Comprehensive Income" (FAS 130). The Company's comprehensive net loss was the same as its net loss for all periods presented.

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

ADVERTISING COSTS

Advertising costs are expensed as incurred and have been immaterial through June 30, 2000.

FAIR VALUE OF FINANCIAL INSTRUMENTS

The fair value of the Company's long-term debt is estimated using a discounted cash flow analysis based on the Company's current incremental borrowing rate for similar types of borrowing arrangements. The carrying value of the Company's long-term debt approximates fair value.

STOCK BASED COMPENSATION

The Company accounts for stock-based awards to employees under the intrinsic value method in accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" (APB Opinion No. 25), and has adopted the disclosure-only alternative of Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" (FAS 123).

RECENT ACCOUNTING PRONOUNCEMENTS

In June 1998, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" (FAS 133). FAS 133 provides a comprehensive and consistent standard for the recognition and measurement of derivatives and hedging activities. In June 1999, the FASB issued FAS 137, "Accounting for Derivative Instruments and Hedging Activities - Deferral of the Effective Date of FASB Statement No. 133," which deferred the effective date of FAS 133 until fiscal years beginning after June 15, 2000. The Company believes that the adoption of FAS 133 will not have a significant impact on the Company's operating results or cash flows.

In December 1999, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 101 "Revenue Recognition in Financial Statements" (SAB 101). SAB 101 provides guidance on the recognition, presentation, and disclosure of revenue in financial statements. SAB 101 is effective for years beginning after December 15, 1999 and is required to be reported beginning in the quarter ended December 31, 2000. SAB 101 is not expected to have a significant effect on the Company's consolidated results of

operations, financial position, or cash flows.

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

RECENT ACCOUNTING PRONOUNCEMENTS (CONTINUED)

In March 2000, the FASB issued FASB Interpretation No. 44, "Accounting for Certain Transactions Involving Stock Compensation - an Interpretation of APB Opinion No. 25" (FIN 44). FIN 44 clarifies the application of APB Opinion No. 25 and, among other issues, clarifies the following: the definition of an employee for purposes of applying APB Opinion No. 25, the criteria for determining whether a plan qualifies as a noncompensatory plan, the accounting consequences of various modifications to the terms of the previously fixed stock options or awards, and the accounting for an exchange of stock compensation awards in a business combination. FIN 44 is effective July 1, 2000, but certain conclusions in FIN 44 cover specific events that occurred after either December 15, 1998 or January 12, 2000. The Company does not expect the application of FIN 44 to have a material impact on the Company's results of operations, financial position, or cash flows.

2. NOTES PAYABLE

Notes payable consisted of the following:

	DECEMBER 31, 1998	DECEMBER 31, 1999	JUNE 30, 2000
Notes payable to Phoenix Leasing, Inc., due in monthly installments through 2001 secured by the Company's equipment	$748,539	$984,561	$761,042
Note payable to bank, due in monthly installments			

through 2001 with interest at prime (8.5%), some of which is secured by the Company's equipment	436,110	91,690	61,127
	1,184,649	1,076,251	822,169
Less current portion	580,933	528,057	531,430
	$603,716	$548,194	$290,739

In June 1999, the Company's $1,200,000 equipment line with Phoenix Leasing, Inc. expired. In September 1999, the Company entered into an agreement for an additional equipment line of $1,500,000. The total outstanding obligations under the combined credit lines cannot exceed $2,000,000. At December 31, 1999, the Company had borrowed approximately $1,376,000 under these arrangements of which $984,561 remains outstanding and is reflected in the notes payable balance.

2. NOTES PAYABLE (CONTINUED)

At December 31, 1999, future minimum principal payments on notes payable are as follows:

2000	$528,057
2001	485,012
2002	63,182
	$1,076,251

3. BRIDGE LOAN

In December 1999, the Company received $2,000,000 in funding from some of its current investors in the form of a Promissory Note. The term of the note is six months and includes warrants for 471,149 shares of common stock at an exercise price of $1.273 per share. The warrants are exercisable through December 2004. The fair value of the warrants issued was immaterial.

If the Company enters into an agreement to issue new securities for an aggregate amount of not less than $5,000,000 before the maturity date of the note, the investor may convert the principal and interest of the note into the new securities. If the new securities are issued at more than one equity closing, conversion shall occur at the first equity closing where at least $2,000,000 in new securities are issued. If elected, the note shall be converted into new securities by dividing the principal and interest by the unit price of the new securities.

If the Company does not enter into an agreement to issue new securities for an aggregate current value amount of not less than $5,000,000 before the maturity date of the note, the investor may elect to convert the principal and interest of the note into Series B preferred stock at a price per share of $1.273.

If the Company enters into an agreement to sell, merge, or consolidate its assets with another corporation before the maturity date of the loan, the investor may elect to convert the principal and interest of the note into Series B preferred stock at a price per share of $1.273.

In June 2000, the bridge loan was extended for an additional six months.

4. COMMITMENTS

The Company currently leases its two facilities under noncancelable operating leases that expire in July 2000 and September 2003. Future minimum lease payments under the operating leases at December 31, 1999 are as follows:

2000	$ 576,455
2001	548,335
2002	563,393
2003	431,204
Total minimum lease payments	$2,119,387

Rental expense under operating leases was approximately $89,000, $255,000, $616,000, and $979,000 for the years ended December 31, 1997, 1998, 1999, and for the period from June 19, 1996 (inception) to December 31, 1999, respectively, and $307,000 for each of the six months ended June 30, 1999 and 2000.

5. STOCKHOLDERS' EQUITY

CONVERTIBLE PREFERRED STOCK

The holders of Series A and B preferred stock are entitled to annual noncumulative cash dividends out of legally available funds, when and if declared by the Board of Directors, in the amounts of $0.07 and $0.10 per share, respectively. As of December 31, 1999, there were no dividends paid or declared by the Company.

5. STOCKHOLDERS' EQUITY (CONTINUED)

CONVERTIBLE PREFERRED STOCK (CONTINUED)

In the event of any liquidation, dissolution, or winding up of the Company, whether voluntary or not, the holders of each share of preferred stock shall be entitled to be paid out of the Company's assets that are available for distribution to its stockholders before any payment or declaration shall be made with respect to the holders of common stock. Series A and B stockholders are entitled to a liquidation preference of $0.830 and $1.273 per share, respectively, plus all declared but unpaid dividends (collectively, the Preference Amount). The remaining balance of proceeds is paid equally to the common stockholders and to the holders of Series A and B preferred stock until the holders of preferred stock have received an aggregate of three times their preference amount. Any remaining funds shall then be distributed entirely to the holders of common stock. Additionally, preferred stockholders have voting rights equal to the number of common shares that would be held upon conversion.

The holders of Series A and B preferred stock have the right, at the option of the holder, at any time, to convert their shares into common stock at a price of $0.830 and $1.273 per share, respectively, subject to adjustments for future dilution. Series A and B preferred stock automatically convert into common stock at the then applicable conversion rate (currently one-for-one) upon a public offering of the Company's common stock at a per share price of not less than $4.00, subject to adjustments for future dilution, with aggregate proceeds in excess of $10,000,000.

STOCK OPTION PLANS

The Company adopted the Founders' 1996 Stock Option Plan (the Founders' Plan) and the 1997 Stock Option Plan (the 1997 Plan), under which officers, employees, directors, and consultants may be granted Incentive Stock Options (ISOs) and Nonstatutory Stock Options (NSOs) to purchase shares of the Company's common stock. The Founders' Plan and the 1997 Plan permit ISOs and NSOs to be granted at exercise prices of not less than 100% and 85%, respectively, of the fair value on the date of grant as determined by the Board of Directors. Options that expire (generally ten years from the grant date) or are canceled are returned to the respective plan. The options generally vest 25% upon completion of one year and 1/48 per month thereafter.

5. STOCKHOLDERS' EQUITY (CONTINUED)

STOCK OPTION PLANS (CONTINUED)

A summary of activity under the option plans is as follows:

		OPTIONS OUTSTANDING		
	SHARES AVAILABLE FOR GRANT	NUMBER OF SHARES	PRICE PER SHARE	WEIGHTED AVERAGE EXERCISE PRICE
Authorized	941,050	-	$ -	$ -
Granted	(832,500)	832,500	$0.24 - $0.30	$0.24
Balance at December 31, 1996	108,550	832,500	$0.24 - $0.30	$0.24
Authorized	1,146,450	-	$ -	$ -
Granted	(485,000)	485,000	$0.30	$0.30
Exercised	-	(100,000)	$0.30	$0.30
Canceled	37,500	(37,500)	$0.24 - $0.30	$0.29
Balance at December 31, 1997	807,500	1,180,000	$0.24 - $0.30	$0.26
Authorized	700,000	-	$ -	$ -
Granted	(750,500)	750,500	$0.30	$0.30
Exercised	-	(90,208)	$0.24 - $0.30	$0.29
Canceled	24,792	(24,792)	$0.24	$0.24
Balance at December 31, 1998	781,792	1,815,500	$0.24 - $0.30	$0.27
Granted	(808,944)	808,944	$0.30	$0.30
Canceled	364,665	(364,665)	$0.30	$0.30
Balance at December 31, 1999	337,513	2,259,779	$0.24 - $0.30	$0.28

At December 31, 1997, 1998, and 1999, $344,375, 661,479, and 1,150,206 options, respectively, were exercisable. The weighted average remaining contractual life of outstanding options was 8.15 years at December 31, 1999. The weighted average fair value of options granted during 1997, 1998, and 1999 was $0.08, $0.07, and $0.07, respectively.

5. STOCKHOLDERS' EQUITY (CONTINUED)

VALUATION OF STOCK OPTIONS

The Company has elected to follow APB Opinion No. 25 and related interpretations in accounting for its employee stock options because the alternative fair value accounting provided for under Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" (FAS 123), requires use of option valuation models that were not developed for use in valuing employee stock options. Under APB Opinion No. 25, when the exercise price of the Company's employee stock options equals the market price of the underlying stock on the date of grant, no compensation expense is recognized.

Pro forma information regarding net loss is required by FAS 123 which also requires that the information be determined as if the Company has accounted for its employee stock options under the fair value method of FAS 123. The fair value for these options was estimated at the date of grant using the minimum value method with the following weighted average assumptions:

	1997	1998	1999
Risk-free interest rate	6.5%	5.2%	5.5%
Dividend yield	-	-	-
Weighted average expected life	5 years	5 years	5 years

For purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense over the options' vesting period. If compensation cost for the Company's stock-based compensation plan had been determined based on the fair value at the grant dates for awards under this plan consistent with the method provided for under FAS 123, then the Company's net loss would have been as indicated in the pro forma amount below:

	YEARS ENDED DECEMBER 31,		
	1997	1998	1999
Net loss as reported	$(1,241,793)	$588,363	$(4,501,102)
Pro forma net loss	$(1,258,093)	$611,828	$4,532,551
Net loss per share as reported, basic and diluted	$(0.15)	$(0.07)	$(0.46)
Pro forma net loss per share, basic and diluted	$(0.15)	$(0.07)	$(0.47)

VPNX.com, Inc.
(a development stage company)
Notes to Financial Statements (continued)
(Information as of June 30, 2000 and for the six months ended
June 30, 1999 and 2000 is unaudited)

5. STOCKHOLDERS' EQUITY (CONTINUED)

VALUATION OF STOCK OPTIONS (CONTINUED)

The pro forma impact of FAS 123 will not be fully reflected until 2000 and is not expected to be indicative of the effects on net income (loss) in future years.

STOCK SUBJECT TO REPURCHASE

In 1996 and 1997, the Company issued 2,083,340 shares of common stock to its President and 150,000 shares of common stock to other members of the Board of Directors, which are subject to repurchase should the individuals discontinue service to the Company. The Company's repurchase rights for these shares expire at various times through 2001. At December 31, 1999, 54,167 of the shares issued to the Company's Board of Directors were subject to repurchase by the Company.

DEFERRED COMPENSATION

During the six-month period ended June 30, 2000, the Company recorded aggregate deferred compensation of $1,790,000 representing the difference between the exercise price of stock options granted and the then deemed fair value of the Company's common stock. These amounts are being amortized as charges to operations, using the straight-line method, over the vesting periods of the individual stock options, generally four years. For the six-month period ended June 30, 2000, the Company amortized $83,000 of deferred compensation.

5. STOCKHOLDERS' EQUITY (CONTINUED)

SHARES RESERVED

Common stock reserved for future issuance is as follows:

	DECEMBER 31, 1999	JUNE 30, 2000
Stock option plans (the 1996 Founders' Plan and the 1997 Plan):		
Outstanding	2,259,779	2,544,490
Reserved for future grants	337,513	751,007
	2,597,292	3,295,497
Conversion of preferred stock	6,272,328	6,272,328
Warrants issued to note holders	471,149	471,149
Total common stock reserved for future issuance	9,340,769	10,038,974

6. EMPLOYEE BENEFIT PLAN

The Company has a Savings Plan that qualifies under Section 401(k) of the Internal Revenue Code. Under the plan, participating employees may defer up to 15% of their pretax salary but not more than statutory limits. The Company may elect to make matching contributions to the plan. For the fiscal year ending December 31, 1999, the Company matched employees' contributions, dollar for dollar, up to $500. The total cost of the contribution was $26,000. For the fiscal years ended December 31, 1998 and before, the Company made no matching contributions. Expenses related to the plan are immaterial.

7. INCOME TAXES

Due to operating losses and the inability to recognize benefits therefrom, there is no provision for income taxes for the periods ended December 31, 1998, 1999, and the period from April 10, 1997 through December 31, 1997.

Deferred income taxes reflect the net effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's deferred tax assets are as follows (in thousands):

	YEARS ENDED DECEMBER 31,	
	1998	1999
Deferred tax assets:		
Net operating loss carryforwards	$ 383	$1,586
Tax credit carryforwards	125	4000
Deferred revenue	62	128
Other accruals and reserves not currently deductible	130	689
Total deferred tax assets	700	2,800
Valuation allowances	(700)	(2,800)
Net deferred tax assets	$ -	$ -

Realization of deferred tax assets is dependent on future earnings, if any, the timing and amount of which are uncertain. Accordingly, a valuation allowance, in an amount equal to the net deferred tax asset as of December 31, 1999 and 1998 has been established to reflect these uncertainties. The change in valuation was a net increase of approximately $400,000 and $2,100,000 for the fiscal years ended December 31, 1998 and 1999, respectively.

As of December 31, 1999, the Company had federal and California net operating loss carryforwards of approximately $4,100,000 and $3,300,000, respectively. The Company also had federal research and development tax credit carryforwards of approximately $400,000. The net operating loss and credit carryforwards will expire at various dates beginning in 2003 through 2019, if not utilized.

Utilization of the net operating losses and credits may be subject to a substantial annual limitation due to the ownership change limitations provided by the Internal Revenue Code of 1986 and similar state provisions. The annual limitation may result in the expiration of net operating losses and credits before utilization.

7. INCOME TAXES (CONTINUED)

Through April 9, 1997, the Company was a Subchapter S corporation, and as such, all items of income and expense were taxed directly to its stockholders.

8. RELATED PARTY TRANSACTION

The Company received legal services of approximately $30,000, $72,000, $51,000, and $172,000 in 1997, 1998, 1999, and the period from June 19, 1996 (inception) to December 31, 1999, respectively, from a stockholder's law firm. In addition, the Company received legal services for approximately $34,000 and $56,000 for the six months ended June 30, 1999 and 2000, respectively, from the same stockholder's law firm.

9. NET LOSS PER SHARE

The Company follows the provisions of Statement of Financial Accounting Standards No. 128, "Earnings Per Share." Basic and diluted net loss per share are computed by dividing the net loss by the weighted average number of common shares outstanding during the period less outstanding nonvested shares. Outstanding nonvested shares are not included in the computation of basic net loss per share until the time-based vesting restrictions have lapsed.

	YEARS ENDED DECEMBER 31,			SIX MONTHS ENDED JUNE 30,	
	1997	1998	1999	1999	2000
Net loss (numerator)	$(1,241,793)	$(588,363)	$(4,501,102)	$(3,395,221)	$(3,273,804)
Shares used in computing basic and diluted net loss per share (denominator):					
Weighted average common shares outstanding	9,672,227	9,959,449	9,966,116	9,966,116	9,978,211
Less shares subject to repurchase	(1,352,870)	(981,607)	(246,533)	(264,840)	(27,083)
Denominator for basic and diluted net loss per share	8,319,357	8,977,842	9,719,583	9,701,276	9,951,128

10. SUBSEQUENT EVENTS

On July 6, 2000, the Company signed a definitive agreement to be acquired by InterNAP Network Services. The transaction closed on July 31, 2000.