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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

(Mark One)

/x/	**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Quarterly Period Ended March 31, 2001

OR

/ /	**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from ________ to ________

Commission File Number: 000-27265

INTERNAP NETWORK SERVICES CORPORATION

(Exact name of registrant as specified in its charter)

WASHINGTON (State or other jurisdiction of incorporation or organization)	**91-1896926** (IRS Employer identification No.)

601 Union Street, Suite 1000
Seattle, Washington 98101
(Address of principal executive offices)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes /x/ No / /

Indicate the number of shares outstanding of each of the registrant's classes of common stock as of the latest practicable date: 150,140,504 shares of common stock, no par value, outstanding as of March 31, 2001.

INTERNAP NETWORK SERVICES CORPORATION
FORM 10-Q
FOR THE QUARTER ENDED MARCH 31, 2001

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

INTERNAP NETWORK SERVICES CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited, in thousands)

	March 31, 2001	December 31, 2000
ASSETS		
Current assets:		
Cash and cash equivalents	$ 70,166	$ 102,160
Short-term investments	35,874	50,770
Investment income receivable	663	1,035
Accounts receivable, net of allowance of $1,452 and $1,370, respectively	17,868	20,291
Prepaid expenses and other assets	2,441	3,303
Total current assets	127,012	177,559
Property and equipment, net	154,084	152,153
Restricted cash	8,515	8,515
Investments	12,000	35,090
Goodwill and other intangible assets, net of accumulated amortization of $15,119 and $54,334, respectively	53,137	268,959
Deposits and other assets, net	8,277	7,834
Total assets	$ 363,025	$ 650,110
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 24,938	$ 26,846
Accrued liabilities	16,407	18,483
Deferred revenue	2,378	3,491
Notes payable, current portion	2,140	2,320
Line of credit	10,000	10,000
Capital lease obligations, current portion	17,961	18,132
Total current liabilities	73,824	79,272
Deferred revenue	11,449	11,239
Notes payable, less current portion	2,606	2,989
Capital lease obligations, less current portion	20,137	24,657

Total liabilities	108,016	118,157
Commitments and contingencies		
Shareholders' equity:		
Common stock, no par value, 500,000 shares authorized; 150,141 and 148,779 shares issued and outstanding, respectively	787,757	786,183
Deferred stock compensation	(9,506)	(11,715)
Accumulated deficit	(511,734)	(244,915)
Accumulated items of other comprehensive income (loss)	(11,508)	2,400
Total shareholders' equity	255,009	531,953
Total liabilities and shareholders' equity	$ 363,025	$ 650,110

The accompanying notes are an integral part of these condensed consolidated financial statements.

INTERNAP NETWORK SERVICES CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited, in thousands, except per share amounts)

	Three Months Ended March 31,	
	2001	2000
Revenues	$ 28,440	$ 8,891
Costs and expenses:		
Cost of network and customer support	37,842	15,326
Product development	3,804	1,578
Sales and marketing	14,494	7,689
General and administrative	17,456	4,233
Amortization of goodwill and other intangible assets	19,828	—
Amortization of deferred stock compensation	2,209	3,074
Restructuring costs	4,342	—
Impairment of goodwill and other intangible assts	195,986	—
Total operating costs and expenses	295,961	31,900
Loss from operations	(267,521)	(23,009)
Other income (expense):		
Interest income	1,890	2,926
Interest and financing expense	(1,188)	(540)
Total other income (expense)	702	2,386
Net loss	$ (266,819)	$ (20,623)
Basic and diluted net loss per share	$ (1.79)	$ (0.16)
Weighted average shares used in computing basic and diluted net loss per share	149,115	132,526

The accompanying notes are an integral part of these condensed consolidated financial statements.

INTERNAP NETWORK SERVICES CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited, in thousands)

	Three Months Ended March 31, 2001	Three Months Ended March 31, 2000
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss	$ (266,819)	$ (20,623)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	30,301	2,609
Impairment of goodwill and other intangible assets	195,986	—
Provision for doubtful accounts	1,368	147
Non-cash compensation expense	2,209	3,074
Loss on disposal of fixed assets	114	—
Changes in operating assets and liabilities:		
Accounts receivable	1,055	(2,396)
Investment income receivable	372	(1,807)
Prepaid expenses, deposits and other assets	419	(221)
Accounts payable	3,948	(865)
Deferred revenue	(903)	195
Accrued liabilities	(2,076)	(668)
Net cash used in operating activities	(34,026)	(20,555)
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of property and equipment	(19,083)	(6,138)
Proceeds from disposal of property and equipment	195	42
Purchase of investments	(6,022)	(65,682)
Redemption of investments	30,100	558
Net cash provided by (used in) investing activities	5,190	(71,220)
CASH FLOWS FROM FINANCING ACTIVITIES		
Principal payments on notes payable	(563)	(238)
Payments on capital lease obligations	(4,169)	(1,374)
Proceeds from equipment leaseback financing	—	717
Proceeds from issuance of and exercise of warrants to purchase capital stock, net of issuance costs	—	1
Proceeds from exercise of stock options	236	1,045
Proceeds from issuance of common stock	1,338	1,436
Net cash (used in) provided by financing activities	(3,158)	1,587
Net increase (decrease) in cash and cash equivalents	(31,994)	(90,188)
Cash and cash equivalents at beginning of period	102,160	155,184
Cash and cash equivalents at end of period	$ 70,166	$ 64,996
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid for interest, net of amounts capitalized	$ 778	$ 385
Purchase (return) of property and equipment financed with capital leases	$ (521)	$ 5,310
Change in accounts payable attributable to purchases of property and equipment	$ (5,856)	$ 166

The accompanying notes are an integral part of these condensed consolidated financial statements.

INTERNAP NETWORK SERVICES CORPORATION

CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY AND COMPREHENSIVE LOSS

THREE MONTHS ENDED MARCH 31, 2001

(Unaudited, in thousands)

	Common Stock						
	Shares	Value	Deferred Stock Compensation	Accumulated Deficit	Accumulated Items of Other Comprehensive Income	Total	Comprehensive Loss
Balances, December 31, 2000	148,779	$ 786,183	$ (11,715)	$ (244,915)	$ 2,400	$ 531,953	—
Amortization of deferred stock compensation	—	—	2,209	—	—	2,209	—
Exercise of employee stock options	549	236	—	—	—	236	—
Issuance of employee stock purchase plan shares	813	1,338	—	—	—	1,338	—
Net loss	—	—	—	(266,819)	—	(266,819)	$ (266,819)
Unrealized loss on investments	—	—	—	—	(13,908)	(13,908)	(13,908)
Comprehensive loss	—	—	—	—	—	—	$ (280,727)
Balances, March 31, 2001	150,141	$ 787,757	$ (9,506)	$ (511,734)	$ (11,508)	$ 255,009	

The accompanying notes are an integral part of these condensed consolidated financial statements.

INTERNAP NETWORK SERVICES CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation:

The unaudited condensed consolidated financial statements have been prepared by Internap Network Services Corporation pursuant to the rules and regulations of the Securities and Exchange Commission and include all the accounts of the Company and its wholly owned subsidiaries. Certain information and footnote disclosures, normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States, have been condensed or omitted pursuant to such rules and regulations. In the opinion of management, the unaudited condensed consolidated financial statements reflect all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the our financial position as of March 31, 2001, our operating results for the three months ended March 31, 2001 and 2000, our cash flows for the three months ended March 31, 2001 and 2000 and changes in our shareholders' equity for the three months ended March 31, 2001. The balance sheet at December 31, 2000 has been derived from our audited financial statements as of that date. These financial statements and the related notes should be read in conjunction with our financial statements and notes thereto contained in our annual report on Form 10-K/A filed with the Securities and Exchange Commission.

The preparation of financial statements in accordance with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities in the financial statements. Examples of estimates subject to possible revision based upon the outcome of future events include, among others, recoverability of long-lived assets, depreciation of property and equipment and the allowance for doubtful accounts. Actual results could differ from those estimates.

Certain prior year balances have been reclassified to conform to current year presentation. These reclassifications have not impacted net loss or cash flows.

The results of operations for the three-month period ended March 31, 2001 are not necessarily indicative of the results that may be expected for the future quarters.

2. Impairment and Restructuring Costs

On June 20, 2000, we completed the acquisition of CO Space which was accounted for under the purchase method of accounting. The purchase price was allocated to net tangible assets and identifiable intangible assets and goodwill. During the first quarter of 2001, our stock price declined to a historical low and we began experiencing larger than expected customer attrition. As a result of these events, we revised our financial projections including reductions in budgeted costs relating to the completion of a series of executed but undeveloped leases acquired from CO Space. Subsequently, on February 28, 2001, management and the board of directors approved a restructuring plan that included the elimination of the completion of the executed but undeveloped leases and the termination of core collocation development personnel.

Consequently, pursuant to the guidance provided by Financial Accounting Standards Board No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of" ("SFAS 121"), management completed a cash flow analysis of the collocation assets, including the assets acquired from CO Space. The cash flow analysis showed that the estimated cash flows were less than the carrying value of the collocation assets. Accordingly, pursuant to SFAS 121, management estimated the fair value of the collocation assets to be $79.5 million based upon a discounted future cash flow analysis. As estimated fair value of the collocation assets was less than their recorded amounts, we recorded an impairment charge of approximately $196.0 million.

In addition to the impairment cost, we recorded related restructuring costs totaling $4.3 million primarily relating to estimated costs for severance relating to the termination of 65 employees, anticipated losses related to subleasing the undeveloped leases, and other associated costs.

3. Holding Company

During February 2001, a holding company named Internap Corporation was formed, capitalized by 100 shares of common stock. Our board of directors has approved a plan, subject to shareholder approval, under which Internap Network Services Corporation would be merged into Internap Corporation and shareholders of Internap Network Services Corporation would receive equivalent shares of Internap Corporation in exchange for their original shares. Subsequent to the merger, Internap Corporation will be an entity with identical ownership as Internap Network Services Corporation just prior to the merger and therefore the recorded assets of Internap Network Services Corporation will be carried forward to the consolidated financial statements of Internap Corporation at their recorded historical amounts.

4. Net Loss Per Share

Basic and diluted net loss per share has been computed using the weighted average number of shares of common stock outstanding during the period, less the weighted average number of unvested shares of common stock issued that are subject to repurchase. We have excluded all warrants, outstanding options to purchase common stock and shares subject to repurchase from the calculation of diluted net loss per share, as such securities are antidilutive for all periods presented. Basic and diluted net loss per share for the three-month periods ended March 31, 2001 and 2000 are calculated as follows (in thousands, except per share amounts):

	Three months ended March 31,	
	2001	**2000**
	(unaudited)	
Net loss	$ (266,819)	$ (20,623)
Basic and diluted:		
Weighted-average shares of common stock outstanding used in computing basic and diluted net loss per share	149,115	132,526
Basic and diluted net loss per share	$ (1.79)	$ (0.16)
Antidilutive securities not included in diluted net loss per share calculation:		
Options to purchase common stock	23,496	16,726
Warrants to purchase common	1,626	1,671
Unvested shares of common stock subject to repurchase	75	225
	25,197	18,622

5. Property and Equipment

Property and equipment consists of the following (in thousands):

	March 31, 2001	December 31, 2000
	(unaudited)	
Network equipment	$ 35,166	$ 32,777
Network equipment under capital lease	52,040	52,637
Furniture, equipment and software	29,616	24,066
Furniture, equipment and software under capital lease	4,447	4,414
Leasehold improvements	70,338	65,622
	191,607	179,516

Less: Accumulated depreciation and amortization ($19,617 and $12,069 related to capital leases at March 31, 2001 and December 31, 2000, respectively)	(37,523)	(27,363)
Property and equipment, net	$ 154,084	$ 152,153

6. Comprehensive Loss

For the three months ended March 31, 2001 and 2000, comprehensive loss was $280.7 million and $20.6 million, respectively. The difference between net loss and comprehensive loss of $13.9 million and $0 for the periods ended March 31, 2001 and 2000, respectively, is due to net unrealized gains and losses on available-for-sale securities.

7. Recent Accounting Pronouncements

We adopted Statement of Financial Accounting Standards ("SFAS") No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended by SFAS No. 137, "Accounting for Derivative Instruments and Hedging Activities—Deferral of the Effective Date of SFAS No. 133" and SFAS No. 138, "Accounting for Derivative Instrumnets and Certain Hedging Activies," effective January 1, 2001. These pronouncements establish accounting and reporting standards for derivative instruments and hedging activies which, among other things, require that an entity recognize all derivatives as either assets or liabilities in the statement of financial position and measure those derivatives at fair value. Our adoption of SFAS No. 133 has not materially impacted our financial position, results of operations or cash flows.

8. Subsequent Events

Joint Venture

On April 10, 2001 Internap announced the formation of a joint venture with NTT-ME Corporation of Japan. The formation of the joint venture involved our investment of $2.8 million to acquire 51% of the common stock of the newly formed entity. The joint venture, Internap Japan, will offer Internap's managed, high performance connectivity service to the Japanese market while leveraging NTT-ME's existing marketing, sales, systems integration and operations capabilities in the target market. Internap Japan anticipates commencing operations during the second half of 2001.

Restructuring Costs

On April 18, 2001 executive management and the board of directors agreed to an additional restructuring of the organization which resulted in the termination of 118 employees and contractors in addition to the employees terminated previously. As a result of these terminations, we expect to incur approximately $0.7 million in additional severance and employee termination costs during the second quarter of 2001.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Certain statements in this Quarterly Report on Form 10-Q, including, without limitation, statements containing the words "believes," "anticipates," "estimates," "expects" and words of similar import, constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. You should not place undue reliance on these forward-looking statements. Our actual results could differ materially from those anticipated in these forward-looking statements for many reasons, including the risks faced by us described below and elsewhere in this Quarterly Report, and in other documents we file with the Securities and Exchange Commission.

OVERVIEW

Internap is a leading provider of high performance Internet connectivity services targeted at businesses seeking to maximize the performance of mission-critical Internet-based applications. Customers connected to one of our service points have their data optimally routed to and from destinations on the Internet using our overlay network, which analyzes the traffic situation on the multiplicity of networks that comprise the Internet and delivers mission-critical information and communications faster and more reliably. Use of our overlay network results in lower instances of data loss and greater quality of service than services offered by conventional Internet connectivity providers. As of March 31, 2001, we provided our high performance Internet connectivity services to 727 customers.

We offer our high performance Internet connectivity services at dedicated line speeds of 1.5 Megabits per second, or Mbps, to 1,000 Mbps to customers desiring a superior level of Internet performance. We provide our high performance connectivity services through the deployment of service points, which are highly redundant network infrastructure facilities coupled with our patented routing technology. Service points maintain high speed, dedicated connections to major global Internet networks, commonly referred to as backbones, such as AT&T, Cable & Wireless USA, Genuity, Global Crossing Telecommunications, Intermedia, Qwest Communications International, Sprint Internet Services, UUNET Technologies and Verio (an NTT Communications Corporation). As of March 31, 2001, we operated 36 service points which are located in the Amsterdam, Atlanta (two service points), Boston (two service points), Chicago (two sevice points), Dallas (three service points), Denver, Fremont, CA, Houston (two service points), London, Los Angeles (three service points), Miami, New York (three service points), Orange County, Philadelphia (two service points), San Diego (two service points), San Francisco, San Jose (two service points), Santa Clara, Seattle (three service points) and Washington, D.C. (two service points) metropolitan areas.

We believe our service points provide a superior quality of service over the public Internet enabling our customers to realize the full potential of their existing Internet-based applications, such as e-commerce and on line trading. In addition, we believe our service points will enable our customers to take advantage of new services, such as using the Internet to conduct video conferencing, make telephone calls or send facsimiles, create private networks, distribute multimedia documents and send and receive audio and video feeds.

Impairment and Restructuring Costs

On June 20, 2000, we completed the acquisition of CO Space which was accounted for under the purchase method of accounting. The purchase price was allocated to net tangible assets and identifiable intangible assets and goodwill. During the first quarter of 2001, our stock price declined to a historical low and we began experiencing larger than expected customer attrition. As a result of these events, we revised our financial projections including reductions in budgeted costs relating to the completion of a series of executed but undeveloped leases acquired from CO Space. Subsequently, on February 28, 2001, management and the board of directors approved a restructuring plan that included the elimination of the completion of the executed but undeveloped leases and the termination of core collocation development personnel.

Consequently, management estimated the fair value of the collocation assets to be $79.5 million based upon discounted future cash flows. As the estimated fair value of the collocation assets was less than their recorded amounts, we recorded an impairment charge of approximately $196.0 million.

In addition to the impairment cost, we recorded related restructuring costs totaling $4.3 million primarily relating to estimated costs for severance relating to the termination of 65 employees, anticipated losses related to subleasing the undeveloped leases, and other associated costs.

Deferred Stock Compensation

During the years ended December 31, 1998 and 1999, in connection with the grant of certain stock options to employees, we recorded deferred stock compensation totaling $25.0 million, representing the difference between the deemed fair value of our common stock on the date options were granted and the exercise price. In connection with our acquisition of VPNX, we recorded deferred stock compensation totaling $5.1 million related to unvested options we assumed. These amounts are included as a component of shareholders' equity and are being amortized over the vesting period of the individual grants, generally four years, using an accelerated method as described in Financial Accounting Standards Board Interpretations No. 28. We recorded amortization of deferred stock compensation in the amount of $2.2 million for the three-month period ended March 31, 2001. At March 31, 2001, we had a total of $9.5 million remaining to be amortized over the corresponding vesting periods of the stock options.

Results Of Operations

The following table sets forth, as a percentage of total revenues, selected statement of operations data for the periods indicated:

	Three months ended March 31,	
	2001	2000
Revenues	100%	100%
Costs and expenses:		
Cost of network and customer support	133	172
Product development	13	18
Sales and marketing	51	86
General and administrative	62	48
Amortization of goodwill and other intangible assets	70	—
Amortization of deferred stock compensation	8	35
Restructuring costs	15	—
Impairment of goodwill and other intangible assets	689	—
Total costs and expenses	1,041	359
Loss from operations	(941)	(259)
Other income (expense):		
Interest income	7	33
Interest and financing expense	(4)	(6)
Total other income (expense)	3	27
Net loss	(938)%	(232)%

Three months Ended March 31, 2001 and 2000

Net Loss. Net loss for the three-month period ended March 31, 2001 was $266.8 million, or $1.79 share, as compared to $20.6 million, or $0.16 per share, for the same period in the preceding year. The increase in net loss was primarily due to restructuring and impairment costs totaling $200.3 million and amortization of goodwill and other intangibles totaling $19.8 million. Excluding these costs, net loss for the three-month period ending March 31, 2001 was $46.7 million, or $0.31 per share.

Revenues. Revenues increased 219% from $8.9 million for the three-month period ended March 31, 2000 to $28.4 million for the three-month period ended March 31, 2001. The increase in Internet connectivity revenue of $19.5 million was attributable to increased sales at our existing service points and the deployment of 20 service points from March 31, 2000 through March 31, 2001.

Costs of Network and Customer Support. Costs of network and customer support increased 147% from $15.3 million for the three-month period ended March 31, 2000 to $37.8 million for the three-month period ended March 31, 2001. This increase of $22.5 million was primarily due to increased connectivity costs related to added and increased usage of connections to Internet backbone and competitive local exchange providers at each service point, comprising 35% of the increase, and to a lesser extent, depreciation expense related to the equipment at deployed service points, comprising 26% of the increase, rent and facility costs, comprising 22% of the increase and additional compensation costs, comprising 14% of the increase. Network and customer support costs as a percentage of total revenues are generally greater than 100% for newly deployed service points because the Company purchases Internet connectivity capacity from the backbone providers in advance of securing new customers. The Company expects these costs to increase in absolute dollars as the Company deploys additional service points.

Product Development. Product development costs increased 138% from $1.6 million for the three-month period ended March 31, 2000 to $3.8 million for the three-month period ended March 31, 2001. This increase of $2.2 million was due to increased compensation costs. The Company expects product development costs to increase in absolute dollars for the foreseeable future.

Sales and Marketing. Sales and marketing costs increased 88% from $7.7 million for the three-month period ended March 31, 2000 to $14.5 million for the three-month period ended March 31, 2001. This increase of $6.8 million was primarily due to advertising costs, comprising 62% of the increase, and, to a lesser extent, increased compensation costs comprising 23% of the increase.

General and Administrative. General and administrative costs increased 316% from $4.2 million for the three-months ended March 31, 2000 to $17.5 million for the three-months ended March 31, 2001. This increase of $13.3 million was primarily due to increased facility costs, representing 25% of the increase, increased compensation costs, representing 24% of the increase, and to a lesser extent increased depreciation expense, representing 14% of the increase, and increased bad debt expense, representing 9% of the increase. The Company expects general and administrative costs to increase in absolute dollars as the Company deploys additional service points and the Company continues to grow.

Other Income (Expense). Other income (expense), net, decreased from $2.4 million of other income for the three-month period ended March 31, 2000 to $0.7 million of other income for the three-month period ended March 31, 2001. This decrease was primarily due to increased interest expense associated with increased borrowings and capital leases and a decline in interest income stemming from decreasing investment and interest earning asset balances.

Liquidity and Capital Resources

Since our inception, we have financed our operations primarily through the issuance of our equity securities, capital leases and bank loans. As of March 31, 2000, we have raised an aggregate of approximately $405.6 million, net of offering expenses, through the sale of our equity securities. In January 2000, we paid a 100% stock dividend on our common stock and, accordingly, all related disclosures have been revised to reflect the stock dividend for all periods presented.

In October 1999, we sold 19,000,000 shares of our common stock at an initial public offering price of $10.00 per share resulting in net proceeds of $176.7 million. During October 1999, in connection with our initial public offering, the underwriters exercised their overallotment option, resulting in the sale of an additional 2,850,000 shares of our common stock at $10.00 per share for additional net proceeds of $26.5 million. Upon the closing of our initial public offering, all shares of outstanding preferred stock converted into 98,953,050 shares of common stock.

Concurrent with the closing of our initial public offering on October 4, 1999, we sold 2,150,537 shares of common stock to Inktomi Corporation for $9.30 per share, resulting in proceeds of $19.0 million. In conjunction with this investment, we issued a warrant to Inktomi to purchase 1,075,268 shares of our common stock at an exercise price of $13.95 per share. The warrant has a two-year term and includes demand and piggyback registration rights. On November 24, 1999, Inktomi exercised 50% of these warrants through a cashless exercise, resulting in the issuance of 397,250 shares of our common stock to Inktomi. The agreement also prohibits Inktomi from acquiring additional shares of our common stock for a period of two years.

On February 22, 2000, pursuant to an investment agreement, we purchased 588,236 shares of Aventail Corporation Series D preferred stock at $10.20 per share for a total cash investment of $6.0 million. The Series D preferred stock is convertible to common stock at a ratio of one share of preferred stock to one share of common stock, subject to adjustment for certain equity transactions. Additionally, we entered into a joint marketing agreement with Aventail which, among other things, granted us limited exclusive rights to sell Aventail's managed extranet service and granted Aventail specified rights to sell our services. In return, we committed to either sell Aventail services or pay

Aventail, or a combination of both, which would result in Aventail's receipt of $3.0 million over a two-year period.

On April 6, 2000, 8,625,000 shares of our common stock were sold in a public offering at a price of $43.50 per share. Of these shares, 3,450,000 were sold by us and 5,175,000 shares were sold by selling shareholders. We did not receive any of the proceeds from the sale of shares of common stock by the selling shareholders. Our proceeds from the offering were $142.9 million, net of underwriting discounts and commissions of $7.1 million.

Pursuant to an investment agreement among us, Ledcor Limited Partnership, Worldwide Fiber Holdings Ltd. and 360networks, Inc., on April 17, 2000, we purchased 374,182 shares of 360networks Class A Non-Voting Stock at $5.00 per share and, on April 26, 2000, we purchased 1,122,545 shares of 360networks Class A Subordinate Voting Stock at $13.23 per share. The total cash investment was $16.7 million. Additionally, we entered into a letter of intent with 360networks to negotiate a strategic agreement that would provide us with long-haul fiber-optic bandwidth capacity and provide 360networks with our Internet connectivity services.

On August 10, 2000, we entered into a credit facility with Speedera Networks, which allows Speedera to borrow up to $6.0 million from us. The credit facility bears interest at the prime rate plus 3% on the date of each draw and matures on May 9, 2004. As of March 31, 2000, we have included $6.0 million in non-current investments related to Speedera borrowings under the credit facility.

At March 31, 2001, we had cash, cash equivalents and short-term investments of $106.7 million and a revolving line of credit and equipment financing arrangements allowing us to borrow up to $105.0 million, of which we had approximately $35.0 million available to us under these facilities subject to obtaining additional financing. Interest rates under these facilities range from 3% to 19%, and these facilities expire at various dates through 2004. These financial arrangements contain financial covenants including covenants to maintain certain liquidity ratios and minimum net worth. We were in compliance with all such financial covenants as of March 31, 2001. In addition, these financing arrangements also include subjective covenants that allow the financial institutions to reduce the available credit based on general credit worthiness.

We are currently pursuing $150.0 million to $250.0 million in additional financing with leading financial institutions and investors. The majority of this financing is expected to be in the form of a credit facility. As of the date of this report, the final terms, including the total facility amount, interest rate and covenants, are currently being negotiated. We may be unable to successfully negotiate a definitive agreement on terms acceptable to us.

We expect to spend significant additional capital to support ongoing operations, capital requirements related to expected increased sales and, to a lesser extent, product development and the development of our internal systems and software. We expect to continue to expend significant amounts of capital on property and equipment related to the expansion of facility infrastructure, computer equipment and for research and development laboratory and test equipment to support on-going research and development operations.

During the next 12 months, we expect to meet our cash requirements with existing cash, cash equivalents, short-term investments, cash flow from sales of our services and proceeds from additional financing. However, our capital requirements depend on several factors, including the rate of market acceptance of our services, the ability to expand our customer base, the rate of deployment of additional service points and other factors. If our capital requirements vary materially from those currently planned, or if we fail to generate sufficient cash flow from the sales of our services, we may require additional financing sooner than anticipated or we may have to delay or abandon some or all of our development and expansion plans or otherwise forego market opportunities. We intend to invest cash in excess of current operating requirements in short-term, interest-bearing, investment-grade securities.

Recent Accounting Pronouncements

We adopted Statement of Financial Accounting Standards ("SFAS") No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended by SFAS No. 137, "Accounting for Derivative Instruments and Hedging Activities—Deferral of the Effective Date of SFAS No. 133" and SFAS No. 138, "Accounting for Derivative Instrumnets and Certain Hedging Activies," effective January 1, 2001. These pronouncements establish accounting and reporting standards for derivative instruments and hedging activies which, among other things, require that an entity recognize all derivatives as either assets or liabilities in the statement of financial position and measure those derivatives at fair value. Our adoption of SFAS No. 133 has not materially impacted our financial position, results of operations or cash flows.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We maintain investment portfolio holdings of various issuers, types, and maturities, the majority of which are commercial paper and government securities. These securities are generally classified as available for sale and, consequently, are recorded on the balance sheet at fair value with unrealized gains or losses reported as a separate component of accumulated other comprehensive income. Part of this portfolio includes our investment of $16.7 million in a minority equity investment in 360networks, a publicly traded company listed on the Nasdaq Stock Market. The value of the 360networks investment is subject to market price volatility. We also have a $6.0 million equity investment in Aventail, an early stage, privately held company, and a $6.0 million credit facility due from Speedera, an early stage, privately held company. These strategic investments are inherently risky, in part because the market for the products or services being offered or developed by 360networks, Aventail and Speedera have not been proven and may never materialize. Because of risk associated with these investments, we could lose our entire initial investment in these companies.

The remaining portion of our investment portfolio, with a fair value of $30.8 million as of March 31, 2001, is invested in commercial paper, government securities and corporate indebtedness that could experience an adverse decline in fair value should an increase in interest rates occur. In addition, declines in interest rates could have an adverse impact on interest earnings for our investment portfolio. We do not currently hedge against these interest rate exposures.

The following sensitivity analysis presents hypothetical changes in the fair values of our investment in 360networks, our only current public equity investment as of March 31, 2001. This modeling technique measures the hypothetical change in fair values arising from selected hypothetical changes in the stock price of 360networks. We selected stock price fluctuations of plus or minus 15%, 35% and 50% because there has been at least one movement in the Nasdaq Composite Index of at least 15% in each of the last three years and movements of at least 35% and 50% in at least one of the last three years.

Security	Fair Value at 3/31/2000 (in thousands)	Valuation of Security Given X% Increase in Security's Price (in thousands) 15%	35%	50%	Valuation of Security Given X% Decrease in Security's Price (in thousands) 15%	35%	50%
360 networks Capital Stock	$ 5,103	$ 5,868	$ 6,889	$ 7,655	$ 4,338	$ 3,317	$ 2,552

As of March 31, 2001, our cash equivalents mature within three months and our short-term investments generally mature in less than one year. Therefore, as of March 31, 2001, we believe the reported amounts of cash and cash equivalents, investments and lease obligations to be reasonable approximations of fair value and the market risk arising from our holdings to be minimal.

All of our revenues are currently in U.S. dollars and are from customers primarily in the United States. Therefore, we do not believe we currently have any significant direct foreign currency exchange rate risk.

RISK FACTORS

Risks Related to the Company's Business

We Have a History of Losses and Expect Future Losses and May Not Achieve or Sustain Annual Profitability. We have incurred net losses in each quarterly and annual period since we began operations. We incurred net losses of $7.0 million, $49.9 million and $185.5 million for the years ended December 31, 1998, 1999 and 2000, respectively. Our net loss for the three months ended March 31, 2001 was $266.8 million. As of March 31, 2001, our accumulated deficit was $511.7 million. As a result of our expansion plans, we expect to incur net losses and negative cash flows from operations on a quarterly and annual basis for at least the next 18 months, and we may never become profitable.

Our Limited Operating History Makes It Difficult to Evaluate Our Prospects. The revenue and income potential of our business and market is unproven, and our limited operating history makes it difficult to evaluate our prospects. We have only been in existence since 1996, and our services are only offered in limited regions. Investors should consider and evaluate our prospects in light of the risks and difficulties frequently encountered by relatively new companies, particularly companies in the rapidly evolving Internet infrastructure, connectivity and collocation markets.

Our Actual Quarterly Operating Results May Disappoint Analysts' Expectations, Which Could Have a Negative Impact on our Stock Price. Our stock price could suffer in the future, as it has in the past, as a result of any failure to meet the expectations of public market analysts and investors about our results of operations from quarter to quarter. Any significant unanticipated shortfall of revenues or increase in expenses could negatively impact our expected quarterly results of operations should we be unable to make timely adjustments to compensate for them. Furthermore, a failure on our part to estimate accurately the timing or magnitude of particular anticipated revenues or expenses could also negatively impact our quarterly results of operations.

Because our quarterly results of operations have fluctuated in the past and will continue to fluctuate in the future, investors should not rely on the results of any past quarter or quarters as an indication of future performance in our business operations or stock price. For example, increases in our quarterly revenues for the quarters ended March 31, 2000, through March 31, 2001, have varied between 5.9% and 61.7%, and total operating costs and expenses, as a percentage of revenues, have fluctuated between 295.7% and 1,040.7%. Fluctuations in our quarterly operating results depend on a number of factors. Some of these factors are industry risks over which we have no control, including the introduction of new services by our competitors, fluctuations in the demand and sales cycle for our services, fluctuations in the market for qualified sales and other personnel, changes in the prices for Internet connectivity we pay backbone providers, our ability to obtain local loop connections to our service points at favorable prices, integration of people, operations, products and technologies of acquired businesses and general economic conditions.

Other factors that may cause fluctuations in our quarterly operating results arise from strategic decisions we have made or may make with respect to the timing and magnitude of capital expenditures such as those associated with the deployment of additional service points and the terms of our Internet connectivity purchases. For example, our practice is to purchase Internet connectivity from backbone providers at new service points and license collocation space from providers before customers are secured. We also have agreed to purchase Internet connectivity from some providers without regard to the amount we resell to our customers.

Some of Our Customers Are Emerging Internet-Based Businesses That May Not Pay Us for Our Services on a Timely Basis and May Not Succeed Over the Long Term. A portion of our revenues is derived from customers that are emerging Internet-based businesses. The unproven business models of some of these customers and an uncertain economic climate make their continued financial viability uncertain. Some

of these customers have encountered financial difficulties and, as a result, have delayed or defaulted on their payments to us. In the future others may also do so. If these payment difficulties are substantial, our business and financial results could be seriously harmed.

We Will Require Additional Capital in the Future and May Not Be Able to Secure Adequate Funds on Terms Acceptable to Us. The expansion and development of our business will require significant capital, which we may be unable to obtain, to fund our capital expenditures and operations, including working capital needs. Our principal capital expenditures and lease payments include the purchase, lease and installation of network equipment such as routers, telecommunications equipment and other computer equipment as well as data center leasehold improvements. The timing and amount of our future capital requirements may vary significantly depending on numerous factors, including regulatory, technological, competitive and other developments in our industry. During the next 12 months, we expect to meet our cash requirements with existing cash, cash equivalents, short-term investments, cash flow from sales of our services and proceeds from additional financing. However, our capital requirements depend on several factors, including the rate of market acceptance of our services, the ability to expand our customer base, the rate of deployment of additional service points and other factors. If our capital requirements vary materially from those currently planned, or if we fail to generate sufficient cash flow from the sales of our services, we may require additional financing sooner than anticipated or we may have to delay or abandon some or all of our development and expansion plans or otherwise forego market opportunities.

We may not be able to obtain future equity or debt financing on favorable terms, if at all. Future borrowing instruments, such as credit facilities and lease agreements, are likely to contain covenants restricting our ability to incur further indebtedness and will likely require us to pledge assets as security for borrowings thereunder. Our inability to obtain additional capital on satisfactory terms may delay or prevent the expansion of our business.

If We Are Unable to Manage Complications That Arise During Deployment of New Service Points, We May Not Succeed in Our Expansion Plans. Any delay in the opening of new service points would significantly harm our plans to expand our business. In our effort to deploy new service points, we face various risks associated with significant construction projects, including identifying and locating service point sites, construction delays, cost estimation errors or overruns, delays in connecting with local exchanges, equipment and material delays or shortages, the inability to obtain necessary permits on a timely basis, if at all, and other factors, many of which are beyond our control and all of which could delay the deployment of a new service point. The deployment of new service points, each of which takes approximately four to six months to complete, is a key element of our business strategy. In addition to our 36 existing service points, we are planning to continue to deploy service points within limited geographic regions, including foreign countries. Although we conduct market research in a geographic area before deploying a service point, we do not enter into service contracts with customers prior to building a new service point.

We Will Incur Additional Expense Associated with the Deployment of New Service Points and May Be Unable to Effectively Integrate New Service Points into Our Existing Network, Which Could Disrupt Our Service. New service points, if completed, will result in substantial new operating expenses, including expenses associated with hiring, training, retaining and managing new employees, provisioning capacity from backbone providers, purchasing new equipment, implementing new systems, leasing additional real estate and incurring additional depreciation expense. In addition, if we do not institute adequate financial and managerial controls, reporting systems, and procedures with which to operate multiple service points in geographically dispersed locations, our operations will be significantly harmed.

If We Are Unable to Continue to Receive Cost-Effective Service from Our Backbone Providers, We May Not Be Able to Provide Our Internet Connectivity Services on Profitable Terms, and These Backbone Providers May Not Continue to Provide Service to Us. In delivering our services, we rely on Internet backbones,

which are built and operated by others. In order to be able to provide high performance routing to our customers through our service points, we must purchase connections from several Internet backbone providers. There can be no assurance that these Internet backbone providers will continue to provide service to us on a cost-effective basis, if at all, or that these providers will provide us with additional capacity to adequately meet customer demand. Furthermore, it is very unlikely that we could replace our Internet backbone providers on comparable terms.

Currently, in each of our fully operational domestic service points, we have connections to some combination of the following nine backbone providers: AT&T, Cable & Wireless USA, Genuity, Global Crossing Telecommunications, Intermedia Communications, Qwest Communications International, Sprint Internet Services, UUNET Technologies and Verio (an NTT Communications Corporation). We may be unable to maintain relationships with, or obtain necessary additional capacity from, these backbone providers. Furthermore, we may be unable to establish and maintain relationships with other backbone providers that may emerge or that are significant in geographic areas, such as Asia and Europe, in which we locate our service points.

Competition from More Established Competitors Who Have Greater Revenues Could Decrease Our Market Share. The Internet connectivity services market is extremely competitive, and there are few substantial barriers to entry. We expect competition from existing competitors to intensify in the future, and we may not have the financial resources, technical expertise, sales and marketing abilities or support capabilities to compete successfully in our market. Many of our existing competitors have greater market presence, engineering and marketing capabilities, and financial, technological and personnel resources than we do. As a result, our competitors may have several advantages over us as we seek to develop a greater market presence.

Our competitors currently include backbone providers that provide connectivity services to us, regional Bell operating companies which offer Internet access, and global, national and regional Internet service providers. In addition, Internet backbone providers may make technological developments, such as improved router technology or the introduction of improved routing protocols, that will enhance the quality of their services.

As we continue to implement our international expansion, we will encounter additional competition from international Internet service providers as well as international telecommunications companies in the countries where we provide services.

Competition from New Competitors Could Decrease Our Market Share. We also believe that new competitors will enter our market. Such new competitors could include computer hardware, software, media and other technology and telecommunications companies. A number of telecommunications companies and online service providers have been offering or expanding their network services. Further, the ability of some of these potential competitors to bundle other services and products with their network services could place us at a competitive disadvantage. Various companies are also exploring the possibility of providing, or are currently providing, high-speed data services using alternative delivery methods including the cable television infrastructure, direct broadcast satellites, wireless cable and wireless local loop.

Pricing Pressure Could Decrease Our Market Share. Increased price competition or other competitive pressures could erode our market share. We currently charge, and expect to continue to charge, more for our Internet connectivity services than our competitors. For example, our current standard pricing is approximately 5% more than UUNET's current standard pricing and approximately 18% more than Sprint's current standard pricing. By bundling their services and reducing the overall cost of their solutions, telecommunications companies that compete with us may be able to provide customers with reduced communications costs in connection with their Internet connectivity services or private network services, thereby significantly increasing the pressure on us to decrease our prices. We

may not be able to offset the effects of any such price reductions even with an increase in the number of our customers, higher revenues from enhanced services, cost reductions or otherwise. In addition, we believe that the Internet connectivity industry is likely to encounter consolidation in the future. Consolidation could result in increased pressure on us to decrease our prices. Furthermore, the recent downturn in the U.S. economy has resulted in many companies who require Internet connectivity to reevaluate the cost of such services. We believe that a prolonged economic downturn could result in existing and potential customers being unwilling to pay for premium Internet connectivity services, which would harm our business.

A Failure in Our Network Operations Center, Service Points or Computer Systems Would Cause a Significant Disruption in Our Internet Connectivity Services. Although we have taken precautions against systems failure, interruptions could result from natural disasters as well as power loss, telecommunications failure and similar events. Our business depends on the efficient and uninterrupted operation of our network operations center, our service points and our computer and communications hardware systems and infrastructure. If we experience a problem at our network operations center, we may be unable to provide Internet connectivity services to our customers, provide customer service and support or monitor our network infrastructure or service points, any of which would seriously harm our business.

Because We Have Limited Experience Operating Internationally, Our International Expansion May Be Limited. Although we currently operate in 18 domestic metropolitan markets, a key component of our strategy is to expand into international markets. We have limited experience operating internationally. We may not be able to adapt our services to international markets or market and sell these services to customers abroad. In addition to general risks associated with international business expansion, we face the following specific risks in our international business expansion plans:

- difficulties in establishing and maintaining relationships with foreign customers as well as foreign backbone providers and local vendors, including collocation and local loop providers;

- difficulties in locating, building and deploying network operations centers and service points in foreign countries, and managing service points and network operations centers across disparate geographic areas; and

- exposure to fluctuations in foreign currency exchange rates.

We may be unsuccessful in our efforts to address the risks associated with our currently proposed international operations, and our international sales growth may therefore be limited.

Our Brand Is Relatively New, and Failure to Develop Brand Recognition Could Hurt Our Ability to Compete Effectively. To successfully execute our strategy, we must strengthen our brand awareness. If we do not build our brand awareness, our ability to realize our strategic and financial objectives could be hurt. Many of our competitors have well-established brands associated with the provision of Internet connectivity services. To date, we have attracted our existing customers primarily through a relatively small sales force, word of mouth and a limited, print-focused advertising campaign. In order to build our brand awareness, we must continue to provide high quality services.

We Are Dependent upon Our Key Employees and May Be Unable to Attract or Retain Sufficient Numbers of Qualified Personnel. Our future performance depends to a significant degree upon the continued contributions of our executive management team and key technical personnel. The loss of any member of our executive management team or a key technical employee, such as our Chief Executive Officer, Anthony Naughtin, our Chief Operating Officer, Michael Vent, our Chief Financial Officer, Paul McBride, or our Chief Technology Officer, Christopher Wheeler, could significantly harm us. Any of our officers or employees can terminate his or her relationship with us at any time. To the extent we are able to expand our operations and deploy additional service points, our workforce will be required

to grow. Accordingly, our future success depends on our ability to attract, hire, train and retain a substantial number of highly skilled management, technical, sales, marketing and customer support personnel. Competition for qualified employees is intense. Consequently, we may not be successful in attracting, hiring, training and retaining the people we need, which would seriously impede our ability to implement our business strategy.

If We Are Not Able to Support Our Growth Effectively, Our Expansion Plans May Be Frustrated or May Fail. Our inability to manage growth effectively would seriously harm our plans to expand our Internet connectivity services into new markets. Since the introduction of our Internet connectivity services, we have experienced a period of rapid growth and expansion, which has placed, and continues to place, a significant strain on all of our resources. For example, as of December 31, 1996, we had one operational service point and nine employees compared to 36 operational service points and 749 full-time employees as of March 31, 2001. In addition, we had $8.9 million in revenues for the three months ended March 31, 2000, compared to $28.4 million in revenues for the three months ended March 31, 2001. Furthermore, we have recently begun to offer our services in Europe and plan to do so in Japan through our joint venture during the second half of 2001. We have also recently begun to resell certain products and services of Akamai Technologies, Inc. and Cisco Systems, Inc. We expect our growth to continue to strain our management, operational and financial resources. For example, we may not be able to install adequate financial control systems in an efficient and timely manner, and our current or planned information systems, procedures and controls may be inadequate to support our future operations. The difficulties associated with installing and implementing new systems, procedures and controls may place a significant burden on our management and our internal resources.

If We Fail to Adequately Protect Our Intellectual Property, We May Lose Rights to Some of Our Most Valuable Assets. We rely on a combination of patent, copyright, trademark, trade secret and other intellectual property law, nondisclosure agreements and other protective measures to protect our proprietary technology. Internap and P-NAP are trademarks of Internap that are registered in the United States. In addition, we have three patents that have been issued by the United States Patent and Trademark Office, or USPTO. The dates of issuance for these patents range from September 1999 through December 1999, and each of these patents is enforceable for a period of 20 years after the date of its filing. We cannot assure you that these patents or any future issued patents will provide significant proprietary protection or commercial advantage to us or that the USPTO will allow any additional or future claims. We have eight additional applications pending, two of which are continuation in patent filings. We may file additional applications in the future. Our patents and patent applications relate to our service point technologies and other technical aspects of our services. In addition, we have filed corresponding international patent applications under the Patent Cooperation Treaty.

It is possible that any patents that have been or may be issued to us could still be successfully challenged by third parties, which could result in our loss of the right to prevent others from exploiting the inventions claimed in those patents. Further, current and future competitors may independently develop similar technologies, duplicate our services and products or design around any patents that may be issued to us. In addition, effective patent protection may not be available in every country in which we intend to do business.

In addition to patent protection, we believe the protection of our copyrightable materials, trademarks and trade secrets is important to our future success. We rely on a combination of laws, such as copyright, trademark and trade secret laws and contractual restrictions, such as confidentiality agreements and licenses, to establish and protect our proprietary rights. In particular, we generally enter into confidentiality agreements with our employees and nondisclosure agreements with our customers and corporations with whom we have strategic relationships. In addition, we generally register our important trademarks with the USPTO to preserve their value and establish proof of our ownership and use of these trademarks. Any trademarks that may be issued to us may not provide

significant proprietary protection or commercial advantage to us. Despite any precautions that we have taken, intellectual property laws and contractual restrictions may not be sufficient to prevent misappropriation of our technology or deter others from developing similar technology.

We May Face Litigation and Liability Due to Claims of Infringement of Third Party Intellectual Property Rights. The telecommunications industry is characterized by the existence of a large number of patents and frequent litigation based on allegations of patent infringement. From time to time, third parties may assert patent, copyright, trademark, trade secret and other intellectual property rights to technologies that are important to our business. Any claims that our services infringe or may infringe proprietary rights of third parties, with or without merit, could be time-consuming, result in costly litigation, divert the efforts of our technical and management personnel or require us to enter into royalty or licensing agreements, any of which could significantly harm our operating results. In addition, in our customer agreements, we agree to indemnify our customers for any expenses or liabilities resulting from claimed infringement of patents, trademarks or copyrights of third parties. If a claim against us was to be successful, and we were not able to obtain a license to the relevant or a substitute technology on acceptable terms or redesign our products to avoid infringement, our ability to compete successfully in our competitive market would be impaired.

Because We Depend on Third Party Suppliers for Key Components of Our Network Infrastructure, Failures of These Suppliers to Deliver Their Components as Agreed Could Hinder Our Ability to Provide Our Services on a Competitive and Timely Basis. Any failure to obtain required products or services from third party suppliers on a timely basis and at an acceptable cost would affect our ability to provide our Internet connectivity services on a competitive and timely basis. We are dependent on other companies to supply various key components of our infrastructure, including the local loops between our service points and our Internet backbone providers and between our service points and our customers' networks. In addition, the routers and switches used in our network infrastructure are currently supplied by a limited number of vendors, including Cisco Systems. Additional sources of these services and products may not be available in the future on satisfactory terms, if at all. We purchase these services and products pursuant to purchase orders placed from time to time. Furthermore, we do not carry significant inventories of the products we purchase, and we have no guaranteed supply arrangements with our vendors. We have in the past experienced delays in installation of services and receiving shipments of equipment purchased. To date, these delays have neither been material nor have adversely affected us, but these delays could affect our ability to deploy service points in the future on a timely basis. If Cisco Systems does not provide us with our routers, or if our limited source suppliers fail to provide products or services that comply with evolving Internet and telecommunications standards or that interoperate with other products or services we use in our network infrastructure, we may be unable to meet our customer service commitments.

We Have Acquired and Expect to Acquire Other Businesses, and these Acquisitions Involve Numerous Risks. In June and July 2000, we acquired CO Space and VPNX, respectively, in merger transactions. We may engage in additional acquisitions in the future in order to, among other things, enhance our existing services and enlarge our customer base. Acquisitions involve a number of risks that could potentially, but not exclusively, include the following:

- difficulties in integrating the operations, personnel, technologies, products and services of the acquired companies in a timely and efficient manner;
- diversion of management's attention from normal daily operations;
- insufficient revenues to offset significant unforeseen costs and increased expenses associated with the acquisitions;
- difficulties in completing projects associated with in-process research and development being conducted by the acquired businesses;

- risks associated with our entrance into markets in which we have little or no prior experience and where
- competitors have a stronger market presence;
- deferral of purchasing decisions by current and potential customers as they evaluate the likelihood of success of the acquisitions;
- difficulties in pursuing relationships with potential strategic partners who may view the combined company as a more direct competitor than our predecessor entities taken independently;
- issuance by us of equity securities that would dilute ownership of existing shareholders;
- Incurrence of significant debt, contingent liabilities and amortization expenses; and
- loss of key employees of the acquired companies.

Acquiring high technology businesses as a means of achieving growth is inherently risky. To meet these risks, we must maintain our ability to manage effectively any growth that results from using these means. Failure to manage effectively our growth through mergers and acquisitions could harm our business and operating results and could result in impairment of related long-term assets.

Risks Related to Our Industry

Because the Demand for Our Services Depends on Continued Growth in Use of the Internet, a Slowing of this Growth Could Harm the Development of the Demand for Our Services. Critical issues concerning the commercial use of the Internet remain unresolved and may hinder the growth of Internet use, especially in the business market we target. Despite growing interest in the varied commercial uses of the Internet, many businesses have been deterred from purchasing Internet connectivity services for a number of reasons, including inconsistent or unreliable quality of service, lack of availability of cost-effective, high-speed options, a limited number of local access points for corporate users, inability to integrate business applications on the Internet, the need to deal with multiple and frequently incompatible vendors and a lack of tools to simplify Internet access and use. Capacity constraints caused by growth in the use of the Internet may, if left unresolved, impede further development of the Internet to the extent that users experience delays, transmission errors and other difficulties. Further, the adoption of the Internet for commerce and communications, particularly by those individuals and enterprises that have historically relied upon alternative means of commerce and communication, generally requires an understanding and acceptance of a new way of conducting business and exchanging information. In particular, enterprises that have already invested substantial resources in other means of conducting commerce and exchanging information may be particularly reluctant or slow to adopt a new strategy that may make their existing personnel and infrastructure obsolete. The failure of the market for business related Internet solutions to further develop could cause our revenues to grow more slowly than anticipated and reduce the demand for our services.

Because the Internet Connectivity Market Is New and Our Viability Is Uncertain, There Is a Risk Our Services May Not Be Accepted. We face the risk that the market for high performance Internet connectivity services might fail to develop, or develop more slowly than expected, or that our services may not achieve widespread market acceptance. This market has only recently begun to develop, is evolving rapidly and likely will be characterized by an increasing number of entrants. There is significant uncertainty as to whether this market ultimately will prove to be viable or, if it becomes viable, that it will grow. Furthermore, we may be unable to market and sell our services successfully and cost-effectively to a sufficiently large number of customers. We typically charge more for our services than do our competitors, which may affect market acceptance of our services. We believe the danger of nonacceptance is particularly acute during economic slowdowns. Finally, if the Internet becomes subject to a form of central management, or if the Internet backbone providers establish an

economic settlement arrangement regarding the exchange of traffic between backbones, the problems of congestion, latency and data loss addressed by our Internet connectivity services could be largely resolved, and our core business rendered obsolete.

If We Are Unable to Respond Effectively and on a Timely Basis to Rapid Technological Change, We May Lose or Fail to Establish a Competitive Advantage in Our Market. The Internet connectivity industry is characterized by rapidly changing technology, industry standards, customer needs and competition, as well as by frequent new product and service introductions. We may be unable to successfully use or develop new technologies, adapt our network infrastructure to changing customer requirements and industry standards, introduce new services, such as virtual private networking and video conferencing, or enhance our existing services on a timely basis. Furthermore, new technologies or enhancements that we use or develop may not gain market acceptance. Our pursuit of necessary technological advances may require substantial time and expense, and we may be unable to successfully adapt our network and services to alternate access devices and technologies.

If our services do not continue to be compatible and interoperable with products and architectures offered by other industry members, our ability to compete could be impaired. Our ability to compete successfully is dependent, in part, upon the continued compatibility and interoperability of our services with products and architectures offered by various other industry participants. Although we intend to support emerging standards in the market for Internet connectivity, there can be no assurance that we will be able to conform to new standards in a timely fashion, if at all, or maintain a competitive position in the market.

New Technologies Could Displace Our Services or Render Them Obsolete. New technologies and industry standards have the potential to replace or provide lower cost alternatives to our services. The adoption of such new technologies or industry standards could render our existing services obsolete and unmarketable. For example, our services rely on the continued widespread commercial use of the set of protocols, services and applications for linking computers known as Transmission Control Protocol/Internetwork Protocol, or TCP/IP. Alternative sets of protocols, services and applications for linking computers could emerge and become widely adopted. A resulting reduction in the use of TCP/IP could render our services obsolete and unmarketable. Our failure to anticipate the prevailing standard or the failure of a common standard to emerge could hurt our business. Further, we anticipate the introduction of other new technologies, such as telephone and facsimile capabilities, private networks, multimedia document distribution and transmission of audio and video feeds, requiring broadband access to the Internet, but there can be no assurance that such technologies will create opportunities for us.

Service Interruptions Caused by System Failures Could Harm Customer Relations, Expose Us to Liability and Increase Our Capital Costs. Interruptions in service to our customers could harm our customer relations, expose us to potential lawsuits and require us to spend more money adding redundant facilities. Our operations depend upon our ability to protect our customers' data and equipment, our equipment and our network infrastructure, including our connections to our backbone providers, against damage from human error or "acts of God." Even if we take precautions, the occurrence of a natural disaster or other unanticipated problem could result in interruptions in the services we provide to our customers.

Capacity Constraints Could Cause Service Interruptions and Harm Customer Relations. Failure of the backbone providers and other Internet infrastructure companies to continue to grow in an orderly manner could result in capacity constraints leading to service interruptions to our customers. Although the national telecommunications networks and Internet infrastructures have historically developed in an orderly manner, there is no guarantee that this orderly growth will continue as more services, users and equipment connect to the networks. Failure by our telecommunications and Internet service providers to provide us with the data communications capacity we require could cause service interruptions.

Our Network and Software Are Vulnerable to Security Breaches and Similar Threats Which Could Result in Our Liability for Damages and Harm Our Reputation. Despite the implementation of network security measures, the core of our network infrastructure is vulnerable to computer viruses, break-ins, network attacks and similar disruptive problems. This could result in our liability for damages, and our reputation could suffer, thereby deterring potential customers from working with us. Security problems caused by third parties could lead to interruptions and delays or to the cessation of service to our customers. Furthermore, inappropriate use of the network by third parties could also jeopardize the security of confidential information stored in our computer systems and in those of our customers.

Although we intend to continue to implement industry-standard security measures, in the past some of these industry-standard measures have occasionally been circumvented by third parties, although not in our system. Therefore, there can be no assurance that the measures we implement will not be circumvented. The costs and resources required to eliminate computer viruses and alleviate other security problems may result in interruptions, delays or cessation of service to our customers, which could hurt our business.

Should the Government Modify or Increase Regulation of the Internet, the Provision of Our Services Could Become More Costly. There is currently only a small body of laws and regulations directly applicable to access to or commerce on the Internet. However, due to the increasing popularity and use of the Internet, international, federal, state and local governments may adopt laws and regulations that affect the Internet. The nature of any new laws and regulations and the manner in which existing and new laws and regulations may be interpreted and enforced cannot be fully determined. The adoption of any future laws or regulations might decrease the growth of the Internet, decrease demand for our services, impose taxes or other costly technical requirements or otherwise increase the cost of doing business on the Internet or in some other manner have a significantly harmful effect on us or our customers. The government may also seek to regulate some segments of our activities as it has with basic telecommunications services. Moreover, the applicability to the Internet of existing laws governing intellectual property ownership and infringement, copyright, trademark, trade secret, obscenity, libel, employment, personal privacy and other issues is uncertain and developing. We cannot predict the impact, if any, that future regulation or regulatory changes may have on our business.

Part II. OTHER INFORMATION

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

On July 31, 2000, the Company issued an aggregate of approximately 2.0 million shares of its common stock in exchange for the outstanding capital stock of VPNX.com. in an unregistered offering in reliance upon Rule 506 of Regulation D under the Securities Act of 1933, as amended. The sales were made without general solicitation or advertising. All recipients of the shares were accredited investors.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits:

None.

(b) Reports on Form 8-K:

No reports on Form 8-K were filed by the Company during the three-month period ended March 31, 2001.

SIGNATURES

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, thereunto duly authorized on this 15th day of May, 2001.

INTERNAP NETWORK SERVICES CORPORATION
(Registrant)

By: /s/ Paul E. McBride

Paul E. McBride
Senior Vice President and Chief Financial Officer
(Principal Financial and Accounting Officer)

QuickLinks

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