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, 2000

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	91-1896926
(State or other jurisdiction of incorporation or organization)	(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: 134,213,706 shares of common stock, $.001 par value, outstanding as of April 30, 2000.

INTERNAP NETWORK SERVICES CORPORATION

FORM 10-Q
FOR THE QUARTER ENDED MARCH 31, 2000
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INTERNAP NETWORK SERVICES CORPORATION
PART 1. FINANCIAL INFORMATION

ITEM 1. CONDENSED FINANCIAL STATEMENTS

INTERNAP NETWORK SERVICES CORPORATION
CONDENSED BALANCE SHEETS
(UNAUDITED, IN THOUSANDS)

	MARCH 31, 2000	DECEMBER 31, 1999
ASSETS		
Current assets:		
Cash and cash equivalents	$ 64,996	$155,184

Short-term investments	102,154	50,168
Investment income receivable	2,398	591
Accounts receivable, net of allowance of $370 and $206, respectively	6,333	4,084
Prepaid expenses and other assets	456	553
Total current assets	176,337	210,580
Property and equipment, net	37,776	28,811
Patents and trademarks, net	157	142
Investments	17,987	5,050
Deposits and other assets, net	1,281	963
Total assets	$233,538	$245,546
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 6,579	$ 7,278
Accrued liabilities	3,541	4,209
Deferred revenue	217	22
Note payable, current position	1,188	1,021
Line of credit	1,525	1,525
Capital lease obligations, current portion	8,310	6,613
Total current liabilities	21,360	20,668
Note payable, less current portion	3,049	2,861
Capital lease obligations, less current portion	13,880	11,517
Total liabilities	38,289	35,046
Commitments and contingencies		
Shareholders equity:		
Common stock, $0.001 par value, 500,000 shares authorized; 133,747 and 132,089 shares issued and outstanding, respectively	134	132
Additional paid-in capital	289,534	287,054
Deferred stock compensation	(14,154)	(17,228)
Accumulated deficit	(80,081)	(59,458)
Accumulated comprehensive (loss)	(184)	--
Total shareholders' equity	195,249	210,500
Total liabilities and shareholders' equity	$233,538	$245,546

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

INTERNAP NETWORK SERVICES CORPORATION

CONDENSED STATEMENT OF OPERATIONS

(UNAUDITED, IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

	THREE MONTHS ENDED MARCH 31,	
	2000	1999
Revenues	$ 8,891	$ 1,244
Costs and expenses:		
Cost of network and customer support	15,326	2,346
Product development	1,578	565
Sales and marketing	7,689	2,236
General and administrative	4,388	1,172
Amortization of deferred stock compensation	3,074	349
Total operating costs and expenses	32,055	6,668
Loss from operations	(23,164)	(5,424)

Other income (expense):		
Interest income	2,926	206
Interest and financing expense	(385)	(57)
Net loss	$(20,623)	$(5,275)
Basic and diluted net loss per share	$ (0.16)	$ (0.79)
Weighted average shares used in computing basic and diluted net loss per share	132,526	6,674

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

INTERNAP NETWORK SERVICES CORPORATION

CONDENSED STATEMENT OF CASH FLOWS

(UNAUDITED, IN THOUSANDS)

	THREE MONTHS ENDED MARCH 31,	
	2000	1999
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss	$(20,623)	$(5,275)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	2,609	511
Non-cash interest and financing expense	--	4
Provision for doubtful accounts	147	13
Non-cash compensation expense	3,074	349
Changes in operating assets and liabilities:		
Accounts receivable	(2,396)	(461)
Investment income receivable	(1,807)	--
Prepaid expenses, deposits and other assets	(221)	(147)
Accounts payable	(865)	(84)
Deferred revenue	195	79
Accrued liabilities	(668)	279
Net cash used in operating activities	(20,555)	(4,732)
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of property and equipment	(6,138)	(1,771)
Proceeds from disposal of property and equipment	42	--
Purchase of investments	(65,665)	(1,000)
Redemption of investments	558	--
Payments for patents and trademarks	(17)	(19)
Net cash used in investing activities	(71,220)	(2,790)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from shareholder loan	--	1,100
Repayment of shareholder loan	--	(1,100)
Principal payments on note payable	(238)	--
Payments on capital lease obligations	(1,374)	(295)
Proceeds from equipment leaseback financing	717	428
Restriction of cash related to obtaining lease line	--	(113)
Proceeds from issuance of and exercise of warrants to purchase preferred stock, net of issuance costs	1	32,025
Proceeds from exercise of stock options	1,045	--
Proceeds from issuance of employee stock purchase plan shares	1,462	--
Costs of issuance of common stock	(26)	--
Net cash provided by financing activities	1,587	32,045

Net increase (decrease) in cash and cash equivalents	(90,188)	24,523
Cash and cash equivalents at beginning of period	155,184	275
Cash and cash equivalents at end of period	$ 64,996	$24,798
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid for interest, net of amounts capitalized	$ 385	$ 52
Purchase of property and equipment financed with capital leases	$ 5,310	$ 358
Purchase of property and equipment included in accounts payable	$ 166	$ 268

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

INTERNAP NETWORK SERVICES CORPORATION

CONDENSED STATEMENT OF SHAREHOLDERS' EQUITY

THREE MONTHS ENDED MARCH 31, 2000

(UNAUDITED, IN THOUSANDS)

	COMMON STOCK		ADDITIONAL PAID-IN CAPITAL	DEFERRED STOCK COMPENSATION	ACCUMULATED DEFICIT	ACCUMULATIVE COMPREHENSIVE LOSS	TOTAL	COMPREHENSIVE LOSS
	SHARES	PAR VALUE						
Balances, December 31, 1999	132,089	$132	$287,054	$(17,228)	$(59,458)		$210,500	
Costs of issuance of common stock			(26)				(26)	
Amortization of deferred stock compensation				3,074			3,074	
Exercise of employee stock options	1,234	1	1,044				1,045	
Issuance of employee stock purchase plan shares	172		1,462				1,462	
Exercise of warrants to purchase common stock	252	1					1	
Net loss					(20,623)		(20,623)	$(20,623)
Unrealized loss on investments						$(184)	(184)	(184)
Balances, March 31, 2000	133,747	$134	$289,534	$(14,154)	$(80,081)	$(184)	$195,249	$(20,807)

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

INTERNAP NETWORK SERVICES CORPORATION

NOTES TO CONDENSED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION:

The unaudited condensed financial statements have been prepared by InterNAP Network Services Corporation (the "Company") pursuant to the rules and regulations of the Securities and Exchange Commission and include all the accounts of the Company. Certain information and footnote disclosures, normally included in financial statements prepared in accordance with generally accepted accounting principles, have been condensed or omitted pursuant to such rules and regulations. In the opinion of management, the unaudited condensed financial statements reflect all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the Company's financial position at March 31, 2000, its operating results and cash flows for the three months ended March 31, 2000 and 1999 and its statement of equity for the three months ended March 31, 2000. The balance sheet at December 31, 1999 has been derived from audited financial statements as of that date. These financial

statements and the related notes should be read in conjunction with the Company's financial statements and notes thereto contained in the Company's annual report on Form 10-K and the Company's registration statement on Form S-1 (File No. 333-95503) filed with the Securities and Exchange Commission.

In December, 1999, the Company incorporated a wholly owned subsidiary in the United Kingdom, InterNAP Network Services U.K. Limited, but there was no activity in the subsidiary through March 31, 2000. On January 7, 2000, the Company paid a 100% share dividend to shareholders of record on December 27, 1999. Accordingly, the number of shares disclosed in the financial statements and related notes have been adjusted to reflect the stock dividend for all periods presented.

The results of operations for the three months ended March 31, 2000 are not necessarily indicative of the results that may be expected for the future quarters.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

USE OF ESTIMATES

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates that affect the reported amounts of assets and liabilities in the financial statements and disclosure of contingent assets and liabilities at the date of the financial statements. Examples of estimates subject to possible revision based upon the outcome of future events include depreciation of property and equipment, income tax liabilities, the valuation allowance against the deferred tax assets and the allowance for doubtful accounts. Actual results could differ from those estimates.

CASH AND CASH EQUIVALENTS

The Company generally considers any highly liquid investments purchased with an original or remaining maturity of three months or less at the date of purchase to be cash equivalents.

The Company invests its cash and cash equivalents in deposits with two financial institutions that may, at times, exceed federally insured limits. Management believes that the risk of loss is minimal. To date, the Company has not experienced any losses related to temporary cash investments.

INVESTMENTS

The Company classifies, at the date of acquisition, its marketable securities into categories in accordance with the provisions of Statement of Financial Accounting Standards No. 115, "Accounting

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES: (CONTINUED)

for Certain Investments in Debt and Equity Securities." Currently, the Company classifies its marketable securities as available-for-sale, which are reported at fair market value with the related unrealized gains and losses included in shareholders' equity. Realized gains and losses and declines in value of securities judged to be other than temporary are included in other income (expense). Interest and dividends on all securities are included in interest income. The fair value of the Company's marketable securities is based on quoted market prices. At March 31, 2000, marketable securities consisted of commercial paper and government securities.

The Company accounts for investments in equity securities without readily determinable fair values at cost. The Company does not own 20 percent of the voting stock or exert significant influence over any of its cost basis investments as of March 31, 2000. Realized gains and losses and declines in value of securities judged to be other than temporary are included in other income (expense).

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. The Company has excluded all convertible preferred stock, 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 months ended March 31, 2000 and 1999 are calculated as follows (in thousands, except per share amounts):

	THREE MONTHS ENDED MARCH 31,	
	2000	1999
	(UNAUDITED)	
Net loss	$(20,623)	$ (5,275)
Basic and diluted:		
Weighted-average shares of common stock outstanding used in computing basic and diluted net loss per share	132,526	6,674
Basic and diluted net loss per share	$ (0.16)	$ (0.79)
Antidilutive securities not included in diluted net loss per share calculation.		
Convertible preferred stock	--	98,953
Options to purchase common stock	16,726	9,715
Warrants to purchase common and Series B preferred stock	1,671	1,200
Unvested shares of common stock subject to repurchase	225	--
	18,622	109,868

3. PROPERTY AND EQUIPMENT:

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

	MARCH 31, 2000	DECEMBER 31, 1999
	(UNAUDITED)	
Network equipment	$ 5,979	$ 4,665
Network equipment under capital lease	26,076	20,095
Furniture, equipment and software	9,022	6,717
Furniture, equipment and software under capital lease	1,210	1,164
Leasehold improvements	3,935	2,009
	46,222	34,650
Less: Accumulated depreciation and amortization ($5,928 and $4,851 related to capital leases at March 31, 2000 and December 31, 1999, respectively)	(8,446)	(5,839)
Property and equipment, net	$37,776	$28,811

4. INVESTMENTS:

On February 22, 2000, pursuant to an investment agreement, the Company purchased 588,236 shares of Aventail Corporation ("Aventail") Series D preferred stock at $10.20 per share for a total cash investment of $6,000,000. 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, the Company and Aventail entered into a joint marketing agreement which, among other things, granted the Company certain limited exclusive rights to sell Aventail's managed extranet service and granted Aventail certain rights to sell the Company's services. In return, the Company committed to either sell Aventail services or pay Aventail, or a combination of both, which would result in Aventail's recognition of $3,000,000 of revenue over a two-year period.

5. ACCRUED LIABILITIES:

Accrued liabilities consist of the following (in thousands):

	MARCH 31, 2000 (UNAUDITED)	DECEMBER 31, 1999
Compensation payable	$3,221	$2,729
Taxes payable	98	49
Private placement fee	--	1,000
Other	222	431
	$3,541	$4,209

6. FINANCING ARRANGEMENTS:

During 1999, the Company entered into an equipment financing arrangement with a financial institution allowing the Company to borrow up to $5.0 million for the purchase of property and

6. FINANCING ARRANGEMENTS: (CONTINUED)

equipment. The equipment financing arrangement includes sublimits of $3.5 million for equipment costs and $1.5 million for the acquisition of software, P-NAP facility and other equipment costs. Loans under the $3.5 million sublimit require monthly principal and interest payments over a term of 48 months. This facility bears interest at 7.5% plus an index rate based on the yield of 4-year U.S. Treasury Notes. This rate was 13.89% at March 31, 2000. Loans under the $1.5 million sublimit require monthly principal and interest payments over a term of 36 months. This facility bears interest at 7.9% plus an index rate based on the yield of 3-year U.S. Treasury Notes. This rate was 13.98% at March 31, 2000. Borrowings under each sublimit must be made prior to May 1, 2000. During March 2000, the Company borrowed an additional $594,000 for equipment purchases. As of March 31, 2000, the Company had outstanding borrowings of approximately $4.2 million pursuant to this arrangement.

7. COMMITMENTS AND CONTINGENCIES:

During January 2000, the Company entered into a service commitment contract with a backbone service provider to provide interconnection services. Monthly fees are to be calculated on a usage basis subject to minimum payments of $37,000,000 through April 2003.

8. STOCK BASED COMPENSATION PLANS:

The Company's stock-based compensation plans include the 1999 Equity Incentive Plan (the "1999 Plan"), the 1998 Stock Option/Stock Issuance Plan (the "1998 Plan"), the 1999 Non-Employee Directors' Stock Option Plan (the "Director Plan") and the Employee Stock Purchase Plan (the "ESPP"). During the three

months ended March 31, 2000, the Company granted 2,448,000 options to purchase common stock pursuant to the 1999 Plan, and 1,233,826 shares of common stock were issued upon exercise of stock options. On March 31, 2000, employees purchased 172,053 shares of common stock for $8.50 per share pursuant to the ESPP.

9. EVENTS SUBSEQUENT TO MARCH 31, 2000:

SECONDARY OFFERING

On April 6, 2000, 7,500,000 shares of the Company's common stock were sold in a secondary public offering at a price of $43.50 per share. Of these shares, 3,000,000 were sold by the Company and 4,500,000 shares were sold by selling shareholders. On April 6, 2000, the underwriters exercised their over-allotment option, resulting in the sale of an additional 1,125,000 shares of common stock at $43.50 per share. Of these shares, 450,000 were sold by the Company and 675,000 were sold by selling shareholders. The Company did not receive any of the proceeds from the sale of shares of common stock by the selling shareholders. The proceeds to the Company from the offering were $142,900,000, net of underwriting discounts and commissions of $7,100,000.

FINANCING ARRANGEMENT

On April 10, 2000, the Company signed a letter of intent (the "Financing Agreement") with a financial institution, which will provide the Company up to $15,000,000 in funding for the purpose of financing capital expenditures. The Financing Agreement has a thirty-six month term and calls for equal payments of accrued interest plus 2.1% of the original principal balance over the term of the agreement with a balloon payment for the residual 27% of principal upon maturity. Interest is at the

9. EVENTS SUBSEQUENT TO MARCH 31, 2000: (CONTINUED)

London Inter Bank Offered Rate plus 3.70% (9.87% at April 10, 2000) and is adjusted monthly. In the event the Company's cash and cash equivalent balance is equal to or less than $60,000,000 at the end of any quarter, the Company will be required to provide an irrevocable renewable letter of credit in an amount equal to the balance of the loan.

INVESTMENT

Pursuant to an investment agreement between the Company and 360networks, Inc. ("360networks"), on April 17, 2000, the Company purchased 374,182 shares of 360networks Class A Non-Voting Stock at $5.00 per share and, on April 26, 2000, the Company purchased 1,122,545 shares of 360networks Class A Subordinate Voting Stock at $13.23 per share. The total cash investment was $16,722,180. Additionally, the Company and 360networks entered into a letter of intent to negotiate a strategic agreement that would provide the Company with long-haul-fiber-optic bandwidth capacity and provide 360networks with the Company's Internet connectivity services.

STOCK-BASED COMPENSATION PLAN

During April 2000, the Company adopted the 2000 Non-Officer Equity Incentive Plan (the "Non-Officer Plan"). The Non-Officer Plan authorizes the issuance of 1,000,000 shares of the Company's common stock. Under the Non-Officer Plan, the Company may grant stock options only to employees of the Company who are not officers or directors. Options granted under the Non-Officer Plan are not intended by the Company to qualify as incentive stock options under the Internal Revenue Code. Options granted under the Non-Officer Plan generally will be subject to the same terms and conditions as options granted under the Company's 1999 Equity Incentive Plan.

EQUANT NETWORK CONNECTIVITY AGREEMENT

In May 2000, the Company and Equant Network Services entered into a network connectivity agreement which, among other things, allows the Company to colocate equipment in Equant's international locations, grants the Company access to the international Equant network and requires Equant to use the Company's connectivity services in cities where the parties colocate equipment, or where

Equant operates a point of presence and the Company operates a P-NAP facility. In addition, the agreement contains certain marketing and exclusivity covenants.

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 the 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

The Company is a leading provider of fast, reliable and centrally managed Internet connectivity services targeted at businesses seeking to maximize the performance of mission-critical Internet-based applications. Customers connected to one of the Company's P-NAP facilities have their data optimally routed to and from destinations on the Internet in a manner that minimizes the use of congested public network access points and private peering points. This optimal routing of data traffic over the multiplicity of networks that comprise the Internet enables higher transmission speeds, lower instances of data loss and greater quality of service.

After the Company decides to open a new P-NAP facility, the Company enters into a deployment phase which typically lasts four to six months, during which time the Company executes the required steps to make the P-NAP facility commercially ready for service. Among other things, this usually entails obtaining co-location space to locate the Company's equipment, entering into agreements with backbone providers, obtaining local loop connections from local telecommunications providers, building P-NAP facilities and initiating pre-sales and marketing activities. Consequently, the Company usually incurs a significant amount of upfront costs related to making a P-NAP facility commercially ready for service prior to generating revenues. Therefore, the Company's results of operations will be negatively affected during times of P-NAP facility deployment.

As of March 31, 2000, the Company had a total of 16 P-NAP facilities deployed in the Atlanta, Boston, Chicago, Dallas, Denver, Freemont CA, Houston, Los Angeles, Miami, New York (two P-NAP facilities), Orange County, CA, Philadelphia, San Jose, Seattle and Washington D.C. metropolitan areas, and expects to have a total of 24 P-NAP facilities operational by the end of 2000.

During the years ended December 31, 1998 and 1999, in connection with the grant of certain stock options to employees, the Company recorded deferred stock compensation totaling $25.0 million, representing the difference between the deemed fair value of the Company's common stock on the date such options were granted and the exercise price. Such amount is included as a component of shareholders' equity and is being amortized over the vesting period of the individual options, generally four years, using an accelerated method as described in Financial Accounting Standards Board Interpretation No. 28. The Company recorded amortization of deferred stock compensation in the amount of $3.1 million for the three months ended March 31, 2000. At March 31, 2000, we had a total of $14.2 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,

	2000	1999
Revenues	100%	100%
Costs and expenses:		
Cost of network and customer support	172	189
Product development	18	45
Sales and marketing	86	180
General and administrative	49	94
Amortization of deferred stock compensation	35	28
Total costs and expenses	360	536
Loss from operations	(260)	(436)
Other income (expense):		
Interest income	33	17
Interest and financing expense	(4)	(5)
Net loss	(231)%	(424)%

THREE MONTHS ENDED MARCH 31, 2000 AND 1999

Revenues. Revenues increased 642% from $1.2 million for the three-month period ended March 31, 1999, to $8.9 million for the three-month period ended March 31, 2000. This increase of $7.7 million was primarily due to increased Internet connectivity revenues. The increase in Internet connectivity revenues was attributable to the increased sales at our existing P-NAP facilities and the deployment of additional P-NAP facilities during 1999 and the first quarter of 2000.

Costs of Network and Customer Support. Costs of network and customer support increased 565% from $2.3 million for the three-month period ended March 31, 1999 to $15.3 million for the three-month period ended March 31, 2000. This increase of $13.0 million was primarily due to increased connectivity costs related to added connections to Internet backbone providers at each P-NAP facility and to a lesser extent, additional compensation costs and depreciation expense related to the equipment at newly deployed P-NAP facilities. Network and customer support costs as a percentage of total revenues are generally greater than 100% for newly deployed P-NAP facilities because we purchase Internet connectivity capacity from the backbone providers in advance of securing new customers. We expect these costs to increase in absolute dollars as we deploy additional P-NAP facilities.

Product Development. Product development costs increased 177% from $565,000 for the three-month period ended March 31, 1999, to $1.6 million for the three-month period ended March 31, 2000. This increase of $1.0 million was primarily due to compensation costs, facilities costs related to additional office space and outside consulting fees. We expect product development costs to increase in absolute dollars for the foreseeable future.

Sales and Marketing. Sales and marketing costs increased 250% from $2.2 million for the three-month period ended March 31, 1999, to $7.7 million for the three-month period ended March 31, 2000. This increase of $5.5 million was primarily due to compensation costs, advertising costs and, to a lesser extent, facility costs related to the addition of sales offices. As part of our expanded sales and

marketing activities, we hired additional sales and support personnel during 1999 and the first quarter of 2000. We expect sales and marketing costs to increase in absolute dollars for the foreseeable future.

General and Administrative. General and administrative costs increased 267% from $1.2 million for the three-months ended March 31, 1999, to $4.4 million for the three-months ended March 31, 2000. This increase of $3.2 million was primarily due to compensation costs, professional services costs and increased depreciation and amortization costs due to the addition of corporate office space during 1999 and first quarter of 2000. We expect general and administrative costs to increase in absolute dollars as we deploy additional P-NAP facilities.

Other Income (Expense). Other income (expense) consists of interest income, interest and financing expense and other non-operating expenses. Other income (expense), net, increased from $149,000 of other income for the three-month period ended March 31, 1999 to $2.5 million of other income for the three-month period ended March 31, 2000. This increase was primarily due to interest income earned on the proceeds from the Company's initial public offering.

LIQUIDITY AND CAPITAL RESOURCES

Since its inception, the Company has financed its operations primarily through the issuance of its equity securities, capital leases, equipment financing and bank loans. As of March 31, 2000, the Company has raised an aggregate of approximately $261.6 million, net of offering expenses, through the sale of its equity securities. In January 2000, a 100% stock dividend was paid on the Company's common stock and, accordingly, all related disclosures have been revised to reflect the stock dividend for all periods presented.

On February 22, 2000, pursuant to an investment agreement, the Company purchased 588,236 shares of Aventail 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, the Company and Aventail entered into a joint marketing agreement which, among other things, granted the Company certain limited exclusive rights to sell Aventail's managed extranet service and granted Aventail certain rights to sell the Company's services. In return, the Company committed to either sell Aventail services or pay Aventail, or a combination of both, which would result in Aventail's recognition of $3.0 million of revenue over a two-year period.

Subsequent to March 31, 2000, 7,500,000 shares of the Company's common stock were sold in a secondary public offering at a price of $43.50 per share. Of these shares, 3,000,000 were sold by the Company and 4,500,000 shares were sold by selling shareholders. On April 6, 2000, the underwriters exercised their over-allotment option, resulting in the sale of an additional 1,125,000 shares of common stock at $43.50 per share. Of these shares, 450,000 were sold by the Company and 675,000 were sold by selling shareholders. The Company did not receive any of the proceeds from the sale of shares of common stock by the selling shareholders. The proceeds to the Company from the offering were $142.9 million, net of underwriting discounts and commissions of $7.1 million.

On April 10, 2000, the Company signed a letter of intent (the "Financing Agreement") with a financial institution which will provide the Company up to $15.0 million in funding for the purpose of financing capital expenditures. The Financing Agreement has a thirty-six month term and calls for equal payments of accrued interest plus 2.1% of the original principal balance over the term of the agreement with a balloon payment for the residual 27% of principal upon maturity. Interest is at the London Inter Bank Offered Rate plus 3.70% (9.87% at April 10, 2000) and is adjusted monthly. In the event the Company's cash and cash equivalent balance is equal to or less than $60.0 million at the end of any quarter, the Company will be required to provide an irrevocable renewable letter of credit in an amount equal to the balance of the loan.

Pursuant to an investment agreement between the Company and 360networks, Inc. ("360networks"), on April 17, 2000, the Company purchased 374,182 shares of 360networks Class A Non-Voting Stock at $5.00 per share and, on April 26, 2000, the Company 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, the Company and 360networks entered into a letter of intent to negotiate a strategic agreement that would provide the Company with long-haul-fiber-optic bandwidth capacity and provide 360networks with the Company's Internet connectivity services.

At March 31, 2000, the Company had cash, cash equivalents, and investments of $185.1 million. The Company has a revolving line of credit with Silicon Valley Bank under which the Company is allowed to borrow up to $3.0 million, as limited by certain borrowing base requirements which include maintaining certain levels of monthly revenues and customer turnover ratios. The line of credit requires monthly payments of interest only at prime plus 1%, or 10% as of March 31, 2000, and matures on June 30, 2000. At March 31, 2000, the Company had outstanding borrowings of $1.5 million on the line of credit.

During 1999, the Company entered into an equipment financing arrangement

with a financial institution allowing the Company to borrow up to $5.0 million for the purchase of property and equipment. The equipment financing arrangement includes sublimits of $3.5 million for equipment costs and $1.5 million for the acquisition of software, P-NAP facility and other equipment costs. Loans under the $3.5 million sublimit require monthly principal and interest payments over a term of 48 months. This facility bears interest at 7.5% plus an index rate based on the yield of 4-year U.S. Treasury Notes. This rate was 13.89% at March 31, 2000. Loans under the $1.5 million sublimit require monthly principal and interest payments over a term of 36 months. This facility bears interest at 7.9% plus an index rate based on the yield of 3-year U.S. Treasury Notes. This rate was 13.98% at March 31, 2000. Borrowings under each sublimit must be made prior to May 1, 2000. During March 2000, the Company borrowed an additional $594,000 for equipment purchases. As of March 31, 2000, the Company had outstanding borrowings of approximately $4.2 million pursuant to this arrangement.

During 1999, the Company amended an existing equipment lease credit facility with a vendor to increase its available credit by $17.5 million to $35.5 million. As of March 31, 2000, the Company had approximately $14.4 million available under this credit facility.

Net cash used in operations was $20.6 million for the three months ended March 31, 2000, and $4.7 million for the three months ended March 31, 1999. Net cash used in operations for the three months ended March 31, 2000 was primarily due to funding our operating losses and increases in accounts receivable and investment income receivable, partially offset by non-cash charges.

Net cash used in investing activities was $71.2 million for the three months ended March 31, 2000 and $2.8 million for the three months ended March 31, 1999. Net cash used in investing activities in each period reflects increased purchases of property and equipment not financed by capital leases. Purchases of property and equipment were partially financed by capital leases (such purchases are excluded from the net cash used in investing activities in the statement of cash flows), and totaled $11.6 million ($5.3 million financed by capital leases) for the three months ended March 31, 2000. Additionally, for the three-month period ended March 31, 2000, $65.7 million was used to purchase investments.

Net cash provided from financing activities was $1.6 million for the three months ended March 31, 2000, and $32.0 million for the three months ended March 31, 1999. Net cash from financing activities primarily reflects proceeds from the sales of our equity securities offset by the costs of those proceeds and payments on capital lease obligations and notes payable.

The Company expects to spend significant additional capital to recruit and train its customer installation team and the sales force and to build out the sales facilities related to newly deployed

P-NAP facilities. In addition to P-NAP facility deployment, although to a lesser extent, product development and the development of the Company's internal systems and software will continue to require significant capital expenditures in the foreseeable future, as will the expansion of its marketing efforts. The Company expects 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.

The Company believes the net proceeds from its secondary offering together with its cash and cash equivalents, investments and funds available under its revolving and capital lease lines will be sufficient to satisfy its cash requirements for the next 12 months. Depending on its rate of growth and cash requirements, the Company may require additional equity or debt financing to meet future working capital needs, which may have a dilutive effect on its then current shareholders. There can be no assurance that such additional financing will be available or, if available, that such financing can be obtained on satisfactory terms. The Company's management intends to invest cash in excess of current operating requirements in short-term, interest-bearing, investment-grade securities.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is exposed to market risk for the impact of interest rate changes and changes in the market value of our investments. Substantially all of the Company's cash equivalents, investments and capital lease obligations are at fixed interest rates, and therefore the fair value of these instruments is

affected by changes in market interest rates. However, as of March 31, 2000, all of the Company's cash equivalents mature within three months. As of March 31, 2000, the Company believes the reported amounts of cash equivalents and capital lease obligations to be reasonable approximations of their fair values.

RISK FACTORS

RISKS RELATED TO THE COMPANY'S BUSINESS

THE COMPANY HAS A HISTORY OF LOSSES, EXPECTS FUTURE LOSSES AND MAY NOT ACHIEVE OR SUSTAIN ANNUAL PROFITABILITY. The Company has incurred net losses in each quarterly and annual period since the Company began operations. The Company incurred net losses of $1.6 million, $7.0 million and $49.9 million for the years ended December 31, 1997, 1998 and 1999, respectively. The Company's net loss for the three months ended March 31, 2000 was $20.6 million. As of March 31, 2000, the Company's accumulated deficit was $80.1 million. As a result of its expansion plans, the Company expects to incur net losses and negative cash flows from operations on a quarterly and annual basis for at least the next 24 months, and the Company may never become profitable.

THE COMPANY'S LIMITED OPERATING HISTORY MAKES IT DIFFICULT TO EVALUATE ITS PROSPECTS. The revenue and income potential of the Company's business and market is unproven, and its limited operating history makes it difficult to evaluate its prospects. The Company has only been in existence since 1996, and its services are only offered in limited regions. Investors should consider and evaluate the Company's prospects in light of the risks and difficulties frequently encountered by relatively new companies, particularly companies in the rapidly evolving Internet infrastructure and connectivity markets.

NEGATIVE MOVEMENTS IN THE COMPANY'S QUARTERLY OPERATING RESULTS MAY DISAPPOINT ANALYSTS' EXPECTATIONS, WHICH COULD HAVE A NEGATIVE IMPACT ON THE COMPANY'S STOCK PRICE. Should the Company's results of operations from quarter to quarter fail to meet the expectations of public market analysts and investors, its stock price could suffer. Any significant unanticipated shortfall of revenues or increase in expenses could negatively impact its expected quarterly results of operations should the Company be unable to make timely adjustments to compensate for them. Furthermore, a failure on the part of the Company to estimate accurately the timing or magnitude of particular anticipated revenues or expenses could also negatively impact its quarterly results of operations.

Because the Company's 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 its business operations or stock price. For example, increases in the Company's quarterly revenues for the quarters ended March 31, 1998, through March 31, 2000 have varied between 13% and 74%, and total operating costs and expenses, as a percentage of revenues, have fluctuated between 310% and 609%. Fluctuations in the Company's quarterly operating results depend on a number of factors. Some of these factors are industry risks over which the Company has no control, including the introduction of new services by its competitors, fluctuations in the demand and sales cycle for its services, fluctuations in the market for qualified sales and other personnel, changes in the prices for Internet connectivity the Company pays backbone providers and its ability to obtain local loop connections to its P-NAP facilities at favorable prices.

Other factors that may cause fluctuations in the Company's quarterly operating results arise from strategic decisions the Company has made or will make with respect to the timing and magnitude of capital expenditures such as those associated with the deployment of additional P-NAP facilities and the terms of its Internet connectivity purchases. For example, the Company's practice is to purchase Internet connectivity from backbone providers at new P-NAP facilities before customers are secured. The Company also has agreed to purchase Internet connectivity from some providers without regard to the amount the Company resells to its customers.

IF THE COMPANY IS UNABLE TO MANAGE COMPLICATIONS THAT ARISE DURING DEPLOYMENT OF NEW P-NAP FACILITIES, THE COMPANY MAY NOT SUCCEED IN ITS EXPANSION PLANS. Any delay in the opening of new P-NAP facilities would significantly harm the Company's plans to expand its business. In its effort to deploy new P-NAP facilities, the Company faces various risks associated with significant construction

projects, including identifying and locating P-NAP facility 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 the Company's control and all of which could delay the deployment of a new P-NAP facility. The deployment of new P-NAP facilities, each of which takes approximately four to six months to complete, is a key element of the Company's business strategy. In addition to its 16 existing locations, the Company is planning to continue to deploy P-NAP facilities across a wide range of geographic regions, including foreign countries. Although the Company conducts market research in a geographic area before deploying a P-NAP facility, the Company does not enter into service contracts with customers prior to building a new P-NAP facility.

THE COMPANY WILL INCUR ADDITIONAL EXPENSE ASSOCIATED WITH THE DEPLOYMENT OF NEW P-NAP FACILITIES AND THE COMPANY MAY BE UNABLE TO EFFECTIVELY INTEGRATE NEW P-NAP FACILITIES INTO ITS EXISTING NETWORK, WHICH COULD DISRUPT ITS SERVICE. New P-NAP facilities, 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 the Company does not institute adequate financial and managerial controls, reporting systems, and procedures with which to operate multiple facilities in geographically dispersed locations, its operations will be significantly harmed.

BECAUSE THE COMPANY'S REVENUES DEPEND HEAVILY ON A FEW SIGNIFICANT CUSTOMERS, A LOSS OF MORE THAN ONE OF THESE SIGNIFICANT CUSTOMERS COULD REDUCE THE COMPANY'S REVENUES. The Company currently derives a substantial portion of its total revenues from a limited number of customers, and the revenues from these customers may not continue. For the quarter ended March 31, 2000 revenues from the Company's five largest customers represented approximately 22% of its total revenues. Typically, the agreements with the Company's customers are based on the Company's standard terms and conditions of service and generally have terms ranging from one year to three years. Revenues from these customers or from other customers that have accounted for a significant portion of the Company's revenues in past periods, individually or as a group, may not continue. If such revenues do continue, they may not reach or exceed historical levels in any future period. In addition, the Company may not succeed in diversifying its customer base in future periods. Accordingly, the Company may continue to derive a significant portion of its revenues from a relatively small number of customers. Further, the Company has had limited experience with the renewal of contracts by customers whose initial service contract terms have been completed and these customers may not renew their contracts with the Company.

IF THE COMPANY IS UNABLE TO CONTINUE TO RECEIVE COST-EFFECTIVE SERVICE FROM ITS BACKBONE PROVIDERS, THE COMPANY MAY NOT BE ABLE TO PROVIDE ITS INTERNET CONNECTIVITY SERVICES ON PROFITABLE TERMS AND THESE BACKBONE PROVIDERS MAY NOT CONTINUE TO PROVIDE SERVICE TO THE COMPANY. In delivering its services, the Company relies on Internet backbones, which are built and operated by others. In order to be able to provide optimal routing to its customers through its P-NAP facilities, the Company must purchase connections from several Internet backbone providers. There can be no assurance that these Internet backbone providers will continue to provide service to the Company on a cost-effective basis, if at all, or that these providers will provide the Company with additional capacity to adequately meet customer demand. Furthermore, it is very unlikely that the Company could replace its Internet backbone providers on comparable terms.

Currently, in each of its fully operational P-NAP facilities, the Company has connections to some combination of the following 11 backbone providers: AT&T, Cable & Wireless USA, Inc., Global Crossing Telecommunications, Inc., GTE Internetworking, Inc., ICG Communications, Intermedia Communications Inc., PSINet, Inc., Qwest Communications International, Inc., Sprint Internet Services,

UUNET, a MCI WorldCom Company, and Verio, Inc. (which entered into an agreement to be acquired by NTT Communication Corporation). The Company may be unable to maintain relationships with, or obtain necessary additional capacity from, these backbone providers. Furthermore, the Company may be unable to establish and maintain relationships with other backbone providers that may emerge or that are

significant in geographic areas in which the Company locates its P-NAP facilities.

COMPETITION FROM MORE ESTABLISHED COMPETITORS WHO HAVE GREATER REVENUES COULD DECREASE ITS MARKET SHARE. The Internet connectivity services market is extremely competitive, and there are few substantial barriers to entry. The Company expects competition from existing competitors to intensify in the future, and the Company may not have the financial resources, technical expertise, sales and marketing abilities or support capabilities to compete successfully in its market. Many of the Company's existing competitors have greater market presence, engineering and marketing capabilities, and financial, technological and personnel resources than the Company does. As a result, the Company's competitors may have several advantages over the Company as it seeks to develop a greater market presence.

The Company's competitors currently include backbone providers that provide connectivity services to the Company, including AT&T, Cable & Wireless USA, Global Crossing, GTE Internetworking, ICG Communications, Intermedia, PSINet, Qwest Communications International, Sprint, UUNET and Verio, regional Bell operating companies which offer Internet access, and global, national and regional Internet service providers.

In addition, if the Company is successful in implementing the Company's international expansion, the Company expects to encounter additional competition from international Internet service providers as well as international telecommunications companies.

COMPETITION FROM NEW COMPETITORS COULD DECREASE THE COMPANY'S MARKET SHARE. The Company also believes that new competitors will enter its 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 announced plans to offer or expand their network services. For example, GTE Internetworking, PSINet and Verio (which entered into an agreement to be acquired by NTT Communication Corporation) have expanded their Internet access products and services through acquisition. Further, the ability of some of these potential competitors to bundle other services and products with their network services could place the Company 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. In addition, Internet backbone providers may make technological developments, such as improved router technology, that will enhance the quality of their services.

PRICING PRESSURE COULD DECREASE THE COMPANY'S MARKET SHARE. Increased price competition or other competitive pressures could erode the Company's market share. The Company currently charges, and expects to continue to charge, more for its Internet connectivity services than its competitors. For example, the Company's 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 the Company 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 the Company to decrease its prices. The Company may not be able to offset the effects of any such price reductions even with an increase in the number of its customers, higher revenues from enhanced services, cost reductions or otherwise. In addition, the Company believes that the Internet connectivity industry is likely to encounter consolidation in the future. Consolidation could result in increased pressure on the Company to decrease its prices.

A FAILURE IN THE COMPANY'S NETWORK OPERATIONS CENTER, P-NAP FACILITIES OR COMPUTER SYSTEMS WOULD CAUSE A SIGNIFICANT DISRUPTION IN THE PROVISION OF ITS INTERNET CONNECTIVITY SERVICES. Although the Company has taken precautions against systems failure, interruptions could result from natural disasters as well as power loss, telecommunications failure and similar events. The Company's business depends on the efficient and uninterrupted operation of its network operations center, its P-NAP facilities and its computer and communications hardware systems and infrastructure. The Company currently has one network operations center located in Seattle, and it has 16 P-NAP facilities which are located in the Atlanta, Boston, Chicago, Dallas, Denver, Freemont, CA, Houston,

Los Angeles, Miami, New York (two P-NAP facilities), Orange County, CA, Philadelphia, San Jose, Seattle and Washington, D.C. metropolitan areas. If the Company experiences a problem at its network operations center, the Company may be unable to provide Internet connectivity services to its customers, provide customer service and support or monitor its network infrastructure and P-NAP facilities, any of which would seriously harm its business.

BECAUSE THE COMPANY HAS NO EXPERIENCE OPERATING INTERNATIONALLY, ITS INTERNATIONAL EXPANSION MAY BE LIMITED. Although the Company currently operates in 15 domestic metropolitan markets, a key component of its strategy is to expand into international markets. The Company has no experience operating internationally. The Company may not be able to adapt its services to international markets or market and sell these services to customers abroad. In addition to general risks associated with international business expansion, the Company faces the following specific risks in its international business expansion plans:

- difficulties in establishing and maintaining relationships with foreign backbone providers and local vendors, including co-location and local loop providers; and

- difficulties in locating, building and deploying P-NAP facilities and a network operations center in foreign countries, including in the United Kingdom and the Netherlands where the Company plans to deploy facilities in 2000, and managing P-NAP facilities and network operations centers across disparate geographic areas.

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

THE COMPANY'S BRAND IS RELATIVELY NEW, AND FAILURE TO DEVELOP BRAND RECOGNITION COULD HURT THE COMPANY'S ABILITY TO COMPETE EFFECTIVELY. To successfully execute its strategy, the Company must strengthen its brand awareness. If the Company does not build its brand awareness, its ability to realize its strategic and financial objectives could be hurt. Many of the Company's competitors have well-established brands associated with the provision of Internet connectivity services. To date, the Company's market presence has been limited principally to the Atlanta, Boston, Chicago, Dallas, Denver, Freemont CA, Houston, Los Angeles, Miami, New York (two P-NAP facilities), Orange County, CA, Philadelphia, San Jose, Seattle and Washington D.C. metropolitan areas. To date, the Company has attracted its existing customers primarily through a relatively small sales force and word of mouth. In order to build its brand awareness, the Company intends to increase its marketing efforts significantly, which may not be successful, and the Company must continue to provide high quality services. As part of its brand building efforts, the Company expects to increase its marketing budget substantially as well as its marketing activities, including advertising, tradeshows, direct response programs and new P-NAP facility launch events.

THE COMPANY IS DEPENDENT UPON ITS KEY EMPLOYEES AND MAY BE UNABLE TO ATTRACT OR RETAIN SUFFICIENT NUMBERS OF QUALIFIED PERSONNEL. The Company's future performance depends to a significant degree upon the continued contributions of its executive management team and key technical personnel. The loss of any member of the Company's executive management team or a key technical employee, such as its Chief Executive Officer, Anthony Naughtin, its Chief Technology Officer, Christopher Wheeler, or

its Chief Financial Officer, Paul McBride, could significantly harm the Company. Any of the Company's officers or employees can terminate his or her relationship with the Company at any time. To the extent the Company is able to expand its operations and deploy additional P-NAP facilities, its workforce will be required to grow. Accordingly, the Company's future success depends on the Company's 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, the Company may not be successful in attracting, hiring, training and retaining the people the Company needs, which would seriously impede its ability to implement its business strategy.

IF THE COMPANY IS NOT ABLE TO SUPPORT ITS RAPID GROWTH EFFECTIVELY, ITS EXPANSION PLANS MAY BE FRUSTRATED OR MAY FAIL. The Company's inability to manage growth effectively would seriously harm its plans to expand its Internet

connectivity services into new markets. Since the introduction of its Internet connectivity services, the Company has experienced a period of rapid growth and expansion, which has placed, and continues to place, a significant strain on all of its resources. For example, as of December 31, 1996 the Company had one operational P-NAP facility and nine employees compared to 16 operational P-NAP facilities and 395 full-time employees as of March 31, 2000. In addition, the Company had $1.2 million in revenues for the three months ended March 31, 1999, compared to $8.9 million in revenues for the three months ended March 31, 2000. The Company expects its growth to continue to strain its management, operational and financial resources. For example, the Company may not be able to install adequate financial control systems in an efficient and timely manner, and its current or planned information systems, procedures and controls may be inadequate to support its future operations. The difficulties associated with installing and implementing new systems, procedures and controls may place a significant burden on the Company's management and its internal resources. The Company's plans to rapidly deploy additional P-NAP facilities could place a significant strain on its management's time and resources.

IF THE COMPANY FAILS TO ADEQUATELY PROTECT ITS INTELLECTUAL PROPERTY, THE COMPANY MAY LOSE RIGHTS TO SOME OF ITS MOST VALUABLE ASSETS. The Company relies on a combination of patent, copyright, trademark, trade secret and other intellectual property law, nondisclosure agreements and other protective measures to protect its proprietary technology. InterNAP and P-NAP are trademarks of InterNAP which are registered in the United States. The United States Patent and Trademark Office, or USPTO, issued a patent in September 1999 relating to an initial patent application the Company filed on September 3, 1997. The patent is enforceable for a duration of 20 years from the date of filing, or until September 3, 2017. There can be no assurance that this patent or any future issued patent will provide significant proprietary protection or commercial advantage to the Company or that the USPTO will allow any additional or future claims. The Company has a second application pending and may file additional applications in the future. Additional claims that were included by amendment in the Company's initial application have now been included in its second patent application. The Company's patent and patent applications relate to its P-NAP facility technology. In addition, the Company has filed a corresponding international patent application under the Patent Cooperation Treaty.

It is possible that any patents that have been or may be issued to the Company could still be successfully challenged by third parties, which could result in the Company's 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 the Company's services and products or design around any patents that may be issued to the Company. In addition, effective patent protection may not be available in every country in which the Company intends to do business.

In addition to patent protection, the Company believes the protection of its copyrightable materials, trademarks and trade secrets is important to its future success. The Company relies 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 its proprietary rights. In

particular, the Company generally enters into confidentiality agreements with its employees and nondisclosure agreements with its customers and corporations with whom the Company has strategic relationships. In addition, the Company generally registers its important trademarks with the USPTO to preserve their value and establish proof of its ownership and use of these trademarks. Any trademarks that may be issued to the Company may not provide significant proprietary protection or commercial advantage to the Company. Despite any precautions that the Company has taken, intellectual property laws and contractual restrictions may not be sufficient to prevent misappropriation of its technology or deter others from developing similar technology.

THE COMPANY 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 and other intellectual property rights to technologies that are important to the Company's business. Any claims that the Company's 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 the Company's technical and management personnel or require the Company to enter into royalty or licensing agreements, any of which could significantly harm its operating results. In addition, in its customer agreements, the Company agrees to indemnify its customers for any expenses or liabilities resulting from claimed infringement of patents, trademarks or copyrights of third parties. If a claim against the Company were to be successful and the Company were not able to obtain a license to the relevant or a substitute technology on acceptable terms or redesign its products to avoid infringement, its ability to compete successfully in its competitive market would be impaired.

BECAUSE THE COMPANY DEPENDS ON THIRD PARTY SUPPLIERS FOR KEY COMPONENTS OF ITS NETWORK INFRASTRUCTURE, FAILURES OF THESE SUPPLIERS TO DELIVER THEIR COMPONENTS AS AGREED COULD HINDER ITS ABILITY TO PROVIDE ITS 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 the Company's ability to provide its Internet connectivity services on a competitive and timely basis. The Company is dependent on other companies to supply various key components of its infrastructure, including the local loops between its P-NAP facilities and its Internet backbone providers and between its P-NAP facilities and its customers' networks. In addition, the routers and switches used in the Company's network infrastructure are currently supplied by a limited number of vendors, including Cisco Systems, Inc. Additional sources of these products may not be available in the future on satisfactory terms, if at all. The Company purchases these products pursuant to purchase orders placed from time to time. The Company does not carry significant inventories of these products, and the Company has no guaranteed supply arrangements with its vendors. The Company has in the past experienced delays in receiving shipments of equipment purchased. To date, these delays have neither been material nor have adversely affected us, but these delays could affect the Company's ability to deploy P-NAP facilities in the future on a timely basis. If Cisco Systems does not provide the Company with its routers, or if the Company's 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 the Company uses in its network infrastructure, the Company may be unable to meet its customer service commitments.

THE COMPANY MAY REQUIRE ADDITIONAL CAPITAL IN THE FUTURE AND MAY NOT BE ABLE TO SECURE ADEQUATE FUNDS ON TERMS ACCEPTABLE TO THE COMPANY. The expansion and development of the Company's business will require significant capital, which the Company may be unable to obtain, to fund its capital expenditures and operations, including working capital needs. The Company's principal capital expenditures and lease payments include the purchase, lease and installation of network equipment such as routers, telecommunications equipment and other computer equipment. The timing and amount of the Company's future capital requirements may vary significantly depending on numerous

factors, including regulatory, technological, competitive and other developments in its industry. During the next 12 months, the Company expects to meet its cash requirements with existing cash, cash equivalents, short-term investments and cash flow from sales of its services. However, the Company's capital requirements depend on several factors, including the rate of market acceptance of the Company's services, the ability to expand its customer base, the rate of deployment of additional P-NAP facilities and other factors. If the Company's capital requirements vary materially from those currently planned, or if the Company fails to generate sufficient cash flow from the sales of its services, the Company may require additional financing sooner than anticipated or the Company may have to delay or abandon some or all of its development and expansion plans or otherwise forego market opportunities.

The Company may not be able to obtain future equity or debt financing on favorable terms, if at all. In addition, the Company's credit agreement contains covenants restricting its ability to incur further indebtedness. Future borrowing instruments such as credit facilities and lease agreements are likely to contain similar or more restrictive covenants and will likely require the Company to pledge assets as security for borrowings thereunder. The Company's inability to obtain additional capital on satisfactory terms may delay or prevent the expansion of its business.

THE COMPANY MAY FIND IT DIFFICULT TO INTEGRATE POTENTIAL FUTURE ACQUISITIONS, WHICH COULD DISRUPT ITS BUSINESS, DILUTE SHAREHOLDER VALUE AND ADVERSELY AFFECT ITS OPERATING RESULTS. The Company may acquire businesses and/or technology in the future, which would complicate its management's tasks.

The Company may need to integrate widely dispersed operations that have different and unfamiliar corporate cultures. These integration efforts may not succeed or may distract management's attention from existing business operations. The Company's failure to successfully manage future acquisitions could seriously harm its business. Also, the Company's existing shareholders would be diluted if the Company financed the acquisitions by issuing equity securities.

RISKS RELATED TO THE COMPANY'S INDUSTRY

BECAUSE THE DEMAND FOR THE COMPANY'S SERVICES DEPENDS ON CONTINUED GROWTH IN USE OF THE INTERNET, A SLOWING OF THIS GROWTH COULD HARM THE DEVELOPMENT OF THE DEMAND FOR THE COMPANY'S 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 the Company targets. 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 the Company's revenues to grow more slowly than anticipated and reduce the demand for its services.

BECAUSE THE INTERNET CONNECTIVITY MARKET IS NEW AND ITS VIABILITY IS UNCERTAIN, THERE IS A RISK THE COMPANY'S SERVICES MAY NOT BE ACCEPTED. The Company faces the risk that the market for high performance Internet connectivity services might fail to develop, or develop more slowly than expected,

or that its 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, the Company may be unable to market and sell its services successfully and cost-effectively to a sufficiently large number of customers. The Company typically charges more for its services than do its competitors, which may affect market acceptance of its services. 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 the Company's Internet connectivity services could be largely resolved and its core business rendered obsolete.

IF THE COMPANY IS UNABLE TO RESPOND EFFECTIVELY AND ON A TIMELY BASIS TO RAPID TECHNOLOGICAL CHANGE, THE COMPANY MAY LOSE OR FAIL TO ESTABLISH A COMPETITIVE ADVANTAGE IN ITS 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. The Company may be unable to successfully use or develop new technologies, adapt its network infrastructure to changing customer requirements and industry standards, introduce new services or enhance its existing services on a timely basis. Furthermore, new technologies or enhancements that the Company uses or develops may not gain market acceptance. The Company's pursuit of necessary technological advances may require substantial time and expense, and the Company may be unable to successfully adapt its network and services to alternate access devices and technologies.

If its services do not continue to be compatible and interoperable with products and architectures offered by other industry members, the Company's ability to compete could be impaired. The Company's ability to compete

successfully is dependent, in part, upon the continued compatibility and interoperability of its services with products and architectures offered by various other industry participants. Although the Company intends to support emerging standards in the market for Internet connectivity, there can be no assurance that the Company 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 THE COMPANY'S SERVICES OR RENDER THEM OBSOLETE. New technologies and industry standards have the potential to replace or provide lower cost alternatives to the Company's services. The adoption of such new technologies or industry standards could render the Company's existing services obsolete and unmarketable. For example, the Company's 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 the Company's services obsolete and unmarketable. The Company's failure to anticipate the prevailing standard or the failure of a common standard to emerge could hurt its business. Further, the Company anticipates 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 the Company.

SERVICE INTERRUPTIONS CAUSED BY SYSTEM FAILURES COULD HARM CUSTOMER RELATIONS, EXPOSE THE COMPANY TO LIABILITY AND INCREASE THE COMPANY'S CAPITAL COSTS. Interruptions in service to the Company's customers could harm the Company's customer relations, expose the Company to potential lawsuits and require the Company to spend more money adding redundant facilities. The Company's operations depend upon its ability to protect its customers' data and equipment, its equipment and its network infrastructure, including its connections to its backbone providers, against damage from human error or "acts of God." Even if the Company takes precautions, the occurrence of a natural disaster or other

unanticipated problem could result in interruptions in the services the Company provides to its 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 the Company's 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 the Company's telecommunications and Internet service providers to provide the Company with the data communications capacity it requires could cause service interruptions.

THE COMPANY'S NETWORK AND SOFTWARE ARE VULNERABLE TO SECURITY BREACHES AND SIMILAR THREATS WHICH COULD RESULT IN ITS LIABILITY FOR DAMAGES AND HARM ITS REPUTATION. Despite the implementation of network security measures, the core of the Company's network infrastructure is vulnerable to computer viruses, break-ins, network attacks and similar disruptive problems. This could result in the Company's liability for damages, and its reputation could suffer, thereby deterring potential customers from working with the Company. Security problems caused by third parties could lead to interruptions and delays or to the cessation of service to the Company's customers. Furthermore, inappropriate use of the network by third parties could also jeopardize the security of confidential information stored in the Company's computer systems and in those of its customers.

Although the Company intends 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 its system. Therefore, there can be no assurance that the measures the Company implements 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 the Company's customers, which could hurt its business.

SHOULD THE GOVERNMENT MODIFY OR INCREASE ITS REGULATION OF THE INTERNET, THE

PROVISION OF ITS 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, which 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 the Company's 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 the Company or its customers. The government may also seek to regulate some segments of the Company's 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. The Company cannot predict the impact, if any, that future regulation or regulatory changes may have on its business.

PART II. OTHER INFORMATION

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits:

27.1 Financial Data Schedule (filed only with the electronic submission of Form 10-Q in accordance with the Edgar requirements).

(b) Reports on Form 8-K:

The Company did not file any reports on Form 8-K during the quarter ended March 31, 2000.

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 12th day of May, 2000.

INTERNAP NETWORK SERVICES CORPORATION
(Registrant)

By: /s/ PAUL E. MCBRIDE

Paul E. McBride
VICE PRESIDENT AND CHIEF FINANCIAL OFFICER
(PRINCIPAL FINANCIAL AND ACCOUNTING OFFICER)

EXHIBIT INDEX

EXHIBIT INDEX	TITLE
27.1	Financial Data Schedule.

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