

INTERNAP NETWORK SERVICES CORP
Form 10-Q/A
January 09, 2003

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q/A
(Amendment No. 1)

(Mark One)

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

For the Quarterly Period Ended September 30, 2002
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)

DELAWARE	91-2145721
(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 and Zip Code)
(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 No

Indicate by check mark whether the registrant is an accelerated filer (as
defined in Rule 12b-2 of the Exchange Act). Yes No

Indicate the number of shares outstanding of each of the registrant's classes
of common stock as of the latest practicable date: 223,309,309 shares of
common stock, \$0.001 par value, outstanding as of December 31, 2002, which
includes 62,726,160 shares of common stock issuable upon conversion by the
holders of the Series A preferred stock.

EXPLANATORY NOTE

We are filing this Amendment No. 1 to our Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2002 to announce that two amendments to our corporate charter presented to our stockholders in May 2002 and October 2002 are not effective for technical reasons of which we recently became aware. The May amendment was intended to permit us to take certain actions affecting the Series A preferred stock with the written consent of the holders of that security. Because the May amendment is not effective and shareholder approval was not properly received, the October amendment, which would have resulted in the balance sheet reclassification of \$80.3 million of Series A preferred stock from mezzanine capital to stockholders' equity in future periods, is also invalid. Accordingly, we are amending our quarterly report on Form 10-Q for the quarterly period ended September 30, 2002 to remove all references to the October amendment and its pro forma effects on our stockholders' equity.

Although we had sought the October amendment to satisfy one of two alternative listing requirements applicable to our maintaining our eligibility for listing on the NASDAQ SmallCap Market, we satisfy the second alternative requirement and, accordingly, we believe the invalidity of the amendments does not affect our current eligibility for listing. We are examining whether to resubmit the amendments for stockholder approval. If we decide to do so, we would expect to seek the requisite approvals at our 2003 annual meeting or at an earlier special meeting.

No changes have been made to our historical financial statements for any period presented, except for the deletion of all references to the October amendment in Footnote 11 (Subsequent Events - Series A Preferred Stock) of the notes to our financial statements for the quarter ended September 30, 2002.

INTERNAP NETWORK SERVICES CORPORATION
FORM 10-Q/A
FOR THE QUARTER ENDED SEPTEMBER 30, 2002

TABLE OF CONTENTS

Table of Contents

	Page
PART I. FINANCIAL INFORMATION.....	4
Item 1. FINANCIAL STATEMENTS.....	4
Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.....	16
Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.....	26

Edgar Filing: INTERNAP NETWORK SERVICES CORP - Form 10-Q/A

Item 4.	CONTROLS AND PROCEDURES.....	27
PART II.	OTHER INFORMATION.....	38
ITEM 2.	CHANGES IN SECURITIES AND USE OF PROCEEDS.....	38
ITEM 4.	SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS....	38
ITEM 5.	MISCELLANEOUS.....	38
ITEM 6.	EXHIBITS.....	39

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

INTERNAP NETWORK SERVICES CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited, in thousands)

September 30,
2002

ASSETS

Current assets:

Cash and cash equivalents.....	\$ 32,520
Short-term investments.....	--
Accounts receivable, net of allowance of \$1,445 and \$1,183, respectively.....	13,120
Prepaid expenses and other assets.....	5,057

Total current assets.....	50,697
Property and equipment, net of accumulated depreciation of \$97,073 and \$70,507, respectively.....	98,455
Restricted cash.....	2,122
Investments.....	3,355
Goodwill and other intangible assets, net of accumulated amortization of \$36,314 and \$32,116, respectively.....	32,013
Deposits and other assets.....	3,352

Total assets.....	\$ 189,994

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:

Accounts payable.....	\$ 12,807
Accrued liabilities.....	10,181
Deferred revenues.....	6,940
Notes payable, current portion.....	4,007
Line of credit.....	15,000
Capital lease obligations, current portion.....	834

Edgar Filing: INTERNAP NETWORK SERVICES CORP - Form 10-Q/A

Restructuring liability, current portion.....	6,969

Total current liabilities.....	56,738
Deferred revenues.....	2,721
Notes payable, less current portion.....	1,597
Capital lease obligations, less current portion.....	24,605
Restructuring liability, less current portion.....	9,196

Total liabilities.....	94,857
Commitments and contingencies:	
Series A convertible preferred stock, \$0.001 par value, 3,500 shares designated; 2,950 and 3,171 issued and outstanding, respectively, with liquidation preferences of \$94,408 and \$101,487, respectively.....	80,292
Stockholders' equity:	
Common stock, \$0.001 par value, 600,000 shares authorized; 159,453 and 151,294 shares issued and outstanding, respectively.....	159
Additional paid in capital.....	798,083
Deferred stock compensation.....	(938)
Accumulated deficit.....	(782,459)
Accumulated items of other comprehensive income.....	--

4

Total stockholders' equity.....	14,845

Total liabilities and stockholders' equity.....	\$ 189,994
	=====

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

5

INTERNAP NETWORK SERVICES CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited, in thousands, except per share amounts)

	Three-month periods ended		Nine- S
	September 30,		
	2002	2001	200
	-----	-----	-----
Revenues.....	\$ 32,711	\$ 29,163	\$ 98,3
Costs and expenses:			
Direct cost of network.....	17,302	24,637	64,0
Customer support.....	2,867	4,789	10,3
Product development.....	1,836	2,760	5,7
Sales and marketing.....	5,330	7,496	17,1

Edgar Filing: INTERNAP NETWORK SERVICES CORP - Form 10-Q/A

General and administrative.....	4,548	9,820	16,0
Depreciation and amortization.....	12,390	13,468	38,7
Amortization of goodwill and other intangible assets.....	1,165	5,658	4,1
Amortization of deferred stock compensation.....	(316)	814	
Restructuring costs.....	352	67,211	(4,6
Impairment of goodwill and other intangible assets.....	--	--	
Loss on sales and retirements of property and equipment.....	1,510	--	2,6
	-----	-----	-----
Total operating costs and expenses.....	46,984	136,653	154,4
	-----	-----	-----
Loss from operations.....	(14,273)	(107,490)	(56,0
Other income (expense):			
Interest income (expense), net.....	(629)	(771)	(1,3
Loss on equity method investment.....	(334)	(518)	(9
Loss on investments.....	--	(6,000)	
	-----	-----	-----
Total other income (expense).....	(963)	(7,289)	(2,3
	-----	-----	-----
Net loss.....	\$ (15,236)	\$ (114,779)	\$ (58,3
	=====	=====	=====
Basic and diluted net loss per share.....	\$ (0.10)	\$ (0.76)	\$ (0.
	=====	=====	=====
Weighted average shares used in computing basic and diluted net loss per share.....	157,177	150,541	154,2

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

6

INTERNAP NETWORK SERVICES CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited, in thousands)

	Nine-mon ended Sep
	----- 2002 -----
CASH FLOWS FROM OPERATING ACTIVITIES	
Net loss.....	\$ (58,382)
Adjustments to reconcile net loss to net cash used in operating activities:	
Depreciation and amortization.....	42,904
Impairment of goodwill and other intangible assets.....	--
Non-cash restructuring costs/(adjustments).....	(4,602)
Non-cash interest expense on capital lease obligations.....	535

Edgar Filing: INTERNAP NETWORK SERVICES CORP - Form 10-Q/A

Provision for doubtful accounts.....	1,508
Provision for note receivable.....	--
Non-cash compensation and warrant expense.....	25
Loss on disposal of property and equipment.....	2,649
Loss on sale of investment security.....	--
Loss on write-down of investment.....	--
Loss on equity method investment.....	996
Translation gain.....	(210)
Changes in operating assets and liabilities:	
Accounts receivable.....	121
Prepaid expenses, deposits and other assets.....	1,222
Accounts payable.....	(942)
Accrued restructuring charge.....	(12,771)
Deferred revenues.....	(2,841)
Accrued liabilities.....	(4,708)

Net cash used in operating activities.....	(34,496)
 CASH FLOWS FROM INVESTING ACTIVITIES	
Purchases of property and equipment.....	(7,914)
Proceeds from disposal of property and equipment.....	436
Reduction of restricted cash.....	310
Purchase of investments.....	(1,347)
Redemption of investments.....	18,748

Net cash provided by investing activities.....	10,233
 CASH FLOWS FROM FINANCING ACTIVITIES	
Proceeds from line of credit.....	5,000
Principal payments on notes payable.....	(2,526)
Payments on capital lease obligations.....	(10,260)
Proceeds from exercise of stock options and warrants.....	320
Proceeds from issuance of common stock.....	698
Proceeds from issuance of Series A convertible preferred stock, net of issuance costs.....	--

Net cash provided by (used in) financing activities.....	(6,768)
	=====
 Net increase (decrease) in cash and cash equivalents.....	(31,031)
Cash and cash equivalents at beginning of period.....	63,551

Cash and cash equivalents at end of period.....	32,520
	=====
 SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION	
Cash paid for interest.....	\$ 2,432
Purchase of property and equipment financed with capital leases.....	\$ 930
Change in accounts payable attributable to purchases of property and equipment.....	\$ (691)
Acquisition liabilities assumed and accrued acquisition costs.....	--
Non-cash adjustment to fixed assets and capital leases due to restructuring of capital lease obligation.....	\$ 3,710
Forfeiture of deposits to restructuring.....	\$ 558
Impairment of fixed assets due to restructuring.....	\$ 5,175
Prepayment of future lease obligation via note payable.....	\$ 3,300
Accrued expense reclassified into a note payable.....	\$ 1,838

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

INTERNAP NETWORK SERVICES CORPORATION
 CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
 AND COMPREHENSIVE LOSS

NINE-MONTH PERIOD ENDED SEPTEMBER 30, 2002
 (Unaudited, in thousands)

	Common Shares	Stock Par Value	Additional Paid-In Capital	Deferred Stock Compen- sation	Accumulated Deficit	Accumulat Items o Other Compensat Income (Loss
	-----	-----	-----	-----	-----	-----
Balances, December 31, 2001	151,294	\$151	\$794,459	\$ (4,371)	\$ (724,077)	\$ 7
Conversion of Series A convertible preferred stock into common stock.....	4,776	5	6,017	--	--	--
Amortization of deferred stock compensation....	--	--	(2,431)	2,456	--	--
Reversal of deferred stock compensation for terminated employees.....	--	--	(977)	977	--	--
Exercise of options and warrants to purchase common stock.....	1,672	2	207	--	--	--
Issuance and exercise of warrants to purchase shares of common stock to a non-employee.....	111	0.1	111	--	--	--
Issuance of employee stock purchase plan shares.....	1,600	1	697	--	--	--
Net loss.....	--	--	--	--	(58,382)	--
Unrealized loss on investments	--	--	--	--	--	(7
Comprehensive loss.....	-----	-----	-----	-----	-----	-----
Balances, September 30, 2002.....	159,453	\$159	\$798,083	\$ (938)	\$ (782,459)	\$--
	=====	=====	=====	=====	=====	=====

Edgar Filing: INTERNAP NETWORK SERVICES CORP - Form 10-Q/A

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

8

INTERNAP NETWORK SERVICES CORPORATION NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation

The unaudited condensed consolidated financial statements of Internap Network Services Corporation have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission and include all the accounts of Internap Network Services Corporation 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. The unaudited condensed consolidated financial statements reflect all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of our financial position as of September 30, 2002, our operating results for the 3-month and 9-month periods ended September 30, 2002 and 2001, cash flows for the nine-month periods ended September 30, 2002 and 2001, and changes in stockholders' equity for the 9-month period ended September 30, 2002. The balance sheet at December 31, 2001 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 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 and disclosure of contingent assets and liabilities and revenues and expenses 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 and goodwill, depreciation of property and equipment, restructuring allowances, amortization of deferred stock compensation 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 affected our financial position, results of operations or net cash flows.

The results of operations for the three- and nine-month periods ended September 30, 2002 are not necessarily indicative of the results that may be expected for the future periods or for the full year.

2. Risks and Uncertainties

We have a limited operating history and our operations are subject to certain risks and uncertainties frequently encountered by companies in rapidly evolving markets. These risks include the failure to develop or supply technology or services, the ability to obtain adequate financing, the ability to manage rapid growth or expansion, competition within the industry and technology trends. We have experienced significant net operating losses since inception. During fiscal year 2001, we incurred net losses of \$479.2 million and used \$123.0 million of cash in our operating activities. From January 1,

Edgar Filing: INTERNAP NETWORK SERVICES CORP - Form 10-Q/A

2002 through September 30, 2002, we incurred net losses of \$58.4 million and used \$34.5 million of cash in our operating activities. Management expects net losses and negative cash flows will continue for several more quarters. We have decreased the size of our workforce by 194 employees during fiscal year 2002 in addition to the reduction of 313 employees during the prior fiscal year, and terminated certain real estate leases, network and other vendor commitments in order to control costs. Our plans indicate our existing cash is adequate to fund our operations for several more quarters. However, our capital requirements depend on several factors, including the rate of market acceptance of our services, the ability to expand and retain our customer base and other factors. If we fail to realize our planned revenues or costs, management believes it has the ability to further curtail spending and reduce expenses. If, however, our cash 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. We cannot assure you such financing will be available on acceptable terms, if at all.

9

3. Restructuring Charges

2001 Restructuring Charge

During fiscal year 2001, due to the decline and uncertainty of the telecommunications market, we announced two separate restructurings of our business. Under the restructuring programs, management decided to exit certain non-strategic real estate lease and license arrangements, consolidate and exit redundant network connections and streamline the operating cost structure. The total charges include restructuring costs of \$71.6 million. During fiscal year 2001, we incurred cash restructuring expenditures totaling \$19.9 million and non-cash restructuring expenditures of \$4.7 million. We reduced the original restructuring cost estimate by \$7.7 million primarily as a result of favorable lease obligation settlements, leaving a balance of \$39.3 million as of December 31, 2001. During the first and third quarters of 2002, we further reduced our restructuring liability by \$5.0 million and \$7.2 million, respectively. The first quarter 2002 reduction was primarily due to settlements to terminate and restructure certain collocation lease obligations on terms more favorable than our original restructuring estimates. The third quarter 2002 reduction was primarily due to the decision to relocate our corporate headquarters to the previously restructured Atlanta, Georgia facility. Pursuant to the original restructuring plans, we did not anticipate using the Atlanta facility in the future. However, due to changes in management, corporate direction, and other factors, that could not be foreseen at the time of the original restructuring plans, the Atlanta facility was selected as the location for the new corporate headquarters.

2002 Restructuring and Asset Impairment Charge

Due to the continuing decline and uncertainty in the telecommunications market, we committed to additional restructuring actions to align our business with market opportunities. As a result, we recorded a business restructuring charge and asset impairments of \$7.6 million in the three months ended September 30, 2002. The charges were primarily comprised of real estate obligations related to a decision to relocate the corporate headquarters from Seattle, Washington to an existing leased facility in Atlanta, Georgia, net asset write-downs related to the departure from the Seattle office and costs associated with further personnel reductions. The

Edgar Filing: INTERNAP NETWORK SERVICES CORP - Form 10-Q/A

restructuring and asset impairment charge of \$7.6 million for the three months ended September 30, 2002 was offset by a \$7.2 million adjustment, described above, resulting from the decision to utilize the Atlanta facility as our corporate headquarters. The previously unused space in the Atlanta location had been accrued as part of the restructuring liability established during fiscal year 2001.

Included in the \$7.6 million restructuring charge is \$1.1 million of personnel costs related to a reduction in force of approximately 145 employees. This represents employee severance payments made during the three months ended September 30, 2002. We expect that there will be additional restructuring costs in the future as additional payments are made to employees who are subject to deferred compensation arrangements payable at the completion of interim employment agreements. We expect these costs to total less than \$2.0 million. Additionally, we continue to evaluate the restructuring reserve as plans are being executed, which could result in additional charges or adjustments.

Real Estate Obligations

Both the 2001 and 2002 restructuring plans require us to abandon certain leased properties not currently in use or that will not be utilized by us in the future. Also included in real estate obligations is the abandonment of certain collocation license obligations. Accordingly, we recorded real estate related restructuring costs of \$40.8 million, net of non-cash plan adjustments, which are estimates of losses in excess of estimated sublease revenues or termination fees to be incurred on these real estate obligations over the remaining lease terms expiring through 2015. This cost was determined based upon our estimate of anticipated sublease rates and time to sublease the facility. If rental rates decrease in these markets or if it takes longer than expected to sublease these properties, the actual loss could exceed this estimate.

10

Network Infrastructure Obligations

The changes to our network infrastructure require that we decommission certain network ports we do not currently use and will not use in the future pursuant to the restructuring plan. These costs have been accrued as components of the restructuring charge because they represent amounts to be incurred under contractual obligations in existence at the time the restructuring plan was initiated. These contractual obligations will continue in the future with no economic benefit, or they contain penalties that will be incurred if the obligations are cancelled.

The following table displays the activity and balances for restructuring activity and asset impairment (in millions):

December 31, 2001 Restructuring Liability	Restructuring and Impairment Charge	Cash reductions	Non-cash and Write Downs
-----	-----	-----	-----

Edgar Filing: INTERNAP NETWORK SERVICES CORP - Form 10-Q/A

Restructuring costs activity for 2001				
restructuring charge--				
Real estate obligations.....	\$ 33.5	\$ --	\$ (9.5)	\$ (0.5)
Network infrastructure obligations	2.7	--	(1.3)	--
Other.....	2.0	--	(0.9)	--
Restructuring costs activity for 2002				
restructuring charge--				
Real estate obligations.....	--	2.2	--	--
Personnel.....	--	1.1	(1.1)	--
Other.....	--	0.2	--	--
	-----	-----	-----	-----
Total restructuring costs...	38.2	3.5	(12.8)	(0.5)
Net asset write-down, 2001 restructuring charge.....	1.1	--	--	(1.1)
Net asset write-downs for 2002 restructuring charge.....	--	4.1	--	(4.1)
	-----	-----	-----	-----
Total asset impairments.....	1.1	4.1	--	(5.2)
	-----	-----	-----	-----
Total.....	\$ 39.3	\$ 7.6	\$ (12.8)	\$ (5.7)
	=====	=====	=====	=====

4. Net Loss Per Share

Basic and diluted net loss per share have 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 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- and nine-month periods ended September 30, 2002 and 2001 are calculated as follows (in thousands, except per share amounts):

	Three-month periods ended September 30,		Nine
	2002	2001	
	(unaudited)	(unaudited)	(
Net loss.....	\$ (15,236)	\$ (114,779)	
Basic and diluted:			
Weighted-average shares of common stock outstanding used in computing basic and diluted net loss per share.....	157,177	150,541	
Basic and diluted net loss per share.....	\$ (0.10)	\$ (0.76)	

Antidilutive securities not included in diluted net loss per share calculation:

Edgar Filing: INTERNAP NETWORK SERVICES CORP - Form 10-Q/A

Convertible preferred stock.....	63,679	68,455
Options to purchase common stock.....	21,258	14,918
Warrants to purchase common stock.....	17,326	18,795
	-----	-----
	102,263	102,168
	=====	=====

5. Accounting for Goodwill and Intangible Assets Pursuant to Statement of Financial Accounting Standard No. 142

Effective January 1, 2002, we adopted Statement of Financial Accounting Standard (SFAS) No. 142, "Goodwill and Other Intangible Assets," which establishes new accounting and reporting requirements for goodwill and other intangible assets. Under SFAS No. 142, all goodwill amortization ceased effective January 1, 2002 and recorded goodwill was tested for impairment by comparing the fair value of Internap Network Services Corporation as a single reporting unit, as determined by its implied market capitalization, to its consolidated carrying value including recorded goodwill. An impairment test is required to be performed at adoption of SFAS No. 142 and at least annually thereafter. Generally, any adjustments made as a result of the impairment testing are required to be recognized as operating expenses. We will perform our annual impairment testing during the third quarter of each year absent any impairment indicators that may cause more frequent analysis, as required by SFAS No. 142.

Based on our initial impairment test performed upon adoption of SFAS No. 142, we determined that none of the recorded goodwill was impaired as of January 1, 2002. During the period ended September 30, 2002, we performed our annual impairment testing. This test was performed by comparing the adjusted book value of the consolidated company to its fair value. In determining Internap's fair value we considered both market-based and income-based approaches to estimate value.

Based on the results of the analysis performed we concluded that no goodwill impairment existed as of September 30, 2002. The assumptions, inputs and judgments used in performing the valuation analysis are inherently subjective and reflect estimates based on known facts and circumstances at the time the valuation was performed. The use of different assumptions, inputs and judgments, or changes in circumstances, could materially affect the results of the valuation. Adverse changes in the valuation would necessitate an impairment charge for the goodwill held by Internap. As of September 30, 2002, goodwill totaled \$27.0 million.

In connection with adopting SFAS 142, we also reassessed the useful lives and the classification of our amortizing identifiable intangible assets and determined that they continue to be appropriate. The components of our amortized intangible assets are as follows (in thousands):

December 31, 2001		September 30, 2001
-----	-----	-----
Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount
-----	-----	-----

Edgar Filing: INTERNAP NETWORK SERVICES CORP - Form 10-Q/A

Contract based.....	\$14,535	\$(6,711)	\$14,535
Technology based.....	\$ 2,600	\$(1,228)	\$ 2,600

Amortization expense for identifiable intangible assets during the third quarter of 2002 was \$1.2 million and \$4.2 million year-to-date. Estimated amortization expense for the remainder of 2002, 2003 and thereafter is as follows (in thousands):

	Estimated Amortization Expense -----
2002 (remainder).....	\$ 1,407
2003.....	3,266
Thereafter.....	325

12

Actual results of operations for the three- and nine-month periods ended September 30, 2002 and pro forma results of operations for the three- and nine-month periods ended September 30, 2001, had we applied the non-amortization provisions of SFAS No. 142 in those periods, are as follows (in thousands, except per share amounts):

	Three-month periods ended September 30,		Nine-mo S
	2002	2001	2002
	-----	-----	-----
Reported net loss.....	\$ (15,236)	\$(114,779)	\$ (58,3
Add amortization of goodwill.....	--	4,267	
Pro forma net loss.....	\$ (15,236)	\$(110,512)	\$ (58,3
	=====	=====	=====
Reported net loss per share.....	\$ (0.10)	\$ (0.76)	\$ (0.
Pro forma net loss per share.....	\$ (0.10)	\$ (0.73)	\$ (0.

6. Investments

On April 10, 2001, we announced the formation of a joint venture with NTT-ME Corporation of Japan. During fiscal years 2001 and 2002, we made an aggregate cash investment of \$4.2 million in two installments to acquire 51% of the common stock of the joint venture, Internap Japan Co., Ltd. We are unable to assert control over the joint venture's operational and financial policies and practices, due to certain minority interest protections afforded to our joint venture partner, NTT-ME Corporation. Consequently, we are precluded from accounting for the joint venture as a subsidiary whose assets,

Edgar Filing: INTERNAP NETWORK SERVICES CORP - Form 10-Q/A

liabilities, revenues and expenses would be consolidated. We are, however, able to assert significant influence over the joint venture and, therefore, account for our joint venture investment using the equity-method of accounting pursuant to Accounting Principles Board Opinion No. 18 "The Equity Method of Accounting for Investments in Common Stock" and consistent with EITF 96-16 "Investor's accounting for an investee when the investor has a majority of the voting interest but the minority shareholder or shareholders have certain approval or veto rights." During the three- and nine-month periods ended September 30, 2002, we recognized our proportionate share of Internap Japan's net losses totaling \$0.3 million and \$1.0 million, respectively. Since inception of the joint venture, we have recognized our proportional share of Internap Japan's aggregate losses totaling \$2.2 million and translation gains due to favorable exchange rates between the United States Dollar and the Japanese Yen totaling \$0.2 million, resulting in a net investment balance of \$2.2 million. Our investment in Internap Japan is reflected as a component of investments and losses and translation gains and losses in other income (expense) on the statements of operations.

Investments at September 30, 2002 consisted of the following (in thousands):

	Cost Basis	Recorded Value
	-----	-----
Equity Method Investment.....	\$ 2,179	\$ 2,179
Cost Basis Investments.....	1,176	1,176
	-----	-----
	\$ 3,355	\$ 3,355
	=====	=====

Investments at December 31, 2001 consisted of the following (in thousands):

	Costs Basis	Unrealized Gain	Unrealized Gain	Record Valu
	-----	-----	-----	-----
U.S. Government and Government Agency Debt				
Securities.....	\$ 6,210	\$ 3	\$ --	\$ 6,213
Corporate Debt Securities.....	12,538	4	--	12,542
Equity Method Investment.....	1,618	--	--	1,618
Cost Basis Investments.....	1,176	--	--	1,176
	-----	-----	-----	-----
	\$ 21,542	\$ 7	\$ --	\$ 21,549
	=====	=====	=====	=====

7. Capital Lease Obligations

During the second quarter of 2002, we amended the terms of our master lease agreement with our primary supplier of networking equipment. The amended terms of the master lease included a retroactive effective date to March 1, 2002 and extended the payment terms and provided for a deferral of lease

Edgar Filing: INTERNAP NETWORK SERVICES CORP - Form 10-Q/A

payments of the underlying lease schedules for a period of 24 months in exchange for a buy-out payment of \$12.1 million in satisfaction of the outstanding lease obligation on 14 schedules totaling \$6.3 million and for the purchase of the equipment leased under the same schedules totaling \$5.8 million. The terms of our master lease agreement, as amended, include financial covenants that require us to maintain minimum liquidity balances, periodic revenues, EBITDA levels and other covenants. Should we breach the covenants, experience a change-of-control represented by a change in 35% of the aggregate ordinary voting power, or should the lessor believe we have experienced a material adverse change in our business, the lessor has the ability to demand payment of all amounts due. As of September 30, 2002, we were not in compliance with a non-financial covenant requiring us to provide the lessor with documentation allowing access to our facilities. We were in compliance with all financial covenants and have obtained a waiver through January 31, 2003. Capital lease obligations and the leased property and equipment are recorded at acquisition at the present value of future lease payments based upon the terms of the lease agreement. The extension of payment terms under the amended master lease agreement reduced the present value of our future lease payments and, therefore, we reduced our capital lease obligation and the cost basis of our related leased property and equipment by \$2.6 million to reflect the reduction. Interest will continue to accrue on a periodic basis and add to the capital lease obligation during the 24-month payment deferral period.

8. Notes Payable

During the second quarter of 2002, we completed negotiations with a collocation space provider that resulted in a reduction of the periodic rents paid to the provider for 36 months in exchange for a \$2.7 million note payable to be paid in quarterly installments over 36 months. The note bears interest at a rate of 5.5% and is collateralized by leaseholds, equipment, and customer revenues at one of our service points. The related prepaid asset is being amortized to direct cost of network over 36 months.

During fiscal year 2000, we entered into an integrated sales agreement to act as an exclusive reseller for a service provider. The agreement included a revenue commitment to be fulfilled over a two-year period that ended during March 2002. We had fully accrued our liability for the \$1.8 million shortfall as of the expiration date of the agreement as a component of accrued expenses. During the second quarter of 2002, we entered into a note payable to the service provider in lieu of immediate payment of the shortfall amount and reclassified the \$1.8 million accrued expense to notes payable. The note matures October 5, 2003, is payable based on a payment schedule, bears interest of 6.0% and is collateralized by a first position interest in certain network equipment and a second position interest in our cash accounts.

9. Stock-Based Compensation Plans

During the nine-month period ended September 30, 2002, we terminated employment of individuals for whom we had recognized deferred stock compensation and had recognized related expenses on unvested options using an accelerated amortization method. Accordingly, during the nine-month period ended September 30, 2002, we reduced our deferred stock compensation that would have been amortized to future expense by \$1.0 million, and we reduced our amortization to expense of deferred stock compensation by \$2.4 million to reverse previously recognized expense on unvested options.

10. Deferred Revenue

During the nine-month period ended September 30, 2002, we completed negotiations with one of our customers that significantly reduced the term of the customer's service contract. As a result of the reduction in the

Edgar Filing: INTERNAP NETWORK SERVICES CORP - Form 10-Q/A

contractual service period and other factors, we changed our estimated life of the customer relationship over which to recognize deferred revenues from 120 months to 46 months, with 17 months remaining at September 30, 2002. The current balance of deferred revenues attributable to the customer on the date of completing the new service contract was increased to reflect the amortization of the remaining balance over the remaining customer relationship

14

period. The reallocation resulted in \$3.9 million of deferred revenues being reclassified from the non-current to current classification at the time the contract was executed.

11. Subsequent Events

Credit Facility

Subsequent to September 30, 2002, we entered into a revised loan and security agreement. Under the terms of the new loan and security agreement, \$15 million outstanding under the previous facility was refinanced into a \$15 million revolving line of credit and a \$5 million term loan. The amount available under the revolver is based on a percentage of eligible accounts receivable plus a percentage of unrestricted cash and investments. The amount available under the revolver is further restricted by the \$5 million outstanding under the term loan until the Company achieves a specified minimum debt coverage service level for six consecutive months as detailed in the agreement. Therefore, the amount available under the revolver at the time of the refinancing was \$10 million. The revolving line of credit is a 24-month facility expiring in October 2004 bearing interest at a rate ranging from prime plus 1% to prime plus 2% per year, depending on a certain balance sheet ratio as specified in the agreement. Monthly payments are comprised only of interest over the term of the facility. The term loan is a 36-month amortizing facility and bears interest at a fixed rate of 8% per year. Equal monthly payments of principal and interest are due over the term of the facility.

Both the revolving facility and the term loan are governed by a common security agreement and the loans are collateralized by substantially all the assets of the Company. The agreement will allow the lender to require us to maintain cash and investment accounts with them and may allow the lender to exercise greater control over our customer deposits if our overall cash position falls below certain levels, as specified in the agreement. Both the revolving credit facility and the term loan also contain financial covenants that require us to maintain a minimum tangible net worth as defined in the agreement. Further, the lender has the ability to demand repayment if there has been a material adverse change in our business.

12. Recent Accounting Pronouncements

Statement of Financial Accounting Standard No. 143 "Accounting for Asset Retirement Obligations" (SFAS No. 143) is effective for fiscal years beginning after June 15, 2001. SFAS No. 143 requires that obligations associated with the retirement of a tangible long-lived asset be recorded as a liability when those obligations are incurred, with the amount of the liability initially measured at fair value. Upon initially recognizing a liability for an asset retirement obligation, an entity must capitalize the cost by recognizing an increase in the carrying amount of the related long-lived asset. Over time, the liability is accreted to its present value each period, and the capitalized cost is depreciated over the useful life of the related asset. Upon settlement of the liability, an entity either settles

Edgar Filing: INTERNAP NETWORK SERVICES CORP - Form 10-Q/A

the obligation for its recorded amount or incurs a gain or loss upon settlement, results of operations and cash flows. We are assessing the requirements of SFAS No. 143 and the effect, if any, on our financial position, results of operations and cash flows.

Effective January 1, 2002, we adopted Statement of Financial Accounting Standard No. 144 "Accounting for the Impairment or Disposal of Long-Lived Assets" (SFAS No. 144), which is effective for fiscal years beginning after December 15, 2001. SFAS No. 144 develops one accounting model, based on the model in SFAS No. 121, for long-lived assets that are to be disposed of by sale, as well as addresses the principal implementation issues. SFAS No. 144 requires that long-lived assets that are to be disposed of by sale be measured at the lower of book value or fair value less cost to sell. That requirement eliminates APB 30's requirement that discontinued operations be measured at net realizable value or that entities include under "discontinued operations" in the financial statements amounts for operating losses that have not yet occurred. Additionally, SFAS No. 144 expands the scope of discontinued operations to include all components of an entity with operations that (1) can be distinguished from the rest of the entity and (2) will be eliminated from the ongoing operations of the entity in a disposal transaction. Our adoption of SFAS No. 144 did not materially impact our financial position, results of operations or cash flows.

Effective May 15, 2002, we adopted Statement of Financial Accounting Standard No. 145 (SFAS No. 145) "Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections," which is effective for all affected transactions occurring after May 15, 2002. SFAS No. 145 requires

15

gains and losses on extinguishments of debt to be classified as income or loss from continuing operations rather than as extraordinary items as previously required under SFAS No. 4 "Reporting Gains and Losses From the Extinguishment of Debt." Extraordinary treatment will be required for certain extinguishments as provided in APB Opinion No. 30 "Reporting the Results of Operations-Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions." SFAS No. 145 also amends SFAS No. 13 "Accounting for Leases" to require certain modifications to capital leases be treated as a sale-leaseback and modifies the accounting for sub-leases when the original lessee remains a secondary obligor (or guarantor). In addition, the FASB rescinded SFAS No. 44 "Accounting for Intangible Assets of Motor Carriers" which addressed the accounting for intangible assets of motor carriers and made numerous technical corrections. Our adoption of SFAS No. 144 did not materially impact our financial position, results of operations or cash flows.

During June 2002, the Financial Accounting Standards Board issued Statement of Financial Accounting Standard (SFAS) No. 146 "Accounting for Costs Associated with Exit or Disposal Activities." SFAS No. 146 addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force (EITF) Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." This Statement requires that a liability for a cost associated with an exit or disposal activity be recognized and measured at fair value when the liability is incurred versus on the date of an entity's commitment to an exit plan as required under EITF Issue No 94-3. The provisions of this Statement are effective for exit or disposal activities that are initiated after December 31, 2002. We are assessing the requirements

Edgar Filing: INTERNAP NETWORK SERVICES CORP - Form 10-Q/A

of SFAS No. 146 and the effects, if any, on our financial position, results of operations and cash flows.

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 Form 10-Q, and in other documents we file with the Securities and Exchange Commission.

The forward-looking information set forth in this Quarterly Report on Form 10-Q is as of October 31, 2002, and Internap undertakes no duty to update this information. Should events occur subsequent to October 31, 2002, that make it necessary to update the forward-looking information contained in this Form 10-Q, the updated forward-looking information will be filed with the SEC in a subsequent Quarterly Report on Form 10-Q, an Annual Report on Form 10-K or as a press release included as an exhibit to a Form 8-K, each of which will be available at the SEC's website at www.sec.gov. More information about potential factors that could affect our business and financial results is included in the section entitled "Risk Factors" beginning on page 28 of this Form 10-Q.

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, located within the 17 metropolitan markets we serve, have their data intelligently routed to and from destinations on the Internet using our overlay network, which analyzes the traffic situation on the many networks that comprise the Internet and delivers mission critical information and communications faster and more reliably with lower instances of data loss and greater quality of service than services offered by conventional Internet connectivity providers. Our customers are primarily businesses that desire high performance Internet connectivity services in order to run mission-critical Internet-based applications. Due to our high quality of service, we generally price our services at a premium to providers of conventional Internet connectivity services. We expect to remain a premium provider of high quality Internet connectivity services and anticipate continuing our pricing policy for premium services in the future although we may also offer lower quality services at lower price points. We believe the market demand for premium service will continue to grow as their Internet connectivity needs grow and become even more complex and, as such, customers will continue to pay a premium for high quality service.

The following discussion should be read in conjunction with the consolidated financial statements provided under Part I, Item 1 of this amended Quarterly Report on Form 10-Q/A. Certain statements contained herein may constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements involve a number of risks, uncertainties and other factors that could cause actual results to

Edgar Filing: INTERNAP NETWORK SERVICES CORP - Form 10-Q/A

differ materially, as discussed more fully herein.

Impairment and Restructuring Costs

2001 Impairment

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 ceasing development of the executed but undeveloped leases and the termination of core collocation development personnel.

Consequently, on February 28, 2001, 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. Because estimated fair value of the collocation assets was less than recorded amounts, we recorded an impairment charge of approximately \$196.0 million as follows (in millions).

Asset Impaired -----	Book Value -----	Accumulated Amortization -----	Net Book Value Impaired -----
Goodwill.....	\$ 229.2	\$ 53.1	\$ 176.1
Assembled workforce.....	2.0	0.5	1.5
Trade name and trademarks.....	2.8	0.6	2.2
Completed real estate leases.....	19.3	4.5	14.8
Customer relationships.....	1.8	0.4	1.4
	-----	-----	-----
Total.....	\$ 255.1	\$ 59.1	\$ 196.0
	=====	=====	=====

2001 Restructuring Charge

During fiscal year 2001, due to the decline and uncertainty of the telecommunications market, we announced two separate restructurings of our business. Under the restructuring programs, management decided to exit certain non-strategic real estate lease and license arrangements, consolidate and exit redundant network connections and streamline the operating cost structure. The total charges include restructuring costs of \$71.6 million. During fiscal year 2001, we incurred cash restructuring expenditures totaling \$19.9 million and non-cash restructuring expenditures of \$4.7 million. We reduced the original restructuring cost estimate by \$7.7 million primarily as a result of favorable lease obligation settlements, leaving a balance of \$39.3 million as of December 31, 2001. During the first and third quarters of 2002, we further reduced our restructuring liability by \$5.0 million and \$7.2 million,

Edgar Filing: INTERNAP NETWORK SERVICES CORP - Form 10-Q/A

respectively. The first quarter 2002 reduction was primarily due to settlements to terminate and restructure certain collocation lease obligations on terms more favorable than our original restructuring estimates. The third quarter 2002 reduction was primarily due to the decision to relocate our corporate headquarters to the previously restructured Atlanta, Georgia facility. Pursuant to the original restructuring plans, we did not anticipate using the Atlanta facility in the future. However, due to changes in management, corporate direction, and other factors, that could not be foreseen at the time of the original restructuring plans, the Atlanta facility was selected as the location for the new corporate headquarters.

17

2002 Restructuring and Asset Impairment Charge

Due to the continuing decline and uncertainty in the telecommunications market, we committed to additional restructuring actions to align our business with market opportunities. As a result, we recorded a business restructuring charge and asset impairments of \$7.6 million in the three months ended September 30, 2002. The charges were primarily comprised of real estate obligations related to a decision to relocate the corporate headquarters from Seattle, Washington to an existing leased facility in Atlanta, Georgia, net asset write-downs related to the departure from the Seattle office and costs associated with further personnel reductions. The restructuring and asset impairment charge of \$7.6 million for the three months ended September 30, 2002 was offset by a \$7.2 million adjustment, described above, resulting from the decision to utilize the Atlanta facility as our corporate headquarters. The previously unused space in the Atlanta location had been accrued as part of the restructuring liability established during fiscal year 2001.

Included in the \$7.6 million restructuring charge is \$1.1 million of personnel costs related to a reduction in force of approximately 145 employees. This represents employee severance payments made during the three months ended September 30, 2002. We expect that there will be additional restructuring costs in the future as additional payments are made to employees who are subject to deferred compensation arrangements payable at the completion of interim employment agreements. We expect these costs to total less than \$2.0 million. Additionally, we continue to evaluate the restructuring reserve as plans are being executed, which could result in additional charges or adjustments.

Real Estate Obligations

Both the 2001 and 2002 restructuring plans require us to abandon certain leased properties not currently in use or that will not be utilized by us in the future. Also included in real estate obligations is the abandonment of certain collocation license obligations. Accordingly, we recorded real estate related restructuring costs of \$40.8 million, net of non-cash plan adjustments, which are estimates of losses in excess of estimated sublease revenues or termination fees to be incurred on these real estate obligations over the remaining lease terms expiring through 2015. This cost was determined based upon our estimate of anticipated sublease rates and time to sublease the facility. If rental rates decrease in these markets or if it takes longer than expected to sublease these properties, the actual loss could exceed this estimate.

Network Infrastructure Obligations

The changes to our network infrastructure require that we

Edgar Filing: INTERNAP NETWORK SERVICES CORP - Form 10-Q/A

decommission certain network ports we do not currently use and will not use in the future pursuant to the restructuring plan. These costs have been accrued as components of the restructuring charge because they represent amounts to be incurred under contractual obligations in existence at the time the restructuring plan was initiated. These contractual obligations will continue in the future with no economic benefit, or they contain penalties that will be incurred if the obligations are cancelled.

The following table displays the activity and balances for restructuring activity and asset impairment (in millions):

	December 31, 2001 Restructuring Liability -----	Restructuring and Impairment Charge -----	Cash reductions -----	Non-cash and Wri Downs -----
Restructuring costs activity for				
2001 restructuring charge--				
Real estate obligations.....	\$ 33.5	\$ --	\$ (9.5)	\$ (0.5)
Network infrastructure obligations	2.7	--	(1.3)	--
Other.....	2.0	--	(0.9)	--
Restructuring costs activity for				
2002 restructuring charge--				
Real estate obligations.....	--	2.2	--	--
Personnel.....	--	1.1	(1.1)	--
Other.....	--	0.2	--	--
	-----	-----	-----	-----
Total restructuring costs.....	38.2	3.5	(12.8)	(0.5)
Net asset write-downs, 2001 restructuring charge.....	1.1	--	--	(1.1)
18				
Net asset write-downs for 2002				
restructuring charge.....	--	4.1	--	(4.1)
	-----	-----	-----	-----
Total asset impairments.....	1.1	4.1	--	(5.2)
	-----	-----	-----	-----
Total.....	\$ 39.3	\$ 7.6	\$ (12.8)	\$ (5.7)
	=====	=====	=====	=====

Results Of Operations

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

Three-month periods ended September 30, Nine-month periods ended September 30,

Three-month
period ended
September 30,

Edgar Filing: INTERNAP NETWORK SERVICES CORP - Form 10-Q/A

	2002	2001
	-----	-----
Revenues.....	100%	100%
Costs and expenses:		
Direct cost of network.....	53%	85%
Customer support.....	9%	16%
Product development.....	6%	9%
Sales and marketing.....	16%	26%
General and administrative.....	14%	34%
Depreciation and amortization.....	38%	46%
Amortization of intangible assets.....	3%	19%
Amortization of deferred stock compensation.....	(1%)	3%
Restructuring costs.....	1%	231%
Impairment of goodwill and other intangible assets.....	--	--
Loss on sales and retirements of property and equipment	5%	--
	-----	-----
Total operating costs and expenses.....	144%	469%
	-----	-----
Loss from operations.....	(44%)	(369%)
Other income (expense):		
Interest income (expense), net.....	(2%)	(3%)
Loss on equity method investment.....	(1%)	(2%)
Loss on investments.....	--	(20%)
	-----	-----
Total other income (expense).....	(3%)	(25%)
	-----	-----
Net loss.....	(47%)	(394%)
	=====	=====

Three-month Periods Ended September 30, 2002 and 2001

Net loss. Net loss for the three-month period ended September 30, 2002 was \$15.2 million, or a net loss of \$0.10 per share, as compared to a net loss of \$114.8 million, or a net loss of \$0.76 per share, for the same period during the preceding year. The \$99.5 million decrease in net loss was primarily due to a \$67.2 million restructuring charge recorded during the prior year, a 12% increase in revenues and a 32% decrease in total operating costs, net of the restructuring. The increase in revenue was driven primarily by new customer acquisitions and a reduction in customer churn. The decrease in operating costs was comprised of decreases in all categories of operating costs and expenses due to the reduction of the cost of network services and the streamlining of operations, including personnel reductions. Other income (expense) improved due to a \$6.0 million provision taken on an investment note receivable recorded during 2001. We anticipate net losses during the next three-month period to remain comparable with those reflected during the three-month period ended September 30, 2002.

Revenues. Revenues increased 12% from \$29.2 million for the three-month period ended September 30, 2001 to \$32.7 million for the three-month period ended September 30, 2002. The increase of \$3.5 million was attributable to increased sales at our existing service points and sales of complementary services such as content distribution. An increased number of customers from 894 customers at September 30, 2001, to 1,202 customers at September 30, 2002, resulted in increased sales. We expect quarterly revenues to remain approximately the same for the remainder of 2002.

Edgar Filing: INTERNAP NETWORK SERVICES CORP - Form 10-Q/A

Direct cost of network. Direct cost of network decreased 30% from \$24.6 million for the three-month period ended September 30, 2001 to \$17.3 million for the three-month period ended September 30, 2002. This decrease of \$7.3 million was primarily due to decreased costs related to renegotiated contracts with our Internet backbone and local exchange providers during the period. Included in the \$7.3 million decrease is a one-time benefit of \$2.1 million related to previously accrued commitment amounts that were reduced as a result of vendor contract negotiations completed during the three-months ended September 30, 2002. We anticipate recurring direct cost of network will remain consistent with those noted during the current quarter.

Customer support. Customer support expenses decreased 40% from \$4.8 million for the three-month period ended September 30, 2001 to \$2.9 million for the three-month period ended September 30, 2002. This decrease of \$1.9 million was primarily due to decreased compensation and benefits costs and facility costs of \$1.3 million and \$0.5 million, respectively. Customer support costs are expected to remain consistent with those noted during the current quarter.

Product development. Product development costs decreased 33% from \$2.8 million for the three-month period ended September 30, 2001 to \$1.8 million for the three-month period ended September 30, 2002. This decrease of \$0.9 million was primarily due to decreased compensation and contract labor and facilities costs of \$0.6 million and \$0.3 million, respectively. Product development costs are expected to remain consistent with those noted during the current quarter.

Sales and marketing. Sales and marketing costs decreased 29% from \$7.5 million for the three-month period ended September 30, 2001 to \$5.3 million for the three-month period ended September 30, 2002. This decrease of \$2.2 million was primarily due to decreased compensation and advertising costs of \$2.0 million and \$0.2 million, respectively. Sales and marketing expenses are expected to remain consistent with those of the current quarter for the foreseeable future.

General and administrative. General and administrative costs decreased 54% from \$9.8 million for the three-month period ended September 30, 2001 to \$4.5 million for the three-month period ended September 30, 2002. This decrease of \$5.3 million was primarily due to decreased compensation, facility, professional services, and bad debt tax expenses, representing \$2.0 million, \$1.6 million, \$1.0 million and \$0.6 million, respectively. General and administrative costs are expected to remain consistent with those of the current quarter.

Depreciation and amortization. Depreciation and amortization decreased 8% from \$13.5 million for the three-month period ended September 30, 2001 to \$12.4 million for the three-month period ended September 30, 2002. This \$1.1 million decrease was primarily due to reduced depreciation of property and equipment in service within our network infrastructure.

Amortization of intangible assets. Amortization of intangible assets declined 79% from \$5.7 million for the three-month period ended September 30, 2001 to \$1.2 million for the three-month period ended September 30, 2002. This decrease of \$4.5 million is due to the cessation of goodwill amortization associated with the VPNX.com acquisition due to our adoption of Statement of Financial Accounting Standard No. 142 "Goodwill and Other Intangible Assets."

Other income (expense). Other income (expense), net, decreased from \$7.3 million for the three-month period ended September 30, 2001 to \$1.0 million for the three-month period ended September 30, 2002. Other income (expense) improved primarily due to a non-recurring \$6.0 million loss on a

Edgar Filing: INTERNAP NETWORK SERVICES CORP - Form 10-Q/A

provision taken for an investment note during the three-month period ended September 30, 2001.

Nine-month Periods Ended September 30, 2002 and 2001

Net loss. Net loss for the nine-month period ended September 30, 2002 was \$58.4 million, or a net loss of \$0.38 per share, as compared to a net loss of \$449.9 million, or a net loss of \$3.00 per share, for the same period during the preceding year. The \$391.5 million decrease in net loss was primarily due to a decrease in restructuring and impairment costs totaling \$272.1 million, decreased amortization of intangible assets of \$28.3 million, decreased other income (expense) of \$24.0 million, and decreased operating expenses, net of the aforementioned items, of \$55.6 million and increased revenue of \$11.5 million. We anticipate net losses during fourth quarter of 2002 to remain consistent with those incurred during the third quarter of 2002.

20

Revenues. Revenues increased 13% from \$86.9 million for the nine-month period ended September 30, 2001 to \$98.4 million for the nine-month period ended September 30, 2002. The increase of \$11.5 million was attributable to increased sales at our existing service points and sales of complementary services such as content distribution. An increased number of customers, from 894 customers at September 30, 2001, to 1,202 customers at September 30, 2002, resulted in increased sales. We expect revenues to remain approximately the same during the fourth quarter of 2002 as were noted during the first three quarters of 2002.

Direct cost of network. Direct cost of network decreased 14% from \$74.4 million for the nine-month period ended September 30, 2001 to \$64.0 million for the nine-month period ended September 30, 2002. This decrease of \$10.4 million was primarily due to reduced costs related to renegotiated contracts with our Internet backbone and local exchange providers during the period. Included in the decrease of \$11.3 million is a one time benefit of \$2.1 million related to previously accrued commitment amounts that were reduced as a result of network vendor contract negotiations completed during the three-month period ended September 30, 2002. This decrease was offset by increased content distribution costs of \$2.0 million and service point facility costs of \$1.8 million. We anticipate direct cost of network to remain consistent with third quarter costs during the next quarter.

Customer support. Customer support expenses decreased 41% from \$17.5 million for the nine-month period ended September 30, 2001 to \$10.4 million for the nine-month period ended September 30, 2002. This decrease of \$7.1 million was primarily due to decreased compensation and benefits costs, facility costs and travel and entertainment costs that decreased \$4.5 million, \$1.9 million and \$0.4 million, respectively. Customer support costs are expected to remain consistent with those noted during the current quarter.

Product development. Product development costs decreased 42% from \$10.0 million for the nine-month period ended September 30, 2001 to \$5.8 million for the nine-month period ended September 30, 2002. This decrease of \$4.2 million was due primarily to decreased compensation, contract labor and facility costs, representing \$1.9 million, \$1.2 million and \$0.9 million of the decrease, respectively. Product development costs are expected to remain consistent with those noted during the current quarter.

Sales and marketing. Sales and marketing costs decreased 46% from

Edgar Filing: INTERNAP NETWORK SERVICES CORP - Form 10-Q/A

\$31.6 million for the nine-month period ended September 30, 2001 to \$17.2 million for the nine-month period ended September 30, 2002. This decrease of \$14.4 million was primarily due to decreases in compensation costs, advertising costs, and travel and entertainment costs, of \$7.2 million, \$5.8 million and \$0.5 million of the decrease, respectively. Sales and marketing expenses are expected to remain consistent with those of the current period for the foreseeable future.

General and administrative. General and administrative costs decreased 57% from \$37.3 million for the nine-month period ended September 30, 2001 to \$16.1 million for the nine-month period ended September 30, 2002. This decrease of \$21.2 million was primarily due to decreased facility, compensation, bad debt, and consulting and professional services costs, representing \$7.6 million, \$6.0 million, \$2.2 million and \$1.5 million of the decrease, respectively. General and administrative costs are expected to remain consistent with those of the current quarter for the foreseeable future.

Depreciation and amortization. Depreciation and amortization increased 7% from \$36.1 million for the nine-month period ended September 30, 2001 to \$38.7 million for the nine-month period ended September 30, 2002. This \$2.6 million increase was primarily due to depreciation of property and equipment in service within our network infrastructure.

Amortization of intangible assets. Amortization of intangible assets declined 87% from \$32.5 million for the nine-month period ended September 30, 2001 to \$4.2 million for the nine-month period ended September 30, 2002. This decrease of \$28.3 million is primarily due to the impairment write-off of the goodwill associated with the acquisition of CO Space, representing approximately 55% of the decrease, and the cessation of amortization of goodwill associated with the VPNX.com acquisition due to our adoption of Statement of Financial Accounting Standard No. 142 "Goodwill and Other Intangible Assets," representing approximately 45% of the decrease.

Other income (expense). Other income (expense), net, decreased from \$26.3 million for the nine-month period ended September 30, 2001 to \$2.3 million for the nine-month period ended September 30, 2002. Other income (expense) improved due to a non-recurring \$14.5 million loss on the sale of an investment in 360 networks,

21

Inc., a non-recurring provision taken on an investment note receivable of \$6.0 million and a non-recurring \$4.8 million impairment charge taken on an investment in Aventail Corporation, all occurring during the nine-month period ended September 30, 2001.

Goodwill

Effective January 1, 2002, we adopted Statement of Financial Accounting Standard (SFAS) No. 142, "Goodwill and Other Intangible Assets," which establishes new accounting and reporting requirements for goodwill and other intangible assets. Under SFAS No. 142, all goodwill amortization ceased effective January 1, 2002 and recorded goodwill was tested for impairment by comparing the fair value of Internap Network Services Corporation as a single reporting unit, as determined by its implied market capitalization, to its consolidated carrying value including recorded goodwill. An impairment test is required to be performed at adoption of SFAS No. 142 and at least annually thereafter. Generally, any adjustments made as a result of the impairment

Edgar Filing: INTERNAP NETWORK SERVICES CORP - Form 10-Q/A

testing are required to be recognized as operating expenses. We will perform our annual impairment testing during the third quarter of each year absent any impairment indicators that may cause more frequent analysis, as required by SFAS No. 142.

Based on our initial impairment test performed upon adoption of SFAS No. 142, we determined that none of the recorded goodwill was impaired as of January 1, 2002. During the period ended September 30, 2002, we performed our annual impairment testing. This test was performed by comparing the adjusted book value of the consolidated company to its fair value based on an independent appraisal. In determining Internap's fair value we considered both market-based and income-based approaches to estimate value.

Based on the results of the analysis performed we concluded that goodwill was not impaired as of September 30, 2002. The assumptions, inputs and judgments used in performing the valuation analysis are inherently subjective and reflect estimates based on known facts and circumstances at the time the valuation was performed. The use of different assumptions, inputs and judgments, or changes in circumstances, could materially impact the results of the valuation. Adverse changes in the valuation would necessitate an impairment charge for the goodwill held by Internap. As of September 30, 2002, goodwill totaled \$27.0 million.

Liquidity and Capital Resources

Cash Flow for the Nine-month periods ended September 30, 2002 and 2001

Net Cash Used in Operating Activities. Net cash used in operating activities was \$34.5 million for the nine-month period ended September 30, 2002 and was primarily due to the loss from continuing operations (adjusted for non-cash items) of \$14.6 million, a decrease in accrued restructuring charge of \$12.8 million, decrease in accrued liabilities of \$4.7 million, decrease in deferred revenues of \$2.8 million and decrease in accounts payable of \$0.9 million. These uses of cash were partially offset by a decrease in prepaid expenses, deposits and other assets of \$1.2 million. The decrease in the accrued restructuring charge reflects the restructuring payments made during the period, primarily relating to real estate obligations and non-cash plan adjustments and asset write downs. The fluctuations noted within the other balance sheet accounts reflect the reduction of our sales outstanding from 45 days at December 31, 2001 to 37 days at September 30, 2002 and fluctuations in the ordinary course of business.

Net cash used in operating activities was \$92.5 million for the nine-month period ended September 30, 2001 and was primarily due to the loss from continuing operations (adjusted for non-cash items) of \$152.2 million, decreased accrued liabilities of \$7.9 million, decreased deferred revenues of \$1.9 million and decreased accounts payable of \$1.5 million. These uses of cash were partially offset by an increase in the accrued restructuring liability of \$63.8 million, a decrease in prepaid expenses, deposits and other assets of \$6.0 million and a decrease in accounts receivable of \$1.3 million. The increase in accounts payable reflects timing variances in payments to vendors. The decrease in accrued liabilities reflects the decrease of capital asset acquisitions that were previously accrued.

Net Cash Provided by Investing Activities. Net cash provided by investing activities was \$10.2 million for the nine-month ended September 30, 2002 and was primarily from proceeds of \$18.7 million received from the maturity of investments, offset by \$7.9 million in purchases of property and equipment and \$1.3 million invested in our Japanese joint venture Internap Japan. The purchases of property and equipment primarily represent payments

made in conjunction with an amendment to our master lease agreement, capitalized labor for the development of internal use software and equipment to be used within our network infrastructure.

On April 10, 2001, we announced the formation of a joint venture with NTT-ME Corporation of Japan. The formation of the joint venture involved our cash investment of \$2.8 million to acquire 51% of the common stock of the newly formed entity, Internap Japan. The investment in the joint venture is being accounted for as an equity-method investment under Accounting Principles Board Opinion No. 18 "The Equity Method of Accounting for Investments in Common Stock." During the nine-month period ended September 30, 2002, the joint venture authorized a second capital call, and we invested an additional \$1.3 million into the partnership in proportion to our ownership interest. We expect this additional capital contribution to fund the partnership through the remainder of 2002.

Net cash provided by investing activities was \$16.5 million for the nine-month period ended September 30, 2001 and was primarily related to the redemption or maturity of investment securities, net of new investments, of \$54.8 million, offset by purchases of property and equipment of \$29.8 million. The purchases of property are primarily comprised of expenditures relating to leasehold improvements on collocation facilities and corporate offices and equipment to be deployed within our network infrastructure. Subsequent to February 28, 2001, the point at which we restructured our collocation activities, purchases of property and equipment for leasehold improvements began to decline.

Net Cash Used in Financing Activities. Since our inception, we have financed our operations primarily through the issuance of our equity securities, capital leases and bank loans. As of September 30, 2002, we have raised an aggregate of approximately \$499.6 million, net of offering expenses, through the sale of our securities.

Net cash used in financing activities for the nine-month period ended September 30, 2002 was \$6.8 million, and related primarily to the payments on notes payable and capital leases, totaling \$12.8 million offset by the proceeds from our line of credit of \$5.0 million and employee stock purchase plan stock purchases and the exercise of options and warrants, totaling \$1.0 million.

Net cash provided by financing activities for the nine-month period ended September 30, 2001 was \$80.6 million, related primarily to proceeds from the issuance of Series A preferred stock offering and shares of common stock of \$97.4 million. These proceeds were offset by payments on notes payable and capital lease obligations totaling \$17.1 million.

Liquidity

We have experienced significant net operating losses since inception. During the three-month period ended September 30, 2002, we incurred net losses of \$15.2 million and used \$8.6 million of cash in operating activities. During the nine-month period ended September 30, 2002, we incurred net losses of \$58.4 million and used \$34.5 million of cash in operating activities. Management expects net losses and negative cash flows will continue for several more quarters. We have decreased the size of our workforce by 194 employees during 2002 in addition to the reduction of 313 employees during the prior fiscal year, and terminated certain real estate leases, network and other vendor commitments in order to control costs. Our plans indicate our existing cash is adequate to fund our operations for several more quarters.

Edgar Filing: INTERNAP NETWORK SERVICES CORP - Form 10-Q/A

However, our capital requirements depend on several factors, including the rate of market acceptance of our services, the ability to expand, the ability to maintain compliance with covenants, the ability to retain our customer base and other factors. If we fail to realize our planned revenues or costs, management believes it has the ability to curtail spending and reduce expenses. If, however, our cash 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. We cannot assure you such financing will be available on acceptable terms, if at all.

Our cash requirements through the end of 2002 are primarily to fund operations, restructuring outlays, and payments to service notes payable and capital expenses.

23

With the slowdown in the macroeconomic environment during fiscal year 2001, we focused on significantly reducing the cost structure of the business while maintaining a continued focus on growing revenues. On February 28, 2001 and September 24, 2001, we announced two restructurings of the business. Under the restructuring programs, management made decisions to exit certain non-strategic real estate lease and license arrangements, consolidate and exit redundant network connections and to streamline the operating cost structure. The total charges include restructuring costs of \$71.6 million and a charge for asset impairment of \$196.0 million. We expect to complete the majority of our restructuring activities during 2002, although certain remaining restructured real estate and network obligations represent long-term contractual obligations that extend through 2015. In July 2002 we announced our decision to further restructure the business by eliminating an additional 135 positions and relocate our corporate headquarters to Atlanta, Georgia. Certain of the 135 positions were eliminated during July 2002 and the restructuring of all positions is expected to be completed by March 2003. For accounting purposes, a restructuring charge was recorded during the third quarter of 2002 to reflect management's decision.

However, because market demand continues to be uncertain and because we are currently implementing initiatives to reduce costs, it is difficult to estimate our ongoing cash requirements. Also, our cost reduction initiatives may have unanticipated adverse effects on our business. Our ability to meet our cash requirements during 2002 also depends on our ability to decrease cash losses from continuing operations throughout the year. A portion of our planned operating cash improvement is expected to come from an increase in revenues and cash collections from customers.

Commitments and Other Obligations.

We have commitments and other obligations that are contractual in nature and will represent a use of cash in the future unless there are modifications to the terms of those agreements. The amounts in the table below captioned "Network commitments" primarily represent purchase commitments made to our largest bandwidth vendors and, to a lesser extent, contractual payments to license collocation space used for resale to customers. Our ability to improve cash used in operations in the future would be negatively impacted if we did not grow our business at a rate that would allow us to offset the service commitments with corresponding revenue growth. Further, the amount and timing of network expense in the future will vary from the minimum contractual amounts set forth in the table below since our actual expense will vary with the usage on our network.

Edgar Filing: INTERNAP NETWORK SERVICES CORP - Form 10-Q/A

The following table summarizes our credit obligations and contractual commitments for the fiscal years indicated. Amounts shown reflect new and amended credit obligations and contractual commitments entered into during the current year.

	Payment due by period (in thou)		
	Total	Current Year	2003 through 2004
Line of credit.....	\$ 10,000	\$ --	\$10,000
Notes payable.....	10,604	4,254	4,839
Capital lease obligations, including interest.....	43,975	3,034	18,262
Operating leases commitments.....	156,867	17,068	30,475
Network commitments.....	75,785	12,714	32,629
	-----	-----	-----
Total.....	\$297,231	\$37,070	\$96,205
	=====	=====	=====

Note that the table above summarizes our most significant contractual commitments but does not represent all uses of cash that will occur in the normal course of business. For example, the summary above does not include cash used for working capital purposes, restructuring expenses or future capital purchases that would be in addition to the amounts above. Also note that the line of credit and notes payable agreements contain covenants that could accelerate the payment schedule in the event of a default.

Credit Facilities.

At September 30, 2002, we had a revolving line of credit of \$15.0 million and had drawn \$15.0 million under the facility. Our ability to maintain the drawn amount under the line of credit at current levels depended on a number of factors, including the level of eligible receivable balances and liquidity. The facility also contained financial covenants that required us to grow revenues, limit cash losses, and require minimum levels of liquidity and tangible net worth as defined in the agreement. The lender also had the ability to demand repayment if there had

24

been a material adverse change in our business. At September 30, 2002, we were in compliance with covenants relating to revenue growth, as defined in the agreement.

Subsequent to September 30, 2002, we entered into a revised loan and security agreement. Under the terms of the new loan and security agreement \$15 million outstanding under the previous facility was refinanced into a \$15 million revolving line of credit and a \$5 million term loan. The amount available under the revolver is based on a percentage of eligible accounts receivable plus a percentage of unrestricted cash and investments. The amount available under the revolver is further restricted by the \$5 million outstanding under the term loan until the Company achieves a specified minimum debt coverage service level for six consecutive months as detailed in the agreement. Therefore, the amount available under the revolver at the time of the refinancing was \$10 million and we do not expect the additional \$5 million

Edgar Filing: INTERNAP NETWORK SERVICES CORP - Form 10-Q/A

to be available for several more quarters.

The revolving line of credit is a 24-month facility expiring in October 2004 bearing interest at a rate ranging from prime plus 1% to prime plus 2% per year, depending on a certain balance sheet ratio as specified in the agreement. Monthly payments are comprised only of interest over the term of the facility. The term loan is a 36-month amortizing facility and bears interest at a fixed rate of 8% per year. Equal monthly payments of principal and interest are due over the term of the facility.

Both the revolving facility and the term loan are governed by a common security agreement and the loans are collateralized by substantially all the assets of the Company. The agreement will allow the lender to require us to maintain cash and investment accounts with them and may allow the lender to exercise greater control over our customer deposits if our overall cash position falls below certain levels, as specified in the agreement. Both the revolving credit facility and the term loan also contain financial covenants that require us to maintain a minimum tangible net worth as defined in the agreement. Further, the lender has the ability to demand repayment if, at its option, there has been a material adverse change in our business.

Series A Preferred Stock.

3,171,000 shares of Series A preferred stock were issued and outstanding at September 30, 2002. Among other things, the Series A preferred stock designation contains restrictions on the amount of new debt or preferred equity that we can incur without specific preferred stockholder approval. Should we in the future decide to obtain additional debt or preferred equity to improve our liquidity, there can be no assurance that preferred stockholder approval can be obtained.

Lease facilities.

Since our inception, we have financed the purchase of network routing equipment using capital leases. The present value of future capital lease payments was \$35.1 million at March 31, 2002. During the second quarter of 2002 we amended the terms of our master lease agreement with our primary supplier of networking equipment. The amended terms of the master lease included a retroactive effective date to March 1, 2002 and extended the payment terms and provided for a deferral of lease payments for the underlying lease schedules for a period of 24 months in exchange for a buy-out payment of \$12.1 million in satisfaction of the outstanding lease obligation on 14 schedules totaling \$6.3 million and for the purchase of the equipment leased under the same schedules totaling \$5.8 million. The terms of our master lease agreement, as amended, contain financial covenants that require us to maintain minimum liquidity balances, periodic revenues, EBITDA levels and other covenants. Should we breach the covenants, experience a change-of-control represented by a change in 35% of the aggregate ordinary voting power of our capital stock, or should the lessor believe we have experienced a material adverse change in our business, the lessor has the ability to demand payment of all amounts due. As of September 30, 2002, we were not in compliance with a non-financial covenant requiring us to provide the lessor with documentation allowing access to our facilities. We were in compliance with all financial covenants and have obtained a waiver through January 31, 2003.

We have fully utilized available funds under our existing lease facilities. While we intend to pursue additional lease financing to accommodate expected network equipment purchases but there can be no assurance that additional lease financing will be available. See "Liquidity--Commitments and Other Obligations" for a summary of lease obligations.

Recent Accounting Pronouncements

Statement of Financial Accounting Standard No. 143 "Accounting for Asset Retirement Obligations" (SFAS No. 143) is effective for fiscal years beginning after June 15, 2001. SFAS No. 143 requires that obligations associated with the retirement of a tangible long-lived asset be recorded as a liability when those obligations are incurred, with the amount of the liability initially measured at fair value. Upon initially recognizing a liability for an asset retirement obligation, an entity must capitalize the cost by recognizing an increase in the carrying amount of the related long-lived asset. Over time, the liability is accreted to its present value each period, and the capitalized cost is depreciated over the useful life of the related asset. Upon settlement of the liability, an entity either settles the obligation for its recorded amount or incurs a gain or loss upon settlement, results of operations and cash flows. We are assessing the requirements of SFAS No. 143 and the effect, if any, on our financial position, results of operations and cash flow.

Effective January 1, 2002, we adopted Statement of Financial Accounting Standard No. 144 "Accounting for the Impairment or Disposal of Long-Lived Assets" (SFAS No. 144), which is effective for fiscal years beginning after December 15, 2001. SFAS No. 144 develops one accounting model, based on the model in SFAS No. 121, for long-lived assets that are to be disposed of by sale, as well as addresses the principal implementation issues. SFAS No. 144 requires that long-lived assets that are to be disposed of by sale be measured at the lower of book value or fair value less cost to sell. That requirement eliminates APB 30's requirement that discontinued operations be measured at net realizable value or that entities include under "discontinued operations" in the financial statements amounts for operating losses that have not yet occurred. Additionally, SFAS No. 144 expands the scope of discontinued operations to include all components of an entity with operations that (1) can be distinguished from the rest of the entity and (2) will be eliminated from the ongoing operations of the entity in a disposal transaction. Our adoption of SFAS No. 144 did not materially impact our financial position, results of operations or cash flows.

Effective May 15, 2002, we adopted Statement of Financial Accounting Standard No. 145 (SFAS No. 145) "Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections," which is effective for all affected transactions occurring after May 15, 2002. SFAS No. 145 requires gains and losses on extinguishments of debt to be classified as income or loss from continuing operations rather than as extraordinary items as previously required under SFAS No. 4 "Reporting Gains and Losses From the Extinguishment of Debt." Extraordinary treatment will be required for certain extinguishments as provided in APB Opinion No. 30 "Reporting the Results of Operations-Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions." SFAS No. 145 also amends SFAS No. 13 "Accounting for Leases" to require certain modifications to capital leases be treated as a sale-leaseback and modifies the accounting for sub-leases when the original lessee remains a secondary obligor (or guarantor). In addition, the FASB rescinded SFAS No. 44 "Accounting for Intangible Assets of Motor Carriers" which addressed the accounting for intangible assets of motor carriers and made numerous technical corrections. Our adoption of SFAS No. 144 did not materially impact our financial position, results of operations or cash flows.

During June 2002, the Financial Accounting Standards Board issued Statement of Financial Accounting Standard (SFAS) No. 146 "Accounting for Costs Associated with Exit or Disposal Activities." SFAS No. 146 addresses

Edgar Filing: INTERNAP NETWORK SERVICES CORP - Form 10-Q/A

financial accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force (EITF) Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." This Statement requires that a liability for a cost associated with an exit or disposal activity be recognized and measured at fair value when the liability is incurred versus on the date of an entity's commitment to an exit plan as required under EITF Issue No 94-3. The provisions of this Statement are effective for exit or disposal activities that are initiated after December 31, 2002. We are assessing the requirements of SFAS No. 146 and the effects, if any, on our financial position, results of operations and cash flows.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We have a \$1.2 million equity investment in Aventail Corporation, an early stage, privately held company. Our \$1.2 million equity investment is net of a \$4.8 million investment write down recorded during 2001. This strategic investment is inherently risky, in part because the market for the products or services being offered or developed by Aventail has not been proven and may never materialize. Because of risk associated with this

26

investment, we could lose our entire initial investment in Aventail. Furthermore we have invested \$4.2 million in a Japan based joint venture with NTT-ME Corporation, Internap Japan. This investment is accounted for using the equity method and is subject to foreign currency exchange rate risk. In addition, the market for services being offered by Internap Japan has not been proven and may never materialize. As of September 30, 2002, our cash equivalents mature within three months. Therefore, as of September 30, 2002, we believe the reported amounts of cash and cash equivalents, investments, notes payable and lease obligations to be reasonable approximations of fair value and the market risk arising from our holdings to be minimal.

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

ITEM 4. CONTROLS AND PROCEDURES

Our chief executive officer and chief financial officer, have evaluated the effectiveness of our disclosure controls and procedures pursuant to Rule 13a-14 of the Securities Exchange Act of 1934, as amended, as of a date within 90 days prior to the filing of this amended quarterly report on Form 10-Q/A, which we refer to as the "Evaluation Date." Based on that evaluation, our chief executive officer and chief financial officer concluded that, as of the Evaluation Date, the disclosure controls and procedures are effective in ensuring that all material information required to be filed in this amended quarterly report on Form 10-Q/A has been made known to them in a timely fashion. There have been no significant changes in internal controls or in other factors that could significantly affect our internal controls, nor were any corrective actions required with regard to significant deficiencies and material weaknesses, subsequent to the Evaluation Date.

27

Edgar Filing: INTERNAP NETWORK SERVICES CORP - Form 10-Q/A

RISK FACTORS

Risks Related to Our Business

We Have a History of Losses, 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 \$49.9 million, \$185.5 million and \$479.2 million for the years ended December 31, 1999, 2000 and 2001, respectively. Our net loss for the three-month period ended September 30, 2002 was \$15.2 million and at September 30, 2002 our accumulated deficit was \$782.5 million. We expect to incur net losses and negative cash flows from operations on a quarterly and annual basis for several more quarters, and we may never become profitable. Moreover, our failure to meet certain financial covenants contained in material agreements with our lender or the lessor of our master equipment lease may negatively impact our financial position and our cash flow and, as a result, we would be in material default under those agreements. A material default under those agreements could result in the entire amounts due thereunder becoming due and payable.

We May Be Unable to Maintain Our Listing on The Nasdaq SmallCap Market, Which Could Have a Negative Impact on the Price and Liquidity of Our Common Stock. Our common stock currently is quoted on The Nasdaq SmallCap Market. Nasdaq has certain compliance requirements for continued listing of common stock, including a requirement that our common stock have a minimum bid price of \$1.00 per share. On April 24, 2002, we were initially notified of our failure to comply with the minimum bid price requirement. Nasdaq granted us 90 calendar days, or until July 23, 2002, to regain compliance with the minimum bid price requirement. Subsequently, we were unable to demonstrate compliance with the minimum bid requirement on or before July 23, 2002, and we received a formal notice of de-listing from The Nasdaq National Market on July 24, 2002. This automatic de-listing was temporarily stayed during our appeal of the de-listing before the Nasdaq Listing Qualifications Panel, or the "Panel". At our hearing with the Panel, which occurred on August 29, 2002, we petitioned to maintain our listing on The Nasdaq National Market pending stockholder approval and implementation of a reverse stock split to increase our share price, in order to maintain compliance with the Nasdaq listing requirements.

On October 2, 2002, the Panel denied our petition for continued inclusion on The Nasdaq National Market and transferred our common stock listing to The Nasdaq SmallCap Market, effective October 4, 2002. Subsequently, on October 21, 2002, the Panel granted us an additional 180-day grace period, until April 21, 2003, to satisfy the \$1.00 bid price requirement. The Panel also stated that our listing on The Nasdaq SmallCap Market was pursuant to the terms of the following exception:

1. We were required to provide documentation to the Panel on or before November 14, 2002 evidencing that the terms of at least \$45 million of our outstanding Series A preferred stock had been modified such that the Series A preferred stock would be classified as equity under GAAP. Further, we were required to file a quarterly report on Form 10-Q on or before November 14, 2002 for the quarter ended September 30, 2002 evidencing stockholders' equity of at least \$12 million. This quarterly report was also required to include a second balance sheet with pro forma adjustments for any significant events or transactions occurring on or before the filing date, evidencing stockholders' equity of at least \$52 million. As of September 30, 2002, we had approximately \$14.8 million of stockholders' equity on our balance sheet, which we reported in our Form 10-Q for the period ended September 30, 2002. In addition, as of that date, our

Edgar Filing: INTERNAP NETWORK SERVICES CORP - Form 10-Q/A

balance sheet reflected approximately \$80.3 million of Series A preferred stock, classified as a mezzanine item under U.S. GAAP rather than as a component of stockholders' equity. In November 2002, we indicated to Nasdaq that we had converted the entire \$80.3 million of our Series A preferred stock into equity and we filed a pro forma balance sheet with our quarterly report on Form 10-Q reflecting the reclassification. However, we recently became aware that the charter amendment that purported to effect the reclassification of our Series A preferred is invalid for technical reasons. Therefore, we do not actually satisfy the terms of this element of the exception.

The Panel's letter also provided as a possible alternative to the minimum equity requirement that we be in compliance with the \$35 million market value of listed securities standard for a minimum of ten consecutive trading days prior to November 14, 2002. As of November 14, 2002, we had been in compliance with the \$35 million market value test for ten consecutive trading days and we

28

have continued to be in compliance with this element of the exception at all times subsequent to that date. We notified Nasdaq of this fact when we became aware that we no longer qualified for the stockholders' equity exception. Accordingly, we believe that the invalidity of the amendment to reclassify the Series A preferred stock does not affect our eligibility for listing.

2. On or before April 21, 2003, we must demonstrate a closing bid price of at least \$1.00 per share and immediately thereafter, we must evidence a closing bid price of at least \$1.00 per share for a minimum of ten consecutive trading days.

If we fail to comply with the foregoing conditions, Nasdaq has notified us that our listing will be terminated immediately. Further, the Panel's written decision stated that the Panel expressly reserves the right to modify, alter or extend the terms of the foregoing conditions upon a review of our reported financial results for the quarter ended September 30, 2002, which we announced on October 29, 2002.

Nasdaq has informed us that we may be eligible to transfer back to The Nasdaq National Market, without paying the initial listing fees, if, on or prior to April 21, 2003, we have been in compliance with the minimum bid price requirement for 30 consecutive trading days and we otherwise comply with the The Nasdaq National Market Continued Listing Requirements. On the other hand, if, on or before April 21, 2003, the closing price of our common stock has not met or exceeded \$1.00 for at least 10 consecutive trading days, we would be subject to de-listing from The Nasdaq SmallCap Market. In addition, we will need to maintain compliance with all continued listing requirements of The Nasdaq SmallCap Market (other than the \$1.00 minimum bid price requirement), in addition to the conditions specified by the Panel in its letter, in order to continue our grace period on The Nasdaq SmallCap Market. These continued listing requirements require, among other things, that we maintain a minimum stockholders' equity of \$2.5 million. We cannot assure you that we will maintain compliance with these or any other of the continued listing requirements, including the conditions specified in the Panel's decision on

Edgar Filing: INTERNAP NETWORK SERVICES CORP - Form 10-Q/A

October 2, 2002 discussed above. Therefore, even if we were to regain compliance with the \$1.00 minimum bid price requirement, we may still be unable to transfer our listing back to The Nasdaq National Market. If we fall out of compliance with the Panel's conditions or any of the other continued listing requirements of The Nasdaq SmallCap Market, we may be subject to immediate de-listing. If our common stock is delisted from trading on The Nasdaq SmallCap Market, trading in our common stock may continue to be conducted on the OTC Bulletin Board or in a non-Nasdaq over-the-counter market, such as the "pink sheets". Delisting of our common stock would result in limited release of the market price of the common stock and limited news coverage of our company and could restrict investors' interest in our common stock. Also, a delisting could materially and adversely affect the trading market and prices for our common stock and our ability to issue additional securities or to secure additional financing. In addition, if our common stock were not listed and the trading price of the common stock was less than \$5 per share, our common stock could be subject to Rule 15c-9 under the Securities Exchange Act of 1934, as amended, which, among other things, requires that broker/dealers satisfy special sales practice requirements, including making individualized written suitability determinations and receiving a purchaser's written consent prior to any transaction. In such case, our common stock could also be deemed to be a "penny stock" under the Securities Enforcement and Penny Stock Reform Act of 1990, as amended, which would require additional disclosure in connection with trades in the common stock, including the delivery of a disclosure schedule explaining the nature and risks of the penny stock market. Such requirements could severely limit the liquidity of our common stock.

Our Board of Directors May Decide to Implement a Reverse Stock Split, Which Could Have a Negative Impact on the Price and Liquidity of Our Common Stock. On October 28, 2002, we filed a preliminary proxy statement and on November 8, 2002, we filed a definitive proxy statement with the SEC, requesting that our stockholders approve several amendments to our certificate of incorporation providing for a reverse stock split and that, if approved by our stockholders, would allow our board of directors, in its sole discretion, to implement a reverse stock split. We held a special meeting of our stockholders on December 17, 2002 at which our stockholders approved the amendments. If our board of directors effects a reverse stock split in order to attempt to achieve compliance with the Nasdaq \$1.00 minimum bid price requirement, our market capitalization could significantly decline as a result of the stock split and/or our announcement of the reverse stock split. In addition, we cannot assure you that a reverse stock split would increase our stock price sufficiently to satisfy the Nasdaq \$1.00 minimum bid price requirement. A reverse stock split could result in a significant devaluation of our market capitalization and our share price, on an actual or an as-adjusted basis, based on the experience of other companies that have effected

29

reverse stock splits in an effort to maintain their Nasdaq listings. The reduced number of shares of our common stock resulting from a reverse stock split could also adversely affect the liquidity of our common stock.

Further, a reverse stock split may leave certain stockholders with one or more "odd lots," which are stock holdings in amounts of less than 100 shares of our common stock. These odd lots may be more difficult for our stockholders to sell than shares of our common stock in even multiples of 100 and can result in increased brokerage commissions. Similarly, a reverse stock split could reduce our number of "round lot" stockholders, which are holders of 100 or more shares of our common stock. Nasdaq continued inclusion

Edgar Filing: INTERNAP NETWORK SERVICES CORP - Form 10-Q/A

requirements require us to maintain a specified minimum number of round lot stockholders. Also, because a reverse stock split would result in an increased number of authorized but unissued shares of our common stock, it may be construed as having an anti-takeover effect, although neither the board of directors nor our management views the possible reverse stock split in that perspective. However, the board of directors, subject to its fiduciary duties and applicable law, could use this increased number of authorized but unissued shares of our common stock to frustrate persons seeking to take over or otherwise gain control of us by, for example, privately placing shares of our common stock with purchasers who might side with the board of directors in opposing a hostile takeover bid. Shares of our common stock could also be issued to a holder that would thereafter have sufficient voting power to assure that any proposal to amend or repeal our by-laws or certain provisions of our certificate of incorporation would not receive the requisite vote. Such uses of our common stock could render more difficult, or discourage, an attempt to acquire control of us if such transaction were opposed by the board of directors. Further, subject to Nasdaq rules on stock issuances, the increased number of authorized but unissued shares of our common stock could be issued by the board of directors without further stockholder approval, which could result in dilution to the holders of our common stock.

Our Limited Operating History, Together with our Recent Decision to Move our Headquarters to Atlanta in the Fourth Quarter of 2002, 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. Further, we announced on July 17, 2002 that we plan to move our company's headquarters from Seattle, Washington to Atlanta, Georgia, in the fourth quarter of 2002. There are many risks inherent in this decision, including without limitation, the risks:

- o that certain key employees who were requested to assist during the transition period may resign their positions prior to the end of the transition period;
- o that we may not be able to recruit appropriate candidates to fill key executive positions in Atlanta;
- o that many of our key employees will decide not to move to Atlanta and will therefore resign their positions with us;
- o that the costs savings that we expect to achieve as a result of our decision to move will not be successful or will not be as successful as we had projected;
- o that our customers may be unwilling to do continued business with us, given the uncertainty that our move to Atlanta will prove successful;
- o that we will be less successful than we currently anticipate in attracting new customers in our new region; and
- o that we will lose customers in the Northwest because of the departure of our senior management team from that region.

If our move to Atlanta does not result in our reducing our operating expenses to the levels that we have predicted, and if our revenues do not increase proportionately to make up any such shortfall, then our operating results, liquidity and financial position could be seriously harmed.

We May Require Additional Cash in the Future and May Not Be Able to Secure Adequate Funds on a Timely Basis or on Terms Acceptable to Us. The continued operation of our business requires cash for ongoing capital and operations expenditures. We expect to meet our cash requirements for several more quarters with existing cash and cash equivalents, and cash flows from sales of our services. If, however, our cash requirements vary materially from those currently planned, or if we fail to generate sufficient cash flow from the sales of our services, management believes it has the ability to curtail spending and reduce expenses to ensure our cash will be sufficient to meet our cash requirements. We may, however, require additional financing sooner than anticipated. In that event, we might not be able to obtain equity or debt financing on acceptable terms, if at all. Also, future borrowing instruments, such as credit facilities and lease agreements, will likely contain covenants restricting, among other things, our ability to incur further indebtedness and will likely require us to pledge assets as security for borrowings thereunder. Given our recent efforts to reduce our capital and operations expenditures, we do not currently contemplate any expansion of our business in the immediate future. Any such expansion would require significant new capital, and we may be unable to obtain additional financing.

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 (decreases) in our quarterly revenues for the quarters ended September 30, 2001 through September 30, 2002, have varied between (1.0)% and 6.9%, and total operating costs and expenses, as a percentage of revenues, have fluctuated between 143.6% and 468.6%. Fluctuations in our quarterly operating results depend on a number of factors. Some of these factors are industry and economic 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.

Pricing Pressure Could Decrease Our Market Share and Threaten the

Edgar Filing: INTERNAP NETWORK SERVICES CORP - Form 10-Q/A

Profitability of Our Business Model. We face competition from competitors along several fronts (more fully described below), including price competition. Increased price competition and other related competitive pressures could erode our market share, and significant price deflation could threaten the profitability of our business model. We currently charge, and expect to continue to charge, more for our Internet connectivity services than our competitors. 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. Because we rely on Internet backbone providers in delivering our services and have agreed with some of these providers to purchase their services without regard to the amount we resell to our customers, we may not be able to offset the effects of competitive 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 the Internet connectivity industry is likely to encounter further 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.

31

If We Are Unable to Continue to Receive Services from Our Backbone Providers, or Receive Their Services on a Cost-Effective Basis, We May Not Be Able to Provide Our Internet Connectivity Services on Profitable Terms. 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 or on otherwise favorable terms, 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 domestic service points, we have connections to some combination of the following nine backbone providers: AT&T, Cable & Wireless USA, Genuity, Global Crossing, Level 3, Qwest, Sprint, Worldcom and Verio. 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

Edgar Filing: INTERNAP NETWORK SERVICES CORP - Form 10-Q/A

services to us, regional Bell operating companies which offer Internet access, and global, national and regional Internet service providers and other Internet infrastructure providers and manufacturers. 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. We also expect to 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 new competitors will enter our market. These 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, intelligent data services that use connections to more than one backbone and other technologies or use alternative delivery methods including the cable television infrastructure, direct broadcast satellites, wireless cable and wireless local loop.

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.

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 or human caused disasters, 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.

We Have Limited Experience Operating Internationally, and Our International Operations May Not Be Successful. Although we currently have a service point in London and a joint venture with NTT-ME Corporation

operating a service point in Tokyo, 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 operations, we face the following specific risks in our international business operations:

Edgar Filing: INTERNAP NETWORK SERVICES CORP - Form 10-Q/A

- o difficulties in establishing and maintaining relationships with foreign customers as well as foreign backbone providers and local vendors, including collocation and local loop providers;
- o 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
- o exposure to fluctuations in foreign currency exchange rates.

We may be unsuccessful in our efforts to address the risks associated with our 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. If we cannot build our brand awareness, our revenues could decline.

We Are Dependent Upon Our Key Employees and May Be Unable to Attract or Retain Sufficient Numbers of Qualified Personnel. In light of moving our corporate headquarters to Atlanta, Georgia, our future performance depends to a significant degree upon the continued contributions of our executive management team and key technical personnel. The loss of members of our executive management team or key technical employees 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. In addition, we may lose a number of our key employees as a result of our plan to relocate our corporate headquarters to Atlanta, Georgia during the second half of 2002.

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 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, serving one metropolitan market and nine employees compared to 34 operational service points serving 17 metropolitan markets and 359 full-time employees as of September 30, 2002. In addition, we had \$29.2 million in revenues for the three-month period ended September 30, 2001, compared to \$32.7 million in revenues for the three-month period ended September 30, 2002. Furthermore, we currently offer our services in Europe and Japan, through our joint venture, Internap Japan. We also resell certain products and services of Akamai Technologies, Inc., Cisco Systems, Inc. and others. We expect our recent

Edgar Filing: INTERNAP NETWORK SERVICES CORP - Form 10-Q/A

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.

33

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 nine 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

Edgar Filing: INTERNAP NETWORK SERVICES CORP - Form 10-Q/A

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. 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 our limited source of suppliers fails 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.

34

We Have Acquired and May Acquire Other Businesses, and these Acquisitions Involve Numerous Risks. During 2000, we acquired CO Space and VPNX, respectively, in purchase 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:

- o difficulties in integrating the operations, personnel, technologies, products and services of the acquired companies in a timely and efficient manner;
- o diversion of management's attention from normal daily operations;
- o insufficient revenues to offset significant unforeseen costs and increased expenses associated with the acquisitions;
- o difficulties in completing projects associated with in-process research and development being conducted by the acquired businesses;
- o risks associated with our entrance into markets in which we have little or no prior experience and where competitors have a stronger market presence;

Edgar Filing: INTERNAP NETWORK SERVICES CORP - Form 10-Q/A

- o deferral of purchasing decisions by current and potential customers as they evaluate the likelihood of success of the acquisitions;
- o 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;
- o issuance by us of equity securities that would dilute ownership of existing stockholders;
- o incurrence of significant debt, contingent liabilities and amortization expenses; and
- o 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. Additionally, even individuals and enterprises that have invested significant resources in the use of the

35

Internet may, for cost reduction purposes during difficult economic times, decrease future investment in the use of the Internet. 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 Its 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

Edgar Filing: INTERNAP NETWORK SERVICES CORP - Form 10-Q/A

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 and when there is significant pricing pressure across the Internet connectivity industry. 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 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/Internet 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,

Edgar Filing: INTERNAP NETWORK SERVICES CORP - Form 10-Q/A

including our connections to our backbone providers, against damage from human error or attack or "acts of God." Even if we take precautions, the occurrence of a natural disaster, attack or other unanticipated problem could result in interruptions in the services we provide to our customers. Any interruptions in service could harm our reputation with our customers and could result in a loss of customers, which would harm our results of operations.

36

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 or failure to maintain their financial viability 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 have been major shifts in the telecommunications industry that have adversely impacted the financial viability of certain backbone providers and there is no guarantee that such providers will be able to continue to provide services 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, 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 or other attack 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

Edgar Filing: INTERNAP NETWORK SERVICES CORP - Form 10-Q/A

cannot predict the impact, if any, that future regulation or regulatory changes may have on our business.

37

PART II. OTHER INFORMATION

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

None.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

ITEM 5. MISCELLANEOUS

(a) November 13, 2002, we sent out to our stockholders a definitive proxy statement requesting that our stockholders consider and vote upon one proposal to approve six separate amendments to our certificate of incorporation to authorize the board of directors in its sole discretion to effect a reverse stock split, ranging from a one-for-five reverse stock split to a one-for-thirty reverse stock split, of all the issued and outstanding shares of our common stock, par value \$0.001 per share, in order to maintain our listing on The Nasdaq SmallCap Market and seek to transfer our listing back to The Nasdaq National Market. Our stockholders approved the amendments at a special meeting of our stockholders held for that purpose on December 17, 2002. The board of directors may abandon any of the amendments or make one of the amendments effective by filing such amendment with the Secretary of State of the State of Delaware at such time or times as the board of directors determines to be necessary in order to maintain our listing on The Nasdaq SmallCap Market and seek to transfer our listing back to The Nasdaq National Market, on or prior to the nine month anniversary of the special meeting held on December 17, 2002.

(b) At September 30, 2002, we had a revolving line of credit of \$15.0 million and had drawn \$15.0 million under the facility. Our ability to maintain the drawn amount under the line of credit at current levels depended on a number of factors, including the level of eligible receivable balances and liquidity. The facility also contained financial covenants that required us to grow revenues, limit cash losses, and require minimum levels of liquidity and tangible net worth as defined in the agreement. The lender also had the ability to demand repayment if there had been a material adverse change in our business. At September 30, 2002, we were in compliance with covenants relating to revenue growth, as defined in the agreement.

Subsequent to September 30, 2002, we entered into a revised loan and security agreement. Under the terms of the new loan and security agreement \$15 million outstanding under the previous facility was refinanced into a \$15 million revolving line of credit and a \$5 million term loan. The amount available under the revolver is based on a percentage of eligible accounts receivable plus a percentage of unrestricted cash and investments. The amount available under the revolver is further restricted by the \$5 million outstanding under the term loan until the Company achieves a specified minimum debt coverage service level for six consecutive months as detailed in the agreement. Therefore, the amount available under the revolver at the time of the refinancing was \$10 million and we do not expect the additional \$5 million to be available for several more quarters.

Edgar Filing: INTERNAP NETWORK SERVICES CORP - Form 10-Q/A

The revolving line of credit is a 24-month facility expiring in October 2004 bearing interest at a rate ranging from prime plus 1% to prime plus 2% per year, depending on a certain balance sheet ratio as specified in the agreement. Monthly payments are comprised only of interest over the term of the facility. The term loan is a 36-month amortizing facility and bears interest at a fixed rate of 8% per year. Equal monthly payments of principal and interest are due over the term of the facility.

Both the revolving facility and the term loan are governed by a common security agreement and the loans are collateralized by substantially all the assets of the Company. The agreement will allow the lender to require us to maintain cash and investment accounts with them and may allow the lender to exercise greater control over our customer deposits if our overall cash position falls below certain levels, as specified in the agreement. Both the revolving credit facility and the term loan also contain financial covenants that require us to maintain a minimum

38

tangible net worth as defined in the agreement. Further, the lender has the ability to demand repayment if there has been a material adverse change in our business.

ITEM 6. EXHIBITS

(a) Exhibits:

Exhibit Number -----	Description -----
3.1	Certificate of Incorporation of the Registrant
3.2*	Bylaws of the Registrant
10.1**	Loan and Security Agreement and Amendments to Loan Documents between Silicon Valley Bank and the Registrant
99.1	Certification of Gregory A. Peters, President and Chief Executive Officer of Registrant, Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
99.2	Certification of John M. Scanlon, Vice President of Finance and Administration and Chief Financial Officer of Registrant, Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
*	Incorporated by reference to designated exhibit to Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2001
**	Incorporated by reference to designated exhibit to Registrant's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2002

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on this 9th day of January, 2003.

INTERNAP NETWORK SERVICES CORPORATION
(Registrant)

By: /s/ JOHN M. SCANLON

John M. Scanlon
Chief Financial Officer and Vice President
of Finance and Administration
(Principal Financial and Accounting Officer)

CERTIFICATION

I, Gregory A. Peters, President and Chief Executive Officer of Internap Network Services Corporation, certify that:

1. I have reviewed this quarterly report on Form 10-Q/A (Amendment No.1) for the period ending September 30, 2002, of Internap Network Services Corporation;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
 - a. Designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - b. Evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation

Edgar Filing: INTERNAP NETWORK SERVICES CORP - Form 10-Q/A

Date"); and

- c. Presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of the registrant's board of directors:
- a. All significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

January 9, 2003

By: /s/ GREGORY A. PETERS

Gregory A. Peters
President and Chief Executive Officer

41

CERTIFICATION

I, John M. Scanlon, Vice President of Finance and Administration and Chief Financial Officer of Internap Network Services Corporation, certify that:

1. I have reviewed this quarterly report on Form 10-Q/A (Amendment No.1) for the period ending September 30, 2002, of Internap Network Services Corporation;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for

Edgar Filing: INTERNAP NETWORK SERVICES CORP - Form 10-Q/A

establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

- a. Designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - b. Evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
 - c. Presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of the registrant's board of directors:
- a. All significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

January 9, 2003

By: /s/ JOHN M. SCANLON

John M. Scanlon
Vice President of Finance and
Administration and Chief Financial Officer