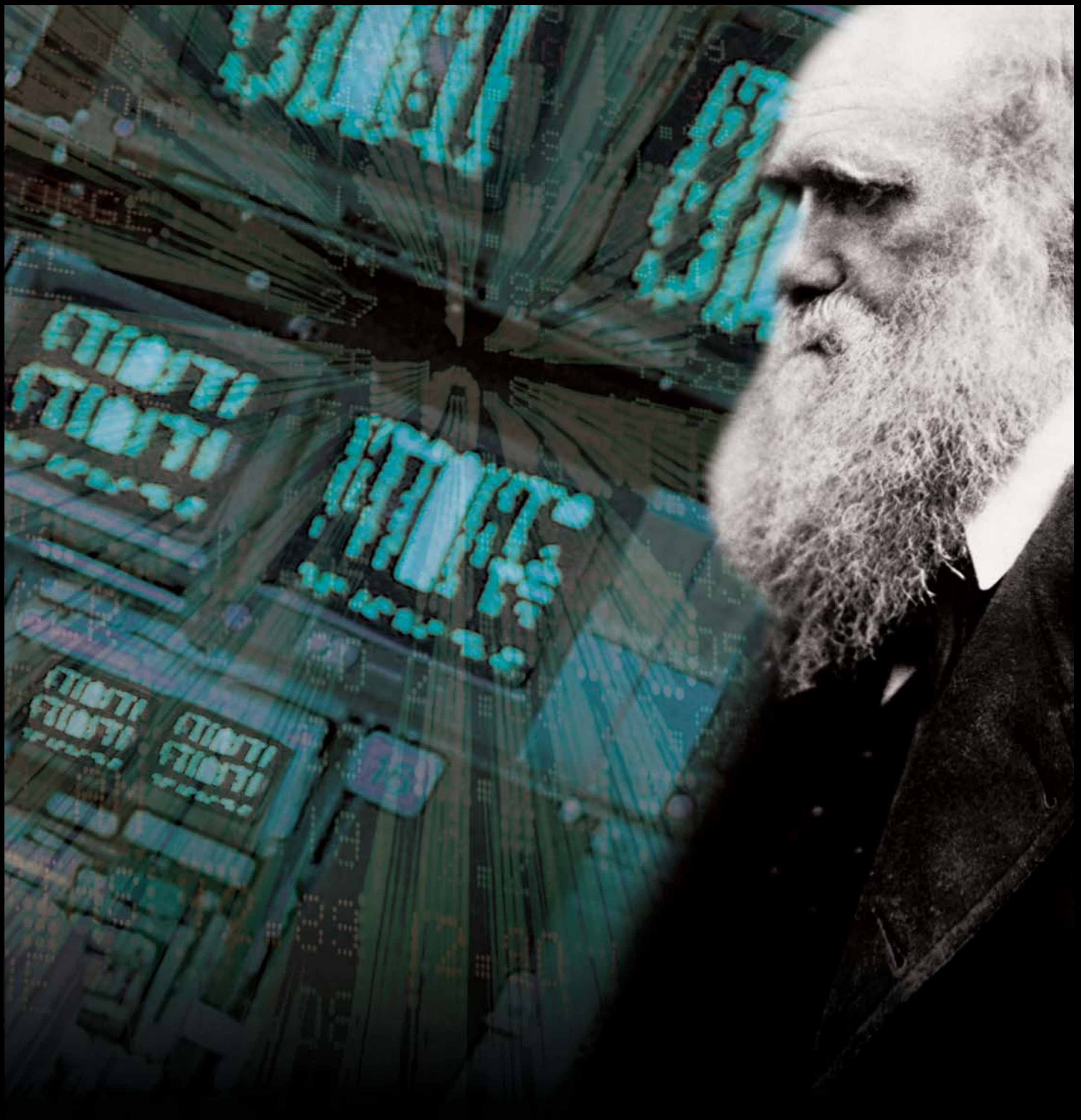


What If Darwin Had Studied Business Instead Of Biology?

Internap Annual Report 2003

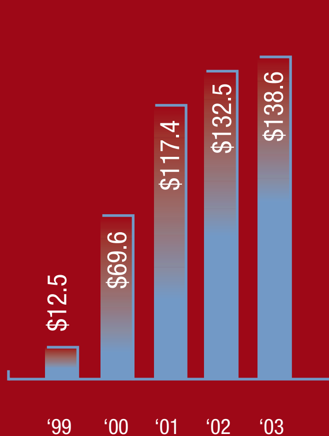
Our Business

Internap delivers mission-critical Internet-based solutions to businesses throughout the United States, Europe and Japan. The Company's network-of-networks architecture, proprietary route optimization technology, industry-leading Service Level Agreements and superior customer service guarantee network availability and high performance levels for business-critical applications, such as e-commerce, video and audio streaming, voice over Internet protocol, virtual private networks and supply chain management.

Financial Highlights

Revenues

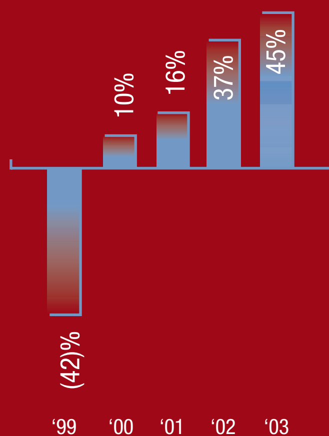
Figures in $ millions



Internap achieved a net increase of 365 new customers in 2003.

Direct Margin*

Expressed as a percentage

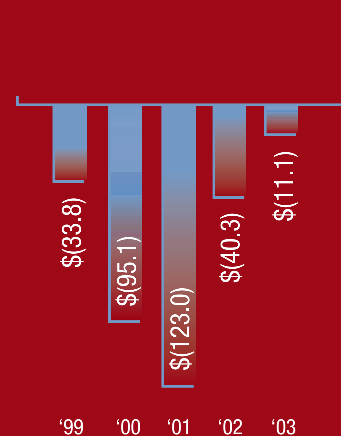


Operating margin grew to 45% due to cost control and improved infrastructure optimization.

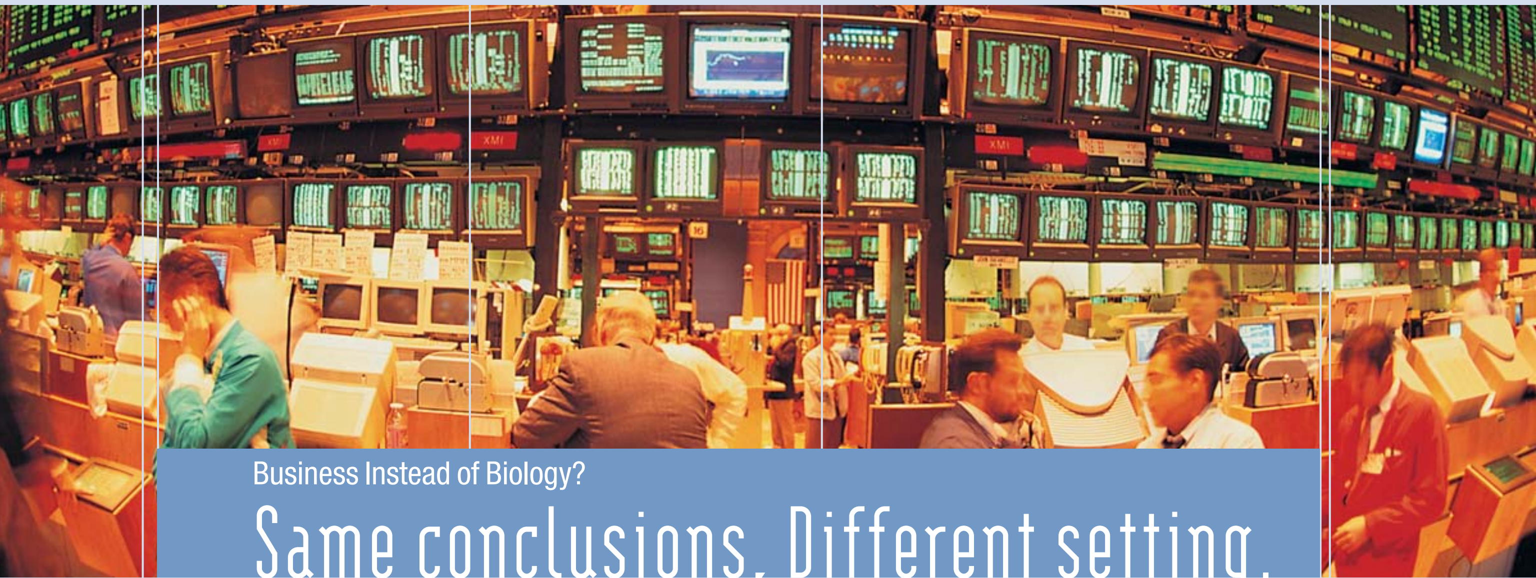
** Direct margin percentage is defined as revenues less direct cost of network divided by revenues.*

Operating Cash Flow

Figures in $ millions



Operating Cash Flow improved 72% during 2003.



Business Instead of Biology?

Same conclusions. Different setting.

Had naturalist Charles Darwin studied business rather than biology, his conclusions would be remarkably similar. Like plants and animals that survive from generation to generation, great companies possess certain “survival” attributes that distinguish them from the pack – a compelling business model, a powerful technological advantage, a superior ability to execute and, of course, a willingness to adapt quickly to changes in the environment. At Internap, we understand how the Internet industry evolved and have demonstrated our ability to exploit our unique competitive advantages to not only survive change, but to use it to sustain growth over the long term.

Willie Jeffery, Senior Field Operations Engineer

Technological Evolution Follows A Predictable Pattern of Boom, Bust and Rebirth

Throughout history, and certainly since the beginning of the industrial era, new technologies have emerged and established themselves in a remarkably consistent pattern. Railroads, steel, automobiles, computers, software – to name a few – each of these industries experienced similar phases of growth from the boom, bust and ultimately sustainable growth built around the surviving companies.

The Boom & Bust Cycle

As new technology gains traction, it attracts a plethora of players. Rapid build out and growth ensue, regardless of whether sufficient demand is present. This culminates in the boom, a period when market momentum is so strong that market reality is largely irrelevant. Inevitably, the boom turns into the bust. Though difficult, the bust phase is an essential growing pain in the evolution of an industry. For it is in this period when companies are truly market tested. And, it is not simply a strategic test of customer demand and product validity, but also a financial test of sound management judgement and execution. Indeed, the winners that gradually emerge are stronger than ever and move into a phase of sustainable growth.

The Next Industry Inflexion Point

The Internet was certainly not immune to this evolutionary phenomenon. The dot-com craze of the 90s will go down as one of the biggest booms in history. Equally as predictable, this boom burst shortly into the new millennium. Companies disappeared as fast as they had appeared. And, most that survived were forced into some form of metamorphosis in order to do so. Certainly for Internap, we were forced to put every aspect of our business to the test and ultimately emerged as a much more viable business and organization. Over the past year, the vetting process has subsided and now industry leaders are emerging. It is at this inflexion point, where Internap finds itself today and where it is now building the process of sustainable growth that will parallel the maturation of the industry itself.

Darwin's Lesson: *A Familiar Cycle of Boom, Bust and Rebirth*

The Railroads

From the very beginning, pioneering entrepreneurs from around the world realized the potential for the steam engine. From 1829, when the first steam engine was imported from England, America started laying down track. Between 1830 and 1850, the amount of rail line in the United States grew from 45 miles to 9,000. By 1910, dozens of manufacturers were building thousands of locomotives. Industrial giants such as John D. Rockefeller, Henry Flagler and J.P. Morgan made a fortune on this new form of transportation.

Unfortunately, many businesses overestimated the demand for the expensive infrastructure of rail, engines and cars. Passenger rail failed to live up to expectations. When freight shipments dropped suddenly during the Great Depression, most railroads went bankrupt. Those that survived were able to consolidate their businesses and continue to grow through the 1940s.

It was only in the 1950s and 1960s when the railroads again began to suffer as trucking and air transportation gained prominence. Again, the surviving railroads consolidated. Today, only seven chief Class 1 railroads exist. But to the victors go the spoils. These competitors share in the majority of a $35.3 billion industry.

Members of Internap’s Engineering Team

CLIENT APPLICATION SPIRIT AIRLINES

Spirit Airlines Flies High to Deliver Low Fares and Quality Service

America's largest privately held airline, Florida-based Spirit Airlines serves 16 cities throughout the U.S. and Mexico with over 120 flights a day. To stay competitive, this fast-growing, low-fare air carrier uses the latest in technology, doing as much as 75% of its business online, selling tickets at its own website and via online travel agencies. And that's where Internap's high-performance IP connectivity comes in.

"The reliability and accuracy of our Internet connection is essential. The crown jewels of our business are carried by our Internap service. It has to be as reliable as the sun coming up in the east."

David Anderson, SVP and
Chief Information Officer

Kelly Flynn-Muller, Program Manager

Competitive Advantage Drives Natural Selection

Internap's ability to survive the Internet's boom and bust era is grounded in an intuitive sense of understanding a given market environment and adapting to it. Since its founding in 1996, Internap's business premise has been built on meeting a very real market need: finding the most efficient and effective Internet transmission path for mission-critical data. Internap's proprietary intelligent route control technology and "carrier-agnostic" architecture represent the ideal solution for business data that requires transmission with the highest standards of reliability and security. Further, Internap understands competitive dynamics and has outpaced its peers with an industry-leading Service Level Agreement that guarantees 100% availability over the entire Internet… all of the time.

Surviving The Bust

Internap's sound business premise was established during the boom. But as the inevitable bust unfolded, Internap adapted swiftly to an environment consumed by rapid and dramatic change. Tough decisions were made in order to survive. Headcount was reduced. Cost structures were realigned to reduce operational expense. A new senior management team was recruited. Headquarters was relocated from Seattle to Atlanta. But perhaps most important, Internap successfully transitioned its culture from a dot-com mentality into a profit sensitive one focused on strategic thinking, financial viability and sustainable growth. All of these decisions combined to produce a business model suited ideally for the next phase of industry evolution.

Managing For Sustained Growth

Internap has entered this next phase in an enviable position. Its financial credentials are strong. The Company is expanding margins and maintaining a healthy balance sheet. The customer base is exemplary. During the year, Internap added 365 new customers and is now serving more than 1,638 customers worldwide, ranging from Fortune 1000 to mid-tier companies, across a diverse base that includes travel, technology, financial services, retail, healthcare and media & entertainment. Yet, despite its successes to date, Internap is constantly aware of continued industry change and is determined not only to adapt to it but, indeed, to be the catalyst of the change.

Darwin's Lesson: *Natural Selection at Work*

Automotive

In 1885, two German engineers, Karl Benz and Gottlieb Daimler, separately produced a gasoline-powered vehicle and simultaneously gave birth to the age of the automobile. Hundreds of companies joined the revolution, adding their own distinct models. However, when Ford Motor Company introduced the Model T in 1908, the automobile became affordable for everyone. Over the next two decades, the automobile industry would rise to sales of $5.5 million.

Those enterprising days ended with the Great Depression. In 1929, sales dropped 80% to under $1.5 million. Automobile manufacturers shrank from 110 companies to 44 in a matter of years. Three companies weathered the storm and grew into superpowers: Ford, General Motors and Chrysler. Even after the end of the Depression, other car companies continued to struggle as the big three continued to gain popularity. Today, these three companies represent over 19.9 million in worldwide unit sales.

Keiana Moore, Senior Telco Cost Analyst

CLIENT APPLICATION EXPERIENCE MUSIC PROJECT

Interactive Museum Delivers Unique Musical 'Experience'

With its gleaming stainless steel "skin" and swooping curves, the Experience Music Project in downtown Seattle gives museum goers much more than just a cool place to see and hear contemporary musical history. Thanks to reliable high-speed IP connectivity from Internap, web surfers can browse through the EMP Digital Collection from the comfort of their own homes and enjoy the eras of rock-and-roll, blues, hip-hop, punk, country, jazz – even disco.

"As a museum committed to the most in-depth, interactive experience possible, we must ensure that our IP needs are met by the best solutions in the industry. Internap does so and is helping to ensure that the Experience Music Project is as cutting edge as the technology that supports it."

Paul Abramowitz, Chief Executive Officer

Ernie Hershey, Software Engineer

Adaptability Drives Sustained Growth

As 2004 begins, the Internet is once again entering a new cycle of growth – one in which Internap and the Internet will emerge as the provider and network of choice. Among the trends influencing this next phase of evolution are advanced applications such as Voice over IP (VoIP), streaming audio and video, Virtual Private Networks (VPN) and IP VPNs. These next-generation applications are driving demand for high-performance Internet service solutions. And, it is expected that large enterprises will increasingly seek bundled IP solutions from single-source providers. This is likely to spur industry consolidation as leaders combine or form alliances to offer customers a single point of service.

Acquisitions and Alliances Expand Opportunity

Internap is adapting quickly to capitalize on this next emerging set of industry dynamics. The acquisitions of netVmg and Sockeye Networks last year expanded Internap's portfolio to include on-site, customer-premise equipment. These acquisitions expand the Company's technology product offerings and its market opportunity through the ability to further penetrate existing customers, support advanced applications and extend geographic footprint. Internap will pursue additional acquisitions and alliances, such as those Internap has forged with Telefonica USA, Akamai, Hitachi, NEC, Dimension Data and Cisco.

Superior Solutions Drive Migration to the Internet

As Internap evolves into a single-source technology solution for the Internet, it has the potential to be *the* catalyst for a sea change in Internet usage. Transmission of the vast majority of business data remains on private networks that were constructed in the 1980s. While these networks are expensive to maintain and upgrade, large enterprises continue to depend upon them due to concerns about the public Internet's ability to meet high security, reliability and cost standards.

Internap Benefits Through Sustained Growth

The Internap solution, however, overcomes these objections and makes a compelling case for the balance of the data world to migrate to the public Internet. Therein lies the Internap opportunity: as the Internet becomes the network of choice, Internap stands to be a major beneficiary. It's a classic case of competitive advantage driving natural selection, which, in turn, drives sustained growth – as history has proven time and again.

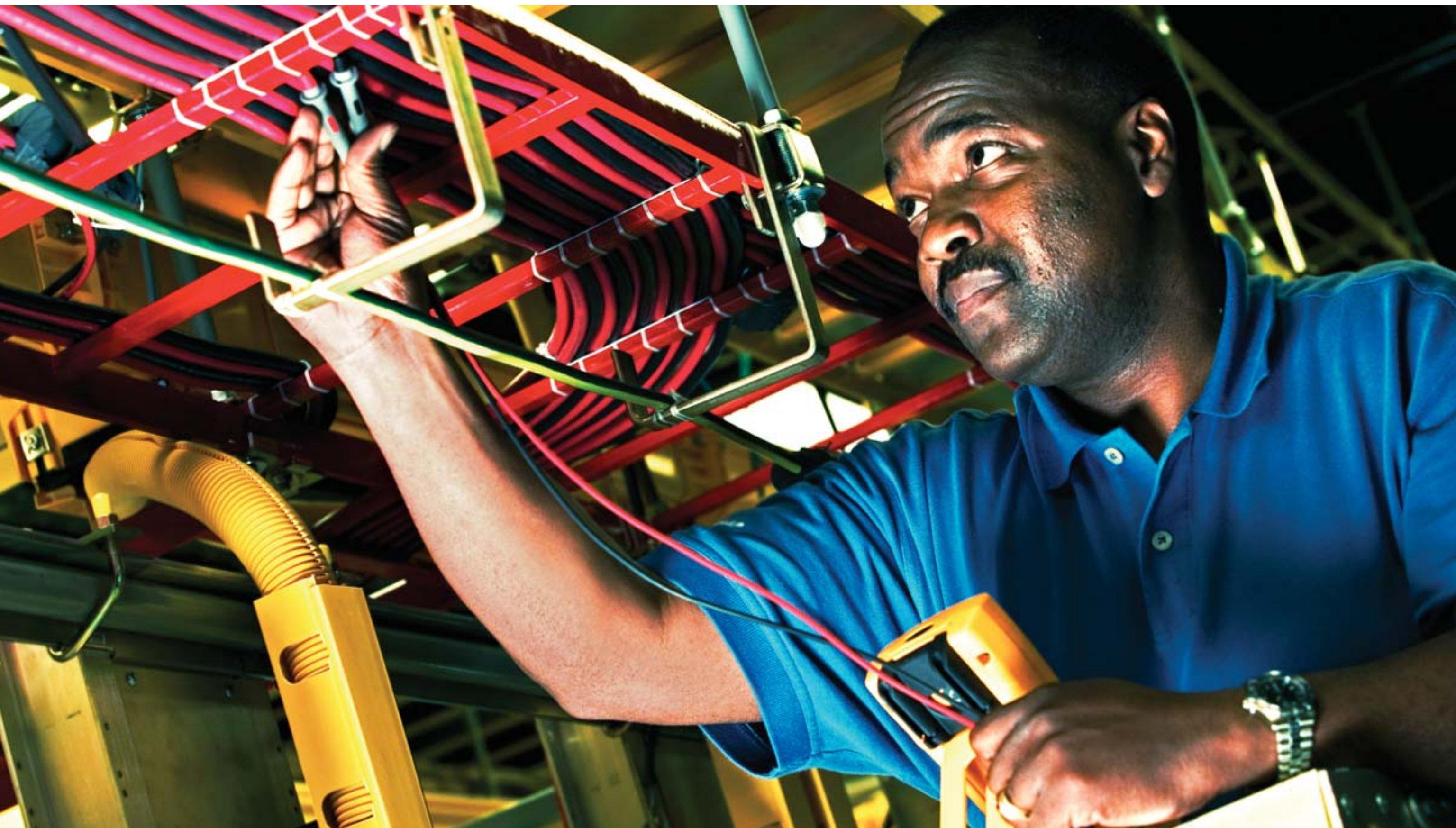
Darwin's Lesson: *A 47-Year History in Innovation*

The Internet

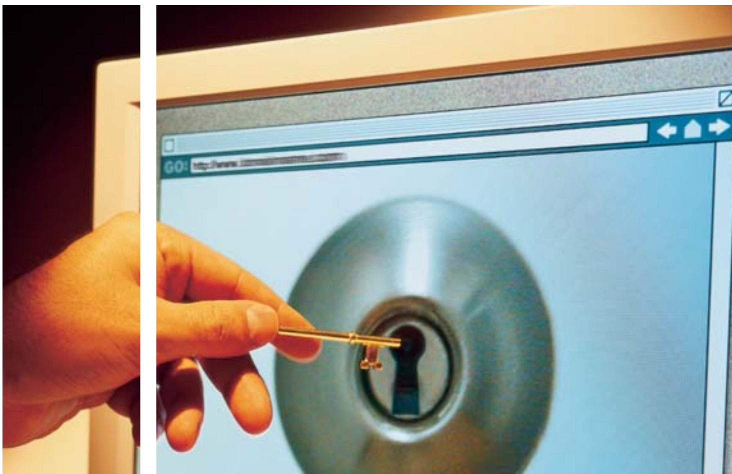
History doesn't have to be far in the past. For the Internet, history started in 1957, when in response to the Russians launching Sputnik, the U.S. government formed ARPA (the Advanced Research Projects Agency). Under this program, some of the best minds in the world gathered to create a way for computers to communicate. In 1969, ARPANET connected four computers. In 1971, it was 15. By 1974, the first public server was launched and the Web never looked back.

In 1995, Netscape signaled the coming boom of the industry when it went public. The browser software provider was the second biggest IPO in Nasdaq history. Soon, a wave of e-companies hit the markets. Prospectors and venture capitalists offered top dollar for companies that found new uses for the Internet.

However, the new century brought anything but prosperity for the young companies. From 2000 to 2002, over 900 companies went bankrupt, and 500,000 jobs and $2 trillion in market value were lost. The survivors, however, have now emerged ready to continue to innovate, change their business model and move forward. Today, consumers spend approximately $4.3 billion a month online. There is no doubt the Internet and the surviving service providers will have a huge role in the future of commerce.



Shannon Wells, Senior Field Operations Engineer

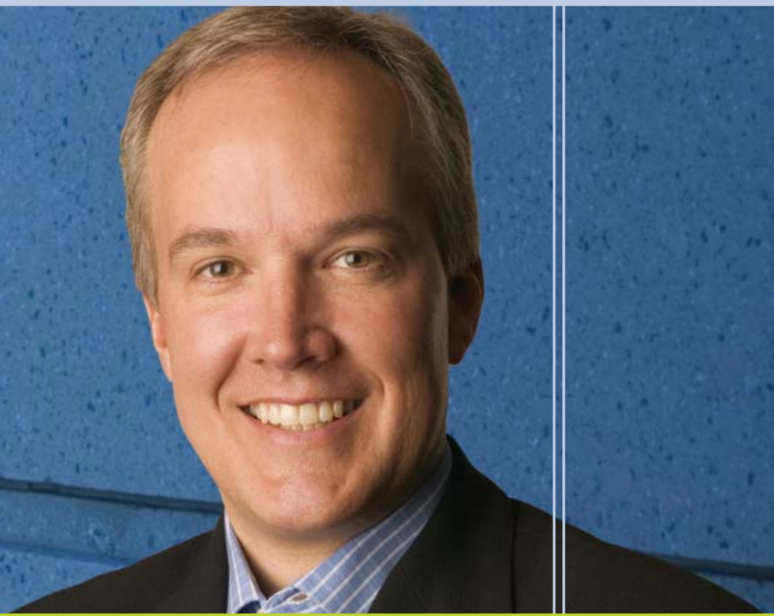


VeriSign: Delivering Reliable, Secure E-Commerce Infrastructure

One of the original architects of the Digital Age, VeriSign Inc. provides online security, digital certification, dot.com registration and other products for customers worldwide, including some 100,000 e-commerce merchants. More than 28% of America's online sales rely on VeriSign – and VeriSign relies on Internap for its high-performance Internet connectivity and colocation services.

"We chose Internap because of their reliability and scalability. Their sales and engineering team 'gets it.' They're more than just a service provider to us. They had a presence where we needed them to be and they had a redundant architecture at a better price point than other providers."

Ken Silva, Vice President
of Networking and Security



GREGORY A. PETERS, President and Chief Executive Officer

"Internap has never been in a stronger position to serve its customers."

DEAR INTERNAP SHAREHOLDER:

Many of you may wonder why Charles Darwin is on the cover of this year's annual report. As you have read on the previous pages, there is a clear logic and correlation between the technological evolution of the Internet and the business evolution of Internap.

As a matter of course, we study technological evolution to learn lessons for the future. In doing so, we have found a predictable pattern throughout history. In the initial stages of an emerging technology, there are the innovators who lead change with experimental designs, productivity breakthroughs and early adoption of new products. Then, come the followers, who discover sustainable applications. Because this group is driven by economics, rather than breakthroughs, new players quickly crowd the space. This pattern leads to the boom and bust cycles that all major technologies have weathered in their formative years.

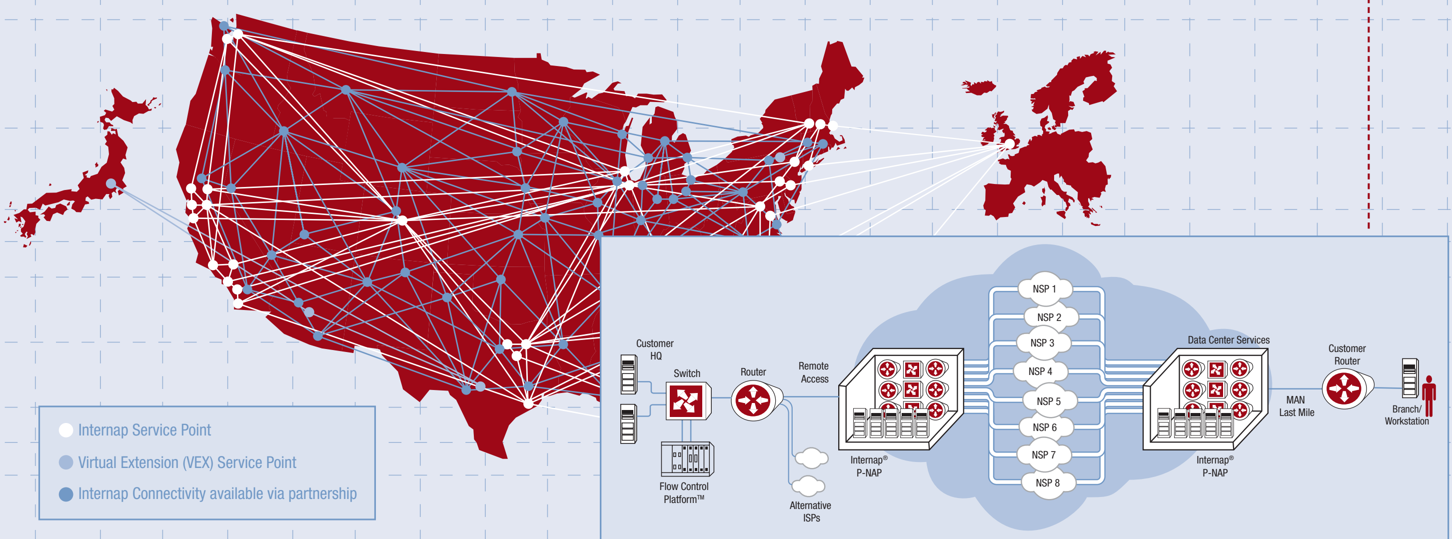
The foundation lesson of this phenomenon is that the boom cycle is characterized by more participants than the market will allow to survive. As a result, the bust cycle is a process of natural selection in which only the strongest survive. And it is around these survivors that sustainable industries are built. From railroads and electricity to automobiles and the Internet, this predictable cycle has driven the evolution of every major technology that shapes the way we live our lives today.

Internap has weathered the Internet natural selection process. We were once one of many and now we are one of a few. Of the many single-product companies created during the Internet boom, we estimate that only five percent survived. Internap, along with partners such as VeriSign, ISS, Akamai and Equinix, are the foundation of the next generation of sustainable Internet businesses, all of which have the technologies, business models and leadership to survive.

After the Bubble: A Focus on Core Strengths

In 2002, our goal was to shed the remnants of the Internet bubble through a series of strategic moves designed to focus Internap on its core strengths. We addressed all aspects of our headquarters operation, focusing on improved financial metrics and enhanced productivity. The culture of the company also went through its own evolution as we moved our corporate

Order From Disorder



Optimizing Reliability and Security For a Worldwide Web of Challenges

A multitude of shared networks comprise the Internet, resulting in an infrastructure design that does not lend itself to routing data or controlling applications in the most effective and efficient manner possible. With the explosion of Internet usage, there is no guarantee that traffic will move swiftly, reliably and securely between destinations. Internap's proprietary technology solutions address these challenges by providing both managed Internet services and route-optimization equipment and software.

A Sampling of Internap's 1,638 Clients

Financial Services	Media & Entertainment	Travel	Retail	Technology	Healthcare
ADP	Associated Press	American Airlines	Best Buy	Apple	Amgen
Allstate	Fox	Delta Airlines	Circuit City	EDS	Bristol-Myers Squibb
Charles Schwab	The McGraw-Hill Companies	Hotwire	CompUSA	Google	Chiron
CheckFree	The New York Times	Southwest Airlines	Crate & Barrel	Microsoft	Covance
Fannie Mae	The Seattle Times	Spirit Airlines	eBay	Motorola	e-NetChina
JPMorgan Chase	Viacom	Travelocity	JCPenney	Sun	HealthAnswers
Mass Mutual	The Walt Disney Co.	United Airlines	Sotheby's	VeriSign	Sharp
Nasdaq			Wal-Mart		QualCare

headquarters from Seattle to Atlanta. This resulted in approximately 60% of new staff at headquarters and over 80% of new senior management team members.

Our 2003 Agenda: A Strengthened Market Position

In 2003, the evolution continued, with a focus on the enhancement of our product-to-market process. We restructured our sales team and forged partnerships and alliances to better position our products and services with larger, more strategic customers. Now, our sales team's productivity is at the highest level since the founding of Internap.

New alliances also are contributing to top line growth. During the year, we announced strategic relationships with Cisco, NEC, Hitachi, Dimension Data, Telefonica, Internet Security Systems (ISS) and VeriSign. Our long-standing relationship with Akamai was also elevated to a more strategic level, with enhanced incentives now in place for the Akamai team to heighten Internap's visibility with their customers. In addition, our joint venture in Japan with NTT continued its growth trajectory with the addition of 24 new customers during the year.

Beyond these product-to-market initiatives, our overall goals in 2003 included completing restructuring activities, exploring strategic opportunities and turning free cash flow positive. Remaining restructuring activities were largely focused on data center and field operations real estate. Our service point locations were rationalized to eliminate redundant or non-carrier neutral facilities. At year-end, we operated 29 service point locations versus more than 40 at the peak of the bubble. This rationalization, combined with aggressive attention to cost of network capacity, drove gross margins to 45% for the year and 48% for the fourth quarter. This healthy gross margin contribution allowed Internap to meet its goal of turning free cash flow positive (defined as net cash flow from operating activities less capital expenditures) for the month of December.

On the strategic front, Internap acquired two respected young companies in the route management space, netVmg and Sockeye Networks. With these acquisitions, Internap purchased leading-edge route management code for a small percentage of invested capital. Our engineering team already has assimilated the majority of the software purchased in these acquisitions with Internap's patented and patent-pending state-of-the-art technology. Our software-based technology can be delivered to customers through Internap's traditional outsourced service model or on a customer's corporate campus in a route control appliance. Thanks to these solutions, Internap now enjoys the enviable position as a premier single-source provider for managed service and premise-based applications, all supported by our unmatched customer service.

This position expands our market opportunity in a number of ways. Our technology solutions can address more complex needs and increase penetration into our existing customer base. The ability to extend our technology to the customer's premise also extends our geographic reach to areas outside of existing service locations and to a broader base of enterprise customers throughout North America and internationally. And, perhaps most significantly, the integration of these solutions enables mission-critical applications to utilize the Internet in the most cost efficient manner and with the highest level of performance. As a result, we have the technological strength to support the industry's most advanced and demanding business applications, such as VoIP, VPN, streaming video, storage, CDN and security – all of which will drive network growth.

“From a single-product company, Internap has expanded to provide a broad portfolio of high-performance technologies that offer an entirely new level of reliable, secure and flexible Internet solutions.”

More Significant 2003 Accomplishments

In addition to these operational and strategic highlights, it is important for you, as stockholders, to be aware of several other important achievements in 2003:

Revenue for the year grew 5%. This growth was achieved in conjunction with two other objectives that had revenue implications. First, we maintained pricing levels commensurate with our value proposition, underscoring management’s commitment to profitable top line growth. Second, Internap took a leadership position in the fight against fraudulent and obscene unsolicited e-mail or “spam.” Though our decision terminated a significant amount of revenue, there is no doubt that our policies will better protect our customers and our business model over the long term.

The Company’s customer base is broad and diversified. Our top 25 customers represent less than 20% of total revenue, with no single customer exceeding three percent of total revenue. This diversification removes risks associated with over-reliance on any one or two individual customers. In addition, our customer base is a broad one that added 365 net new customers during the year to reach 1,638 customers in total. Finally, our customers are quality customers, with approximately seven percent of the Fortune 1000 represented in key strategic verticals.

Our focus on profitability is well demonstrated. Gross margins grew from 37% to 45% in 2003. Based on organic growth, our model is expected to contribute healthy gross margins in the high 40% to low 50% range in 2004 and 2005, respectively. We continue, however, to be alert to strategic prospects and are open to adjusting this metric as needed in order to capitalize on opportunities that enhance our long-term position.

Fixed operating expenses decreased 17%. Our headcount, after reaching a low of approximately 260 during our transition to Atlanta, leveled out at 332 employees in early 2003. With the addition of the netVmg and Sockeye team, we are now at approximately 350 staff members – a very favorable comparison with our staffing level of over 800 a few years ago. Our productivity levels are at historical highs in all departments.

Capital expenditures were less than $4 million in 2003. Internap invested heavily in routing infrastructure during its early growth period. As a result, the Company has enjoyed the benefit of lower capital expenditures during its restructuring period. We have also redeployed infrastructure, while investing in software upgrades to maintain feature functionality. Our routing infrastructure is operating at approximately 35% of capacity, allowing for significant growth on our current platform.

Our balance sheet is strong. In August, Internap closed a $10 million private placement of common stock, with the proceeds remaining on our balance sheet. This transaction not only was important for balance sheet purposes, but it also served as a strong indicator of the public market’s acceptance of Internap. With this acceptance and the appreciation that the investment community illustrated during the year, we also completed a public offering of common stock during the first quarter of 2004, which contributed approximately $57 million to our balance sheet. Finally, we successfully convinced over 50% of the Series A Preferred Stockholders to convert to common stock. Today, approximately 20% of the fully diluted shares are in the hands of preferred stockholders with a mandatory convert coming in September of this year. With the orderly conversion of these stockholders and our low debt levels, Internap’s capital structure is and will be one of the strongest in our industry segment, and our balance sheet is strong.

I share these points with a great sense of pride, satisfaction and accomplishment. Internap has faced and successfully met a series of challenges over the past several years, some unique to our company and others that were felt throughout the industry. The past year, however, has been our most successful ever and reflects the incredible talent and commitment of our employees. I cannot thank them enough. Indeed, the past 12 months have been a transformational period on every front for Internap. From a single-product company, Internap has expanded to provide a broad portfolio of high-performance technologies that offer an entirely new level of reliable, secure and flexible Internet solutions. Now, Internap is at an inflection point, ready to pursue market share and take the business to its next phase of expansion and level of performance.

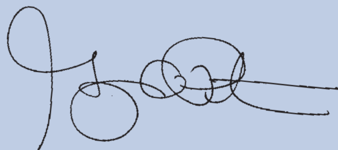
Well-Positioned For The Next Market Opportunity

As Internap moves to its next level of performance, its potential is aligned perfectly with the next round of emerging industry trends. By 2006, the market for Internet value-added services is expected to exceed $60 billion annually, as enterprises view IP-based services as mission-critical and VoIP, Virtual Private Networks (VPN), streaming audio/video and other services as significant cost-savings opportunities. Market growth is directly correlated to the development of a suitable level of confidence in the medium. And, this requires acceptable performance standards.

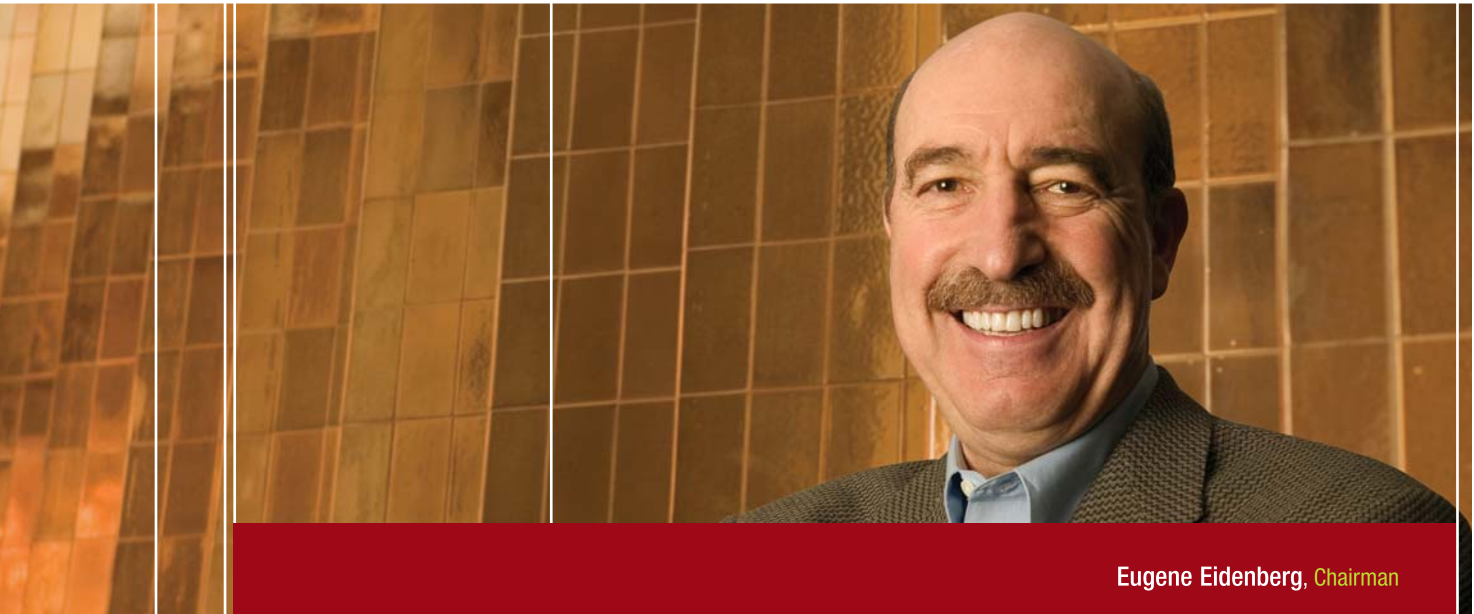
Internap is in an exceptional position to meet these requirements. For example, an assessment by NEC Business Network Solutions documented that Internap's multi-carrier methodology for managing voice and video traffic over the public Internet far exceeded the acceptable performance levels of delay, packet loss and jitter recommended by the ITU Telecommunications Standardization Sector. Simply put, Internap is setting the industry standard for service quality.

Technology solutions that combine cost effectiveness with quality and reliability will increasingly provide enterprises with the confidence level necessary to abandon their inefficient and costly private networks in favor of Internet-based services. In doing so, they will look to industry leaders like Internap to provide the same level of reliability, security and flexibility that they have received from their private networks. This transformation – from private to public data services – is the growth opportunity that Internap seeks to exploit and, indeed, will be the catalyst for offering the performance services that companies demand from the Internet.

Like the evolution of the railroad, the automobile and numerous other industries in the past, the Internet is a marketplace still in its formative stages, and, as such, represents a valuable opportunity for companies that can adapt to its constantly changing dynamics and demand. Internap will continue to adapt. Internap will continue to lead. Internap will continue to be a winner. We appreciate your support as we make this happen for you.



Gregory A. Peters
President and Chief Executive Officer



Eugene Eidenberg, Chairman

"The rate of change in our industry continues to accelerate. Your board is confident that change is good and that Internap is increasingly driving that change."

FROM THE CHAIRMAN

Dear Fellow Shareholders,

The year 2003 was important in Internap's development as the provider of the gold-standard for Internet connectivity for business enterprises. As Internap CEO Greg Peters noted in his letter, your company had its best year ever in 2003. The Company's board is enthusiastic about the opportunities that are before us as the Company focuses on a period of sustained growth.

American business has entered an era of renewed focus on corporate governance. Each member of your board of directors takes his obligation to represent shareholder interests very seriously. Considerable time and effort is directed to meeting the standards of the Sarbanes-Oxley Act, which is the new legal touchstone of corporate governance in the United States.

During the past year, we welcomed two new board members, Charles B. Coe and James DeBlasio, who have assumed important leadership roles on the board. Charlie Coe chairs the board's Compensation Committee and Jim DeBlasio chairs the board's Audit Committee.

Charlie Coe is a 28-year veteran of the telecommunications industry, having served in a number of senior management positions for BellSouth, AT&T Communications and American Telesystems Corporation. Jim DeBlasio brings 22 years of financial experience in the telecommunications industry to Internap. He is currently Financial Vice President for Lucent Technologies' Mobility & INS Products. We are fortunate to have the 50 years of experience that these industry leaders bring to your board's deliberations.

Early in 2004, Internap co-founder, board member and former CEO, Anthony (Tony) Naughtin, retired from Internap's board. Needless to say, without Tony's vision and leadership, Internap would not have had the chance to be the exciting and promising company it has become. The board is grateful for Tony's lasting contributions to the Company and wishes him well in his new endeavors.

As 2003 drew to a close, the Company prepared to move from the Nasdaq Small Cap Market to the American Stock Exchange, where we are now trading under the symbol "IIP." This move allows the Company to trade on a national exchange rather than a "small cap" exchange. This positions Internap to trade alongside its peers in the public markets.

The rate of change in our industry continues to accelerate. Your board is confident that change is good and that Internap is increasingly driving that change. Greg and the team at Internap are focused alongside the board in creating value for you — our owners. On behalf of that team, I want to express our gratitude for your continuing support and look forward to working for and with you during the exciting period ahead.

Eugene Eidenberg
Chairman

SELECTED FINANCIAL DATA

The following selected financial data are qualified by reference to, and should be read in conjunction with our financial reports filed with The Securities and Exchange Commission, our financial statements and the notes thereto and "Management's Discussion and Analysis of Financial Condition and Results of Operations" appearing elsewhere in the annual report. The consolidated statement of operations data and other financial data presented below for the years ended December 31, 2001, 2002 and 2003, and the balance sheet data as of December 31, 2002 and 2003 are derived from our audited financial statements included elsewhere in this annual report. The consolidated statement of operations data presented below for the years ended December 31, 1999 and 2000, and the balance sheet data as of December 31, 1999, 2000 and 2001 are derived from our audited financial statements that are not included in this annual report.

Year Ended December 31,	2003	2002	2001	2000	1999
(In thousands, except per share data)					
Statement of Operations Data:					
Revenues	$138,580	$132,487	$ 117,404	$ 69,613	$ 12,520
Costs and expenses:					
Direct cost of network, exclusive of depreciation shown below	75,730	83,207	98,915	62,465	17,848
Customer support	9,045	12,913	21,480	20,320	5,796
Product development	6,923	7,447	12,233	11,924	3,876
Sales and marketing	18,429	21,641	38,151	35,390	17,519
General and administrative	20,032	20,848	44,491	32,962	7,335
Depreciation and amortization	33,892	49,600	48,550	20,522	4,808
Amortization of goodwill and other intangible assets	3,352	5,626	38,116	54,334	–
Amortization of deferred stock compensation	390	260	4,217	10,651	7,569
Pre-acquisition liability adjustment	(1,313)	–	–	–	–
Lease termination expense	–	804	–	–	–
Restructuring cost (benefit)[(1)]	1,084	(3,781)	64,096	–	–
Impairment of goodwill and other intangible assets[(2)]	–	–	195,986	–	–
In-process research and development[(3)]	–	–	–	18,000	–
(Gain) loss on sales and retirements of property and equipment	(53)	2,829	2,714	–	–
Total operating costs and expenses	167,511	201,394	568,949	266,568	64,751
Loss from operations	(28,931)	(68,907)	(451,545)	(196,955)	(52,231)
Other income (expense):					
Interest income (expense), net	(3,280)	(2,194)	(1,272)	11,498	2,314
Loss on investments	(827)	(1,244)	(26,345)	–	–
Total other income (expense)	(4,107)	(3,438)	(27,617)	11,498	2,314
Net loss	(33,038)	(72,345)	(479,162)	(185,457)	(49,917)
Less deemed dividend related to beneficial conversion feature[(4)]	(34,576)	–	–	–	–
Net loss attributable to common stockholders	$ (67,614)	$ (72,345)	$(479,162)	$(185,457)	$(49,917)
Basic and diluted net loss per share	$ (0.39)	$ (0.47)	$ (3.19)	$ (1.30)	$ (1.31)
Weighted average shares used in computing basic and diluted net loss per share[(5)]	174,602	155,545	150,328	142,451	37,994

SELECTED FINANCIAL DATA continued

Year Ended December 31,	2003	2002	2001	2000	1999
(In thousands)					
Balance Sheet Data:					
Cash, cash equivalents and short-term investments	$ 18,885	$ 25,219	$ 82,306	$153,965	$205,352
Total assets	142,451	172,969	284,977	650,110	245,546
Notes payable and capital lease obligations, less current portion	17,812	27,913	16,448	27,646	14,378
Series A convertible preferred stock[5][6]	51,841	79,790	86,314	–	–
Total stockholders' equity	78,150	1,835	66,169	531,953	210,500

Year Ended December 31,	2003	2002	2001	2000	1999
(In thousands)					
Other Financial Data:					
Purchases of property and equipment	$ (3,799)	$ (8,632)	$ (32,094)	$ (57,698)	$ (12,905)
Net cash used in operating activities	(11,088)	(40,261)	(123,048)	(95,104)	(33,818)
Net cash (used in) provided by investing activities	561	9,581	12,292	(106,193)	(68,020)
Net cash (used in) provided by financing activities	4,193	(7,652)	72,147	148,273	256,747

(1) Restructuring cost (benefit) relates to restructuring programs in which management determined to exit certain non-strategic real estate lease and license arrangements, consolidate network access points and streamline the operating cost structure.

(2) In 2000, we acquired CO Space, Inc. and the purchase price was allocated to net tangible assets and identifiable intangible assets and goodwill. In 2001, the estimated fair value of certain assets acquired was less than their recorded amounts, and an impairment charge was recorded for approximately $196.0 million.

(3) In-process research and development is related to technology acquired in 2000 from VPNX.com, Inc., formerly Switchsoft Systems, Inc., that was expensed immediately subsequent to the closing of the acquisition since the technology had not completed the preliminary stages of development, had not commenced application development and did not have alternative future uses.

(4) In August 2003, we completed a private placement of our common stock which resulted in a decrease of the conversion price of our series A preferred stock to $0.95 per share and an increase in the number of shares of common stock issuable upon conversion of all shares of series A preferred stock by 34.5 million shares. We recorded a deemed dividend of $34.6 million in connection with the conversion price adjustment, which is attributable to the additional incremental number of shares of common stock issuable upon conversion of our series A preferred stock.

(5) See note 2 of notes to financial statements for a description of the computation of basic and diluted net loss per share and the number of shares used to compute basic and diluted net loss per share.

(6) As of December 31, 2003, there were 1,751,385 shares of our series A preferred stock outstanding convertible into 58,994,032 shares of our common stock. These shares are included in total stockholders' equity as of December 31, 2003.

Overview

We provide high performance, managed Internet connectivity solutions to business customers who require guaranteed network availability and high performance levels for business-critical applications, such as e-commerce, video and audio streaming, voice over Internet Protocol, virtual private networks and supply chain management. We deliver services through our 29 network access points, which feature multiple direct high speed connections to major Internet networks. Our proprietary route optimization technology monitors the performance of these Internet networks and allows us to intelligently route our customers' Internet traffic over the optimal Internet path in a way that minimizes data loss and network delay. We believe this approach provides better performance, control, predictability and reliability than conventional Internet connectivity providers. Our service level agreements guarantee performance across the entire Internet in the United States, excluding local connections, whereas conventional Internet connectivity providers typically only guarantee performance on their own network. We provide services to customers in various industry verticals, including financial services, entertainment and media, travel, e-commerce and retail and technology. As of December 31, 2003, we provided our services to over 1,600 customers in the United States and abroad, including approximately 70 customers in the Fortune 1000 companies.

At December 31, 2003, we operated 29 network access points in 17 metropolitan market areas. During 2003, our total number of network access points were reduced from 34 to 29, with nine network access points relocated during the year to lower operating cost, enhance customer connectivity and improve our technology.

Due to the nature of the services we provide, we generally price our Internet connectivity services at a premium to the services offered by conventional Internet connectivity service providers. We believe customers with business-critical Internet applications will continue to demand the highest quality of service as their Internet connectivity needs grow and become even more complex and, as such, will continue to pay a premium for our high performance managed Internet connectivity services.

Our success in executing our premium pricing strategy depends, to a significant degree, on our ability to differentiate our connectivity solutions from lower cost alternatives. The key measures of our success in achieving this differentiation are revenue and customer growth. During 2003, our net new customers increased by 365 to over 1,600 enterprise customers as of December 31, 2003. Revenue for the year ended December 31, 2003 increased 5% to $138.6 million, compared to revenue of $132.5 million for the year ended December 31, 2002.

We intend to increase revenue by leveraging the capabilities of our existing network access points. In our existing markets, we realize incremental margin as new customers are added. Additional volume in an existing market allows improved utilization of existing facilities and an improved ability to cost-effectively predict and acquire additional network capacity. Conversely, decreases in the number of customers in an established market lead to decreased facility utilization and increase the possibility that direct network resources are not cost-efficiently employed. These factors have a direct bearing on our financial position and results of operations.

We also intend to increase revenue by expanding our geographic coverage in key markets in the United States and abroad. As we enter new geographic markets, operating results will be affected by increased expenses for hiring, training and managing new employees, acquiring and implementing new systems and expenses for new facilities. Our ability to generate increased revenues depends on the success of our cost control measures as we expand our geographic coverage.

Finally, we intend to increase revenue by expanding our complementary managed Internet service product offerings. These services include, but are not limited to, content distribution, virtual private networking, colocation services, managed security, managed storage, video conferencing and Voice over Internet Protocol services.

Business Combinations

On October 1, 2003, we completed our acquisition of netVmg. The acquisition was recorded using the purchase method of accounting under Statement of Financial Accounting Standards, or SFAS, No. 141, "Business Combinations" ("SFAS 141"). The aggregate purchase price of the acquired company, plus related charges, was approximately $13.7 million and was comprised of 345,905 shares of our series A preferred stock, acquisition costs and warrants to purchase 1.5 million shares of our common stock. The warrants are exercisable only in the event the former netVmg stockholders invest an amount no less than $4.4 million in any future private placement of our equity securities. Results of operations of netVmg have been included in our financial results since the closing date of the transaction.

On October 15, 2003, we completed our acquisition of Sockeye. The acquisition was recorded using the purchase method of accounting under SFAS 141. The aggregate purchase price of the acquired company, plus related charges, was approximately $1.9 million and was comprised of 1,420,775 shares of our common stock and acquisition costs. Results of operations of Sockeye have been included in our financial results since the closing date of the transaction.

Critical accounting policies and estimates

The discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates, including those related to revenue recognition, customer credit risk, investments, goodwill and other intangible assets, long-lived assets, income taxes, restructuring costs, long-term service contracts, contingencies and litigation. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ materially from these estimates under different assumptions or conditions.

Management believes the following critical accounting policies affect the judgments and estimates used in the preparation of our consolidated financial statements.

Revenue recognition. The majority of our revenue is derived from high-performance Internet connectivity and related colocation services. Our revenues are generated primarily from the sale of Internet connectivity services at fixed rates or usage-based pricing to our customers that desire a DS-3 or faster connection and other ancillary services, such as colocation, content distribution, server management and installation services, virtual private networking services, managed security services, data backup, remote storage and restoration services, and video conferencing services. We also offer T-1 and fractional DS-3 connections at fixed rates.

We recognize revenues when persuasive evidence of an arrangement exists, the service has been provided, the fees for the service rendered are fixed or determinable and collectibility is probable. Contracts and sales or purchase orders are generally used to determine the existence of an arrangement. We test for availability or use shipping documents when applicable to verify delivery of our product or service. We assess whether the fee is fixed or determinable based on the payment terms associated with the transaction and whether the sales price is subject to refund or adjustment.

Deferred revenues consist of revenues for services to be delivered in the future and consist primarily of advance billings, which are amortized over the respective service period, and billings for initial installation of customer network equipment, which are amortized over the estimated life of the customer relationship. Revenues associated with billings for installation of customer network equipment are deferred and amortized over the estimated life of the customer relationship, as the installation service is integral to our primary service offering and does not have value to a customer on a stand-alone basis.

Customer credit risk. We review the creditworthiness of our customers routinely. If we determine that collection of service revenues is uncertain, we do not recognize revenue until cash has been collected. Additionally, we maintain allowances for doubtful accounts resulting from the inability of our customers to make required payments on accounts receivable. To establish the amount of the allowances against revenue and receivables on the balance sheet, we apply a credit risk rating system that is based on management's best understanding of our customers' ability to pay. Our assessment of customers' creditworthiness may include consideration of payment history. The sum of individual customer receivable balances multiplied by the credit rating is the basis for reserves against revenues and receivables. We also increase our reserve estimates for estimated customer credits. If the financial condition of our customers were to deteriorate, or management becomes aware of new information impacting a customer's credit risk, additional allowances may be required.

Investments. We account for investments without readily determinable fair values at historical cost, as determined by our initial investment. The recorded value of cost basis investments is periodically reviewed to determine the propriety of the recorded basis. When a decline

in the value that is judged to be other than temporary has occurred, based on available data, the cost basis is reduced and an investment loss is recorded.

We account for investments that provide us with the ability to exercise significant influence, but not control, over an investee using the equity method of accounting. Significant influence, but not control, is generally deemed to exist if we have an ownership interest in the voting stock of the investee of between 20% and 50%, although other factors, such as minority interest protections, are considered in determining whether the equity method of accounting is appropriate. As of December 31, 2003, we have a single investment that qualifies for equity method accounting, our joint venture with NTT-ME Corporation of Japan, known as Internap Japan. We record our proportional share of the losses of our investee one month in arrears on the consolidated balance sheets as a component of non-current investments and our share of the investee's losses as loss on investment on the consolidated statement of operations.

Goodwill. We may record goodwill as a result of acquisitions. We recorded goodwill as a result of our acquisitions of CO Space, Inc., VPNX.com, Inc., netVmg, Inc., and Sockeye Networks, Inc. We account for goodwill under SFAS No. 142, "Goodwill and Other Intangible Assets." This statement requires an impairment-only approach to accounting for goodwill. The SFAS No. 142 goodwill impairment model is a two-step process. First, it requires a comparison of the book value of net assets to the fair value of the related operations that have goodwill assigned to them. If the fair value is determined to be less than book value, a second step is performed to compute the amount of the impairment. In this process, a fair value for goodwill is estimated, based in part on the fair value of the operations used in the first step, and is compared to the carrying value for goodwill. Any shortfall of the fair value below carrying value represents the amount of goodwill impairment. SFAS No. 142 requires goodwill to be tested for impairment annually at the same time every year and when an event occurs or circumstances change such that it is reasonably possible that impairment may exist. We selected August 1 as our annual testing date.

To estimate fair value in the future, for purposes of completing the first step of the SFAS No. 142 analysis, we will use a market-based analysis based on the value of our equity and a discounted cash flow analysis. The forecasts of future cash flows will be based on our best estimate of future revenues, operating costs and general market conditions, and is subject to review and approval by senior management. Both approaches to determining fair value will depend on our stock price since market capitalization will impact the discount rate to be applied as well as a market multiple analysis. Changes in the forecast could cause us to either pass or fail the first step test and could result in the impairment of goodwill.

Restructuring liability. When circumstances warrant, we may elect to exit certain business activities or change the manner in which we conduct ongoing operations. When such a change is made, management will estimate the costs to exit a business or restructure ongoing operations. The components of the estimates may include estimates and assumptions regarding the timing and costs of future events and activities that represent management's best expectations based on known facts and circumstances at the time of estimation. Management periodically reviews its restructuring estimates and assumptions relative to new information, if any, of which it becomes aware. Should circumstances warrant, management will adjust its previous estimates to reflect what it then believes to be a

Robert Jenks, David Buckel and Don Burke

"Our financial achievements reflected in improved revenue and a decline in network cost and operating expenses underscore the validity of our operational model."

Robert Jenks, Chief Financial Officer

more accurate representation of expected future costs. Because management's estimates and assumptions regarding restructuring costs include probabilities of future events, such estimates are inherently vulnerable to changes due to unforeseen circumstances, changes in market conditions, regulatory changes, changes in existing business practices and other circumstances that could materially and adversely affect our results of operations. A 10% change in our restructuring estimates in a future period, compared to the $6.4 million restructuring liability at December 31, 2003 would result in a $0.6 million expense or benefit in the statement of operations during the period in which the change in estimate occurred.

Deferred taxes. We record a valuation allowance to reduce our deferred tax assets to the amount that is more likely than not to be realized. Since inception we have recorded a valuation allowance equal to our net deferred tax assets. Although we consider the potential for future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for the valuation allowance, in the event we determine we would be able to realize our deferred tax assets in the future in excess of our net recorded amount, an adjustment to the deferred tax asset would increase income in the period such determination was made.

Eric Klinker, David Lindstrom and Ali Marashi

"New, high-demand applications, such as VoIP, virtual private networks, e-commerce, streaming audio and video will further drive demand in the intelligent route control market."

Ali Marashi, Chief Technology Officer and Vice President, Engineering

Network service commitment liability. We monitor our network service commitments with our network service providers. When we determine that a service commitment will not be achieved through the ordinary course of business and the service provider is not expected to provide relief from the commitment, we record an expense to the direct costs of network and a liability for the estimated shortfall. If we are unable to continue increasing our base of customers or if our customer base decreases, we may experience a deterioration of our operating margins.

Recent accounting pronouncements

In January 2003, the FASB issued Interpretation No. 46 ("FIN 46"), "Consolidation of Variable Interest Entities," which clarifies the application of Accounting Research Bulletin No. 51, "Consolidated Financial Statements," relating to consolidation of certain entities. First, FIN 46 requires identification of our participation in variable interest entities ("VIE"), which are defined as entities with a level of invested equity that is not sufficient to fund future activities to permit them to operate on a stand-alone basis, or whose equity holders lack certain characteristics of a controlling financial interest. Then, for entities identified as VIE, FIN 46 sets forth a model to evaluate potential consolidation based on an assessment of which party to the VIE, if any, bears a majority of the exposure to its expected losses, or stands to gain from a majority of its expected returns. FIN 46 also sets forth certain disclosures regarding interests in VIE that are deemed significant, even if consolidation is not required. We evaluated our investments and other relationships and concluded that none qualify as a VIE as defined in FIN 46.

On May 15, 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity." This statement establishes standards for classifying and measuring as liabilities certain financial instruments that embody obligations of the issuer and have characteristics of both liabilities and equity. This statement represents a significant change in practice in the accounting for a number of financial instruments, including mandatorily redeemable equity instruments and certain equity derivatives that are frequently used in connection with share repurchase programs. This statement is effective for all financial instruments created or modified after May 31, 2003, and to other instruments as of July 1, 2003. We adopted the provisions of this standard during 2003 and it had no material impact on our financial position and results from operations.

Results of Operations

Our revenues are generated primarily from the sale of Internet connectivity services at fixed rates or usage-based pricing to our customers that desire a DS-3 or faster connection and other ancillary services, such as colocation, content distribution, server management and installation services, virtual private networking services, managed security services, data backup, remote storage and restoration services and video conferencing services. We also offer T-1 and fractional DS-3 connections at fixed rates. We recognize revenues when persuasive evidence of an arrangement exists, the service has been provided, the fees for the service rendered are fixed or determinable and collectibility is probable. Customers are billed on the first day of each month either on a usage or a flat-rate basis. The usage based billing relates to the month prior to the month in which the billing occurs, whereas certain flat rate billings relate to the month in which the billing occurs. Deferred revenues consist of revenues for services to be delivered in the future and consist primarily of advance billings, which are amortized over the respective service period, and billings for initial installation of customer network equipment, which are amortized over the estimated life of the customer relationship.

Direct cost of network is comprised primarily of the costs for connecting to and accessing Internet network service providers and competitive local exchange providers, costs related to operating and maintaining network access points and data centers and costs incurred for providing additional third-party services to our customers. To the extent a network access point is located a distance from the respective Internet network service providers, we may incur additional local loop charges on a recurring basis. Connectivity costs vary depending on customer demands and pricing variables while network access point facility costs are generally fixed in nature.

Customer support costs consist primarily of employee compensation costs for employees engaged in connecting customers to our network, installing customer equipment into network access point facilities, and servicing customers through our network operation centers. In addition, facilities costs associated with the network operations center are included in customer support costs.

Product development costs consist principally of compensation and other personnel costs, consultant fees and prototype costs related to the design, development and testing of our proprietary technology, enhancement of our network management software and development of internal systems. Costs associated with internal use software are capitalized when the software enters the application development stage until implementation of the software has been completed. All other product development costs are expensed as incurred.

Sales and marketing costs consist of compensation, commissions and other costs for personnel engaged in marketing, sales and field service support functions, as well as advertising, tradeshows, direct response programs, new service point launch events, management of our web site and other promotional costs.

General and administrative costs consist primarily of compensation and other expenses for executive, finance, human resources and administrative personnel, professional fees and other general corporate costs.

The revenue and income potential of our business and market is unproven, and our limited operating history makes it difficult to evaluate our prospects. Although we have been in existence since 1996, we have recently substantially completed significant operational restructurings, which have included substantial changes in our senior management team, a reduction in headcount from a high of 860 employees to 354 employees at December 31, 2003, streamlining our cost structure, consolidating network access points, terminating certain nonstrategic real estate leases and license arrangements and moving our headquarters from Seattle, Washington to Atlanta, Georgia to further reduce costs. We have incurred net losses in each quarterly and annual period since we began operations in May 1996. As of December 31, 2003, our accumulated deficit was $829.5 million.

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

Year Ended December 31,	2003	2002	2001
Revenues	100%	100%	100%
Costs and expenses:			
Direct cost of network, exclusive of depreciation shown below	55%	63%	84%
Customer support	7%	10%	18%
Product development	5%	6%	10%
Sales and marketing	13%	16%	32%
General and administrative	14%	16%	38%
Depreciation and amortization	25%	37%	41%
Amortization of goodwill and other intangible assets	2%	4%	33%
Amortization of deferred stock compensation	–	–	4%
Pre-acquisition liability adjustment	(1)%	–	–
Lease termination expense	–	1%	–
Restructuring costs (benefit)	1%	(3)%	55%
Impairment of goodwill and other intangible assets	–	–	167%
Loss on sales and retirements of property and equipment	–	2%	2%
Total operating costs and expenses	121%	152%	484%
Loss from operations	(21)%	(52)%	(384)%
Other expense:			
Interest expense, net	2%	2%	1%
Loss on investments	1%	1%	23%
Total other expense	3%	3%	24%
Net loss	(24)%	(55)%	(408)%

Years Ended December 31, 2003 and 2002

Revenues. Revenues for 2003 increased $6.1 million from $132.5 million for the year ended December 31, 2002 to $138.6 million for the year ended December 31, 2003, an increase of 5%. Revenue for Internet Protocol connectivity and third party services at our existing network access points increased 2% primarily due to an increase in our customer base from 1,273 to 1,638, a 29% increase. Pricing pressures due to general market conditions caused a decrease in our revenue per customer.

Revenue from complementary managed Internet services, such as content distribution, increased 10% excluding the revenues from the acquisition of netVmg. Revenue for 2003 reflects the addition of netVmg operations subsequent to its acquisition in the fourth quarter. We expect the composition of future revenue increases will include an increasing percentage of revenue from complementary managed Internet services than in the past.

Direct cost of network. Direct cost of network decreased 9% from $83.2 million for the year ended December 31, 2002 to $75.7 million for the year ended December 31, 2003. This decrease of $7.5 million was primarily due to a reduction in negotiated rates with Internet network service and local exchange providers throughout 2003. The decrease was partially offset by a 28% increase in content distribution costs, which were in line with the increase in content distribution revenue.

Facility costs comprise approximately one-third of total direct network costs. During 2004, we anticipate achieving a reduction in these facilities costs due to the consolidation from 34 to 29 locations late in 2003. The resulting lower facilities costs are expected to be stable in future years with incremental increases directly related to expansion into new metropolitan market areas. The remaining direct network cost is anticipated to maintain a similar relationship with revenue.

Customer support. Customer support expenses decreased 30% from $12.9 million for the year ended December 31, 2002 to $9.0 million for the year ended December 31, 2003. This decrease of $3.9 million was primarily driven by decreases in compensation and related costs (representing 70% of the decrease) due to a headcount reduction of 51 employees and decreased facilities costs (representing 28% of the decrease).

Product development. Product development costs for the year ended December 31, 2003 decreased 7% to $6.9 million from $7.4 million for the year ended December 31, 2002. The decrease of $0.5 million was due primarily to decreased facilities costs of $0.8 million, partially offset by increases in compensation and related costs of $0.2 million related to the acquisitions of Sockeye and netVmg.

Sales and marketing. Sales and marketing costs for the year ended December 31, 2003 decreased 15% to $18.4 million from $21.6 million for the year ended December 31, 2002. This decrease of $3.2 million was primarily due to decreases in facilities costs (representing 59% of the decrease), compensation and related costs (representing 53% of the decrease) due to a headcount reduction of 29 employees, partially offset by a $0.3 million increase in market research expenditures.

General and administrative. General and administrative costs for the year ended December 31, 2003 decreased 4% to $20.0 million from $20.8 million for the year ended December 31, 2002. The decrease of $0.8 million primarily reflects decreased compensation and related expenses of $1.8 million due to a headcount reduction of 20 employees offset by increased facilities costs of $1.3 million.

Depreciation and amortization. Depreciation and amortization of property and equipment for the year ended December 31, 2003 decreased 32% to $33.9 million compared to $49.6 million for the year ended December 31, 2002. The decrease of $15.7 million was primarily due to assets becoming fully depreciated during 2003, which were not replaced by the same level of purchases of property and equipment as during prior years.

Amortization of goodwill and other intangible assets for the year ended December 31, 2003 decreased 40% to $3.4 million compared to $5.6 million for the year ended December 31, 2002. The decrease of $2.2 million was due to intangible assets becoming fully amortized during 2003, which was only partially offset by amortization expense for the additional intangible assets related to the netVmg acquisition during 2003.

Pre-acquisition liability adjustment. As part of our acquisition of CO Space on June 20, 2000, we recorded a pre-acquisition liability of $1.3 million for network equipment purchased by CO Space. During 2003, we reevaluated the likelihood of settling the liability related to this equipment and concluded that a contingent obligation no longer exists. Therefore, the liability was eliminated resulting in a one-time reduction in costs and expenses of $1.3 million.

Restructuring cost (benefit). A restructuring charge of $1.1 million was recorded in 2003 for costs associated with the relocation of our corporate headquarters to Atlanta, Georgia. This compares with a restructuring benefit of ($3.8) million in 2002 reflecting non-cash restructuring plan adjustments and write-downs net of additional 2002 restructuring and impairment charges.

Other expense. Other expense consists of interest income, interest and financing expense, investment losses and other non-operating expenses. Other expense for the year ended December 31, 2003 increased to $4.1 million from $3.4 million for the year ended December 31, 2002. The increase of $0.7 million is due to a $1.1 million increase in interest expense, offset by a $0.4 million reduction in losses from our investment accounted for using the equity method.

Deemed dividend related to beneficial conversion feature. Our 2003 net loss per share includes the effect of a deemed dividend of $34.6 million related to certain conversion features of our series A preferred stock in 2003. In August 2003, we completed a private placement of our common stock which resulted in a decrease of the conversion price of our series A preferred stock to $0.95 per share and an increase in the number of shares of common stock issuable upon conversion of

Process Improvement/Operations

Marla Eichmann and Eric Suddith

"Using group and individual productivity metrics, we achieved significant improvements in 2003."

Marla Eichmann, Vice President, Cross Fuctional Operations

all shares of series A preferred stock by 34.5 million shares. We recorded a deemed dividend of $34.6 million in connection with the conversion price adjustment, which is attributable to the additional incremental number of shares of common stock issuable upon conversion of our series A preferred stock. See note 15 to our financial statements included in this annual report on Form 10-K.

Years Ended December 31, 2002 and 2001

Revenues. Revenues for the year ended December 31, 2002 increased by 13% to $132.5 million, up from $117.4 million for the year ended December 31, 2001. The increase during 2002 was primarily driven by increased connectivity service revenues, accounting for 75% of the increase, which reflects a full year of operations at the six network access points that were opened during 2001, and an increase in our overall customer base from 974 to 1,273 customers across our metropolitan market network access points. Revenues for the year ended December 31, 2002 also increased by $3.2 million compared to 2001 due to a reduction in the term of a customer's service contract. As a result of this reduction in the contractual service period and other factors,

Corporate Development

Constantine Dantoulis, Ping Kiang and John Scanlon

"We believe the industry is entering a consolidation phase and we will continue to look for business combinations that expand our product portfolio, footprint and/or market share."

John Scanlon, Vice President, Corporate Development

we changed the estimated life of the customer relationship over which we recognize deferred revenues from 120 months to 46 months, with 14 months remaining at December 31, 2002. The current balance of deferred revenue attributable to the customer therefore increased to reflect the amortization of the remaining balance over the remaining customer relationship period. Also included are contract termination revenues of $1.3 million collected from customers that discontinued service during the year. Of the remaining increase, 23% can be attributed primarily to content delivery network services and the remaining 2% can be attributed to colocation data center services, including facilities charges.

Direct cost of network. Direct cost of network for the year ended December 31, 2002 decreased 16% to $83.2 million from $98.9 million for the year ended December 31, 2001. The decrease of $15.7 million in 2002 reflects reduced network cost and local access expenses (representing 107% of the decrease), resolution of disputes with network vendors (representing 9% of the decrease) and lower third-party colocation and service point facility costs (representing an additional 8% of the decrease). These decreases were offset by a 10% increase in customer local access costs, a 6% increase in colocation costs in our facilities and a 14% increase in costs associated with content delivery network services.

Customer support. Customer support costs for the year ended December 31, 2002 decreased 40% to $12.9 million from $21.5 million for the year ended December 31, 2001. The decrease of $8.6 million was primarily driven by decreases in compensation (representing 65% of the decrease), facilities (representing 20% of the decrease), and decreases in communications, general office, travel and entertainment and other costs (representing 15% of the decrease). Customer support costs are primarily related to employee costs.

Product development. Product development costs for the year ended December 31, 2002 decreased 39% to $7.4 million from $12.2 million for the year ended December 31, 2001. The decrease of $4.8 million reflects reduced compensation expense (representing 51% of the decrease), facilities (representing 16% of the decrease), outside professional services (representing 25% of the decrease) and communications and other costs (representing 8% of the decrease).

Sales and marketing. Sales and marketing costs for the year ended December 31, 2002 decreased 44% to $21.6 million from $38.1 million for the year ended December 31, 2001. Approximately 35% of the $16.5 million decrease can be attributed to a marketing and advertising campaign in 2001. Additionally, 34% of the decrease relates to compensation costs as a result of employee terminations completed during 2002.

General and administrative. General and administrative costs for the year ended December 31, 2002 decreased 54% to $20.8 million from $44.5 million for the year ended December 31, 2001. The decrease of $23.7 million reflects lower facility costs (representing 28% of the decrease), lower compensation costs (representing 25% of the decrease), decreases in taxes and bad debt expense (each representing 12% of the decrease), reduced professional services (representing 8% of the decrease), lower training, communications, travel and entertainment and other office costs (representing 15% of the decrease).

Depreciation and amortization. Depreciation and amortization of property and equipment for the year ended December 31, 2002 increased 2% to $49.6 million as compared to $48.6 million for the year ended December 31, 2001. The increase is attributable to a 6% increase in depreciation and amortization expense relating to network and service point assets, including the deployment of six additional network access points during 2001. The increase in depreciation and amortization related to network assets was partially offset by a 5% decrease in depreciation and amortization related to non-network assets. This decrease was primarily due to retirements and write-downs of assets during 2001 and 2002.

Other expense. Other expense consists of interest income, interest and financing expense, investment losses and other non-operating expenses. Other expense for the year ended December 31, 2002 decreased to $3.4 million from $27.6 million for the year ended December 31, 2001. This decrease was primarily due to losses incurred during 2001 on our investments in 360networks, Inc. and Aventail Corporation of $14.5 million and $4.8 million, respectively, and the $6.0 million provision we recorded on a note receivable. During 2002, our other expense items consisted of $1.2 million in losses related to our equity-method investment and $2.2 million of interest, which increased approximately $900,000 during 2002 as compared to 2001 due primarily to lower interest income on reduced cash balances.

Liquidity and Capital Resources

Cash Flow for the Years Ended December 31, 2003, 2002, and 2001

Net cash used in operating activities. Net cash used in operating activities was $11.1 million for the year ended December 31, 2003, and was primarily due to the net loss of $33.0 million adjusted for non-cash items of $40.8 million, an increase in accounts receivable of $2.7 million, a decrease in accounts payable of $5.9 million, a decrease in deferred revenue of $4.5 million, a decrease in accrued restructuring costs of $7.2 million and a decrease in accrued liabilities of $1.1 million. These uses of cash were offset by a $2.5 million decrease in prepaid and other assets. The increase in receivables at December 31, 2003 compared to December 31, 2002 was related to the 5% increase in revenue compared to the prior year as day's sales outstanding remained constant at 38 days. The decrease in payables is primarily related to a lower overall level of operating expenses in 2003 compared to 2002.

Net cash used in operating activities was $40.3 million for the year ended December 31, 2002, and was primarily due to the net loss of $72.3 million adjusted for non-cash items of $58.0 million, an increase in accounts receivable of $2.4 million, a decrease in accounts payable of $0.8 million, a decrease in deferred revenue of $4.3 million, a decrease in accrued restructuring costs of $15.3 million and a decrease in accrued liabilities of $3.9 million. These uses of cash were offset by a $0.7 million decrease in prepaid and other assets. The increase in receivables was related to higher overall revenue offset by a seven-day improvement in day's sales outstanding compared to the prior year. The decrease in payables is primarily related to a lower overall level of operating expenses in 2002 compared to 2001.

Net cash used in operating activities was $123.0 million for the year ended December 31, 2001 and was primarily due to the net loss of $479.2 million adjusted for non-cash items of $325.7 million, a decrease in accounts payable of $8.5 million, a decrease in deferred revenue of $2.2 million and a decrease in accrued liabilities of $3.1 million. These uses of cash were partially offset by decreases in receivables of $0.7 million and an increase in accrued restructuring costs of $39.3 million. The decreases in accounts payable and accrued liabilities are a result of our efforts to streamline operations during 2001, resulting in lower monthly operating costs in the final quarter of 2001. The accounts receivable decrease is largely a result of improved collections during 2001. Day's sales outstanding were 62 days at December 31, 2000, and reached 65 days during the first half of 2001,

ending 2001 at 45 days. The decrease in prepaid expenses is due to our focus on cash flow during 2001 and a related reduction in prepayment activities.

Net cash provided by investing activities. Net cash provided by investing activities for the year ended December 31, 2003 was $0.6 million and primarily consisted of net cash received from acquired businesses of $2.3 million and a reduction in restricted cash of $2.1 million, partially offset by purchases of property and equipment of $3.8 million. The purchase of property and equipment related to the purchase of assets for our network infrastructure and the cost related to the relocation of nine network access points. We expect the purchase of property and equipment will increase during 2004 as we continue to enhance and expand our service offerings.

Net cash provided by investing activities was $9.6 million for the year ended December 31, 2002 and was primarily from proceeds of $18.7 million received on the redemption or maturity of investments. Cash received was partially offset by $8.6 million used for purchases of property and equipment and $1.3 million contributed to our joint venture investment, Internap Japan. Of the $8.6 million used for purchases of property and equipment, $5.8 million related to the purchase of assets from our primary provider of leased networking equipment as part of terms of an amendment to our master lease arrangement with the lessor.

Net cash provided by investing activities was $12.3 million for the year ended December 31, 2001 and was primarily from proceeds of $62.0 million received on the redemption or maturity of investments and $6.1 million received from restricted cash related to a real estate settlement of a corporate office facility. As part of the settlement, the lessor was paid from a restricted cash deposit. Cash provided from investing activities was offset by $32.1 million used for purchases of property and equipment and $22.7 million used to purchase investments. The purchases of property and equipment primarily represent leasehold improvements and infrastructure purchases for our colocation facilities that were not financed through lease facilities. The majority of the cash paid for purchases of property and equipment occurred during the first two quarters of 2001 to complete certain colocation facilities under construction during 2000. In connection with the restructuring plan adopted by management during February 2001, capital spending for new colocation facilities was significantly reduced.

Net cash provided by (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. See "Liquidity" below. Net cash provided by financing activities for the year ended December 31, 2003 was $4.2 million. Cash provided included net proceeds from issuance of common stock of $9.3 million and proceeds from exercise of stock options and warrants of $4.0 million. Net cash provided by financing activities was reduced by principal payments on notes payable of $4.6 million, payments on capital lease obligations of $2.9 million and a $1.6 million reduction in our revolving credit facility.

Net cash used in financing activities for the year ended December 31, 2002 was $7.7 million. Cash used included $10.3 million related to payments on capital lease obligations and $3.4 million for payments of notes payable. These uses were offset by proceeds of $0.4 million related to exercises of stock options and warrants and $0.7 million related to the sale of common stock, including stock issued to employees pursuant to the Amended and Restated 1999 Employee Stock Purchase Plan. During 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 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.

Net cash provided by financing activities for the year ended December 31, 2001 was $72.1 million, primarily related to a $95.6 million issuance of Series A convertible preferred stock, net of issuance costs, and $2.2 million in proceeds from the issuance of common stock and the exercise of stock options. Net cash provided by financing activities was offset by $23.4 million in payments on capital leases and $2.3 million paid on a note payable. Net proceeds from financing activities were primarily used to fund operating losses during 2001 and, to a lesser extent, for purchases of property and equipment.

Capital equipment leases have been used since inception to finance the majority of our networking equipment located in our network access points other than leasehold improvements related to our colocation facilities. Payments under capital lease agreements totaled $2.9 million, $10.3 million and $23.4 million for the years ended December 31, 2003, 2002 and 2001, respectively.

On September 14, 2001, we completed a $101.5 million private placement of units at a per unit price of $1.60 per unit and issued an aggregate of 63,429,976 units, with each unit consisting of 1/20 of a share of series A preferred stock and a warrant to purchase 1/4 of a share of common stock, resulting in the issuance of 3,171,499 shares of series A preferred stock and 17,113,606 warrants to purchase equivalent shares of common stock at an exercise price of $1.48256 per share, which are exercisable for a period of five years.

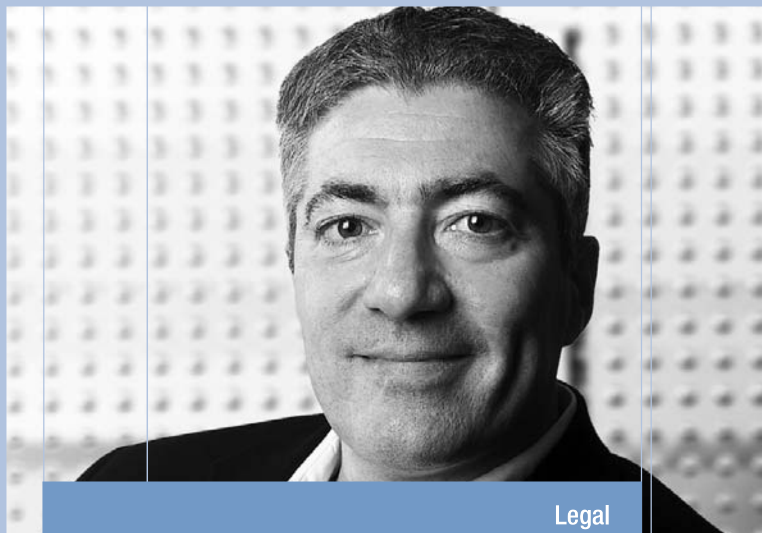
In August 2003, we completed the sale, pursuant to a private placement, of 10,650,000 shares of our common stock, par value $0.001 per share, at a price of $0.95 per share. We received $9.3 million, net of issuance costs.

Liquidity

We have incurred net losses in each quarterly and annual period since we began operations in May 1996. We incurred net losses of $33.0 million, $72.3 million and $479.2 million for the years ended December 31, 2003, 2002 and 2001, respectively. As of December 31, 2003, our accumulated deficit was $829.5 million. We expect to incur additional operating losses in the future, and we cannot guarantee that we will become profitable. Even if we achieve profitability, given the competitive and evolving nature of the industry in which we operate, we may not be able to sustain or increase profitability on a quarterly or annual basis, and our failure to do so would adversely affect our business, including our ability to raise additional funds.

We have experienced negative operating cash flow and have depended upon equity and debt financings, as well as borrowings under our credit facilities, to meet our cash requirements in each quarterly and annual period since we began our operations in May 1996. We expect to meet our cash requirements in 2004 through a combination of existing cash, cash equivalents and short-term investments, borrowings under our credit facilities and proceeds from our recently completed public offering in March of 2004. 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 our cash requirements vary materially from those currently planned, if our cost reduction initiatives have unanticipated adverse effects on our business, 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 that we will be able to obtain additional financing on commercially favorable terms, or at all. Provisions in our existing credit facility and the terms of our series A preferred stock limit our ability to incur additional indebtedness. Our credit facility with Silicon Valley Bank of $20.0 million expires on October 22, 2004 and we are currently negotiating its renewal. Under our credit facility as of December 31, 2003, we had $3.3 million and $8.4 million outstanding under the term loan and revolving credit facility, respectively. We cannot assure you that this credit facility will be renewed upon expiration on commercially favorable terms. We believe we have sufficient cash to operate our business plan for the foreseeable future.

Public offering. On March 4, 2004, we sold 40,250,000 shares of our common stock in a public offering at a purchase price of $1.50 per share which resulted in net proceeds to us of $56 million, after deducting underwriting



Walter DeSocio

"Ethical conduct is at the core of our business. To this end, we continually look to strengthen our corporate governance processes and accountability to our stakeholders."

Walter DeSocio, Chief Administrative Officer and General Counsel

discounts and commissions and estimated offering expenses. We intend to use the net proceeds from the offering for general corporate purposes. General corporate purposes may include capital investments in our network access point infrastructure and systems, repayment of debt and capital lease obligations and potential acquisitions of complementary businesses or technologies.

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. Network commitments primarily represent purchase commitments made to our largest bandwidth vendors and, to a lesser extent, contractual payments to license colocation space used for resale to customers. Our ability to improve cash used in operations in the future would be negatively impacted if we do not grow our business at a rate that would allow us to offset the service commitments with corresponding revenue growth.

The following table summarizes our credit obligations and future contractual commitments (in thousands, as of December 31, 2003):

	Payments Due by Period				
	Total	Less than 1 year	Years 1 to 3	Years 3 to 5	After 5 years
Revolving credit facility	$ 8,392	$ 8,392	$ –	$ –	$ –
Notes payable	5,431	3,067	2,364	–	–
Capital lease obligations	38,138	12,582	14,839	2,455	8,262
Operating lease commitments	130,059	13,175	22,483	21,486	72,915
Service commitments(1)	57,353	22,490	20,457	10,105	4,301
Total	$239,373	$59,706	$60,143	$34,046	$85,478

(1) One of our service commitment contracts with an Internet network service provider, representing $8.0 million of scheduled minimum payments in 2004 and $1.0 million in 2005, includes a provision allowing us to defer portions of our minimum commitments into future periods in the event we do not meet annual contract minimums.

Credit facility. We have a loan and security agreement with a $15.0 million revolving credit facility and a $5.0 million term loan with Silicon Valley Bank. Availability under the revolving credit facility and term loan is based on 80% of eligible accounts receivable plus 50% of unrestricted cash and investments. In addition, the loan and security agreement will make available to us an additional $5.0 million under a term loan if we meet certain debt coverage ratios. The balance outstanding under the term loan was $3.3 million at December 31, 2003, while the balance under the revolving credit facility was $8.4 million. As of December 31, 2003, we had no further borrowing capacity under the revolving credit facility. As of December 31, 2003, the variable interest rate under the revolving credit facility was 6.0% and the interest rate under the term loan is fixed at 8.0%. This credit facility expires on October 22, 2004. There can be no assurance that the credit facility will be renewed upon expiration or that we will be able to obtain credit facilities on commercially favorable terms.

The credit facility contains certain covenants, including covenants that require us to maintain a minimum tangible net worth and that restrict our ability to incur further indebtedness. As of December 31, 2003, we were in compliance with the covenants under our credit facility.

Common and preferred stock. On September 14, 2001, we completed a $101.5 million private placement of series A preferred stock and warrants to purchase shares of our common stock. The terms of the series A preferred stock contain restrictions that limit our ability to incur additional debt without the consent of the holders of the series A preferred stock. If we required additional debt financing in the future, we cannot assure you that we will be able to obtain the consent of the series A preferred stockholders.

On August 22, 2003, we completed a private placement of 10,650,000 shares of our common stock at a price of $0.95 per share. We received $9.5 million, net of issuance costs. Because we issued shares of our common stock in the private placement at a price below the conversion price of the series A preferred stock at that time, the number of shares of common stock into which the outstanding shares of series A preferred stock are convertible increased by 34.5 million shares. In accordance with generally accepted accounting principles, we recorded a deemed dividend of $34.6 million, which is attributable to the additional incremental number of shares of the series A preferred stock convertible into common stock. If we offer our common stock in the future at a price below $0.95 per share, the conversion price of our series A preferred stock will adjust to that lower price and the number of shares of common stock into which shares of our series A preferred stock are convertible will again increase.

During the year ended December 31, 2003, series A preferred stockholders converted 1,526,321 shares of series A preferred stock into 50,621,204 shares of common stock at a recorded value of $41.5 million. As of December 31, 2003, we had 1,751,385 shares of series A preferred stock outstanding with a recorded value of $51.8 million.

Lease facilities. Since our inception, we have financed the purchase of network routing equipment using capital leases with our primary supplier. Our future minimum lease payments on the capital lease obligations totaled $38.1 million at December 31, 2003. Of this total principal amount $12.6 million is to be paid over the next 12 months. We have fully utilized available funds under our lease facilities.

In April 2003, we amended the terms of our master lease agreement with our primary supplier. Specifically, the lease amendment provides for adjustments to our required minimum quarterly revenue levels and minimum quarterly earnings before interest, taxes, depreciation and amortization levels. Under the lease amendment we paid $2.2 million on April 15, 2003, which represented an advance payment of our lease payments due in March and April 2004. The terms of our master lease agreement, as amended, include financial covenants that require us to maintain minimum liquidity balances, minimum revenue levels, specified levels of earnings before interest, taxes, depreciation and amortization and other customary covenants. On September 4, 2003, we entered into an additional agreement to further amend our equipment lease obligations with our primary supplier. This lease amendment provided for additional adjustments to our required minimum quarterly levels of earnings before interest, taxes, depreciation and amortization and also provided for the removal of the requirement to maintain compliance with all financial covenants when we resume lease payments. This lease amendment also required us to issue 213,675 shares of common stock to our primary supplier having an aggregate value of $250,000 based on the closing price of our common stock on September 3, 2003. The value of the common stock issued was recorded as an additional discount to the initial capital lease obligation and the discount is being amortized over the remaining lease term. If we are unable to meet the requirements of the revised covenants under the lease or make payments when due, our primary supplier could immediately demand all remaining payments due under the lease agreement.

Restructuring and Impairment Costs

2001 restructuring charge. During 2001, due to the overcapacity created in the Internet connectivity market and Internet Protocol Services market, we announced

David Abrahamson and Allen Tothill

"An expanded product portfolio and continued investments in our sales force allowed us to achieve a significant increase in the number of new clients during 2003."

David Abrahamson, Chief Marketing Officer

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. As part of the 2001 restructuring activity, 313 employees were involuntarily terminated. Employee separations occurred in all departments. The majority of the costs related to the termination of employees in 2001 were paid during 2001. The total charges include restructuring costs of $71.6 million. During 2001, we incurred cash restructuring expenditures totaling $19.9 million, non-cash restructuring expenditures of $4.7 million, and we reduced the original 2001 restructuring charge 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 2001 restructuring charge 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 colocation lease obligations on terms more favorable than our original restructuring estimates. The third quarter 2002 reduction was primarily due to returning the previously restructured Atlanta, Georgia facility into service as the site of the new corporate headquarters. Pursuant to the original restructuring plans, the Atlanta facility was not to be used by us in the future. However, due to changes in management, corporate direction, and other factors, which 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 charge. With the continuing overcapacity created in the Internet connectivity market and Internet Protocol Services market, during 2002, we implemented 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 during 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 2002 restructuring charge are $1.1 million of personnel costs related to a reduction in force of approximately 145 employees. This represents employee severance payments made during 2002.

2003 restructuring costs. For the year ended December 31, 2003, we incurred approximately $1.1 million in restructuring costs which primarily represented retention bonuses and moving expenses related to the relocation of our corporate headquarters to Atlanta, Georgia. We continue to evaluate our restructuring reserve as plans are being executed, which could result in additional charges in future periods.

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 colocation license obligations. Accordingly, we recorded real estate related restructuring costs of $43.0 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. These costs were determined based upon our estimate of anticipated sublease rates and time to sublease the facilities. 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 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.

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

The following table displays the activity and balances for restructuring and asset impairment activity for 2001 (in millions):

	Charge	Cash Reductions	Non-cash Write-downs	Non-cash Plan Adjustments	December 31, 2001 Restructuring Liability
Restructuring costs					
Real estate obligations	$ 60.0[a]	$(14.7)[a]	$ (3.7)	$(7.0)	$34.6
Employee separations	3.3	(3.2)	–	–	0.1
Network infrastructure obligations	6.3	(1.9)	(1.0)	(0.7)	2.7
Other	2.0	(0.1)	–	–	1.9
Total restructuring costs	71.6	(19.9)	(4.7)	(7.7)	39.3
Asset impairments					
Goodwill	176.1	–	(176.1)	–	–
Assembled workforce	1.5	–	(1.5)	–	–
Trade name and trademarks	2.2	–	(2.2)	–	–
Completed real estate leases	14.8	–	(14.8)	–	–
Customer relationships	1.4	–	(1.4)	–	–
Total asset impairments	196.0	–	(196.0)	–	–
Total	$267.6	$(19.9)	$(200.7)	$(7.7)	$39.3

(a) Includes the use of $6.0 million in restricted cash related to payment of a lease deposit on our corporate office space.

Of the $71.6 million recorded during 2001 as restructuring reserves, approximately $50.7 million related to the direct cost of network, $1.1 million related to customer support, $0.3 million related to product development, $1.5 million related to sales and marketing and $18.0 million related to general and administrative costs.

The following table displays the activity and balances for restructuring and asset impairment activity for 2002 (in millions):

	December 31, 2001 Restructuring Liability	Restructuring and Impairment Charges	Cash Reductions	Non-cash and Write-downs	Non-cash Plan Adjustments	December 31, 2002 Restructuring Liability
Restructuring costs activity for 2001 restructuring charge –						
Real estate obligations	$34.6	$ –	$(11.2)	$(1.6)	$(12.2)	$ 9.6
Network infrastructure obligations	2.7	–	(1.4)	–	–	1.3
Other	2.0	–	(0.9)	–	–	1.1
Restructuring costs activity for 2002 restructuring charge –						
Real estate obligations	–	2.2	(0.4)	–	–	1.8
Personnel	–	1.1	(1.1)	–	–	–
Other	–	0.2	(0.1)	–	–	0.1
Total	39.3	3.5	(15.1)	(1.6)	(12.2)	13.9
Net asset write-downs for 2002 restructuring charge	–	4.1	–	(4.3)	–	(0.2)
Total	$39.3	$7.6	$(15.1)	$(5.9)	$(12.2)	$13.7

Of the $3.5 million recorded during 2002 as restructuring reserves, approximately $212,000 related to the direct cost of network and $3.3 million related to general and administrative costs.

The following table displays the activity and balances for restructuring and asset impairment activity for 2003 (in millions):

	December 31, 2002 Restructuring Liability	Restructuring Charges	Cash Reductions	December 31, 2003 Restructuring Liability
Restructuring costs activity for 2001 restructuring charge –				
Real estate obligations	$ 9.6	$ –	$(5.2)	$4.4
Network infrastructure obligations	1.3	–	(0.1)	1.2
Other	1.1	–	(0.1)	1.0
Restructuring costs activity for 2002 restructuring charge –				
Real estate obligations	1.8	–	(1.8)	–
Personnel	–	1.1	(1.1)	–
Other	0.1	–	(0.1)	–
Total restructuring costs	13.9	1.1	(8.4)	6.6
Net asset write-downs for 2002 restructuring charge	(0.2)	–	–	(0.2)
Total	$13.7	$1.1	$(8.4)	$6.4

Off-Balance Sheet Arrangements

As of December 31, 2003, we did not have any arrangements that would qualify as an off-balance sheet arrangement.

Quantitative and Qualitative Disclosures about Market Risk

Cash and cash equivalents. We maintain cash and short-term deposits at our financial institutions. Due to the short-term nature of our deposits, they are recorded on the balance sheet at fair value. As of December 31, 2003, all of our cash equivalents mature within three months and our short-term investments generally mature in less than one year.

Investments. We have a $1.2 million equity investment in Aventail, an early stage, privately held company, after having reduced the balance for an impairment loss of $4.8 million in 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. Because of risk associated with this investment, we could lose our entire initial investment in Aventail. Furthermore, we have invested $4.1 million in Internap Japan, our joint venture with NTT-ME Corporation. This investment is accounted for using the equity method and to date we have recognized $3.2 million in equity-method losses, representing our proportionate share of the aggregate joint venture losses. Furthermore, the joint venture investment 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.

Notes payable. As of December 31, 2003 we had notes payable recorded at their present value of $5.1 million bearing a rate of interest which we believe is commensurate with their associated market risk.

Capital leases. As of December 31, 2003 we had capital leases recorded at $24.3 million reflecting the present value of future lease payments. We believe the interest rates used in calculating the present values of these lease payments are a reasonable approximation of fair value and their associated market risk is minimal.

Credit facility. As of December 31, 2003 we had $8.4 million outstanding under our revolving credit facility with Silicon Valley Bank and $3.3 million outstanding under the term loan portion of that same facility included in notes payable above. The interest rate under the revolving credit facility is variable and was 8% at December 31, 2003. Interest under the term loan portion is fixed at 8%. We believe these interest rates are reasonable approximations of fair value and the market risk is minimal.

Interest rate risk. Our objective in managing interest rate risk is to maintain a balance of fixed and variable rate debt that will lower our overall borrowing costs within reasonable risk parameters. Currently, our strategy for managing interest rate risk does not include the use of derivative securities.

Foreign currency risk. 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.

CONSOLIDATED BALANCE SHEETS

December 31,	2003	2002
(In thousands)		
ASSETS		
Current assets:		
Cash and cash equivalents	$ 18,885	$ 25,219
Restricted cash	125	–
Accounts receivable, net of allowance of $2,429 and $1,595, respectively	15,587	15,232
Inventory	492	–
Prepaid expenses and other assets	4,245	5,632
Total current assets	39,334	46,083
Property and equipment, net	59,337	88,394
Restricted cash	–	2,053
Investments	2,371	3,047
Intangible assets, net of accumulated amortization of $16,941 and $13,578, respectively	3,488	3,557
Goodwill	36,163	27,022
Deposits and other assets	1,758	2,813
Total assets	$142,451	$172,969
LIABILITIES, CONVERTIBLE PREFERRED STOCK AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 7,556	$ 13,247
Accrued liabilities	8,585	11,020
Deferred revenue, current portion	3,674	6,850
Notes payable, current portion	2,790	4,514
Revolving credit facility	8,392	10,000
Capital lease obligations, current portion	8,770	2,831
Restructuring liability, current portion	1,965	6,574
Total current liabilities	41,732	55,036
Deferred revenue, less current portion	316	1,317
Notes payable, less current portion	2,275	5,196
Capital lease obligations, less current portion	15,537	22,717
Restructuring liability, less current portion	4,441	7,078
Total liabilities	64,301	91,344
Commitments and contingencies (Note 14)		
Series A convertible preferred stock, $0.001 par value, 3,500 shares designated, 2,931 shares outstanding	–	79,790
Stockholders' equity:		
Common stock, $0.001 par value, 600,000 shares authorized, 228,751 and 160,094 shares issued and outstanding, respectively	229	160
Series A convertible preferred stock, $0.001 par value, 3,500 shares designated, 1,751 shares outstanding, liquidation preference of $56,032	51,841	–
Additional paid-in capital	855,240	798,344
Deferred stock compensation	–	(396)
Accumulated deficit	(829,460)	(796,422)
Accumulated items of other comprehensive income	300	149
Total stockholders' equity	78,150	1,835
Total liabilities, convertible preferred stock and stockholders' equity	$142,451	$172,969

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

CONSOLIDATED STATEMENTS OF OPERATIONS

Year Ended December 31,	2003	2002	2001
(In thousands, except per share amounts)			
Revenues	$138,580	$132,487	$ 117,404
Costs and expenses:			
Direct cost of network, exclusive of depreciation shown below	75,730	83,207	98,915
Customer support	9,045	12,913	21,480
Product development	6,923	7,447	12,233
Sales and marketing	18,429	21,641	38,151
General and administrative	20,032	20,848	44,491
Depreciation and amortization	33,892	49,600	48,550
Amortization of goodwill and other intangible assets	3,352	5,626	38,116
Amortization of deferred stock compensation	390	260	4,217
Pre-acquisition liability adjustment	(1,313)	–	–
Lease termination expense	–	804	–
Restructuring costs (benefits)	1,084	(3,781)	64,096
Impairment of goodwill and other intangible assets	–	–	195,986
(Gain) loss on sales and retirements of property and equipment	(53)	2,829	2,714
Total operating costs and expenses	167,511	201,394	568,949
Loss from operations	(28,931)	(68,907)	(451,545)
Other expense:			
Interest expense, net	(3,280)	(2,194)	(1,272)
Loss on investments	(827)	(1,244)	(26,345)
Total other expense	(4,107)	(3,438)	(27,617)
Net loss	(33,038)	(72,345)	(479,162)
Less deemed dividend related to beneficial conversion feature	(34,576)	–	–
Net loss attributable to common stockholders	$ (67,614)	$ (72,345)	$(479,162)
Basic and diluted net loss per share	$ (0.39)	$ (0.47)	$ (3.19)
Weighted average shares used in computing basic and diluted net loss per share	174,602	155,545	150,328

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

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY AND COMPREHENSIVE LOSS

(In thousands)	Common Stock Shares	Common Stock Par Value	Series A Convertible Preferred Stock Shares	Series A Convertible Preferred Stock Par Value	Additional Paid-In Capital	No Par Value Common Stock	Deferred Stock Compensation	Accumulated Deficit	Accumulated Items of Comprehensive Income (Loss)	Total Stockholders' Equity	Comprehensive Loss
Balance, January 1, 2001	148,779	$ –	–	$ –	$ –	$786,183	$(11,715)	$(244,915)	$2,400	$531,953	
Amortization of deferred stock compensation	–	–	–	–	–	(1,893)	6,110	–	–	4,217	
Reversal of deferred stock compensation for terminated employees	–	–	–	–	–	(1,234)	1,234	–	–	–	
Sale of stock through the Employee Stock Purchase Plan	1,292	–	–	–	–	1,745	–	–	–	1,745	
Exercise of employee stock options	1,223	–	–	–	–	440	–	–	–	440	
Issuance of common stock warrants in conjunction with Series A financing	–	–	–	–	–	9,321	–	–	–	9,321	
Issuance of warrants to purchase shares of common stock to non-employees	–	–	–	–	–	48	–	–	–	48	
Establishment of par value of common stock	–	151	–	–	794,459	(794,610)	–	–	–	–	
Comprehensive loss:											
Net loss	–	–	–	–	–	–	–	(479,162)	–	(479,162)	$(479,162)
Unrealized loss on investments	–	–	–	–	–	–	–	–	(16,883)	(16,883)	(16,883)
Realized loss on investments	–	–	–	–	–	–	–	–	14,490	14,490	14,490
Comprehensive loss, December 31, 2001	–	–	–	–	–	–	–	–	–	–	(481,555)
Balance, December 31, 2001	151,294	151	–	–	794,459	–	(4,371)	(724,077)	7	66,169	
Amortization of deferred stock compensation	–	–	–	–	(2,668)	–	2,928	–	–	260	
Reversal of deferred stock compensation for terminated employees	–	–	–	–	(1,047)	–	1,047	–	–	–	
Sale of stock through the Employee Stock Purchase Plan	1,599	2	–	–	696	–	–	–	–	698	
Exercise of options and warrants to purchase common stock	1,915	2	–	–	275	–	–	–	–	277	
Conversion of Series A preferred stock to common stock	5,174	5	–	–	6,518	–	–	–	–	6,523	
Issuance and exercise of warrants to purchase common stock to non-employees	112	–	–	–	111	–	–	–	–	111	
Comprehensive loss:											
Net loss	–	–	–	–	–	–	–	(72,345)	–	(72,345)	(72,345)
Realized loss on investments	–	–	–	–	–	–	–	–	(7)	(7)	(7)
Unrealized gain on investments	–	–	–	–	–	–	–	–	149	149	149
Comprehensive loss, December 31, 2002	–	–	–	–	–	–	–	–	–	–	(72,203)
Balance, December 31, 2002	160,094	160	–	–	798,344	–	(396)	(796,422)	149	1,835	
Conversion of Series A convertible preferred stock into common stock before reclassification to stockholders' equity	953	1	–	–	1,201	–	–	–	–	1,202	
Reclassification of preferred stock to stockholders' equity	–	–	2,888	78,589	–	–	–	–	–	78,589	
Conversion of Series A convertible preferred stock into common stock after reclassification to stockholders' equity	49,668	50	(1,483)	(40,338)	40,288	–	–	–	–	–	
Amortization of deferred stock compensation and reversal for terminated employees	–	–	–	–	(6)	–	396	–	–	390	
Exercise of options to purchase common stock	1,908	2	–	–	1,721	–	–	–	–	1,723	
Sale of stock through the Employee Stock Purchase Plan	1,781	2	–	–	363	–	–	–	–	365	
Issuance of common stock to investors	10,650	11	–	–	9,288	–	–	–	–	9,299	
Issuance of common stock to lessor	214	–	–	–	250	–	–	–	–	250	
Issuance and exercise of warrants to purchase common stock to non-employees	2,062	2	–	–	1,942	–	–	–	–	1,944	
Issuance of stock in conjunction with acquisition of netVmg	–	–	346	13,590	–	–	–	–	–	13,590	
Issuance of stock in conjunction with acquisition of Sockeye	1,421	1	–	–	1,849	–	–	–	–	1,850	
Record embedded beneficial conversion feature charge related to Series A preferred stock	–	–	–	(34,576)	34,576	–	–	–	–	–	
Amortize deemed dividend related to beneficial conversion feature	–	–	–	34,576	(34,576)	–	–	–	–	–	
Comprehensive loss:											
Net loss	–	–	–	–	–	–	–	(33,038)	–	(33,038)	(33,038)
Unrealized gain on investments	–	–	–	–	–	–	–	–	151	151	151
Comprehensive loss, December 31, 2003	–	–	–	–	–	–	–	–	–	–	$ (32,887)
Balance, December 31, 2003	228,751	$229	1,751	$51,841	$855,240	$ –	$ –	$(829,460)	$ 300	$ 78,150	

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

Year Ended December 31,	2003	2002	2001
(In thousands)			
Cash flows from operating activities:			
Net loss	$(33,038)	$(72,345)	$(479,162)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation and amortization	37,244	55,226	86,666
Impairment of goodwill and other intangible assets	–	–	195,986
(Gain) loss on disposal of assets	(53)	2,829	2,714
Non-cash restructuring costs (adjustments)	–	(4,602)	4,714
Non-cash interest expense on capital lease obligations	1,304	702	–
Pre-acquisition liability adjustment	(1,313)	–	–
Provision for doubtful accounts	2,435	1,902	4,798
Provision for notes receivable	–	–	6,000
Loss on write-down of deposits related to a lease termination	–	474	–
Loss on write-down of investment	–	–	4,824
Loss on sale of investment security	–	–	14,490
Loss on equity-method investment	827	1,244	1,216
Non-cash expense related to warrants issued	–	–	48
Non-cash compensation expense	390	260	4,217
Changes in operating assets and liabilities, net of the effect of acquisitions:			
Accounts receivable	(2,704)	(2,385)	744
Inventory	43	–	–
Prepaid expenses and other assets	2,540	712	4,248
Accounts payable	(5,941)	(802)	(8,477)
Deferred revenue	(4,461)	(4,335)	(2,228)
Accrued restructuring	(7,246)	(15,284)	39,271
Accrued liabilities	(1,115)	(3,857)	(3,117)
Net cash used in operating activities	(11,088)	(40,261)	(123,048)
Cash flows from investing activities:			
Net cash received from acquired businesses	2,307	–	–
Purchases of property and equipment	(3,799)	(8,632)	(32,094)
Proceeds from disposal of property and equipment	–	434	1,880
Purchase of investments	–	–	(22,729)
Investment in equity-method investee	–	(1,347)	(2,833)
Redemption of investments	–	18,747	61,985
Reduction of restricted cash	2,053	379	6,083
Net cash provided by investing activities	561	9,581	12,292
Cash flows from financing activities:			
Proceeds from issuance of common stock, net of issuance costs	9,299	698	1,745
Proceeds from the issuance of Series A convertible preferred stock, net of issuance costs	–	–	95,635
Proceeds from exercise of stock options and warrants	4,035	388	440
Principal payments on notes payable	(4,645)	(3,420)	(2,317)
Change in revolving credit facility	(1,608)	5,000	–
Payments on capital lease obligations	(2,888)	(10,318)	(23,356)
Net cash provided by (used in) financing activities	4,193	(7,652)	72,147
Net decrease in cash and cash equivalents	(6,334)	(38,332)	(38,609)
Cash and cash equivalents at beginning of period	25,219	63,551	102,160
Cash and cash equivalents at end of period	$ 18,885	$ 25,219	$ 63,551

Supplemental disclosure of cash flow information:			
Cash paid for interest, net of amounts capitalized	$ 2,292	$ 3,264	$ 5,235
Non-cash adjustment to fixed assets and capital leases due to restructuring of capital lease obligation	$ –	$ 3,710	$ –
Impairment of fixed assets due to restructuring	$ –	$ 5,175	$ –
Equipment note transferred from revolving credit facility	$ –	$ 5,000	$ –
Prepayment of future lease obligation via note payable	$ –	$ 3,300	$ –
Accrued expenses transferred to a note payable	$ –	$ 1,838	$ –
Purchase of property and equipment financed with capital leases	$ 125	$ 930	$ 18,511
Forfeiture of deposits to restructuring	$ –	$ 558	$ –
Change in accounts payable attributable to purchases of property and equipment	$ (7)	$ (991)	$ (5,311)
Non-cash cost of issuing Series A convertible preferred stock	$ –	$ –	$ 500
Conversion of preferred stock to common stock	$ 41,540	$ 6,523	$ –
Items of other comprehensive income	$ 151	$ 142	$ 7
Issuance of stock related to capital lease amendment	$ 250	$ –	$ –

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

1 DESCRIPTION OF THE COMPANY

Internap Network Services Corporation ("Internap," "we," "us," "our" or the "Company") provides high performance, managed Internet connectivity solutions to business customers who require guaranteed network availability and high performance levels for business-critical applications, such as e-commerce, video and audio streaming, Voice over Internet Protocol, virtual private networks and supply chain management. We deliver services through our 29 network access points, which feature multiple direct high-speed connections to major Internet networks. Our proprietary route optimization technology monitors the performance of these Internet networks and allows us to intelligently route our customers' Internet traffic over the optimal Internet path in a way that minimizes data loss and network delay. We believe this approach provides better performance, control, predictability and reliability than conventional Internet connectivity providers. Our service level agreements guarantee performance across the entire Internet in the United States, excluding local connections, whereas conventional Internet connectivity providers typically only guarantee performance on their own network. We provide services to customers in various industry verticals, including financial services, media and communications, travel, e-commerce and retail and technology. As of December 31, 2003, we provided our services to over 1,600 customers in the United States and abroad, including approximately 70 customers in the Fortune 1000 companies.

Our high-performance Internet connectivity services are available at speeds ranging from fractional T-1 (256 kbps) to OC-12 (622 mbps), and Ethernet Connectivity from 10 mbps to 1,000 mbps (Gigabit Ethernet) from Internap's 29 network access points to customers. We provide our connectivity services through the deployment of network access points, which are redundant network infrastructure facilities coupled with our proprietary routing technology. Network access points maintain high-speed, dedicated connections to major global Internet networks, commonly referred to as backbones. As of December 31, 2003, we operated 29 network access points in 17 major metropolitan market areas.

Through our recent acquisitions of netVmg, Inc. and Sockeye Networks, Inc., we have extended the reach of our high-performance connectivity capabilities from our network access points to the customer's premises through a hardware and software route optimization product we refer to as our Flow Control Platform. This product enables customers to manage Internet traffic cost, performance and operational decisions directly from their corporate locations. Our Flow Control Platform is designed for large businesses that choose either to manage their Internet services with in-house information technology expertise or outsource these services to us.

During 2001, we changed the state of our incorporation from Washington to Delaware by merging Internap Network Services Corporation with and into our newly formed, wholly owned Delaware subsidiary, Internap Delaware, Inc. Upon consummation of the merger, stockholders of Internap Network Services Corporation became stockholders of Internap Delaware, Inc. and Internap Delaware's name was changed to Internap Network Services Corporation. As part of the reincorporation, the number of authorized shares of common and series A preferred stock changed to 600,000,000 and 3,500,000, respectively, and par value of $0.001 per share of common stock and preferred stock was established.

During December 1999, we formed a wholly owned subsidiary in the United Kingdom, Internap Network Services U.K. Limited, and during June 2000, we formed a wholly owned subsidiary in the Netherlands, Internap Network Services B.V. During 2002, we discontinued our operations in Amsterdam and are providing service to our Amsterdam customers from our London service point. The consolidated financial statements of Internap Network Services Corporation include all activity of these subsidiaries since their dates of incorporation forward. Foreign exchange gains and losses have not been material to date.

We have a limited operating history and our operations are subject to certain risks and uncertainties frequently encountered by rapidly evolving markets. These risks include the failure to develop or supply technology or services, the ability to obtain adequate financing, competition within the industry and technology trends.

We have experienced significant net operating losses since inception. During 2003, we incurred net losses of $33.0 million and used $11.1 million of cash in our operating activities. As of December 31, 2003, we have an accumulated deficit of $829.5 million. We have taken various steps to control our costs, including decreasing the size of our workforce, terminating certain real estate leases and commitments, making process enhancements and renegotiating network contracts for more

favorable pricing and terms. We expect operating losses will continue through December 31, 2004.

As discussed in Note 18, we have recently sold additional common stock resulting in net proceeds to us of approximately $56 million. We expect this capital, along with our improved operating performance, to be sufficient to meet our cash requirements for the foreseeable future. Our liquidity and capital requirements depend on several factors, including the rate of market acceptance of our services, the ability to expand and retain our customer base, our ability to execute our current business plan and other factors. 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 such financing will be available on commercially favorable terms.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND BASIS OF PRESENTATION

Accounting principles

The consolidated financial statements and accompanying notes are prepared in accordance with accounting principles generally accepted in the United States of America. The consolidated financial statements include the accounts of Internap and all majority owned subsidiaries. Significant inter-company transactions have been eliminated in consolidation.

Estimates and assumptions

Our consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates, including those related to revenue recognition, doubtful accounts, investments, intangible assets, income taxes, restructuring costs, long-term service contracts, contingencies and litigation. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ materially from these estimates.

Cash and cash equivalents

We consider all highly liquid investments purchased with an original or remaining maturity of three months or less at the date of purchase and money market mutual funds to be cash equivalents. We invest our cash and cash equivalents with major financial institutions and may at times exceed federally insured limits. We believe that the risk of loss is minimal. To date, we have not experienced any losses related to cash and cash equivalents.

At December 31, 2003 and 2002, we had placed approximately $125,000 and $2.1 million respectively, in restricted cash accounts to collateralize letters of credit with financial institutions. These amounts are reported separately as restricted cash and are classified as current or non-current assets, based on their respective maturity dates.

Investments

We account for investments without readily determinable fair values at historical cost, as determined by our initial investment. The recorded value of cost basis investments is periodically reviewed to determine the propriety of the recorded basis. When a decline in the value that is judged to be other than temporary has occurred based on available data, the cost basis is reduced and an investment loss is recorded.

We account for investments that provide us with the ability to exercise significant influence, but not control, over an investee using the equity method of accounting. Significant influence, but not control, is generally deemed to exist if we have an ownership interest in the voting stock of the investee of between 20% and 50%, although other factors, such as minority interest protections, are considered in determining whether the equity method of accounting is appropriate. As of December 31, 2003 and 2002, we have a single investment that qualifies for equity method accounting, our joint venture with NTT-ME Corporation of Japan. We record our proportional share of the losses of our investee one month in arrears on the consolidated balance sheets as a component of non-current investments and our share of the investee's losses as a component of loss on investment on the consolidated statements of operations.

Inventory

Inventory is carried at the lower of cost or market using the first-in, first-out method. Cost includes materials related to the production of our Flow Control Platform.

Fair value of financial instruments

Our short-term financial instruments, including cash and cash equivalents, accounts receivable, accounts payable, notes payable, capital lease obligations, and our revolving credit facility are carried at cost. The cost of our short-term financial instruments approximate fair value due to their relatively short maturities. The carrying value of our long-term financial instruments, including notes payable and capital lease obligations, approximate fair value as the interest rates approximate current market rates of similar debt obligations.

Property and equipment

Property and equipment are carried at original acquisition cost less accumulated depreciation. Depreciation is calculated on a straight-line basis over the lesser of the estimated useful lives of the assets or the duration of the underlying lease obligation or commitment. Estimated useful lives used for network equipment are three years, furniture, equipment and software are three to seven years, and leasehold improvements are the shorter of seven years or the duration of the lease. Lease obligations and commitment durations range from 24 months for certain networking equipment to 180 months for certain leasehold improvements. Additions and improvements that increase the value or extend the life of an asset are capitalized. Maintenance and repairs are expensed as incurred. Gains or losses from asset disposals are charged to operations.

Costs of computer software developed or obtained for internal use

In accordance with Statement of Position 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use," we capitalize certain direct costs incurred developing internal use software. During the year ended December 31, 2003, we did not capitalize any internal software development costs. During the years ended December 31, 2002 and 2001, we capitalized approximately $1.3 million and $3.0 million, respectively, of internal software development costs.

Goodwill and other intangible assets

Goodwill and other intangible assets consist of goodwill, covenants not to compete and developed technology recorded as a result of our acquisitions of VPNX.com, Inc, netVmg Inc., and Sockeye Networks Inc. We adopted Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets" during 2002. Accordingly, effective January 1, 2002, goodwill is not being amortized and is being reviewed for impairment on an annual basis, or more frequently if indications of impairment arise. We have determined that the remainder of our intangible assets have finite lives and we have recorded these assets at cost less accumulated amortization. Intangibles, other than goodwill, are being amortized on a straight-line basis over the economic useful life of the assets, generally three to seven years, except approximately $418,000 of capitalized patent costs, which are being amortized over 15 years.

Valuation of long-lived assets

Management periodically evaluates the carrying value of its long-lived assets, including, but not limited to, property and equipment pursuant to the guidance provided by SFAS No. 144, "Accounting for the Impairment and Disposal of Long-Lived Assets." The carrying value of a long-lived asset is considered impaired when the undiscounted cash flow from such asset is separately identifiable and is estimated to be less than its carrying value. In that event, a loss is recognized based on the amount by which the carrying value exceeds the fair value of the long-lived asset. Fair value is determined primarily using the anticipated cash flows discounted at a rate commensurate with the risk involved. Losses on long-lived assets to be disposed of would be determined in a similar manner, except that fair values would be reduced by the cost of disposal. Losses due to impairment of long-lived assets are charged to operations during the period in which the impairment is identified.

Income taxes

We account for income taxes under the liability method. Deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities, and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. We provide a valuation allowance to reduce our deferred tax assets to their estimated realizable value.

Stock-based compensation

On December 31, 2003, we had eight stock-based employee compensation plans, which are described more fully in Note 16. We account for those plans under the recognition and measurement principles of Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations. The following table illustrates the effect on net loss and loss per share if we had applied the fair value recognition provisions of SFAS No. 123,

"Accounting for Stock-Based Compensation," to stock-based employee compensation.

Year ended December 31, (In thousands, except per share amounts)	2003	2002	2001
Net loss attributable to common stockholders, as reported	$(67,614)	$(72,345)	$(479,162)
Add: stock-based employee compensation expense included in reported net loss	390	260	4,217
Deduct: total stock-based employee compensation expense determined under fair value based method for all awards	(8,362)	37,577	32,844
Pro forma net loss	$(75,586)	$(34,508)	$(442,101)
Loss per share:			
Basic and diluted– as reported	$ (0.39)	$ (0.47)	$ (3.19)
Basic and diluted– pro forma	$ (0.43)	$ (0.22)	$ (2.94)

The $8.4 million increase and the $37.6 million and $32.8 million reductions to the pro forma employee compensation expense during 2003, 2002 and 2001, respectively, were inclusive of reductions of $0.2 million, $115.1 million and $184.2 million, for the effect related to options cancelled as a result of employee terminations, offset by amortization of compensation determined under the fair-value based method.

Revenue recognition and concentration of credit risk

The majority of our revenue is derived from high-performance Internet connectivity and related colocation services. Our revenues are generated primarily from the sale of Internet connectivity services at fixed rates or usage-based pricing to our customers that desire a DS-3 or faster connection and other ancillary services, such as colocation, content distribution, server management and installation services, virtual private networking services, managed security services, data backup, remote storage and restoration services, and video conferencing services. We also offer T-1 and fractional DS-3 connections at fixed rates.

We recognize revenues when persuasive evidence of an arrangement exists, the service has been provided, the fees for the service rendered are fixed or determinable and collectibility is probable. Contracts and sales or purchase orders are generally used to determine the existence of an arrangement. We test for availability or use shipping documents when applicable to verify delivery of our product or service. We assess whether the fee is fixed or determinable based on the payment terms associated with the transaction and whether the sales price is subject to refund or adjustment.

Deferred revenues consist of revenues for services to be delivered in the future and consist primarily of advance billings, which are amortized over the respective service period, and billings for initial installation of customer network equipment, which are amortized over the estimated life of the customer relationship. Revenues associated with billings for installation of customer network equipment are deferred and amortized over the estimated life of the customer relationship, as the installation service is integral to our primary service offering and does not have value to a customer on a stand-alone basis.

We review the creditworthiness of our customers routinely. If we determine that collection of service revenues is uncertain, we do not recognize revenue until cash has been collected. Additionally, we maintain allowances for doubtful accounts resulting from the inability of our customers to make required payments on accounts receivable. We apply a credit risk rating system that is based on management's best understanding of our customers' ability to pay. Our assessment of customers' creditworthiness may include consideration of payment history. The sum of individual customer receivable balances multiplied by the credit rating is the basis for reserves against revenues and receivables. We also increase our reserve estimates for estimated customer credits. If the financial condition of our customers were to deteriorate, or management becomes aware of new information impacting a customer's credit risk, additional allowances may be required.

Product development costs

Product development costs are primarily related to network engineering costs associated with changes to the functionality of our proprietary services and network architecture. Such costs that do not qualify for capitalization are expensed as incurred. Research and development costs, which are included in product development cost, primarily consist of compensation cost related to our service development network architecture and are expensed as incurred. Research and development costs were approximately $1.5 million, $4.1 million and $6.3 million for the years ended December 31, 2003, 2002 and 2001, respectively.

Advertising costs

We expense all advertising costs as they are incurred. Advertising costs for 2003, 2002 and 2001 were $945,000, $575,000 and $4.5 million, respectively.

Net loss per share

Basic and diluted net loss per share has been computed using the weighted average number of shares of common stock outstanding during the period, less the weighted average number of unvested shares of common stock issued that are subject to repurchase. We have excluded all outstanding convertible preferred stock and outstanding options and warrants to purchase common stock from the calculation of diluted net loss per share, as such securities are antidilutive for all periods presented.

Year ended December 31,	2003	2002	2001
(In thousands, except per share amounts)			
Net loss	$(33,038)	$(72,345)	$(479,162)
Less deemed dividend related to beneficial conversion feature	(34,576)	–	–
Net loss attributable to common stockholders	$(67,614)	$(72,345)	$(479,162)
Basic and diluted:			
Weighted average shares of common stock outstanding used in computing basic and diluted net loss per share	174,602	155,545	150,328
Basic and diluted net loss per share	$ (0.39)	$ (0.47)	$ (3.19)
Antidilutive securities not included in diluted net loss per share calculation:			
Convertible preferred stock – equivalent common shares	58,994	63,281	68,455
Options to purchase common stock	39,161	23,321	25,732
Warrants to purchase common stock	17,133	17,327	18,259
	115,288	103,929	112,446

Segment information

We use the management approach for determining which, if any, of our products, locations, customers or management structures constitute a reportable business segment. The management approach designates the internal organization that is used by management for making operating decisions and assessing performance as the source of our reportable segments. Management uses one measurement of profitability and does not disaggregate its business for internal reporting and therefore operates in a single business segment. Through December 31, 2003, long-lived assets and revenues located outside the United States were not significant.

Recent accounting pronouncements

In January 2003, the FASB issued Interpretation No. 46 ("FIN 46"), "Consolidation of Variable Interest Entities," which clarifies the application of Accounting Research Bulletin No. 51, "Consolidated Financial Statements," relating to consolidation of certain entities. First, FIN 46 requires identification of our participation in variable interest entities ("VIE"), which are defined as entities with a level of invested equity that is not sufficient to fund future activities to permit them to operate on a stand-alone basis, or whose equity holders lack certain characteristics of a controlling financial interest. Then, for entities identified as VIE, FIN 46 sets forth a model to evaluate potential consolidation based on an assessment of which party to the VIE, if any, bears a majority of the exposure to its expected losses, or stands to gain from a majority of its expected returns. FIN 46 also sets forth certain disclosures regarding interests in VIE that are deemed significant, even if consolidation is not required. We evaluated our investments and other relationships and concluded that none qualify as a VIE as defined in FIN 46.

On May 15, 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity." This statement establishes standards for classifying and measuring as liabilities certain financial instruments that embody obligations of the issuer and have characteristics of both liabilities and equity. This statement represents a significant change in practice in the accounting for a number of financial instruments, including mandatorily redeemable equity instruments and certain equity derivatives that are frequently used in connection with share repurchase programs. This statement is effective for all financial instruments created or modified after May 31, 2003, and to other instruments as of July 1, 2003. We adopted the provisions of this standard during 2003 and it had no material impact on our financial position and results from operations.

Reclassifications

Certain reclassifications have been made to prior year balances to conform to the current year presentation. These reclassifications had no impact on previously reported net loss, stockholders' equity or cash flows.

3 IMPAIRMENT AND RESTRUCTURING COSTS

2001 restructuring

During 2001, due to the overcapacity created in the Internet connectivity and Internet Protocol services 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 2001, we incurred cash restructuring expenditures totaling $19.9 million, non-cash restructuring expenditures of $4.7 million, and 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 favorable settlements to terminate and restructure certain colocation lease obligations on terms favorable to our original restructuring estimates. The third quarter 2002 reduction was primarily due to returning the previously restructured Atlanta, Georgia facility into service as the site of the new corporate headquarters. Pursuant to the original restructuring plans, the Atlanta facility was not to be used by us in the future. However, due to changes in management, corporate direction, and other factors, which 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

With the continuing overcapacity created in the Internet connectivity and Internet Protocol services market, we implemented 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 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 during 2002 was partially 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 2002 restructuring charge was $1.1 million of personnel costs related to a reduction in force of approximately 145 employees. This represents employee severance payments made during 2002.

2003 restructuring costs. For the year ended December 31, 2003, we incurred approximately $1.1 million in restructuring costs which primarily represented retention bonuses and moving expenses related to the relocation of our corporate headquarters to Atlanta, Georgia. We continue to evaluate our restructuring reserve as plans are being executed, which could result in additional charges in future periods.

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 colocation license obligations. Accordingly, we recorded real estate related restructuring costs of $43 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. These costs were 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 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.

Asset impairments

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 colocation development personnel. Consequently, financial projections for the business were lowered and, pursuant to the guidance provided by SFAS No. 121, “Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of” (“SFAS No. 121”), management completed a cash flow analysis of the colocation assets. The cash flow analysis showed that the estimated cash flows were less than the carrying value of the colocation assets. Accordingly, pursuant to SFAS No. 121, management estimated the fair value of the colocation assets to be $79.5 million based upon a discounted future cash flow analysis. As estimated fair value of the colocation assets was less than their recorded amounts, we recorded an impairment charge of approximately $196.0 million.

The following table displays the activity and balances for restructuring and asset impairment activity for 2001 (in millions):

	Restructuring and Impairment Charge	Cash Reductions	Non-cash Write-Downs	Non-cash Plan Adjustments	December 31, 2001 Restructuring Liability
Restructuring costs					
Real estate obligations	$ 60.0[a]	$(14.7)[a]	$ (3.7)	$(7.0)	$34.6
Employee separations	3.3	(3.2)	–	–	0.1
Network infrastructure obligations	6.3	(1.9)	(1.0)	(0.7)	2.7
Other	2.0	(0.1)	–	–	1.9
Total restructuring costs	71.6	(19.9)	(4.7)	(7.7)	39.3
Asset impairments					
Goodwill	176.1	–	(176.1)	–	–
Assembled workforce	1.5	–	(1.5)	–	–
Trade name and trademarks	2.2	–	(2.2)	–	–
Completed real estate leases	14.8	–	(14.8)	–	–
Customer relationships	1.4	–	(1.4)	–	–
Total asset impairments	196.0	–	(196.0)	–	–
Total	$267.6	$(19.9)	$(200.7)	$(7.7)	$39.3

(a) Includes the use of $6.0 million in restricted cash related to payment of a lease deposit on our corporate office space.

Of the $71.6 million recorded during 2001 as restructuring reserves, approximately $50.7 million related to the direct cost of network, $1.1 million related to customer support, $0.3 million related to product development, $1.5 million related to sales and marketing and $18.0 million related to general and administrative costs.

The following table displays the activity and balances for restructuring and asset impairment activity for 2002 (in millions):

	December 31, 2001 Restructuring Liability	Restructuring Charge	Cash Reductions	Non-cash Write Downs	Non-cash Plan Adjustments	December 31, 2002 Restructuring Liability
Restructuring costs activity for 2001 restructuring charge –						
Real estate obligations	$34.6	$ –	$(11.2)	$(1.6)	$(12.2)	$ 9.6
Network infrastructure obligations	2.7	–	(1.4)	–	–	1.3
Other	2.0	–	(0.9)	–	–	1.1
Restructuring costs activity for 2002 restructuring charge –						
Real estate obligations	–	2.2	(0.4)	–	–	1.8
Personnel	–	1.1	(1.1)	–	–	–
Other	–	0.2	(0.1)	–	–	0.1
Total	39.3	3.5	(15.1)	(1.6)	(12.2)	13.9
Net asset write-downs for 2002 restructuring charge	–	4.1	–	(4.3)	–	(0.2)
Total	$39.3	$7.6	$(15.1)	$(5.9)	$(12.2)	$13.7

Of the $3.5 million recorded during 2002 as restructuring reserves, approximately $212,000 related to the direct cost of network and $3.3 million related to general and administrative costs.

The following table displays the activity and balances for restructuring and asset impairment activity for 2003 (in millions):

	December 31, 2002 Restructuring Liability	Restructuring Charge	Cash Reductions	Non-cash Write Downs	Non-cash Plan Adjustments	December 31, 2003 Restructuring Liability
Restructuring costs activity for 2001 restructuring charge –						
Real estate obligations	$ 9.6	$ –	$(5.2)	$ –	$ –	$4.4
Network infrastructure obligations	1.3	–	(0.1)	–	–	1.2
Other	1.1	–	(0.1)	–	–	1.0
Restructuring costs activity for 2002 restructuring charge –						
Real estate obligations	1.8	–	(1.8)	–	–	–
Personnel	–	1.1	(1.1)	–	–	–
Other	0.1	–	(0.1)	–	–	–
Total	13.9	1.1	(8.4)	–	–	6.6
Net asset write-downs for 2002 restructuring charge	(0.2)	–	–	–	–	(0.2)
Total	$13.7	$1.1	$(8.4)	$ –	$ –	$6.4

The $1.1 million recorded during 2003 as restructuring reserves related to general and administrative costs.

4 BUSINESS COMBINATIONS

On October 1, 2003, we completed our acquisition of netVmg, Inc. (“netVmg”). netVmg enables customers to manage Internet traffic cost, performance and operations decisions directly from their corporate locations. The acquisition was recorded using the purchase method of accounting under SFAS No. 141, “Business Combinations” (“SFAS No. 141”). The aggregate purchase price of the acquired company, plus related charges, was approximately $13.7 million and was comprised of 345,905 shares of our preferred stock, acquisition costs and warrants to purchase 1.5 million shares of our common stock. The warrants are exercisable only in the event the former netVmg stockholders invest an amount no less than $4.4 million in any future private placement of our equity securities. Results of operations of netVmg have been included in our financial statements since the closing date of the transaction.

The purchase price allocation for netVmg is as follows (in thousands):

Cash acquired	$ 1,443
Restricted cash	105
Inventory	421
Property and equipment	531
Other tangible assets	80
Tangible assets acquired	2,580
Product technology	3,311
Goodwill	8,216
Intangible assets acquired	11,527
Total assets acquired	$14,107
Acquisition expenses incurred	79
Liabilities assumed	438
Value of stock issued	13,590
Total liabilities assumed and preferred stock issued	$14,107

On October 15, 2003, we completed our acquisition of Sockeye Networks, Inc. ("Sockeye"). The acquisition was recorded using the purchase method of accounting under SFAS No. 141. The aggregate purchase price of the acquired company, plus related charges, was approximately $1.9 million and was comprised of 1,420,775 shares of our common stock and acquisition costs. Results of operations of Sockeye have been included in our financial statements since the closing date of the transaction.

The purchase price allocation for Sockeye is as follows (in thousands):

Cash acquired	$ 864
Restricted cash	20
Property and equipment	291
Other tangible assets	109
Tangible assets acquired	1,284
Goodwill	926
Total assets acquired	$2,210

Acquisition expenses incurred	$ 79
Liabilities assumed	281
Value of stock issued	1,850
Total liabilities assumed and common stock issued	$2,210

In accordance with SFAS No. 141, all identifiable assets were assigned a portion of the purchase price of the acquired companies on the basis of their respective fair values. Intangible assets other than goodwill are amortized over their average estimated useful lives. The value assigned to the identifiable intangible assets was based on an analysis performed by an independent third party as of the date of the acquisitions. Pro forma results of operations have not been presented because the effects of these acquisitions were not material on either an individual or aggregate basis to our results of operations.

As part of our acquisition of CO Space on June 20, 2000, we recorded a pre-acquisition liability of $1.3 million for network equipment purchased by CO Space. During 2003, we reevaluated the likelihood of settling the liability related to this equipment and concluded that a contingent obligation no longer exists. Therefore, the liability was eliminated resulting in a one-time reduction in costs and expenses of $1.3 million.

5 INVESTMENTS

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. We are unable to assert control over the joint venture's operational and financial policies and practices required to account for the joint venture as a subsidiary whose assets, liabilities, revenues and expenses would be consolidated (due to certain minority interest protections afforded to our joint venture partner, NTT-ME Corporation). 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 APB 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 Stockholder or Stockholders Have Certain Approval or Veto Rights." During the year ended December 31, 2001, we recognized our proportional share of Internap Japan's losses totaling $1.2 million, resulting in a net investment balance of $1.6 million. Our investment in Internap Japan is reflected as a component of long-term investments and losses are reflected as a component of loss on investments.

During the year ended December 31, 2002, the joint venture authorized a capital call pursuant to which we invested an additional $1.3 million and maintained our 51% ownership interest. We recognized our proportional share of Internap Japan's losses totaling $1.2 million and recorded an unrealized translation gain of $149,000, resulting in a net investment balance of $1.9 million at December 31, 2002. During the year ended December 31, 2003, we recognized our proportional share of Internap Japan's losses totaling $0.8 million and recorded an unrealized translation gain of $151,000, resulting in a net investment balance of $1.2 million at December 31, 2003.

On April 17, 2000, pursuant to an investment agreement among Internap, Ledcor Limited Partnership, Worldwide Fiber Holdings Ltd. and 360networks, Inc. ("360networks"), we purchased 374,182 shares of 360networks Class A Non-Voting Stock at $5.00 per share

and, on April 26, 2000, we purchased 1,122,545 shares of 360networks Class A Subordinate Voting Stock at $13.23 per share. The total cash investment was $16.7 million. During 2001 we liquidated our entire investment in 360networks for cash proceeds of $2.2 million and recognized a loss on investment totaling $14.5 million.

We account for investments without readily determinable fair values at cost. Realized gains and losses and declines in value of securities judged to be other than temporary are included in other expense. On February 22, 2000, pursuant to an investment agreement, we purchased 588,236 shares of Aventail Corporation ("Aventail") series D preferred stock at $10.20 per share for a total cash investment of $6.0 million. Because Aventail is a privately held enterprise for which no active market for its securities exists, the investment is recorded as a cost basis investment. During 2001, we concluded based on available information, specifically Aventail's most recent round of financing, that our investment in Aventail had experienced a decline in value that was other than temporary. As a result, during 2001 we recognized a $4.8 million loss on investment when we reduced its recorded basis to $1.2 million, which remains its estimated value as of December 31, 2003.

Investments consist of the following (in thousands):

As of December 31, 2003	Cost Basis	Unrealized Gain	Recorded Value
Equity-method investments	$ 895	$300	$1,195
Cost basis investments	1,176	–	1,176
	$2,071	$300	$2,371

As of December 31, 2002	Cost Basis	Unrealized Gain	Recorded Value
Equity-method investments	$1,722	$149	$1,871
Cost basis investments	1,176	–	1,176
	$2,898	$149	$3,047

6 PROPERTY AND EQUIPMENT

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

December 31,	2003	2002
Network equipment	$ 48,117	$ 56,663
Network equipment under capital lease	37,075	37,753
Furniture, equipment and software	27,549	26,024
Furniture, equipment and software under capital lease	4,434	4,378
Leasehold improvements	69,974	68,923
Property and equipment, gross	187,149	193,741
Less: Accumulated depreciation ($37,849 and $28,735 related to capital leases at December 31, 2003 and 2002, respectively)	(127,812)	(105,347)
Property and equipment, net	$ 59,337	$ 88,394

Assets under capital leases are pledged as collateral for the underlying lease agreements. Assets not under lease are pledged as collateral under our revolving credit facility or notes payable facilities.

During the year ended December 31, 2002, the Company amended the terms of the master lease agreement with our primary supplier of networking equipment (Note 11). As part of this amendment we purchased a portion of our leased network equipment for $5.8 million. This purchase resulted in a $23.7 million transfer from network equipment under capital lease to network equipment and a transfer of $19.6 million of accumulated depreciation under capital lease to accumulated depreciation.

7 GOODWILL AND OTHER INTANGIBLE ASSETS

Effective January 1, 2002, we adopted 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 our fair value 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 as of January 1, 2002, as well as our annual testing during the interim periods ended September 30, 2002 and 2003, we determined that none of the recorded goodwill was impaired. 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 is 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 us. As of December 31, 2003 and 2002, the recorded amount of goodwill totaled $36.2 million and $27.0 million, respectively.

In connection with adopting SFAS No. 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 amortizing intangible assets are as follows (in thousands):

	December 31, 2003		December 31, 2002	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Contract based	$14,518	$(14,207)	$14,518	$(11,467)
Technology based	5,911	(2,734)	2,600	(2,094)
	$20,429	$(16,941)	$17,118	$(13,561)

Amortization expense for identifiable intangible assets during 2003 and 2002 was $3.4 million and $5.6 million, respectively. Estimated amortization expense for the next five years and thereafter is as follows (in thousands):

Years Ending December 31,	
2004	$ 578
2005	578
2006	545
2007	443
2008	443
Thereafter	901
	$3,488

We adopted SFAS No. 142 on January 1, 2002. Accordingly, our 2001 results presented herein are not comparable with those in 2002 and 2003 results. On a pro forma basis, retroactively applying the provisions of SFAS No. 142 to exclude amortization of goodwill, 2001 net loss would have been $462,096, or $17,066 lower than the reported net loss of $479,162 and loss per share would have been $3.07, or $0.12 lower than the reported loss per share of $3.19.

8 NOTE RECEIVABLE

During August 2000, we loaned a private network company $6.0 million in exchange for a convertible promissory note bearing interest at the prime rate plus 3% and initially maturing during May 2001. In two separate amendments executed during December 2000 and February 2001, we agreed to modify the note to eliminate the conversion feature and to extend the note's maturity through the earlier of May 2004 or upon the completion of a transaction in which there is a change in control of borrower or in which the borrower sells substantially all its assets.

Subsequent to the February 2001 amendment, we performed an updated analysis of the collection risk associated with this note receivable. The results of our analysis indicated that there was substantial doubt that the borrower would be able to repay the $6.0 million obligation to us at the time of maturity. Therefore, we recorded a provision of $6.0 million as an allowance against our note receivable in 2001. The impact of the provision is reflected as a component of loss on investments. As of December 31, 2001, the $6.0 million loan

was outstanding and recorded at the outstanding balance as a note receivable offset in full by a $6.0 million allowance for doubtful collection.

During 2002, we entered into negotiations with the borrower to settle the amounts due to us in advance of the stated May 2004 maturity. As a result of the negotiations, we agreed to release the borrower of its liability to us under the note in exchange for a cash payment for outstanding accounts receivable and the note receivable and equity in the company, for which the estimated fair value is zero. During January of 2002 we recognized an investment gain of $0.4 million with respect to the settlement of the note receivable.

9 ACCRUED LIABILITIES

Accrued liabilities consist of the following (in thousands):

December 31,	2003	2002
Network commitments	$2,616	$ 3,455
Taxes	2,206	2,370
Compensation payable	1,791	1,478
Other	1,142	574
Insurance payable	830	915
Property and equipment purchases	–	2,228
	$8,585	$11,020

10 REVOLVING CREDIT FACILITY AND NOTES PAYABLE

Revolving credit facility and notes payable consist of the following (in thousands):

December 31,	2003	2002
Revolving credit facility	$ 8,392	$10,000
Notes payable to financial institutions	3,349	6,094
Notes payable to vendors	1,716	3,616
	$13,457	$19,710

We have a loan and security agreement with a $15.0 million revolving credit facility and a $5.0 million term loan with Silicon Valley Bank. Availability under the revolving credit facility and term loan is based on 80% of eligible accounts receivable plus 50% of unrestricted cash and investments. In addition, the loan and security agreement will make available to us an additional $5.0 million under a term loan if we meet certain debt coverage ratios. The balance outstanding under the term loan was $3.3 million at December 31, 2003, while the balance under the revolving credit facility was $8.4 million.

As of December 31, 2003, we had no further borrowing capacity under the revolving credit facility. As of December 31, 2003, the variable interest rate under the revolving credit facility was 6.0% and the interest rate under the term loan is fixed at 8.0%. This credit facility expires on October 22, 2004. There can be no assurance that the credit facility will be renewed upon expiration or that we will be able to obtain credit facilities on commercially favorable terms.

Both the revolving credit facility and the term loan are governed by a common security agreement and are collateralized by substantially all of our assets. The agreement allows the lender to require us to maintain cash and investment accounts with them and allows the lender greater control over our customer deposits, as defined 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 in the event, in its view, there has been a material adverse change in our business. As of December 31, 2003, we were in compliance with the covenants under our credit facility.

During August 1999, we entered into an equipment financing arrangement with our primary supplier, which allows borrowings of up to $5.0 million for the purchase of property and equipment. The equipment financing arrangement includes sub-limits of $3.5 million for equipment costs and $1.5 million for the acquisition of software and other service point and facility costs. Loans under the $3.5 million sub-limit require monthly principal and interest payments over a term of 48 months. This facility bears interest at 7.5% plus an index rate based on the yield of four-year U.S. Treasury Notes. Loans under the $1.5 million sub-limit require monthly principal and interest payments over a term of 36 months. This facility bears interest at 7.9% plus an index rate based on the yield of 3-year U.S. Treasury Notes. Borrowings under each sub-limit were completed prior to May 1, 2000 in accordance with the facility terms and the aggregate balance outstanding under this facility totaled $16,000 and $781,000 as of December 31, 2003 and 2002, respectively. The weighted average interest rate for all borrowings under this facility was approximately 13.9% as of December 31, 2003 and 2002, respectively.

During 2002, we completed negotiations with a colocation 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 secured by leaseholds, equipment, and customer revenues at one of our network access points. The note payable was recorded with an equal prepaid asset that is being amortized to direct cost of network over 36 months. Outstanding borrowings under this note were $1.3 million and $2.1 million at December 31, 2003 and 2002, respectively.

During 2002, we completed negotiations with a second colocation space provider that resulted in a reduction of the periodic rent payments made to the provider in exchange for a $0.6 million unsecured note payable to be paid in monthly installments of principal and interest beginning in April 2003 and continuing for 28 months. The note bears interest at 12% per annum. The outstanding borrowings under this note were $0.4 million at December 31, 2003.

During 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. Outstanding borrowings under this note were $0.9 million as of December 31, 2002. The note matured and was paid in full in October 2003.

Maturities of notes payable at December 31, 2003 are as follows (in thousands):

Years Ending December 31,	
2004	$2,790
2005	2,275
Total maturities and principal payments	5,065
Less: current portion	(2,790)
Notes payable, less current portion	$2,275

The carrying value of our notes payable as of December 31, 2003, approximates fair value as the interest rates approximate current market rates of similar debt obligations.

11 CAPITAL LEASES

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 related lease agreement. Interest rates on capital leases range from 2.3% to 21.5%. Leases have terms expiring through 2015 and generally include an option allowing us to purchase the leased equipment or furniture at the end of the lease term for fair market value.

During January 1998, we entered into a Master Agreement to Lease Equipment with one of our equipment vendors. The terms of individual leases under the Master Agreement to Lease Equipment range from 24 to 39 months. Since inception we have leased approximately $61.7 million of equipment under the agreement.

During 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 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 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. At December 31, 2003, the capital lease obligation and leased property accounts were reduced by $0.9 million representing the remaining discount. Interest will continue to accrue on a periodic basis and add to the capital lease obligation through March 2004, the remaining deferral period.

On April 14, 2003, we amended the terms of our master lease agreement with our primary supplier. Specifically, this lease amendment provides for adjustments to our required minimum quarterly revenue levels and minimum quarterly earnings before interest, taxes, depreciation and amortization levels. The lease amendment also required a payment that was made on April 15, 2003, for $2.2 million, which represented advance payment of our lease payments due in March and April 2004. The

terms of our master lease agreement, as amended, include financial covenants that require us to maintain minimum liquidity balances, minimum revenue levels, specified levels of earnings before interest, taxes, depreciation and amortization and other customary covenants. On September 4, 2003, we entered into an additional agreement to further amend our equipment lease obligations with our primary supplier. This lease amendment provides for additional adjustments to our required minimum quarterly levels of earnings before interest, taxes, depreciation and amortization and also provided for the removal of the requirement to maintain compliance with all financial covenants when we resume lease payments. This lease amendment also required us to issue 213,675 shares of common stock to our primary supplier having an aggregate value of $250,000 based on the closing price of our common stock on September 3, 2003. The value of the common stock issued was recorded as an additional discount to the initial capital lease obligation and the discount is being amortized over the remaining lease term. As of December 31, 2003, we were in compliance with all financial covenants.

Future minimum capital lease payments together with the present value of the minimum lease payments are as follows (in thousands):

Years Ending December 31,	
2004	$12,582
2005	12,260
2006	2,579
2007	1,246
2008	1,209
Beyond 2008	8,262
Total minimum lease payments	38,138
Less: amount representing interest	(12,927)
Less: amount representing discount	(904)
Present value of minimum lease payments	24,307
Less: current portion	(8,770)
Capital lease obligations, less current portion	$15,537

12 INCOME TAXES:

We account for income taxes under the liability method. Deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities, and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. We provide a valuation allowance to reduce our deferred tax assets to their estimated realizable value.

A reconciliation of the provision (benefit) for income taxes from continuing operations to the amount compiled by applying the statutory federal income tax rate to loss before income taxes is as follows:

Year Ended December 31,	2003	2002	2001
Federal income tax benefit at statutory rates	(34)%	(34)%	(34)%
State income tax benefit at statutory rates	(4)%	(4)%	(4)%
Foreign operating losses at statutory rates	1%	0%	1%
Amortization and write-down of goodwill	0%	0%	16%
Stock compensation expense	(1)%	0%	0%
Future utilization of losses precluded by Section 382	0%	0%	11%
Other	1%	0%	(1)%
Change in valuation allowance	37%	38%	11%
Effective tax rate	0%	0%	0%

Temporary differences between the financial statement carrying amounts and tax bases of assets and liabilities that give rise to significant portions of deferred taxes relate to the following:

	2003	2002
Deferred income tax assets:		
Net operating loss carryforwards	$123,212	$106,391
Capital loss carryforwards	5,446	5,446
Investments	1,824	1,824
Restructuring costs	2,435	5,425
Provision for doubtful accounts	1,017	564
Deferred revenue	1,491	3,538
Accrued compensation	144	113
Property and equipment	23,987	13,993
Other	447	361
	160,003	137,655
Deferred income tax liabilities:		
Amortization of discounts on investments	–	(23)
Purchased intangibles	(1,228)	(1,584)
	(1,228)	(1,607)
	158,775	136,048
Valuation allowance	(158,775)	(136,048)
Net deferred tax assets	$ –	$ –

As of December 31, 2003, we have net operating loss carryforwards and capital loss carryforwards of approximately $530.5 million and $14.0 million, respectively. The net operating loss carryforwards expire during 2012 through 2023. The capital loss carryforwards expire in 2006. Utilization of net operating losses and capital loss

carryforwards are subject to the limitations imposed by Section 382 of the Internal Revenue Code. Under this provision, we will be precluded from utilizing approximately $220.3 million of our net operating and capital loss carryforwards. The occurrence of additional changes in ownership pursuant to Section 382 of the Internal Revenue Code may have the impact of additional limitations on the use of our net operating loss carryforwards. We have placed a valuation allowance against our deferred tax assets in excess of deferred tax liabilities due to the uncertainty surrounding the realization of such excess tax assets. Management periodically evaluates the recoverability of the deferred tax assets and the level of the valuation allowance. At such time as it is determined that it is more likely than not that the deferred tax assets are realizable, the valuation allowance will be reduced.

13 EMPLOYEE RETIREMENT PLAN

We sponsor a defined contribution retirement savings plan that qualifies under Section 401(k) of the Internal Revenue Code. Plan participants may elect to have a portion of their pre-tax compensation contributed to the plan, subject to certain guidelines issued by the Internal Revenue Service.

During 2001, the plan provided for us to match employee contributions by contributing an amount equal to 50% of employee contributions. For purposes of calculating our matching portion, only employee contributions up to 6% of their compensation were considered. Contributions for employer matching were $1.0 million in 2001. During 2002, the plan was amended such that employer contributions, as calculated above, were discretionary. Employer matching contributions during 2002 were $0.3 million.

Effective January 1, 2003, the plan was further amended to change the manner in which employer contributions were made from a percentage of employee contributions to a discretionary percentage. Pursuant to the 2003 amendment, employer contributions continue to be discretionary. No employer contributions were made during 2003.

14 COMMITMENTS, CONTINGENCIES, CONCENTRATIONS OF RISK AND LITIGATION

Operating leases

We, as lessee, have entered into leasing arrangements relating to office and service point rental space and office equipment that are classified as operating leases. Future minimum lease payments on non-cancelable operating leases are as follows at December 31, 2003 (in thousands):

Years Ending December 31,	
2004	$ 13,175
2005	11,740
2006	10,743
2007	10,800
2008	10,686
Beyond 2008	72,915
	$130,059

Rent expense was approximately $13.1 million, $14.8 million and $14.3 million for the years ended December 31, 2003, 2002 and 2001, respectively. Sublease income, recorded as a reduction of rent expense, was approximately $327,000 and $406,000 during the years ended December 31, 2003 and 2002, respectively.

Service commitments

We have entered into service commitment contracts with Internet network service providers to provide interconnection services and colocation providers to provide space for customers. Minimum payments under these service commitments are as follows at December 31, 2003 (in thousands):

Years Ending December 31,	
2004	$22,490
2005	12,415
2006	8,042
2007	5,044
2008	5,061
Beyond 2008	4,301
	$57,353

One of our service commitment contracts with an Internet network service provider, representing $8.0 million of scheduled minimum payments in 2004 and $1.0 million in 2005, includes a provision allowing us to defer portions of our minimum commitments into future periods in the event we do not meet annual contract minimums.

Concentrations of risk

We participate in a highly volatile industry that is characterized by strong competition for market share. We, and others in the industry encounter aggressive pricing practices, evolving customer demands and continual technological developments. Our operating results could be negatively affected should we not be able to adequately address pricing strategies, customers' demands, and technological advancements.

We depend on other companies to supply various key elements of our infrastructure including the network access local loops between our network access points and our Internet network service providers and the local loops between our network access 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. We currently purchase routers and switches from a limited number of vendors. Furthermore, we do not carry significant inventories of the products we purchase, and we have no guaranteed supply arrangements with our vendors. A loss of a significant vendor could delay build-out of our infrastructure and increase our costs. If our limited source of suppliers fails to provide products or services that comply with evolving Internet standards or that interoperate with other products or services we use in our network infrastructure, we may be unable to meet all or a portion of our customer service commitments, which could adversely affect our business, results of operations and financial condition.

Litigation

We may be subject to legal proceedings, claims and litigation arising in the ordinary course of business. Although the outcome of these matters is currently not determinable, we do not expect that the ultimate costs to resolve these matters will have a material adverse effect on our financial condition, results of operations or cash flows.

15 CONVERTIBLE PREFERRED STOCK AND STOCKHOLDERS' EQUITY

During 2001, we changed the state of our incorporation from Washington to Delaware by merging Internap Network Services Corporation with and into our newly formed, wholly owned Delaware subsidiary, Internap Delaware, Inc. Upon consummation of the merger, stockholders of Internap Network Services Corporation became stockholders of Internap Delaware, Inc. and Internap Delaware's name was changed to Internap Network Services Corporation.

As part of the reincorporation, we increased the number of authorized shares of our common stock from 50,000,000 shares to 600,000,000 shares and the number of authorized shares of our preferred stock from 10,000,000 shares to 200,000,000 shares. We designated 3,500,000 of the 200,000,000 authorized shares of preferred stock as "series A preferred stock." We also changed the par values of our common stock and preferred stock from no par to $0.001 per share.

Accordingly, the disclosures in the financial statements and related notes have been adjusted to reflect the September 2001 Certificate of Incorporation and the stock dividend for all periods presented.

Convertible preferred stock

On September 14, 2001, we completed a $101.5 million private placement of units at a per unit price of $1.60 per unit and issued an aggregate of 63,429,976 units, with each unit consisting of 1/20 of a share of series A convertible preferred stock and a warrant to purchase 1/4 of a share of common stock, resulting in the issuance of 3,171,499 shares of series A convertible preferred stock ("series A preferred stock") and 17,113,606 warrants to purchase equivalent shares of common stock. The conversion price for the series A preferred stock and the exercise price for the warrants were both $1.48. We received net proceeds of $95.6 million from the issuance of the series A preferred stock and allocated $86.3 million to the series A preferred stock and $9.3 million to the warrants to purchase shares of common stock based upon their relative fair values on the date of issuance pursuant to APB Opinion No. 14 "Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants." The fair value used to allocate proceeds to the series A preferred stock was based upon a valuation that, among other considerations, was based upon the closing price of the common stock on the date of closing, on an as converted basis, and liquidation preferences. The fair value used to allocate proceeds to the warrants to purchase common stock was based on a valuation using the Black-Scholes model and the following assumptions: exercise price $1.48; no dividends; term of five years; risk free rate of 3.92%; and volatility of 80%.

The series A preferred stock was reported as mezzanine financing since its inception because holders of the series A preferred stock had rights to receive payment of shares under specific circumstances which were deemed to be outside our control. In July 2003, we

amended the deemed liquidation provisions of our charter to eliminate the events that could result in payment to the series A preferred stockholders such that the events giving rise to payment would be within our control. As a result, 2,887,661 shares of our series A preferred stock, with a recorded value of $78.6 million, was reclassified from mezzanine financing to stockholders' equity during 2003.

The August 2003 common stock private placement discussed below resulted in a decrease of the conversion price of our series A preferred stock to $0.95 per share and an increase in the number of shares of common stock issuable upon conversion of all shares of series A preferred stock by 34,500,000 shares. We recorded a deemed dividend of $34.6 million, which is attributable to the additional incremental number of shares of the series A preferred stock convertible into common stock. Also as a result of the private placement, under the terms of the common stock warrants issued on September 14, 2001 by us in connection with issuance of the series A preferred stock, the exercise price for the warrants to purchase approximately 17.3 million shares of our common stock was adjusted from $1.48 per share of common stock to $0.95 per share.

Holders of series A preferred stock are entitled to the number of votes equal to the number of shares of common stock into which the shares of series A preferred stock can be converted. Each share of series A preferred stock was originally convertible into 21.58428 shares of common stock subject to adjustments for certain dilutive events. Also in conjunction with the August 2003 common stock private placement discussed below, the conversion factor was changed to 33.68421053. Each share of series A preferred stock may be converted at any time at the option of the holder. Subject to satisfaction of certain conditions, including the listing of our common stock issuable upon the mandatory conversion of the series A preferred stock and upon the exercise of the warrants on the New York Stock Exchange, the Nasdaq National Market or the American Stock Exchange ("AMEX"), the series A preferred stock automatically convert to common stock on the earlier of September 14, 2004, a date more than six months after issuance on which the common stock has traded in excess of $8.00 for a period of 45 consecutive trading days or upon the affirmative vote of 60% of the outstanding shares of series A preferred stock.

Upon the liquidation, dissolution, merger or event in which existing stockholders own less than 50% of the post-event voting power, holders of series A preferred stock are entitled to be paid out of existing assets an amount equal to $32.00 per share prior to distributions to holders of common stock. Upon completion of distribution to holders of series A preferred stock, remaining assets will be distributed ratably between holders of series A preferred stock and holders of common stock until holders of series A preferred stock have received an amount equal to three times the original issue price. In connection with our acquisition of netVmg, we issued to the stockholders of netVmg an aggregate of 345,905 shares of our series A preferred stock, convertible into 11,651,537 shares of our common stock, and warrants to purchase an aggregate of 1,500,000 shares of our common stock exercisable only in certain situations as described below.

During 2002, series A convertible preferred stockholders converted 240,000 shares of convertible preferred stock at a recorded value of $6.5 million into 5,173,716 shares of common stock. During 2003, series A stockholders converted 1,526,321 shares of series A preferred stock into 50,621,204 shares of common stock at a recorded value of $41.5 million. As of December 31, 2003, we had 1,751,385 shares of series A preferred stock outstanding with a recorded value of $51.8 million.

Common Stock

On August 22, 2003, we issued 10,650,000 shares of our common stock in a private placement at a price of $0.95 per share. We received $9.5 million, net of issuance cost. In addition, in connection with the amendment of one of our equipment leases, we issued 213,675 shares of common stock to our primary supplier.

On October 15, 2003, in connection with our acquisition of Sockeye and as discussed in Note 4, we issued an aggregate of 1,420,775 shares of our common stock in a private placement to the stockholders of Sockeye.

Warrants to purchase common stock

As of December 31, 2003, there were warrants outstanding to purchase 17,133,464 shares of our common stock at a weighted average exercise price of $1.06 per share.

On August 2, 2000, we issued a warrant to purchase 20,000 shares of common stock at an exercise price of $26.88 to an executive recruiting firm. The fair value of these warrants on the date of issuance was estimated to be approximately $286,000 based upon the Black-Scholes model and was charged to expense.

On April 4, 2001, we issued a warrant to purchase 35,000 shares of common stock at an exercise price of $1.156 to a consultant. The fair value of these warrants on the date of issuance was estimated to be approximately $22,000 based upon the Black-Scholes model and was charged to expense.

On September 14, 2001, in conjunction with our series A preferred stock financing, we issued warrants to purchase up to 17,113,606 shares of common stock at $1.48256 per share for a period of five years. The value allocated to these warrants was estimated to be approximately $9.3 million based upon the Black-Scholes model. As a result of the private placement of our common stock in August 2003, the exercise price of the warrants was adjusted to $0.95 per share.

On October 20, 2003, we issued warrants to purchase 426,000 shares of common stock at an exercise price of $0.95 in connection with a private placement of our common stock. These warrants expire on August 22, 2008.

In connection with our acquisition of netVmg Inc., we granted warrants to purchase an aggregate of 1,500,000 shares of our common stock to stockholders of netVmg Inc. These warrants are exercisable if netVmg Inc. stockholders participate in a private placement of shares of our common or preferred stock and their participation is in an amount equal to or greater than $4.4 million. Each warrant is exercisable for one share of our common stock at an exercise price of $1.26 per share and expires on October 1, 2006. There was no value allocated to these warrants as of December 31, 2003.

Outstanding warrants to purchase shares of common stock at December 31, 2003, are as follows (shares in thousands):

Year of Expiration	Weighted Average Exercise Price	Shares
2004	$8.38	191
2005	–	–
2006	0.98	16,601
2007	–	–
2008	0.95	341
		17,133

16 STOCK-BASED COMPENSATION PLANS

During March 1998, our board of directors adopted the 1998 Stock Options/Stock Issuance Plan (the “1998 Plan”), which provides for the issuance of incentive stock options and non-qualified options to eligible individuals responsible for Internap’s management, growth and financial success. Shares of common stock reserved for the 1998 Plan during March 1998 totaled 8,070,000 and were increased to 10,070,000 during January 1999. As of December 31, 2003 there were 2,504,000 options outstanding and 482,000 options available for grant pursuant to the 1998 Plan.

During June 1999, our board of directors adopted the 1999 Equity Incentive Plan (the “1999 Plan”), which provides for the issuance of incentive stock options and nonqualified stock options to eligible individuals responsible for Internap’s management, growth and financial success. As of December 31, 1999, 13,000,000 shares of common stock were reserved for the 1999 Plan. Upon the first nine anniversaries of the adoption date of the 1999 Plan, the number of shares reserved for issuance under the 1999 Plan will automatically be increased by 3.5% of the total shares of common stock then outstanding or, if less, by 6,500,000 shares. Accordingly on June 19, 2000, and June 19, 2001, the number of shares reserved for the grant of stock options under the 1999 Plan was increased by 4,831,738 and 5,263,537 shares, respectively. There was no increase to options reserved for issuance under the 1999 Plan during 2003 and 2002. The terms of the 1999 Plan are the same as the 1998 Plan with respect to incentive stock options treatment and vesting. As of December 31, 2003, there were 20,852,000 options outstanding and no options available for grant pursuant to the 1999 Plan.

During May 2000, we adopted the 2000 Non-Officer Equity Incentive Plan (the "2000 Plan"). The 2000 Plan initially authorized the issuance of 1,000,000 shares of our common stock. On July 18, 2000, our board of directors increased the shares reserved under the 2000 Plan to 4,500,000. Under the 2000 Plan, we may grant stock options only to Internap employees who are not officers or directors. Options granted under the 2000 Plan are not intended to qualify as incentive stock options under the Internal Revenue Code. Otherwise, options granted under the 2000 Plan generally will be subject to the same terms and conditions as options granted under the 1999 Plan. As of December 31, 2003, there were 3,747,000 options outstanding and 406,000 options available for grant pursuant to the 2000 Plan.

During July 1999, we adopted the 1999 Non-Employee Directors' Stock Option Plan (the "Director Plan"). The Director Plan provides for the grant of non-qualified stock options to non-employee directors. A total of 1,000,000 shares of Internap's common stock have been reserved for issuance under the Director Plan. Under the terms of the Director Plan, 480,000 fully vested options were granted to existing directors on the effective date of our initial public offering with an exercise price of $10.00 per share. Subsequent to our 1999 initial public offering, initial grants, which are fully vested as of the date of the grant, of 80,000 shares of our common stock are to be made under the Director Plan to all non-employee directors on the date such person is first elected or appointed as a non-employee director. On the day after each of our annual stockholder meetings, starting with the annual meeting in 2000, each non-employee director will automatically be granted a fully vested and exercisable option for 20,000 shares, provided such person has been a non-employee director for at least the prior six months. The options are exercisable as long as the non-employee director continues to serve as a director, employee or consultant of Internap or any of its affiliates. During December 2003, the number of shares reserved for grant under the Director Plan was increased by 3,000,000 shares. As of December 31, 2003, there were 920,000 options outstanding and 2,920,000 options available for grant pursuant to the Director Plan.

In connection with the 2000 acquisition of CO Space, we assumed the CO Space, Inc. 1999 Stock Incentive Plan (the "CO Space Plan"). After applying the acquisition conversion ratio, the CO Space Plan authorizes the issuance of up to 1,346,840 options to purchase shares of Internap's common stock. As of December 31, 2003, there were 332,000 options outstanding and 737,000 options available for grant pursuant to the CO Space Plan.

In connection with the 2000 acquisition of VPNX, we assumed the Switchsoft Systems, Inc. Founders 1996 Stock Option Plan and the Switchsoft Systems, Inc. 1997 Stock Option Plan (the "VPNX Plans"). After applying the acquisition conversion ratio, the VPNX Plans authorize the issuance of up to 307,000 options to purchase shares of our common stock. As of December 31, 2003, there were 11,000 options outstanding and 212,000 options available for grant pursuant to the VPNX Plans.

On September 10, 2002, we adopted the Internap Network Services Corporation 2002 stock compensation plan ("2002 Plan"). The 2002 Plan provides for the grant of non-qualified stock options to employees and non-employees. A total of 32,000,000 shares of our common stock has been reserved for issuance under the 2002 Plan; however, this overall share reserve is reduced by any outstanding options issued under the VPNX Plans, the 1998 Plan, the 1999 Plan, the Directors Plan, the CO Space Plan, and the 2000 Plan, discussed above. The maximum number of shares granted to a single participant in any particular year is 10,000,000 shares. Also, subject to certain exclusions, the maximum number of awards issued to officers and directors is limited to 50% of the shares eligible for issuance at the time of the award or grant. During December 2003, the number of shares reserved for grant under the 2002 Plan was increased by 21,000,000 shares. As of December 31, 2003, there were 10,796,000 options outstanding and 10,204,000 options available for grant pursuant to the 2002 Plan.

Incentive stock options may be issued only to our employees and have a maximum term of 10 years from the date of grant. The exercise price for incentive stock options may not be less than 100% of the estimated fair market value of the common stock at the time of the grant. All shares issued under stock option plans are issued at the fair value at the date of grant. In the case of options granted to holders of more than 10% of the voting power of the Company, the exercise price may not be less than 110% of the estimated fair market value of the common stock at the time of grant, and the term of the option may not exceed five years. Options become exercisable in whole or in part from time to time as determined by the board of directors at the date of grant, which will administer the Plan. Both incentive stock options and non-qualified options generally vest over four years.

We have elected to account for stock-based compensation using the intrinsic value method prescribed in APB Opinion No. 25. Accordingly, compensation cost for stock options is measured as the excess, if any, of the fair value of our common stock at the date of grant over the exercise price to be paid to acquire the stock.

On May 4, 2001, we allowed employees to cancel certain outstanding stock option grants to purchase 8.9 million shares of common stock. On that date we agreed to grant to the same employees options to purchase 8.9 million shares of common stock to be granted six months plus one day after the cancellation, or November 5, 2001, provided, however, that (i) the exercise price of the future grant was the fair value of our common stock on the date of grant, the participating employees cancelled all options granted six months prior to the May 2001 offer exchange date, (ii) the participating employees did not receive any additional grants of options prior to the November 5, 2001 grant date, and (iii) the participating employees were common law employees on the date of grant. Since we account for stock-based compensation using the intrinsic value method prescribed by APB Opinion No. 25, compensation cost for stock options is measured as the excess, if any, of the fair value of our stock at the date of grant over the exercise price to be paid to acquire the stock. Therefore, we did not recognize compensation expense related to the grant of the new options.

Similarly, on January 6, 2003, under the terms of a related tender offer to allow domestic employees to cancel certain outstanding stock option grants, we accepted cancellation of 2.0 million options to purchase shares of common stock. On that date, we agreed to grant the same employees options to purchase 2.0 million shares of common stock to be granted six months and one day after the cancellation, or subsequent to June 7, 2003. The tender offer provides, however, that (i) the exercise price of the future grant must be the fair value of our common stock on the date of grant; the participating employees must also cancel all options granted six months prior to November 18, 2002, offer exchange date; (ii) the participating employees must not receive any additional grants of options prior to the future grant date; and (iii) the participating employees must be domestic common law employees on the date of grant. Since we account for stock-based compensation using the intrinsic value method prescribed by APB Opinion No. 25, compensation cost for stock options is measured as the excess, if any, of the fair value of our stock at the date of grant over the exercise price to be paid to acquire the stock. Therefore, we did not recognize compensation expense related to the grant of the new options.

Option activity for 2001, 2002 and 2003 under all of our stock option plans is as follows (shares in thousands):

	Shares	Weighted Average Exercise Price
Balance, December 31, 2000	24,159	$21.71
Granted	16,729	1.40
Exercised	(1,223)	0.36
Cancelled	(13,933)	31.69
Balance, December 31, 2001	25,732	4.21
Granted	11,668	0.60
Exercised	(1,252)	0.25
Cancelled	(12,827)	4.49
Balance, December 31, 2002	23,321	2.43
Granted	25,499	1.22
Exercised	(1,974)	0.89
Cancelled	(7,685)	3.47
Balance, December 31, 2003	39,161	1.52

The following table summarizes information about options outstanding at December 31, 2003 (shares in thousands):

	Options Outstanding		Options Exercisable (Excluding Options Which Shares Would Be Subject to the Company's Right of Repurchase)	
Exercise Prices	Number of Shares	Weighted Average Remaining Contractual Life (In years)	Number of Shares	Weighted Average Exercise Prices
$ 0.03 - $ 0.43	5,695	8.31	2,299	$ 0.27
$ 0.44 - $ 0.44	4,821	9.18	1,525	0.44
$ 0.47 - $ 0.48	6,104	9.04	1,991	0.48
$ 0.52 - $ 0.96	5,863	8.13	3,708	0.88
$ 0.99 - $ 1.27	4,650	8.57	2,036	1.23
$ 1.35 - $ 2.00	1,797	8.04	1,223	1.88
$ 2.16 - $ 2.15	9,027	9.98	–	–
$ 2.24 - $ 69.88	1,184	6.81	950	17.46
$87.19 - $ 87.19	10	6.20	10	87.19
$105.91	10	6.16	10	105.91
$ 0.03 - $105.91	39,161	8.86	13,752	2.09

During July 1999, we adopted the 1999 Employee Stock Purchase Plan (the "ESPP"). The ESPP provides a means by which employees may purchase Internap common stock through payroll deductions. The purchase plan is implemented by offering rights to eligible employees. Under the purchase plan, management may specify offerings with duration of not more than 27 months, and may specify shorter purchase periods within each offering. The first offering began on September 29, 1999 and terminated on September 30, 2002. Purchase dates occur each March 31 and September 30. Employees who participate in an offering under the purchase plan may have up to 15% of their earnings withheld. The amount withheld is then used to purchase shares of the common stock on specified dates determined by the board of directors. The price of common stock purchased under the ESPP is equal to 85% of the lower of the fair market value of the common stock at the commencement date of each offering period or the relevant purchase date. Employees may end their participation in an offering at any time during the offering except during the 15-day period immediately prior to a purchase date. Employees' participation in all offerings ends automatically on termination of their employment with Internap or one of its subsidiaries. A total of 3,000,000 shares of common stock have been reserved for issuance pursuant to the ESPP. Upon the first nine anniversaries of the adoption date of the ESPP, the number of shares reserved for issuance under the ESPP will be increased by 2% of the total number of shares of common stock then outstanding or, if less, by 3,000,000 shares, subject to Series A stockholder approval. Accordingly, on July 24, 2000 and July 23, 2001, pursuant to the terms of the ESPP, the number of shares reserved for the sale of stock under the ESPP was increased by 1,500,000 shares on each date. There was no increase to shares reserved during 2002 and 2003. The ESPP is intended to qualify as an employee stock purchase plan within the meaning of Section 423 of the Internal Revenue Code.

We have adopted the disclosure only provisions of SFAS No. 123, "Accounting for Stock-Based Compensation." Pro forma information regarding the net loss is required by SFAS No. 123, and has been determined as if we had accounted for its employee stock options (including ESPP participation) under the fair value method. The fair value of options granted in 2001, 2002 and 2003 (including ESPP participation) subsequent to Internap's initial public offering was estimated at the date of grant using the Black-Scholes model assuming no expected dividends and the following weighted average assumptions:

Year Ended December 31,	2003	2002	2001
Risk free interest rate	4.01%	3.52%	4.50%
Volatility	144%	100%	100%
Expected life	4 years	4 years	4 years

The pro forma effect of adopting SFAS No. 123 is described in Note 2.

Deferred stock compensation

Prior to 2000, we issued stock options to certain employees under the 1998 and 1999 Plans with exercise prices below the deemed fair value of our common stock at the date of grant. In accordance with the requirements of APB Opinion No. 25, we recorded deferred stock compensation for the difference between the exercise price of the stock options and the deemed fair value of the common stock at the date of grant. Additionally, in connection with the acquisition of VPNX, we recorded deferred stock compensation related to the unvested options assumed, totaling $5.1 million.

Deferred stock compensation is amortized to expense over the period during which the options or common stock subject to repurchase vest, generally four years, using an accelerated method as described in Financial Accounting Standards Board Interpretation No. 28.

During 2002 and 2001, primarily related to reductions in our workforce, we cancelled the options of individuals for whom we had recognized deferred stock compensation and had recognized related expense on unvested options using an accelerated amortization method. Accordingly, during the year ended December 31, 2002 and 2001, we reduced our deferred stock compensation, which would have been amortized to future expense, by $1.0 million and $1.2 million, and we reduced our amortization to expense of deferred stock compensation by $2.7 million and $1.9 million to record the benefit of previously recognized expense on unvested options.

As of December 31, 2003, the deferred stock compensation related to such options granted during 1998 and 1999 for the total amount of $28.9 million has been entirely written off to expense. Amortization of deferred stock compensation was $0.4 million, $0.3 million and $4.2 million during the years ended December 31, 2003, 2002 and 2001, respectively.

17 RELATED PARTY TRANSACTIONS

On January 1, 2002, we entered into a consulting agreement with Lyford Cay Securities Corp., an affiliate of one of our stockholders, INT Investments, Inc., that beneficially owned more than 5% of our outstanding common stock. Under the terms of this consulting agreement, which was completed in 2002, we paid Lyford Cay Securities Corp. $400,000 to provide us with financial advisory and strategic advice.

In 2003 and 2002, we engaged Korn/Ferry International, a national executive recruiting firm, to assist in the identification and recruitment of senior executives. For 2003 and 2002, we paid Korn/Ferry $3,178 and $262,096, respectively, in connection with executive placements. As of December 31, 2003, the Company had a liability of $75,000 to be paid to Korn/Ferry. Gregory A. Peters, our president and chief executive officer, is the son-in-law of a managing director of Korn/Ferry.

We have entered into indemnification agreements with our directors and executive officers for the indemnification of and advancement of expenses to such persons to the fullest extent permitted by law. We also intend to enter into these agreements with our future directors and executive officers.

18 SUBSEQUENT EVENTS

On February 18, 2004, our common stock began trading on the American Stock Exchange, or AMEX, under the symbol "IIP." We voluntarily delisted our common stock from the Nasdaq SmallCap Market effective February 17, 2004.

On March 4, 2004, we sold 40,250,000 shares of our common stock in a public offering at a purchase price of $1.50 per share which resulted in net proceeds to us of $56 million, after deducting underwriting discounts and commissions and estimated offering expenses. We intend to use the net proceeds from the offering for general corporate purposes. General corporate purposes may include capital investments in our network access point infrastructure and systems, repayment of debt and capital lease obligations and potential acquisitions of complementary businesses or technologies.

After the effectiveness of the registration statement filed in connection with our recent underwritten public offering, we became aware that (1) certain unauthorized persons may have accessed an Internet-based investor presentation, or road show, that had been used by us in the offering and (2) portions of the road show presentation had been posted by an unauthorized third party on a generally-available Internet photo sharing website. The road show presentation appeared on a third party vendor's password-protected website, and, consistent with the Securities and Exchange Commission's guidance relating to electronic road show presentations, was intended for access only by prospective investors authorized by the managing underwriters. The presentation included electronic slides that could be viewed during the presentation and oral statements made by members of our management team. Unauthorized access to the road show presentation was provided by posting, without our consent or the consent of the managing underwriters, the website link and passwords on a generally accessible message board maintained on the Yahoo Finance website. In addition, unauthorized access to the electronic slides used in the road show presentation was provided by posting images of some but not all of the slides to an Internet photo sharing website. The road show presentation and the posted road show slides did not disclose the related risks and uncertainties described in the prospectus for the offering. The unauthorized access to the Internet-based investor presentation and the unauthorized postings to the Internet photo sharing website may each be deemed to constitute a prospectus that does not meet the requirements of the Securities Act and thus a violation of the Securities Act of 1933, as amended. If we are found to have violated the Securities Act, then for a period of one year from the date of the violation, certain investors who purchased shares of our common stock in the public offering may have the right to obtain recovery of the consideration paid in connection with their purchase from us or any person who participated in the offering or, if they had already sold their shares, damages resulting from their purchase and sale of those shares. Any liability would depend, in part, upon the number of shares purchased by investors who assert their right of rescission or claim for damages within the one year statute of limitations period. If asserted, we intend to contest any claims for rescission or damages vigorously. At this stage, it is not possible to estimate the financial impact, if any, of any possible settlement from these potential claims.

19 UNAUDITED QUARTERLY RESULTS

The following table sets forth our unaudited quarterly results of operations for the years ended December 31, 2003 and 2002. In the opinion of management, this information has been prepared on the same basis as the audited financial statements and all necessary adjustments, consisting of only normal recurring adjustments, have been included in the amounts stated below to present fairly, in all material respects, the quarterly information when read in conjunction with the audited financial statements and notes thereto included elsewhere in this annual report on Form 10-K. The quarterly operating results below are not necessarily indicative of those of future periods (in thousands, except for per share data).

	March 31, 2002	June 30, 2002	September 30, 2002	December 31, 2002	March 31, 2003	June 30, 2003	September 30, 2003	December 31, 2003
Revenues	$ 32,614	$ 33,030	$ 32,711	$ 34,132	$ 34,177	$ 34,240	$ 34,379	$35,784
Costs and expenses:								
Direct cost of network, exclusive of depreciation shown below	24,105	22,627	17,302	19,173	18,668	18,669	19,795	18,598
Customer support	3,826	3,669	2,867	2,551	2,364	2,257	2,125	2,299
Product development	1,957	1,977	1,836	1,677	1,684	1,701	1,694	1,844
Sales and marketing	6,057	5,801	5,330	4,453	5,177	5,048	4,688	3,516
General and administrative	6,492	5,047	4,548	4,761	4,475	4,054	4,700	6,803
Depreciation and amortization	12,812	13,504	12,390	10,894	10,583	9,779	7,931	5,599
Amortization of goodwill and other intangible assets	1,427	1,606	1,165	1,428	1,428	1,428	362	134
Amortization of deferred stock compensation	352	(11)	(316)	235	390	–	–	–
Pre-acquisition liability adjustment	–	–	–	–	–	–	–	(1,313)
Lease termination expense	–	–	–	804	–	–	–	–
Restructuring costs (benefits)	(4,954)	–	352	821	754	198	132	–
(Gain) loss on sale and retirements of property and equipment	298	841	1,510	180	–	–	(53)	–
Total operating costs and expenses	52,372	55,061	46,984	46,977	45,523	43,134	41,374	37,480
Loss from operations	(19,758)	(22,031)	(14,273)	(12,845)	(11,346)	(8,894)	(6,995)	(1,696)
Other expense:								
Interest expense, net	(231)	(464)	(629)	(870)	(738)	(943)	(792)	(794)
Loss on investments	(349)	(313)	(334)	(248)	(290)	(194)	(291)	(65)
Total other expense	(580)	(777)	(963)	(1,118)	(1,028)	(1,137)	(1,083)	(859)
Net loss	(20,338)	(22,808)	(15,236)	(13,963)	(12,374)	(10,031)	(8,078)	(2,555)
Less deemed dividend related to beneficial conversion feature	–	–	–	–	–	–	(34,576)	–
Net loss attributable to common stockholders	$(20,338)	$(22,808)	$(15,236)	$(13,963)	$(12,374)	$(10,031)	$(42,654)	$ (2,555)
Basic and diluted net loss per share	$ (0.13)	$ (0.15)	$ (0.10)	$ (0.09)	$ (0.08)	$ (0.06)	$ (0.25)	$ (0.01)
Weighted average shares used in computing basic and diluted net loss per share	152,002	153,537	157,177	159,433	161,084	162,058	169,352	206,876

REPORT OF INDEPENDENT AUDITORS

To the Board of Directors and Stockholders
of Internap Network Services Corporation

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, of stockholders' equity and comprehensive loss and of cash flows present fairly, in all material respects, the financial position of Internap Network Services Corporation (the "Company") at December 31, 2003 and 2002, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2003 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 7, effective January 1, 2002, the Company adopted the provisions of Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets," resulting in cessation of the amortization of goodwill in 2002.

PricewaterhouseCoopers LLP

Atlanta, Georgia
March 11, 2004

STOCKHOLDER INFORMATION

Corporate Headquarters

Internap Network Services Corporation
250 Williams Street
Atlanta, GA 30303
404-302-9700
www.internap.com

Stock Trading Information

Internap's common stock trades on the American Stock Exchange under the ticker symbol: IIP.

Independent Auditor

PricewaterhouseCoopers LLP
10 Tenth Street, Suite 1400
Atlanta, GA 30309
678-419-1000

Transfer Agent

American Stock Transfer & Trust Company
59 Maiden Lane
New York, NY 10038
800-937-5449
info@amstock.com

Form 10-K

A copy of Internap's 2003 Annual Report on Form 10-K for the year ended December 31, 2003, as filed with the Securities and Exchange Commission, is posted to the investor relations section of our website, www.internap.com. A printed copy is available without charge to stockholders upon written request by contacting Investor Relations at our headquarters address.

Product/Services Information

Information on Internap's products and services can be obtained by contacting our corporate headquarters or visiting our website at: www.internap.com

Other Information

Forward-looking statements in this annual report are subject to change based on various factors. Stockholders and other persons reading this annual report are urged to read carefully our annual report on Form 10-K for the year ended December 31, 2003, as well as other documents and materials filed by the Company with the Securities and Exchange Commission.

Inquiries regarding stock transfers, lost certificates or address changes should be directed to the transfer agent.

Market and Dividend Information

Internap's common stock is listed on the AMEX under the symbol "IIP" and has traded on the AMEX since February 18, 2004. Our common stock traded on the Nasdaq SmallCap Market from October 4, 2002 until February 17, 2004. Prior to that, our common stock traded on the Nasdaq National Market from September 29, 1999, the date of our initial public offering, until October 4, 2002, when we fell below certain listing criteria of the Nasdaq National Market.

The following table sets forth on a per share basis the high and low closing prices for our common stock on the Nasdaq National Market or the Nasdaq SmallCap Market, as applicable, during the periods indicated.

	High	Low
Year Ended December 31, 2003		
Fourth Quarter	$2.59	$1.11
Third Quarter	1.55	1.04
Second Quarter	1.37	0.37
First Quarter	0.55	0.39
Year Ended December 31, 2002:		
Fourth Quarter	$0.69	$0.19
Third Quarter	0.34	0.13
Second Quarter	0.81	0.23
First Quarter	1.74	0.77

As of March 5, 2004, the number of stockholders of record of our common stock was 1,212.

We have never declared or paid any cash dividends on our capital stock, and we do not anticipate paying cash dividends in the foreseeable future. We are prohibited from paying cash dividends under covenants contained in our current credit agreement and our master lease with our primary supplier. In addition, as long as shares of our series A preferred stock convertible into at least five million shares of our common stock are outstanding, we may not declare or pay dividends on our common stock without the approval of at least 50% of the outstanding shares of our series A preferred stock. We currently intend to retain our earnings, if any, for future growth. Future dividends on our common stock, if any, will be at the discretion of our board of directors and will depend on, among other things, our operations, capital requirements and surplus, general financial condition, contractual restrictions and such other factors as our board of directors may deem relevant.

BOARD OF DIRECTORS

Board of Directors *standing (l-r):* William J. Harding, James P. DeBlasio and Kevin L. Ober; *seated (l-r):* Fredric W. Harman, Eugene Eidenberg, Gregory A. Peters and Charles B. Coe; *not pictured:* Robert D. Shurtleff, Jr.

Board of Directors

Eugene Eidenberg
Chairman
Managing Director, Granite Venture Associates LLC; and Principal, Hambrecht Quist Venture Associates
Director since: 1997

Gregory A. Peters
President and Chief Executive Officer, Internap
Director since: 2002

Charles B. Coe
Former President, BellSouth Network Services
Director since: 2003

James P. DeBlasio
Financial Vice President, Lucent Technologies' Mobility & INS Products
Director since: 2003

William J. Harding
General Partner, Morgan Stanley Dean Whitter Venture Partners
Director since: 1999

Fredric W. Harman
General Partner, Oak Investment Partners
Director since: 1999

Kevin L. Ober
Divergent Venture Partners
Director since: 1997

Robert D. Shurtleff, Jr.
S.L. Partners, a strategic consulting group
Director since: 1997

Anthony C. Naughtin
Founding CEO, Internap
Retired from Board effective January 2004
Director since: 1997

Executive Management Team

Gregory A. Peters
President and Chief Executive Officer

David L. Abrahamson
Vice President, Sales and Chief Marketing Officer

Walter G. DeSocio
Vice President, Chief Administrative Officer and General Counsel

Marla Eichmann
Vice President, Cross Functional Operations

Robert R. Jenks
Vice President and Chief Financial Officer

Ali Marashi
Vice President, Engineering and Chief Technology Officer

John M. Scanlon
Vice President, Corporate Development

Eric Suddith
Vice President, Operations

Allen K. Tothill
Vice President, Carrier Alliances

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