INTERNAP®

2006 Annual Report

play

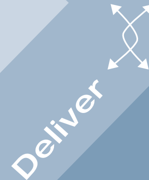
to win

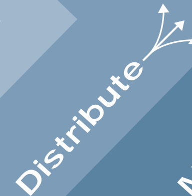
our time is now

We ignite customer innovation. Internap is a leading Internet solutions provider that manages, delivers and distributes applications and content with unsurpassed performance and reliability. With a global platform of data centers, managed Internet Protocol (IP) services, content delivery networks (CDNs) and content monetization services, Internap frees its customers to drive innovation inside their businesses and create new revenue opportunities. Today, more than 3,000 companies across the globe trust Internap to help them achieve their Internet business goals. Internap's 450 employees are located in our Atlanta headquarters, as well as in offices around the world, including major U.S. cities, Canada, London and Asia. Founded in 1996, Internap trades on the NASDAQ Global Market under the ticker symbol INAP.

Our Value Proposition

Internap's colocation and data center solutions manage the complex applications and vital content that form the foundation of our customers' businesses. Our industry-leading IP services ensure the reliable delivery of these Web-based assets, offering levels of performance essential for growth and innovation in their business. Internap's leading-edge content delivery and advertising solutions distribute our customers' valued content reliably and cost-effectively, so they can recognize new revenue streams, connect with and engage their customers, partners, employees and consumers across the globe.





Monetize $

The future of Internap has never looked better. A disciplined and highly-focused strategy to strengthen fundamentals has resulted in a growing and profitable business. With the acquisition of VitalStream, a world leader in audio and video streaming, we are moving aggressively to realize our strategic vision – to ignite the confidence to innovate – by offering the most comprehensive portfolio of Internet solutions in the industry. The Internet is increasingly the world's preferred medium to facilitate communication and commerce. Internap is becoming the provider of choice for technologies that enable Internet collaboration, productivity and profitability.

clearly, our time is

now

fast forward

advancing

into hot new markets

Unprecedented levels of broadband penetration in homes and businesses are supporting an explosion in the delivery of rich media content and video streaming. From user-generated content such as a homemade video to a movie trailer produced by a major motion picture studio, the integration of video into virtually every Web-based property is growing exponentially. Indeed, for the first time in history, Internet viewership is surpassing television usage levels. This behavior is creating a unique opportunity for content providers to monetize their digital assets. Advertising dollars are following this migration and also opening the door for Internap to capitalize on an Internet advertising market that AccuStream iMedia projects to be $2.3 billion within four years.

pause

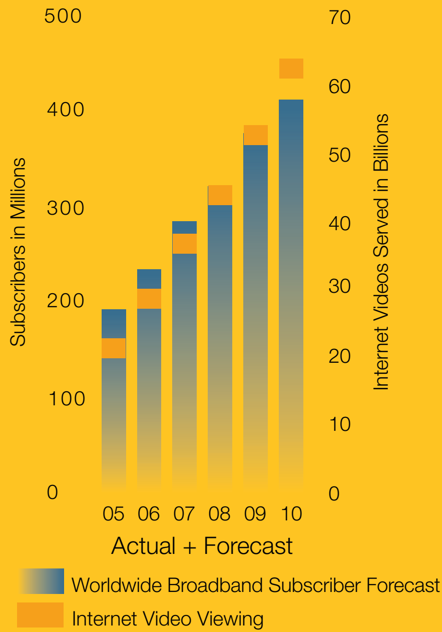
consider

our complete suite of solutions

No single competitor can match the breadth and depth of Internap's technology portfolio and service delivery platform. The foundation of this portfolio is our unique network architecture combined with patented route control technology, which has been the industry standard for the past decade. This intelligent network, which includes our Private Network Access Points (P-NAP®) infrastructure, makes end-to-end delivery of Web-based traffic faster and more reliable. In fact, our service level agreement guarantees 100 percent uptime. Our colocation services are strategic assets that provide secure, reliable and redundant data center services for our customers. Combined with our high-performance IP connectivity service, this segment of our business is growing annually as we continue to meet customer demands.

VitalStream has enhanced our portfolio significantly, providing valuable content delivery solutions that ensure a high-quality end-user experience. Services also include streaming video and audio advertising solutions with targeted, real-time ad insertion technology, creating an entirely new revenue source for Internap. Dynamic applications such as streaming audio and video require reliable and consistent delivery with the type of quality inherent to Internap's history of providing high-performance Internet services. The net result is a combined portfolio of complementary services that create profound synergies for Internap and its customers.

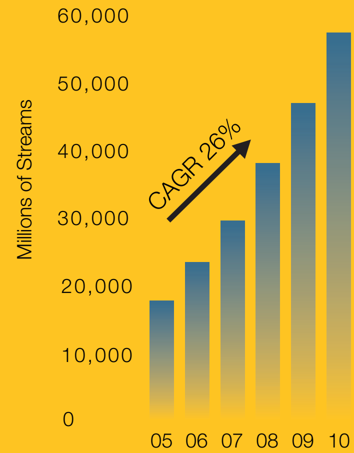
Broadband Subscription Drives Internet Video Viewing...



The rapid growth in access to high-speed Internet is driving video usage online.

Source: In-Stat, 3/06

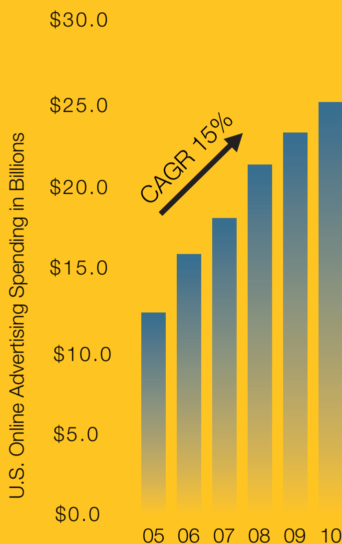
... and Increases the Total Number of Streams Over the Internet



The total number of video streams over the Internet is expanding at a 26 percent compound annual growth rate.

Source: eMarketer, 2006

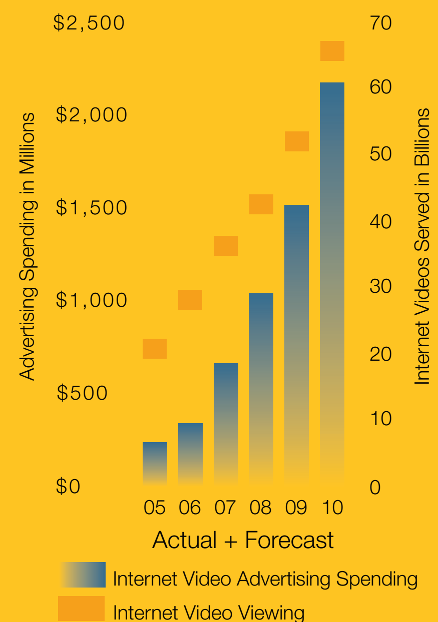
Total Internet Advertising Dollars Continue to Grow...



Total Internet advertising dollars are growing at a 15 percent compound annual growth rate.

Source: AccuStream iMedia Research, 2006

... and Video Ad Spending is Accelerating



We expect video ad spending to reach nearly $2.5 billion by 2010.

Source: eMarketer, 2006

our advantages are worth a second look

Internap is changing the way content owners outsource their Internet technology needs with a one-stop comprehensive solution that is unsurpassed by competitors in service, performance and quality. Only Internap can offer an integrated product suite that includes data center services, IP connectivity, content delivery services (CDS) and advertising solutions that have global reach. Internap's MediaConsole® platform is a key strategic differentiator in this product suite. This platform is an integrated software suite and customer portal through which customers can manage media assets, capture business intelligence and reporting, as well as monetize their media via subscription or advertising. Our end-to-end solution creates a compelling value proposition that allows customers to focus on using their online assets and Internet applications in ways that drive new and increased revenue.

turn it up

As Internet-centric business models evolve, Internap frees our clients to innovate, become more customer-focused, expand to new markets, improve overall service quality, and ultimately increase their profitability.

accelerated

growth is all about volume

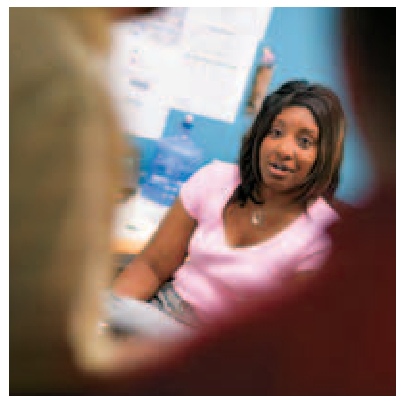
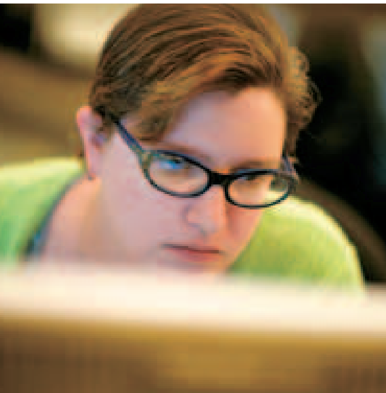
Our growth strategy is all about *high* volume. More customers. Larger accounts. New products. Increased revenue. The combination of Internap and VitalStream creates a broad enterprise customer base of more than 3,000 companies. With a strong sales and service group of 130 people, we are pursuing disciplined, targeted sales strategies to offer our new and expanded suite of solutions to this existing base of customers, as well as to attract new customers. At the same time, we are focused intently on innovation, superior service delivery and new product development. The goal is for Internap to be the strategic partner of choice for businesses that want to innovate and leverage the Internet to accelerate their growth and profitability. Our global platform and comprehensive portfolio allow Internap to compete for more of every dollar spent by customers for service and management of mission-critical applications.

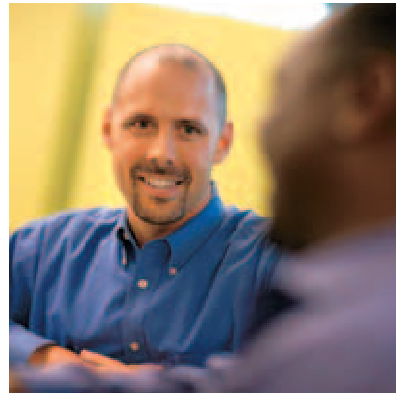
Internap now competes for

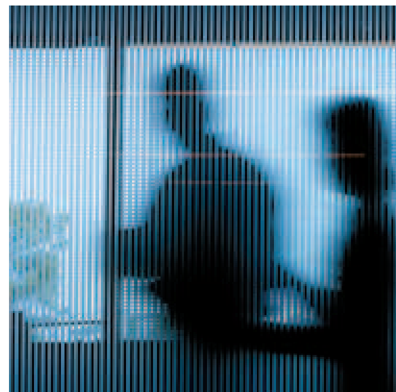
more

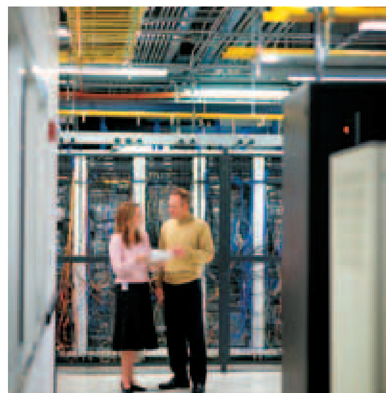
of every dollar

INTERNAP







to our stockholders

our time is now

Last year, our commitment to you was to make Internap thrive – to transform our organization and our business into one that was healthy, growing and successful. I am pleased to report on behalf of the entire Internap team that we have kept this promise *and* significantly strengthened Internap's potential to not simply thrive, but to WIN in the marketplace as never before.

We began 2006 with a strong foundation – a world-class portfolio of technology solutions, strategic relevancy to a large and loyal customer base and a team of outstanding Internet experts renowned for their exceptional level of knowledge and service. Our challenge was to leverage these assets to improve Internap's bottom line and to deliver long overdue value to our stockholders. It was time for change, so we developed a plan and successfully executed it to make this change a reality.

Our top line revenue grew at an unprecedented rate of 18 percent to $181.4 million. Expense-to-revenue levels decreased from 40 percent in 2005 to 33 percent in 2006 by achieving operating efficiencies and increasing productivity.

In the first quarter of 2006, we recorded the first profitable quarter in our 10-year history, and we continued to be profitable in each successive quarter throughout the year. As a result, for the fiscal year 2006, we generated GAAP net income of $3.7 million, or $0.11 per basic share – a significant improvement over 2005. Our adjusted EBITDA for 2006 was $25.0 million, an increase of $14.3 million over 2005, another record for Internap.

We ended the year with a cash and short-term investment balance of $58.9 million, up $18.4 million over 2005. Cash from operations continues to be an area of strength, and our operational discipline continues to provide positive financial leverage, generating cash and allowing us to fund future growth.

Throughout the year, we experienced minimal revenue churn and gained 186 net new customers. At year-end, we counted approximately 2,300 customers, representing many of the largest and most respected names in the financial services, technology, retail, media and entertainment fields. The fact that no single customer represents more than two percent of revenue demonstrates the diversity of our business.

In the first quarter of 2006, we recorded the first profitable quarter in our 10-year history, and we continued to be profitable in each successive quarter throughout the year.

James P. DeBlasio
President and Chief Executive Officer

In order to provide a new level of scale and service to our customers, we invested in the business by building out our high-performance IP network to 10-Gigabit capacity in 11 of our largest markets. We also deployed new colocation assets in key cities and, in early 2007, announced the build-out of our eighth owned data center, as well as a third facility in the Seattle market, to meet customer demand.

This potential begins with the integration of VitalStream, which provides us with tremendous synergistic benefits, including an infusion of talent and leadership, complementary products and technology platforms, economies of scale and increased market reach.

Throughout 2006, management met regularly with current and potential investors to apprise them on how we are building a new Internap, steeped in a commitment to discipline and to achieving our full potential. A 1-for-10 reverse stock split in July removed much of the volatility in our stock, better aligning us with our technology peers. We also returned to the NASDAQ Stock Market in September, this time to the global stage. In turn, the Market recognized our achievements.

And, in what is potentially a game-changing transaction for Internap, we announced in October our intention to acquire VitalStream Holdings, Inc., thereby extending our presence into the growing CDN and streaming video market. This transaction closed in February 2007 and, as you read earlier, has resulted in one of the most comprehensive suites of Internet solutions in the marketplace today.

You will note the extensive use of the word ***we*** in our recounting of 2006 accomplishments. The challenges met, the changes made, the progress realized and the value created are all a reflection of a team that could not have worked any harder or smarter on your behalf. For their relentless commitment and dedication, I extend my deep personal appreciation. The Internap that is before us today is truly a reflection of their efforts to help build a company that allows our customers to focus on innovation, while we manage, deliver, distribute and monetize their Internet applications. As a result of our ability to deliver this value proposition, enterprise customers such as ABC Radio, FastSearch, FXCM Group and Pandora trust Internap with their critical Internet business.

This potential begins with the integration of VitalStream, which provides us with tremendous synergistic benefits, including an infusion of talent and leadership, complementary products and technology platforms, economies of scale and increased market reach. In-Stat estimated, in a 2006 market analysis, that by 2010 more than $315 billion in strategic transactions per year will occur via the Internet. Most of these transactions will involve far more complex applications than just a few years ago. We believe business such as e-commerce, online financial transactions, software downloads, VoIP, IPTV and gaming can be conducted more efficiently through a global network.

The integration of VitalStream solutions uniquely positions Internap to provide our customers with a comprehensive set of products that exceeds their business needs. Trends such as global broadband penetration, the rise in user-generated content and the increased desire among businesses to engage online customers in more targeted and interactive ways support the demand for these solutions.

One of our enterprise customers, Planetvu, which is a global IPTV provider, is an excellent example of how the new Internap can win in the marketplace by benefiting our customers in a meaningful way. Planetvu is a multi-language entertainment and TV service focused on delivering television to various

national audiences throughout North America. Live television programming is now available from 6,000 miles away in Asia. Our unique bundled offering enables Planetvu to serve their entire customer base. The Internap solutions we provide Planetvu include route optimization technologies that deliver media content from India to the United States; data center services that manage and store these applications; and CDN services to distribute live video streams to Planetvu's customers residing in North America. Planetvu's success story is just one of many customer examples that illustrate the relevance of our end-to-end suite of Internet solutions.

We have several projects under way in 2007 to further raise the quality, scale and geographic reach of our service offerings. We will interconnect all of our CDN points of presence (PoPs) into our global P-NAP infrastructure, as announced in a press release in April of 2007.

The initiative will occur in scheduled phases throughout the year and adhere to our disciplined approach to managing capital expenditures, while strengthening service reliability. With this CDN expansion, Internap will be in a position to offer new global and regional contracts across Asia, Europe and North America for both streaming and content delivery services.

Our network optimization plan also includes consolidation of our CDN PoPs into our data centers. This consolidation will enable and facilitate the migration of our 800-plus newly acquired streaming and content delivery customers onto one of the industry's highest performing and most reliable networks.

Our solutions are broader and more easily tailored to meet the demands of the world's fastest-growing and most dynamic companies.

These initiatives, combined with Internap's enhanced portfolio of solutions, bring new opportunities for our 130-plus direct sales and service professionals to sell a differentiated solution in this fast-growing market. The opportunity to sell additional services to our combined Internap and VitalStream base of over 3,000 customers is substantial. Because our solutions are broader and more easily tailored to meet the demands of the world's fastest-growing and most dynamic companies, our sales force has the opportunity to pursue previously untapped customer markets.

Internap's strong balance sheet and cash flow position enable us to respond quickly to opportunities in the market and allow flexibility in making strategic investments. This financial position also allows us to grow the business organically. We continue to look strategically at solutions and new technologies that can expand and leverage our existing business.

While Internap is thriving today, more work remains. We will continue moving forward with the sense of discipline and determination that proved successful in 2006. By pursuing our strategic vision – to ignite confidence and innovation in our customers – we plan to keep Internap firmly focused on the day-to-day operating activities and customer service critical to maximizing profitability.

Our commitment is to be the leader in this space by enabling new business models and empowering our customers to keep pace with the rapidly growing potential of the Internet, its technology and applications.

We look forward to updating you on our progress and extend our appreciation to the customers, stockholders and employees who have and continue to support our efforts.

Sincerely,

James P. DeBlasio
President and Chief Executive Officer

now more than ever

Q&A with Jim DeBlasio and Gene Eidenberg

Gene, as one of the founders of Internap in 1996, you have seen the Company go through a number of stages over the past decade. How significant of a milestone is the VitalStream acquisition in the Company's history?

Gene: Extremely significant when you consider Internap's original value proposition. We always viewed the IP business as a foundation upon which more services could be launched. VitalStream's content delivery and streaming solutions are really about fulfilling the original promise of Internap. Actually, it is more accurate to say, "*beginning* to fulfill the promise." We are enthusiastic about continuing to build this Company.

Does that mean you intend to undertake additional acquisitions in the near future?

Jim: We are always looking at new products and services that complement our portfolio and add value for our stockholders. We begin this process with a well-defined strategy that aligns with the vision of where Internap is heading, as well as consideration for what is going on in the marketplace. This approach allows us to qualify opportunities as they arise, so that we can make informed decisions about whether acquiring new technologies makes sense for moving the Company forward. We will continue to evaluate any new developments and qualify opportunities as they come along. In the meantime, our new Internap has ample opportunities to pursue as we continue to integrate our respective customer bases, sales forces and operational teams.

The Internet seems to be going through another evolutionary period with the popularity of user-generated content, IPTV and rich media streaming. How does Internap capitalize on this new era of Internet usage?

Jim: The statistics about video usage are phenomenal. According to eMarketer, half of all online consumers watched streaming video during the last month. Video influences the way sites are now structured and provides businesses new ways to communicate with end-users on the Web. Video traffic doubles every six to eight months on a typical media site. Consumers are telling researchers that they will watch a 15-second advertisement if it is embedded in the video they want to see as a way to continue to receive "free" content. The Internet is the ultimate vehicle for enterprises that are creating new business models and for people who want to try something new. These groups and their behavior represent the type of opportunities created by the evolving Internet landscape. Internap wants to be their trusted partner of choice and the go-to for making the end-user experience fast and reliable.

How will you maintain the same level of fiscal discipline now that you are a larger company?

Jim: The key is to first understand what we did well in 2006 and determine what drives Internap's success, then replicate those strategies in 2007 to help grow the business. One way we are achieving scale is through an organizational design that supports our core products and services, which are Data Center Services, IP Services and Content Delivery & Monetization Services. Each of these three primary business units is run by a general manager who is responsible for the adjusted gross profit and has decision-making authority for the products and services within his group. Having each business unit managed by a subject-matter expert allows us to increase our focus on delivering new, innovative services to our growing customer base, and takes advantage of cross-selling and up-selling opportunities to scale the business. This structure also improves our ability to respond quickly to opportunities and to focus intensely on driving both our margins and profitable growth. Look for us to continue to be relentless, accountable and passionate about winning in the marketplace and providing world-class solutions to our customers.

What does Internap stand for in the marketplace today?

Gene: Today, Internap stands for confidence and innovation. Through the hard and dedicated work of all those who have been a part of Internap over the last decade, our Company has become one of the most recognized and trusted for delivering customer service and high-performance Internet solutions. Our people are some of the world's leading experts on Internet routing and optimization, which has resulted in a deep level of customer loyalty. Internap gives customers the confidence that we will reliably manage their critical business applications. In fact, we guarantee a 100 percent uptime for our IP service. The VitalStream brand shares similar respect in the marketplace, and we believe our combined knowledge and dedication to excellence will serve us well.

Jim: As the Company grows, I believe Internap's signature brand traits, which have resulted in our credibility as a trusted partner, will continue to serve us well. Both Internap and VitalStream are known as pioneers in their respective fields and both have a culture of innovation, which positions us for leadership in the rich media streaming market. Combined with the best-in-class talent, commitment and experience of our people, I certainly agree that these qualities define what Internap stands for in the marketplace and help drive our success.

How does Internap plan to leverage the combined Internap and VitalStream customer base?

Jim: Internap has always been a customer-centric organization with a reputation that is differentiated by our best-in-class customer support. Our combined base of more than 3,000 customers creates new opportunities for our direct sales team of 130 to up-sell products and services to our existing accounts. We have an expanded suite of services to offer, and no single customer represents more than 2 percent of our revenue. Combined with our enhanced portfolio of solutions, we believe Internap is better positioned to compete for a greater percentage of dollars spent by customers on Internet products and services.

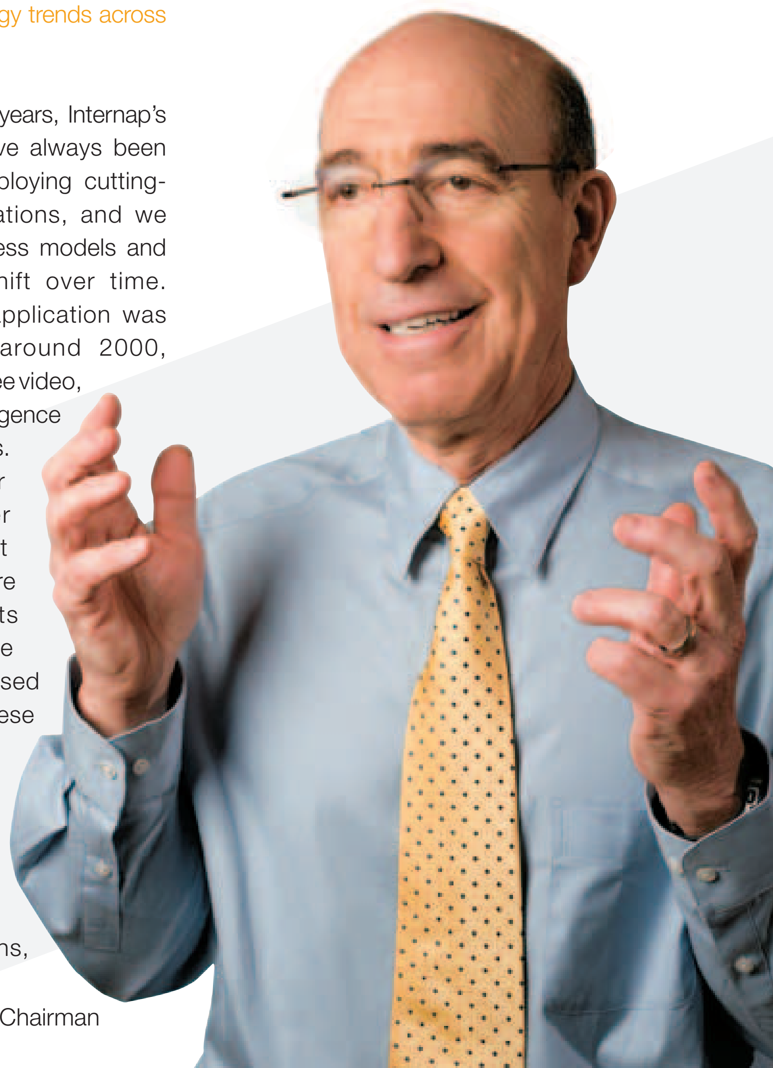
Our sales and service delivery road map will also create opportunities to penetrate new enterprise accounts, regardless of size or location. We plan to aggressively help customers uncover new ways to leverage the Internet to solve their unique business challenges, improve productivity and ultimately generate more revenue. In turn, Internap can become more profitable and return greater value to our stockholders.

Internap's customers range from financial services and retail to media and entertainment companies. Do you see any interesting technology trends across these verticals?

Gene: For the past 10 years, Internap's diverse customers have always been at the forefront of deploying cutting-edge Internet applications, and we have seen both business models and technology needs shift over time. In the 90s, the hot application was e-commerce, then around 2000, it was VoIP. Today, we see video, rich media and the emergence of Web 2.0 applications. With each new "killer app" came a richer user experience, but each also created more complex requirements for performance. We believe Internap is poised to take advantage of these trends by giving businesses a complete end-to-end solution – from managing Internet infrastructure, to delivering and distributing applications, as well as the ability for content owners to monetize their assets.

What is the status of Internap's legacy products such as the Flow Control Platform™ (FCP), given the current focus on VitalStream?

Jim: Internap has a unique heritage of delivering intelligent routing solutions that overcome the Internet's inherent weaknesses, such as latency and packet loss that can plague performance. The FCP still plays a key role in our end-to-end suite of Internet solutions and is ideal for larger companies that prefer to manage their networks in-house. Internap's technology remains unsurpassed and provides yet another solution in our portfolio that differentiates our ability to enable peak performance of our customers' mission-critical applications.



Gene Eidenberg, Chairman

Executive Management Team

James P. DeBlasio
President and
Chief Executive Officer

Vincent J. Molinaro
Chief Operating Officer

David A. Buckel
Vice President and
Chief Financial Officer

Philip N. Kaplan
Chief Strategy Officer

Tim P. Sullivan
Chief Technology Officer

Richard P. Dobb
Vice President, General Counsel
and Secretary

Eric Suddith
Vice President, Human Resources

Board of Directors

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

James P. DeBlasio
President and Chief Executive Officer,
Internap
Director since: 2003

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

William J. Harding
Managing Member,
Morgan Stanley Venture Partners
Director since: 1999

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

Patricia L. Higgins
Former President and
Chief Executive Officer,
Switch and Data
Director since: 2004

Kevin L. Ober
Managing Partner,
Divergent Venture Partners
Director since: 1997

Dr. Daniel C. Stanzione
President Emeritus, Bell Laboratories
and former Chief Operating Officer,
Lucent Technologies
Director since: 2004

** (resigned 3/15/07)*

Our Management Team

Left to Right: James DeBlasio, David Buckel,
Vincent Molinaro, Philip Kaplan, Richard Dobb
Tim Sullivan and Eric Suddith

Internap Network Services Corporation

2006

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Selected Financial Data

Financial Review 2006

The consolidated statement of operations data and other financial data presented below were prepared using our consolidated financial statements for the five years ended December 31, 2006. You should read this selected consolidated financial data together with the consolidated financial statements and related notes contained in this Annual Report and in our 2005 and 2004 Annual Reports on Form 10-K filed with the SEC, as well as the section of this Report and of our 2005 and 2004 Annual Reports on Form 10-K entitled, "Management's Discussion and Analysis of Financial Condition and Results of Operations."

	Year Ended December 31,				
(In thousands, except per share data)	2006[1]	2005	2004	2003	2002
Consolidated Statement of Operations Data:					
Revenue	$ 181,375	$153,717	$144,546	$138,580	$132,487
Costs and expense:					
Direct cost of network and sales, exclusive of depreciation and amortization, shown below [2]	97,854	82,535	77,569	78,334	85,734
Direct cost of customer support	11,566	10,670	10,180	9,483	12,913
Product development	4,475	4,864	6,412	6,982	7,447
Sales and marketing	27,173	25,864	23,411	21,491	21,641
General and administrative	22,104	20,096	24,772	16,711	20,907
Depreciation and amortization[2]	15,856	14,737	15,461	37,087	55,285
Amortization of deferred stock compensation	–	60	–	390	260
Asset impairment and restructuring cost (benefit)	323	44	3,644	1,084	(2,857)
(Gain) loss on disposals of property and equipment	(113)	(19)	(3)	(53)	3,722
Pre-acquisition liability adjustment	–	–	–	(1,313)	–
Lease termination expense	–	–	–	–	804
Total operating costs and expense	179,238	158,851	161,446	170,196	205,856
Income (loss) from operations	2,137	(5,134)	(16,900)	(31,616)	(73,369)
Non-operating (income) expense	(1,551)	(87)	772	2,158	1,055
Net income (loss) before income taxes	3,688	(5,047)	(17,672)	(33,774)	(74,424)
Provision for income taxes	145	–	–	–	–
Equity in (earnings) loss of equity-method investment, net of taxes	(114)	(83)	390	827	1,244
Less deemed dividend related to beneficial conversion feature [3]	–	–	–	34,576	–
Net income (loss)	$ 3,657	$ (4,964)	$ (18,062)	$ (69,177)	$ (75,668)
Net income (loss) per share:					
Basic [4]	$ 0.11	$ (0.15)	$ (0.63)	$ (3.96)	$ (4.87)
Diluted [4]	$ 0.10	$ (0.15)	$ (0.63)	$ (3.96)	$ (4.87)
Weighted average shares used in per share calculations					
Basic [4]	34,748	33,939	28,732	17,460	15,555
Diluted [4]	35,739	33,939	28,732	17,460	15,555

Selected Financial Data

Financial Review 2006

	As of December 31,				
	2006	2005	2004	2003	2002
Consolidated Balance Sheet Data:					
Cash, cash equivalents and short-term marketable securities	$ 58,882	$ 40,494	$ 45,985	$ 18,885	$ 25,219
Non-current marketable investments securities	–	–	4,656	–	–
Total assets	173,702	155,369	168,149	135,839	166,334
Note payable and capital lease obligations, less current portion	3,364	7,903	12,837	12,742	22,739
Series A convertible preferred stock [5]	–	–	–	–	79,790
Total stockholders' equity	126,525	109,728	113,738	70,524	(4,228)

	As of December 31,				
	2006	2005	2004	2003	2002
Other Financial Data:					
Purchases of property and equipment	$ 13,382	$ 10,161	$ 13,066	$ 3,799	$ 8,632
Net cash provided by (used in) operating activities	29,599	5,493	(1,150)	(11,175)	(40,331)
Net cash (used in) provided by investing activities	(10,399)	(9,428)	(29,659)	561	9,581
Net cash provided by (used in) financing activities	1,957	(5,454)	45,747	4,280	(7,582)

(1) Effective January 1, 2006, we adopted SFAS No. 123 (revised 2004), "Share-Based Payment" (SFAS No. 123R) and related interpretations, using the modified prospective transition method and therefore have not restated prior periods' results. Prior to the adoption of SFAS No. 123R on January 1, 2006, we accounted for stock-based compensation plans under the recognition and measurement provisions of Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations. We also provided disclosures in accordance with SFAS No. 123, "Accounting for Stock-Based Compensation," as amended by SFAS No. 148, "Accounting for Stock-Based Compensation – Transition and Disclosures – an Amendment of FASB Statement No. 123." Accordingly, no expense was recognized for options to purchase our common stock that were granted with an exercise price equal to fair market value at the date of grant and no expense was recognized in connection with purchases under employee stock purchase plans for any periods prior to January 1, 2006.

(2) Prior to 2006, direct cost of network and sales did not include amortization of purchased technology and such amounts were included in depreciation and amortization. In accordance with Question 17 of the Financial Accounting Standards Board (FASB) Implementation Guide to Statement of Financial Accounting Standard (SFAS) No. 86, "Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed," we have reclassified these costs from "Depreciation and amortization" to "Direct cost of network and sales." These reclassifications had no effect on previously reported operating loss or net loss.

(3) 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 $9.50 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 3.5 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.

(4) Adjusted to reflect the 1-for-10 reverse stock split of our common stock on July 11, 2006.

(5) 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, were reclassified from mezzanine financing to stockholders' equity during 2003. Effective September 14, 2004, all shares of our outstanding series A convertible preferred stock were mandatorily converted into common stock in accordance with the terms of our Certificate of Incorporation.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Financial Review 2006

The following discussion should be read in conjunction with the consolidated financial statements and accompanying notes of this Annual Report.

OVERVIEW

We market products and services that provide managed and premise-based Internet Protocol (IP) and route optimization technologies that enable business-critical applications such as e-commerce, Customer Relationship Management (CRM), video and audio streaming, Voice-over Internet Protocol (VoIP), Virtual Private Networks (VPNs), and supply chain management. Our core IP connectivity services and route control technology product and service offerings are complemented by IP access solutions such as data center services, Content Delivery Networks (CDNs) and managed security. At December 31, 2006, we delivered services through our 43 network access points across North America, London, and the Asia-Pacific region, including Tokyo, Japan and Sydney, Australia. Our Private Network Access Points (P-NAP) feature direct high-speed connections to major Internet backbones such as AT&T, Sprint, Verizon, Savvis, Global Crossing Telecommunications and Level 3 Communications.

The key characteristic that differentiates us from our competition is our portfolio of patented and patent-pending route optimization solutions that address the inherent weaknesses of the Internet and overcome the inefficiencies of traditional IP connectivity options. Our intelligent routing technology can facilitate traffic over multiple carriers, as opposed to just one carrier's network, to ensure highly-reliable performance over the Internet.

We believe our unique managed multi-network approach provides better performance, control and reliability compared to conventional Internet connectivity alternatives. Our service level agreements guarantee performance across the entire Internet in the United States, excluding local connections, whereas providers of conventional Internet connectivity typically only guarantee performance on their own network. We serve customers in a variety of industries, including financial services, entertainment and media, travel, e-commerce, retail and technology. As of December 31, 2006, we provided our services to more than 2,250 customers in the United States and abroad, including several Fortune 1000 and mid-tier enterprises.

HIGHLIGHTS AND OUTLOOK

- *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 2006, we added more than 180 net new customers, bringing our total to more than 2,250 enterprise customers as of December 31, 2006. Revenue for the year ended December 31, 2006 increased 18% to $181.4 million, compared to revenue of $153.7 million for the year ended December 31, 2005.

- *Solidified management team is focused on achieving profitability and revenue by leveraging operating efficiencies.* In November 2005, James P. DeBlasio, a 20-year technology veteran and former Lucent executive, was appointed CEO. Throughout 2006, our management team implemented a renewed emphasis on aggressive cost containment with a focus on reducing net losses and driving gross profit to achieve cost savings to benefit gross profit to improve stockholder value.

- *We intend to increase revenue by leveraging the capabilities of our existing network access points.* In our existing markets, we realize incremental margins 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. The company experienced a net increase in customers from 2005 to 2006. 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.

- *Approximately two-thirds of our new monthly recurring revenue is from new customers.* Selling new monthly recurring revenue to new customers allows us to expand our customer base, as well as guard against customer loss.

- *While we have limited traditional advertising over the past year, we are focused on increasing brand awareness through appropriate marketing vehicles.* We will continue to develop integrated marketing campaigns that identify qualified leads, generate interest and promote business benefits among key audiences. We will also conduct public relations efforts focused on securing third party recognition of our products and services from media and industry analysts. Our marketing organization is also responsible for creating our product strategy based upon primary and secondary market research and the advancement of new technologies.

RECENT DEVELOPMENTS

Reverse stock split. On July 10, 2006, we implemented a 1-for-10 reverse stock split of our common stock. Our stockholders authorized the reverse stock split on June 21, 2006, at our annual stockholders' meeting. Our common stock began trading on a split-adjusted basis on July 11, 2006. All share and per share information herein (including shares outstanding, earnings per share and warrant and stock option exercise prices) have been retroactively restated for all periods presented to reflect the reverse stock split.

VitalStream acquisition. On October 12, 2006, we entered into a definitive agreement to acquire VitalStream Holdings, Inc., or VitalStream, in an all-stock transaction to be accounted for using the purchase method of accounting for business combinations. The transaction closed on February 20, 2007.

Under the terms of the agreement, VitalStream stockholders received, at a fixed exchange ratio, 0.5132 shares of our common stock for every share of VitalStream common stock in a tax-free exchange. As a result, we issued approximately 12.2 million shares of common stock to VitalStream stockholders, which represented approximately 25% of our outstanding shares. We also assumed outstanding options for the purchase of shares of VitalStream common stock, converted into options to purchase approximately 1.5 million shares of Internap common stock. The purchase price for the acquisition includes the estimated fair value of our common stock issued, stock options assumed, and estimated direct transaction costs. We derived the values using an average market price per share of our common stock of $16.40, which was based on an average of the closing prices for a range of trading days from October 6, 2006 through October 16, 2006, which range spans October 12, 2006, the announcement date of the proposed transaction. The preliminary purchase price of $222.0 million was determined based upon the number of VitalStream shares and options outstanding at the closing date of February 20, 2007 and taking into consideration estimated direct transaction costs.

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, revenue and expense, and related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates, including those summarized below. 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 data center services. Our revenue is 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. Ancillary services include data center services, CDN, server management and installation services, virtual private networking services, managed security services, data back-up, and remote storage and restoration services. We also offer T-1 and fractional DS-3 connections at fixed rates.

We recognize revenue when persuasive evidence of an arrangement exists, the product, service or software license has been provided, the fees 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 services, products or software licenses. 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 revenue consists of revenue for services to be delivered in the future and consists primarily of advance billings, which are amortized over the respective service period. Revenue associated with billings for installation of customer network equipment are deferred and amortized over the estimated life of the customer relationship (generally two years), as the installation service is integral to our primary service offering and does not have value to a customer on a stand-alone basis. Deferred post-contract customer support, or PCS, associated with sales of our FCP solution and similar products are amortized ratably over the contract period, which is generally one year.

Customer credit risk. We routinely review the creditworthiness of our customers. If we determine that collection of service revenue 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. The allowance for doubtful accounts is based upon specific and general customer information, which also includes estimates based on management's best understanding of the customer's ability to pay. Customer's ability to pay takes into consideration payment history, legal status (e.g., bankruptcy), and the status of services we are providing. Once all collection efforts have been exhausted, we write the uncollectible balance off against the allowance for doubtful accounts. We also estimate a reserve for sales adjustments, which reduces net accounts receivable and revenue. The reserve for sales adjustments is based upon specific and general customer information, including outstanding promotional credits, customer disputes, credit adjustments not yet processed through the billing system and historical activity. If the financial condition of our customers were to deteriorate, or management become aware of new information impacting a customer's credit risk, additional allowances may be required.

Accounting for leases and leasehold improvements. We record leases as capital or operating leases and account for leasehold improvements in accordance with SFAS No. 13, "Accounting for Leases" and related literature. Rent expense for operating leases is recorded in accordance with FASB Technical Bulletin Financial Accounting Standards Board (FTB) No. 88-1, "Issues Relating to Accounting for Leases." This FTB requires lease agreements that include periods of free rent or other incentives, specific escalating lease payments, or both, to be recorded on a straight-line or other systematic basis over the initial lease term and those renewal periods that are reasonably assured. The difference between rent expense and rent paid is recorded as deferred rent in non-current liabilities on our consolidated balance sheets.

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 have a $1.2 million equity investment at December 31, 2006 in Aventail Corporation, or Aventail, a privately-held company, after having reduced the balance for an impairment loss of $4.8 million in 2001. The carrying value of our investment in Aventail is recorded in non-current investments on our consolidated balance sheets.

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, 2006, Internap Japan Co., Ltd., or Internap Japan, our joint venture with NTT-ME Corporation of Japan and another NTT affiliate, qualifies for equity method accounting. We record our proportional share of the income and losses of Internap Japan one month in arrears on the consolidated balance sheets as a component of non-current investments and as other income, net on our consolidated statements of operations.

Investments in marketable securities primarily include high-credit quality corporate debt securities and U.S. Government Agency debt securities. These investments are classified as available-for-sale and are recorded at fair value with changes in fair value reflected in other comprehensive income.

Goodwill. 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 assist us in estimating the fair value for purposes of completing the first step of the SFAS No. 142 analysis, we engaged a professional business valuation and appraisal firm that utilized discounted cash flow valuation methods and the guideline company method for reasonableness. The forecasts of future cash flows was based on our best estimate of future revenue, operating costs and general market conditions, and was subject to review and approval by senior management. Both approaches to determining fair value depend on our stock price, since market capitalization will impact the discount rate to be applied as well as market multiple analyses. Changes in the forecast could cause us to either pass or fail the first step test and could result in the impairment of goodwill.

Accruals for disputed telecommunication costs. In delivering our services, we rely on a number of Internet network, telecommunication and other vendors. We work directly with these vendors to provision services such as establishing, modifying or discontinuing services for our customers. Because of the volume of activity, billing disputes inevitably arise. These disputes typically stem from disagreements concerning the starting and ending dates of service, quoted rates, usage and various other factors. For potential billing errors made in the vendor's favor, for example a duplicate billing, we initiate a formal dispute with the vendor and record the related cost and liability on a range of 5% to 100% of the disputed amount, depending on our assessment of the likely outcome of the dispute. Conversely, for billing errors in our favor, such as the vendor's failure to invoice us for new service, we record an estimate for the related cost and liability based on the full amount that we should have been invoiced. Disputed costs, both in the vendors' favor and our favor, are researched and discussed with vendors on an ongoing basis until ultimately resolved. Estimates are periodically reviewed by management and modified in light of new information or developments, if any. Conversely, any resolved disputes that will result in a credit over the disputed amounts are recognized in the month when we determine the resolution. Because estimates regarding disputed costs include assessments of uncertain outcomes, such estimates are inherently vulnerable to changes due to unforeseen circumstances that could materially and adversely affect our results of operations and cash flows.

Accrued liabilities. Similar to accruals for disputed telecommunications costs above, we must estimate other significant costs such as utilities and sales, use, telecommunications and other taxes. These estimates are often necessary, either because invoices for services are not received on a timely basis from our vendors or by virtue of the complexity surrounding the costs. In every instance in which an estimate is necessary, we record the related cost and liability based on all available facts and circumstances, including, but not limited to, historical trends, related usage, forecasts and quotes. Management periodically reviews and modifies estimates in light of new information or developments, if any. Because estimates regarding accrued liabilities include assessments of uncertain outcomes, such estimates are inherently vulnerable to changes due to unforeseen circumstances that could materially and adversely affect our results of operations and cash flows.

Restructuring liability. When circumstances warrant, we may elect to exit certain business activities or change the manner in which we conduct ongoing operations. When we make such a change, 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 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 $4.8 million restructuring liability at December 31, 2006 would result in an $0.5 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 valuation allowance would increase income in the period such determination was made.

Stock-based compensation. We account for stock-based instruments issued to employees in exchange for their services under the fair value recognition provisions of SFAS No. 123 (revised 2004), "Share-Based Payment" (SFAS No. 123R) and related interpretations. We adopted this statement using the modified prospective transition method and therefore have not restated prior period's results. Under SFAS No. 123R, share-based compensation cost is measured at the grant date based on the calculated fair value of the award. The expense is recognized over the employees' requisite service period, generally the vesting period of the award. Prior to the adoption of SFAS No. 123R on January 1, 2006, we utilized the disclosure only provisions of SFAS No. 123, "Accounting for Stock-Based Compensation" and accounted for stock-based compensation plans under the recognition and measurement provisions of APB Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations. Accordingly, no expense was recognized for options to purchase our common stock that were granted with an exercise price equal to fair market value at the date of grant, and no expense was recognized in connection with purchases under our employee stock purchase plans for any periods prior to January 1, 2006.

The fair value of equity instruments granted to employees is estimated using the Black-Scholes option-pricing model. To determine the fair value, this model requires that we make certain assumptions regarding the volatility of our stock, the expected term of each option and the risk-free interest rate. Further, we also make assumptions regarding employee termination and stock option forfeiture rates that impact the timing of aggregate compensation expense recognized. These assumptions are subjective and generally require significant analysis and judgment to develop.

Because our options are not publicly traded, assumed volatility is based on the historical volatility of our stock. We have also used historical data to estimate option exercises, employee termination and stock option forfeiture rates. The risk-free interest rate for periods within the expected life of the option is based on the U.S. Treasury yield curve in effect at the time of grant. Changes in any of these assumptions could materially impact our results of operations in the period the change is made.

RECENT ACCOUNTING PRONOUNCEMENTS

In February 2006, the FASB issued SFAS No. 155, "Accounting for Certain Hybrid Financial Instruments – an amendment of FASB Statements No. 133 and 140." SFAS No. 155 eliminates the exemption from applying SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," to interests in securitized financial assets so that similar instruments are accounted for similarly, regardless of the form of the instruments. SFAS No. 155 also allows issuers of financial statements to elect fair value measurement at acquisition, at issuance, or when a previously recognized financial instrument is subject to a remeasurement (new basis) event, on an instrument-by-instrument basis, in cases in which a derivative would otherwise have to be bifurcated. SFAS No. 155 is effective for all financial instruments acquired or issued after the first fiscal year beginning after September 15, 2006. We believe that SFAS No. 155 will not have a material impact on our consolidated financial statements.

In March 2006, the FASB issued SFAS No. 156, "Accounting for Servicing of Financial Assets – an amendment of FASB Statement No. 140." SFAS No. 156 requires that all separately recognized servicing assets and servicing liabilities be initially measured at fair value, if practicable. It also permits, but does not require, the subsequent measurement of servicing assets and servicing liabilities at fair value. An entity that uses derivative instruments to mitigate the risks inherent in servicing assets and servicing liabilities is required to account for those derivative instruments at fair value. Under SFAS No. 156, an entity can elect subsequent fair value measurement of its servicing assets and servicing liabilities by class, thus simplifying its accounting and providing for income statement recognition of the potential offsetting changes in fair value of the servicing assets, servicing liabilities, and related derivative instruments. An entity that elects to subsequently measure servicing assets and servicing liabilities at fair value is expected to recognize declines in fair value of the servicing assets and servicing liabilities more consistently than by reporting other-than-temporary impairments. SFAS No. 156 is effective for fiscal years beginning after September 15, 2006. We believe that SFAS No. 156 will not have a material impact on our consolidated financial statements.

In June 2006, Emerging Issues Task Force Issue No. 06-3, "How Sales Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross Versus Net Presentation)," or EITF 06-3, was issued. EITF 06-3 requires disclosure of the presentation of taxes on either a gross (included in revenues and costs) or a net (excluded from revenues) basis as an accounting policy decision. The provisions of this standard are effective for interim and

annual reporting periods beginning after December 15, 2006. We do not expect the adoption of EITF 06-3 to have a material impact on our consolidated financial statements.

In June 2006, the FASB issued FASB Interpretation No. 48, or FIN 48, "Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109, Accounting for Income Taxes," which clarifies the accounting for uncertainty in income taxes. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The Interpretation requires that we recognize in the financial statements the impact of a tax position, if that position is more-likely-than-not of being sustained on audit, based on the technical merits of the position. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods and disclosure. The provisions of FIN 48 are effective beginning January 1, 2007 with the cumulative effect of the change in accounting principle recorded as an adjustment to opening retained earnings. We are continuing to evaluate the possible impact of FIN 48, on our consolidated financial statements.

In September 2006, the Securities and Exchange Commission, or SEC, released Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements When Quantifying Misstatements in Current Year Financial Statements" (SAB 108). SAB 108 provides guidance on how the effects of the carryover or reversal of prior year financial statement misstatements should be considered in quantifying a current year misstatement. Prior practice allowed the evaluation of materiality on the basis of the error quantified as the amount by which the current year income statement was misstated (rollover method) or the cumulative error quantified as the cumulative amount by which the current year balance sheet was misstated (iron curtain method). The guidance provided in SAB 108 requires both methods to be used in evaluating materiality. Immaterial prior year errors may be corrected with the first filing of prior year financial statements after adoption. The cumulative effect of the correction would be reflected in the opening balance sheet with appropriate disclosure of the nature and amount of each individual error corrected in the cumulative adjustment, as well as a disclosure of the cause of the error and that the error had been deemed to be immaterial in the past. The adoption of SAB 108 did not have a material impact on our consolidated financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, "Fair Value Measurements," or SFAS No. 157. This Statement defines fair value as used in numerous accounting pronouncements, establishes a framework for measuring fair value in generally accepted accounting principles, or GAAP, and expands disclosure related to the use of fair value measures in financial statements. SFAS No. 157 does not expand the use of fair value measures in financial statements, but standardizes its definition and guidance in GAAP. The Standard emphasizes that fair value is a market-based measurement and not an entity-specific measurement based on an exchange transaction in which the entity sells an asset or transfers a liability (exit price). SFAS No. 157 establishes a fair value hierarchy from observable market data as the highest level to fair value based on an entity's own fair value assumptions as the lowest level. The Statement is to be effective for our financial statements issued in 2008; however, earlier application is encouraged. We believe that SFAS No. 157 will not have a material impact on our consolidated financial statements.

In September 2006, the FASB issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans – an amendment of FASB Statements No. 87, 88, 106, and 132R," which requires the recognition of the over-funded or under-funded status of a defined benefit postretirement plan in a company's balance sheet. This portion of the new guidance is effective on December 31, 2006. Additionally, the pronouncement eliminates the option for companies to use a measurement date prior to their fiscal year-end effective December 31, 2008. SFAS No. 158 provides two approaches to transition to a fiscal year-end measurement date, both of which are to be applied prospectively. Under the first approach, plan assets are measured on September 30, 2007 and then remeasured on January 1, 2008. Under the alternative approach, a 15-month measurement will be determined on September 30, 2007 that will cover the period until the fiscal year-end measurement is required on December 31, 2008. We do not have any defined benefit pension or postretirement plans that are subject to SFAS No. 158. As such, we do not expect the pronouncement to have a material impact on our consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115," which permits companies to measure many financial instruments and certain other assets and liabilities at fair value on an instrument-by-instrument basis (the fair value option). Adoption of the standard is optional and may be adpoted beginning in the first quarter of 2007. We are currently evaluating the possible impact of adopting SFAS No. 159 on our consolidated financial statements.

RESULTS OF OPERATIONS

Revenue is 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 related data center services. In addition to our connectivity and data center services, we also provide premise-based route optimization products and other ancillary services, such as CDN, server management and installation services, virtual private networking services, managed security services, data back-up, remote storage and restoration services.

Direct cost of network and sales is comprised primarily of:

- costs for connecting to and accessing Internet network service providers and competitive local exchange providers;
- costs incurred for providing additional third party services to our customers;
- costs incurred for providing additional third party services to our customers;
- costs of Flow Control Platform solution and similar products sold; and
- amortization of technology-based intangible assets.

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. Direct cost of network and sales does not include compensation, depreciation or amortization other than the amortization of technology-based intangible assets.

Direct cost of customer support consists 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 operations centers. In addition, facilities costs associated with the network operations center are included in direct cost of customer support.

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 for software to be sold, leased or otherwise marketed are capitalized upon establishing technological feasibility and ending when the software is available for general release to customers. 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, trade shows, direct response programs, new service point launch events, management of our website 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.

Liquidity. Although we have been in existence since 1996, we have experienced significant operational restructurings in recent years, which include substantial changes in our senior management team, streamlining our cost structure, consolidating network access points and terminating certain non-strategic real estate leases and license arrangements. We have a history of quarterly and annual period net losses through the year ended December 31, 2005. For the year ended December 31, 2006, we recognized net income in each quarter with year to date net income of $3.7 million. As of December 31, 2006, our accumulated deficit was $856.5 million. We continue to analyze our business to control our costs, principally through making process enhancements and renegotiating network contracts for more favorable pricing and terms.

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

	Year Ended December 31,		
	2006	2005	2004
Revenue	**100%**	100%	100%
Costs and expense:			
Direct cost of network and sales, exclusive of depreciation and amortization shown below	**54**	54	54
Direct cost of customer support	**6**	7	7
Product development	**3**	3	4
Sales and marketing	**15**	17	16
General and administrative	**12**	13	17
Depreciation and amortization	**9**	9	11
Other operating costs and expense	**–**	–	3
Total operating costs and expense	**99**	103	112
Income (loss) from operations	**1**	(3)	(12)
Total other (income) expense, net	**(1)**	–	–
Net income (loss)	**2%**	(3)%	(12)%

Years Ended December 31, 2006 and 2005

Revenue. Revenue for 2006 increased $27.7 million, or 18%, from $153.7 million for the year ended December 31, 2005 to $181.4 million summarized as follows (in thousands):

	Year Ended December 31,	
	2006	2005
Revenue:		
Internet protocol (IP) services	**$104,393**	$ 99,848
Data center services	**53,996**	36,226
Other/reseller services	**22,986**	17,643
	$181,375	$153,717

The revenue increase is primarily attributable to growth in new and existing data center customers, resulting in an increase in data center services revenue of $17.8 million, or 49%, to $54.0 million. Revenue growth is facilitated in part by the continued expansion of our available data center space and our continued efforts to bundle our IP and data center services. The demand for data center services has outpaced industry-wide supply, which has allowed us to increase the overall pricing for the data center component of our pricing models.

Demand for IP traffic also continues to increase but with declining prices. During the year ended December 31, 2006, IP traffic over our networks increased approximately 83% from the year ended December 31, 2005. The increase in IP traffic has come as both existing and new customers require greater overall capacity due to growth in the usage of their applications as well as in the nature of applications consuming greater amounts of bandwidth. In particular, we added a number of high-traffic customers through competitive IP pricing and minimum commitments

during the year ended December 31, 2006. Overall, revenue from IP connectivity services increased $4.5 million, or 5%, to $104.4 million for the year ended December 31, 2006.

Similar to past years, revenue for the three months ending December 31, 2006 was also modestly enhanced by our customers' increased holiday traffic. Other/reseller services are specifically influenced by "bursting rates" for exceeding rate caps or usage limits in the fourth quarter of the year. Other/reseller services also include a recovery of revenue previously reserved as uncollectible, which also contributed to the increase in IP revenue for 2006.

As of December 31, 2006, our customer base totaled more than 2,250 customers across our 22 metropolitan markets.

Direct cost of network and sales. Direct cost of network and sales increased from $82.5 million for the year ended December 31, 2005 to $97.9 million for the year ended December 31, 2006, representing an increase of 19%. The increase of $15.4 million in direct cost of network and sales was largely related to variable cost components associated with revenue growth. We, however, have also had significant increases in fixed cost components as we have upgraded our P-NAP facilities and expanded data centers for customer growth. The primary components of the increase in direct costs include $11.2 million for data centers, $2.5 million for content delivery, or CDN, services, and $1.4 million related to IP services. Costs for IP services are especially subject to ongoing negotiations for pricing and minimum commitments. As our IP traffic continues to grow, we have greater bargaining power for lower bandwidth rates and more opportunities to proactively manage network costs, such as utilization and traffic optimization among network service providers.

Connectivity costs vary based upon customer traffic and other demand-based pricing variables. Data center costs have substantial fixed cost components, primarily for rent, but also significant demand-based pricing variables, such as utilities. CDN, Edge Appliance and other costs associated with reseller arrangements are generally variable in nature. We expect all of these costs to continue to increase during 2007 with any revenue increases. In addition, data center services give us access to new customers for whom we can bundle hosting and connectivity services together, potentially generating greater profitability. At December 31, 2006, we had approximately 149,000 square feet of data center space with a utilization rate of approximately 79%, as compared to approximately 124,000 square feet of data center space with a utilization rate of approximately 76% at December 31, 2005.

Other operating expenses. Compensation and facilities-related costs have a pervasive impact on operating expenses other than direct cost of network and sales. After direct cost of network and sales, compensation and benefits are our most significant expense. Cash-basis compensation and benefits were $42.9 million for both the years ended December 31, 2006 and 2005, which reflects a net increase in commissions of $1.6 million, offset by a $1.0 million decrease in salaries and wages and a $0.6 million decrease in employee benefits. The increase in commissions is revenue-driven while the decreases in compensation and benefits reflect a consistent headcount of approximately 330 full-time employees compared to December 31, 2005 and favorable experience on self-insured medical claims. Compensation for the year ended December 31, 2006 also includes a substantial increase in employee bonuses over the year ended December 31, 2005.

As discussed in note 2 of the consolidated financial statements, we adopted SFAS No. 123R on January 1, 2006. Accordingly, total operating costs and expense and net income for 2006 includes stock-based compensation expense in the following amounts:

Direct cost of customer support	$1,102
Product development	628
Sales and marketing	2,145
General and administrative	2,067
Total stock-based compensation	$5,942

Prior to the adoption of SFAS No. 123R on January 1, 2006, we utilized the disclosure only provisions of SFAS No. 123 and accounted for stock-based compensation plans under the recognition and measurement provisions of APB Opinion No. 25 and related interpretations. Accordingly, no expense was recognized for options to purchase our common stock that were granted with an exercise price equal to fair market value at the date of grant for any periods prior to January 1, 2006.

Pro forma stock-based compensation expense as previously reported for 2005 was $9.7 million. The decrease of $3.8 million in recorded stock-based compensation expense for the year ended December 31, 2006 compared to the pro forma stock-based compensation expense for the year ended December 31, 2005 is due primarily to cancellations of outstanding stock options and the difference between estimated and actual forfeitures. SFAS No. 123R requires compensation expense to be recorded net of estimated forfeitures with a subsequent adjustment to reflect actual forfeitures as they occur. Previously, forfeitures of unvested stock options were accounted for on a pro forma basis as they were incurred, generally resulting in higher pro forma stock compensation than under the current provisions of SFAS No. 123R. In addition, a significant number of unvested stock options were forfeited upon the resignation of Mr. Gregory Peters, our former Chief Executive Officer, thus reducing the number of outstanding stock options for determining comparative stock-based compensation expense for the year ended December 31, 2006.

Overall, facility and related costs, including repairs and maintenance, communications and office supplies but excluding direct cost of network and sales, decreased $0.9 million, or 13%, to $6.0 million for the year ended December 31, 2006 compared $6.9 million for the year ended December 31, 2005. Facility costs decreased $0.7 million in sales and marketing and $0.9 million in general and administrative, primarily through consolidation and cost containment efforts.

Other significant operating costs are discussed with the financial statement captions below:

Direct cost of customer support. Direct cost of customer support increased 8% from $10.7 million for the year ended December 31, 2005 to $11.6 million for the year ended December 31, 2006. The increase of $0.9 million was primarily due to increases in costs related to stock-based compensation of $1.1 million, offset by decreased compensation and employee benefits of $0.7 million, as discussed above. In addition, facilities and related expenses increased $0.7 million, based on more accurate data for allocation of costs, primarily from sales and marketing.

Product development. Product development costs for the year ended December 31, 2006 decreased 8% to $4.5 million from $4.9 million for the year ended December 31, 2005. The decrease of $0.4 million is attributable to decreases in costs related to compensation and employee benefits of $0.5 million, outside professional services of $0.5 million and training expenses of $0.1 million. The decreases were offset by an increase in stock-based compensation expense of $0.6 million for the year ended December 31, 2006, as discussed above. The decrease in compensation and employee benefits partially reflects the redeployment of technical resources from product support to internal network support, which is accounted for in general and administrative expense. The decrease in outside professional services is primarily due to a specific project in 2005.

Sales and marketing. Sales and marketing costs for the year ended December 31, 2006 increased 5% to $27.2 million from $25.9 million for the year ended December 31, 2005. The net increase of $1.3 million was primarily due to increases in stock-based compensation expense of $2.1 million and commissions of $1.6 million, offset by decreases in compensation and employee benefits expenses of $1.4 million, all of which were discussed above. Also, as discussed with direct cost of customer support above, facilities and related expenses decreased $0.7 million, largely due to more accurate data allocations of expenses to direct cost of customer support.

Outside professional services decreased $0.3 million, and travel, entertainment and training expenses decreased $0.2 million. The decreases in outside professional services and training are the result of better utilization of internal resources while the decrease in travel and entertainment resulted from an effort to reduce less essential travel. All of these reductions were partially offset by an increase of $0.3 million in marketing and advertising efforts during the year ended December 31, 2006.

General and administrative. General and administrative costs for the year ended December 31, 2006 increased 10% to $22.1 million from $20.1 million for the year ended December 31, 2005. The increase of $2.0 million reflects a $2.4 million increase in taxes (non-income based), licenses, and fees, a $2.1 million increase in stock-based compensation expense and a $1.1 million increase in compensation and employee benefits. These increases were offset by decreases in outside professional services of $0.9 million, bad debt expense of $0.9 million, facility and related expense of $0.9 million, a reduction of insurance and administrative expense of $0.3 million and a reduction of training expense of $0.2 million. Part of the increase in cash-basis compensation and benefits is the redeployment of technical resources from product support as noted under the caption product development above.

The increase in taxes, licenses and fees is principally related to a March 2005 reduction in an accrual for an assessment of $1.4 million, including interest and penalties, received in July 2004 from the New York State Department of Taxation and Finance. The New York assessment resulted from an audit of our state franchise tax returns for the years 2000–2002. In March 2005, New York State Department of Taxation and Finance reduced the assessment to $0.1 million, including interest, and waived penalties.

The increases in compensation and benefits, including stock-based compensation, and the decrease in facility-related costs are discussed above. In addition, the decrease in outside professional services can be attributed to a number of factors, including focused cost control and better utilization of internal resources. Professional services for the year ended December 31, 2006 also includes $0.6 million related to an abandoned corporate development project.

Depreciation and amortization. Depreciation and amortization, including other intangible assets, for the year ended December 31, 2006 increased 8% to $15.9 million compared to $14.7 million for the year ended December 31, 2005. The increase of $1.2 million was primarily attributed to an increased depreciable base of assets as we upgraded our P-NAP facilities and continue to expand our data center facilities.

Income taxes. The provision for income taxes reflects alternative minimum taxes as we have become profitable during the year ended December 31, 2006. We continue to maintain a full valuation allowance against our deferred tax assets of approximately $172.9 million, consisting primarily of net operating loss carryforwards. We may recognize deferred tax assets in future periods when they are determined to be realizable. To the extent we may owe income taxes in future periods, we intend to use our net operating loss carryforwards to the extent available to reduce cash outflows for income taxes.

Years Ended December 31, 2005 and 2004

Revenue. Revenue for 2005 increased $9.1 million, or 6%, from $144.5 million for the year ended December 31, 2004 to $153.7 million for the year ended December 31, 2005, summarized as follows (in thousands):

	Year Ended December 31,	
	2005	2004
Revenue:		
IP services	$ 99,848	$101,103
Data center services	36,226	25,737
Other/reseller services	17,643	17,706
	$153,717	$144,546

The increase in total revenue was primarily attributable to increases in data center services revenue of $10.5 million, or 41%, to $36.2 million. This increase principally results from growth in new and existing customers as we have expanded our available data center space. A generally positive technology services environment along with a continued focus on selling and managing data center services also contributed to the revenue increase compared to the year ended December 31, 2004. Similar to past years, revenue for the three months ending December 31, 2005 was also modestly enhanced by our customers' increased holiday traffic, much of which was subject to "bursting rates" for exceeding rate caps. Revenue from our Edge Appliance products, included in other/reseller services, contributed $4.2 million of revenue for the year ended December 31, 2005 compared to $2.7 million for the prior year. Offsetting the increase in revenue from data center services and Edge Appliance products were decreases of $1.3 million from IP connectivity services and decreases of $0.9 million in non-recurring and other revenue. Although the number of IP customers and volume has increased during the year ended December 31, 2005, revenue from IP connectivity services continues to decrease as a result of repricing of our customer base. Other/reseller services also includes termination fees and service revenue from VPN, managed security, managing customer premise equipment, and data storage services.

Our customer base increased by more than 150 customers to approximately 2,100 at December 31, 2005, an 8% increase from December 31, 2004. While our customer base grew from a year ago, revenue per customer continued to decrease due to price reductions in charges for our Internet connectivity services necessitated by general market conditions. We expect a continuing trend of future revenue increases to include an increasing percentage of revenue from non-connectivity products and services than in the past, particularly from data centers and the sale of our FCP solution and other Edge Appliance technology.

Direct cost of network and sales. Direct cost of network and sales increased from $77.6 million for the year ended December 31, 2004 to $82.5 million for the year ended December 31, 2005, representing an increase of 6%.

The increase of $4.9 million in direct cost of network and sales was primarily due to increased costs related to expanded data centers, representing $10.7 million, offset by decreases in costs from our IP connectivity services of $3.5 million due to favorable contract negotiations with service providers and improved network efficiencies. The increase was also offset by decreased expenses related to P-NAP facility costs and decreased CDN expense of $1.1 million each.

Connectivity costs vary, based upon customer traffic and other demand-based pricing variables. Data center costs have substantial fixed cost components, primarily for rent, but also significant demand-based pricing variables. Edge Appliance and CDN and other costs associated with reseller arrangements are generally variable in nature. We expect all of these costs to continue to increase during 2006 as revenue increases. Data center services provide us access to new customers for whom we can bundle hosting and connectivity services, potentially generating greater combined gross margins. At December 31, 2005, we had approximately 124,000 square feet of data center space with a utilization rate of approximately 76%.

Direct cost of customer support. Direct cost of customer support increased 5% from $10.2 million for the year ended December 31, 2004 to $10.7 million for the year ended December 31, 2005. This increase of $0.5 million is comparable to revenue growth and was primarily driven by compensation and benefits of $0.3 million for higher staffing levels, along with increases of $0.2 million in costs for outside professional services.

Product development. Product development costs for the year ended December 31, 2005 decreased 23% to $4.9 million from $6.4 million for the year ended December 31, 2004. The decrease of $1.5 million was primarily driven by a decrease of $1.6 million in compensation and employee benefits, along with a $0.2 million decrease in office equipment maintenance costs. The decrease in compensation and employee benefit costs were related to organizational changes that allowed us to reprioritize projects and more efficiently utilize certain employees. The decrease in product development costs is also attributed to the capitalization of certain project development costs in 2005. These decreases were partially offset by an increase in outside professional service expense of $0.3 million.

Sales and marketing. Sales and marketing costs for the year ended December 31, 2005 increased 11% to $25.9 million from $23.4 million for the year ended December 31, 2004, due to an increased focus for marketing Edge Appliances and technology and expansion in the Asia-Pacific region. The net increase of $2.5 million was primarily due to increases in commissions and other compensation expense of $2.1 million, as well as increases in outside professional services totaling $0.4 million, and a $0.5 million increase in facility expense. These increases were partially offset by decreases in marketing-related expenses of $0.4 million.

General and administrative. General and administrative costs for the year ended December 31, 2005 decreased 19% to $20.1 million from $24.8 million for the year ended December 31, 2004. The decrease of $4.7 million primarily reflects a $2.7 million gross reduction in taxes, licenses and fees, a $1.7 million decrease in outside professional services, $1.3 million reduction in facility, communication and office equipment, repairs, and maintenance expense, and a $1.0 million decrease in bad debt expense. These reductions were partially offset by increases of $2.0 million in employee compensation and benefits.

The reduction in taxes, licenses and fees related to the combination of an accrual in July 2004 for an assessment from the New York State Department of Taxation and Finance for $1.4 million, including interest and penalties, resulting from an audit of our state franchise tax returns for the years 2000 – 2002 and a reduction of the accrual in April 2005 when we became aware that the assessment had been reduced to $0.1 million, including interest and with penalties waived. The substantial decrease from the original assessment was a result of including the weighted averages of investment capital and subsidiary capital, along with business capital,

used in New York in determining the apportionment factor. The original assessment was based solely on an apportionment of business capital, while investment capital and subsidiary capital both have significantly lower apportionment percentages in New York.

The decrease in outside professional services of $1.7 million is largely due to substantially less use of consultants and contractors in 2005 compared to the implementation of the Sarbanes-Oxley Act of 2002 and related initiatives in 2004. The improvement in facility and related costs is attributed to focused cost controls and a much more centrally-managed purchasing function. The reduction in bad debt expense is due largely to an accrual for a large customer balance in 2004 along with a more favorable collections experience in 2005.

Depreciation and amortization. Depreciation and amortization, including non-technology-based other intangible assets, for the year ended December 31, 2005 decreased 5% to $14.7 million compared to $15.5 million for the year ended December 31, 2004. The decrease of $0.8 million was primarily due to assets becoming fully depreciated during 2005, which were not replaced by the same level of purchases of property and equipment as during prior years.

Restructuring cost. For the year ended December 31, 2005, we incurred less than $0.1 million of additional restructuring costs. These additional costs were primarily the result of a change in estimated expenses related to real estate obligations.

For the year ended December 31, 2004, the net charge of $3.6 million to restructuring resulted from an increase of $5.3 million relating to real estate obligations, offset by a reduction of $1.7 million pertaining to network infrastructure and other obligations. After reviewing the analysis in the third quarter of 2004, management concluded that the facilities remaining in the restructuring accrual were taking longer than expected to sublease and those that were subleased resulted in lower than expected sublease rates. Consequently, the projected obligations exceeded the unadjusted liability by $5.3 million over the remaining lease terms. During the quarter ended September 30, 2004, all remaining contractual obligations for network infrastructure and other costs included in the restructuring were satisfied, and we reduced the remaining recorded liability for the obligations from $1.7 million to zero.

LIQUIDITY AND CAPITAL RESOURCES

Cash Flow for the Years Ended December 31, 2006, 2005, and 2004

Net cash from operating activities. Net cash provided by operating activities was $29.6 million for the year ended December 31, 2006, and was primarily due to net income of $3.7 million adjusted for non-cash items of $25.4 million, offset by changes in working capital items of $0.5 million. The changes in working capital items include net use of cash for accounts receivable of $1.7 million, inventory, prepaid expense and other assets of $1.8 million, and accrued restructuring of $1.5 million. These were offset by net sources of cash in accounts payable of $3.0 million, accrued liabilities of $1.4 million and deferred revenue of $1.1 million. The increase in receivables at December 31, 2006 compared to December 31, 2005 was related to the 18% increase in revenue. Quarterly days sales outstanding at December 31, 2006 decreased to 38 days from 43 days as of December 31, 2005. The increase in payables is primarily related to the timing of payments with the 2006 balance being consistent with our normal operating expenses and payment terms.

Net cash provided by operating activities was $5.5 million for the year ended December 31, 2005, and was primarily due to the net loss of $5.0 million adjusted for non-cash items of $19.7 million, offset by changes in working capital items of $9.3 million. The changes in working capital items include net use of cash for accounts payable of $5.4 million, accounts receivable of $3.6 million, accrued restructuring of $1.9 million, and $0.2 million of inventory, prepaid expense and other assets. These items were offset by net sources of cash in accrued liabilities of $0.8 million and deferred revenue of $1.0 million. The increase in receivables at December 31, 2005 compared to December 31, 2004 was related to the 6% increase in revenue. The decrease in payables is primarily related to a general decrease in expenses when compared to last year.

Net cash used in operating activities was $1.2 million for the year ended December 31, 2004, and was primarily due to the net loss of $18.1 million adjusted for non-cash items of $20.8 million, offset by changes in working capital items of $3.9 million. The changes in working capital items include net use of cash for accounts receivable of $3.8 million, deferred revenue of $1.7 million, and accrued liabilities of $1.3 million. These items were offset by net sources of cash in inventory, prepaid expense and other assets of $1.6 million, accounts payable of $0.9 million and accrued restructuring costs of $0.5 million. The increase in receivables at December 31, 2004 compared to December 31, 2003 was related to the 4% increase in revenue compared to the prior year as days sales outstanding increased to 41 days from 39 days as of December 31, 2004 and 2003, respectively. The increase in payables is primarily related to more stringent cash controls in 2004 compared to 2003.

Net cash from investing activities. Net cash used in investing activities for the year ended December 31, 2006 was $10.4 million, primarily due to capital expenditures of $13.4 million. Our capital expenditures were principally for upgrading our P-NAP facilities and the expansion of our data center facilities.

Net cash used in investing activities for the year ended December 31, 2005 was $9.4 million, primarily due to capital expenditures of $10.2 million. Our capital expenditures were principally comprised of leasehold improvements related to the upgrade of several data center facilities.

Net cash used in investing activities for the year ended December 31, 2004 was $29.7 million and primarily consisted of capital expenditures of $13.1 million and total investments in marketable securities of $16.8 million, partially offset by proceeds from disposal of property and equipment and

a reduction in restricted cash of $0.1 million. Our capital expenditures were principally comprised of the buy-out of capital leases from a primary supplier of network equipment during the third quarter and build-outs of data center and office space in the latter half of the year.

Net cash from financing activities. Net cash provided by financing activities for the year ended December 31, 2006 was $2.0 million. Cash provided by financing activities was primarily due to proceeds from stock options, employee stock purchase plan and exercise of warrants of $6.8 million, offset by principal payments on a note payable of $4.4 million and payments on capital lease obligations of $0.5 million. As a result of these activities, we had $7.7 million in a note payable and $0.4 million in capital lease obligations as of December 31, 2006 with $4.7 million in the note payable and capital leases scheduled as due within the next 12 months.

Net cash used in financing activities for the year ended December 31, 2005 was $5.5 million. Cash used in financing activities included principal payments on notes payable of $6.5 million and payments on capital lease obligations of $0.5 million. These payments were partially offset by proceeds received from the exercise of stock options of $1.5 million. As a result of these activities, we had $12.0 million in notes payable and $0.8 million in capital lease obligations as of December 31.

Net cash provided by financing activities for the year ended December 31, 2004 was $45.7 million. In September 2004, we negotiated the buy-out of all remaining lease schedules under a master lease agreement with a primary supplier of network equipment. Under the terms of the buy-out agreement, we paid the supplier $19.7 million, representing remaining capital lease payment obligations, end-of-lease asset values and sales tax. The $19.7 million buy-out was paid with $2.2 million in cash on hand and the proceeds from the new $17.5 million term loan from a bank.

On March 4, 2004, we sold 40.25 million 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 $55.9 million after deducting underwriting discounts and commissions and offering expense. We continue to use the net proceeds from the offering for general corporate purposes. General corporate purposes primarily include capital investments in our network access point infrastructure and systems, expansion of data center facilities and repayment of debt and capital lease obligations. General corporate purposes could also include potential acquisitions of complementary businesses or technologies. In addition, we received $5.0 million from the exercise of stock options and warrants during the year ended December 31, 2004. Cash used in financing activities included $24.3 million toward reducing our notes payable and aforementioned capital lease obligations and $8.4 million to repay the outstanding balance on our revolving credit facility.

Liquidity. We recorded net income of $3.7 million and a net loss of $5.0 million for the years ended December 31, 2006 and 2005, respectively. As of December 31, 2006, our accumulated deficit was $856.5 million. We cannot guarantee that we will remain profitable, 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 basis, and our failure to do so would adversely affect our business, including our ability to raise additional funds.

Although we experienced positive operating cash flow for the year ended December 31, 2006, we have a history of negative operating cash flow and have primarily depended upon equity and debt financings, as well as borrowings under our credit facilities, to meet our cash requirements for most quarters since we began our operations. Furthermore, we cannot guarantee that we will continue to generate positive cash flow as we integrate VitalStream. However, we expect to meet our cash requirements in 2007 through a combination of cash from operating cash flows, existing cash, cash equivalents and short-term investments in marketable securities, borrowings under our credit facilities, and proceeds from our public offering in March of 2004. Our capital requirements depend on a number of factors, including the continued market acceptance of our services and products, 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 and products, we may require additional financing sooner than anticipated. We can offer no assurance that we will be able to obtain additional financing on commercially favorable terms, or at all, and provisions in our existing credit facility limit our ability to incur additional indebtedness. Our $5.0 million credit facility will expire on December 27, 2007. We cannot assure you that this credit facility will be renewed upon expiration on commercially favorable terms, or at all. We believe we have sufficient cash to operate our business for the foreseeable future.

Revolving credit facility. At December 31, 2006, we had a $5.0 million revolving credit facility and a $17.5 million term loan under a loan and security agreement with a bank. The agreement was reviewed and amended as of December 27, 2006, to modify the amount available for borrowing under the revolving credit agreement from $10.0 million to $5.0 million with an additional $5.0 million available as needed, decrease the letter of credit sub-limit from $6.0 million to $4.7 million, extend the expiration date of the revolving credit facility from December 28, 2006 to December 27, 2007 and update the loan covenants.

Availability under the revolving credit facility is based on 85% of eligible accounts receivable. As of December 31, 2006, $3.9 million in letters of credit were issued, and we had available $1.1 million in borrowing capacity under the revolving credit facility.

The credit facility contains certain covenants, including covenants that restrict our ability to incur further indebtedness. As of December 31, 2006, we were in compliance with the various loan covenants.

Note payable to financial institutions. The $17.5 million term loan discussed with the revolving credit facility above has a fixed interest rate of 7.5% and is due in 48 equal monthly installments of $0.4 million for principal plus interest through September 1, 2008. The balance outstanding at December 31, 2006 was $7.7 million. Proceeds from the loan were used to purchase assets recorded as capital leases under a master agreement with a primary supplier of networking equipment. The loan is secured by all of our assets, except patents.

Capital leases. Our future minimum lease payments on remaining capital lease obligations at December 31, 2006 totaled $0.5 million.

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 contractual payments to license data center 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 as of December 31, 2006 but does not include credit obligations or future contractual commitments assumed in the VitalStream acquisition consummated on February 20, 2007 (in thousands):

	Payments Due by Period				
	Total	Less than 1 year	1–3 Years	3–5 Years	More than 5 years
Note payable (1)	$ 7,656	$ 4,375	$ 3,281	$ –	$ –
Capital lease obligations (2)	456	367	89	–	–
Operating lease commitments	186,977	20,083	37,062	34,399	95,433
Service commitments	33,367	12,490	13,672	3,496	3,709
	$228,456	$37,315	$54,104	$37,895	$99,142

(1) Note payable does not include interest expense of $0.4 million and $0.1 million due in less than one year and between one and three years, respectively.

(2) Capital lease obligations include imputed interest expense of less than $0.1 million.

Common and preferred stock. Our Certificate of Incorporation includes authorization for 200 million shares of preferred stock, of which 3.5 million shares were designated as Series A. As of December 31, 2006, no shares of preferred stock were issued or outstanding.

We issued approximately 12.2 million shares of our common stock to the former stockholders of VitalStream in connection with the acquisition, which closed on February 20, 2007.

On July 10, 2006, we implemented a 1-for-10 reverse stock split and amended our Certificate of Incorporation to reduce our authorized shares from 600 million to 60 million. The Company began trading on a post-reverse split basis on July 11, 2006. All share and per share information herein (including shares outstanding, earnings per share and warrant and stock option data) have been retroactively adjusted for all periods presented to reflect this reverse split.

In June 2006, our stockholders approved a measure to reprice certain outstanding options under our existing equity incentive plans. Options with an exercise price per share greater than or equal to $13.00 were eligible for the repricing. The repricing was implemented through an exchange program under which eligible participants were offered the opportunity to exchange their eligible options for new options to purchase shares. Each new option had substantially the same terms and conditions as the eligible options cancelled except as follows:

- The exercise price per share of each replacement option granted in the exchange offer was $14.46, the average of the closing prices of the common stock as reported by the American Stock Exchange and the NASDAQ Global Market, as applicable, for the 15 consecutive trading days ending immediately prior to the grant date of the replacement options;

- For all eligible options with an exercise price per share greater than or equal to $20.00, the exchange ratio was 1-for-2; and

- Each new option has a three-year vesting period, vesting in equal monthly installments over three years, so long as the grantee continues to be a full-time employee of the Company and has a ten-year term.

Employees of the Company eligible to participate in the exchange offer tendered, and the Company accepted for cancellation, eligible options to purchase an aggregate of 344,987 shares of common stock, representing 49.4% of the total shares of common stock underlying options eligible for exchange in the exchange offer. The Company issued replacement options to purchase an aggregate of 179,043 shares of common stock in exchange for the cancellation of the tendered eligible options.

On March 4, 2004, we sold 4.03 million shares of our common stock in a public offering at a purchase price of $15.00 per share which resulted in net proceeds to us of $55.9 million, after deducting underwriting

discounts and commissions and offering expense. We continue to use the net proceeds from the offering for general corporate purposes. General corporate purposes primarily include capital investments in our network access point infrastructure and systems, expansion of data center facilities and repayment of debt and capital lease obligations. General corporate purposes could also include potential acquisitions of complementary businesses or technologies.

ASSET IMPAIRMENT AND RESTRUCTURING COSTS

As described in note 3 to the financial statements, we recognized an impairment charge of $0.3 million during the year ended December 31, 2006 for certain costs incurred on a new financial accounting system. Additionally, we implemented significant restructuring plans in 2001 and 2002 that resulted in substantial charges for real estate and network infrastructure obligations, personnel and other charges. Additional charges have subsequently been incurred as we continued to evaluate our restructuring reserve. Nominal charges were recorded in the years ended December 31, 2006 and 2005, and net restructuring charges of $3.6 million were recorded during the year ended December 31, 2004. We may incur additional changes in future periods.

OFF-BALANCE SHEET ARRANGEMENTS

As discussed in note 4 to the consolidated financial statements, we maintain a 51% ownership interest in Internap Japan, a joint venture with NTT-ME Corporation of Japan and another NTT affiliate. Due to certain minority interest protections afforded to our joint venture partners, 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, revenue and expense would be consolidated.

As discussed in note 13 to the consolidated financial statements, warrants to purchase approximately 34,000 shares of our common stock at a weighted exercise price of $9.50 per share were outstanding as of December 31, 2006.

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, we record them on the balance sheet at fair value.

Other investments. We have a $1.2 million equity investment in Aventail, a privately-held company, after reducing 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 investment in Aventail.

We have also invested $4.1 million in Internap Japan, our joint venture with NTT-ME Corporation and another NTT affiliate. This investment is accounted for using the equity-method and to date we have recognized $3.5 million in equity-method losses, representing our proportionate share of the aggregate joint venture losses and income. Furthermore, the joint venture investment is subject to foreign currency exchange rate risk. The market for services being offered by Internap Japan has not been proven and may never materialize.

Note payable. As of December 31, 2006, we had a note payable recorded at its present value of $7.7 million bearing a rate of interest which we believe is commensurate with its associated market risk.

Capital leases. As of December 31, 2006, we had capital leases recorded at $0.4 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, 2006, we had $1.1 million available under our revolving credit facility with a bank, and the balance outstanding under the $17.5 million term loan was $7.7 million. The interest rate for the loan was fixed at 7.5%. The interest rate under the revolving credit facility is variable and was 8.75% at December 31, 2006. 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 favorable long-term fixed rate or 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. The table below presents principal cash flows by expected maturity dates for our debt obligations that extend beyond one year as of December 31, 2006 (dollars in thousands):

	2007	2008	Fair Value
Long-term debt:			
Term loan	$4,375	$3,281	$7,656
Interest rate	7.5%	7.5%	7.5%

Foreign currency risk. Substantially all of our revenue is currently in United States dollars and from customers primarily in the United States. We do not believe, therefore, that we currently have any significant direct foreign currency exchange rate risk.

Inflation. The effect of inflation and changing prices on net sales and revenues and income from continuing operations has not been material to the Company.

Consolidated Statements of Operations

Financial Review 2006

(In thousands, except per share amounts)	Year Ended December 31, 2006	2005	2004
Revenue	$ 181,375	$153,717	$ 144,546
Costs and expense:			
Direct cost of network and sales, exclusive of depreciation and amortization, shown below	97,854	82,535	77,569
Direct cost of customer support	11,566	10,670	10,180
Product development	4,475	4,864	6,412
Sales and marketing	27,173	25,864	23,411
General and administrative	22,104	20,096	24,772
Depreciation and amortization	15,856	14,737	15,461
Asset impairment and restructuring	323	44	3,644
Amortization of deferred stock compensation	–	60	–
Gain on disposals of property and equipment	(113)	(19)	(3)
Total operating costs and expense	179,238	158,851	161,446
Income (loss) from operations	2,137	(5,134)	(16,900)
Non-operating (income) expense:			
Interest expense	883	1,373	1,981
Interest income	(2,305)	(1,284)	(665)
Other, net	(129)	(176)	(544)
Total non-operating (income) expense	(1,551)	(87)	772
Net income (loss) before income taxes and equity in earnings of unconsolidated subsidiary	3,688	(5,047)	(17,672)
Provision for income taxes	145	–	–
Equity in (earnings) loss of equity-method investment, net of taxes	(114)	(83)	390
Net income (loss)	$ 3,657	$ (4,964)	$ (18,062)
Net income (loss) per share:			
Basic	$ 0.11	$ (0.15)	$ (0.63)
Diluted	$ 0.10	$ (0.15)	$ (0.63)
Weighted average shares used in per share calculations			
Basic	34,748	33,939	28,732
Diluted	35,739	33,939	28,732

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

Consolidated Balance Sheets

Financial Review 2006

(In thousands, except per share amounts)	Year Ended December 31, 2006	2005
ASSETS		
Current assets:		
Cash and cash equivalents	$ 45,591	$ 24,434
Short-term investments in marketable securities	13,291	16,060
Accounts receivable, net of allowance of $888 and $963, respectively	20,282	19,128
Inventory	474	779
Prepaid expenses and other assets	3,818	2,741
Total current assets	83,456	63,142
Property and equipment, net	47,493	50,072
Investments	2,135	1,999
Intangible assets, net	1,785	2,329
Goodwill	36,314	36,314
Deposits and other assets	2,519	1,513
Total assets	$ 173,702	$ 155,369
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Note payable, current portion	$ 4,375	$ 4,375
Accounts payable	8,776	5,766
Accrued liabilities	8,689	7,267
Deferred revenue, current portion	3,260	2,737
Capital lease obligations, current portion	347	559
Restructuring liability, current portion	1,400	1,202
Other current liabilities	84	–
Total current liabilities	26,931	21,906
Note payable, less current portion	3,281	7,656
Deferred revenue, less current portion	1,080	533
Capital lease obligations, less current portion	83	247
Restructuring liability, less current portion	3,384	5,075
Deferred rent	11,432	9,185
Other long-term liabilities	986	1,039
Total liabilities	$ 47,177	$ 45,641
Commitments and contingencies		
Stockholders' equity:		
Series A convertible preferred stock, $0.001 par value, 3,500 shares designated, no shares issued or outstanding	–	–
Common stock, $0.001 par value, 60,000 shares authorized, 35,873 and 34,168 shares issued and outstanding, respectively	36	34
Additional paid-in capital	982,624	970,221
Deferred stock compensation	–	(420)
Accumulated deficit	(856,455)	(860,112)
Accumulated items of other comprehensive income	320	5
Total stockholders' equity	126,525	109,728
Total liabilities and stockholders' equity	$ 173,702	$ 155,369

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

Consolidated Statements of Stockholders' Equity and Comprehensive Income (Loss)

Financial Review 2006

(In thousands)	Series A Convertible Preferred Stock		Common Stock		Additional Paid-In Capital	Treasury Stock	Deferred Stock Compensation	Accumulated Deficit	Accumulated Items of Comprehensive Income (Loss)	Total Stockholders' Equity
	Shares	Par Value	Shares	Par Value						
Balance, December 31, 2003	1,751	$ 51,841	22,875	$23	$855,446	$ –	$ –	$(837,086)	$300	$ 70,524
Net loss	–	–	–	–	–	–	–	(18,062)	–	(18,062)
Change in unrealized gains and losses on investments	–	–	–	–	–	–	–	–	68	68
Foreign currency translation adjustment	–	–	–	–	–	–	–	–	229	229
Total comprehensive loss										(17,765)
Conversion of Series A convertible preferred stock	(1,751)	(51,841)	5,900	6	51,835	–	–	–	–	–
Issuance of common stock, net of issuance cost	–	–	4,025	4	55,928	–	–	–	–	55,932
Stock compensation plans activity	–	–	897	1	4,972	–	–	–	–	4,973
Exercise of warrants	–	–	118	–	74	–	–	–	–	74
Balance, December 31, 2004	–	–	33,815	34	968,255	–	–	(855,148)	597	113,738
Net loss	–	–	–	–	–	–	–	(4,964)	–	(4,964)
Change in unrealized gains and losses on investments	–	–	–	–	–	–	–	–	(118)	(118)
Foreign currency translation adjustment	–	–	–	–	–	–	–	–	(474)	(474)
Total comprehensive loss										(5,556)
Deferred stock compensation grant	–	–	–	–	480	–	(480)	–	–	–
Amortization of deferred stock compensation	–	–	–	–	–	–	60	–	–	60
Stock compensation plans activity	–	–	353	–	1,486	–	–	–	–	1,486
Balance, December 31, 2005	–	–	34,168	34	970,221	–	(420)	(860,112)	5	109,728
Net income	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**3,657**	**–**	**3,657**
Change in unrealized gains and losses on investments	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**80**	**80**
Foreign currency translation adjustment	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**235**	**235**
Total comprehensive income										**3,972**
Reclassification of deferred stock compensation resulting from implementation of SFAS No. 123R	**–**	**–**	**–**	**–**	**(420)**	**–**	**420**	**–**	**–**	**–**
Stock-based compensation	**–**	**–**	**578**	**1**	**5,985**	**(395)**	**–**	**–**	**–**	**5,591**
Stock compensation plans activity	**–**	**–**	**576**	**1**	**3,030**	**395**	**–**	**–**	**–**	**3,426**
Exercise of warrants	**–**	**–**	**551**	**–**	**3,808**	**–**	**–**	**–**	**–**	**3,808**
Balance, December 31, 2006	**–**	**–**	**35,873**	**$36**	**$982,624**	**$ –**	**$ –**	**$(856,455)**	**$320**	**$126,525**

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

Consolidated Statements of Cash Flows

Financial Review 2006

(In thousands)	Year Ended December 31, 2006	2005	2004
Cash flows from operating activities:			
Net income (loss)	$ 3,657	$ (4,964)	$ (18,062)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Depreciation and amortization	16,372	15,314	16,040
Gain on disposal of property and equipment, net	(113)	(19)	(3)
Provision for doubtful accounts	548	1,431	2,415
Equity in (earnings) loss of equity-method investment	(114)	(83)	390
Non-cash changes in deferred rent	2,247	2,690	879
Stock-based compensation expense	5,942	75	–
Asset impairment	319	–	–
Lease incentives	–	713	–
Non-cash interest expense on capital lease obligations	–	–	904
Other, net	212	(397)	176
Changes in operating assets and liabilities:			
Accounts receivable	(1,702)	(3,616)	(3,771)
Inventory, prepaid expense and other assets	(1,778)	(170)	1,633
Accounts payable	3,010	(5,433)	851
Accrued liabilities	1,422	805	(1,316)
Deferred revenue	1,070	1,023	(1,743)
Accrued restructuring	(1,493)	(1,876)	457
Net cash flows provided by (used in) operating activities	29,599	5,493	(1,150)
Cash flows from investing activities:			
Purchases of investments in marketable securities	(17,427)	(18,710)	(16,753)
Maturities of marketable securities	20,277	19,350	–
Purchases of property and equipment	(13,382)	(10,161)	(13,066)
Proceeds from disposal of property and equipment	133	17	51
Reduction of restricted cash	–	76	49
Other, net	–	–	60
Net cash flows (used in) provided by investing activities	(10,399)	(9,428)	(29,659)
Cash flows from financing activities:			
Change in revolving credit facility	–	–	(8,392)
Proceeds from note payable	–	–	17,500
Principal payments on notes payable	(4,375)	(6,483)	(4,051)
Payments on capital lease obligations	(538)	(512)	(20,289)
Proceeds from issuance of common stock, net of issuance costs	–	–	55,932
Proceeds from exercise of warrants	3,808	–	74
Proceeds from exercise of stock options and employee stock purchase plan	3,031	1,471	4,973
Other, net	31	70	–
Net cash flows provided by (used in) financing activities	1,957	(5,454)	45,747
Net increase (decrease) in cash and cash equivalents	21,157	(9,389)	14,938
Cash and cash equivalents at beginning of period	24,434	33,823	18,885
Cash and cash equivalents at end of period	$ 45,591	$ 24,434	$ 33,823
Supplemental disclosure of cash flow information:			
Cash paid for interest, net of amounts capitalized	$ 793	$ 1,223	$ 1,767
Cash paid for taxes	149	–	–
Non-cash acquisition of property and equipment	162	971	1,597
Capitalized stock-based compensation	43	–	–
Conversion of preferred stock to common stock	–	–	51,841

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

1. DESCRIPTION OF THE COMPANY AND NATURE OF OPERATIONS

Internap Network Services Corporation ("Internap," "we," "us," "our" or the "Company") markets products and services that provide managed and premise-based Internet Protocol, or IP, and route optimization technologies that enable business-critical applications such as e-commerce, customer relationship management, or CRM, video and audio streaming, Voice-over-IP, or VoIP, virtual private networks, or VPNs, and supply chain management. Our product and service offerings are complemented by IP access solutions such as data center services, content delivery networks, or CDN, and managed security. We deliver services through our 43 network access points across North America, London, and the Asia-Pacific region, including Tokyo. Our Private Network Access Points, or P-NAPs, feature multiple direct high-speed connections to major Internet networks, including AT&T, Sprint, Verizon, (formerly MCI), Savvis, Global Crossing Telecommunications, and Level 3 Communications.

The nature of our business subjects us 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.

Although we have been in existence since 1996, we have incurred significant operational restructurings in recent years, which have included substantial changes in our senior management team, streamlining our cost structure, consolidating network access points, terminating certain non-strategic real estate leases and license arrangements. We have a history of quarterly and annual period net losses through the year ended December 31, 2005. For the year ended December 31, 2006, we recognized net income in each quarter with year to date net income of $3.7 million. At December 31, 2006, our accumulated deficit was $856.5 million. We continue to analyze our business to control our costs, principally through making process enhancements and renegotiating network contracts for more favorable pricing and terms.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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 intercompany 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, revenue and expense, and related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates, including those related to revenue recognition, doubtful accounts, cost-basis investments, intangible assets, stock-based compensation, 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 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.

Investments in marketable securities

Marketable securities primarily include high credit quality corporate debt securities and U.S. Government Agency debt securities. Management determines the appropriate classification of marketable securities at the time of purchase. At December 31, 2006 and 2005, all marketable securities are classified as available-for-sale. Available-for-sale securities are carried at fair value, with the unrealized gains and losses reported in other comprehensive income. Our marketable securities are reviewed each reporting period for declines in value that are considered to be other-than temporary and, if appropriate, written down to their estimated fair value. Realized gains and losses and declines in value judged to be other-than-temporary on available-for-sale securities are included in other non-operating income (expense) in the consolidated statements of operations. The cost of securities sold is based on the specific identification method. Interest and dividends on securities classified as available-for-sale are included in interest income in the consolidated statements of operations.

Other 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 have a $1.2 million equity investment at December 31, 2006 in Aventail Corporation, or Aventail, a privately-held company, after having reduced the balance for an impairment loss of $4.8 million in 2001. The carrying value of our investment in Aventail is recorded in non-current investments in the accompanying consolidated balance sheets.

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, 2006, Internap Japan Co. Ltd., or Internap Japan, our joint venture with NTT-ME Corporation of Japan and another NTT affiliate, qualifies for equity method accounting. We record our proportional share of the income and losses of Internap Japan one month in arrears on the consolidated balance sheets as a component of non-current investments and our share of Internap Japan's income and losses, net of taxes, as separate caption in our consolidated statements of operations.

Fair value of financial instruments

Our short-term financial instruments, including cash and cash equivalents, accounts receivable, accounts payable, note payable, and capital lease obligations are carried at cost. The cost of our short-term financial instruments approximate fair value due to their relatively short maturities. Our marketable securities are designated as available-for-sale and are recorded at fair value with changes in fair value reflected in other comprehensive income. The carrying value of our long-term financial instruments, including note payable and capital lease obligations, approximate fair value as the interest rates approximate current market rates of similar debt obligations.

Management evaluates outstanding accounts receivable for collectibility each period. This evaluation involves assessing the aging of the amounts due to the Company and reviewing the creditworthiness of customers. Based on this evaluation, we record an allowance for accounts receivable that are estimated to not be collectible.

Financial instrument credit risk

Financial instruments that potentially subject us to a concentration of credit risk principally consist of cash, cash equivalents, marketable securities and trade receivables. We currently invest the majority of our cash in money market funds and maintain them with financial institutions with high credit ratings. We also invest in debt instruments of the U.S. government and its agencies and corporate issuers with high credit ratings. As part of our cash management process, we perform periodic evaluations of the relative credit ratings of these financial institutions. We have not experienced any credit losses on our cash, cash equivalents or marketable securities.

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, or FCP, and our Flow Control Xcelerator, or FCX, solutions.

Property and equipment

Property and equipment is carried at original acquisition cost less accumulated depreciation and amortization. Depreciation and amortization are calculated on a straight-line basis over the lesser of the estimated useful lives of the assets or the lease term. Estimated useful lives used for network equipment are generally three years; furniture, equipment and software are three to seven years; and leasehold improvements are seven years or over the lease term, depending on the nature of the improvement, but in no event beyond the lease term. The duration of lease obligations and commitments range from 24 months for certain networking equipment to 240 months for certain facility leases. 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 disposals of property and equipment are charged to operations.

Leases and leasehold improvements

We record leases as capital or operating leases and account for leasehold improvements in accordance with Statement of Financial Accounting Standards (SFAS) No. 13, "Accounting for Leases" and related literature. Rent expense for operating leases is recorded in accordance with Financial Accounting Standards Board (FASB) Technical Bulletin (FTB) No. 88-1, "Issues Relating to Accounting for Leases." This FTB requires lease agreements that include periods of free rent or other incentives, specific escalating lease payments, or both, to be recorded on a straight-line or other systematic basis over the initial lease term and those renewal periods that are reasonably assured. The difference between rent expense and rent paid is recorded as deferred rent in non-current liabilities in the consolidated balance sheets.

Costs of computer software development

In accordance with the American Institute of Certified Public Accountants' 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. We capitalized $0.9 million and $1.9 million in internal software development costs for the years ended December 31, 2006 and 2004, respectively. We did not capitalize any costs during the year ended December 31, 2005.

As of December 31, 2006 and 2005, the balance of unamortized software costs was $2.5 million and $1.9 million, respectively. The software has not been placed in service as of December 31, 2006, so no amortization expense has been recorded.

For the year ended December 31, 2005 we capitalized $0.5 million of costs for internally developed software in accordance with SFAS No. 86, "Accounting for the Costs of Computer Software to Be Sold, Leased or Otherwise Marketed." No amounts were capitalized for the years ended December 31, 2006 or 2004. As of December 31, 2006 and 2005, the balance of unamortized software costs was $0.2 million and $0.1 million, respectively, and for the years ended December 31, 2006 and 2005, amortization expense was $0.2 million and $0.4 million, respectively.

Goodwill and other intangible assets

In accordance with SFAS No. 142 "Goodwill and Other Intangible Assets," we review our goodwill for impairment annually or more frequently if facts and circumstances warrant a review. The provisions of SFAS No. 142 require that a two-step test be performed to assess goodwill for impairment. First, the fair value of each reporting unit is compared to its carrying value. If the fair value exceeds the carrying value, goodwill is not impaired and no further

testing is performed. The second step is performed if the carrying value exceeds the fair value. The implied fair value of the reporting unit's goodwill must be determined and compared to the carrying value of the goodwill. If the carrying value of a reporting unit's goodwill exceeds its implied fair value, an impairment loss equal to the difference will be recorded. We completed our annual goodwill impairment test as of August 1, 2006 and determined that the carrying amount of goodwill was not impaired.

Other acquired intangible assets, including developed technologies and patents, have finite lives, and we have recorded these assets at cost less accumulated amortization. Amortization is calculated on a straight-line basis over the estimated economic useful life of the assets, which is three to seven years for developed technologies and fifteen years for patents.

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

Effective January 1, 2006, we adopted SFAS No. 123 (revised 2004), "Share-Based Payment" (SFAS No. 123R) and related interpretations, using the modified prospective transition method and therefore have not restated prior periods' results. SFAS No. 123R establishes the accounting for equity instruments exchanged for employee services. Under SFAS No. 123R, share-based compensation cost is measured at the grant date based on the calculated fair value of the award. The expense is recognized over the employees' requisite service period, generally the vesting period of the award. Prior to the adoption of SFAS No. 123R on January 1, 2006, we accounted for stock-based compensation plans under the recognition and measurement provisions of Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations. We also provided disclosures in accordance with SFAS No. 123, "Accounting for Stock-Based Compensation," as amended by SFAS No. 148, "Accounting for Stock-Based Compensation – Transition and Disclosures – an Amendment of FASB Statement No. 123." Accordingly, no expense was recognized for options to purchase our common stock that were granted with an exercise price equal to fair market value at the date of grant and no expense was recognized in connection with purchases under our employee stock purchase plans for any periods prior to January 1, 2006.

On November 10, 2005, the FASB issued FASB Staff Position No. FAS 123R-3, "Transition Election Related to Accounting for Tax Effects of Share-Based Payment Awards," that allows for a simplified method to establish the beginning balance of the APIC pool related to the tax effects of employee stock-based compensation, and to determine the subsequent impact on the APIC pool and consolidated statements of cash flows of the tax effects of employee stock-based compensation awards that are outstanding upon adoption of SFAS 123R. In 2006, the Company adopted the alternative transition method provided in the FASB Staff Position for calculating the tax effects of stock-based compensation pursuant to SFAS 123R. The adoption did not have a material impact on our results of operations and financial condition.

SFAS No. 123R does not allow the recognition of a deferred tax asset for unrealized tax benefits associated with the tax deductions in excess of the compensation recorded (excess tax benefit). The Company will recognize a benefit from stock-based compensation in equity if the excess tax benefit is realized by following the tax law ordering approach.

Treasury stock

As permitted by our stock-based compensation plans, we may, from time to time, acquire shares of treasury stock as payment of taxes due from employees for stock-based compensation. During 2006, shares of treasury stock were acquired as payment of taxes and subsequently reissued as part of our stock-based compensation plans. When shares are reissued, we use the weighted average cost method for determining cost. The difference between the cost of the shares and the issuance price is added or deducted from additional contributed capital.

Reverse stock split

On July 10, 2006, we implemented a 1-for-10 reverse stock split on our common stock and amended our Certificate of Incorporation to reduce our authorized shares from 600 million to 60 million. We began trading on a post reverse split basis on July 11, 2006. All share and per share information herein (including shares outstanding, earnings per share and warrant and stock option data) have been retroactively adjusted for all periods presented to reflect this reverse split.

Revenue recognition and concentration of credit risk

The majority of our revenue is derived from high-performance Internet connectivity and related data center services. Our revenue is 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. Ancillary services include data center services, content delivery network, or CDN, services, server management and installation services, virtual private networking services, managed security services, data back-up, remote storage and restoration services. We also offer T-1 and fractional DS-3 connections at fixed rates.

We recognize revenue when persuasive evidence of an arrangement exists, the product, service or software license has been delivered, the fees are fixed or determinable and collectibility is probable. Contracts and sales or purchase orders are used to determine the existence of an arrangement. We test for availability or use shipping documents when applicable to verify delivery of our services, products or software licenses. 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 revenue consists of revenue for services to be delivered in the future and consists primarily of advance billings, which are amortized over the respective service period. Revenue associated with billings for installation of customer network equipment is deferred and amortized over the estimated life of the customer relationship, which is generally two years, as the installation service is integral to our primary service offering and does not have value to a customer on a stand-alone basis. Deferred post-contract customer support associated with sales of our FCP solution and similar products are amortized ratably over the contract period, which is generally one year.

We routinely review the creditworthiness and payment status of our customers. If we determine that collection of service revenue 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. The allowance for doubtful accounts is based upon specific and general customer information, which also includes estimates based on management's best understanding of our customers' ability to pay and their payment status. Customers' ability to pay takes into consideration payment history, legal status (e.g., bankruptcy), and the status of services we are providing. We assess the payment status of customers by reference to the terms under which services or goods are provided with any payments not made on or before their due date considered past-due. Once all collection efforts have been exhausted, we write the uncollectible balance off against the allowance for doubtful accounts. We also estimate a reserve for sales adjustments, which reduces net accounts receivable and revenue. The reserve for sales adjustments is based upon specific and general customer information, including outstanding promotional credits, customer disputes, credit adjustments not yet processed through the billing system and historical activity. If the financial condition of our customers were to deteriorate, or management become aware of new information impacting a customer's credit risk, additional allowances may be required.

Research and 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 as software development are expensed as incurred. Research and development costs, which are included in product development cost and are expensed as incurred, primarily consist of compensation related to our development and enhancement of IP Routing Technology, the FCP and BusinessNet acceleration technologies. Research and development costs were $2.4 million, $2.9 million and $2.4 million for the years ended December 31, 2006, 2005, and 2004, respectively.

Advertising costs

We expense all advertising costs as they are incurred. Advertising costs for 2006, 2005 and 2004 were $1.3 million, $0.2 million and $1.3 million, respectively.

Net income (loss) per share

Basic and diluted net income (loss) per share has been computed using the weighted average number of shares of common stock outstanding during the period. Diluted net income (loss) per share is computed using the weighted average number of common and potentially dilutive shares outstanding during the period. Potentially dilutive shares consist of the incremental common shares issuable upon the exercise of outstanding stock options and warrants and unvested restricted stock using the treasury stock method. The treasury stock method calculates the dilutive effect for only those stock options and warrants for which the sum of proceeds, including unrecognized compensation and windfall tax benefits, if any, is less than the average stock price during the period presented. Potentially dilutive shares are excluded from the computation of net income (loss) per share if their effect is antidilutive.

Basic and diluted net income (loss) per share for the years ended December 31, 2006, 2005 and 2004 are calculated as follows (in thousands, except per share amounts):

	Year Ended December 31,		
	2006	2005	2004
Net income (loss)	**$ 3,657**	$ (4,964)	$ (18,062)
Weighted average shares used in per share calculations:			
Basic	**34,748**	33,939	28,732
Diluted	**35,739**	33,939	28,732
Net income (loss) per share:			
Basic	**$ 0.11**	$ (0.15)	$ (0.63)
Diluted	**$ 0.10**	$ (0.15)	$ (0.63)
Antidilutive securities not included in diluted net income (loss) per share calculation:			
Options to purchase common stock	**1,408**	35,562	43,949
Restricted stock	**–**	1,000	–
Warrants to purchase common stock	**–**	14,998	14,998
	1,408	51,560	58,947

Reclassifications

In 2005 and 2004, direct cost of network and sales did not include amortization of purchased technology and such amounts were included in depreciation and amortization. In accordance with Question 17 of the Financial Accounting Standards Board (FASB) Implementation Guide to Statement of Financial Accounting Standard (SFAS) No. 86, "Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed," we have reclassified these costs from "Depreciation and amortization" to "Direct cost of network and sales" in the accompanying consolidated statements of operations with the following effect (in thousands):

	Year Ended December 31,	
	2005	2004
Direct cost of network and sales, exclusive of depreciation and amortization shown below:		
Previously reported	$81,958	$76,990
Reclassification	577	579
As reclassified	$82,535	$77,569
Depreciation and amortization:		
Previously reported	$15,314	$16,040
Reclassification	(577)	(579)
As reclassified	$14,737	$15,461

These reclassifications had no effect on previously reported operating loss or net loss.

Segment information

We use the management approach for determining which, if any, of our products and services, 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 any reportable segments. Since the sale of products and the related assets comprise less than 10% of our total revenue and total assets, respectively, management does not disaggregate its business for internal reporting and therefore presents a single business segment. Through December 31, 2006, neither revenue generated nor long-lived assets located outside the United States were significant, as all were less than 10%.

Recent accounting pronouncements

In February 2006, the FASB issued SFAS No. 155, "Accounting for Certain Hybrid Financial Instruments – an amendment of FASB Statements No. 133 and 140." SFAS No. 155 eliminates the exemption from applying SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," to interests in securitized financial assets so that similar instruments are accounted for similarly, regardless of the form of the instruments. SFAS No. 155 also allows issuers of financial statements to elect fair value measurement at acquisition, at issuance, or when a previously recognized financial instrument is subject to a remeasurement (new basis) event, on an instrument-by-instrument basis, in cases in which a derivative would otherwise have to be bifurcated. SFAS No. 155 is effective for all financial instruments acquired or issued after the first fiscal year beginning after September 15, 2006. We believe that SFAS No. 155 will not have a material impact on our consolidated financial statements.

In March 2006, the FASB issued SFAS No. 156, "Accounting for Servicing of Financial Assets – an amendment of FASB Statement No. 140." SFAS No. 156 requires that all separately recognized servicing assets and servicing liabilities be initially measured at fair value, if practicable. It also permits, but does not require, the subsequent measurement of servicing assets and servicing liabilities at fair value. An entity that uses derivative instruments to mitigate the risks inherent in servicing assets and servicing liabilities is required to account for those derivative instruments at fair value. Under SFAS No. 156, an entity can elect subsequent fair value measurement of its servicing assets and servicing liabilities by class, thus simplifying its accounting and providing for income statement recognition of the potential offsetting changes in fair value of the servicing assets, servicing liabilities, and related derivative instruments. An entity that elects to subsequently measure servicing assets and servicing liabilities at fair value is expected to recognize declines in fair value of the servicing assets and servicing liabilities more consistently than by reporting other-than-temporary impairments. SFAS No. 156 is effective for fiscal years beginning after September 15, 2006. We believe that SFAS No. 156 will not have a material impact on our consolidated financial statements.

In June 2006, Emerging Issues Task Force Issue No. 06-3, "How Sales Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross Versus Net Presentation)" (EITF 06-3), was issued. EITF 06-3 requires disclosure of the presentation of taxes on either a gross (included in revenues and costs) or a net (excluded from revenues) basis as an accounting policy decision. The provisions of this standard are effective for interim and annual reporting periods beginning after December 15, 2006. We do not expect the adoption of EITF 06-3 to have a material impact on our consolidated financial statements.

In June 2006, the FASB issued FASB Interpretation No. 48 (FIN 48), "Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109, Accounting for Income Taxes," which clarifies the accounting for uncertainty in income taxes. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The Interpretation requires that we recognize in the financial statements the impact of a tax position, if that position is more-likely-than-not of being sustained on audit, based on the technical merits of the position. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, and disclosure. The provisions of FIN 48 are effective beginning January 1, 2007 with the cumulative effect of the change in accounting principle recorded as an adjustment to opening retained earnings. We are continuing to evaluate the possible impact of FIN 48 on our consolidated financial statements.

In September 2006, the Securities and Exchange Commission, or SEC, released Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements When Quantifying Misstatements in Current Year Financial Statements" (SAB 108). SAB 108 provides guidance on how the effects of the carryover or reversal of prior year financial statement misstatements should be considered in quantifying a current year misstatement. Prior practice allowed the evaluation of materiality on the basis of the error quantified as the amount by which the current year income statement was misstated (rollover method) or the cumulative error quantified as the cumulative amount by which the current year balance sheet was misstated (iron curtain method). The guidance provided in SAB 108 requires both methods to be used in evaluating materiality. Immaterial prior year errors may be corrected with the first filing of prior year financial statements after adoption. The cumulative effect of the correction would be reflected in the opening balance sheet with appropriate disclosure of the nature and amount of each individual error corrected in the cumulative adjustment, as well as a disclosure of the cause of the error and that the error had been deemed to be immaterial in the past. The adoption of SAB 108 did not have a material impact on our consolidated financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, "Fair Value Measurements" (SFAS No. 157). SFAS No. 157 defines fair value as used in numerous accounting pronouncements, establishes a framework for measuring fair value in generally accepted accounting principles, or GAAP, and expands disclosure related to the use of fair value measures in financial statements. SFAS No. 157 does not expand the use of fair value measures in financial statements, but standardizes its definition and guidance in GAAP. SFAS No. 157 emphasizes that fair value is a market-based measurement and not an entity-specific measurement based on an exchange transaction in which the entity sells an asset or transfers a liability (exit price). SFAS No. 157 establishes a fair value hierarchy from observable market data as the highest level to fair value based on an entity's own fair value assumptions as the lowest level. SFAS No. 157 is to be effective for our financial statements issued in 2008; however, earlier application is encouraged. We believe that SFAS No. 157 will not have a material impact on our consolidated financial statements.

In September 2006, the FASB issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans – an amendment of FASB Statements No. 87, 88, 106, and 132R," which requires the recognition of the over-funded or under-funded status of a defined benefit postretirement plan in a company's balance sheet. This portion of the new guidance is effective on December 31, 2006. Additionally, the pronouncement eliminates the option for companies to use a measurement date prior to their fiscal year-end effective December 31, 2008. SFAS No. 158 provides two approaches to transition to a fiscal year-end measurement date, both of which are to be applied prospectively. Under the first approach, plan assets are measured on September 30, 2007 and then remeasured on January 1, 2008. Under the alternative approach, a 15-month measurement will be determined on September 30, 2007 that will cover the period until the fiscal year-end measurement is required on December 31, 2008.

We do not have any defined benefit pension or postretirement plans that are subject to SFAS No. 158. As such, we do not expect the pronouncement to have a material impact on our consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115," which permits companies to measure many financial instruments and certain other assets and liabilities at fair value on an instrument-by-instrument basis (the fair value option). Adoption of the standard is optional and may be adpoted beginning in the first quarter of 2007. We are currently evaluating the possible impact of adopting SFAS No. 159 on our consolidated financial statements.

3. ASSET IMPAIRMENT AND RESTRUCTURING COSTS

In 2004, we began the implementation of a new financial system. In accordance with the American Institute of Certified Public Accountants (AICPA) Statement of Position (SOP) 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use," certain costs related to the system implementation were capitalized. Implementation of the financial system was suspended at the end of 2004, and resumed during 2006 with a new vendor to assist in the initial phase of the implementation. During the 2006 implementation process and as part of our periodic evaluation of the carrying value of long-lived assets, management evaluated the carrying value of the costs capitalized during the 2004 implementation in accordance with the guidance provided by SFAS No. 144, "Accounting for the Impairment and Disposal of Long-Lived Assets." We determined that due to the selection of a new implementation vendor, process changes resulting from internal reorganizations and new procedures established to comply with the Sarbanes-Oxley Act of 2002, some of the work completed during the 2004 implementation would no longer be used and that the related carrying value of the capitalized costs was not recoverable. As such, management recognized an impairment charge of $0.3 million during the year ended December 31, 2006.

In 2001 and 2002, we implemented significant restructuring plans that resulted in substantial charges for real estate and network infrastructure obligations, personnel and other charges. Additional related charges have subsequently been incurred as we continue to evaluate our restructuring reserve.

In 2006, we recorded a nominal charge for net changes in estimated expenses related to real estate obligations. The following table displays the activity and balances for restructuring activity for 2006 (in thousands):

	December 31, 2005 Restructuring Liability	Restructuring Charges	Cash Reductions	**December 31, 2006 Restructuring Liability**
Restructuring costs activity for 2001 restructuring charge:				
Real estate obligations	$6,277	$4	$(1,497)	**$4,784**

In 2005, we recorded net charges totaling less than $0.1 million primarily for changes in estimated expenses related to real estate obligations. The following table displays the activity and balances for restructuring and asset impairment activity for 2005 (in thousands):

	December 31, 2004 Restructuring Liability	Restructuring Charges	Cash Reductions	December 31, 2005 Restructuring Liability
Restructuring costs activity for 2001 restructuring charge:				
Real estate obligations	$8,153	$44	$(1,920)	$6,277

In 2004, we incurred net additional restructuring costs of $3.6 million as a result of a comprehensive analysis of the remaining accrued restructuring liability. After reviewing the analysis, management concluded that subleasing the facilities remaining in the restructuring accrual took longer than expected to sublease and those that were subleased resulted in lower than expected sublease rates. Consequently, the projected obligations exceeded the unadjusted liability by $5.3 million over the remaining lease terms, with the last commitment expiring in July 2015. During the quarter ended September 30, 2004, all other remaining contractual obligations for network infrastructure and other costs included in the restructuring were satisfied, and we reduced the remaining recorded liability for the obligations from $1.7 million to zero. The following table displays the activity and balances for restructuring and asset impairment activity for 2004 (in thousands):

	December 31, 2003 Restructuring Liability	Restructuring Charges (Benefit)	Cash Reductions	December 31, 2004 Restructuring Liability
Restructuring costs activity for 2001 restructuring charge:				
Real estate obligations	$5,843	$5,323	$(3,013)	$8,153
Network infrastructure obligations	1,125	(951)	(174)	–
Other	867	(867)	–	–
	7,835	3,505	(3,187)	8,153
Net asset write-downs for 2002 restructuring charge	(139)	139	–	–
	$7,696	$3,644	$(3,187)	$8,153

Of the $5.3 million recorded during 2004 as additional real estate restructuring charges, $3.0 million related to the direct cost of revenue and $2.3 million related to general and administrative costs.

4. INVESTMENTS

Investments in marketable securities primarily include high-credit-quality corporate debt securities and U.S. Government Agency debt securities. These investments are classified as available-for-sale and are recorded at fair value with changes in fair value reflected in other comprehensive income. All proceeds were from the maturity of the securities, not from sales. Accordingly, we have not recognized any realized gains or losses.

Summaries of our investments in marketable securities are as follows (in thousands):

	December 31, 2006		
	Cost Basis	**Unrealized Gain**	**Recorded Value**
Short-term investments in marketable securities	**$13,264**	**$27**	**$13,291**

	December 31, 2005		
	Cost Basis	Unrealized Gain	Recorded Value
Short-term investments in marketable securities	$16,113	$(53)	$16,060

We maintain a 51% ownership interest in Internap Japan, a joint venture with NTT-ME Corporation of Japan and another NTT affiliate. 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, revenue and expense would be consolidated (due to certain minority interest protections afforded to our joint venture partners). 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 Emerging Issues Task Force No. 96-16, "Investor's Accounting for an Investee When the Investor Has a Majority of the Voting Interest but the Minority Shareholder or Shareholders Have Certain Approval or Veto Rights."

Our investment activity in the joint venture is as follows (in thousands):

	Year Ended December 31,		
	2006	2005	2004
Investment balance, January 1,	**$823**	$ 861	$1,195
Proportional share of net income (loss)	**114**	83	(390)
Unrealized foreign currency translation gain (loss), net	**21**	(121)	56
Investment balance, December 31,	**$958**	$ 823	$ 861

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 series D preferred stock at $10.20 per share for a total cash investment of $6.0 million. Aventail is a privately-held enterprise for which no active market for its securities exists. In connection with Aventail's 2001 round of financing, we concluded 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 basis as of December 31, 2006.

5. PROPERTY AND EQUIPMENT

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

	Year Ended December 31,	
	2006	2005
Network equipment	$ 65,430	$ 67,186
Network equipment under capital lease	1,596	1,596
Furniture, equipment and software	31,712	30,393
Leasehold improvements	100,024	94,583
Property and equipment, gross	198,762	193,758
Less: Accumulated depreciation and amortization ($1,375 and $843 related to capital leases at December 31, 2006 and 2005, respectively)	(151,269)	(143,686)
	$ 47,493	$ 50,072

During 2006 and 2005, $8.6 million and $8.4 million, respectively, of fully depreciated assets were retired. In conjunction with the ongoing analysis of our property and equipment, we identified certain assets, initially classified predominantly as network equipment, that are more characteristic of infrastructure. As of December 31, 2005, $20.3 million and $1.2 million, representing the cost basis initially recorded in network equipment and furniture, equipment and software, respectively, were reclassified to leasehold improvements. These reclassifications had no effect on previously reported balance sheets, depreciable lives or operations.

Depreciation and amortization of property and equipment associated with direct cost of network and sales and other depreciation expense is summarized as follows (in thousands):

	Year Ended December 31,		
	2006	2005	2004
Direct cost of network and sales	$13,250	$11,804	$10,898
Other depreciation and amortization	2,606	2,933	4,563
Subtotal	15,856	14,737	15,461
Amortization of purchased technology, included in direct cost of network and sales	516	577	579
Total depreciation and amortization	$16,372	$15,314	$16,040

6. GOODWILL AND OTHER INTANGIBLE ASSETS

We perform our annual goodwill impairment test as of August 1 of each calendar year and estimated the fair value of our reporting units utilizing a discounted cash flow method. Based on the results of these analyses our goodwill was not impaired as of August 1, 2006.

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, 2006 and 2005, the recorded amount of goodwill totaled $36.3 million.

Generally, any adjustments made as a result of the impairment testing are required to be recognized as operating expense. We will continue to perform our annual impairment testing as of August 1 each year absent any impairment indicators that may cause more frequent analysis, as required by SFAS No. 142, "Goodwill and Other Intangible Assets."

The components of our amortizing intangible assets are as follows (in thousands):

	December 31, 2006		December 31, 2005	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Contract-based	$14,518	$(14,291)	$14,518	$(14,263)
Technology-based	5,911	(4,353)	5,911	(3,837)
	$20,429	$(18,644)	$20,429	$(18,100)

Amortization expense for identifiable intangible assets during 2006, 2005 and 2004 was $0.5 million, $0.6 million and $0.6 million, respectively. Estimated amortization expense for the next five years is as follows as of December 31, 2006 (in thousands):

2007	$ 443
2008	443
2009	443
2010	339
2011	28
Thereafter	89
	$1,785

7. ACCRUED LIABILITIES

Accrued liabilities consist of the following (in thousands):

	Year Ended December 31,	
	2006	2005
Taxes	$2,005	$1,753
Compensation payable	4,075	2,463
Network commitments	520	305
Insurance payable	38	639
Other	2,051	2,107
	$8,689	$7,267

8. REVOLVING CREDIT FACILITY AND NOTE PAYABLE

At December 31, 2006, we had a $5.0 million revolving credit facility and a $17.5 million term loan (note payable) under a loan and security agreement with a bank. The agreement was amended as of December 27, 2006, to modify the amount available for borrowing under the revolving credit agreement from $10.0 million to $5.0 million with an additional $5.0 million available as needed, decrease the letter of credit sub-limit from $6.0 million to $4.7 million, extend the expiration date of the revolving credit facility from December 28, 2006 to December 27, 2007 and update the loan covenants. The interest rate on the revolving credit was set to the bank's prime rate.

Availability under the revolving credit facility is based on 85% of eligible accounts receivable. As of December 31, 2006, $3.9 million of letters of credit were issued, and we had available $1.1 million in borrowing capacity under the revolving credit facility. The credit facility contains certain covenants, including covenants that restrict our ability to incur further indebtedness.

The note payable under the security agreement described above has a fixed interest rate of 7.5% and is due in 48 equal monthly installments of principal plus interest through September 1, 2008. The loan was used to purchase assets previously recorded as capital leases under a master agreement with a primary supplier of networking equipment. The loan is collateralized by all of our assets, except patents. The balance outstanding under the note payable was $7.7 million and $12.0 million at December 31, 2006 and 2005, respectively.

The maturity of the note payable at December 31, 2006 is as follows (in thousands):

2007	$4,375
2008	3,281
Total maturities and principal payments	7,656
Less: current portion	(4,375)
	$3,281

The carrying value of our note payable as of December 31, 2006, approximates fair value as the interest rates approximate current market rates of similar debt obligations.

9. 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. As of December 31, 2006, our capital leases have expiration dates ranging from June 2007 to May 2009.

Future minimum capital lease payments together with the present value of the minimum lease payments as of December 31, 2006, are as follows (in thousands):

2007	$ 367
2008	63
2009	26
Remaining capital lease payments	456
Less: Amounts representing imputed interest	(26)
Present value of minimum lease payments	430
Less: Current portion	(347)
	$ 83

10. INCOME TAXES

The current and deferred income tax provisions were as follows for the years ended December 31, 2005 and 2006 (in thousands):

	Year Ended December 31,	
	2006	2005
Current		
Federal	**$145**	$–
State	**–**	–
Total current	**145**	–
Deferred		
Federal	**–**	–
State	**–**	–
Total deferred	**–**	–
Income tax provision	**$145**	$–

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.

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

	Year Ended December 31,		
	2006	2005	2004
Federal income tax (benefit) at statutory rates	**34%**	(34%)	(34%)
State income tax (benefit)	**4%**	(4%)	(4%)
Nondeductible stock compensation	**8%**	–	–
Other	**1%**	1%	1%
Change in valuation allowance	**(43%)**	37%	37%
Effective tax rate	**4%**	–	–

Temporary differences between the financial statement carrying amounts and tax bases of assets and liabilities that give rise to deferred taxes relate to the following at December 31 (in thousands):

	Year Ended December 31,	
	2006	2005
Current deferred income tax assets:		
Provision for doubtful accounts	**$ 115**	$ 329
Deferred revenue	**1,225**	860
Accrued compensation	**132**	433
Restructuring costs	**532**	457
Capital loss carryforwards	**–**	5,383
Other	**390**	854
Current deferred income tax assets	**2,394**	8,316
Less: Valuation allowance	**(2,379)**	(8,263)
	15	53
Non-current deferred income tax assets:		
U.S. net operating loss carryforwards	**128,527**	133,917
Foreign operating loss carryforwards	**14,574**	14,582
Tax credit carryforwards	**165**	–
Property and equipment	**20,315**	22,738
Investments	**1,824**	1,824
Stock compensation	**216**	–
Deferred revenue, less current portion	**386**	367
Restructuring costs, less current portion	**1,286**	1,438
Deferred rent	**4,344**	3,413
Non-current deferred income tax assets	**171,637**	178,279
Less: Valuation allowance	**(170,568)**	(177,249)
	1,069	1,030
Non-current deferred income tax liabilities:		
Purchased intangibles	**(1,084)**	(1,083)
Non-current deferred income tax assets (liabilities), net	**(15)**	(53)
Net deferred tax assets (liabilities)	**$ –**	$ –

As of December 31, 2006 we have net operating loss carryforwards of approximately $553.9 million that will expire from 2012 through 2025. Capital loss carryforwards of $5.4 million expired in 2006. In addition, alternative minimum tax credit carryforwards were created during 2006 of approximately $165,000, which have an indefinite carryforward period.

We also have foreign net operating loss carryforwards of approximately $41.9 million as of December 31, 2006 that will begin to expire in 2008. During 2005, the Company did not present foreign net operating losses as a deferred tax asset. Such losses would have required a full valuation allowance, in the opinion of management. The foreign net operating losses are presented in the table above as deferred tax assets that require a full valuation allowance as of December 31, 2006 and 2005, respectively.

Utilization of net operating losses is subject to the limitations imposed by Section 382 of the Internal Revenue Code. Under this provision, we will be precluded from utilizing approximately $215.7 million of our $553.9 million in net operating losses. 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 losses. 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.

It is company policy to reinvest foreign earnings indefinitely within each country when foreign operations become profitable. As a result, no provision or benefit is made for income taxes that would be payable upon the distribution of such earnings, and it is not practicable to determine the amount of the related unrecognized deferred income tax liability.

11. 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. Employer contributions are discretionary and were $0.7 million, $0.6 million and $0.2 million for 2006, 2005 and 2004, respectively.

12. COMMITMENTS, CONTINGENCIES, CONCENTRATIONS OF RISK AND LITIGATION

Operating leases

We, as a lessee, have entered into leasing arrangements relating to office and service point rental space and office equipment that are classified as operating leases. Lease terms range from 2 to 30 years and contain various periods of free rent and renewal options. However, rent expense is recorded on a straight-line basis over the initial lease term and renewal periods that are reasonably assured. Future minimum lease payments on non-cancelable operating leases are as follows at December 31, 2006 (in thousands):

2007	$ 20,083
2008	19,740
2009	17,322
2010	16,924
2011	17,475
Thereafter	95,433
	$186,977

Rent expense was $18.8 million, $13.6 million and $12.9 million for the years ended December 31, 2006, 2005 and 2004, respectively. Sub-lease income, recorded as a reduction of rent expense, was $0.6 million, $0.2 million and $0.3 million during the years ended December 31, 2006, 2005 and 2004, respectively.

Service commitments

We have entered into service commitment contracts with Internet network service providers to provide interconnection services and data center providers to provide space for our customers. Future minimum payments under these service commitments having terms in excess of one year are as follows at December 31, 2006 (in thousands):

2007	$12,491
2008	8,532
2009	5,140
2010	1,722
2011	1,773
Thereafter	3,709
	$33,367

Vendor disputes

In delivering our services, we rely on a number of Internet network, telecommunication and other vendors. We work directly with these vendors to provision services such as establishing, modifying or discontinuing services for our customers. Because of the volume of activity, billing disputes inevitably arise. These disputes typically stem from disagreements concerning the starting and ending dates of service, quoted rates, usage and various other factors. Disputed costs, both in the vendors' favor and our favor, are researched and discussed with vendors on an ongoing basis until ultimately resolved. We record the cost and a liability based on our estimate of the most likely outcome of the dispute. These estimates are periodically reviewed by management and modified in light of new information or developments, if any. Because estimates regarding disputed costs include assessments of uncertain outcomes, such estimates are inherently vulnerable to changes due to unforeseen circumstances that could materially and adversely affect our results of operations and cash flows.

As part of our acquisition of CO Space on June 20, 2000, we assumed a pre-acquisition accounts payable liability of $1.3 million. As disclosed in our 2003 financial statements, we wrote off the $1.3 liability amount as we believed the obligation no longer existed. In the fourth quarter of 2006, the Company received an inquiry from the vendor regarding the status of the former $1.3 million payable. We have reviewed the inquiry and continue to believe that we have no obligation to make the $1.3 million payment. However, the vendor may continue to assert it has rights to a claim and has made a request for payment. As of December 31, 2006, we have not accrued any amounts associated with this claim as we believe a loss is neither probable or estimable. Any associated legal costs will be expensed as incurred.

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. 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.

In July 2004, we received an assessment from the New York State Department of Taxation and Finance for $1.4 million, including interest and penalties, resulting from an audit of our state franchise tax returns for the years 2000–2002. The assessment related to an unpaid license fee due upon our entry into the state for the privilege of doing business in the state. Management recorded its best estimate of the probable liability resulting from the assessment in accrued liabilities and general and administrative expense as of June 30, 2004 and engaged a professional service provider to initiate an appeal. In April 2005, New York State Department of Taxation and Finance reduced the assessment to $0.1 million, including interest and waived penalties. The substantial decrease from the original assessment resulted from including the weighted averages of investment capital and subsidiary capital, along with business capital, used in New York in determining the apportionment factor. The original assessment was based solely on an apportionment of business capital, while investment capital and subsidiary capital both have significantly lower apportionment percentages in New York. The adjustment for the revised New York assessment, as well as other tax accruals based on our best estimate of probable liabilities, resulted in a reduction of non-income based tax expenses of approximately $1.7 million as of March 31, 2005. These tax adjustments are reflected in accrued liabilities and general and administrative expense in the accompanying financial statements.

13. CONVERTIBLE PREFERRED STOCK AND STOCKHOLDERS' EQUITY

Convertible preferred stock

Effective September 14, 2004, all shares of our outstanding series A convertible preferred stock were mandatorily converted into common stock in accordance with the terms of our Certificate of Incorporation. An aggregate of 1.7 million shares of convertible preferred stock with a recorded value of $49.6 million was converted into 56.2 million shares of common stock. Accordingly, as of December 31, 2004, we had no shares of series A convertible preferred stock outstanding. The mandatory conversion had no effect on the outstanding warrants to purchase common stock that were issued in conjunction with the series A preferred stock.

Common stock

On September 18, 2006, our common stock began trading on the NASDAQ Global Market, under the symbol "INAP." We voluntarily delisted our common stock from the American Stock Exchange (AMEX), effective September 17, 2006.

On July 10, 2006, we implemented a 1-for-10 reverse stock split of our common stock. Authorization to implement the reverse stock split was approved on June 21, 2006, by our stockholders at our annual stockholders' meeting. Our common stock began trading on a split-adjusted basis on July 11, 2006. All share and per share information herein (including shares outstanding, earnings per share and warrant and stock option exercise prices) have been retroactively restated for all periods presented to reflect the reverse stock split.

On March 4, 2004, we sold 4.03 million shares of our common stock in a public offering at a purchase price of $15.00 per share which resulted in net proceeds to us of $55.9 million after deducting underwriting discounts and commissions and offering expense.

Treasury stock

During 2006, shares of treasury stock were acquired as payment of taxes on stock-based compensation from employees and subsequently reissued as part of our stock-based compensation plans.

Warrants to purchase common stock

As of December 31, 2006, there were warrants outstanding to purchase approximately 34,000 shares of our common stock at an exercise price of $9.50 per share.

On September 14, 2001, in conjunction with our series A preferred stock financing, we issued warrants to purchase up to 17.1 million 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 $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 0.4 million 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 an acquisition in 2003, we granted warrants to purchase an aggregate of 0.2 million shares of our common stock to stockholders of the acquired company. These warrants were exercisable if the stockholders of the acquired company participated in a private placement of shares of our common or preferred stock and their participation was in an amount equal to or greater than $4.4 million. Each warrant was exercisable for one share of our common stock at an exercise price of $9.50 per share and expired on October 1, 2006. There was no value allocated to these warrants.

Outstanding warrants to purchase shares of common stock at December 31, 2006, are as follows (shares in thousands):

Year of Expiration	Weighted Average Exercise Price	Shares
2008	$9.50	34,080

14. STOCK-BASED COMPENSATION PLANS

General

We have adopted SFAS No. 123 (revised 2004), "Share-Based Payment" (SFAS No. 123R) and related interpretations, using the modified prospective transition method and therefore have not restated prior periods' results. SFAS No. 123R establishes the accounting for equity instruments exchanged for employee services. Under SFAS No. 123R, share-based compensation cost is measured at the grant date based on the calculated fair value of the award. The expense is recognized over the employee's requisite service period, generally the vesting period of the award. Prior to the adoption of SFAS No. 123R on January 1, 2006, we accounted for stock-based compensation plans under the recognition and measurement provisions of Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations. We also provided disclosures in accordance with SFAS No. 123, "Accounting for Stock-Based Compensation," as amended by SFAS No. 148, "Accounting for Stock-Based Compensation – Transition and Disclosures – an Amendment of FASB Statement No. 123." Accordingly, no expense was recognized for options to purchase our common stock that were granted with an exercise price equal to fair market value at the date of grant, and no expense was recognized in connection with purchases under our employee stock purchase plans for any periods prior to January 1, 2006. As a result of adopting SFAS No. 123R on January 1, 2006, our income before taxes and net income for the year ended December 31, 2006 was $5.1 million, or $0.15 per basic and $0.14 per diluted share, lower than if we had continued to account for stock-based compensation under APB Opinion No. 25.

Deferred compensation related to 100,000 shares of restricted stock was granted in connection with the September 30, 2005 employment agreement between the Company and its new President and Chief Executive Officer. This deferred compensation was reflected in stockholders' equity as of December 31, 2005, and is being recognized ratably in accordance with the terms of vesting. Upon the adoption of SFAS No. 123R, the unamortized balance of the deferred compensation was reclassified to additional paid-in capital.

In June 2006, our stockholders approved a measure to reprice certain outstanding options under our existing equity incentive plans. Options with an exercise price per share greater than or equal to $13.00 were eligible for the repricing. The repricing was implemented through an exchange program under which eligible participants were offered the opportunity to exchange their eligible options for new options to purchase shares. Each new option had substantially the same terms and conditions as the eligible options cancelled, except as follows:

- The exercise price per share of each replacement option granted in the exchange offer was $14.46, the average of the closing prices of the common stock as reported by the American Stock Exchange and the NASDAQ Global Market, as applicable, for the 15 consecutive trading days ending immediately prior to the grant date of the replacement options;
- For all eligible options with an exercise price per share greater than or equal to $20.00, the exchange ratio was 1-for-2; and
- Each new option has a three-year vesting period, vesting in equal monthly installments over three years, so long as the grantee continues to be a full-time employee of the Company and has a ten-year term.

A total of 50 employees eligible to participate in the exchange offer tendered, and we accepted for cancellation, eligible options to purchase an aggregate of 344,987 shares of common stock, representing 49.4% of the total shares of common stock underlying options eligible for exchange in the exchange offer. We issued replacement options to purchase an aggregate of 179,043 shares of common stock in exchange for the cancellation of the tendered eligible options.

In accordance with SFAS No. 123R, we will recognize $0.1 million of incremental compensation cost over the three-year vesting period as a result of the option exchange. The incremental expense was measured as the excess of the fair value of the repriced options over the fair value of the original options immediately before the terms of the original options were modified. The measurement was based on the share price and other pertinent factors at that date of modification.

Stock-based compensation expense

The following table summarizes the amount of stock-based compensation expense, net of estimated forfeitures in accordance with SFAS No. 123R, included in the accompanying consolidated statements of operations for the year ended December 31, 2006 (in thousands):

	Year Ended December 31, 2006
Direct cost of customer support	$1,102
Product development	628
Sales and marketing	2,145
General and administrative	2,067
Total stock-based compensation expense included in net income	$5,942

Less than $0.1 million of stock-based compensation was capitalized during the twelve months ended December 31, 2006.

The following table illustrates the effect on net loss and net loss per share as if we had applied the fair value recognition provisions of SFAS No. 123 to stock-based employee compensation for years ended December 31, 2005 and 2004 (in thousands except per share amounts):

	Year Ended December 31,	
	2005	2004
Net loss, as reported	$ (4,964)	$(18,062)
Add: Stock-based employee compensation expense included in reported net loss	75	–
Adjust: Total stock-based employee compensation expense determined under fair-value-based method for all awards	(9,678)	(15,364)
Pro forma net loss	$(14,567)	$(33,426)
Loss per share:		
Basic and diluted – as reported	$ (0.15)	$ (0.63)
Basic and diluted – pro forma	(0.43)	(1.16)

Note that the above pro forma disclosure was not presented for the twelve months ended December 31, 2006 because stock-based compensation has been accounted for in the statement of operations using the fair value recognition method under SFAS No. 123R for those periods.

The decrease in recorded stock-based compensation expense for the twelve months ended December 31, 2006, compared to the pro forma stock-based compensation expense for the twelve months ended December 31, 2005 is due primarily to cancellations of outstanding stock options and the difference between estimated and actual forfeitures.

SFAS No. 123R requires compensation expense to be recorded net of estimated forfeitures with a subsequent adjustment to reflect actual forfeitures as they occur. Previously, forfeitures of unvested stock options were accounted for on a pro forma basis as they were incurred, generally resulting in higher pro forma stock compensation than under the current provisions of SFAS No. 123R. In addition, a significant number of unvested stock options were forfeited upon the resignation on November 18, 2005 of Mr. Gregory Peters, our former Chief Executive Officer, thus reducing the number of outstanding stock options for determining comparative stock-based compensation expense for the twelve months ended December 31, 2006. These unvested options were included in the calculation of our pro forma stock expense previously reported for the twelve months ended December 31, 2005.

The weighted average fair values of outstanding stock options has been estimated at the date of grant using a Black-Scholes option pricing model. The significant weighted average assumptions used for estimating the fair value of the activity under our stock option plans for the years ended December 31, 2006, 2005 and 2004, were expected terms of 5.7, 4.0 and 4.0 years, respectively; historical volatilities of 123%, 118% and 142%, respectively; risk free interest rates of 4.63%, 4.22% and 4.27%, respectively and no dividend yield. The weighted average estimated fair value per share of our employee stock options at grant date was $7.75, $3.50 and $11.83 for the years ended December 31, 2006, 2005 and 2004, respectively.

Stock compensation and option plans

On June 23, 2005, we adopted the Internap Network Services Corporation 2005 Incentive Stock Plan, which was amended and restated on March 15, 2006, or the 2005 Plan. The 2005 Plan provides for the issuance of stock options, stock appreciation rights, stock grants and stock unit grants to eligible employees and directors and is administered by the compensation committee of the Board of Directors. A total of 6.8 million shares of stock is reserved for issuance under the 2005 Plan, comprised of 2.0 million shares designated in the 2005 Plan, plus 1.0 million shares that remain available for issuance of options and awards and 3.8 million shares of unexercised options under certain pre-existing plans. We will not make any future grants under the specified pre-existing plans, but each of the specified pre-existing plans were made a part of the 2005 Plan so that the shares available for issuance under the 2005 Plan may be issued in connection with grants made under those plans. As of December 31, 2006, 2.6 million options were outstanding, 0.4 million shares of non-vested restricted stock awards were outstanding and 2.9 million shares of stock were available for issuance under the 2005 plan.

The 2005 Plan also provides that in any calendar year, no eligible employee or director shall be granted an option to purchase more than 1.4 million shares of stock or a stock appreciation right based on the appreciation with respect to more than 1.4 million shares of stock, and no stock grant or stock unit grant shall be made to any eligible employee or director in any calendar year where the fair market value of the stock subject to such grant on the date of the grant exceeds $3.0 million. Furthermore, no more than 0.7 million non-forfeitable shares of stock shall be issued pursuant to stock grants.

During July 1999, we adopted the 1999 Non-Employee Directors' Stock Option Plan, or the Director Plan. The Director Plan provides for the grant of non-qualified stock options to non-employee directors. A total of 0.4 million shares of our common stock have been reserved for issuance under the Director Plan. Under the terms of the Director Plan, non-employee directors receive fully-vested and exercisable initial grants of 8,000 shares of our common stock on the date such person is first elected or appointed as a non-employee director. The Director Plan provides that on the day after each of our annual stockholder meetings, starting with the annual meeting in 2000, each non-employee director receives a fully vested and exercisable option for 2,000 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. As of December 31, 2006, 0.1 million options were outstanding and 0.3 million options were available for grant pursuant to the Director Plan.

The option price for each share of stock subject to an option shall generally be no less than the fair market value of a share of stock on the date the option is granted. Stock options generally have a maximum term of ten years from the date of grant. Incentive stock options, or ISOs, may be granted only to eligible employees and if granted to a 10% stockholder, the terms of the grant will be more restrictive than for other eligible employees. Terms for stock appreciation rights are similar to those of options. Upon exercise of a stock appreciation right, the compensation committee of the Board of Directors shall determine the form of payment as cash, shares of stock issued under the 2005 Plan based on the fair market value of a share of stock on the date of exercise, or a combination of cash and shares.

Options and stock appreciation rights become exercisable in whole or in part from time to time as determined at the date of grant by the Board of Directors or the compensation committee of the Board of Directors, as applicable. Stock options generally vest 25% after one year and monthly over the following three years, except for non-employee directors who usually receive immediately exercisable options. Similarly, conditions, if any, under which stock will be issued under stock grants or cash will be paid under stock unit grants and the conditions under which the interest in any stock that has been issued will become non-forfeitable are determined at the date of grant by the compensation committee. If the only condition to the forfeiture of a stock grant or stock unit grant is the completion of a period of service, the minimum period of service will generally be three years from the date of grant. Common stock has been reserved under each of the stock compensation plans to satisfy option exercises with newly issued stock.

During 2006, we completed an internal review of our prior stock option granting practices. As a result of the review, however, we determined that approximately $0.2 million of net expense should have been recognized in prior periods in accordance with APB Opinion No. 25, "Accounting for Stock Issued to Employees." The expense was due to a small number of grants made in 2002 and 2003 that had exercise prices that were lower than our stock price at the date of grant and one grant that should have been accounted for as a variable stock option, in accordance with FASB Interpretation No. 28, "Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans, an interpretation of APB Opinions No. 15 and 25." Substantially all of the net expense should have been recorded between April 1, 2003 and December 31, 2004. We have considered the impact of the error, including the assessment of any potential impact on prior period loan covenants and concluded that the error was not material to our financial statements for any prior period. Based on this evaluation, we recorded the expense in the current period and it is included in general and administrative expense in the accompanying statements of operations.

Option activity for each of the three years ended December 31, 2006 under all of our stock option plans is as follows (shares in thousands):

	Shares	Weighted Average Exercise Price
Balance, December 31, 2003	3,916	$15.20
Granted	1,638	17.39
Exercised	(750)	5.70
Cancelled	(409)	22.44
Balance, December 31, 2004	4,395	16.96
Granted	948	4.92
Exercised	(202)	4.51
Cancelled	(1,585)	19.15
Balance, December 31, 2005	3,556	13.49
Granted	**752**	**9.30**
Exercised	**(497)**	**5.84**
Cancelled	**(1,112)**	**19.94**
Balance, December 31, 2006	**2,699**	**$11.07**

The total intrinsic value of options exercised was $2.6 million, $0.2 million and $6.0 million for the years ended December 31, 2006, 2005 and 2004, respectively.

The following table summarizes information about options outstanding at December 31, 2006 (shares in thousands):

	Options Outstanding			Options Exercisable		
Exercise Prices	Number of Shares	Weighted Average Remaining Contractual Life (In Years)	Weighted Average Exercise Price	Number of Shares	Weighted Average Remaining Contractual Life (In Years)	Weighted Average Exercise Price
$ 0.30 – $ 4.60	282	5.8	$ 2.80	269	5.7	$ 2.73
$ 4.80 – $ 5.20	746	8.4	4.81	342	8.0	4.81
$ 5.30 – $ 7.40	482	8.9	6.44	42	7.1	6.13
$ 7.70 – $ 11.30	281	6.0	9.99	229	5.6	10.07
$11.60 – $ 14.30	331	6.3	13.02	231	5.4	13.11
$14.46 – $ 18.70	321	7.9	16.02	142	5.6	17.72
$18.80 – $345.00	256	6.2	39.67	198	5.8	45.04
$ 0.30 – $345.00	2,699	7.4	$11.07	1,453	6.2	$13.36

None of our stock options or the underlying shares is subject to any right to repurchase by the Company.

The total intrinsic value at December 31, 2006 of all options outstanding and expected to vest was $28.8 million. The total intrinsic value at December 31, 2006 of all options exercisable was $14.5 million.

Restricted stock activity for each two years ended December 31, 2006 is as follows (shares in thousands):

	Shares	Weighted Average Grant-Date Fair Value
Non-vested balance, December 31, 2004	–	$ –
Granted	104	4.78
Vested	(4)	4.30
Non-vested balance, December 31, 2005	100	4.80
Granted	**568**	**6.18**
Vested	**(158)**	**5.68**
Forfeited	**(90)**	**5.61**
Non-vested balance, December 31, 2006	**420**	**$6.17**

The total fair value of restricted stock awards vested during the years ended December 31, 2006 and 2005 was $2.1 million and $16,000, respectively. The cumulative effect of the change in the forfeiture rate for non-vested restricted stock was immaterial and recorded as part of operating expense. There were no restricted stock awards during the year ended December 31, 2004.

Total unrecognized compensation costs related to non-vested stock-based compensation as of December 31, 2006, is summarized as follows (dollars in thousands):

	Stock Options	Restricted Stock	Total
Unrecognized compensation	$9,309	$3,088	$12,397
Weighted average remaining recognition period (in years)	2.7	3.0	2.8

Employee stock purchase plans

Effective June 15, 2004, we adopted the 2004 Internap Network Services Corporation Employee Stock Purchase Plan, or the 2004 ESPP. The purpose of the 2004 ESPP is to encourage ownership of our common stock by each of our eligible employees by permitting eligible employees to purchase our common stock at a discount. Eligible employees may elect to participate in the 2004 ESPP for two consecutive calendar quarters, referred to as a "purchase period," at any time during a designated period immediately preceding the purchase period. Purchase periods have been established as the six-month periods ending June 30 and December 31 of each year. A participation election is in effect until it is amended or revoked by the participating employee, which may be done at any time on or before the last day of the purchase period.

Initially, the price for shares of common stock purchased under the 2004 ESPP was the lesser of 85% of the closing sale price per share of common stock on the first day of the purchase period or 85% of such closing price on the last day of the purchase period. Approximately 0.1 million shares were granted under the 2004 ESPP during each of the years ended December 31, 2006 and 2005. The 2004 ESPP was intended to be a non-compensatory plan for both tax and financial reporting purposes. Upon our adoption of SFAS No. 123R in the first quarter of 2006, however, we recognized compensation expense of $0.1 million during the year ended December 31, 2006, representing the estimated fair value of the benefit to participants as of the beginning of the purchase period. In January 2006, the 2004 ESPP was amended to change the purchase price from 85% to 95% of the closing sale price per share of common stock on the last day of the purchase period and to eliminate the alternative to use the first day of the offering period as a basis for determining the purchase price. This amendment restores the plan to being non-compensatory for financial reporting purposes and is effective for the purchase period July 1 through December 31, 2006. As such, no additional compensation expense for the 2004 ESPP was recognized after June 30, 2006. Cash received from participation in the 2004 ESPP was $0.5 million and $0.3 million for the years ended December 31, 2006 and 2005, respectively. At December 31, 2006, 0.3 million shares were reserved for future issuance under the 2004 ESPP.

At December 31, 2006, total shares reserved for future awards under all plans was 6.1 million.

Cash received from all stock-based compensation arrangements was $3.0 million, $1.5 million and $5.0 million for the years ended December 31, 2006, 2005 and 2004, respectively.

15. RELATED PARTY TRANSACTIONS

As discussed in note 4, we have an investment in Aventail, who is also a customer for data center and connectivity services. We invoiced Aventail $0.3 million each year from 2004 through 2006. As of December 31, 2006 and 2005, our outstanding receivable balances with Aventail were less than $0.1 million.

We have entered into indemnification agreements with our directors and executive officers for the indemnification of and advancement of expense 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.

16. SUBSEQUENT EVENT – VITALSTREAM ACQUISITION

On October 12, 2006, we entered into a definitive agreement to acquire VitalStream Holdings, Inc., or VitalStream, in an all-stock transaction to be accounted for using the purchase method of accounting for business combinations. The transaction closed on February 20, 2007. Under the terms of the agreement, VitalStream stockholders received, at a fixed exchange ratio, 0.5132 shares of Internap common stock for every share of VitalStream common stock in a tax-free exchange. As a result, we issued approximately 12.2 million shares of common stock in respect of outstanding VitalStream common shares, which represented approximately 25% of our outstanding shares. The purchase price for the acquisition includes the estimated fair value of Internap common stock issued, stock options assumed, and estimated direct transaction costs. The values are derived using an average market price per share of Internap common stock of $16.40, which was based on an average of the closing prices for a range of trading days, from October 6, 2006 through October 16, 2006, around the announcement date, which was October 12, 2006. The preliminary purchase price of $222.0 million was determined based upon the number of VitalStream shares and options outstanding at the closing date of February 20, 2007 and taking into consideration estimated direct transaction costs.

The total purchase price and purchase price allocation have not been finalized. Using VitalStream's balance sheet as of December 31, 2006, total assets acquired are $224.1 million and total liabilities assumed are $15.0 million. Included in total assets will be intangible assets for developed technologies, customer relationships, trade names and goodwill.

17. UNAUDITED QUARTERLY RESULTS

The following table sets forth selected unaudited quarterly data for the years ended December 31, 2006 and 2005. 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 state 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. The quarterly operating results below are not necessarily indicative of those of future periods (in thousands, except for per share data).

	Quarter Ended			
2006	**March 31**	**June 30**	**September 30**	**December 31**
Revenue	**$42,625**	**$43,905**	**$45,874**	**$48,971**
Net income	**541**	**713**	**195**	**2,208**
Basic net income per share	**$ 0.02**	**$ 0.02**	**$ 0.01**	**$ 0.06**
Diluted net income per share	**0.01**	**0.02**	**0.01**	**0.06**

	Quarter Ended			
2005	March 31	June 30	September 30	December 31
Revenue	$37,855	$37,571	$37,999	$40,292
Net loss	(570)	(1,046)	(3,171)	(177)
Basic and diluted net loss per share	$ (0.02)	$ (0.03)	$ (0.09)	$ (0.01)

Effective January 1, 2006, we adopted SFAS No. 123R and related interpretations, using the modified prospective transition method. Therefore, results for 2005 do not include stock-based compensation expense for options to purchase our common stock that were granted with an exercise price equal to fair market value at the date of grant and do not include expense for purchases under employee stock purchase plans.

Report of Independent Registered Public Accounting Firm

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

We have completed integrated audits of Internap Network Services Corporation's consolidated financial statements and of its internal control over financial reporting as of December 31, 2006, in accordance with the standards of the Public Company Accounting Oversight Board (United States). Our opinions, based on our audits, are presented below.

Consolidated financial statements

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, of stockholders' equity and comprehensive income (loss) and of cash flows present fairly, in all material respects, the financial position of Internap Network Services Corporation and its subsidiaries at December 31, 2006 and 2005, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2006 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 the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit of financial statements 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 2 to the financial statements, the Company changed the manner in which it accounts for share-based compensation in fiscal 2006.

Internal control over financial reporting

Also, in our opinion, management's assessment, included in the accompanying Management's Report on Internal Control Over Financial Reporting, that the Company maintained effective internal control over financial reporting as of December 31, 2006 based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), is fairly stated, in all material respects, based on those criteria. Furthermore, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on criteria established in *Internal Control – Integrated Framework* issued by the COSO. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express opinions on management's assessment and on the effectiveness of the Company's internal control over financial reporting based on our audit. We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that: (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

PricewaterhouseCoopers LLP

Atlanta, GA
March 9, 2007

Management's Report on Internal Control Over Financial Reporting

Financial Review 2006

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission, or COSO.

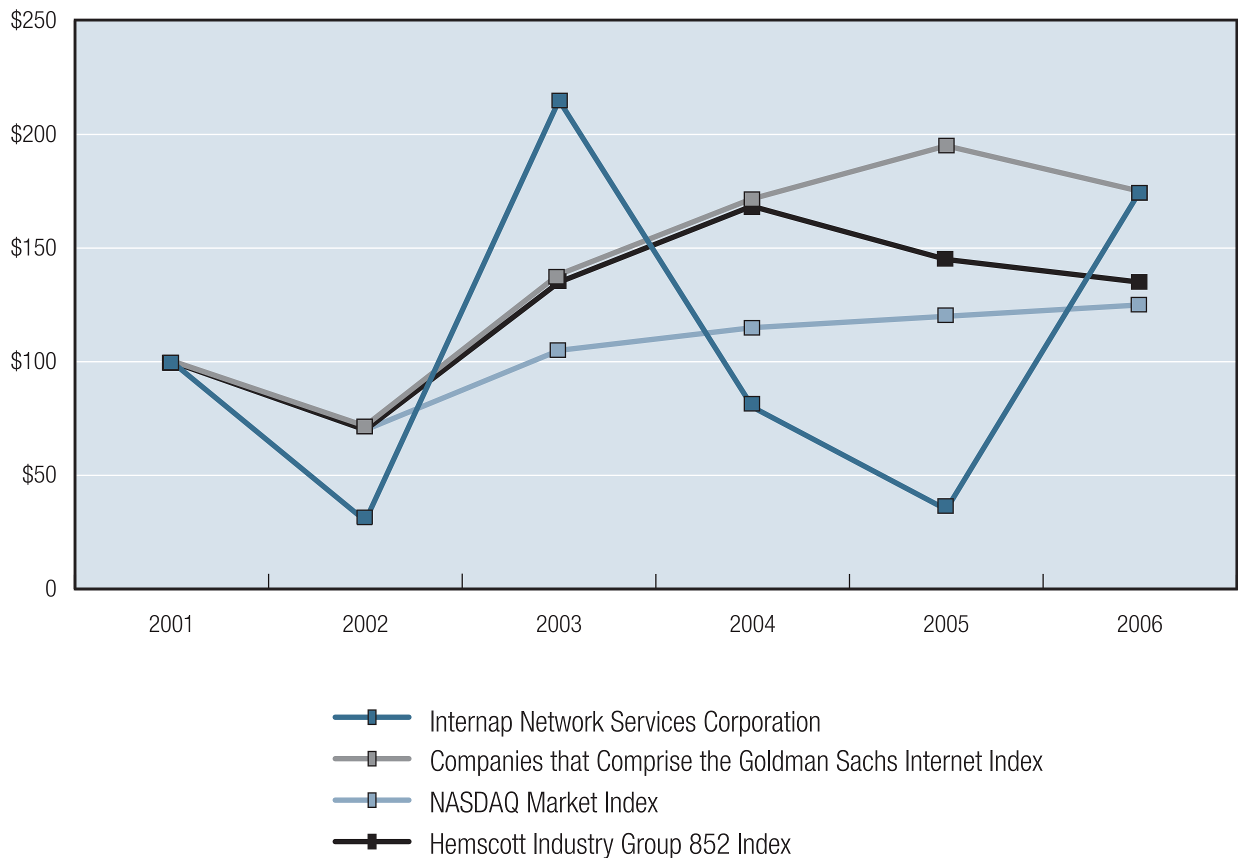
Based on our evaluation under the framework in *Internal Control – Integrated Framework* issued by COSO, our management concluded that our internal control over financial reporting was effective as of December 31, 2006. Our management's assessment of the effectiveness of our internal control over financial reporting as of December 31, 2006 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which is included herein.

Stock Performance Graph

Financial Review 2006

The graph set forth below compares cumulative total return to our stockholders from an investment in our common stock with the cumulative total return of the NASDAQ Market Index, the Hemscott Industry Group 852 Index and companies that comprise the Goldman Sachs Internet Index, resulting from an initial assumed investment of $100 in each on December 31, 2001, assuming the reinvestment of any dividends, ending at December 31, of each year, 2002–2006, respectively.

Comparison of 5-Year Cumulative Total Return Among Internap Network Services Corporation, NASDAQ Market Index, the Companies that Comprise the Goldman Sachs Internet Index, and Hemscott Industry Group 852 Index



Assumes $100 Invested on December 31, 2001.
Assumes Dividends Reinvested.
Fiscal Year Ending December 31, 2006.

Stockholder Information

Financial Review 2006

Corporate Headquarters

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

Investor Relations

Andrew Albrecht
Vice President, Investor Relations
404-302-9841

Stock Trading Information

Internap's common stock trades on the NASDAQ under the ticker symbol: INAP.

Independent Registered Public Accounting Firm

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 2006 Annual Report on Form 10-K/A for the year ended December 31, 2006, 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.

Market and Dividend Information

Internap's common stock is listed on the NASDAQ Global Market under the symbol "INAP" and has traded on the NASDAQ Global Market since September 19, 2006. Our common stock traded on the American Stock Exchange under the symbol "IIP" from February 18, 2004 through September 18, 2006. Our common stock traded on the NASDAQ SmallCap Market from October 4, 2002 through 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.

On July 11, 2006, we implemented a 1-for-10 reverse stock split of our common stock. The information in the following table has been adjusted to reflect these stock splits. Our fiscal year ends on December 31.

	High	Low
Year Ended December 31, 2006		
Fourth Quarter	**$21.25**	**$14.10**
Third Quarter	**16.80**	**9.30**
Second Quarter	**15.50**	**9.00**
First Quarter	**10.60**	**4.20**
Year Ended December 31, 2005		
Fourth Quarter	$ 5.20	$ 3.60
Third Quarter	5.90	4.20
Second Quarter	6.30	4.10
First Quarter	11.00	5.10

As of April 20, 2007, the total number of beneficial holders of our common stock was 37,219.

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. 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.

Safe Harbor Statement Under the Private Securities Litigation Reform Act of 1995

Special Note Regarding Forward-Looking Statements:

Some of the statements contained in this Annual Report contain forward-looking statements that reflect our plans, beliefs and current views with respect to, among other things, future events and financial performance. We often identify these forward-looking statements by the use of words such as "believe," "expect," "potential," "continue," "may," "will," "should," "could," "would," "seek," "predict," "intend," "plan," "estimate," "anticipate," or other comparable words.

Specifically, this Annual Report contains, among others, forward-looking statements regarding: our ability to successfully integrate the operations of Internap and VitalStream; our ability to compete against existing and future competitors; our ability to respond successfully to the evolution of the high performance Internet connectivity, content delivery, streaming and related services industries; our ability to respond successfully to technological change; the availability on favorable terms or at all of services from various Internet network and other third parties on whom we rely to provide our services, and the failure of such third party suppliers to deliver their products and services; failures in our network operations centers, network access points or computer systems; our ability to complete successfully the integration of acquired companies, including VitalStream; our ability to protect ourselves and our customers from security breaches; our ability to protect our intellectual property; claims relating to intellectual property rights; government regulation of the Internet; and the effects of natural disasters or terrorist activity.

Any forward-looking statements contained in this Annual Report are based upon our historical performance and on our current plans, estimates and expectations. You should not regard the inclusion of this forward-looking information as a representation by us or any other person that we will achieve the future plans, estimates or expectations contained in this Annual Report. Such forward-looking statements are subject to various risks and uncertainties. In addition, there are or will be important factors that could cause our actual results to differ materially from those in the forward-looking statements. We believe these factors include, but are not limited to, those described in Part I, Item IA. Risk Factors of our Annual Report on Form 10-K/A.

You should not construe these cautionary statements as exhaustive and should read such statements in conjunction with the other cautionary statements that are included in this Annual Report. Moreover, we operate in a continually changing business environment, and new risks and uncertainties emerge from time to time. We cannot predict these new risks or uncertainties, nor can we assess the impact, if any, that any such risks or uncertainties may have on our business or the extent to which any factor, or combination of factors, may cause actual results to differ from those projected in any forward-looking statement. Accordingly, the risks and uncertainties to which we are subject can be expected to change over time, and we undertake no obligation to update publicly or review the risks or uncertainties described in this Annual Report. We also undertake no obligation to update publicly or review any of the forward-looking statements made in this Annual Report, whether as a result of new information, future developments or otherwise. If one or more of the risks or uncertainties referred to in this Annual Report materialize, or if our underlying assumptions prove to be incorrect, actual results may vary materially from what we have projected. Any forward-looking statements contained in this Annual Report reflect our current views with respect to future events and are subject to these and other risks, uncertainties and assumptions relating to our operations, financial condition, growth strategy, and liquidity. You should specifically consider the factors identified in this Annual Report that could cause actual results to differ. We qualify all of our forward-looking statements by these cautionary statements. In addition, with respect to all of our forward-looking statements, we claim the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995.

As used herein, except as otherwise indicated by the context, references to "we," "us," "our," or the "Company" refer to Internap Network Solutions Corporation and its subsidiaries.

Designed and produced by Corporate Reports Inc./Atlanta www.corporatereport.com

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NASDAQ: INAP