2007 Annual Report

Business Description

Internap is a leading Internet business solutions company that provides *The Ultimate Online Experience*™ by managing, delivering and monetizing applications and content with unsurpassed performance and reliability. From increasing the performance of enterprise applications, to faster, more robust websites, to serving cutting-edge video – and driving revenue from it – Internap helps business and government organizations take the Internet further than ever imagined.

With a global platform of data centers, managed Internet services, a content delivery network (CDN), and ad delivery services, Internap frees its customers to innovate by enhancing their business processes and creating new revenue opportunities. More than 3,700 companies across the globe trust Internap to help them achieve their business and technology goals.

Internap's 420 employees are located in our Atlanta headquarters, as well as in offices around the world, including major U.S. cities, Canada, London and Japan. Founded in 1996, Internap trades on the NASDAQ Global Market under the ticker symbol INAP.

You're Online...

Being a Sports Fan

Blogging

Downloading Music

Trading Stocks

Watching Live TV

Shopping

Listening to the Radio

And We’re Making It Happen

Internap is the only company with end-to-end solutions that can handle an organization’s entire online business from origin to destination.

We Network
Your Business And Your Customers

We Guarantee 100%
The Best In The Business

We Integrate
To Optimize Performance

We Host
Safe And Reliable IT Systems

We Connect
Better Than Anyone Else

We Store
As Much As You Need

We Convert
Content Into Cash

We Stream
Music, Video, New Media

We Deliver
Content-Rich Media

From enabling Internet applications for millions of end-users around the world, to creating business opportunities for our more than 3,700 customers; and transforming market potential into financial performance, Internap is making it happen right now.

Right Now: Our Data Centers Are Hosting, Storing, Powering and Securing...

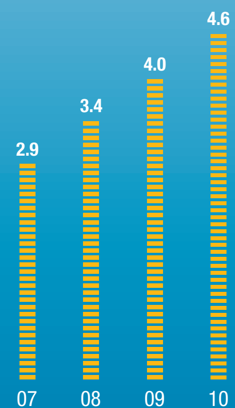
A Strategic Customer Entry Point

Our data centers are a foundation for our bundling strategy rather than a stand-alone business platform. Businesses can dramatically speed their time to market and reduce capital spending by renting a portion of our data centers instead of building their own. Rather than running applications in-house, our customers can quickly make their online products and systems “enterprise-ready” by leveraging Internap’s unmatched integrated infrastructure and customer service.

We package data center space with IP networking, managed servers and storage, professional services and content delivery network (CDN) services to drive higher satisfaction for our customers and increased margins for Internap.

By using a “just-in-time” build strategy with our data centers, we can expand capacity in a modular fashion to meet market demand. This approach enables us to more closely align capital spending with revenue generation, thus realizing a quicker return on investment.

Data Center Services – Total Available Market In North America
($ in billions)



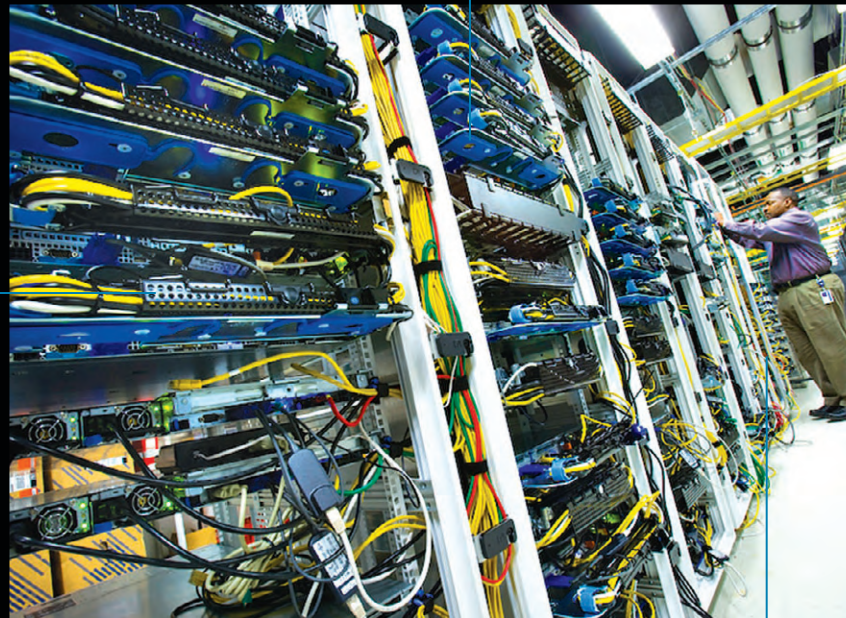
With strong demand and increasing power needs, the Data Center services market is expected to grow more than 16 percent compounded annually through 2010.

Source: Gartner North America Forecast

Direct Network Access

Businesses require off-site data center space to improve the availability of their applications and control their ongoing costs of operation. When they choose Internap for these services, however, they also gain seamless access to the Internap® route-optimized network, providing the most reliable IP networking available. Because customers can purchase data center services and highly reliable IP from a single enterprise-class provider, they can confidently reduce the complexity of their products and concentrate on what they do best. These are critical benefits for businesses that want to get their products to market quickly and within budget.

Global Scale
Our 8 Company-owned data centers and 34 partner-owned data centers currently comprise more than 170,000 square feet throughout North America and in London and Asia.



High-Quality Facilities
With Internap, customers can be assured of a secured, redundant, scalable and managed data center solution. Our data center services also offer managed servers, managed storage and remote hands.

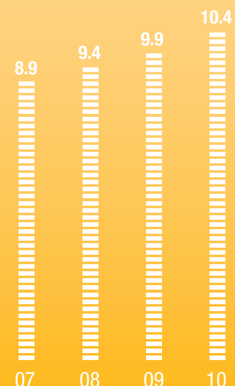
Guaranteed Service
As with our other services, Internap data centers are supported by 100 percent Service Level Agreements that cover both colocation and connectivity.

The Internap Difference

Utilizing an Internap data center ensures direct access to Internap's patented, best-in-class route-optimized network services, which reduces online risks.

Right Now: Our IP Services Are Connecting, Optimizing, Networking, Designing and Managing...

IP – Total Available Market In North America
($ in billions)



The market for IP services is expected to grow at a compounded annual rate of 5 percent through 2010. In 2007, Internap Performance IP™ business grew at an annual rate of 9 percent, significantly outpacing the market.

Source: Gartner Dataquest

Intelligent Route-Optimization Leads The Industry

Since its inception more than a decade ago, our Performance IP™ service has been in a class of its own. Our patented route-optimization technology provides customers with speed, reliability and service guarantees that have remained unmatched in the industry. Through constant monitoring and management, Internap alerts customers to network issues across the Internet and remedies them efficiently. Internap defined our Service Level Agreements to lead the industry, so customers get reliable performance supported with excellent service.

100% Network Performance

"Time is money." This expression has never been more true than in the world of e-commerce, where real time equals real money. Though Internet reliability has evolved to higher levels of performance, hazards such as network congestion, disabled carriers, and latency spikes continue to create business risk. With the advent of hyper-paced Web 2.0 applications, network demands will become even greater. As thousands of our Performance IP customers know, however, the Internap solution goes beyond technology. Our Network Operations Center (NOC) is nothing less than legendary in the industry for the problem-solving expertise and customer-centric orientation of our network engineers. As our customers will tell you, when you have to know the answer quickly and correctly, this level of attention is priceless.

Network Intelligence

Our redundant P-NAP® (Private Network Access Point) facilities located around the world provide us with a unique competitive advantage. We can intelligently route applications and content across Internet backbones, a capability that a single-source Internet service provider cannot duplicate.

Professional Services

From assessment and design through implementation, Internap Professional Services teams speed the deployment of our customers' networks. By helping businesses analyze and assemble the right IP infrastructure, Internap enhances performance and saves our customers time and money.

The Route Matters

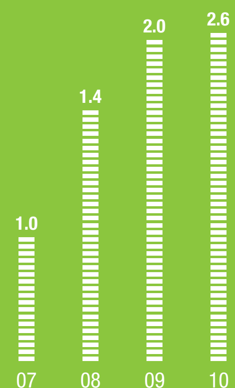
Just like vehicle traffic, Internet performance can be affected by traffic volume and temporary outages. Our optimized route technology ensures that customer traffic keeps moving at the speed needed to satisfy business requirements.

The Internap Difference

Our Performance IP service is so reliable that we offer a proactive Service Level Agreement with a 100 percent uptime and performance guarantee.

Right Now: Our Content Delivery Network Is Delivering, Streaming, Analyzing and Monetizing…

CDN Market Worldwide Revenue Forecast
($ in billions)



High-speed broadband connections are driving the growth of the Internet video viewing market and the need for content delivery expertise.

**Source: Morgan Stanley/Frost & Sullivan*

CDN Provides Growth Opportunities

It is estimated that the worldwide CDN market will grow at an average compounded rate of 38 percent through 2010*. This makes CDN one of the largest growth opportunities in the Internet services market today. Our CDN segment has the highest growth potential among our businesses and is accompanied by high margins. As CDN customers use our network for activities such as streaming media, high definition video and ad delivery, Internap also increases its relevance and value to customers by becoming an integral part of their revenue models.

Optimal Performance For Every Play

There's more to streaming media and other advanced content delivery than simply clicking "play." Quality matters. Delivery challenges include transcoding, player development, latency, jitter, and packet loss. Since no single network has the optimal path for all destinations, the only way to identify problems is to possess visibility into traffic flows and to control optimal routing among a variety of network service providers. This is the essence of the Internap CDN value proposition. With our intelligent route architecture integrated into our CDN and monetization services, we elevate quality and performance to an entirely new level.

Ad Delivery

Content owners can monetize their digital assets through our advertising delivery services.

Unparalleled Control

Our feature-rich MediaConsole® integrates all streaming formats. This customer portal provides media asset management, digital rights management (DRM), event authentication, detailed reporting and analytical tools and real-time statistics. A robust dashboard displays the business intelligence that customers can use to guide their operations.

Rich Media Content

From home videos posted on the Web to studio movie trailers, rich media content also includes user-generated content and consumer-oriented applications such as social networking and blogging, as well as a variety of enterprise management applications.

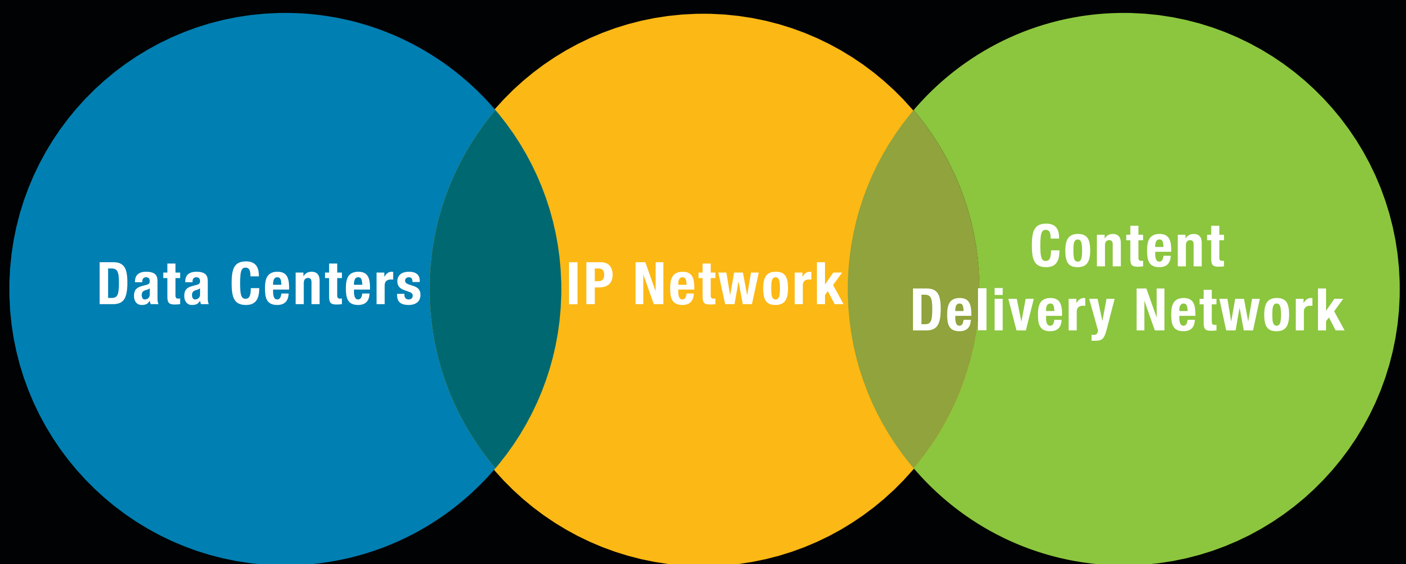
Mobile Entertainment

Music downloads created a new industry. Gaming has grown from single-user systems to massive multi-player online models. Movie downloads are not far away. Technology will enable a whole new breed of interactive entertainment delivered to mobile devices. Internap content delivery network solutions will be there.

The Internap Difference

Our patented route-optimization software and CDN technology are integrated into our global IP network infrastructure. This creates a unique and unmatched solution that optimizes content delivery supported by the only 100 percent performance guarantee in the industry.

Right Now: Only Internap Does So Much, So Well



The Internap Difference: A Bundled Solution

We enable our customers to better serve their customers through an integrated solution suite based on our global networked infrastructure and core route-optimization technology. No other service provider delivers such a value-added mix of products: data center space, IP networking and content delivery network services. This entire suite is supported by industry-leading SLAs (service level agreements) with 100 percent performance guarantees, comprehensive visibility and control, and world-class, round-the-clock engineering expertise. Not only do we help our customers determine the optimal mix of services today, we're there to help them scale their businesses for tomorrow.

James P. DeBlasio
President and Chief Executive Officer

To Our Stockholders

Right Now The Future Is Right In Front Of Us.

More than 12 years ago, when the Internet was beginning to make its mark on popular culture and mainstream commerce, Internap recognized the need to ensure swift and reliable connectivity. We introduced a proprietary route-optimization technology that met this need and quickly set an industry performance standard. Today, we continue to anticipate needs and introduce solutions that ensure optimal functionality and performance so that our customers can do what they do best – capitalize on the potential of the Internet to innovate and create some of the most exciting services and applications in the world. No other service provider does this better than Internap, and this expertise is translating directly into profitable growth. Continued on page 12

The past 12 months have been a transformational period for Internap. We completed the acquisition of VitalStream to broaden our product offerings to include a content delivery network (CDN) and related technologies. We scaled our business by expanding our global footprint and capacity in order to continue to provide the highest levels of support for our customers worldwide. We signed the largest customer contracts in the Company's history and continued to grow our diverse customer base. We began to build positive traction in the market for our end-to-end, bundled service offering. All of this was accomplished while generating record revenue, adjusted EBITDA and adjusted gross margins.

Record Results

During 2007, Internap grew revenue 29 percent, the highest annual growth rate in six years, to $234 million. Adjusted gross margins expanded 310 basis points to 49 percent, a significant achievement given the operating losses that we had to work through from the former VitalStream business. Our commitment to financial discipline remained strong. We held our expense-to-revenue ratio to approximately 33.5 percent in 2007, very close to the same ratio in 2006, despite growth throughout the organization. As a result, we were able to continue our profitable growth. Adjusted EBITDA increased 49 percent to $37 million. Normalized net income, which excludes the impact of stock compensation expense and items that we consider nonrecurring, totaled $16.1 million in 2007, an increase of 62.3 percent over 2006.

CDN Integration

Beyond the financial achievements of 2007, Internap made significant progress against numerous strategic priorities. We also dealt with some challenges, namely a more lengthy integration process of VitalStream's CDN services than we had anticipated initially. As a result, CDN performance in 2007 was lower than we expected. With the integration of CDN into our patented IP network completed by year-end, we began 2008 in a much stronger position to realize the full potential of this business.

During the year we made significant investments to increase the scale of our CDN technology to support our enterprise customers. We added five new CDN Points of Presence (POPs) to expand our network infrastructure in Asia and Europe. We also fully integrated CDN with our proprietary route-optimization technology to ensure optimal performance. Finally, we extended our 100 percent Service Level Agreements that have been a hallmark of our Performance IP™ service to Internap's CDN services. The end result is a CDN offering that is in a considerably stronger competitive position and one that should be an effective growth vehicle for the Company going forward.

Building Scale

Our core IP network and data center businesses performed well in 2007. Data center operations, which often serve as the initial entry point for our customers, increased revenue 47.9 percent, thanks to high market demand and an expanded footprint. During the year, we added more than 20,000 square feet of built-out data center space, and plans call for an additional build-out of more than 30,000 square feet in 2008. Our strategy of modular, "just-in-time" build-outs is serving us well, enabling the Company to capture market demand in a risk-averse manner.

IP services was again our largest segment in 2007 and represents the foundation of our business. Fundamentals in IP network services were strong during the year, with a 35 percent increase in traffic. Strong demand, combined with some easing of pricing pressure in this business, helped to maintain year-over-year margins. As traffic continues to grow in this business segment, we expect that operating leverage,

The Right Team

Our leadership team brings years of high-tech and communications experience, as well as a proven track record for operational expertise, financial discipline and customer service commitment. Most importantly, this team is united by its focus to expand existing customer relationships and grow into new markets in order to create value for Internap stockholders.

George E. Kilguss III
Chief Financial Officer

Tim P. Sullivan
Chief Technology Officer

Richard Dobb
General Counsel and
Chief Administrative Officer

Eric Suddith
Vice President, Human Resources

Randal Thompson
Vice President, Global Sales

Andrew Albrecht
Vice President,
Corporate
Development

Tamara Augustyn
Vice President,
Finance and
Chief Accountant

David Frigeri
Vice President and
General Manager,
Content Delivery and
Advertising Solutions

Michael Higgins
Vice President and
General Manager,
Data Center and IP
Network Solutions

James Leach
Vice President,
Marketing and
Sales Operations

Andrew McBath
Director,
Investor Relations

scale and profitability will continue to expand. No other Internet service provider can route mission-critical traffic and applications as effectively and with the guarantees that Internap offers. With this patented technology now integrated into our CDN, Internap can deliver more compelling value to customers than ever before.

Competitive Differentiation

It is this value proposition that continues to fuel our enthusiasm about the opportunities that drove the VitalStream acquisition and our bundled services strategy. The explosive growth of user-generated content, streaming video, social networking, multi-player gaming and other applications, represents an enormous opportunity for Internap. Virtually every type of business today leverages the Internet in some manner. The technology to support these applications requires more than simply a CDN company, an IP service provider, or a data center facility. It requires a company that encompasses all of these services with guaranteed speed and reliability, as well as an innovative and customer-centric approach to business.

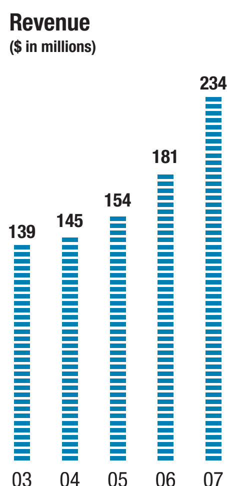
This profile is at the core of our bundled, end-to-end service offering; a strategy that provides a high degree of differentiation in the marketplace for us today. There is simply no peer that can match the combination of our product offering and performance guarantee. This strategy provides customers with unique "one-stop shopping" and provides us with numerous competitive advantages.

First, we expand our market opportunity through the ability to cross-sell among the customer bases of each business. Among our CDN customers, for example, only a small percentage opt for a service bundle today, creating a significant base of potential into which we can sell our other services. Second, our sales proposition to bundled customers ultimately becomes a quality-driven rather than a price-driven decision. This moves our relationship with the customer to a higher-value level, which translates directly into increased margins. Finally, a "bundled" customer is more likely to remain an Internap customer. Among customers who subscribe to two or more of our service offerings, churn is significantly lower than for those who subscribe to only one offering.

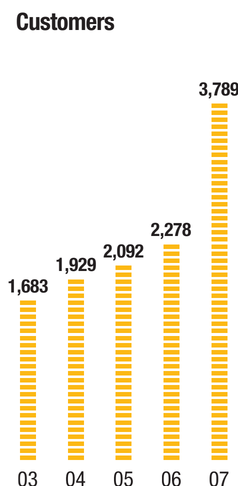
Customer Wins

Marketplace enthusiasm for our bundled offerings gained momentum throughout 2007 and was underscored by the signing of the two largest contracts in the Company's history. Quality Technology Services (QTS), one of the nation's largest privately-held providers of data center facilities and managed services, selected Internap to be the preferred provider of CDN services and exclusive provider of IP connectivity services to all of their accounts. This three-year agreement represents revenues of approximately $15 million for Internap.

Similarly, hosting provider SoftLayer Technologies initially signed a five-year, $16 million



The addition of CDN services and strong demand in data center and core managed IP services contributed to a 29.1 percent year-over-year increase in revenue.



The Company's diverse customer base, which approached 4,000 at year-end 2007, spans multiple sectors including transportation, technology, entertainment and financial services.

contract with Internap for data center and network services. Once on board, Internap's execution and performance impressed SoftLayer enough that the agreement was expanded to include CDN services. We believe that our team's hard work will pay off handsomely over the next five years, with an estimated $56 million in total revenue expected.

The confidence that QTS and SoftLayer have placed in Internap is echoed across our growing customer base. Overall, we added more than 600 new accounts in 2007 to end the year with 3,789 customers. Customers such as Register.com, Scottrade and Red Hat have joined our highly diversified customer base, which serves multiple market sectors.

World-Class Organization

An expanded product portfolio and an ever-expanding customer base bring more opportunity. In order to fully capitalize on these opportunities, it is critical that the appropriate business structure and talent be in place. To this end, we have successfully recruited a number of new executives to our ranks in the areas of finance, marketing and information technology. Our management team today has the experience and industry knowledge necessary to take Internap to its next level of performance. Our ability to recruit respected technology executives also speaks to their level of confidence in Internap's future.

Our management team is fortunate to lead one of the most respected employee teams in the industry. Our staff "in the field and on the floor" enjoys a well-deserved reputation for providing superior technological solutions and customer service par excellence. You can be sure that every customer win is an endorsement of Internap's technology and its people. This team continues to have my personal gratitude for their talent and their commitment.

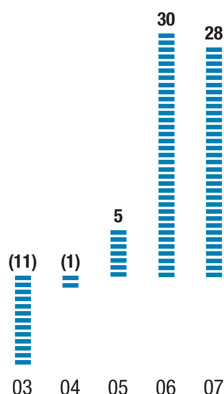
As we enter 2008, we feel very confident about Internap's competitive position in the marketplace and its strategy to generate profitable growth for our stockholders.

Challenges are an inherent part of growing in a rapidly evolving, dynamic marketplace, and we will continue to demonstrate our commitment to solve them in an effective manner. Our focus remains on growing existing customer relationships through our bundled product offering and expanding our presence to win increased market share. Financial discipline and operational diligence will be improved and maintained as we execute these strategic priorities in order to maximize profitability. We appreciate the confidence that our customers and stockholders continue to place in Internap and intend to reward your confidence with performance.

Sincerely,

James P. DeBlasio
President and Chief Executive Officer
May 15, 2008

Operating Cash Flow
($ in millions)



For the second consecutive year, strong sales and operational discipline helped generate strong operating cash flow.

Right Time, Right Place

A Conversation With Jim DeBlasio About Internap's Competitive Position

Q. Internap acquired VitalStream in order to add CDN to its product and service portfolio. Have you been satisfied with the performance of your CDN offering in its first year as part of Internap?

A. Our purchase of VitalStream enabled us to enter the fast-growing CDN market and to provide a differentiated end-to-end solution for our customers, both of which were important, long-term strategic goals for Internap. Our expectation was that we would be able to bring CDN to enterprise scale more quickly, and the delay did slow our CDN revenue growth in the second half of 2007. However, we made a great deal of progress in scaling CDN to increase reliability, reach and range of product. This progress is beginning to pay off with an increasing deal size and pace. Our efforts to upsell existing customers have been well received, with 38 percent of new CDN bookings being sold into our existing customer base.

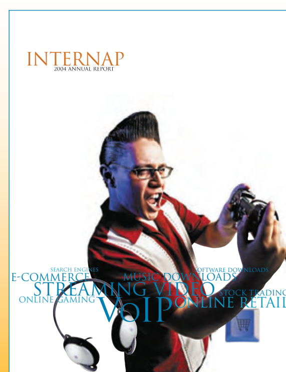
Q. There have been several new entrants into the CDN market since you acquired VitalStream. How does this affect the competitive landscape?

A. It doesn't surprise us to see more competitors in a space that is growing as fast as CDN. It really has had no effect on our bundling strategy or on our premium CDN service. Our premium CDN service is armed with an unmatched SLA, patented route-optimization technology, NOC support, delivery diversity, and service customizability. It's a very unique service that should perform well, regardless of the competitive environment.

Q. The marketplace for Internet service providers has long been an exceptionally competitive one. What type of pricing trends do you see going forward?

A. Pricing declines are a reality of the telecom services market. Internap typically achieves premium pricing relative to the market because of the proprietary nature of our service and the value that it delivers to customers in the form of reliability and speed. We also

The Right Direction



The Next-Generation IP Company (2004)

It's hard to believe that only three-to-four years ago VoIP, music downloads and online gaming were just beginning to become mainstream. Well aware of the market opportunity, Internap's superior route-optimization technology was well-positioned to meet the demands of a new generation of Internet use.

have the advantage of bundling Performance IP with other services, which leads to increased operating leverage and expanding margins. It's important to note that on a per-megabit basis, while we did see pricing pressure in 2007, it was at a slower rate than several years ago.

Q. Internap shares were under a great deal of pressure during the second half of 2007. From your perspective, what caused this pressure?

A. The stock market has been hit hard across the board in recent quarters, and our shares have certainly traded in line with this trend. We cannot speculate on the relatively short-term ups and downs of the market, nor can we manage our business around it. Our focus is to continue to manage the business for profitable growth, which we believe the market will reward in time. It is worth noting and a bit ironic that the bundled service offering that serves our customers so well makes us a bit of an anomaly for investors. Internap has no pure investment peers. We are neither a pure Internet service play nor a pure CDN play. When there is a headwind in either of these markets, we tend to get caught up in it. It's an interesting dynamic, but in the long run, we believe the end-to-end solution will benefit the Company and its stockholders from a strategic perspective.

Q. Why did the Company extend the filing of its 2007 10-K?

A. Our filing was extended due to the need to examine the adequacy of our sales and billing allowance primarily associated with customer credits for CDN service. In the second and third quarter of 2007, some CDN customers experienced network outages that led to a number of disputes and credit requests. We have addressed this issue on two levels. At the service level, we have improved the reliability and reach of our CDN platform, as well as extended our 100 percent uptime Service Level Agreement to our CDN products. On an administrative level, we have implemented a number of new processes that better identify, track and monitor customer usage and credit requests. All of these measures should significantly improve customer satisfaction and service, which have long been a core business strength at Internap

Q. The expectation is that the U.S. economy will continue to weaken in 2008. What is your strategy for managing through a strong economic downturn?

A. Through the first quarter of 2008, we have not seen any signs of weakness in our business due to macroeconomic forces. Should this change, I believe we are in solid shape to weather any downturn. The diversity of our customer base and the vertical markets that we serve should help mitigate the effect of an overall downturn. We also have demonstrated our ability to control costs and run the business in a prudent and disciplined manner. Finally, our balance sheet is very strong, as are the overall fundamentals of the Company. Combined, all of these factors put us in a relatively favorable position to weather a possible downturn.

We Can Make This Company Thrive (2005)

As Internap approached its 10-year anniversary, the Company made a renewed commitment to achieving profitability through a fortified core business, excellent execution and a winning workforce. Accountability, discipline and focus were the operative words for a new management team dedicated to rewarding stockholders.

Play To Win (2006)

Making good on commitments from the previous year, Internap achieved profitability in a record performance year. To sustain profitable growth well into the future, the Company acquired VitalStream in order to capitalize on the fast-growing CDN market and to expand Internap's bundled service offering.

A Message From Gene Eidenberg

Internap is a growing and profitable company with healthy margins. As an investor and director of Internap since 1997, I have been fortunate to be part of the building of an increasingly important company.

Internap has had its challenges as it has grown and developed. It survived the bursting of the tech bubble in 2000, and it was forced to accommodate dramatic reductions in network pricing for most of the first half of the new decade.

More recently, we have come through the complex integration of VitalStream that Internap acquired to enable its entry in the rapidly growing Content Delivery Network (CDN) business.

Internap now has the most robust and reliable CDN network available in the marketplace, and is poised to become a significant provider of global CDN services, including high-definition video.

In short, its valued customers increasingly see Internap as an essential supplier of managed services just as the Internet has become a primary source of information and management for global companies and audiences.

Your board is grateful to you, our stockholders, who have believed in the Internap business model as the Company developed over this past decade. The board and management are dedicated to giving you a return on your investment that justifies your loyalty.

Gene Eidenberg
Chairman

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
Co-Head of IT Practice and Managing Director,
VantagePoint Venture 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

Gary Pfeiffer
Former Senior Vice President and *Chief Financial Officer,*
The DuPont Company
Director since: 2007

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

INTERNAP NETWORK SERVICES CORPORATION

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SELECTED FINANCIAL DATA

Financial Review 2007

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, 2007. 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 2006 and 2005 annual reports on Form 10-K/A and Form 10-K, respectively, filed with the SEC, as well as the section of this annual report and of our 2006 and 2005 annual reports on Form 10-K/A and Form 10-K, respectively, entitled, "Management's Discussion and Analysis of Financial Condition and Results of Operations."

	Year Ended December 31,				
(In thousands, except per share data)	**2007[1]**	2006[2]	2005	2004	2003
Consolidated Statement of Operations Data:					
Revenue	**$234,090**	$181,375	$153,717	$144,546	$138,580
Operating costs and expenses:					
Direct costs of network, sales and services, exclusive of depreciation and amortization, shown below [3]	**118,394**	97,338	81,958	76,990	78,200
Direct costs of amortization of acquired technologies [3]	**4,165**	516	577	579	134
Direct costs of customer support	**16,547**	11,566	10,670	10,180	9,483
Product development	**6,564**	4,475	4,864	6,412	6,982
Sales and marketing	**31,533**	27,173	25,864	23,411	21,491
General and administrative	**32,512**	22,104	20,096	24,772	16,711
Depreciation and amortization	**22,242**	15,856	14,737	15,461	37,087
Gain on disposals of property and equipment	**(5)**	(113)	(19)	(3)	(53)
Restructuring and asset impairment	**11,349**	323	44	3,644	1,084
Acquired in-process research and development	**450**	–	–	–	–
Amortization of deferred stock compensation	**–**	–	60	–	390
Pre-acquisition liability adjustment	**50**	–	–	–	(1,313)
Total operating costs and expense	**243,801**	179,238	158,851	161,446	170,196
(Loss) income from operations	**(9,711)**	2,137	(5,134)	(16,900)	(31,616)
Non-operating (income) expense	**(937)**	(1,551)	(87)	772	2,158
(Loss) income before income taxes and equity in earnings of equity method investment	**(8,774)**	3,688	(5,047)	(17,672)	(33,774)
(Benefit) provision for income taxes	**(3,080)**	145	–	–	–
Equity in (earnings) loss of equity-method investment, net of taxes	**(139)**	(114)	(83)	390	827
Less deemed dividend related to beneficial conversion feature [4]	**–**	–	–	–	34,576
Net (loss) income	**$ (5,555)**	$ 3,657	$ (4,964)	$ (18,062)	$ (69,177)
Net (loss) income per share:					
Basic	**$ (0.12)**	$ 0.11	$ (0.15)	$ (0.63)	$ (3.96)
Diluted	**$ (0.12)**	$ 0.10	$ (0.15)	$ (0.63)	$ (3.96)
Weighted average shares used in per share calculations					
Basic	**46,942**	34,748	33,939	28,732	17,460
Diluted	**46,942**	35,739	33,939	28,732	17,460

	Year Ended December 31,				
	2007[1]	2006	2005	2004	2003
Consolidated Balance Sheet Data:					
Cash, cash equivalents and short-term marketable securities	**$ 71,599**	$ 58,882	$ 40,494	$ 45,985	$ 18,885
Non-current marketable securities	**–**	–	–	4,656	–
Total assets	**427,010**	173,702	155,369	168,149	135,839
Note payable and capital lease obligations, less current portion	**17,806**	3,364	7,903	12,837	12,742
Total stockholders' equity	**346,633**	126,525	109,728	113,738	70,524

	Year Ended December 31,				
	2007[1]	2006	2005	2004	2003
Other Financial Data:					
Purchases of property and equipment	**$ 30,271**	$ 13,382	$ 10,161	$ 13,066	$ 3,799
Net cash provided by (used in) operating activities	**27,592**	29,599	5,493	(1,150)	(11,175)
Net cash (used in) provided by investing activities	**(36,393)**	(10,399)	(9,428)	(29,659)	561
Net cash provided by (used in) financing activities	**15,240**	1,957	(5,454)	45,747	4,280

(1) On February 20, 2007 we completed our acquisition of VitalStream, whereby VitalStream became a wholly-owned subsidiary of Internap. Prior to our acquisition of VitalStream, we did not offer proprietary CDN services, but instead, we were a reseller of third party CDN services. Under the purchase method of accounting, we allocated the total estimated purchase price to VitalStream's net tangible and intangible assets based on their estimated fair values as of February 20, 2007. We recorded the excess purchase price over the value of the net tangible and identifiable intangible assets as goodwill. Also, as a result of the acquisition we issued approximately 12.2 million shares of Internap common stock.

(2) 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 we 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.

(3) Prior to 2007, direct costs of amortization of acquired technologies were included in the caption direct costs of network, sales and services, exclusive of depreciation and amortization. In 2007, we reclassified these costs to a separate caption. These reclassifications had no effect on previously reported operating loss (income) or net loss (income).

(4) In August 2003, we completed a private placement of our common stock, which resulted in a decrease of the conversion price of our series A preferred stock to $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 was issuable upon conversion of our series A preferred stock.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Financial Review 2007

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

OVERVIEW

We deliver high performance and reliable Internet solutions through a suite of network optimization and delivery of products and services. These solutions, combined with progressive and proactive technical support, enable companies to confidently migrate business-critical applications, including audio and video streaming and monetization services, to the Internet. Our suite of products and services support a broad range of Internet applications. We currently have approximately 3,800 customers, serving financial services, healthcare, technology, retail, travel, and media/entertainment markets. Our customers are located in the United States and abroad and include several Fortune 1000 and mid-tier enterprises. Our product and service offerings are complemented by Internet protocol, or IP, access solutions such as data center services, content delivery networks, or CDN, and managed security. We deliver services through our 50 service points across North America, Europe and the Asia-Pacific region. Our Private Network Access Points, or P-NAPs, feature multiple direct high-speed connections to major Internet networks including AT&T Inc., Sprint Nextel Corporation, Verizon Communications Inc., Savvis, Inc., Global Crossing Limited, and Level 3 Communications, Inc.

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.

On October 12, 2006, we entered into a definitive agreement to acquire VitalStream Holdings, Inc., or VitalStream, in an all-stock transaction accounted for using the purchase method of accounting for business combinations. The transaction closed on February 20, 2007. Our results of operations include the activities of VitalStream from February 21, 2007 through December 31, 2007.

As discussed in note 18 to our consolidated financial statements, we revised our quarterly statement of operations for the quarter ended September 30, 2007 to appropriately record (1) $0.5 million for sales adjustments, which reduced net accounts receivable and revenue, and (2) $0.1 million for accretion of interest income that we initially included as unrealized gain in accumulated other comprehensive income within stockholders' equity. The effect of these revisions had no impact on our consolidated statement of cash flows. We have determined that these adjustments are not material to our consolidated financial statements for any of the affected quarterly periods. Accordingly, we have not revised the 2007 quarterly financial statements included in our previously filed Forms 10-Q for the quarterly periods ended March 31, June 30 and September 30, 2007, for these adjustments.

We operate in three business segments: IP services, data center services and CDN services. For additional information about these segments, see note 5 to the consolidated financial statements.

The following is a brief description of each of our reportable business segments.

IP Services

Our patented and patent-pending network performance optimization technologies address the inherent weaknesses of the Internet, allowing enterprises to take advantage of the convenience, flexibility and reach of the Internet to connect to customers, suppliers and partners. Our solutions take into account the unique performance requirements of each business application to ensure performance as designed, without unnecessary cost. Prior to recommending appropriate network solutions for our customers' applications, we consider key performance objectives including (1) performance and cost optimization, (2) application control and speed and (3) delivery and reach. Our charges for IP services are based on a fixed-fee, usage or a combination of both fixed fee and usage.

Our IP services segment also includes our Flow Control Platform™, or FCP. The FCP provides network performance management and monitoring for companies with multi-homed networks and redundant Internet connections. The FCP proactively reviews customer networks for the best performing route or the most cost-effective and routes according to our customers' requirements. We offer FCP as either a one-time hardware purchase or as a monthly subscription service. Sales of FCP also generate annual maintenance fees and professional service fees for installation and ongoing network configuration. Since the FCP emulates our Performance IP service in many ways, this product affords us the opportunity to serve customers outside of our P-NAP market footprint. This product represents approximately 4% of our IP services revenue and approximately 2% of our consolidated revenue for the year ended December 31, 2007.

Data Center Services

Our data center services provide a single source for network infrastructure, IP and security, all of which are designed to maximize solution performance while providing a more stable, dependable infrastructure, and are backed

by guaranteed service levels and our team of dedicated support professionals. We offer a comprehensive solution at 42 service points, including 8 locations managed by us and 34 locations managed by third parties.

Data center services also enable us to have a more flexible product offering, including bundling our high performance IP connectivity and managed services, such as content delivery, along with hosting customers' applications. We charge monthly fees for data center services based on the amount of square footage that the customer leases in our facilities. We also have relationships with various providers to extend our Performance IP model into markets with high demand.

CDN Services

Our CDN services enable our customers to quickly and securely stream and distribute video, audio, advertising, and software to audiences across the globe through strategically located data centers. Providing capacity-on-demand to handle large events and unanticipated traffic spikes, content is delivered with high quality regardless of audience size or geographic location. Our MediaConsole® content management tool provides our customers the benefit of a single, easy to navigate system featuring Media Asset Management, Digital Rights Management, or DRM, support, and detailed reporting tools. With MediaConsole, our customers can use one application to manage and control access to their digital assets, deliver advertising campaigns, view network conditions, and gain insight into habits of their viewing audience.

Our CDN and monetization services provide a complete turnkey solution for the monetization of online media. These multi-faceted "live" and "on-demand" advertisement insertion and advertising placement solutions include a full campaign management suite, inventory prediction tools, audience research and metrics, and extensive reporting features to effectively track advertising campaigns in real-time. Online advertising solutions enable our customers to offset the costs associated with the creation, transformation, licensing, and management of online content. Prior to our acquisition of VitalStream on February 20, 2007, we did not offer proprietary CDN services, but instead, we were a reseller of third party CDN services for which results of operations are included in Other revenues and direct costs of network, sales and services, discussed below.

Other

Other revenues and direct costs of network, sales and services include our non-segmented results of operations, including certain reseller and miscellaneous services such as third party CDN services, termination fee revenue, other hardware sales, and consulting services.

HIGHLIGHTS AND OUTLOOK

- *Due to the nature of the services we provide, we generally price our IP services at a premium compared 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 IP 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 2007, we added approximately 1,500 net customers (including approximately 900 VitalStream customers that we added as part of the VitalStream acquisition), bringing our total to approximately 3,800 enterprise customers as of December 31, 2007. Revenue for the year ended December 31, 2007 increased 29% to $234.1 million, compared to revenue of $181.4 million for the year ended December 31, 2006.
- *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. We experienced a net increase in customers from 2006 to 2007. Conversely, decreases in the number of customers in an established market lead to decreased facility utilization and increase the possibility that direct network resources are not cost-efficiently employed. These factors have a direct bearing on our financial position and results of operations.
- *We offer a 100% operational uptime guarantee for our network performance management.* Coupled with the lowest packet loss and latency in the industry, we provide our customers with a proactive industry-leading Service Level Agreement (SLA) that covers the entire Internet – not just one single network. Unlike our competitors, we believe so strongly in the consistent performance of our network that we offer *proactive* SLA notification and *automatic* bill credits if we ever break our SLAs. We believe that this commitment allows us to provide the best network performance available.

DEVELOPMENTS IN 2007

VitalStream Acquisition. On February 20, 2007, we completed the previously announced acquisition of VitalStream Holdings, Inc., or VitalStream, for approximately $214.0 million, whereby VitalStream became a wholly-owned subsidiary of Internap. VitalStream provides products and services for storing and delivering digital media to large

audiences over the Internet and advertisement insertion and related advertising services to companies that stream digital media over the Internet. VitalStream enhances our position as a leading provider of high performance route control products and services by adding complementary service offerings in the rapidly growing content delivery and on-line advertising markets. Integrating VitalStream's digital media delivery platform into our portfolio of products and services enables us to provide customers with one of the most complete product lines in content delivery solutions, content monetization and on-line advertising, while supporting the significant long-term growth opportunities in the network services market. We also considered the following:

- VitalStream's services were a logical extension and complement to our high performance route control products and services.
- We evaluated demand for CDN services within our customer base and determined that a market for proprietary CDN services existed.
- VitalStream's services offered our legacy customers additional high growth and high margin revenue streams.
- We believed that large audio and video files are more effectively delivered over the Internet with a combination of VitalStream's platform and our route management network.
- VitalStream's initiatives in the rich media advertising services business present an entirely new set of opportunities and potential customer relationships for us, as advertisers seek to access a large and growing base of Internet users that watch increasing amounts of video online.

We accounted for the acquisition using the purchase method of accounting in accordance with SFAS No. 141, "Business Combinations." Our results of operations include the activities of VitalStream from February 21, 2007 through December 31, 2007.

Restructuring Liability. On March 31, 2007, we incurred a restructuring and impairment charge totaling $10.3 million. The charge was the result of a review of our business, particularly in light of our acquisition of VitalStream, and our plan to finalize the overall integration and implementation plan before the end of the first quarter. The charge to expense included $7.8 million for leased facilities, representing both the net present value of costs less anticipated sublease recoveries that will continue to be incurred without economic benefit to us and costs to terminate leases before the end of their term. The charge also included severance payments of $1.1 million for the termination of certain Internap employees and $1.4 million for impairment of assets. Related expenditures are estimated to be $10.7 million, of which $3.7 million has been paid during the year ended December 31, 2007, and the balance continuing through December 2016, the last date of the longest lease term. The impairment charge of $1.3 million was related to the leases referenced above and less than $0.1 million for other assets.

We also incurred a $1.1 million impairment recorded for a sales order-through-billing system, which was a result of an evaluation of the existing infrastructure relative to our new financial accounting system and the acquisition of VitalStream.

Write-Off of Investment. In connection with the preparation of our quarterly report for the quarter ended June 30, 2007, we wrote-off an investment, totaling $1.2 million, representing the remaining carrying value of our investment in series D preferred stock of Aventail Corporation, or Aventail. We made an initial cash investment of $6.0 million in Aventail series D preferred stock pursuant to an investment agreement in February 2000. In connection with a subsequent round of financing by Aventail, we recognized an initial impairment loss on our investment of $4.8 million in 2001. On June 12, 2007, SonicWall, Inc. announced that it had entered into an agreement to acquire Aventail for approximately $25.0 million in cash. The transaction closed on July 11, 2007, all shares of series D preferred stock were cancelled and the holders of series D preferred stock did not receive any consideration for such shares. Consequently, we recorded a write-off of our investment in Aventail to reduce our carrying value to $0.

Rights Agreement. On March 15, 2007, the Board of Directors declared a dividend of one preferred share purchase right, or a Right, for each outstanding share of common stock, par value $0.001 per share, of the Company. The dividend was payable on March 23, 2007 to the stockholders of record on that date. Each Right entitles the registered holder to purchase from the Company one one-thousandth of a share of Series B Preferred Stock of the Company, par value $0.001 per share, or the Preferred Shares, at a price of $100.00 per one one-thousandth of a Preferred Share, subject to adjustment. The description and terms of the Rights are set forth in a Rights Agreement between the Company and American Stock Transfer & Trust Company, as Rights Agent dated April 11, 2007.

Data Center Expansion. On June 12, 2007, we announced that we approved an investment of up to $40.0 million to fund the expansion of our data center facilities in several key markets. We anticipate implementing the expansion over the next several calendar quarters, with at least a portion of the funding to be provided under our credit agreement, discussed below. Through December 31, 2007, we have spent less than $10.0 million.

Credit Agreement. On September 14, 2007, we entered into a $35.0 million credit agreement. We discuss this agreement in note 10 to the consolidated financial statements and the section captioned "Liquidity and Capital Resources" under "Management's Discussion and Analysis of Financial Condition and Results of Operations." At December 31, 2007, the outstanding balance was $19.8 million, of which we used $4.4 million to repay prior debt, approximately $7.8 million for capital expenditures and the balance for general corporate and other purposes. The availability under the revolving credit facility and term loan was $1.1 million and $10.0 million, respectively at December 31, 2007.

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 IP services, related data center services, CDN services, and other ancillary products and services throughout the United States. Our IP services revenue is derived from the sale of high performance Internet connectivity services at fixed rates or usage-based pricing to our customers that desire a DS3 or faster connection. Slower T1 and fractional DS3 connections are provided at fixed rates. Data center revenue includes both physical space for hosting customers' network and other equipment plus associated services such as redundant power and network connectivity, environmental controls and security. Data center revenue is based on occupied square feet and both allocated and variable-based usage. CDN revenue includes three components, none of which are sold separately: (1) data storage; (2) streaming/delivery and (3) a user interface/reporting tool. We provide the CDN service components via internally developed and acquired technology that resides on our network. CDN revenue is based on either fixed rates or usage-based pricing. All of the foregoing revenue arrangements have contractual terms and in many instances, include minimum usage commitments. Other ancillary products and services include our Flow Control Platform, or FCP, product, server management and installation, virtual private networking, managed security, data backup, remote storage and restoration.

We recognize revenue in accordance with the Securities and Exchange Commission's Staff Accounting Bulletin No. 104, *Revenue Recognition*, or SAB No. 104, and the Financial Accounting Standards Board's, or FASB, Emerging Issues Task Force Issue No. 00-21, *Revenue Arrangements with Multiple Deliverables*, or EITF No. 00-21. Revenue is recognized when persuasive evidence of an arrangement exists, the product or service has been delivered, the fees are fixed or determinable and collectibility is probable. For most of our IP, data center and CDN revenue, services are delivered ratably over the contract term. Contracts and sales or purchase orders are used to determine the existence of an arrangement. We test for availability or connectivity to verify delivery of our services. 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. Because the software component of our FCP is more than incidental to the product as a whole, we recognize associated FCP revenue in accordance with the American Institute of Certified Public Accountants' (AICPA) Statement of Position 97-2, *Software Revenue Recognition*.

We derive revenue from the sale of IP services, data center services and CDN services to customers under contracts that generally commit the customer to a minimum monthly level of usage on a calendar month basis and provide the rate at which the customer must pay for actual usage above the monthly minimum. For these services, we recognize the monthly minimum as revenue each month provided that an enforceable contract has been signed by both parties, the service has been delivered to the customer, the fee for the service is fixed or determinable and collection is reasonably assured. Should a customer's usage of our services exceed the monthly minimum, we recognize revenue for such excess in the period of the usage. We record the installation fees as deferred revenue and recognize as revenue ratably over the estimated life of the customer arrangement. We also derive revenue from services sold as discrete, non-recurring events or based solely on usage. For these services, we recognize revenue after both parties have signed an enforceable contract, the fee is fixed or determinable, the event or usage has occurred and collection is reasonably assured.

We also enter into multiple-element arrangements or bundled services, such as combining IP services with data center, CDN services or both. When we enter into such arrangements, we account for each element separately over its respective service period or at the time of delivery, provided that there is objective evidence of fair value for the separate elements. Objective evidence of fair value includes the price charged for the element when sold separately. If we cannot objectively determine the fair value of each element, we recognize the total value of the arrangement ratably over the entire service period to the extent that we have begun to provide the services, and other revenue recognition criteria have been satisfied.

Deferred revenue consists of revenue for services to be delivered in the future and consist 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, which was two to three years for each

of the three years in the period ended December 31, 2007. Revenue for installation services is deferred and amortized because 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.

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 collection is probable. 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. A customer's ability to pay takes into consideration payment history, legal status (i.e., bankruptcy) and the status of services we are providing. Once we have exhausted all collection efforts, we write the uncollectible balance off against the allowance for doubtful accounts.

We record an amount for sales adjustments, which reduces net accounts receivable and revenue. The amount 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.

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. We record rent expense for operating leases in accordance with 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.

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 incurred a charge during the three months ended June 30, 2007, totaling $1.2 million, representing the write-off of the remaining carrying value of our investment in series D preferred stock of Aventail. See note 6 to the consolidated financial statements for further discussion of this investment and the recorded loss.

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, 2007, Internap Japan Co, Ltd. (Internap Japan), our joint venture with NTT-ME Corporation of Japan and NTT Holdings, 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 a separate caption on the consolidated statement of operations.

Pursuant to our formal investment policy, investments in marketable securities include high credit quality corporate debt securities, auction rate securities, commercial paper, and U.S. Government Agency debt securities. Auction rate securities are variable rate bonds tied to short-term interest rates with maturities on the face of the securities in excess of 90 days and have interest rate resets through a modified Dutch auction, at predetermined short-term intervals, usually every 7, 28 or 35 days. Auction rate securities generally trade at par and are callable at par on any interest payment date at the option of the issuer. Interest received during a given period is based upon the interest rate determined through the auction process. Although these securities are issued and rated as long term bonds, they are priced and traded as short-term instruments because of the liquidity provided through the interest rate reset. All of our marketable securities 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. As a first step, 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. We also assess on a quarterly basis whether any events have occurred or circumstances have changed that would indicate an impairment could exist.

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 appropriate month when the resolution has been determined. 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 consolidated financial condition, results of operations and cash flows.

Accrued Liabilities. Similar to accruals for disputed telecommunications costs above, it is necessary for us to 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 $10.1 million restructuring liability at December 31, 2007 would result in an $1.0 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. Historically, 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 reduce the valuation allowance would increase income in the period such determination was made.

For the year ended December 31, 2007, the tax provision includes a net benefit of $3.5 million related to the release of the valuation allowance associated with U.K. deferred tax assets. The gross amount of U.K. deferred tax assets was $4.4 million, which was offset by a reserve of $0.9 million. The net tax provision benefit of $3.5 million reduced our loss for the year ended December 31, 2007.

The reduction in valuation allowance was due to the existence of sufficient positive evidence as of December 31, 2007 to indicate that our net operating losses in the U.K. would more likely than not be realized in the future. The evidence primarily consist s of the results of prior performance in the U.K. and the expectation of future performance based on historical results. We will continue to assess in the future the recoverability of U.S. and other deferred tax assets, and whether or not the valuation allowance should be reduced relative to the U.S. and other deferred tax assets outside the U.K.

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," or SFAS No. 123R, and related interpretations. 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 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, we did not recognize any expense for options to purchase our common stock granted with an exercise price equal to fair market value at the date of grant and did not recognize any expense in connection with purchases under our employee stock purchase plans for any periods prior to January 1, 2006.

We elected to adopt SFAS No. 123R using the modified prospective application method. Under this method, compensation cost recognized during the period includes: (1) compensation cost for all share-based payments granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123 amortized over the awards' vesting period, and (2) compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS No. 123R amortized on a straight-line basis over the awards' vesting period. The fair value of stock options is estimated at the date of grant using the Black-Scholes option pricing model with weighted average assumptions for the activity under our stock plans. Option pricing model input assumptions such as expected term, expected volatility, and risk-free interest rate, impact the fair value estimate. Further, the forfeiture rate impacts the amount of aggregate compensation. These assumptions are subjective and generally require significant analysis and judgment to develop.

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

RECENT ACCOUNTING PRONOUNCEMENTS

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements," or SFAS No. 157. SFAS No. 157 defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles, or GAAP, and expands disclosures about fair value measurements. SFAS No. 157 is effective for fiscal years beginning after December 15, 2007. In February 2008, the FASB issued Staff Position, or FSP, FAS 157-1, which provides supplemental guidance on the application of SFAS No. 157, and FSP FAS 157-2, which delays the effective date of SFAS No. 157 for nonfinancial assets and nonfinancial liabilities. We are currently in the process of evaluating the impact that the adoption of SFAS No. 157 will have on our financial position, results of operations and cash flows.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities," or SFAS NO. 159. SFAS No. 159 permits companies to choose to measure, on an instrument-by-instrument basis, many financial instruments and certain other assets and liabilities at fair value that are not currently required to be measured at fair value. SFAS No. 159 is effective as of the beginning of a fiscal year that begins after November 15, 2007. While we will not elect to adopt fair value accounting to any assets or liabilities allowed by SFAS No. 159, we are currently in the process of evaluating SFAS No. 159 and its potential impact to us.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), "Business Combinations," or SFAS No. 141R. SFAS No. 141R replaces SFAS No. 141, "Business Combinations." SFAS No. 141R establishes principles and requirements for how an acquiror recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquiree, and the goodwill acquired or a gain from a bargain purchase. SFAS No. 141R also determines disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. SFAS No. 141R applies prospectively to business combinations for which the acquisition date is on or after the beginning of a fiscal year that begins on or after December 15, 2008 and has implications for acquisitions that occur prior to this date. We are currently in the process of evaluating the impact that the adoption of SFAS No. 141R will have on our financial position, results of operations and cash flows.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financ ial Statements," or SFAS No. 160. SFAS No. 160 amends Accounting Research Bulletin 51, " Consolidated Financial Statements," or ARB 51, and requires all entities to report noncontrolling (minority) interests in subsidiaries within equity in the consolidated financial statements, but separate from the parent shareholders' equity. SFAS No. 160 also requires any acquisitions or dispositions of noncontrolling interests that do not result in a change of control to be accounted for as equity transactions. Further, SFAS No. 160 requires that a parent recognize a gain or loss in net income when a subsidiary is deconsolidated. SFAS No. 160 is effective for fiscal years beginning on or after December 15, 2008. We do not expect the adoption of SFAS No. 160 will have a significant, if any, impact on our financial position, results of operations and cash flows.

RESULTS OF OPERATIONS

Revenues. Revenues are generated primarily from the sale of IP services, data center services and CDN services. Our revenues typically consist

of monthly recurring revenues from contracts with terms of one year or more. These contracts usually have fixed minimum commitments based on a certain level of usage with additional charges for any usage over a specified limit. We also provide premise-based route optimization products and other ancillary services, such as server management and installation services, virtual private networking services, managed security services, data back-up, remote storage, restoration services, and professional services.

Direct Costs of Network, Sales and Services. Direct costs of network, sales and services are comprised primarily of:

- costs for connecting to and accessing Internet network service providers, or ISPs, and competitive local exchange providers;
- facility and occupancy costs for housing and operating our and our customers' network equipment;
- costs of license fees for operating systems software, advertising royalties to content rights owners and advertising distribution costs;
- costs incurred for providing additional third party services to our customers; and
- costs of FCP solutions sold.

To the extent a network access point is located a distance from the respective ISP, 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 costs of network, sales and services do not include compensation, depreciation or amortization.

Direct Costs of Amortization of Acquired Technologies. Direct costs of amortization of acquired technologies are for technologies acquired through business combinations that are an integral part of the services and products we sell. The cost of the acquired technologies is amortized over original lives of three to eight years.

Direct Costs of Customer Support. Direct costs of customer support consist primarily of compensation and other personnel 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 costs of customer support.

Product Development Costs. Product development costs consist principally of compensation and other personnel costs, consultant fees and prototype costs related to the design, development and testing of our proprietary technology, enhancement of our network management software and development of internal systems. Costs 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 the software is ready for its intended use. All other product development costs are expensed as incurred.

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

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

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

	Year Ended December 31,		
	2007	2006	2005
Revenues:			
Internet protocol (IP) services	**51.2%**	60.5%	68.3%
Data center services	**35.5**	31.0	24.1
Content delivery network (CDN) services	**7.6**	–	–
Other	**5.7**	8.5	7.6
Total revenues	**100.0**	100.0	100.0
Operating costs and expenses:			
Direct costs of network, sales and services, exclusive of depreciation and amortization, shown below:			
IP services	**18.7**	21.9	25.0
Data center services	**25.4**	25.6	22.9
CDN services	**2.8**	–	–
Other	**3.7**	6.1	5.4
Direct costs of amortization of acquired technologies	**1.8**	0.3	0.4
Direct costs of customer support	**7.1**	6.4	6.9
Product development	**2.8**	2.5	3.2
Sales and marketing	**13.4**	15.0	16.8
General and administrative	**13.9**	12.2	13.1
Depreciation and amortization	**9.5**	8.7	9.6
Restructuring and asset impairment	**4.9**	0.2	–
Other operating costs and expenses	**0.2**	(0.1)	–
Total operating costs and expenses	**104.2**	98.8	103.3
(Loss) income from operations	**(4.2)%**	1.2%	(3.3)%

REVENUES

Revenues for the years ended December 31, 2007, 2006 and 2005 are summarized as follows (in thousands):

	Year Ended December 31,		
	2007	2006	2005
Revenues:			
Internet protocol (IP) services	**$119,848**	$109,748	$105,032
Data center services	**83,058**	56,152	36,996
Content delivery network (CDN) services	**17,718**	–	–
Other	**13,466**	15,475	11,689
	$234,090	$181,375	$153,717

Segment Information. We have three business segments: IP services, data center services and CDN services. IP services include managed and premise-based high performance IP and route optimization technologies. Data center services include hosting of customer applications directly on our network to eliminate issues associated with the quality of local connections. Data center services are increasingly bundled with our high performance IP connectivity services. CDN services include products and services for storing, delivering and monetizing digital media to large global audiences over the Internet. Prior to our acquisition of VitalStream on February 20, 2007, we did not offer proprietary CDN services, but instead, we were a reseller of third party CDN services for which revenues and direct costs are included in other revenues and direct costs of network, sales and services, discussed below.

Our reportable segments are strategic business units that offer different products and services. As of December 31, 2007, our customer base totaled approximately 3,800 customers across more than 20 metropolitan markets.

IP Services. Revenue for IP services increased $10.1 million, or 9%, to $119.9 million for the year ended December 31, 2007, compared to $109.7 million for the year ended December 31, 2006. The increase in IP revenue is driven by an increase in demand, partially offset by a decline in pricing, and an increase in sales of our premise-based FCP products and other large hardware sales. We continue to experience increasing demand for our traditional IP services, with IP traffic for the year ended December 31, 2007 increasing approximately 35% from the year ended December 31, 2006. The increase in IP traffic has resulted from both existing and new customers requiring 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 have continued to add high-traffic customers through competitive IP pricing and minimum commitments during the year ended December 31, 2007. New IP services customers added approximately $1.7 million of revenue. Ongoing industry-wide pricing declines over the last 12 months, however, offset a portion of our gains in customers and IP traffic. The blended rate in megabits per second, or Mbps, decreased approximately 23% annually from December 31, 2006 to December 31, 2007. We recorded approximately $0.5 million of sales adjustments in the fourth quarter of 2007 related predominantly to disputes over contractual service periods.

Revenue for IP services increased $4.7 million, or 5%, to $109.7 million for the year ended December 31, 2006, compared to $105.0 million for the year ended December 31, 2005. This change is due to the increase in demand for IP traffic, partially offset by 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.

Data Center Services. Data center services are a significant source of revenue growth for our business. Revenue for data center services increased $26.9 million, or 48%, to $83.1 million for the year ended December 31, 2007, compared to $56.2 million for the year ended December 31, 2006. During the year ended December 31, 2007, we (1) implemented a broad-based rate increase, generating additional revenue of approximately $8.0 million, (2) began executing a data center growth initiative and (3) completed the build-out of our Seattle facility. The overall increase in revenue has resulted from both new and existing customers, with new customers adding approximately $1.7 million of revenue during 2007. The remaining increase is largely due to existing customers using more space within our facilities, and the design and installation revenue from new customers. We have also structured our data center business to accommodate larger, global customers and ensure a platform for robust traffic growth.

Revenue for data center services increased $19.2 million, or 52%, to $56.2 million for the year ended December 31, 2006, compared to $37.0 million for the year ended December 31, 2005. The revenue increase is primarily attributable to growth in new and existing data center customers. 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.

CDN Services. Revenue for our CDN services segment was $17.7 million for the year ended December 31, 2007. This activity represents the operations from our acquisition of VitalStream, which we completed on February 20, 2007. Revenue for the year was slightly lower than originally anticipated as we completed the integration of the VitalStream business

with and into our network and infrastructure. As previously noted, we did not offer proprietary CDN services prior to our acquisition of VitalStream, but instead, we were a reseller of third party CDN services, which is included in Other revenue, below. We expect CDN to be an area of significant growth and have upgraded and expanded related infrastructure, including in Europe and Asia, to serve the expected industry-wide demand, particularly in those regions. In December 2007, we extended our 100% uptime SLA to CDN services. In the second half of 2007, the Company experienced platform instability in its CDN business, which caused an increase in customer dissatisfaction and a higher than historical amount of customer disputes over service billings. In the fourth quarter of 2007, we recorded a total of appoximately $1.4 million in sales and billing adjustments related to both service interruptions and disputes over contractual service periods. These sales and billing adjustments have been recorded against revenue. We have substantially completed integrating our combined networks through technological improvements and systems integration with operational stability achieved late in the year and expect this integration to result in a decrease in performance-related adjustments in 2008.

Other. Other revenues primarily include reseller and miscellaneous services such as third party CDN services, termination fee revenue, referral fees for other hardware sales, and consulting services. Other revenues decreased substantially as the revenue streams from our acquisition of VitalStream replaced the activity of the former third party CDN service provider.

DIRECT COSTS OF NETWORK, SALES AND SERVICES
(exclusive of depreciation and amortization)

IP Services. Direct costs of IP network, sales and services, exclusive of depreciation and amortization, increased $3.9 million, or 10%, to $43.7 million for the year ended December 31, 2007, compared to $39.7 million for the year ended December 31, 2006. For the year ended December 31, 2006 compared to the year ended December 31, 2005, the related direct costs increased $1.4 million, or 4%, to $39.7 million as of December 31, 2006, compared to $38.4 million as of December 31, 2005. While IP services revenue has increased, the direct costs of IP network, sales and services has continued to be approximately 36% of IP services revenue for each of the last three years, even as we have had a change in the mix of revenue with traditionally higher margin IP services, lower margin high volume customers, and FCP and other hardware sales. Connectivity costs vary based upon customer traffic and other demand-based pricing variables. Costs for IP services are especially subject to ongoing negotiations for pricing and minimum commitments. As our IP traffic continues to grow, we expect to 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.

Data Center Services. The direct costs of data center services, exclusive of depreciation and amortization, increased $13.0 million, or 28%, to $59.4 million for the year ended December 31, 2007, compared to $46.5 million for the year ended December 31, 2006. For the year ended December 31, 2006 compared to the year ended December 31, 2005, the related direct costs increased $11.2 million, or 32%, to $46.5 million as of December 31, 2006, compared to $35.2 million as of December 31, 2005. As data center services revenue has increased, direct costs of data center services as a percentage of corresponding revenue have decreased to approximately 72%, 83% and 95% for the year ended December 31, 2007, 2006 and 2005, respectively. This trend is the result of an increase in total occupancy at higher rates, as discussed with revenues above, while substantial direct costs are subject to previously negotiated rates. Direct costs of data center services, exclusive of depreciation and amortization, have substantial fixed cost components, primarily for rent, but also significant demand-based pricing variables, such as utilities, which are highest in the summer for cooling the facilities.

The growth in data center services largely follows our expansion of data center space. The demand for data center services is outpacing industry-wide supply, which contributes to our improvement of data center direct costs as a percentage of data center revenue. At December 31, 2007, we had approximately 179,000 square feet of data center space with a utilization rate of approximately 75%, as compared to approximately 149,000 square feet of data center space with a utilization rate of approximately 79% at December 31, 2006. At December 31, 2005, we had approximately 124,000 square feet of data center space with a utilization rate of approximately 76%. Our recent data center expansion has resulted in the lower utilization rate as of December 31, 2007 compared to December 31, 2006. However, the recent expansion should provide us lower costs per occupied square foot in future periods, enabling us to increase revenue compared to relatively lower direct costs of data center services. At December 31, 2007, 104,000 square feet, or approximately 58% of total square feet, was in data centers operated by us versus data centers operated by our vendors, or partner sites. Additionally, approximately 62% of our available square feet as of December 31, 2007 are in data centers operated by us.

CDN Services. Direct costs of network, sales and services, exclusive of depreciation and amortization, for our CDN services segment were $6.6 million for the year ended December 31, 2007. Direct costs of CDN network, sales and services were approximately 37% of CDN services revenue for the year ended December 31, 2007, which was a little more favorable than our initial expectations. This activity represents the operations from our acquisition of VitalStream, which was completed on February 20, 2007. The direct costs include the benefit of lower rates throughout the year as we have migrated VitalStream's former contracts and terms to our own. Direct costs of CDN network sales and services also includes an allocation of $0.7 million from direct costs of IP network sales and

services based on the average cost of actual usage by the CDN segment. As previously noted, we did not offer proprietary CDN services prior to our acquisition of VitalStream, but instead, we were a reseller of third party CDN services, which is included in Other direct costs, below. We expect CDN to be an area of significant growth and are expanding related infrastructure, including in Europe and Asia, to serve the expected industry-wide demand, particularly in those regions.

Other. Other direct costs of network, sales and services, exclusive of depreciation and amortization primarily include reseller and miscellaneous services such as third party CDN services and consulting services. These costs decreased substantially as the revenue streams from our acquisition of VitalStream replaced the activity of the former third party CDN service provider.

OTHER OPERATING EXPENSES

Other than direct costs of network, sales and services, compensation and facilities-related costs have the most pervasive impact on operating expenses. Compensation and benefits comprise the largest expenses after direct costs of network, sales and services. Cash-basis compensation and benefits increased $12.0 million to $53.4 million for the year ended December 31, 2007 from $41.4 million for the year ended December 31, 2006. Stock-based compensation increased $2.8 million to $8.7 million for the year ended December 31, 2007 from $5.9 million for the year ended December 31, 2006. All of the increases in compensation and benefits are primarily due to increased headcount, largely attributable to the additional employees resulting from the VitalStream acquisition. For the year ended December 31, 2007, the additional VitalStream employees accounted for $6.6 million of the increase in cash-basis compensation and $1.3 million of the increase in stock-based compensation. Compensation also increased due to the hiring of other employees throughout the Company, including at the senior management level. Total headcount increased to 420 at December 31, 2007 compared to 330 at December 31, 2006.

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 2007 and 2006 includes stock-based compensation expense in the following amounts:

	Year Ended December 31,	
	2007	2006
Direct costs of customer support	**$1,892**	$1,102
Product development	**856**	628
Sales and marketing	**2,135**	2,145
General and administrative	**3,798**	2,067
Total stock-based compensation	**$8,681**	$5,942

Total unrecognized compensation costs related to non-vested stock-based compensation as of December 31, 2007 was $26.9 million with a weighted-average remaining recognition period of 2.8 years.

Cash-basis compensation and benefits decreased $1.5 million to $41.4 million for the year ended December 31, 2006 from $42.9 million for the year ended December 31, 2005, which reflects a net decrease in salaries and wages and a decrease in employee benefits, partially offset by a net increase in commissions. The decreases in compensation and benefits reflect a consistent headcount of approximately 330 full-time employees for both 2006 and 2005, but favorable experience on self-insured medical claims in 2006, while the increase in commissions is revenue driven. Compensation for the year ended December 31, 2006 also includes an increase of $1.8 million in employee bonuses over the year ended December 31, 2005.

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, we did not recognize any expense for options to purchase our common stock 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 costs of network, sales and services, increased $1.0 million, or 17%, to $7.0 million for the year ended December 31, 2007 compared to $6.0 million for the year ended December 31, 2006. The increase is primarily due to $0.7 million of VitalStream post-acquisition operating costs.

Facility and related costs 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 Costs of Amortization of Acquired Technologies. Direct costs of amortization of acquired technologies increased $3.7 million from $0.5 million for the year ended December 31, 2006 to $4.2 million for the year ended December 31, 2007. The increase in amortization expense is due to the amortization of the post-acquisition intangible technology assets of VitalStream.

Direct Costs of Customer Support. Direct costs of customer support increased 43% from $11.6 million for the year ended December 31, 2006 to $16.5 million for the year ended December 31, 2007. The increase of more than $4.9 million was primarily due to compensation of employees and facilities-related costs as discussed above. VitalStream employees accounted for $1.7 million of added cash-basis compensation and benefits and $0.5 million of additional stock-based compensation for the year ended December 31, 2007. Other increases in cash-basis and stock-based compensation amounted to $1.3 million and $0.3 million, respectively, whereas facilities-related costs increased $0.6 million.

Direct costs 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, 2007 increased 47% to $6.6 million from $4.5 million for the year ended December 31, 2006. The increase of $2.1 million is primarily attributable to the addition of VitalStream employees and facilities-related costs. For the year ended December 31, 2007, the additional VitalStream employees accounted for $1.0 million of additional cash-basis compensation and benefits costs and $0.3 million of additional stock-based compensation costs. In addition, facilities-related costs amounted to $0.3 million of this increase.

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, 2007 increased 16% to $31.5 million from $27.2 million for the year ended December 31, 2006. The increase of more than $4.3 million is primarily comprised of VitalStream employee costs. Cash-basis compensation, benefits and commissions related to VitalStream employees accounted for $2.8 million and stock-basis compensation for these employees amounted to $0.4 million for the year ended December 31, 2007.

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 costs of customer support above, facilities and related expenses decreased $0.7 million largely due to more accurate data allocations of expenses to direct costs 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, 2007 increased 47% to $32.5 million from $22.1 million for the year ended December 31, 2006. The increase of $10.4 million is primarily due to increases in cash-basis compensation and benefits, professional services and stock-based compensation. Cash-basis compensation and benefits for the year ended December 31, 2007 increased $3.6 million, including $1.0 million for the additional VitalStream employees. As discussed earlier, the other cause for the increase in cash-basis compensation is the hiring of other employees throughout the Company, including at the senior management level. The overall increase in head-count caused us to accrue employee bonuses $0.3 million higher during 2007 than we did for 2006 and caused higher self-insured medical claims of $0.6 million compared to 2006. Professional services for the

year ended December 31, 2007 increased $2.0 million primarily due to consultation fees on our information technology systems, compliance activities for domestic and international tax and financial statement requirements, recruiting fees and contract labor to fill a number of open job requisitions, and legal fees, including those associated with new proxy disclosure requirements and ongoing litigation. Bad debt expense increased approximately $1.7 million to $2.2 million for the year ended December 31, 2007. The increase in bad debt expense is due primarily to our integration of VitalStream with their legacy customers causing bad debt expense to be greater than our historical expense. Stock-based compensation costs increased $1.7 million for the year ended December 31, 2007 due to annual grants of stock options and unvested restricted common stock to non-employee directors, the stock options assumed in the VitalStream acquisition and initial grants and awards to new members of senior management.

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 primarily reflects a $2.4 million increase in taxes (non-income based), licenses, 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.

Restructuring and Asset Impairment. As discussed in note 4 to the financial statements, we incurred a restructuring and asset impairment charge of $10.3 million during the three months ended March 31, 2007. The charge was the result of a review of our business, particularly in light of our acquisition of VitalStream and our plan to finalize the overall integration and implementation plan before the end of the first quarter. The charge to expense included $7.8 million for leased facilities, representing both the costs less anticipated sublease recoveries that will continue to be incurred without economic benefit to us and costs to terminate leases before the end of their term. The charge also included severance payments of $1.1 million for the termination of certain employees and $1.4 million for impairment of assets. Net related expenditures were estimated to be $10.7 million, of which $2.8 million has been paid during the year ended December 31, 2007, and the balance continuing through December 2016, the last date of the longest lease term. These expenditures are expected to be paid out of operating cash flows. Cost savings from the restructuring were estimated to be approximately $0.8 million per year through 2016, primarily for rent expense.

We incurred a $1.1 million impairment charge during the three months ended March 31, 2007 for the sales order-through-billing system, which was a result of an evaluation of the existing infrastructure relative to our new financial accounting system and the acquisition of VitalStream.

Depreciation and Amortization. For the year ended December 31, 2007, depreciation and amortization, including other intangible assets but excluding acquired technologies, increased 40% to $22.2 million compared to $15.9 million for the year ended December 31, 2006. The increase of $6.4 million primarily relates to post-acquisition depreciation and amortization of VitalStream property and equipment and acquired amortizable intangible assets, excluding amortization of acquired technologies. The VitalStream property and equipment and acquired amortizable intangible assets account for $5.8 million of the expense for the year ended December 31, 2007. The remaining increase in depreciation and amortization relates to the expansion of P-NAPs and on-going expansion of data center facilities. The restructuring and asset impairment described above initially reduced depreciation and amortization by approximately $0.4 million per year, decreasing to $0 in 2009. The amortization of acquired technologies is included in its own caption and discussed above.

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.

Write-Off of Investment. We incurred a charge of $1.2 million representing the write-off of the remaining carrying value of our investment in series D preferred stock of Aventail Corporation, or Aventail. We made an initial cash investment of $6.0 million in Aventail series D preferred stock pursuant to an investment agreement in February 2000. In connection with a

subsequent round of financing by Aventail, we recognized an initial loss on our investment of $4.8 million in 2001. On June 12, 2007, SonicWall, Inc. announced that it entered into an agreement to acquire Aventail for approximately $25.0 million in cash. The transaction closed on July 11, 2007, and all shares of series D preferred stock were cancelled and the holders of series D preferred stock did not receive any consideration for such shares. The write-off is included in non-operating (income) expense in the accompanying consolidated statement of operations.

Income Taxes. The provision for income taxes was a net benefit of $3.1 million for the year ended December 31, 2007 and expense of $0.1 million for the year ended December 31, 2006. For the year ended December 31, 2007, the tax provision includes a $4.4 million benefit related to the release of the valuation allowance associated with our U.K. deferred tax assets. The U.K. benefit is offset by a reserve of $0.9 million and a U.S. deferred tax liability relating to the VitalStream acquisition.

The reduction in valuation allowance was due to the existence of sufficient positive evidence as of December 31, 2007 to indicate that our net operating losses in the U.K. would more likely than not be realized in the future. The evidence primarily consists of the results of prior performance in the U.K. and the expectation of future performance based on historical results. We will continue to assess in the future the recoverability of U.S. and other deferred tax assets, and whether or not the valuation allowance should be reduced relative to the U.S. and other deferred tax assets outside the U.K.

LIQUIDITY AND CAPITAL RESOURCES

Cash Flows for the Years Ended December 31, 2007, 2006 and 2005

Net Cash from Operating Activities. Net cash provided by operating activities was $27.6 million for the year ended December 31, 2007. Our net loss, adjusted for non-cash items, generated cash from operations of $32.1 million while changes in operating assets and liabilities, excluding effects of the VitalStream acquisition, represented a use of cash from operations of $4.5 million. The primary non-cash adjustment was $26.4 million for depreciation and amortization, which includes the amortizable intangible assets acquired through the acquisition of VitalStream on February 20, 2007 and the expansion of our P-NAP and data center facilities throughout 2007. Non-cash adjustments also include $8.7 million for stock-based compensation expense, which is discussed above in the section captioned "Results of Operations." The change in working capital includes an increase in accounts receivable of $15.8 million. The increase in accounts receivable results in quarterly days sales outstanding at December 31, 2007 increasing to 54 days from 38 days as of December 31, 2006. This increase in accounts receivable is largely due to revenue growth and also, in part, our days' sales outstanding trending up from lower than historical levels at December 31, 2006. We have also experienced some collection delays on certain larger, high credit quality customers that tend to pay over longer terms and in conjunction with the migration of some former VitalStream and other customers to Internap billing and systems platforms. We expect our quarterly days sales outstanding to improve over the next several quarters. The change in working capital also includes a net increase in accounts payable of $7.9 million due to the growth of our business, primarily attributed to the acquisition of VitalStream and our data center growth initiative. A portion of the increase is also caused by the implementation near year-end of a new telecommunications expense management system for our direct costs. We do not expect this implementation to have an impact on our accounts payable balance in the future. We anticipate continuing to generate cash flows from our results of operations, that is net income (loss) adjusted for non-cash items and manage changes in operating assets and liabilities towards a net $0 change over time in subsequent periods. We also expect to use cash flows from operating activities to fund a portion of our capital expenditures and other requirements, to repay our outstanding debt as it becomes due and to meet our other commitments and obligations as they become due.

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 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 from Investing Activities. Net cash used in investing activities for the year ended December 31, 2007 was $36.4 million primarily due to capital expenditures of $30.3 million and net purchases of short-term investments of $6.1 million. Our capital expenditures were principally for the expansion of our data center facilities, CDN infrastructure and upgrading our P-NAP facilities and were funded from both cash from operations and borrowings from the new credit agreement we entered into on September 14, 2007. We discuss the credit agreement in greater detail in the section below captioned "Liquidity." Our forecast for capital expenditures in 2008 ranges from $45 – $50 million. However, our credit agreement, discussed below, limits us to unfunded capital expenditures of $25.0 million per year. Investing activities for the year ended December 31, 2007 also includes purchases and sales of auction rate securities. While we have noted auction rate reset failures in the market and have experienced our own auction rate reset failures subsequent to year-end, we do not expect to incur any significant liquidity constraints in the current auction rate securities market and anticipate that, based on the nature of the underlying assets, we will be able to recover the full cost basis of the assets within one year.

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 from Financing Activities. Net cash provided by financing activities for the year ended December 31, 2007 was $15.2 million. Cash provided by financing activities was primarily due to proceeds from note payable of $19.7 million, net of discount, and proceeds from stock compensation plan activity of $8.6 million, partially offset by the repayment of prior outstanding debt of $11.3 million and payments on capital leases of $1.6 million. The proceeds from note payable were a result of entering into the new credit agreement on September 14, 2007. As a result of these activities, we had balances of $19.8 million in a note payable (net of discount) and $1.3 million in capital lease obligations as of December 31, 2007 with $3.2 million in the note payable and capital leases scheduled as due within the next 12 months. While we anticipate funding a large portion of our capital expenditures by drawing down on our credit facility, we expect to meet most of our cash requirements, including repayment of debt as it becomes due, through cash from operations, and as needed, cash on hand and short-term investments. We may also utilize our revolving line of credit if we consider it economically favorable to do so.

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 balances of $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 activity 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 balances of $12.0 million in notes payable and $0.8 million in capital lease obligations as of December 31, 2005.

Liquidity

We recorded a net loss of $5.6 million of the year ended December 31, 2007 and net income of $3.7 million for the year ended December 31, 2006. As of December 31, 2007, our accumulated deficit was $862.0 million. Our net loss for the year ended December 31, 2007 includes $13.0 million in charges for restructuring, asset impairment, write-off of an investment, and acquired in-process research and development, none of which we expect to incur on a regular basis. We cannot guarantee that we will return to profitability given the competitive and evolving nature of the industry in which we operate. We may not be able to sustain or increase profitability on a quarterly basis, and our failure to do so would adversely affect our business, including our ability to raise additional funds.

We expect to meet our cash requirements in 2008 through a combination of net cash provided by operating activities, existing cash, cash equivalents and short-term investments in marketable securities, and borrowings under our credit agreement, especially for capital expenditures. We expect to incur these capital expenditures primarily for the expansion of our P-NAP and data center facilities. We may also utilize our revolving line of credit, particularly if we consider it economically favorable to do so. 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 flows from the sales of our services and products, we may require greater or 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 agreement limit our ability to incur additional indebtedness. We believe we have sufficient cash to operate our business for the foreseeable future.

Short-Term Investments. Short-term investments primarily consist of high credit quality corporate debt securities, auction rate securities whose underlying assets are state-issued student and educational loans which are substantially backed by the federal government, commercial paper, and U.S. Government Agency debt securities. At December 31, 2007, our balance in short-term investments was $19.6 million, of which $7.2 million were auction rate securities carrying AAA/Aaa ratings as of December 31, 2007. Auction rate securities are variable rate bonds tied to short-term interest rates with maturities on the face of the securities in excess of 90 days and have interest rate resets through a modified Dutch auction, at predetermined short-term intervals, usually every 7, 28 or 35 days. They generally trade at par and are callable at par on any interest payment date at the option of the issuer. Interest received during a given period is based upon the interest rate determined through the auction process. Although these securities are issued and rated as long-term bonds, they are priced and traded as short-term instruments because of the liquidity provided through the interest rate reset. We have also noted auction rate reset failures in the market and have experienced our own auction rate reset failures subsequent to year-end, however, we do not expect to incur any significant liquidity constraints and anticipate that, based on the nature of the underlying assets, we will be able to recover the full cost basis of the assets within one year. We expect to hold the auction rate securities until liquidity improves or the borrower calls the underlying securities. All short-term investments either (1) have original maturities greater than 90 days but less than one year or (2) are auction rate securities expected to be liquidated within one year, are classified as available for sale, and reported at fair value.

Credit Agreement. On September 14, 2007, we entered into a $35.0 million credit agreement, or the Credit Agreement, with Bank of America, N.A., as administrative agent, and lenders who may become a party to the Credit Agreement from time to time. VitalStream Holdings, Inc., VitalStream, Inc., PlayStream, Inc., and VitalStream Advertising Services, Inc., four of our subsidiaries, are guarantors of the Credit Agreement.

The Credit Agreement replaced the prior credit agreement, a $5.0 million revolving credit facility and a $17.5 million term loan, which was evidenced by a Loan and Security Agreement between the Company and Silicon Valley Bank that was last amended on December 27, 2005. We paid off and terminated this prior credit agreement concurrently with the execution of the Credit Agreement.

Our obligations under the Credit Agreement are pledged, pursuant to a pledge and security agreement and an intellectual property security agreement by a security interest granted in substantially all of our assets including the capital stock of our domestic subsidiaries and 65% of the capital stock of our foreign subsidiaries.

The Credit Agreement provides for a four-year revolving credit facility, or the Revolving Credit Facility, in the aggregate amount of up to $5.0 million which includes a $5.0 million sub-limit for letters of credit. With the prior approval of the administrative agent, we may increase the total commitments by up to $15.0 million for a total commitment under the Revolving Credit Facility of $20.0 million. The Revolving Credit Facility is available to finance working capital, capital expenditures and other general corporate purposes. As December 31, 2007, no amounts were outstanding on the Revolving Credit Facility.

The Credit Agreement also provides for a four-year term loan, or the Term Loan, in the amount of $30.0 million. We borrowed $20.0 million concurrently with the closing and used a portion of the proceeds from the Term Loan to pay off our prior credit facility. We intend to use the remaining proceeds to fund capital expenditures related to the expansion of our data center facilities.

The interest rate on the Revolving Credit Facility and Term Loan is a tiered LIBOR-based rate that depends on our 12-month trailing EBITDA. As of December 31, 2007, the interest rate was 7.075%.

We will only pay interest on the Term Loan during the first 12 months of its four-year term. Commencing on the last day of the first calendar quarter after the first anniversary of the closing, the outstanding amount of the Term Loan will amortize on a straight-line schedule with the payment of 1/16 of the original principal amount of the Term Loan due quarterly. We will pay all unpaid amounts at maturity, which is September 14, 2011.

The Credit Agreement includes customary representations, warranties, negative and affirmative covenants, including certain financial covenants relating to net funded debt to EBITDA ratio and fixed charge coverage ratio, as well as customary events of default and certain default provisions that could result in acceleration of the Credit Agreement. As of December 31, 2007, we were in compliance with the financial and other covenants.

The net proceeds received from the Term Loan were reduced by $0.3 million for fees paid to Bank of America and its agents. We treated these fees as a debt discount and will amortize the fees to interest expense using the interest method over the term of the loan. We recorded less than $0.1 million of related amortization during the year ended December 31, 2007. As of December 31, 2007, the balance on the Term Loan, net of the discount, was $19.8 million. We incurred other costs of less than $0.1 million in connection with entering into the Credit Agreement, which were recorded as debt issue costs and will amortize over the term of the Credit Agreement.

As a result of the transactions discussed above, we recorded a loss on extinguishment of debt of less than $0.1 million during the year ended December 31, 2007. The loss on extinguishment of debt is included in Other, net in the non-operating (income) expense section of the consolidated statements of operations.

Also during the year ended December 31, 2007, we paid off the term loans and line of credit issued pursuant to the loan and security agreement assumed in the VitalStream acquisition.

Capital Leases. Our future minimum lease payments on remaining capital lease obligations at December 31, 2007 totaled $1.4 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, 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]	$ 23,815	$ 3,980	$11,980	$ 7,855	$ –
Capital lease obligations	1,392	922	470	–	–
Operating lease commitments	220,894	28,211	50,689	53,208	88,786
Service commitments	22,014	12,167	9,847	–	–
	$268,115	$45,280	$72,986	$61,063	$88,786

(1) As noted in the section captioned "Credit Agreement" under this Item 7, the interest rate on the Term Loan is a tiered LIBOR-based rate that depends on our 12-month trailing EBITDA as defined in the Credit Agreement. As of December 31, 2007, the interest rate was 7.075%. The projected interest included in the debt payments above incorporates this rate.

Common and Preferred Stock. Our Certificate of Incorporation includes designation for 3.5 million shares of preferred stock, which includes 0.5 million shares of series B preferred stock. As of December 31, 2007, 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 one-for-ten reverse stock split 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.

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 a ten-year term.

Employees of the Company 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.

As discussed in note 15 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, 2007.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Short-Term Investments in Marketable Securities. Short-term investments primarily consist of high credit quality corporate debt securities, auction rate securities whose underlying assets are state-issued student and educational loans which are substantially backed by the federal government, commercial paper, and U.S. Government Agency debt securities. All of our investments have original maturities greater than 90 days but less than one year, except for investments in auction rate securities, further discussed below. All short-term investments are classified as available-for-sale and reported at fair value. Due to the short-term nature of our investments in marketable securities, we do not believe there is any material exposure to market risk changes in interest rates. We estimate that a change in the effective yield of 100 basis points would change our interest income by less than $0.2 million per year.

Auction rate securities are variable rate bonds tied to short-term interest rates with maturities on the face of the securities in excess of 90 days and have interest rate resets through a modified Dutch auction, at pre-determined short-term intervals, usually every 7, 28, or 35 days. Auction rate securities generally trade at par and are callable at par on any interest payment date at the option of the issuer. Interest received during a given period is based upon the interest rate determined through the auction process. Although these securities are issued and rated as long-term bonds, they are priced and traded as short-term instruments because of the liquidity provided through the interest rate resets. Uncertainties in the credit markets may affect the liquidity of our holdings in auction rate securities. We did not experience any unsuccessful auction rate resets during the year ended or the initial rate resets immediately following December 31, 2007; however, we have experienced failures on each of our subsequent auction rate resets. Nevertheless, we continue to receive interest every 28-35 days. While our investments are of high credit quality, at this time we are uncertain as to whether or when the liquidity issues relating to these investments will worsen or improve. We do not expect to incur any significant liquidity constraints and anticipate that, based on the nature of the underlying assets, we will be able to recover the full cost basis of the assets within one year. Therefore, we do not believe that adjusting the fair value of our portfolio of auction rate securities is necessary at this time. We expect to hold the auction rate securities until liquidity improves or the borrower calls the underlying securities. In the meantime, we believe we have sufficient liquidity through our cash balances, other short-term investments and available credit. As of December 31, 2007, we have a total of $7.2 million invested in auction rate securities.

Other Investments. We have invested $4.1 million in Internap Japan, our joint venture with NTT-ME Corporation and NTT Holdings. We account for this investment using the equity-method, and to date we have recognized $3.3 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 offered by Internap Japan has not been proven and may never materialize.

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. We estimate that a change in the interest rate of 100 basis points would change our interest expense and payments by less than $0.2 million per year. The table below presents principal cash flows by expected maturity dates for our debt obligations that extend beyond one year as of December 31, 2007 (dollars in thousands):

	2008	2009	2010	2011	Fair Value
Long-term debt:					
Term loan	$2,500	$5,000	$5,000	$7,500	$20,000
Interest rate	7.075%	7.075%	7.075%	7.075%	7.075%

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

CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Principal Accounting Officer, evaluated the effectiveness of our disclosure controls and procedures as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act") as of December 31, 2007. Our disclosure controls and procedures are designed to ensure that information we are required to disclose in the reports we file or submit under the Exchange Act is accumulated and

communicated to our management, including our Chief Executive Officer and Principal Accounting Officer, as appropriate, to allow timely decisions regarding required disclosures, and is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms. Based upon the evaluation described above our Chief Executive Officer and Principal Accounting Officer concluded that, as of December 31, 2007, our disclosure controls and procedures were not effective because of the material weakness described below in Management's Report on Internal Control Over Financial Reporting.

Background

During its review of sales credit activity subsequent to year end, management identified the activity as an area for further review and investigation. Management concluded that an investigation was appropriate to identify the underlying cause and to obtain completeness, accuracy, valuation, and disclosure of sales adjustments. This investigation caused the Company to file its annual report on Form 10-K late.

Management's Report on Internal Control Over Financial Reporting

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).

We assessed the effectiveness of our internal control over financial reporting as of December 31, 2007. In making this assessment, we used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control – Integrated Framework*.

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis.

Management identified the following material weakness in our internal control over financial reporting as of December 31, 2007:

We did not maintain effective controls over the completeness, accuracy, valuation, and disclosure of sales adjustments. Specifically, we did not maintain effective controls, including controls over the analysis of requests for sales credits and billing adjustments, to provide timely information for management to assess the completeness, accuracy, valuation, and disclosure of sales adjustments. This control deficiency resulted in the misstatement of our revenue, net accounts receivable and related financial disclosures, and in the revision of the Company's consolidated financial statements for the quarter ended September 30, 2007 and in an adjustment to the consolidated financial statements for the quarter ended December 31, 2007. Additionally, this control deficiency could result in misstatements of the aforementioned accounts and disclosures that would result in a material misstatement of the consolidated financial statements that would not be prevented or detected. Accordingly, our management has determined that this control deficiency constitutes a material weakness.

As a result of the material weakness described above, management concluded that our internal control over financial reporting was not effective as of December 31, 2007 based on the criteria established in *Internal Control – Integrated Framework* issued by the COSO.

The effectiveness of our internal control over financial reporting as of December 31, 2007 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report, which is included herein.

Plan for Remediation of the Material Weakness

To remediate the material weakness described above and to enhance our internal control over financial reporting, management implemented plans in the first quarter of 2008, or will supplement plans during 2008, to its existing controls for the analysis of requests for sales adjustments, which may include but are not limited to, the following additional processes and controls:

- A single, common logging system for customers to record all disputes, disconnects and requests for credits;
- A weekly review of a customer request log with appropriate designated management and approval pursuant to the schedule of authorization;
- A more robust, proactive tracking of customer usage patterns and overall customer satisfaction; and
- Perform a review by the appropriate designated finance management of the accounting estimates developed from the relevant, sufficient, and reliable data collected above.

Notwithstanding the material weakness, management believes that the financial statements included in this report fairly present in all material respects our financial position, results of operations and cash flows for the periods presented.

Changes in Internal Control Over Financial Reporting

No change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) occurred during the quarter ended December 31, 2007 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

CONSOLIDATED STATEMENTS OF OPERATIONS

Financial Review 2007

(In thousands, except per share amounts)	Year Ended December 31, 2007	2006	2005
Revenues:			
Internet protocol (IP) services	**$119,848**	$109,748	$105,032
Data center services	**83,058**	56,152	36,996
Content delivery network (CDN) services	**17,718**	–	–
Other	**13,466**	15,475	11,689
Total revenues	**234,090**	181,375	153,717
Operating costs and expenses:			
Direct costs of network, sales and services, exclusive of depreciation and amortization, shown below:			
IP services	**43,681**	39,744	38,377
Data center services	**59,439**	46,474	35,244
CDN services	**6,584**	–	–
Other	**8,690**	11,120	8,337
Direct costs of amortization of acquired technologies	**4,165**	516	577
Direct costs of customer support	**16,547**	11,566	10,670
Product development	**6,564**	4,475	4,864
Sales and marketing	**31,533**	27,173	25,864
General and administrative	**32,512**	22,104	20,096
Depreciation and amortization	**22,242**	15,856	14,737
Gain on disposals of property and equipment	**(5)**	(113)	(19)
Restructuring and asset impairment	**11,349**	323	44
Acquired in-process research and development	**450**	–	–
Other	**50**	–	–
Amortization of deferred stock compensation	**–**	–	60
Total operating costs and expenses	**243,801**	179,238	158,851
(Loss) income from operations	**(9,711)**	2,137	(5,134)
Non-operating (income) expense:			
Interest income	**(3,228)**	(2,305)	(1,284)
Interest expense	**1,111**	883	1,373
Write-off of investment	**1,178**	–	–
Other, net	**2**	(129)	(176)
Total non-operating (income) expense	**(937)**	(1,551)	(87)
(Loss) income before income taxes and equity in earnings of equity-method investment	**(8,774)**	3,688	(5,047)
(Benefit) provision for income taxes	**(3,080)**	145	–
Equity in earnings of equity-method investment, net of taxes	**(139)**	(114)	(83)
Net (loss) income	**$ (5,555)**	$ 3,657	$ (4,964)
Net (loss) income per share:			
Basic	**$ (0.12)**	$ 0.11	$ (0.15)
Diluted	**$ (0.12)**	$ 0.10	$ (0.15)
Weighted average shares used in per share calculations:			
Basic	**46,942**	34,748	33,939
Diluted	**46,942**	35,739	33,939

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

CONSOLIDATED BALANCE SHEETS

Financial Review 2007

(In thousands, except per share amounts)	December 31, 2007	December 31, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	$ 52,030	$ 45,591
Short-term investments in marketable securities	19,569	13,291
Accounts receivable, net of allowance of $5,470 and $888, respectively	36,429	20,282
Inventory	304	474
Prepaid expenses and other assets	8,464	3,818
Deferred tax asset, current portion	479	–
Total current assets	117,275	83,456
Property and equipment, net	65,491	47,493
Investments	1,138	2,135
Intangible assets, net	43,008	1,785
Goodwill	190,677	36,314
Restricted cash	4,120	–
Deferred tax asset, non-current	3,014	–
Deposits and other assets	2,287	2,519
Total assets	$ 427,010	$ 173,702
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Notes payable, current portion	$ 2,413	$ 4,375
Accounts payable	19,624	8,776
Accrued liabilities	10,159	8,689
Deferred revenue, current portion	4,807	3,260
Capital lease obligations, current portion	805	347
Restructuring liability, current portion	2,396	1,400
Other current liabilities	108	84
Total current liabilities	40,312	26,931
Notes payable, less current portion	17,354	3,281
Deferred revenue, less current portion	2,275	1,080
Capital lease obligations, less current portion	452	83
Restructuring liability, less current portion	7,697	3,384
Deferred rent	11,011	11,432
Deferred tax liability	398	–
Other long-term liabilities	878	986
Total liabilities	80,377	47,177
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, $0.001 par value, 200,000 shares authorized, no shares issued or outstanding	–	–
Common stock, $0.001 par value, 60,000 shares authorized, 49,759 and 35,873 shares issued and outstanding, respectively	50	36
Additional paid-in capital	1,208,191	982,624
Accumulated deficit	(862,010)	(856,455)
Accumulated items of other comprehensive income	402	320
Total stockholders' equity	346,633	126,525
Total liabilities and stockholders' equity	$ 427,010	$ 173,702

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY AND COMPREHENSIVE (LOSS) INCOME

Financial Review 2007

	For the Three Years Ended December 31, 2007							
	Common Stock							
(In thousands)	Shares	Par Value	Additional Paid-In Capital	Treasury Stock	Deferred Stock Compensation	Accumulated Deficit	Accumulated Items of Comprehensive Income (Loss)	Total Stockholders' Equity
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, net of taxes	–	–	–	–	–	–	(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, net of taxes	–	–	–	–	–	–	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
Net loss	**–**	**–**	**–**	**–**	**–**	**(5,555)**	**–**	**(5,555)**
Change in unrealized gains and losses on investments, net of taxes	**–**	**–**	**–**	**–**	**–**	**–**	**(25)**	**(25)**
Foreign currency translation adjustment	**–**	**–**	**–**	**–**	**–**	**–**	**107**	**107**
Total comprehensive loss								**(5,473)**
Stock issued in connection with VitalStream acquisition	**12,206**	**12**	**208,281**	**–**	**–**	**–**	**–**	**208,293**
Stock-based compensation	**420**	**1**	**8,705**	**–**	**–**	**–**	**–**	**8,706**
Stock compensation plans activity	**1,260**	**1**	**8,581**	**–**	**–**	**–**	**–**	**8,582**
Balance, December 31, 2007	**49,759**	**$50**	**$1,208,191**	**$ –**	**$ –**	**$(862,010)**	**$ 402**	**$346,633**

See note 2 for information on effect of 10-for-1 reverse stock split in July 2006.

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

Financial Review 2007

(In thousands)	Year Ended December 31, 2007	2006	2005
Cash flows from operating activities:			
Net (loss) income	$ (5,555)	$ 3,657	$ (4,964)
Adjustments to reconcile net (loss) income to net cash provided by operating activities:			
Depreciation and amortization	26,407	16,372	15,314
Gain on disposal of property and equipment, net	(5)	(113)	(19)
Asset impairment	2,454	319	–
Acquired in-process research and development	450	–	–
Stock-based compensation expense	8,681	5,942	75
Write-off of investment	1,178	–	–
Equity in earnings from equity-method investment	(139)	(114)	(83)
Provision for doubtful accounts	2,261	548	1,431
Non-cash changes in deferred rent	(421)	2,247	2,690
Lease incentives	–	–	713
Deferred income taxes	(3,095)	–	–
Other, net	(84)	212	(397)
Changes in operating assets and liabilities, excluding effects of acquisition:			
Accounts receivable	(15,825)	(1,702)	(3,616)
Inventory, prepaid expenses, deposits and other assets	(2,182)	(1,778)	(170)
Accounts payable	7,920	3,010	(5,433)
Accrued and other liabilities	(2,466)	1,422	805
Deferred revenue	2,704	1,070	1,023
Accrued restructuring liability	5,309	(1,493)	(1,876)
Net cash flows provided by operating activities	27,592	29,599	5,493
Cash flows from investing activities:			
Purchases of short-term investments in marketable securities	(38,508)	(17,427)	(18,710)
Maturities of short-term investments in marketable securities	32,395	20,277	19,350
Purchases of property and equipment	(30,271)	(13,382)	(10,161)
Proceeds from disposal of property and equipment	5	133	17
Cash received from acquisition, net of costs incurred for the transaction	3,203	–	–
Change in restricted cash, excluding effects of acquisition	(3,217)	–	76
Net cash flows used in investing activities	(36,393)	(10,399)	(9,428)
Cash flows from financing activities:			
Proceeds from notes payable, net of discount	19,742	–	–
Principal payments on notes payable	(11,318)	(4,375)	(6,483)
Payments on capital lease obligations	(1,617)	(538)	(512)
Debt issuance costs	(65)	–	–
Proceeds from exercise of stock options and employee stock purchase plan	8,582	3,031	1,471
Proceeds from exercise of warrants	–	3,808	–
Other, net	(84)	31	70
Net cash flows provided by (used in) financing activities	15,240	1,957	(5,454)
Net increase (decrease) in cash and cash equivalents	6,439	21,157	(9,389)
Cash and cash equivalents at beginning of period	45,591	24,434	33,823
Cash and cash equivalents at end of period	$ 52,030	$ 45,591	$ 24,434
Supplemental disclosure of cash flow information:			
Common stock issued and stock options assumed for acquisition of VitalStream	$208,293	$ –	$ –
Cash paid for interest, net of amounts capitalized	1,152	793	1,223
Cash paid for income taxes	103	149	–
Non-cash acquisition of property and equipment	148	162	971
Capitalized stock-based compensation	25	44	–

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") delivers high performance and reliable Internet solutions through a suite of network optimization and delivery products and services. These solutions, combined with progressive and proactive technical support, enable companies to confidently migrate business-critical applications, including audio and video streaming and monetization services, to the Internet. Our suite of products and services support a broad range of Internet applications. We serve both domestic and international customers in the financial services, healthcare, technology, retail, travel, media/entertainment and other markets. Our product and service offerings are complemented by Internet Protocol, or IP, access solutions such as data center services, content delivery networks, or CDN, and managed security. We deliver services through our 54 service points across North America, Europe and the Asia-Pacific region. Our Private Network Access Points, or P-NAPs, feature multiple direct high-speed connections to major Internet networks including AT&T Inc., Sprint Nextel Corporation, Verizon Communications Inc., Savvis Inc., Global Crossing Limited, and Level 3 Communications, Inc. We operate and manage the Company in three business segments: IP services, data center services and CDN services. Prior to 2007 we operated and managed the Company as a single business segment.

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. For the year ended December 31, 2007 we recognized a year to date net loss $5.6 million. At December 31, 2007, our accumulated deficit was $862.0 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.

As discussed in note 18, we revised our quarterly statement of operations for the quarter ended September 30, 2007 to appropriately record (1) $0.5 million for sales adjustments, which reduce net accounts receivable and revenue, and (2) $0.1 million for accretion of interest income that we initially included as unrealized gain in accumulated other comprehensive income within stockholders' equity.

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 inter-company transactions have been eliminated in consolidation.

Estimates and Assumptions

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, accruals, 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.

Restricted Cash

Restricted cash represents time deposits used to secure letters of credit on certain of our real estate leases and a capital lease for equipment. The letters of credit for the real estate leases were secured by our former credit agreement and are in the process of being secured under our new credit agreement. The letter of credit securing the capital lease for equipment was assumed in the VitalStream acquisition.

Investments in Marketable Securities

We account for marketable securities in accordance with Statement of Financial Accounting Standards, or SFAS, No. 115, "Accounting for Certain Investments in Debt and Equity Securities." Management determines the appropriate classification of marketable securities at the time of

purchase. At December 31, 2007 and 2006, 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. Any realized gains or losses or 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 on securities classified as available-for-sale is 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 incurred a charge during the three months ended June 30, 2007, totaling $1.2 million, representing the write-off of the remaining carrying value of our investment in series D preferred stock of Aventail Corporation, or Aventail. See note 6 for further discussion of this investment and the recorded loss. As of December 31, 2006, the carrying value of the Aventail investment of $1.2 million was recorded in non-current investments in the accompanying consolidated balance sheet.

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, 2007, Internap Japan Co. Ltd., or Internap Japan, our joint venture with NTT-ME Corporation and Nippon Telegraph and Telephone Corporation, or NTT Holdings, 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 statement 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. Our investments in marketable securities are recorded at fair value. Our marketable securities are designated as available for sale 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.

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 and cash equivalents in money market funds and maintain them with financial institutions with high credit ratings. We also invest in high credit quality corporate debt securities, auction rate securities whose underlying assets are state-issued student and educational loans which are substantially backed by the federal government, commercial paper, and U.S. Government Agency debt securities pursuant to a formal investment policy. As of December 31, 2007, we have a total of $7.2 million invested in auction rate securities. Uncertainties in the credit markets may affect the liquidity of our holdings in auction rate securities. We did not experience any unsuccessful auction rate resets during the year ended or on the initial rate resets immediately following December 31, 2007, however we have experienced failures on each of our subsequent auction rate resets. Nevertheless, we continue to receive interest every 28-35 days. While our investments are of high credit quality, at this time we are uncertain as to whether or when the liquidity issues relating to these investments will worsen or improve. We do not believe that it is necessary at this time to adjust the fair value of our portfolio of auction rate securities. We also perform periodic evaluations of the relative credit ratings of the financial institutions with whom we invest as part of our cash management process. 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 assembly of our Flow Control Platform, or FCP solutions.

Property and Equipment

Property and equipment are 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 expected 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 SFAS No. 13, "Accounting for Leases" and related literature. Rent expense for operating leases is recorded in accordance with Financial Accounting Standards Board, or FASB, Technical Bulletin, or 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 $1.6 million and $0.9 million in internal software development costs for the years ended December 31, 2007 and 2006, respectively. We did not capitalize any costs during the year ended December 31, 2005. During the year ended December 31, 2007, we impaired $1.1 million of software development costs capitalized prior to December 31, 2005 related to the implementation of a billing and order entry system initiated during 2004. Subsequent to our acquisition of VitalStream, we determined that we would utilize our legacy billing system and abandon the former project because (1) the developer of our financial software purchased the developer of our legacy billing system, and (2) the legacy billing system would be more flexible in integrating the VitalStream business. During the year ended December 31, 2006, we impaired $0.3 million of software development costs capitalized prior to December 31, 2005 related to the implementation of our financial system software also initiated during 2004. Amortization expense on internally developed software commences when the software project is ready for its intended use.

As of December 31, 2007 and 2006, the balance of unamortized software costs was $2.7 million and $2.5 million, respectively, and for the year ended December 31, 2007, amortization expense was $0.2 million. The software was not ready for its intended use and had not been placed in service as of December 31, 2006; therefore, no amortization expense was recorded for the years ended December 31, 2006 or 2005.

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, 2007 or 2006. As of December 31, 2007 and 2006, the balance of unamortized software costs was $0.1 million and $0.2 million, respectively. Amortization expense was $0.2 million, $0.2 million, and $0.4 million for the years ended December 31, 2007, 2006, and 2005, 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, 2007 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 are 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 flows 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.

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 appropriate month when the resolution has been determined. 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 consolidated financial condition, results of operations and cash flows.

Accrued Liabilities

Similar to accruals for disputed telecommunications costs above, it is necessary for us to 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.

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.

In June 2006, the FASB issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109," or FIN 48. FIN 48 clarifies the accounting for uncertainty in income taxes recognized under SFAS No.109, "Accounting for Income Taxes." FIN 48 prescribes a recognition threshold and measurement attribute for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return and also provides guidance on various related matters such as derecognition, interest and penalties, and disclosure. We adopted FIN 48 on January 1, 2007. As of January 1, 2007, no material tax benefit existed for uncertain tax positions. During 2007, as discussed in Note 12, we recognized a FIN 48 liability of $0.9 million that was netted on the balance sheet with U.K. deferred tax assets.

We classify interest and penalties arising from the underpayment of income taxes in the statement of operations under general and administrative expenses. As of December 31, 2007, we have no accrued interest or penalties related to uncertain tax positions, as a result of substantial U.K. net operating loss carryforwards.

We account for telecommunication, sales and other similar taxes on a net basis in general and administrative expense.

Stock-Based Compensation

Effective January 1, 2006, we adopted SFAS No. 123 (revised 2004), "Share-Based Payment," or SFAS No. 123R, and related interpretations. 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.

We elected to adopt SFAS No. 123R using the modified prospective application method. Under this method, compensation cost recognized during the period includes: (1) compensation cost for all share-based payments granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123 amortized over the awards' vesting period, and (2) compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS No. 123R amortized on a straight-line basis over the awards' vesting period. The fair value of stock options is estimated at the date of grant using the Black-Scholes option pricing model with weighted average assumptions for the activity under our stock plans. Option pricing model input assumptions such as expected term, expected volatility, and risk-free interest rate, impact the fair value estimate. Further, the forfeiture rate impacts the amount of aggregate compensation. These assumptions are subjective and generally require significant analysis and judgment to develop.

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 "short-cut" method to establish the beginning balance of the additional paid-in capital, or 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 No. 123R. In 2006, we adopted the alternative transition method provided in the FASB Staff Position for calculating the tax effects of stock-based compensation pursuant to SFAS No. 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). At adoption of SFAS No. 123R on January 1, 2006, we elected to utilize the "with and without" approach for utilization of tax attributes upon realization of net operating losses in the future. This method allocates stock compensation benefits last among other tax benefits recognized. In addition, we elected to adopt the "direct only" method of calculating the amount of windfalls or shortfalls.

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 one-for-ten 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 IP services, related data center services, CDN services, and other ancillary products and services throughout the United States. Our IP services revenue is derived from the sale of high performance Internet connectivity services at fixed rates or usage-based pricing to our customers that desire a DS3 or faster connection. Slower T1 and fractional DS3 connections are provided at fixed rates. Data center revenue includes both physical space for hosting customers' network and other equipment plus associated services such as redundant power and network connectivity, environmental controls and security. Data center revenue is based on occupied square feet and both allocated and variable-based usage. CDN revenue includes three components, none of which are sold separately: (1) data storage; (2) streaming/delivery and (3) a user interface/reporting tool. We provide the CDN service components via internally developed and acquired technology that resides on our network. CDN revenue is based on either fixed rates or usage-based pricing. All of the foregoing revenue arrangements have contractual terms and in many instances, include minimum usage commitments. Other ancillary products and services include our Flow Control Platform, or FCP, product, server management and installation, virtual private networking, managed security, data backup, remote storage and restoration.

We recognize revenue in accordance with the Securities and Exchange Commission's Staff Accounting Bulletin No. 104, *Revenue Recognition*, or SAB No. 104, and the Financial Accounting Standards Board's, or FASB, Emerging Issues Task Force Issue No. 00-21, *Revenue Arrangements with Multiple Deliverables*, or EITF No. 00-21. Revenue is recognized when persuasive evidence of an arrangement exists, the product or service has been delivered, the fees are fixed or determinable and collectibility is probable. For most of our IP, data center and CDN revenue, services are delivered ratably over the contract term. Contracts and sales or purchase orders are used to determine the existence of an arrangement. We test for availability or connectivity to verify delivery of our services. 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. Because the software component of our FCP is more than incidental to the product as a whole, we recognize associated FCP revenue in accordance with the American Institute of Certified Public Accountants' (AICPA) Statement of Position 97-2, *Software Revenue Recognition*, or SOP 97-2.

We derive revenue from the sale of IP services, data center services and CDN services to customers under contracts that generally commit the customer to a minimum monthly level of usage on a calendar month basis and provide the rate at which the customer must pay for actual usage above the monthly minimum. For these services, we recognize the monthly minimum as revenue each month provided that an enforceable contract has been signed by both parties, the service has been delivered to the customer, the fee for the service is fixed or determinable and collection is reasonably assured. Should a customer's usage of our services exceed the monthly minimum, we recognize revenue for such excess in the period of the usage. We record the installation fees as deferred revenue and recognize as revenue ratably over the estimated life of the customer arrangement. We also derive revenue from services sold as discrete, non-recurring events or based solely on usage. For these services, we recognize revenue after both parties have signed an enforceable contract, the fee is fixed or determinable, the event or usage has occurred and collection is reasonably assured.

We also enter into multiple-element arrangements or bundled services, such as combining IP services with data center and (or) CDN services. When we enter into such arrangements, we account for each element separately over its respective service period or at the time of delivery, provided that there is objective evidence of fair value for the separate elements. Objective evidence of fair value includes the price charged for the element when sold separately. If we cannot objectively determine the fair value of each element, we recognize the total value of the arrangement ratably over the entire service period to the extent that we have begun to provide the services, and other revenue recognition criteria have been satisfied.

Deferred revenue consists of revenue for services to be delivered in the future and consist 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, which was two to

three years during the three year period ended December 31, 2007. Revenue for installation services is deferred and amortized because the installation service is integral to our primary service offering and does not have value to customers 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 collection is probable. 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 (i.e., 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 record an amount for sales adjustments, which reduces net accounts receivable and revenue. The amount for sales adjustments is based upon specific 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 becomes aware of new information impacting a customer's credit risk, additional adjustments 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 costs 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, progressive download and streaming technology for our CDN, and acceleration technologies. Research and development costs were $3.1 million, $2.4 million and $2.9 million for the years ended December 31, 2007, 2006, and 2005, respectively.

Advertising Costs

We expense all advertising costs as incurred. Advertising costs for the years ended December 31, 2007, 2006 and 2005 were $1.2 million, $1.3 million and $0.2 million, respectively.

Net (Loss) Income per Share

Basic and diluted net (loss) income per share has been computed using the weighted average number of shares of common stock outstanding during the period. Diluted net (loss) income 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 (loss) income per share if their effect is anti-dilutive.

Basic and diluted net (loss) income per share for the years ended December 31, 2007, 2006 and 2005 are calculated as follows (in thousands, except per share amounts):

	Year Ended December 31,		
	2007	2006	2005
Net (loss) income	**$ (5,555)**	$ 3,657	$ (4,964)
Weighted average shares outstanding, basic	**46,942**	34,748	33,939
Effect of dilutive securities:			
Stock compensation plans	**–**	984	–
Warrants	**–**	7	–
Weighted average shares outstanding, diluted	**46,942**	35,739	33,939
Net (loss) income per share:			
Basic	**$ (0.12)**	$ 0.11	$ (0.15)
Diluted	**$ (0.12)**	$ 0.10	$ (0.15)
Anti-dilutive securities not included in diluted net (loss) income per share calculation:			
Stock compensation plans	**3,860**	1,408	3,656
Warrants to purchase common stock	**34**	–	1,500
	3,894	1,408	5,156

Reclassifications

Prior to 2007, "Direct costs of amortization of acquired technologies" were included in the caption "Direct costs of network, sales and services, exclusive of depreciation and amortization." In 2007 we reclassified these costs to a separate caption in the accompanying Consolidated Statements of Operations with the following effect (in thousands):

	Year Ended December 31,	
	2006	2005
Direct costs of network, sales and services, exclusive of depreciation and amortization show below:		
Previously reported	$97,854	$82,535
Reclassification	(516)	(577)
As reclassified	$97,338	$81,958

A reconciliation of total direct costs of network, sales and services, exclusive of depreciation and amortization to the accompanying consolidated statements of operations is shown below (in thousands):

	Year Ended December 31,	
	2006	2005
IP services	$39,744	$38,377
Data center services	46,474	35,244
Other	11,120	8,337
Total	$97,338	$81,958

This reclassification had no effect on previously reported (loss) income from operations or net (loss) income.

Segment Information

We use the management approach for determining which, if any, of our services and products, locations, customers or management structures constitute a reportable business segment. The management approach designates the internal organization that is used by management for making operating decisions and assessing performance as the source of any reportable segments. As a result of our acquisition of VitalStream Holdings, Inc., as discussed in note 3, and the information presented to executive management, we classified our operations into three reportable business segments: IP services, data center services and CDN services. In accordance with SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information," we have presented the corresponding items of segment information for the years ended December 31, 2006 and 2005.

Recent Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements." SFAS No. 157 defines fair value, establishes a framework for measuring fair value under GAAP, and expands disclosures about fair value measurements. SFAS No. 157 is effective for fiscal years beginning after December 15, 2007. In February 2008, the FASB issued Staff Position, or FSP, FAS 157-1, which provides supplemental guidance on the application of SFAS No. 157, and FSP FAS 157-2, which delays the effective date of SFAS No. 157 for nonfinancial assets and nonfinancial liabilities. We are currently in the process of evaluating the impact that the adoption of SFAS No. 157 will have on our financial position, results of operations and cash flows.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities." SFAS No. 159 permits companies to choose to measure, on an instrument-by-instrument basis, many financial instruments and certain other assets and liabilities at fair value that are not currently required to be measured at fair value. SFAS No. 159 is effective as of the beginning of a fiscal year that begins after November 15, 2007. While we will not elect to adopt fair value accounting to any assets or liabilities allowed by SFAS No. 159, we are currently in the process of evaluating SFAS No. 159 and its potential impact to us.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), "Business Combinations," or SFAS No. 141R. SFAS No. 141R replaces SFAS No. 141, "Business Combinations." SFAS No. 141R establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquiree and the goodwill acquired or a gain from a bargain purchase. SFAS No. 141R also determines disclosure requirements to enable the evaluation of the nature and financial effects of the busin ess combination. SFAS No. 141R applies prospectively to business combinations for which the acquisition date is on or after the beginning of a fiscal year that begins on or after December 15, 2008 and there are also implications for acquisitions that occur prior to this date. We are currently in the process of evaluating the impact that the adoption of SFAS No. 141R will have on our financial position, results of operations and cash flows.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements." SFAS No. 160 amends Accounting Research Bulletin 51, " Consolidated Financial Statements," or ARB 51, and requires all entities to report noncontrolling (minority) interests in subsidiaries within equity in the consolidated financial statements, but separate from the parent shareholders' equity. SFAS No. 160 also requires any acquisitions or dispositions of noncontrolling interests that do not result in a change of control to be accounted for as equity transactions. Further, SFAS No. 160 requires that a parent recognize a gain or loss in net income when a subsidiary is deconsolidated. SFAS No. 160 is effective for fiscal years beginning on or after December 15, 2008. We do not expect the adoption of SFAS No. 160 will have a significant, if any, impact on our financial position, results o f operations and cash flows.

3. BUSINESS COMBINATION

On February 20, 2007, we completed the previously announced acquisition of VitalStream Holdings, Inc., or VitalStream, for approximately $214.0 million, whereby VitalStream became a wholly owned subsidiary of Internap. VitalStream provides products and services for storing and delivering digital media to large audiences over the Internet and advertisement insertion and related advertising services to companies that stream digital media over the Internet. VitalStream also enhances our position as a leading provider of high performance route control products and services by adding complementary service offerings in the rapidly growing content delivery and on-line advertising markets. Integrating VitalStream's digital media delivery platform into our portfolio of products and services enables us to provide customers with one of the most complete product lines in content delivery solutions, content monetization and on-line advertising, while supporting the significant long-term growth opportunities in the network services market. We accounted for the transaction using the purchase method of accounting in accordance with SFAS No. 141, "Business Combinations." Our results of operations include the activities of VitalStream from February 21, 2007 through December 31, 2007.

Purchase Price

Assets acquired and liabilities assumed were recorded at their fair values as of February 20, 2007. The total $214.0 million purchase price is comprised of the following (in thousands):

Value of Internap stock issued	$197,272
Fair value of stock options assumed	11,021
Direct transaction costs	5,729
Total purchase price	$214,022

As a result of the acquisition, we issued approximately 12.2 million shares of Internap common stock based on an exchange ratio of 0.5132 shares of Internap common stock for each outstanding share of VitalStream common stock as of February 20, 2007. This fixed exchange ratio gave effect to the one-for-ten reverse stock split by Internap implemented on July 11, 2006 and the one-for-four reverse stock split by VitalStream implemented on April 4, 2006. The average market price per share of Internap common stock of $16.16 was based on an average of the closing prices for a range of trading days from October 10, 2006 through October 16, 2006, which range spanned the announcement date of the transaction on October 12, 2006.

Under the terms of the merger agreement, each VitalStream stock option that was outstanding and unexercised was converted into an option to purchase Internap common stock and we assumed that stock option in accordance with the terms of the applicable VitalStream stock option plan and terms of the stock option agreement. Based on VitalStream's stock options outstanding at February 20, 2007, we converted options to purchase approximately 3.0 million shares of VitalStream common stock into options to purchase approximately 1.5 million shares of Internap common stock.

Purchase Price Allocation

Under the purchase method of accounting, we allocated the total estimated purchase price to VitalStream's net tangible and intangible assets based on their estimated fair values as of February 20, 2007. We recorded the excess purchase price over the value of the net tangible and identifiable intangible assets as goodwill. We determined the fair value assigned to identifiable intangible assets acquired using the income approach, which discounts expected future cash flows to present value using estimates and assumptions determined by management. The allocation of the purchase price and the estimated useful lives are as follows (dollars in thousands):

	Amount	Estimated Useful Life
Net tangible assets	$ 12,286	–
Identifiable intangible assets:		
Developed technologies	36,000	8 years
Customer relationships	9,000	9 years
Trade name and other	1,500	3-6 years
Acquired in-process research and development	450	–
Goodwill (1)	154,786	–
Total estimated purchase price	$214,022	

(1) Subsequent to the finalization of the purchase price allocation, we recorded a net increase of $0.1 million to goodwill as a result of adjustments to certain pre-acquisition assets and liabilities and decrease of $0.4 million as a result of the utilization of a portion of VitalStream's net operating loss carryforwards.

Net Tangible Assets. We recorded VitalStream's tangible assets and liabilities as of February 20, 2007 at their fair value. Net tangible assets included restricted and unrestricted cash of $9.8 million, accounts receivable of $3.2 million, property and equipment of $11.2 million, other assets of $2.2 million, loan and security agreement (including both term loans and an outstanding line of credit) and capital lease obligations of $6.1 million, and accounts payable and other liabilities of $8.0 million. Subsequent to the acquisition of VitalStream, we paid off the term loans and line of credit assumed in the VitalStream acquisition.

Identifiable Intangible Assets. Developed technologies relate to VitalStream products that have reached technological feasibility and include processes and trade secrets acquired or developed through design and development of their products. Customer relationships represent contracts with existing customers. Trade name primarily relates to the VitalStream and other product names. We valued each of the identifiable intangible assets using various forms of the income approach, detailed financial projections and various assumptions, including, among others, the evolution of the existing technology platforms to future technology, expected net cash flows, customer attrition rates, tax rates, and discount rates. Amortization of identifiable intangibles is on a straight-line basis over their respective useful lives.

In-Process Research and Development. As of the closing date, one project was in development that has not reached technological feasibility and therefore qualifies as in-process research and development. The amount allocated to in-process research and development was charged to the statement of operations as of the date of acquisition.

Goodwill. Goodwill is the residual of the excess of fair value over the book value of the acquired entity's net assets at the date of acquisition. We note that under SFAS No. 141, an assembled workforce shall not be recognized apart from goodwill and therefore is embedded in goodwill. Part of the acquisition included an assembled workforce that is included as a component of goodwill. Another component of goodwill is the estimated fair value of the expected synergies and other benefits from combining ours and VitalStream's net assets and businesses. Our expected synergies are significant in this acquisition, including synergies in the sales channel, our network costs, general and administrative costs, and capital expenditures. We allocated approximately $154.8 million to goodwill for the CDN services segment. In accordance with SFAS No. 142, we will not amortize goodwill but instead will test it for impairment at least annually, or more frequently if certain indicators are present. A total of $18.3 million of goodwill will be deductible for tax purposes.

Pro Forma Results (Unaudited)

VitalStream provides products and services for storing and delivering digital media to large audiences over the Internet and ad insertion and related advertising services to companies that stream digital media over the Internet. VitalStream also enhances our position as a leading provider of high performance route control products and services by adding complementary service offerings in the rapidly growing content delivery and on-line advertising markets. Integrating VitalStream's digital media delivery platform into our portfolio of products and services enables us to provide customers with one of the most complete product lines in content delivery solutions, content monetization and on-line advertising, while supporting the significant long-term growth opportunities in the network services market.

The following unaudited pro forma consolidated financial information reflects the results of our operations for the year ended December 31, 2007 and 2006, as if the acquisition of VitalStream had occurred at the beginning of each period. Prior to the acquisition, VitalStream was a customer of ours, and for the years ended December 31, 2007 and 2006 we recognized revenues of $0.4 million and $0.2 million, respectively, from VitalStream which has been excluded from pro forma revenues below. The related receivables were settled in the normal course of business. The pro forma results presented below are not necessarily indicative of what our operating results would have been had the acquisition actually taken place at the beginning of each period (in thousands, except per share amounts):

	Year Ended December 31,	
	2007	2006
Pro forma revenues	**$236,418**	$205,052
Pro forma net loss	**(14,269)**	(16,153)
Pro forma net loss per share, basic and diluted	**(0.25)**	(0.34)

4. ASSET IMPAIRMENT AND RESTRUCTURING COSTS

During the three months ended March 31, 2007, we incurred a restructuring and impairment charge of $10.3 million. The charge was the result of a review of our business, particularly in light of our acquisition of VitalStream and our plan to finalize the overall integration and implementation plan before the end of the first quarter. The charge to expense included $7.8 million for leased facilities, representing both the costs less anticipated sublease recoveries that will continue to be incurred without economic benefit to us and costs to terminate leases before the end of their term. The charge also included severance payments of $1.1 million for the termination of certain employees and $1.4 million for impairment of assets. Net related expenditures were estimated to be $10.7 million, of which $2.8 million has been paid during the year ended December 31, 2007, and the balance continuing through December 2016, the last date of the longest lease term. These expenditures are expected to be paid out of operating cash flows. The impairment charge of $1.3 million is related to the leases referenced above and less than $0.1 million for other assets. Cost savings from the restructuring were estimated to be approximately $0.8 million per year through 2016, primarily for rent expense.

In 2001, 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 continued to evaluate our restructuring reserve. The following table displays the activity and balances for the restructuring and asset impairment activity for the year ended December 31, 2007 (in thousands):

	December 31, 2006 Restructuring Liability	Restructuring and Impairment Charges	Cash Payments	Non-Cash Write-Downs	Non-Cash Plan Adjustments	**December 31, 2007 Restructuring Liability**
Activity for 2007 restructuring charge:						
Real estate obligations	$ –	**$ 7,755**	**$(2,248)**	$ –	**$ 805**	**$ 6,312**
Employee separations	–	**1,140**	**(615)**	–	**(119)**	**406**
Total restructuring costs	–	**8,895**	**(2,863)**	–	**686**	**6,718**
Activity for 2007 impairment charge:						
Leasehold improvements	–	**897**	–	**(897)**	–	–
Other	–	**471**	–	**(471)**	–	–
Total asset impairments	–	**1,368**	–	**(1,368)**	–	–
Activity for 2001 restructuring charge:						
Real estate obligations	**4,784**	–	**(1,199)**	–	**(211)**	**3,374**
Total	**$4,784**	**$10,263**	**$(4,062)**	**$(1,368)**	**$ 475**	**$10,092**

The impairment charges referenced in the table above were primarily associated with our data center segment.

We also recorded a $1.1 million impairment during year ended December 31, 2007 for the sales order-through-billing system, described further in Note 2. This impairment charge was not related to any specific segment.

In 2006, we recorded a nominal charge for changes in estimated expenses related to real estate obligations. The following table displays the activity and balances for restructuring activity for the year ended December 31, 2006 (in thousands):

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

Also, during the year ended December 31, 2006, we recognized an impairment charge of $0.3 million as a result of the implementation of a new financial system which began in 2004.

In 2005, we recorded net restructuring charges totaling less than $0.1 million primarily for changes in estimated expenses related to real estate obligations.

5. OPERATING SEGMENTS

We operate and manage the Company in three business segments: IP services, data center services and CDN services. IP services primarily include our high performance Internet connectivity as well as sales of our FCP products. Data center services primarily include physical space for hosting customers' network and other equipment plus associated services such as redundant power and network connectivity, environmental controls and security. CDN services primarily include data storage, streaming/delivery and a user interface/reporting tool, none of which are sold separately. Other revenues and direct costs represent non-segmented activities and primarily include reseller and miscellaneous services such as third party CDN services, termination fee revenue, referral fees for other hardware sales, and consulting services. In conjunction with the preparation of our financial statements, we analyzed sales credits activity for the years ended December 31, 2007, 2006 and 2005 and reclassified all of the credits to the related operating segments. The following tables show operating results for our reportable segments, along with reconciliations from segment gross profit to (loss) income before income taxes and equity in earnings of equity-method investment:

	Year Ended December 31, 2007				
	IP Services	**Data Center Services**	**CDN Services**	**Other**	**Total**
Revenues	**$119,848**	**$83,058**	**$17,718**	**$13,466**	**$234,090**
Direct costs of network, sales and services, exclusive of depreciation and amortization	**43,681**	**59,439**	**6,584**	**8,690**	**118,394**
Segment profit	**$ 76,167**	**$23,619**	**$11,134**	**$ 4,776**	**115,696**
Other operating expenses					**125,407**
Loss from operations					**(9,711)**
Non-operating income					**937**
Loss before income taxes and equity in earnings of equity-method investment					**$ (8,774)**

Direct costs of network, sales and services, exclusive of depreciation and amortization, includes an allocation of $0.7 million from the IP services segment to the CDN services segment based on the average cost of actual usage by the CDN segment.

	Year Ended December 31, 2006				
	IP Services	Data Center Services	CDN Services	Other	Total
Revenues	$109,748	$56,152	$ –	$15,475	$181,375
Direct costs of network, sales and services, exclusive of depreciation and amortization	39,744	46,474	–	11,120	97,338
Segment profit	$ 70,004	$ 9,678	$ –	$ 4,355	84,037
Other operating expenses					81,900
Income from operations					2,137
Non-operating income					1,551
Income before income taxes and equity in earnings of equity-method investment					$ 3,688

	Year Ended December 31, 2005				
	IP Services	Data Center Services	CDN Services	Other	Total
Revenues	$105,032	$36,996	$ –	$11,689	$153,717
Direct costs of network, sales and services, exclusive of depreciation and amortization	38,377	35,244	–	8,337	81,958
Segment profit	$ 66,655	$ 1,752	$ –	$ 3,352	71,759
Other operating expenses					76,893
Loss from operations					(5,134)
Non-operating income					87
Loss before income taxes and equity in earnings of equity-method investment					$ (5,047)

The following table includes selected segment financial information as of December 31, 2007 and 2006, related to goodwill and total assets:

	IP Services	Data Center Services	CDN Services	Other	Total
December 31, 2007:					
Goodwill	**$ 36,314**	**$ –**	**$154,363**	**$ –**	**$190,677**
Total assets	**148,697**	**64,498**	**211,469**	**2,346**	**427,010**
December 31, 2006:					
Goodwill	$ 36,314	$ –	$ –	$ –	$ 36,314
Total assets	130,609	41,185	–	1,908	173,702

Through December 31, 2007, neither revenues generated nor long-lived assets located outside the United States were significant (all less than 10%).

6. INVESTMENTS

Investment in Marketable Securities

Pursuant to our formal investment policy, investments in marketable securities primarily consist of high credit quality corporate debt securities, auction rate securities whose underlying assets are state-issued student and educational loans which are substantially backed by the federal government, commercial paper and U.S. Government Agency debt securities. Auction rate securities are variable rate bonds tied to short-term interest rates with maturities on the face of the securities in excess of 90 days and have interest rate resets through a modified Dutch auction, at predetermined short-term intervals, usually every 7, 28 or 35 days. Auction rate securities generally trade at par and are callable at par on any interest payment date at the option of the issuer. Interest received during a given period is based upon the interest rate determined through the auction process. Although these securities are issued and rated as long term bonds, they are priced and traded as short-term instruments because of the liquidity provided through the interest rate reset. All short-term marketable securities either (1) have original maturities greater than 90 days but less than one year or (2) are auction rate securities expected to be liquidated within one year, 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 or sales of auction rate securities at par value. Accordingly, we have not recognized any realized gains or losses.

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

	December 31, 2007		
	Cost Basis	**Unrealized Gain (Loss)**	**Carrying Value**
Corporate debt securities	**$ 7,607**	**$ 3**	**$ 7,610**
Auction rate securities	**7,150**	**–**	**7,150**
Commercial paper	**4,787**	**2**	**4,789**
Other	**24**	**(4)**	**20**
Total short-term investments in marketable securities	**$19,568**	**$ 1**	**$19,569**

	December 31, 2006		
	Cost Basis	Unrealized Gain (Loss)	Carrying Value
Corporate debt securities	$ 4,826	$ 1	$ 4,827
Commercial paper	4,755	–	4,755
U.S. government agency debt securities	3,659	(1)	3,658
Other	24	27	51
Total short-term investments in marketable securities	$13,264	$27	$13,291

Uncertainties in the credit markets may affect the liquidity of our holdings in auction rate securities. We did not experience any unsuccessful auction rate resets during the year ended or the initial rate resets immediately following December 31, 2007, however we have experienced failures on each of our subsequent auction rate resets. Nevertheless, we continue to receive interest every 28-35 days. While our investments in auction rate securities are of high credit quality with AAA/Aaa ratings as of December 31, 2007, at this time we are uncertain as to whether or when the liquidity issues relating to these investments will worsen or improve. We do not believe that it is necessary at this time to adjust the fair value of our portfolio of auction rate securities and we expect to hold the auction rate securities until liquidity improves or the borrower calls the underlying securities. However, if uncertainties in the credit and capital markets continue, these markets deteriorate further or we experience any rating downgrades on any of the investments in our portfolio, we may incur temporary or other than temporary impairments, which could negatively affect our financial condition, results of operations or cash flows. In addition, a continued deterioration in market conditions that lead us to conclude our marketable securities are not available to fund current operations would result in us classifying our auction rate securities as noncurrent assets. In the meantime, we believe we have sufficient liquidity through our cash balances, other short-term investments and available credit.

Investment in Internap Japan

We maintain a 51% ownership interest in Internap Japan, a joint venture with NTT-ME Corporation and NTT Holdings. 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,		
	2007	2006	2005
Investment balance, January 1,	**$ 958**	$823	$ 861
Proportional share of net income	**139**	114	83
Unrealized foreign currency translation gain (loss), net	**41**	21	(121)
Investment balance, December 31,	**$1,138**	$958	$ 823

Investment in Aventail

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. We incurred a charge during the three months ended June 30, 2007, totaling $1.2 million, representing the write-off of the remaining carrying value of our investment in series D preferred stock of Aventail. We made an initial cash investment of $6.0 million in Aventail series D preferred stock pursuant to an investment agreement in February 2000. In connection with a subsequent round of financing by Aventail, we recognized an initial loss on our investment of $4.8 million in 2001. On June 12, 2007, SonicWall, Inc. announced that it entered into an agreement to acquire Aventail for approximately $25.0 million in cash. The transaction closed on July 11, 2007, with all shares of series D preferred stock being cancelled and the holders of series D preferred stock not receiving any consideration for such shares.

7. PROPERTY AND EQUIPMENT

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

	December 31,	
	2007	2006
Network equipment	**$ 86,496**	$ 65,430
Network equipment under capital lease	**1,596**	1,596
Furniture, equipment and software	**31,726**	31,712
Leasehold improvements	**111,216**	100,024
Property and equipment, gross	**231,034**	198,762
Less: Accumulated depreciation and amortization ($1,596 and $1,375 related to capital leases at December 31, 2007 and 2006, respectively)	**(165,543)**	(151,269)
	$ 65,491	$ 47,493

During 2007 and 2006, $2.7 million and $8.6 million, respectively, of fully depreciated assets were retired.

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

	Year Ended December 31,		
	2007	2006	2005
Direct costs of network, sales and services	**$18,313**	$13,250	$11,804
Other depreciation and amortization	**3,929**	2,606	2,933
Subtotal	**22,242**	15,856	14,737
Amortization of acquired technologies	**4,165**	516	577
Total depreciation and amortization	**$26,407**	$16,372	$15,314

8. 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, 2007.

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 value of our reporting units would necessitate an impairment charge of our goodwill. In connection with our acquisition of VitalStream on February 20, 2007, we recorded $154.8 million of additional goodwill based on our allocation of the VitalStream purchase price, as discussed in note 3. In December 2007, a decrease of $0.4 million was recorded to goodwill as a result of the utilization of a portion of VitalStream's net operating loss carryforwards. The total recorded amount of goodwill was $190.7 million and $36.3 million as of December 31, 2007 and December 31, 2006, respectively.

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.

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

	December 31, 2007		December 31, 2006	
	Gross Carrying Amount	**Accumulated Amortization**	Gross Carrying Amount	Accumulated Amortization
Contract based	**$25,018**	**$(15,403)**	$14,518	$(14,291)
Technology based	**41,911**	**(8,518)**	5,911	(4,353)
	$66,929	**$(23,921)**	$20,429	$(18,644)

Amortization expense for identifiable intangible assets during 2007, 2006 and 2005 was $5.3 million, $0.5 million and $0.6 million, respectively. As of December 31, 2007, estimated amortization expense for the next five years is as follows (in thousands):

2008	$ 6,243
2009	6,243
2010	6,056
2011	5,728
2012	5,728
Thereafter	13,010
	$43,008

9. ACCRUED LIABILITIES

Accrued liabilities consist of the following (in thousands):

	December 31,	
	2007	2006
Compensation payable	**$ 4,942**	$4,075
Telecommunications, sales, use and other taxes	**2,317**	2,005
Other	**2,900**	2,609
	$10,159	$8,689

10. REVOLVING CREDIT FACILITY AND NOTE PAYABLE

On September 14, 2007, we entered into a $35.0 million credit agreement, or the Credit Agreement, with Bank of America, N.A., as administrative agent, and lenders who may become a party to the Credit Agreement from time to time. VitalStream Holdings, Inc., VitalStream, Inc., PlayStream, Inc., and VitalStream Advertising Services, Inc., four of our subsidiaries, are guarantors of the Credit Agreement.

The Credit Agreement replaced our prior credit agreement, which was evidenced by a Loan and Security Agreement between the Company and Silicon Valley Bank that was last amended on December 27, 2006. We paid off and terminated this prior credit facility concurrently with the execution of the Credit Agreement.

Our obligations under the Credit Agreement are pledged, pursuant to a pledge and security agreement and an intellectual property security agreement, by substantially all of our assets including the capital stock of our domestic subsidiaries and 65% of the capital stock of our foreign subsidiaries.

The Credit Agreement provides for a four-year revolving credit facility, or the Revolving Credit Facility, in the aggregate amount of up to $5.0 million, which includes a $5.0 million sub-limit for letters of credit. With the prior approval of the administrative agent, we may increase the total commitments by up to $15.0 million for a total commitment under the Revolving Credit Facility of $20.0 million. The Revolving Credit Facility is available to finance working capital, capital expenditures and other general corporate purposes. As of December 31, 2007 we had a total of $8.0 million of letters of credit issued (including $3.9 million which are secured by the Revolving Credit Facility and the balance secured by restricted cash) and $1.1 million in borrowing capacity on the Revolving Credit Facility. There were no amounts outstanding on the Revolving Credit Facility as of December 31, 2007.

The Credit Agreement also provides for a four-year term loan, or the Term Loan, in the amount of $30.0 million. We borrowed $20.0 million concurrently with the closing and used a portion of the proceeds from the Term Loan to pay off the prior credit agreement. The Term Loan had $10.0 million in borrowing capacity as of December 31, 2007.

The interest rate on the Revolving Credit Facility and Term Loan is a tiered LIBOR-based rate that depends on our 12-month trailing EBITDA. As of December 31, 2007, the interest rate was 7.075%.

We will only pay interest on the Term Loan during the first 12 months of its four-year term. Commencing on the last day of the first calendar quarter after the first anniversary of the closing, the outstanding amount of the Term Loan will amortize on a straight-line schedule with the payment of 1/16 of the original principal amount of the Term Loan due quarterly. We will pay all unpaid amounts at maturity, which is September 14, 2011.

The Credit Agreement includes customary representations, warranties, negative and affirmative covenants, including certain financial covenants relating to net funded debt to EBITDA ratio and fixed charge coverage ratio, as well as a prohibition against paying dividends, limitations on unfunded capital expenditures of $25.0 million per year, customary events of default and certain default provisions that could result in acceleration of the Credit Agreement.

The net proceeds received from the Term Loan were reduced by $0.3 million for fees paid to Bank of America and its agents. We treated these fees as a debt discount and will amortize the fees to interest expense using the interest method over the term of the loan. We recorded less than $0.1 million of related amortization during the year ended December 31, 2007. As of December 31, 2007, the balance on the Term Loan, net of the discount, was $19.8 million. We incurred other costs of less than $0.1 million in connection with entering into the Credit Agreement, which we recorded as debt issue costs and will amortize over the term of the Credit Agreement.

As a result of the transactions discussed above, we recorded a loss on extinguishment of prior debt of less than $0.1 million during the year ended December 31, 2007. The loss on extinguishment of debt is included in the caption Other, net within the Non-operating (income) expense section of the consolidated statements of operations.

The future maturity of the Term Loan at December 31, 2007, which does not reflect the debt discount, is as follows (in thousands):

2008	$ 2,500
2009	5,000
2010	5,000
2011	7,500
Total maturities and principal payments	20,000
Less: current portion	(2,500)
	$17,500

Also during the year ended December 31, 2007, we paid off the term loans and line of credit issued pursuant to the loan and security agreement assumed in the VitalStream acquisition, as discussed in note 3.

At December 31, 2006, we had a $5.0 million revolving credit facility and a $17.5 million term loan (note payable) under the former loan and security agreement with Silicon Valley Bank. The note payable had a fixed interest rate of 7.5% and was paid off in connection with the new Credit Agreement discussed above. There were $3.9 million of letters of credit previously outstanding under the former revolving credit facility which have been secured with restricted cash and are in the process of being secured by the new Revolving Credit Facility. There was no outstanding balance under the former revolving credit facility as of December 31, 2006.

The carrying value of our notes payable as of December 31, 2007 and 2006, approximate fair value as the interest rates approximate current market rates of similar debt obligations.

11. CAPITAL LEASES

Capital lease obligations and the leased property and equipment are recorded at acquisition at the present value of future lease payments based upon the terms of the related lease agreement. As of December 31, 2007, our capital leases have expiration dates ranging from May 2009 to March 2010.

Future minimum capital lease payments together with the present value of the minimum lease payments as of December 31, 2007, are as follows (in thousands):

2008	$ 922
2009	456
2010	14
Remaining capital lease payments	1,392
Less: amounts representing imputed interest	(135)
Present value of minimum lease payments	1,257
Less: current portion	(805)
	$ 452

One capital lease assumed in the VitalStream acquisition requires us to maintain a restricted cash balance of $0.7 million.

12. INCOME TAXES

The current and deferred income tax (benefit) provision were as follows for the years ended December 31, 2007 and 2006 (in thousands):

	Year Ended December 31,	
	2007	2006
Current:		
Federal	**$ 15**	$145
State	**–**	–
Foreign	**921**	–
Total current provision	**936**	145
Deferred:		
Federal	**356**	–
State	**42**	–
Foreign	**(4,414)**	–
Total deferred benefit	**(4,016)**	–
Net income tax (benefit) provision	**$(3,080)**	$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. We had no income tax provision or benefit for the year ended December 31, 2005.

A reconciliation of the effect of applying the federal statutory rate and the effective income tax rate on our income tax provision (benefit) is as follows:

	Year Ended December 31,		
	2007	2006	2005
Federal income tax (benefit) expense at statutory rates	**(34)%**	34%	(34)%
State income tax (benefit) expense	**(4)**	4	(4)
Stock compensation expense	**6**	8	–
Tax reserves	**11**	–	–
Other	**–**	1	1
Change in valuation allowance	**(14)**	(43)	37
Effective tax rate	**(35)%**	4%	–%

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

	December 31,	
	2007	2006
Current deferred income tax assets:		
Provision for doubtful accounts	**$ 593**	$ 115
Accrued compensation	**233**	132
Other accrued expenses	**196**	–
Deferred revenue	**1,648**	1,225
Restructuring costs	**910**	532
Foreign net operating loss carryforwards – current portion	**479**	–
Other	**77**	390
Current deferred income tax assets	**4,136**	2,394
Less: valuation allowance	**(3,625)**	(2,379)
	511	15
Non-current deferred income tax assets:		
Property and equipment	**21,488**	20,315
Investments	**–**	1,824
Deferred revenue, less current portion	**717**	386
Restructuring costs, less current portion	**2,925**	1,286
Deferred rent	**4,184**	4,344
Stock Compensation	**2,620**	216
U. S. net operating loss carryforwards	**136,963**	128,527
Foreign net operating loss carryforwards, less current portion	**13,717**	14,574
Capital loss carryforwards	**2,271**	–
Tax credit carryforwards	**180**	165
Other	**502**	–
Non-current deferred income tax assets	**185,567**	171,637
Less: valuation allowance	**(180,133)**	(170,568)
	5,434	1,069
Non-current deferred income tax liabilities:		
Purchased intangibles	**(1,531)**	(1,084)
FIN 48 liability related to net operating loss carryforwards	**(921)**	–
Goodwill	**(398)**	–
Non-current deferred income tax assets (liabilities), net	**2,584**	(15)
Net deferred tax assets	**$ 3,095**	$ –

As of December 31, 2007, we have U.S. net operating loss carryforwards for federal tax purposes of approximately $589.4 million that will expire through 2026. Of the total U.S. net operating loss carryforwards, $13.3 million of net operating losses relate to the deduction of stock compensation that will be tax-effected and the benefit credited to additional paid in capital when realized. In addition, we have alternative minimum tax credit carryforwards of approximately $0.2 million, which have an indefinite carryforward period, and foreign net operating loss carryforwards of approximately $39.3 million that will begin to expire in 2008.

The future utilization of the U.S. net operating losses is subject to certain 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 $589.4 million in net operating losses. Also, 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 future utilization of our U.S. net operating losses.

As prescribed under SFAS No. 109, we periodically evaluate the recoverability of the deferred tax assets and the appropriateness of the valuation allowance. For U.S. tax purposes, a valuation allowance of approximately $173.7 million has been established against the U.S. deferred tax assets that we do not believe are more likely than not to be realized. We will continue to assess the requirement for a valuation allowance on a quarterly basis and, at such time when it is determined that it is more likely than not that the deferred tax assets will be realized, the valuation allowance will be reduced accordingly.

During the fourth quarter of 2007, we concluded that it was more likely than not that U.K. deferred tax assets will be realized in future years. The U.K. deferred tax assets primarily consist of net operating loss carryforwards in the amount of $11.6 million as of December 31, 2007. We therefore released $4.4 million of the valuation allowance associated with U.K. deferred tax assets, which resulted in the recognition of a $4.4 million tax benefit. The tax benefit was offset by a liability for uncertain tax positions of $0.9 million, discussed below, for a net recognized tax benefit of $3.5 million. On the accompanying balance sheet, $0.5 million of the tax benefit is reflected as a current deferred tax asset because realization is anticipated to occur within the next 12 months. The resulting non-current deferred tax asset is $3.0 million.

As discussed in note 3 we acquired VitalStream in February 2007, resulting in the addition of $13.5 million in deferred tax assets, primarily consisting of $34.5 million in net operating loss carryforwards. The acquisition of VitalStream was a stock-for-stock transaction treated as a tax-free reorganization. The difference between the tax basis and the net book value of VitalStream assets is treated as a temporary difference and is reported as a deferred tax asset in the table above.

It is our policy to reinvest foreign earnings indefinitely within each country when foreign operations become profitable. Accordingly, no deferred taxes have been recorded for the difference between our financial and tax basis investment in foreign entities. A portion of these earnings were distributed to the U.S. and resulted in U.S. dividend income (eliminated in consolidation for financial statement purposes) and reduced the U.S. net operating loss carryforward. The distribution was not subject to withholding taxes. No other foreign distributions have occurred and no provision or benefit is made for income taxes that would be payable upon the distribution of future foreign earnings. Because it is the intention of management to reinvest future profits within each country, it is not practicable to determine the amount of the unrecognized deferred income tax liability related to future foreign earnings.

Effective January 1, 2007, we adopted the provisions of FIN 48. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements in accordance with SFAS No. 109. FIN 48 requires a company to determine whether it is more likely than not that a tax position will be sustained upon examination based upon the technical merits of the position. If the more-likely-than-not threshold is met, a company must measure the tax position to determine the amount to recognize in the financial statements.

Upon the adoption of FIN 48 on January 1, 2007, we recognized no increase in our liability for unrecognized tax benefits. A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows (in thousands):

Unrecognized tax benefits balance at January 1, 2007	**$ –**
Additions for tax positions of prior years	**–**
Reductions for tax positions of prior years settlements	**–**
Additions for tax positions of current year	**921**
Lapse of statute of limitations	**–**
Unrecognized tax benefits balance at December 31, 2007	**$921**

All of the $0.9 million addition would impact our effective income tax rate in the respective period of change. We classify interest and penalties arising from the underpayment of income taxes in the statement of operations as a component of general and administrative expenses. As of December 31, 2007, we have no accrued interest or penalties related to uncertain tax positions. Our federal income tax returns remain open to examination for the tax years 2007, 2006 and 2005, as do returns filed in other taxing jurisdictions to which we are also subject to examination for years prior to 2005.

13. EMPLOYEE RETIREMENT PLAN

We sponsor a defined contribution retirement savings plan that qualifies under Section 401(k) of the Internal Revenue Code. Plan participants may elect to have a portion of their pre-tax compensation contributed to the plan, subject to certain guidelines issued by the Internal Revenue Service. Employer contributions are discretionary and were $0.8 million, $0.7 million and $0.6 million for the years ended December 31, 2007, 2006 and 2005, respectively.

14. 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. Initial lease terms range from two 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. Certain leases require that we maintain letters of credit or restricted cash balances to ensure payment. Future minimum lease payments on non-cancelable operating leases are as follows at December 31, 2007 (in thousands):

2008	$ 28,211
2009	25,510
2010	25,179
2011	26,135
2012	27,073
Thereafter	88,786
	$220,894

Rent expense was $15.1 million, $18.8 million and $13.6 million for the years ended December 31, 2007, 2006 and 2005, respectively. Sublease income, recorded as a reduction of rent expense, was $0.5 million, $0.6 million and $0.2 million during the years ended December 31, 2007, 2006 and 2005, 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 data center services for our customers. Future minimum payments under these service commitments having terms in excess of one year are as follows at December 31, 2007 (in thousands):

2008	$12,167
2009	7,457
2010	2,390
	$22,014

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 million liability amount as we believed the obligation no longer existed. In the fourth quarter of 2006, we received an inquiry from the vendor, ADC Telecommunications, Inc., or ADC, regarding the status of the former $1.3 million payable and on March 19, 2007, ADC sued us in Minnesota state court. We settled this suit on June 29, 2007 for less than $0.1 million, which we expensed when we incurred the settlement cost and associated legal costs.

Concentrations of Risk

We participate in an industry that is characterized by relatively high volatility and 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 supply inventories of the products and equipment that we purchase and use, 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 are 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 to 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.

15. 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. We have no shares of series A convertible preferred stock outstanding.

Rights Agreement

On March 15, 2007, the Board of Directors declared a dividend of one preferred share purchase right, or a Right, for each outstanding share of common stock, par value $0.001 per share, of the Company. The dividend was payable on March 23, 2007 to the stockholders of record on that date. Each Right entitles the registered holder to purchase from the Company 1/1000 of a share of Series B Preferred Stock of the Company, par value $0.001 per share, or the Preferred Shares, at a price of $100.00 per 1/1000 of a Preferred Share, subject to adjustment. Our Certificate of Designation of Rights, Preferences and Privileges of Series B Preferred Stock designates 0.5 million shares of Series B Preferred Stock. The description and terms of the Rights are set forth in a Rights Agreement between the Company and American Stock Transfer & Trust Company, as Rights Agent, dated April 11, 2007.

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, or AMEX, effective September 17, 2006.

On July 10, 2006, we implemented a one-for-ten 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.

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

On October 20, 2003, we issued warrants to purchase less than 0.1 million shares of common stock at an exercise price of $9.50 in connection with a private placement of our common stock. These warrants continue to be outstanding and expire on August 22, 2008.

16. STOCK-BASED COMPENSATION PLANS

General

We have adopted 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 APB Opinion No. 25 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 was $6.5 million and $5.1 million lower, or $0.14 and $0.15 per basic and $0.13 and $0.14 per diluted share, lower for the years ended December 31, 2007 and 2006, respectively, than had we continued to account for stock-based compensation under APB Opinion No. 25.

Deferred compensation related to 0.1 million shares of restricted stock was granted in connection with the September 30, 2005 employment agreement between the Company and its current 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 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 the 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, 2007 and 2006 (in thousands):

	Year Ended December 31,	
	2007	2006
Direct costs of customer support	**$1,892**	$1,102
Product development	**856**	628
Sales and marketing	**2,135**	2,145
General and administrative	**3,798**	2,067
Total stock-based compensation expense included in net income	**$8,681**	$5,942

Less than $0.1 million of stock-based compensation was capitalized during each of the years ended December 31, 2007 and 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 year ended December 31, 2005 (in thousands except per share amounts):

Net loss, as reported	$ (4,964)
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)
Pro forma net loss	$(14,567)
Loss per share:	
Basic and diluted–as reported	$ (0.15)
Basic and diluted–pro forma	(0.43)

Note that the above pro forma disclosure was not presented for the twelve months ended December 31, 2007 and 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 fair values of outstanding stock options have 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, 2007, 2006 and 2005, were expected terms of 6.2, 5.7 and 4.0 years, respectively; historical volatilities of 114%, 123% and 118%, respectively; risk free interest rates of 4.44%, 4.63% and 4.22%, respectively and no dividend yield. The weighted average estimated fair value per share of our employee stock options at grant date was $13.71, $7.75 and $3.50 for the years ended December 31, 2007, 2006 and 2005, respectively. The expected term represents the weighted average period of time that granted options are expected to be outstanding, giving consideration to the vesting schedules and our historical exercise patterns. Because our options are not publicly traded, assumed volatility is based on the historical volatility of our stock. The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant for periods corresponding to the expected life of the options. We have also used historical data to estimate option exercises, employee termination and stock option forfeiture rates.

Stock Compensation and Option Plans

On June 23, 2005, we adopted the Internap Network Services Corporation 2005 Incentive Stock Plan, or the 2005 Plan, which was amended and restated on March 15, 2006. 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 are 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 preexisting 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, 2007, 3.0 million options were outstanding, 0.7 million shares of non-vested restricted stock awards were outstanding and 2.3 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.

As a result of the acquisition of VitalStream as discussed in note 3, we assumed the VitalStream Stock Option/Stock Issuance Plan, or the VitalStream Plan, and all of the corresponding options to purchase stock. Under the terms of the merger agreement, each VitalStream stock option that was outstanding and unexercised was converted into an option to purchase Internap common stock and we assumed that stock option in accordance with the terms of the applicable VitalStream stock option plan and terms of the stock option agreement. Based on VitalStream's stock options outstanding at February 20, 2007, we converted options to purchase approximately 3.0 million shares of VitalStream common stock into options to purchase approximately 1.5 million shares of Internap common stock. We determined the fair value of the outstanding options using a Black-Scholes valuation model with the following assumptions: volatility of 48.8% to 120.1%; risk-free interest rates ranging from 4.7% to 5.1%; remaining expected lives ranging from 0.18 to 6.25 years; and dividend yield of zero.

The VitalStream Plan provided for the granting of incentive stock options, non-statutory stock options or shares of common stock directly to certain key employees, members of the board of directors, consultants, and

independent contractors according to the terms of the plan. There were 5.4 million VitalStream shares, or 2.8 million Internap shares on a post-converted basis, reserved for issuance under the plan and 0.5 million VitalStream shares, or 0.3 million Internap shares on a post-converted basis, available for grant. Generally, the assumed options had exercise prices equal to the stock price on the date of grant and had contractual terms of 5 years. Vesting schedules ranged from quarterly periods over one year to four years with 1/4 th vesting after one year and 1/16 th vesting each quarter thereafter.

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 option for 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. On January 18, 2007, the Board of Directors approved certain changes, effective as of January 1, 2007, to compensation for non-employee Directors. The annual stock option grant to each director is now an option to acquire up to 5,000 shares instead of an option to acquire up to 2,000 shares of our common stock. These options also have an exercise price equal to 100% of the fair market value of our common stock on the date of grant and are fully vested and exercisable as of the date of grant. Each Director also receives an annual grant of 2,500 restricted stock awards , which vest ratably over a three-year period, subject to the terms of the 2005 Plan, under which these restricted stock awards are granted. In addition, new non-employee Directors receive a grant of 12,500 restricted stock awards , which vest ratably over a three-year period, subject to the terms of the 2005 Plan and the stock grant agreement under which the restricted stock awards are granted. As of December 31, 2007, 0.1 million options were outstanding and 0.2 million shares 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. However, we may also use treasury stock to satisfy option exercises.

During 2006, we completed an internal review of our prior stock option granting practices. As a result of the review, 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 FIN 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 statement of operations.

Option activity for each of the three years ended December 31, 2007, 2006, and 2005 under all of our stock option plans is as follows (shares in thousands):

	Shares	Weighted Average Exercise Price
Balance, December 31, 2004	4,395	$16.96
Granted	948	4.92
Exercised	(202)	4.51
Forfeitures and post-vesting cancellations	(1,585)	19.15
Balance, December 31, 2005	3,556	13.49
Granted	752	9.30
Exercised	(497)	5.84
Forfeitures and post-vesting cancellations	(1,112)	19.94
Balance, December 31, 2006	2,699	11.07
Granted	**897**	**15.74**
Assumed with the VitalStream Plan	**1,496**	**10.81**
Exercised	**(1,241)**	**6.74**
Forfeitures and post-vesting cancellations	**(678)**	**14.23**
Balance, December 31, 2007	**3,173**	**$13.29**

The total intrinsic value of options exercised was $11.8 million, $2.6 million and $0.2 million for the years ended December 31, 2007, 2006 and 2005, respectively.

The following table summarizes information about options outstanding at December 31, 2007 (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
$ 0.75 – $ 4.60	172	4.1	$ 4.05	169	4.00	$ 4.04
$ 4.80 – $ 4.80	608	7.5	4.80	387	7.42	4.80
$ 5.20 – $ 9.15	624	8.1	7.54	191	6.67	6.56
$ 9.40 – $ 13.64	484	5.4	11.60	368	4.90	11.53
$14.17 – $ 18.70	518	4.3	16.55	316	3.17	16.68
$18.80 – $ 18.82	456	9.0	18.82	4	6.16	18.80
$18.83 – $345.00	311	4.6	35.60	239	4.57	40.58
$ 0.75 – $345.00	3,173	6.5	$13.29	1,674	5.22	$13.80

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, 2007 of all options outstanding and expected to vest was $3.6 million. The total intrinsic value at December 31, 2007 of all options exercisable was $2.4 million.

Restricted stock activity for each of the three years ended December 31, 2007, 2006, and 2005 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
Granted	**657**	**15.66**
Vested	**(161)**	**10.21**
Forfeited	**(237)**	**9.60**
Non-vested balance, December 31, 2007	**679**	**$13.19**

The total fair value of restricted stock awards vested during the years ended December 31, 2007, 2006, and 2005 was $2.3 million, $2.1 million, and less than $0.1 million, respectively. The cumulative effect of the change in the forfeiture rate for non-vested restricted stock was upon the adoption of SFAS No. 123R was immaterial and recorded as part of operating expense. The total intrinsic value at December 31, 2007 of all non-vested restricted stock awards was $5.7 million.

Total unrecognized compensation costs related to non-vested stock-based compensation as of December 31, 2007 and 2006, is summarized as follows (dollars in thousands):

	December 31, 2007		
	Stock Options	**Restricted Stock**	**Total**
Unrecognized compensation	**$10,532**	**$10,448**	**$20,980**
Weighted-average remaining recognition period (in years)	**2.7**	**3.0**	**2.9**

	December 31, 2006		
	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," 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. The 2004 ESPP was intended to be a non-compensatory plan for both tax and financial reporting purposes. However, upon our adoption of SFAS No. 123R in the first quarter of 2006, 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 restored the plan to being non-compensatory for financial reporting purposes and was 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. Less than 0.1 million and approximately 0.1 million shares were granted under the 2004 ESPP during each of the years ended December 31, 2007 and 2006, respectively. Cash received from participation in the 2004 ESPP was $0.2 million and $0.5 million for the years ended December 31, 2007 and 2006, respectively. At December 31, 2007, 0.3 million shares were reserved for future issuance under the 2004 ESPP.

At December 31, 2007, total shares reserved for future awards under all plans were 6.0 million shares. Cash received from all stock-based compensation arrangements was $8.6 million, $3.0 million and $1.5 million for the years ended December 31, 2007, 2006 and 2005, respectively.

17. RELATED PARTY TRANSACTIONS

As discussed in note 6, we had an investment in Aventail, who was also a customer for data center and connectivity services. We invoiced Aventail $0.2 million during 2007 and $0.3 million during both 2006 and 2005. As of December 31, 2007 and 2006, our outstanding receivable balance with Aventail was less than $0.1 million. As discussed in note 4, we incurred a charge during the period ended June 30, 2007, totaling $1.2 million, representing the write-off of the remaining carrying value of our investment in series D preferred stock of Aventail.

One of our executive officers has a material equity ownership interest in and is a member of the board of directors of a customer of ours, Surfline/Wavetrak, Inc., or Surfline. We invoiced Surfline $0.1 million during 2007, of which $0.1 million was outstanding as of December 31, 2007. Surfline was not a customer prior to 2007.

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.

18. UNAUDITED QUARTERLY RESULTS

The following table sets forth selected unaudited quarterly data for the years ended December 31, 2007 and 2006. We have revised our quarterly statement of operations for the quarter ended September 30, 2007 to appropriately record (1) $0.5 million for sales adjustments, which reduce net accounts receivable and revenue, and (2) $0.1 million for accretion of interest income that we initially included as unrealized gain in accumulated other comprehensive income within stockholders' equity. The effect of these revisions had no impact on our consolidated statement of cash flows. We have determined that these adjustments are not material to our consolidated financial statements for any of the affected quarterly periods. Accordingly, we have not revised the 2007 quarterly financial statements included in our previously filed Form 10-Q for the quarterly periods ended March 31, June 30 and September 30, 2007 for these adjustments. The quarterly operating results below are not necessarily indicative of those in future periods (in thousands, except for share data).

	Quarter Ended			
2007	**March 31**	**June 30**	**September 30**	**December 31**
Revenues [1]	**$ 53,534**	**$58,494**	**$60,426**	**$61,636**
Direct costs of network, sales and services, exclusive of depreciation and amortization	**28,629**	**29,617**	**29,272**	**30,876**
Direct costs of amortization of acquired technologies	**654**	**1,054**	**1,228**	**1,229**
Direct costs of customer support	**3,388**	**4,330**	**4,495**	**4,334**
Restructuring and asset impairment	**11,349**	**–**	**–**	**–**
Acquired in-process research and development	**450**	**–**	**–**	**–**
Write-off of investment	**–**	**1,178**	**–**	**–**
Net (loss) income [2]	**(10,695)**	**(1,683)**	**1,383**	**5,440**
Basic and diluted net (loss) income per share [3]	**(0.26)**	**(0.03)**	**0.03**	**0.11**

(1) Amounts included in this table for the third quarter of 2007 are approximately $0.5 million lower than the amounts previously reported in our Form 10-Q for the quarterly period ended September 30, 2007.

(2) Amounts included in this table for the third quarter of 2007 are approximately $0.4 million lower than the amounts previously reported in our Form 10-Q for the quarterly period ended September 30, 2007.

(3) Amounts included in this table for the third quarter of 2007 are approximately $0.01 lower than the amounts previously reported in our Form 10-Q for the quarterly period ended September 30, 2007.

	Quarter Ended			
2006	March 31	June 30	September 30	December 31
Revenues	$ 42,625	$43,905	$45,874	$48,971
Direct costs of network, sales and services, exclusive of depreciation and amortization	22,217	23,606	25,236	26,279
Direct costs of amortization of acquired technologies	137	138	137	104
Direct costs of customer support	2,897	2,769	2,930	2,970
Restructuring and asset impairment	–	–	319	4
Net income	541	713	195	2,208
Basic and diluted net income per share	0.02	0.02	0.01	0.06

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Financial Review 2007

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

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, of stockholders' equity and comprehensive income (loss) and cash flows present fairly, in all material respects, the financial position of Internap Network Services Corporation and its subsidiaries, at December 31, 2007 and 2006, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2007 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company did not maintain, in all material respects, effective internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) because a material weakness in internal control over financial reporting related to the completeness, accuracy, valuation and disclosure of sales adjustments existed at that date. A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the annual or interim financial statements will not be prevented or detected on a timely basis. The material weakness referred to above is described in Management's Report on Internal Control Over Financial Reporting appearing under Item 9A. We considered this material weakness in determining the nature, timing, and extent of audit tests applied in our audit of the 2007 consolidated financial statements, and our opinion regarding the effectiveness of the Company's internal control over financial reporting does not affect our opinion on those consolidated financial statements. The Company's management is responsible for these financial statements and financial statement schedule, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in management's report referred to above. Our responsibility is to express opinions on these financial statements, on the financial statement schedule, and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of financial statements included 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. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

As discussed in Note 2 to the consolidated financial statements, the Company changed the manner in which it accounts for share-based compensation in 2006 and the manner in which it accounts for uncertain tax positions in 2007.

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

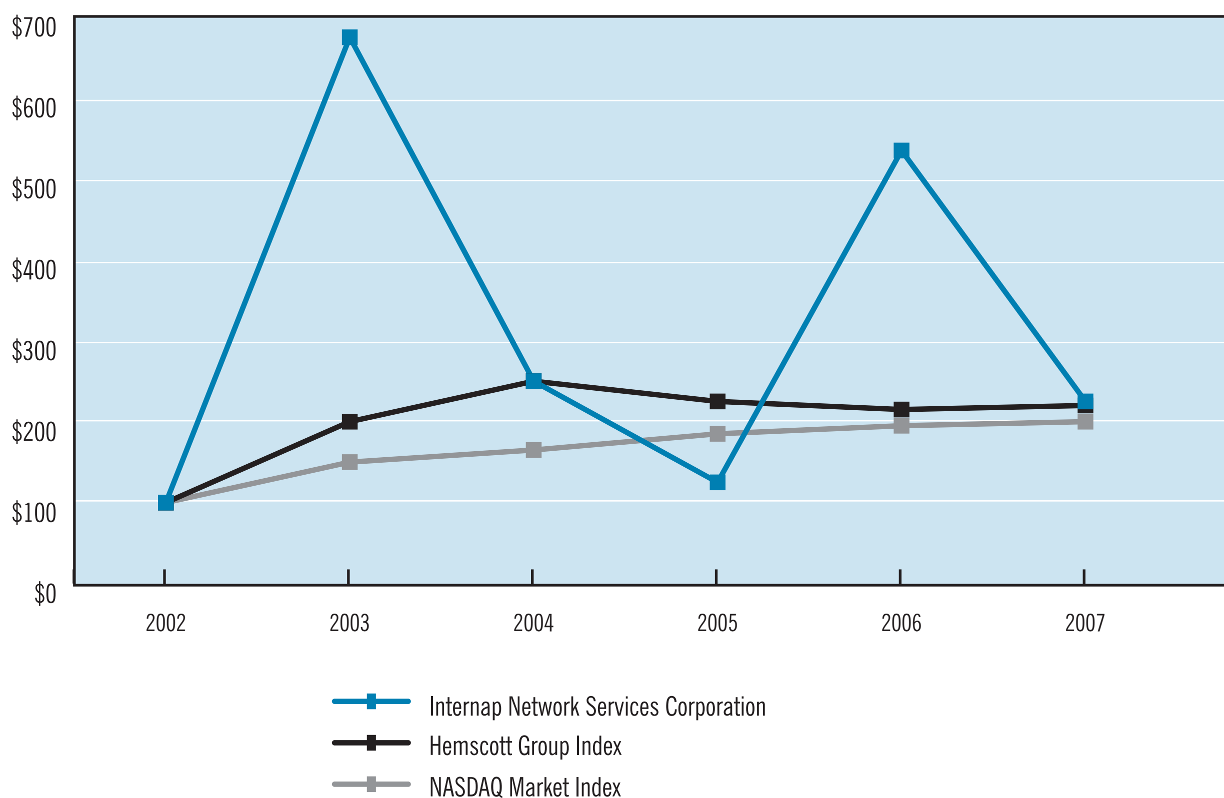
Atlanta, GA
March 28, 2008

STOCK PERFORMANCE GRAPH

Financial Review 2007

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 and the Hemscott Group Index, resulting from an initial assumed investment of $100 in each on December 31, 2002, assuming the reinvestment of any dividends, ending at December 31, of each year, 2003 – 2007, respectively.

COMPARISON OF 5-YEAR CUMULATIVE TOTAL RETURN AMONG INTERNAP NETWORK SERVICES CORP., NASDAQ MARKET INDEX AND HEMSCOTT GROUP INDEX



Assumes $100 Invested on Dec. 31, 2002
Assumes Dividend Reinvested
Fiscal Year Ending Dec. 31, 2007

STOCKHOLDER INFORMATION

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250 Williams Street
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404-302-9700
www.internap.com

Investor Relations
Andrew McBath
Director, Investor Relations
404-302-9700

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
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Annual Report
A copy of Internap's 2007 Annual Report on Form 10-K/A for the year ended December 31, 2007, 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
Our 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 Small Cap Market from October 4, 2002 through February 17, 2004. The following table presents, for the periods indicated, the range of high and low per share sales prices for our common stock, as reported on the NASDAQ Global Market since September 19, 2006 and on the American Stock Exchange prior to September 19, 2006.

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

	High	Low
Year Ended December 31, 2007		
Fourth Quarter	$17.18	$ 8.14
Third Quarter	16.15	13.04
Second Quarter	19.33	12.95
First Quarter	20.98	15.60
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

As of March 6, 2008, the number of stockholders of record of our common stock was approximately 24,600.

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.

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.

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