

INTERNAP NETWORK SERVICES CORP  
Form 10-Q  
April 28, 2011

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

x

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

For the quarterly period ended March 31, 2011  
OR

o

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 000-27265

INTERNAP NETWORK SERVICES CORPORATION  
(Exact Name of Registrant as Specified in Its Charter)

DELAWARE  
(State or Other Jurisdiction of  
Incorporation or Organization)

91-2145721  
(I.R.S. Employer  
Identification No.)

250 Williams Street  
Atlanta, Georgia 30303  
(Address of Principal Executive Offices, Including Zip Code)

(404) 302-9700  
(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

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Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer   
Non-accelerated filer  Smaller reporting company

(Do not check if a smaller reporting company)

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

As of April 22, 2011, 52,262,023 shares of the registrant's outstanding common stock, \$0.001 par value per share, were outstanding.

INTERNAP NETWORK SERVICES CORPORATION  
FORM 10-Q  
FOR THE QUARTER ENDED MARCH 31, 2011  
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## Part 1. FINANCIAL INFORMATION

## Item 1. FINANCIAL STATEMENTS

INTERNAP NETWORK SERVICES CORPORATION AND SUBSIDIARIES  
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share amounts)

|  | Three Months Ended<br>March 31, |           |
|--|---------------------------------|-----------|
|  | 2011                            | 2010      |
| Revenues:  |                                 |           |
| Data center services   | \$ 31,542                       | \$ 33,722 |
| Internet protocol (IP) services  | 27,862                          | 29,643    |
| Total revenues   | 59,404                          | 63,365    |
| Operating costs and expenses:  |                                 |           |
| Direct costs of network, sales and services, exclusive of depreciation and amortization,<br>shown below: |                                 |           |
| Data center services   | 18,530                          | 23,043    |
| IP services  | 10,500                          | 11,042    |
| Direct costs of customer support   | 5,110                           | 4,940     |
| Direct costs of amortization of acquired technologies  | 875                             | 979       |
| Sales and marketing  | 7,833                           | 7,124     |
| General and administrative   | 9,129                           | 8,330     |
| Depreciation and amortization  | 8,053                           | 7,774     |
| Loss on disposal of property and equipment, net  | 73                              | 1         |
| Restructuring  | 189                             | 18        |
| Total operating costs and expenses   | 60,292                          | 63,251    |
| (Loss) income from operations  | (888 )                          | 114       |
| Non-operating expense (income):  |                                 |           |
| Interest expense   | 648                             | 304       |
| Interest income  | —                               | (29 )     |
| Other, net   | 38                              | 30        |
| Total non-operating expense (income)   | 686                             | 305       |
| Loss before income taxes and equity in (earnings) of equity-method investment                            | (1,574 )                        | (191 )    |
| Provision for income taxes   | 73                              | 156       |
| Equity in (earnings) of equity-method investment, net of taxes   | (147 )                          | (87 )     |
| Net loss   | \$(1,500 )                      | \$(260 )  |
| Basic and diluted net loss per share   | \$(0.03 )                       | \$(0.01 ) |

|  |        |        |
|--|--------|--------|
| Weighted average shares outstanding used in computing basic and diluted net loss per share | 50,124 | 49,944 |
|--|--------|--------|

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

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INTERNAP NETWORK SERVICES CORPORATION AND SUBSIDIARIES  
UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except par value amounts)

|  | March 31,<br>2011 | December<br>31,<br>2010 |
|--|-------------------|-------------------------|
| <b>ASSETS</b>  |                   |                         |
| Current assets:  |                   |                         |
| Cash and cash equivalents  | \$46,298          | \$59,582                |
| Accounts receivable, net of allowance for doubtful accounts of \$1,682 and \$1,883, respectively | 16,460            | 17,588                  |
| Inventory  | 171               | 160                     |
| Prepaid expenses and other assets  | 11,296            | 11,057                  |
| <b>Total current assets</b>  | <b>74,225</b>     | <b>88,387</b>           |
| Property and equipment, net  | 156,323           | 142,289                 |
| Investment   | 2,488             | 2,265                   |
| Intangible assets, net   | 13,824            | 14,698                  |
| Goodwill   | 39,464            | 39,464                  |
| Deposits and other assets  | 3,971             | 3,600                   |
| Deferred tax asset, net  | 2,484             | 2,439                   |
| <b>Total assets</b>  | <b>292,779</b>    | <b>\$293,142</b>        |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>  |                   |                         |
| Current liabilities:   |                   |                         |
| Accounts payable   | \$18,410          | \$25,383                |
| Accrued liabilities  | 7,889             | 8,975                   |
| Deferred revenues  | 3,030             | 3,268                   |
| Capital lease obligations  | 171               | 1,071                   |
| Term loan, less discount of \$118 and \$116, respectively  | 882               | 884                     |
| Restructuring liability  | 2,587             | 2,691                   |
| Other current liabilities  | 138               | 135                     |
| <b>Total current liabilities</b>   | <b>33,107</b>     | <b>42,407</b>           |
| Deferred revenues  | 2,242             | 2,134                   |
| Capital lease obligations  | 29,085            | 19,139                  |
| Term loan, less discount of \$296 and \$328, respectively  | 18,204            | 18,422                  |
| Restructuring liability  | 4,880             | 5,273                   |
| Deferred rent  | 16,585            | 16,655                  |
| Other long-term liabilities  | 467               | 501                     |
| <b>Total liabilities</b>   | <b>104,570</b>    | <b>104,531</b>          |
| Commitments and contingencies  |                   |                         |
| Stockholders' equity:  |                   |                         |
| Preferred stock, \$0.001 par value, 20,000 shares authorized; no shares issued or outstanding    | —                 | —                       |

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|  |             |             |
|--|-------------|-------------|
| Common stock, \$0.001 par value; 120,000 shares authorized and 52,274 shares outstanding at March 31, 2011; 120,000 shares authorized and 52,017 shares outstanding at December 31, 2010 | 52          | 52          |
| Additional paid-in capital   | 1,231,063   | 1,229,684   |
| Treasury stock, at cost, 190 and 115 shares, respectively  | (1,001 )    | (520 )      |
| Accumulated deficit  | (1,041,670) | (1,040,170) |
| Accumulated items of other comprehensive loss  | (235 )      | (435 )      |
| Total stockholders' equity   | 188,209     | 188,611     |
| Total liabilities and stockholders' equity   | \$292,779   | \$293,142   |

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



INTERNAP NETWORK SERVICES CORPORATION AND SUBSIDIARIES  
 UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF  
 STOCKHOLDERS' EQUITY AND COMPREHENSIVE LOSS  
 (In thousands)

|  | Common<br>Stock |              | Additional<br>Paid-In<br>Capital | Treasury<br>Stock | Accumulated<br>Deficit | Accumulated<br>Items of<br>Comprehensive<br>Loss | Total<br>Stockholders'<br>Equity |
|--|-----------------|--------------|----------------------------------|-------------------|------------------------|--|----------------------------------|
|  | Shares          | Par<br>Value |                                  |                   |                        |  |                                  |
| <b>THREE MONTHS ENDED MARCH 31, 2011:</b>                            |                 |              |                                  |                   |                        |  |                                  |
| Balance, December 31, 2010   | 52,017          | \$ 52        | \$ 1,229,684                     | \$ (520 )         | \$ (1,040,170)         | \$ (435 )  | \$ 188,611                       |
| Net loss   | —               | —            | —                                | —                 | (1,500 )               | —  | (1,500 )                         |
| Foreign currency translation adjustment                              | —               | —            | —                                | —                 | —                      | 200  | 200                              |
| Total comprehensive loss   |                 |              |                                  |                   |                        |  | (1,300 )                         |
| Stock-based compensation plans activity and stock-based compensation | 257             | —            | 1,379                            | (481 )            | —                      | —  | 898                              |
| Balance, March 31, 2011  | 52,274          | \$ 52        | \$ 1,231,063                     | \$ (1,001 )       | \$ (1,041,670)         | \$ (235 )  | \$ 188,209                       |
| <b>THREE MONTHS ENDED MARCH 31, 2010:</b>                            |                 |              |                                  |                   |                        |  |                                  |
| Balance, December 31, 2009   | 50,763          | \$ 51        | \$ 1,221,456                     | \$ (127 )         | \$ (1,036,548)         | \$ (430 )  | \$ 184,402                       |
| Net loss   | —               | —            | —                                | —                 | (260 )                 | —  | (260 )                           |
| Foreign currency translation adjustment                              | —               | —            | —                                | —                 | —                      | (225 )   | (225 )                           |
| Total comprehensive loss   |                 |              |                                  |                   |                        |  | (485 )                           |
| Stock-based compensation plans activity and stock-based compensation | 1,069           | 1            | 3,934                            | (177 )            | —                      | —  | 3,758                            |
| Balance, March 31, 2010  | 51,832          | \$ 52        | \$ 1,225,390                     | \$ (304 )         | \$ (1,036,808)         | \$ (655 )  | \$ 187,675                       |

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

INTERNAP NETWORK SERVICES CORPORATION AND SUBSIDIARIES  
 UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
 (In thousands)

|   | Three Months Ended<br>March 31, |           |
|---|---------------------------------|-----------|
|   | 2011                            | 2010      |
| <b>Cash Flows from Operating Activities:</b>                                    |                                 |           |
| Net loss  | \$(1,500 )                      | \$ (260 ) |
| Adjustments to reconcile net loss to net cash provided by operating activities: |                                 |           |
| Depreciation and amortization   | 8,928                           | 8,753     |
| Loss on disposal of property and equipment, net                                 | 73                              | 1         |
| Stock-based compensation expense  | 911                             | 991       |
| Equity in (earnings) from equity-method investment                              | (147 )                          | (87 )     |
| Provision for doubtful accounts   | 165                             | 330       |
| Non-cash changes in deferred rent   | (70 )                           | 357       |
| Deferred income taxes   | (45 )                           | 297       |
| Other, net  | 156                             | (12 )     |
| Changes in operating assets and liabilities:                                    |                                 |           |
| Accounts receivable   | 963                             | (414 )    |
| Inventory, prepaid expenses, deposits and other assets                          | (657 )                          | (153 )    |
| Accounts payable  | (6,973 )                        | 1,447     |
| Accrued and other liabilities   | (1,086 )                        | (1,812 )  |
| Deferred revenues   | (130 )                          | (523 )    |
| Accrued restructuring liability   | (497 )                          | (622 )    |
| Net cash flows provided by operating activities                                 | 91                              | 8,293     |
| <b>Cash Flows from Investing Activities:</b>                                    |                                 |           |
| Maturities of investments in marketable securities                              | —                               | 100       |
| Purchases of property and equipment   | (12,650 )                       | (3,908 )  |
| Proceeds from disposal of property and equipment                                | 4                               | 1         |
| Net cash flows used in investing activities                                     | (12,646 )                       | (3,807 )  |
| <b>Cash Flows from Financing Activities:</b>                                    |                                 |           |
| Proceeds from credit agreements   | —                               | 19,500    |
| Principal payments on credit agreements   | (250 )                          | (19,500 ) |
| Payments on capital lease obligations   | (361 )                          | (13 )     |
| Stock-based compensation plans  | (115 )                          | 2,762     |
| Other, net  | (33 )                           | (30 )     |
| Net cash flows (used in) provided by financing activities                       | (759 )                          | 2,719     |
| Effect of exchange rates on cash and cash equivalents                           | 30                              | (23 )     |
| Net (decrease) increase in cash and cash equivalents                            | (13,284 )                       | 7,182     |
| Cash and cash equivalents at beginning of period                                | 59,582                          | 73,926    |
| Cash and cash equivalents at end of period                                      | \$46,298                        | \$ 81,108 |
| <b>Supplemental disclosure of cash flow information:</b>                        |                                 |           |
| Cash paid for interest, net of amounts capitalized                              | \$907                           | \$ 172    |
| Cash paid for income taxes  | 142                             | 82        |
| Non-cash acquisition of property and equipment under capital leases             | 9,258                           | 16,528    |
| Capitalized stock-based compensation  | 104                             | 4         |

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

INTERNAP NETWORK SERVICES CORPORATION AND SUBSIDIARIES  
UNAUDITED CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. NATURE OF OPERATIONS AND BASIS OF PRESENTATION

Internap Network Services Corporation (“Internap,” “we,” “us” or “our”) provides high-performance IT infrastructure services that enable our customers to focus on their core business, improve service levels and lower the cost of IT operations. Our colocation, connectivity and managed hosting solutions are differentiated by superior performance, availability and support.

We provide services at 37 data centers across North America, Europe and the Asia-Pacific region and through 77 Internet Protocol (“IP”) service points, which include 18 content delivery network (“CDN”) points of presence (“POPs”) and one additional standalone CDN POP.

We prepare our unaudited condensed consolidated financial statements pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”) which include all of our accounts and those of our wholly owned subsidiaries. As permitted by such rules and regulations, we have condensed or omitted certain information and note disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”). The unaudited condensed consolidated financial statements reflect all adjustments, which consist of normal recurring adjustments, necessary for a fair statement of our financial position as of March 31, 2011 and our operating results, cash flows and changes in stockholders’ equity for the interim periods presented. We derived the balance sheet at December 31, 2010 from our audited financial statements as of that date. You should read these financial statements and the related notes in conjunction with our financial statements and notes thereto contained in our Annual Report on Form 10-K for the year ended December 31, 2010 filed with the SEC.

The preparation of financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates, including those related to revenue recognition, doubtful accounts, goodwill and intangible assets, accruals, stock-based compensation, income taxes, restructuring charges, leases, long-term service contracts, contingencies and litigation. We base our estimates on historical experience and on various other assumptions that we believe 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.

The results of operations for the three months ended March 31, 2011 are not necessarily indicative of the results that may be expected for any future periods or for the year ending December 31, 2011 or subsequent years.

Certain prior period information has been reclassified to conform to the current period presentation.

2. REVENUE RECOGNITION

In January 2011, we adopted new guidance, which eliminates the residual method of allocation for multiple-deliverable revenue arrangements, and requires that arrangement consideration be allocated at the inception of an arrangement to all deliverables using the relative selling price method. This new guidance also establishes a selling price hierarchy for determining the selling price of a deliverable, which includes (a) vendor-specific objective evidence, if available, (b) third-party evidence, if vendor-specific objective evidence is not available, and (c) best estimated selling price, if neither vendor-specific nor third-party evidence is available. Additionally, the disclosure requirements have been expanded related to a vendor’s multiple-deliverable revenue arrangements. Adoption of this

guidance did not have a material impact on our consolidated financial statements.

Vendor-specific objective evidence is generally limited to the price charged when the same or similar product is sold separately. If a product or service is seldom sold separately, it is unlikely that we will determine vendor-specific objective evidence for the product or service. We define vendor-specific objective evidence as a median price of recent standalone transactions that are priced within a narrow range as defined by us.

Third-party evidence is determined based on the prices charged by our competitors for a similar deliverable when sold separately. It is difficult for us to obtain sufficient information on competitor pricing to substantiate third-party evidence and therefore we may not always be able to use this measure.

If we are unable to establish selling price using vendor-specific objective evidence or third-party evidence, and a sales order is received or materially modified after our implementation date of January 1, 2011, we use best estimated selling price in our allocation of arrangement consideration. The objective of best estimated selling price is to determine the price at which we would transact if the product or service were sold by us on a standalone basis. Our determination of best estimated selling price involves a weighting of several factors including, but not limited to, pricing practices and market conditions.

We analyze the selling prices used in our allocation of arrangement consideration at a minimum on an annual basis. We will analyze selling prices on a more frequent basis if a significant change in our business necessitates a more timely analysis or if we experience significant variances in our selling prices.

Each deliverable within a multiple-deliverable revenue arrangement is accounted for as a separate unit of accounting under the new guidance if both of the following criteria are met: (a) the delivered item or items have value to the customer on a standalone basis and (b) for an arrangement that includes a general right of return relative to the delivered item(s), delivery or performance of the undelivered item(s) is considered probable and substantially in our control. We consider a deliverable to have standalone value if we sell this item separately or if the item is sold by another vendor or could be resold by the customer. Further, our revenue arrangements generally do not include a general right of return relative to delivered products.

Deliverables not meeting the criteria for being a separate unit of accounting are combined with a deliverable that does meet that criterion. We then determine the appropriate allocation of arrangement consideration and recognition of revenue for the combined unit of accounting.

For additional information regarding our revenue recognition accounting policies, see our Annual Report on Form 10-K for the year ended December 31, 2010 and the condensed consolidated financial statements contained therein.

### 3. OPERATING SEGMENTS

We operate in two business segments: data center services and IP services. The data center services segment includes colocation services, which involve physical space for hosting customers' IT infrastructure network and other equipment, as well as associated services such as redundant power and network connectivity, environmental controls and security. The segment also includes managed hosting services whereby customers own and manage the software applications and content, while we provide and maintain the hardware, operating system, colocation and bandwidth. The IP services segment represent our IP transit activities and include our patented Performance IPTM service, our XIPTM Acceleration-as-a-Service solution, CDN services and FCP products.

The following table shows operating results for our business segments, along with reconciliations from segment gross profit to loss before income taxes and equity in (earnings) of equity-method investment:

|   | Three Months Ended<br>March 31, |          |
|---|---------------------------------|----------|
|   | 2011                            | 2010     |
| Revenues:   |                                 |          |
| Data center services  | \$31,542                        | \$33,722 |
| IP services   | 27,862                          | 29,643   |
| Total revenues:   | 59,404                          | 63,365   |
| Direct costs of network, sales and services, exclusive of depreciation and amortization:      |                                 |          |
| Data center services  | 18,530                          | 23,043   |
| IP center services  | 10,500                          | 11,042   |
| Total direct costs of network, sales and services, exclusive of depreciation and amortization | 29,030                          | 34,085   |
| Segment profit:   |                                 |          |
| Data center services  | 13,012                          | 10,679   |
| IP services   | 17,362                          | 18,601   |
| Total segment profit  | 30,374                          | 29,280   |

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|   |            |          |
|---|------------|----------|
| Restructuring   | 189        | 18       |
| Other operating expenses, including direct costs of customer support, depreciation and amortization | 31,073     | 29,148   |
| (Loss) income from operations   | (888 )     | 114      |
| Non-operating expense   | 686        | 305      |
| Loss before income taxes and equity in (earnings) of equity-method investment                       | \$(1,574 ) | \$(191 ) |

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## 4. RESTRUCTURING

In prior years, we implemented significant restructuring plans that resulted in substantial charges for our real estate obligations. The following table displays the restructuring activity and balances during the three months ended March 31, 2011 (in thousands):

|  | December<br>31,<br>2010<br>Restructuring<br>Liability | Subsequent<br>Plan<br>Adjustments | Cash<br>Payments | March 31,<br>2011<br>Restructuring<br>Liability |
|--|---|-----------------------------------|------------------|---|
| Activity for 2010<br>restructuring charge: |   |                                   |                  |   |
| Real estate obligations                    | \$ 12   | \$ —                              | \$ (8 )          | \$ 4  |
| Activity for 2007<br>restructuring charge: |   |                                   |                  |   |
| Real estate obligations                    | 5,635   | (50 )                             | (393 )           | 5,192   |
| Activity for 2001<br>restructuring charge: |   |                                   |                  |   |
| Real estate obligations                    | 2,317   | 129                               | (175 )           | 2,271   |
|  | \$ 7,964  | \$ 79                             | \$ (576 )        | \$ 7,467  |

## 5. INCOME TAXES

At the end of each quarterly reporting period, we estimate the effective income tax rate we expect to be applicable for the full year. We use the expected effective income tax rate to provide for income taxes on a year-to-date basis. We reflect the tax effect of any tax law changes and certain other discrete events in the period in which they occur.

Our overall effective income tax rate, as a percentage of pre-tax ordinary income, for the three months ended March 31, 2011 and 2010 was (5%) and (151%), respectively. The fluctuation in the effective income tax rate was due to recognition of income taxes in the United Kingdom ("U.K."), permanent tax adjustment items, a change in valuation allowance and state income taxes.

The annual effective tax rate for 2011 could change due to a number of factors including, but not limited to, our geographic profit mix between the United States ("U.S."), the U.K. and other foreign jurisdictions, new tax laws, new interpretations of existing tax law and rulings by and settlements with taxing authorities.

We continue to maintain a valuation allowance against our deferred tax assets of \$139.0 million. The total deferred tax assets primarily consist of net operating loss carryforwards. We may recognize U.S. deferred tax assets in future periods when we estimate them to be realizable. Based on an analysis of our historic and projected future U.S. pre-tax income, we do not have sufficient positive evidence to expect a release of our valuation allowance against our U.S. deferred tax assets currently or within the next 12 months. Accordingly, we continue to maintain the full valuation allowance in the U.S. and all foreign jurisdictions, other than the U.K.

For the three months ended March 31, 2011, there were no new material uncertain tax positions. Also, we do not expect the total amount of unrecognized tax benefits to significantly increase or decrease within the next 12 months.

## 6. LOSS PER SHARE

We calculated basic and diluted net loss per share as follows (in thousands, except per share amounts):

|  | Three Months Ended<br>March 31, |           |
|--|---------------------------------|-----------|
|  | 2011                            | 2010      |
| Net loss and net loss available to common stockholders   | \$(1,500 )                      | \$(260 )  |
| Weighted average shares outstanding, basic and diluted   | 50,124                          | 49,944    |
| Net loss per share, basic and diluted  | \$(0.03 )                       | \$(0.01 ) |
| Anti-dilutive securities excluded from diluted net loss per share calculation for stock-based compensation plans | 6,688                           | 6,144     |

## 7. FAIR VALUE MEASUREMENTS

We account for certain assets and liabilities at fair value. The hierarchy below lists three levels of fair value based on the extent to which inputs used in measuring fair value are observable in the market. We categorize each of our fair value measurements in one of these three levels based on the lowest level input that is significant to the fair value measurement in its entirety. These levels are:

Level 1: Quoted prices in active markets for identical assets or liabilities;

Level 2: Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities; and

Level 3: Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The following table represents the fair value hierarchy for our financial assets (cash equivalents, investments in marketable securities and other related assets) measured at fair value on a recurring basis (in thousands):

|                                       | Level 1  | Level 2 | Level 3 | Total    |
|---------------------------------------|----------|---------|---------|----------|
| March 31, 2011 and December 31, 2010: |          |         |         |          |
| Available for sale securities:        |          |         |         |          |
| Money market funds(1)                 | \$39,283 | \$—     | \$—     | \$39,283 |
|                                       | \$39,283 | \$—     | \$—     | \$39,283 |

- (1) Included in “Cash and cash equivalents” in the consolidated balance sheets as of March 31, 2011 and December 31, 2010 in addition to \$7.0 million and \$20.3 million, respectively, of cash. Unrealized gains and losses on money market funds were nominal due to the short-term nature of the investments.

## 8. CONTINGENCIES AND LITIGATION

**Securities Class Action Litigation.** On November 12, 2008, a putative securities fraud class action lawsuit was filed against us and our former chief executive officer in the United States District Court for the Northern District of Georgia, captioned Catherine Anastasio and Stephen Anastasio v. Internap Network Services Corp. and James P. DeBlasio, Civil Action No. 1:08-CV-3462-JOF. The complaint alleges that we and the individual defendant violated Section 10(b) of the Securities Exchange Act of 1934 (the “Exchange Act”) and that the individual defendant also violated Section 20(a) of the Exchange Act as a “control person” of Internap. Plaintiffs purport to bring these claims on behalf of a class of our investors who purchased our common stock between March 28, 2007 and March 18, 2008.

Plaintiffs allege generally that, during the putative class period, we made misleading statements and omitted material information regarding (a) integration of VitalStream, which we acquired in 2007, (b) customer issues and related credits due to services outages and (c) our previously reported 2007 revenue that we subsequently reduced in 2008 as announced on March 18, 2008. Plaintiffs assert that we and the individual defendant made these misstatements and omissions to keep our stock price high. Plaintiffs seek unspecified damages and other relief.

On August 12, 2009, the Court granted plaintiffs leave to file an Amended Class Action Complaint (“Amended Complaint”). The Amended Complaint added a claim for violation of Section 14(a) of the Exchange Act based on alleged misrepresentations in our proxy statement in connection with our acquisition of VitalStream. The Amended Complaint also added our former chief financial officer as a defendant and lengthened the putative class period.

On September 11, 2009, we and the individual defendants filed motions to dismiss. On November 6, 2009, plaintiffs filed a Corrected Amended Class Action Complaint. On December 7, 2009, plaintiffs filed a motion for leave to file a Second Amended Class Action Complaint to add allegations regarding, inter alia, an alleged failure to conduct due diligence in connection with the VitalStream acquisition and additional statements from purported confidential witnesses.

On September 15, 2010, the Court granted our motion to dismiss and denied the individual defendants’ motion to dismiss. The Court dismissed plaintiffs’ claims under Section 14(a) of the Exchange Act. With respect to plaintiffs’ claims under Section 10(b) of the Exchange Act, the Court held that the Amended Complaint failed to satisfy the pleading requirements of the Private Securities Litigation Reform Act, but allowed plaintiffs’ one final opportunity to amend the complaint. On October 26, 2010, plaintiffs filed their Third Amended Class Action Complaint. On December 10, 2010, we filed a motion to dismiss this complaint, which is currently pending before the Court.

Derivative Action Litigation. On November 12, 2009, stockholder Walter M. Unick filed a putative derivative action purportedly on behalf of Internap against certain of our directors and officers in the Superior Court of Fulton County, Georgia, captioned Unick v. Eidenberg, et al., Case No. 2009cv177627. This action is based upon substantially the same facts alleged in the securities class action litigation described above. The complaint seeks to recover damages in an unspecified amount. On January 28, 2010, the Court entered the parties' agreed order staying the matter until the motions to dismiss are resolved in the securities class action litigation.

While we intend to vigorously contest these lawsuits, we cannot determine the final resolution of the lawsuits or when they might be resolved. In addition to the expenses incurred in defending this litigation and any damages that may be awarded in the event of an adverse ruling, our management's efforts and attention may be diverted from the ordinary business operations to address these claims. Regardless of the outcome, this litigation described above may have a material adverse impact on our financial results because of defense costs, including costs related to our indemnification obligations, diversion of resources and other factors.

We are subject to other 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 impact on our financial condition, results of operations or cash flows.

#### 9. CAPITAL LEASE OBLIGATIONS

We record capital lease obligations, leased property and equipment at the time of entering into the respective lease at the lesser of the present value of future lease payments based upon the terms of the related lease agreement or the fair value of the assets held under capital leases. As of March 31, 2011, our capital leases had expiration dates ranging from 2011 to 2023.

During the three months ended March 31, 2011, we entered into a lease for a new company-controlled data center in Dallas, Texas. As a result, property and equipment and corresponding capital lease obligations increased by \$9.3 million.

Future minimum capital lease payments and the present value of the minimum lease payments for all capital leases as of March 31, 2011, are as follows (in thousands):

|   |           |
|---|-----------|
| 2011  | \$ 2,230  |
| 2012  | 3,637     |
| 2013  | 4,568     |
| 2014  | 4,629     |
| 2015  | 4,758     |
| Thereafter                                  | 29,261    |
| Remaining capital lease payments            | 49,083    |
| Less: amounts representing imputed interest | (19,827)  |
| Present value of minimum lease payments     | 29,256    |
| Less: current portion                       | (171)     |
|   | \$ 29,085 |

#### 10. SUBSEQUENT EVENT

On April 26, 2011, we entered into a lease for new company-controlled data center space in Los Angeles, California. The lease has a term of 11 years and will expand our company controlled data center footprint by approximately 55,000 net sellable square feet over time.

INTERNAP NETWORK SERVICES CORPORATION AND SUBSIDIARIES

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This Quarterly Report on Form 10-Q contains "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements include statements regarding industry trends, our future financial position and performance, business strategy, revenues and expenses in future periods, projected levels of growth, impairments, levels of cash, utilization of borrowings and financing needs, performance of and demand for our IT infrastructure services, results of litigation and other matters that do not relate strictly to historical facts. These statements are often identified by the use of words such as "may," "will," "seeks," "anticipates," "believes," "estimates," "expects," "projects," "forecasts," "plans," "intends," "continue," "could," "should" or similar expressions or variations. These statements are based on the beliefs and expectations of our management team based on information currently available. Such forward-looking statements are not guarantees of future performance and are subject to risks and uncertainties that could cause actual results to differ materially from those contemplated by forward-looking statements. Important factors currently known to our management that could cause or contribute to such differences include, but are not limited to, those referenced in this Quarterly Report on Form 10-Q under Part II Item 1A "Risk Factors." We undertake no obligation to update any forward-looking statements as a result of new information, future events or otherwise.

As used herein, except as otherwise indicated by context, references to "we," "us," "our" or "Internap" refer to Internap Network Services Corporation.

Overview

Internap provides high-performance IT infrastructure services that enable our customers to focus on their core business, improve service levels and lower the cost of IT operations. Our colocation, connectivity and managed hosting solutions are differentiated by superior performance, availability and support.

Data center services are comprised of colocation and managed hosting. Colocation allows our customers to deploy and manage their servers, storage and other equipment in our secure data centers. Our managed hosting services increase our customers' operating flexibility while eliminating the need to provision and manage their own data centers, servers, storage and operating systems.

We sell our colocation and/or managed hosting services at 37 data centers across North America, Europe and the Asia-Pacific region. We refer to nine of these facilities as "company-controlled," meaning we control the data centers' operations and infrastructure and have directly negotiated long-term leases with the properties' lessors. We refer to the remaining 28 data centers as "partner" sites. In these locations, we typically do not control operations and infrastructure and terms are shorter than those in company-controlled data centers. Our company-controlled facilities feature our enhanced IP connectivity, are designed and operated to be fully-secure and provide best-in-class power and environmental reliability.

IP services include our patented Performance IP™ service, XIP™ Acceleration-as-a-Service solution, content delivery network ("CDN") and flow control platform ("FCP") products. By intelligently routing traffic with redundant, high-speed connections over multiple major Internet backbones, our IP services provide high-performance and highly-reliable delivery of content, applications and communications to end-users globally. Our IP services are sold through 77 Internet Protocol ("IP") service points around the world, which include 18 CDN points of presence ("POPs") and one additional standalone CDN POP. Our service level agreements ("SLAs") guarantee performance across multiple networks covering a broader segment of the Internet in the United States, excluding local connections, than providers

of conventional Internet connectivity, which typically only guarantee performance on their own network.

We currently have approximately 2,700 customers across 28 metropolitan markets, serving a variety of industries, such as entertainment and media, including gaming; financial services; business services; software, including software-as-a-service (“SaaS”); hosting and information technology infrastructure; and telecommunications. For the three months ended March 31, 2011, revenues generated and long-lived assets located outside the United States (“U.S.”) were each less than 10% of our total revenues and assets.

#### Operating Segments

##### Data Center Services

Our data center services segment includes colocation services, which involve physical space for hosting customers’ IT infrastructure network and other equipment as well as associated services such as redundant power and network connectivity, environmental controls and security. The segment also includes managed hosting services whereby our customers own and manage the software applications and content, while we provide and maintain the hardware, operating system, data center infrastructure and bandwidth. Managed hosting also includes our new public cloud storage service in its beta stage.

Our data center services enable us to have a broader product offering that provides customer flexibility and the ability to bundle these services with our high performance IP connectivity and CDN services, along with hosting customers’ infrastructure, data and applications. Our data center services provide a single source for network infrastructure, IP connectivity and security, all of which are designed to maximize solution performance while providing a more stable, dependable infrastructure, and are backed by SLAs and our team of dedicated support professionals.

We believe the demand for data center services continues to outpace industry-wide supply. To address this demand, during the three months ended March 31, 2011, we began to build-out our new company-controlled data center in Dallas, Texas. We expect this expansion to increase the footprint of our company-controlled data centers by 55,000 net sellable square feet over time.

As a service provider in today's global economy, we must demonstrate that we have adequate controls and safeguards in place to protect our customers' infrastructure in our data centers. To do this, we utilize a third-party service auditor (an independent accounting firm) to perform an examination in accordance with Statement on Auditing Standards No. 70 (commonly referred to as a "SAS 70" Audit) and issue a Type II report which includes a description of our controls, along with detailed testing of the design and operation of these controls. We have SAS 70 Audits performed at our company-controlled data centers every six months. Additionally, the underlying providers for several of our partner sites also have SAS 70 Audits performed and we have obtained and reviewed these reports to our satisfaction.

### IP Services

IP services represent our IP transit activities and include our patented Performance IP service, XIP Acceleration-as-a-Service solution, CDN services and FCP products. Our intelligent routing technology facilitates traffic over multiple carriers' networks, as opposed to just one carrier's network, to ensure highly-reliable performance over the Internet. We believe that our unique managed multi-network approach provides better performance, control and reliability as compared to conventional Internet connectivity alternatives.

Our patented and patent-pending network route optimization technologies address the inherent weaknesses of the Internet, allowing businesses to take advantage of the convenience, flexibility and reach of the Internet to connect to customers, suppliers and partners, and to adopt new information technology delivery models, in a reliable and predictable manner. Our services and products take into account the unique performance requirements of each business application to ensure performance as designed, without unnecessary cost. Our fees for IP services are based on a fixed fee, usage or a combination of both.

Our CDN services enable our customers to quickly and securely stream and distribute rich media and content, such as video, audio software and applications, to audiences across the globe through strategically located data POPs. Providing capacity-on-demand to handle large events and unanticipated traffic spikes, we deliver scalable high-quality content distribution and the analytic tools to allow our customers to refine their marketing programs.

### Critical Accounting Policies and Estimates

In January 2011, we adopted new accounting guidance related to the accounting and disclosure for revenue recognition. This guidance, which was effective for us beginning January 1, 2011, modifies the criteria for recognizing revenue in multiple element arrangements and the scope of what constitutes a non-software deliverable. Adoption of this new guidance did not have a material impact on our consolidated financial statements.

We summarize our revenue recognition policies related to this new guidance in note 2 to the accompanying financial statements. For additional information regarding all of our revenue recognition accounting policies see our Annual Report on Form 10-K for the year ended December 31, 2010 and the condensed consolidated financial statements contained therein.



## Results of Operations

The following table sets forth selected consolidated statements of operations data during the periods presented, including comparative information between the periods (dollars in thousands):

|   | Three Months Ended |                   | Increase (decrease)                                |         |
|---|--------------------|-------------------|--|---------|
|   | 2011               | March 31,<br>2010 | from March 31, 2010 to<br>March 31, 2011<br>Amount | Percent |
| <b>Revenues:</b>  |                    |                   |  |         |
| Data center services  | \$31,542           | \$33,722          | \$(2,180 )   | (6 )%   |
| IP services   | 27,862             | 29,643            | (1,781 )   | (6 )    |
| Total revenues  | 59,404             | 63,365            | (3,961 )   | (6 )    |
| <b>Operating costs and expenses:</b>  |                    |                   |  |         |
| Direct costs of network, sales and services, exclusive of depreciation and amortization, shown below: |                    |                   |  |         |
| Data center services  | 18,530             | 23,043            | (4,513 )   | (20 )   |
| IP services   | 10,500             | 11,042            | (542 )   | (5 )    |
| Direct costs of customer support  | 5,110              | 4,940             | 170  | 3       |
| Direct costs of amortization of acquired technologies   | 875                | 979               | (104 )   | (11 )   |
| Sales and marketing   | 7,833              | 7,124             | 709  | 10      |
| General and administrative  | 9,129              | 8,330             | 799  | 10      |
| Depreciation and amortization   | 8,053              | 7,774             | 279  | 4       |
| Loss on disposals of property and equipment, net  | 73                 | 1                 | 72   | nm      |
| Restructuring   | 189                | 18                | 171  | 950     |
| Total operating costs and expenses  | 60,292             | 63,251            | (2,959 )   | (5 )    |
| (Loss) income from operations   | \$(888 )           | \$114             | \$(1,002 )   | (879 )  |
| Interest expense  | \$648              | \$304             | \$344  | 113     |
| Provision for income taxes  | \$73               | \$156             | \$(83 )  | (53 )%  |

## Three Months Ended March 31, 2011 and 2010

## Data Center Services

Revenues for data center services decreased \$2.2 million, or 6%, to \$31.5 million for the three months ended March 31, 2011, compared to \$33.7 million for the same period in 2010. The decrease in revenue in the three months ended March 31, 2011 was primarily due to our proactive churn program in the amount of \$3.2 million, which was offset by underlying revenue growth of \$1.0 million.

Direct costs of data center services, exclusive of depreciation and amortization, decreased \$4.5 million, or 20%, to \$18.5 million for the three months ended March 31, 2011, compared to \$23.0 million for the same period in 2010. The decrease was primarily the result of our efforts to proactively churn less profitable customers and contracts in partner sites.

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. Direct costs of data center services as a percentage of revenues vary with the mix of usage between company-controlled data centers and partner sites, as well as the utilization of total available space. While we recognize some of the initial operating

costs of company-controlled data centers in advance of revenues, these sites are more profitable at certain levels of utilization than are partner sites. Conversely, costs in partner sites are more demand-based and therefore are more closely associated with the recognition of revenues.

#### IP Services

Revenues for IP services decreased \$1.7 million, or 6%, to \$27.9 million for the three months ended March 31, 2011, compared to \$29.6 million for the same period in 2010. The decrease was driven by a decline in IP pricing for new and renewing customers and the loss of legacy contracts at higher effective prices, partially offset by an increase in overall traffic. IP traffic increased approximately 27% for the three months ended March 31, 2011, compared to the three months ended March 31, 2010, calculated based on an average over the sum of the months in the respective periods.

Direct costs of IP services, exclusive of depreciation and amortization, decreased \$0.5 million, or 5%, to \$10.5 million for the three months ended March 31, 2011, compared to \$11.0 million for the same period in 2010. This decrease was due to lower connectivity costs, which vary based upon customer traffic volume and other demand-based pricing variables. In addition, costs for IP services are subject to ongoing negotiations for pricing and minimum commitments. We expect to obtain lower bandwidth rates and more opportunities to proactively manage network costs, such as utilization and traffic optimization among network service providers.

## Other Operating Costs and Expenses

Compensation. Total compensation and benefits, including stock-based compensation, were \$14.9 million and \$13.7 million during the three months ended March 31, 2011 and 2010, respectively.

Cash-based compensation and benefits increased \$1.3 million to \$14.0 million during the three months ended March 31, 2011 from \$12.7 million during the same period in 2010. The increase was primarily due to a \$1.3 million increase in cash-based compensation and payroll taxes related to a higher employee headcount and increased salary levels, a \$0.6 million increase in severance and a \$0.2 million increase in commissions, offset by a \$0.9 million decrease due to capitalized payroll and benefit costs related to software development in 2011.

Stock-based compensation decreased \$0.1 million to \$0.9 million during the three months ended March 31, 2011 from \$1.0 million during the same period in 2010. The following table summarizes the amount of stock-based compensation, net of estimated forfeitures, included in the accompanying consolidated statements of operations during the three months ended March 31, 2011 and 2010 (in thousands):

|                                  | 2011   | 2010   |
|----------------------------------|--------|--------|
| Direct costs of customer support | \$ 179 | \$ 175 |
| Sales and marketing              | 228    | 256    |
| General and administrative       | 504    | 560    |
|                                  | \$ 911 | \$ 991 |

Direct Costs of Customer Support. Direct costs of customer support increased 3% to \$5.1 million during the three months ended March 31, 2011 from \$4.9 million during the same period in 2010. The increase was primarily due to a \$0.2 million increase in cash-based compensation related to a higher employee headcount and increased salary levels.

Direct Costs of Amortization of Acquired Technologies. Direct costs of amortization of acquired technologies were \$0.9 million and \$1.0 million during the three months ended March 31, 2011 and 2010, respectively.

Sales and Marketing. Sales and marketing costs during the three months ended March 31, 2011 increased 10% to \$7.8 million from \$7.1 million during the same period in 2010. The increase was primarily due to a \$0.4 million increase in cash-based compensation related to a higher employee headcount, a \$0.2 million increase in commissions and a \$0.4 million increase in training related to conference costs, offset by a \$0.3 million decrease in professional services related to recruiting fees.

General and Administrative. General and administrative costs during the three months ended March 31, 2011 increased 10% to \$9.1 million from \$8.3 million during the same period in 2010. The increase was primarily due to a \$0.6 million increase in severance, a \$0.5 million increase in cash-based compensation related to a higher employee headcount and increased salary levels, a \$0.2 million increase in the 2011 bonus accrual and an \$0.8 million increase in professional services, which includes \$0.5 million related to increased legal and accounting and audit fees and \$0.3 million related to the use of consultants for IT projects, offset by a \$0.5 million decrease in taxes, licenses and fees for the capitalization of use tax on equipment purchases related to our expansion of company-controlled data centers and P-NAP infrastructure and a \$0.9 million decrease due to capitalized payroll and benefit costs related to software development in 2011.

Depreciation and Amortization. Depreciation and amortization increased 4% to \$8.1 million during the three months ended March 31, 2011, compared to \$7.8 million during the same period in 2010. The increase was primarily due to the effects of our expansion of company-controlled data centers and P-NAP infrastructure.

**Interest Expense.** Interest expense increased to \$0.6 million during the three months ended March 31, 2011, compared to \$0.3 million during the same period in 2010. The increase in interest expense was primarily due to new capital lease obligations related to our expansion of company-controlled data centers that began at the end of the first quarter of 2010 and continued through March 31, 2011.

**Provision for Income Taxes.** The provision for income taxes was \$0.1 million during the three months ended March 31, 2011, compared to \$0.2 million during the same period in 2010. Our effective income tax rate, as a percentage of pre-tax income, for the three months ended March 31, 2011 and 2010 was (5%) and (151%), respectively. The fluctuation in the effective income tax rate was attributable to recognition of income taxes in the U.K., permanent tax adjustment items, a change in valuation allowance and state income taxes.

We continue to maintain a valuation allowance against our deferred tax assets of \$139.0 million. The total deferred tax assets primarily consist of net operating loss carryforwards. We may recognize U.S. deferred tax assets in future periods when we estimate them to be realizable. Based on an analysis of our historic and projected future U.S. pre-tax income, we do not have sufficient positive evidence to expect a release of our valuation allowance against our U.S. deferred tax assets currently or within the next 12 months. Accordingly, we continue to maintain the full valuation allowance in the U.S. and all foreign jurisdictions, other than the U.K.

## Liquidity and Capital Resources

### Liquidity

At March 31, 2011, we had \$46.3 million in cash and cash equivalents and \$48.8 million in debt obligations, which included \$29.3 million in capital leases and \$19.5 million borrowed under our term loan. Net cash flows provided by operations were \$0.1 million for the three months ended March 31, 2011.

We expect to meet our cash requirements for the next 12 months through a combination of net cash provided by operating activities and existing cash and cash equivalents. We may also utilize additional borrowings under our new credit agreement described below in “—Capital Resources—Credit Agreement,” particularly for capital expenditures 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 and the ability to expand and retain our customer base. If our cash requirements vary materially from those currently expected or if we fail to generate sufficient cash flows from selling 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 new credit facility limit our ability to incur additional indebtedness. We believe we have sufficient cash to operate our business for the next 12 months.

We monitor and review our performance and operations in light of global economic conditions. The current economic environment may impact the ability of our customers to meet their obligations to us, which could result in delayed collection of accounts receivable and an increase in our provision for doubtful accounts.

We have experienced significant impairments and operational restructurings in recent years, which included substantial changes in our senior management team, streamlining our cost structure, consolidating network access points and terminating certain non-strategic real estate leases and license arrangements. We have a history of quarterly and annual period net losses. During the three months ended March 31, 2011, we had a net loss of \$1.5 million. As of March 31, 2011, our accumulated deficit was \$1.0 billion. We do not expect to incur impairment charges on a regular basis, but we cannot guarantee that we will not incur other similar charges in the future or that we will be profitable in the future. Also, we continue to see signs of cautious behavior from our customers given economic conditions. 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. We may not be able to sustain or increase profitability on a quarterly basis, and our failure to do so may adversely affect our business, including our ability to raise additional funds.

### Cash Flows for the Three Months Ended March 31, 2011 and 2010

#### Operating Activities

Net cash provided by operating activities for the three months ended March 31, 2011 was \$0.1 million. Our net loss, after adjustments for non-cash items, generated cash from operations of \$8.5 million, while changes in operating assets and liabilities used cash from operations of \$8.4 million. We anticipate continuing to generate cash flows from our results of operations, adjusted for non-cash items, and managing changes in operating assets and liabilities toward a net \$0 change over time. We also expect to use cash flows from operating activities to fund a portion of our capital expenditures and other requirements and to meet our other commitments and obligations, including outstanding debt, as they become due.

The primary non-cash adjustment for the three months ended March 31, 2011 was \$8.9 million for depreciation and amortization, including direct costs of amortization of acquired technologies, which included the effects of the expansion of our company-controlled data centers and P-NAP facilities. Non-cash adjustments also included \$0.9

million for stock-based compensation expense. The changes in operating assets and liabilities included a \$7.0 million increase in accounts payable primarily due to expenses incurred as a result of the upgrade and expansion of our company-controlled data centers.

Days sales outstanding at March 31, 2011 was 25 days, down from 27 days at March 31, 2010. Days sales outstanding are measured as of a point in time and may fluctuate based on a number of factors, including, among other things, changes in revenues, cash collections, allowance for doubtful accounts and the amount of revenues billed in advance.

#### Investing Activities

Net cash used in investing activities for the three months ended March 31, 2011 was \$12.6 million primarily for capital expenditures, which related to the continued expansion and upgrade of our company-controlled data centers and network infrastructure.

#### Financing Activities

Net cash used in financing activities for the three months March 31, 2011 was \$0.8 million primarily due to principal payments on our credit agreement and capital lease obligations.

## Capital Resources

### Credit Agreement

We have an \$80.0 million credit agreement (the "Credit Agreement"), which provides for a four-year revolving credit facility up to \$40.0 million, which includes a \$10.0 million sub-limit for letters of credit. The Credit Agreement also provides for a four-year term loan up to \$40.0 million (the "Term Loan"). We borrowed \$20.0 million under the Term Loan at the closing of the Credit Agreement, and we have a one-time option to borrow an additional \$20.0 million until November 2012.

As of March 31, 2011, the Term Loan had an outstanding principal amount of \$19.5 million (due in quarterly installments with the remaining balance due November 2014), we issued \$4.6 million of letters of credit and we had an additional \$55.4 million in borrowing capacity under the Credit Agreement. As of March 31, 2011, the interest rate on the Term Loan was 3.56%.

We made customary representations, warranties, negative and affirmative covenants, including certain financial covenants relating to minimum liquidity 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 March 31, 2011, we were in compliance with these covenants.

### Capital Leases

During the three months ended March 31, 2011, we entered into a lease for a new company-controlled data center in Dallas, Texas. As a result, property and equipment and corresponding capital lease obligations increased by \$9.3 million.

We summarize our capital lease obligations in note 9 to the accompanying consolidated financial statements.

On April 26, 2011, we entered into a lease for new company-controlled data center space in Los Angeles, California. The lease has a term of 11 years and will expand our company controlled data center footprint by approximately 55,000 net sellable square feet over time.

## ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

### Other Investments

We have invested \$4.1 million in Internap Japan Co., Ltd., our joint venture with NTT-ME Corporation and NTT Holdings. We account for this investment using the equity method and we have recognized \$2.5 million in equity-method losses, representing our proportionate share of the aggregate joint venture losses and income. The joint venture investment is subject to foreign currency exchange rate risk.

### 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. As of March 31, 2011, our long-term debt consisted of \$19.5 million borrowed under our Term Loan with a current interest rate of 3.56%. We estimate that a change in the interest rate of 100 basis points would change our interest expense and payments by \$0.2 million per year, assuming we do not increase our amount outstanding.

#### Foreign Currency Risk

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

#### ITEM 4. CONTROLS AND PROCEDURES

##### Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of our disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of March 31, 2011.

##### Changes in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting that occurred during the quarter ended March 31, 2011 that has materially affected, or that is reasonably likely to materially affect, our internal control over financial reporting.



## PART II. OTHER INFORMATION

## ITEM 1. LEGAL PROCEEDINGS

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 impact on our financial condition, results of operations or cash flows.

## ITEM 1A. RISK FACTORS

There have been no material changes from the Risk Factors we previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2010 filed with the Securities and Exchange Commission on February 24, 2011.

## ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

The following table sets forth information regarding our repurchases of securities for each calendar month in the quarter ended March 31, 2011:

## ISSUER PURCHASES OF EQUITY SECURITIES

| Period                 | Total<br>Number<br>of Shares<br>Purchased* | Average<br>Price<br>Paid per<br>Share | Total<br>Number of<br>Shares<br>Purchased as<br>Part of<br>Publicly<br>Announced<br>Plans or<br>Programs | Maximum<br>Number<br>(or<br>Approximate<br>Dollar Value) of<br>Shares That<br>May Yet Be<br>Purchased<br>Under the<br>Plans<br>or Programs |
|------------------------|--|---------------------------------------|--|--|
| January 1 to 31, 2011  | 525  | \$ 6.84                               | —  | —  |
| February 1 to 28, 2011 | 13,039                                     | 7.08                                  | —  | —  |
| March 1 to 31, 2011    | 61,851                                     | 6.22                                  | —  | —  |
| Total                  | 75,415                                     | \$ 6.37                               | —  | —  |

\* These shares were surrendered to us to satisfy tax withholding obligations in connection with the vesting of shares of restricted stock previously issued to employees.

## ITEM 6. EXHIBITS

| Exhibit<br>Number | Description |
|-------------------|-------------|
|-------------------|-------------|

|      |  |
|------|--|
| 31.1 | Rule 13a-14(a)/15d-14(a) Certification, executed by J. Eric Cooney, President, Chief Executive Officer and Director of Internap. |
|------|--|

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- 31.2 Rule 13a-14(a)/15d-14(a) Certification, executed by George E. Kilguss, III, Chief Financial Officer of Internap.
- 32.1 Section 1350 Certification, executed by J. Eric Cooney, President, Chief Executive Officer and Director of Internap.
- 32.2 Section 1350 Certification, executed by George E. Kilguss, III, Chief Financial Officer of Internap.

INTERNAP NETWORK SERVICES CORPORATION AND SUBSIDIARIES

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized

INTERNAP NETWORK SERVICES  
CORPORATION

By: /s/ George E. Kilguss, III  
George E. Kilguss, III  
Chief Financial Officer  
(Principal Accounting Officer)

Date: April 28, 2011