NAVISITE INC
Form S-2/A
March 08, 2004

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As filed with the Securities and Exchange Commission on March 8, 2004

Registration Statement No. 333-112087

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Amendment No. 1
to

Form S-2

REGISTRATION STATEMENT
UNDER
THE SECURITIES ACT OF 1933

NaviSite, Inc.

(Exact name of Registrant as specified in its charter)

Delaware	**52-2137343**
(State or Other Jurisdiction of Incorporation or Organization)	*(I.R.S. Employer Identification Number)*

---

400 Minuteman Road
Andover, Massachusetts 01810
(978) 682-8300

(Address, Including Zip Code, and Telephone Number Including Area Code, of Registrant s Principal Executive Offices)

Arthur P. Becker
Chief Executive Officer and President
NaviSite, Inc.
400 Minuteman Road
Andover, Massachusetts 01810
(978) 682-8300

(Name, Address, Including Zip Code, and Telephone Number Including Area Code, of Agent for Service)

Copies to:

Thomas B. Rosedale **Kevin P. Lanouette** **Browne Rosedale & Lanouette LLP** **31 St. James Avenue, Suite 830** **Boston, MA 02116** **(617) 399-6931**	**Steven B. Stokdyk** **Sullivan & Cromwell LLP** **1888 Century Park East** **Los Angeles, CA 90067** **(310) 712-6600**

Approximate date of commencement of proposed sale to the public: As soon as practicable after this registration statement becomes effective.

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 of the Securities Act of 1933, check the following box. o

If the registrant elects to deliver its latest annual report to security holders, or a complete and legible facsimile thereof, pursuant to Item 11(a)(1) of this Form, check the following box. o

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act of 1933, please check the following box and list the Securities Act of 1933 registration statement number of the earlier effective registration statement for the same offering. o ______________

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act of 1933, check the following box and list the Securities Act of 1933 registration statement number of the earlier effective registration statement for the same offering. o ______________

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act of 1933, check the following box and list the Securities Act of 1933 registration statement number of the earlier effective registration statement for the same offering. o ______________

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box. o

The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until this Registration Statement shall become effective on such date as the Securities and Exchange Commission, acting pursuant to said Section 8(a), may determine.

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The information in this prospectus is not complete and may be changed. Neither we nor the selling stockholders may sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and it is not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.

SUBJECT TO COMPLETION, DATED MARCH 8, 2004

8,000,000 Shares
Common Stock

NaviSite, Inc. is selling 7,300,000 shares of common stock and the selling stockholders identified in this prospectus are selling an additional 700,000 shares. We will not receive any of the proceeds from the sale of the shares sold by the selling stockholders. Together with a selling stockholder identified in this prospectus, we have granted the underwriters a 30-day option to purchase up to an additional 1,200,000 shares to cover over-allotments, if any.

Our common stock is traded on the Nasdaq SmallCap Market under the symbol NAVI. On March 5, 2004, the last reported sale price for our common stock was $6.82 per share. We have applied for quotation of our common stock on the Nasdaq National Market under the same symbol to be effective upon completion of this offering.

INVESTING IN OUR COMMON STOCK INVOLVES RISKS. SEE RISK FACTORS BEGINNING ON PAGE 7.

	Per Share	Total
Public offering price	$	$
Underwriting discount	$	$
Proceeds, before expenses, to us[(1)]	$	$
Proceeds to the selling stockholders	$	$

(1) Expenses estimated to be $615,000, all of which will be paid by us.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

Thomas Weisel Partners LLC

CIBC World Markets

SG Cowen

The date of this prospectus is , 2004

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You should rely only on the information contained in this prospectus. We have not authorized anyone to provide you with information different from that contained in this prospectus. We are offering to sell shares of common stock and seeking offers to buy shares of common stock only in jurisdictions where offers and sales are permitted. The information contained in this prospectus is accurate only as to the date of this prospectus, regardless of the time of delivery of this prospectus or of any sale of common stock.

We obtained the market data and industry information contained in this prospectus from internal surveys, reports and studies, as appropriate, as well as from market research, publicly available information and industry publications. In general, industry publications state that the information they contain has been obtained from sources believed to be reliable, but they do not guarantee the accuracy or completeness of such information.

In this prospectus we, us and our refer to NaviSite, Inc. and its subsidiaries. Unless otherwise indicated, all information in this prospectus assumes no exercise of the underwriters over-allotment option.

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PROSPECTUS SUMMARY

You should read the following summary together with the more detailed information and consolidated financial statements and related notes thereto appearing elsewhere in this prospectus and in the documents incorporated by reference in this prospectus. You should read the entire prospectus, including the documents incorporated by reference in this prospectus, before you invest in our common stock. This prospectus contains forward-looking statements. The outcome of the events described in these forward-looking statements is subject to risks, and actual results could differ materially. Read this entire prospectus carefully, especially the risks described under Risk Factors.

Our Business

We provide a broad range of outsourced hosting and managed application services for middle-market organizations, which include mid-sized companies, divisions of large multi-national companies and government agencies. Our service offerings allow our customers to outsource the hosting and management of their information technology infrastructure and applications, such as commerce systems, enterprise software applications and e-mail. We offer services that are designed to focus on the needs of middle-market organizations, where we believe the need for outsourcing is most acute. We believe that by using our services, our customers are able to focus on, and apply resources to, their core business operations by avoiding the significant ongoing investments required to replicate our infrastructure, performance, reliability and expertise.

We currently operate 14 data centers in the United States and one data center in the United Kingdom. We believe that our data centers and infrastructure have the capacity necessary to expand our business for the foreseeable future. Our services combine our developed infrastructure with established processes and procedures for delivering hosting and application management services.

We currently service approximately 900 customers, including approximately 75 customers through our sales channel relationships. Our customers typically enter into service agreements with us for a term of one to three years and monthly payment installments, providing us with a base of recurring revenue.

During the past 18 months we have completed five acquisitions. As a result, we believe we have developed a disciplined acquisition strategy and significant integration expertise that will allow us to further expand our service offering, grow our customer base and improve our overall profitability. As of October 31, 2003, we had incurred losses since our incorporation resulting in an accumulated deficit of approximately $422 million. During the fiscal quarter ended October 31, 2003, we had a net loss of approximately $3.4 million. The audit report from KPMG LLP, our independent auditors, relating to our fiscal year 2003 financial statements contains an explanatory paragraph that states that our recurring losses from operations since inception and accumulated deficit, as well as other factors, raise substantial doubt about our ability to continue as a going concern.

Our Services

We offer a range of application, infrastructure and messaging services that can be deployed quickly and cost-effectively. We specialize in developing, deploying and managing information technology infrastructure and applications for our customers. Since 1999, we have invested approximately

$56 million in our operating platform and automation capabilities and have refined our processes over time across a large base of customers. Our services include:

Managed Application Services (A-Services)	Application Hosting Application Management Application Development
Managed Infrastructure Services (I-Services)	Content and Electronic Software Distribution Colocation Bandwidth Security Disaster Recovery
Managed Messaging Services (M-Services)	Managed Messaging

Our service offerings are enhanced by our proprietary Collaborative Application Management platform, or CAM. Our CAM platform enables us to work with our customers information technology teams, systems integrators and other third parties to provide seamless operation of outsourced applications and infrastructure and convenient access to information through the platform s user interface.

Our Industry

Many businesses are deploying Internet-enabled applications to enhance their core business operations, increase efficiency and remain competitive. The proliferation of these applications has created a strong demand for specialized information technology support and application expertise. The trend towards outsourced hosting and management of Internet-enabled applications is driven by the need to improve reliability and overall performance of the applications, the need to focus on core business operations, and the complexity and cost of managing the applications.

Independent market research firms indicate that the markets for our services are large and expected to grow rapidly over the next few years. According to Gartner Dataquest, or Gartner, the North American Web-hosting market will grow from $5.8 billion in 2002 to $20.0 billion in 2007. Gartner also estimates that the North American content distribution network and software delivery services market will grow from $173 million in 2002 to $814 million by 2007. According to The Radicati Group, the hosted and managed business email market will grow from approximately $2.3 billion in 2003 to approximately $3.1 billion in 2007.

Notwithstanding increasing demand for these services, we believe the number of providers of outsourced application hosting and management services has decreased over the past three years, primarily as a result of industry consolidation and bankruptcies. We believe this consolidation trend will continue, and will benefit a small number of service providers that have the resources and infrastructure to cost effectively provide the scalability, performance, reliability and business continuity that customers expect.

Our Strategy

Our goal is to become the leading provider of outsourced hosting and managed application services for middle-market organizations, which include mid-sized companies, divisions of large multi-national companies and government agencies. Key elements of our strategy are to:

Grow Through Disciplined Acquisitions. We intend to derive much of our future growth through acquisitions of technologies, products and companies that enhance our services portfolio and strengthen our position in our target markets.

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Deepen Existing Customer Relationships and Expand Our Customer Base. Most of our customers currently utilize only one of our service offerings. We plan to further penetrate our existing customer base with minimal additional costs by cross-selling our broad suite of services. We also plan to increase our customer base through direct sales and by expanding our channel relationships with key systems integrators and independent software vendors.

Improve Operating Margins Through Efficiencies. We have made significant improvements to our overall cost structure during the last twelve months. We intend to continue to improve operating margins as we improve the efficiency of our operations.

Emphasize and Invest in New High-Growth Service Areas. We plan to target emerging high growth service areas and increase the number of value-add services we provide to our customers.

Corporate Information

We were formed in 1996 within CMGI, Inc., our former majority stockholder, to support the networks and host Web sites of CMGI, its subsidiaries and several of its affiliated companies. In 1997, we began offering and supplying Web site hosting and management services to companies not affiliated with CMGI. We were incorporated in Delaware in December 1998. In October 1999, we completed our initial public offering of common stock and remained a majority-owned subsidiary of CMGI until September 2002. In September 2002, ClearBlue Technologies, Inc., or CBT, and its subsidiaries became our majority stockholder upon CBT s acquisition from CMGI and Hewlett-Packard Financial Services Company of all of their shares of our common stock then held, warrants to purchase our common stock and convertible promissory notes issued by us in exchange for shares of CBT common stock. In December 2002 and August 2003, CBT transferred shares of our common stock held by it to its stockholders, including the shares of our common stock currently held by Hewlett-Packard Financial Services Company. In connection with CBT s August 2003 transfers to its stockholders of its remaining shares of our common stock, Atlantic Investors, LLC, the indirect majority stockholder of CBT, became our majority stockholder. As of February 20, 2004, Atlantic Investors owned approximately 72% of the issued and outstanding shares of our common stock. Following the completion of this offering, Atlantic Investors will own approximately 55% of our common stock, allowing it to continue to control our management and affairs and determine the outcome of any corporate action requiring stockholder approval.

Our corporate headquarters are located at 400 Minuteman Road, Andover, Massachusetts, and our telephone number is (978) 682-8300. Our Web site is found at www.navisite.com. The information available on, or that can be accessed through, our Web site is not a part of this prospectus.

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The Offering

Common stock offered by us	7,300,000 shares
Common stock offered by selling stockholders	700,000 shares
Common stock to be outstanding after the offering	32,183,754 shares
Underwriters over-allotment option	1,200,000 shares
Use of proceeds	We expect to receive net proceeds from this offering of approximately $33.7 million. We intend to use the net proceeds to us from this offering as follows: approximately $3.3 million for the repayment of outstanding indebtedness owed to Atlantic Investors, LLC; and approximately $30.4 million for general corporate purposes, including working capital, and potential acquisitions of technologies, products and companies, although we have no current specific plans with respect to the $30.4 million. We will not receive any proceeds from the sale of our common stock by the selling stockholders.
Nasdaq SmallCap Market symbol[(1)]	NAVI

The number of shares of our common stock outstanding after this offering is based on 24,801,254 shares outstanding as of February 20, 2004 and excludes as of February 20, 2004:

- 3,327,898 shares of common stock issuable upon exercise of outstanding stock options, at a weighted average exercise price of $3.29 per share, under our Amended and Restated 2003 Stock Incentive Plan;
- 3,891 shares of common stock issuable upon exercise of outstanding stock options, at a weighted average exercise price of $128.44 per share, under our 2000 Stock Option Plan;
- 236,567 shares of common stock issuable upon exercise of outstanding stock options, at a weighted average exercise price of $69.64 per share, under our 1998 Equity Incentive Plan; and
- 372,239 additional shares of common stock reserved for future issuance under all of our stock plans.

Unless otherwise specifically stated, information throughout this prospectus assumes:

- no exercise of outstanding options or warrants to purchase shares of common stock, other than the warrant held by Silicon Valley Bancshares, which we expect will be fully exercised for a net aggregate of approximately 82,500 shares of our common stock, all of which will be included in this offering; and
- no exercise of the underwriters over-allotment option.

We have never declared or paid cash dividends on our common stock and do not anticipate declaring or paying any cash dividends on our common stock for the foreseeable future. We expect that we will retain all future earnings to fund the growth and development of our business. We are also restricted from paying any cash dividends on our common stock by the terms of our amended accounts receivable financing agreement with Silicon Valley Bank.

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(1)

We have applied for quotation of our common stock on the Nasdaq National Market under the same symbol to be effective upon completion of this offering.

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SUMMARY CONSOLIDATED FINANCIAL DATA

(In thousands, except per share data)

You should read the summary consolidated financial data set forth below together with the Management s Discussion and Analysis of Financial Condition and Results of Operations section included later in this prospectus, and our consolidated financial statements and related notes beginning on page F-1 of this prospectus.

On August 8, 2003, we completed the acquisition of certain assets and the assumption of certain liabilities of CBT in a business combination accounted for in a manner similar to a pooling-of-interest due to common control ownership. Accordingly, our consolidated financial statements have been restated for all periods prior to the business combination to include CBT s financial results beginning on September 11, 2002, the date on which CBT acquired the controlling interest in us, after the elimination of intercompany balances.

Consolidated Statement of Operations Data:

	Year Ended July 31,			Three Months Ended October 31,	
	2003	**2002**	**2001**	**2003**	**2002**
				(Unaudited)	
Revenue:					
Revenue	$ 75,281	$ 40,968	$ 66,358	$23,473	$ 14,561
Revenue, related parties	1,310	18,453	36,368		1,310
Total revenue	76,591	59,421	102,726	23,473	15,871
Cost of revenue	70,781	67,000	127,155	17,924	16,495
Impairment, restructuring and other		68,317	1,930	633	
Total cost of revenue	70,781	135,317	129,085	18,557	16,495
Gross profit (deficit)	5,810	(75,896)	(26,359)	4,916	(624)
Operating expenses:					
Product development	950	5,281	14,072	348	382
Selling and marketing	5,960	9,703	32,251	1,972	1,287
General and administrative	20,207	19,272	33,011	4,958	3,677
Impairment, restructuring and other	8,882	(2,633)	8,011	456	147
Total operating expenses	35,999	31,623	87,345	7,734	5,493
Loss from operations	(30,189)	(107,519)	(113,704)	(2,818)	(6,117)
Other income (expense):					
Interest income	851	1,060	2,753	64	305
Interest expense	(43,403)	(14,718)	(8,042)	(609)	(3,940)
Other income (expense), net	(733)	(516)	292	10	(253)
Loss before cumulative effect of change in accounting principle and income tax expense	(73,474)	(121,693)	(118,701)	(3,353)	(10,005)
Income tax expense	(153)				
Loss before cumulative effect of change in accounting principle	(73,627)	(121,693)	(118,701)	(3,353)	(10,005)
Cumulative effect of change in accounting principle			(4,295)		

Net loss	$(73,627)	$(121,693)	$(122,996)	$ (3,353)	$(10,005)
Basic and diluted net loss per common share:(1)					
Before cumulative effect of change in accounting principle	$ (6.32)	$ (22.30)	$ (30.18)	$ (0.14)	$ (1.60)
Cumulative effect of change in accounting principle			(1.09)		
Basic and diluted net loss per common share	$ (6.32)	$ (22.30)	$ (31.27)	$ (0.14)	$ (1.60)
Basic and diluted weighted average number of common shares outstanding	11,654	5,457	3,933	24,506	6,270

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Consolidated Balance Sheet Data:

	As of October 31, 2003	
	Actual	As Adjusted(2)
	(Unaudited)	
Cash and cash equivalents	$ 2,898	$ 33,343
Working capital (deficit)	(14,751)	15,694
Total assets	67,592	98,037
Accrued expenses	16,316	16,066
Debt	19,450	16,450
Long-term liabilities, excluding the note to the AppliedTheory Estate	7,585	7,585
Stockholders equity	14,341	48,037

(1) As discussed in the notes to our consolidated financial statements, in January 2003 we completed a 1-for-15 reverse stock split of our outstanding shares of common stock. All historical share and per share data have been adjusted for the reverse stock split.

(2) Adjusted to give effect to this offering and the application of the net proceeds to us, including the repayment of approximately $3.3 million of indebtedness.

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RISK FACTORS

You should carefully consider the risks described below before making an investment decision. Our business could be harmed by any of these risks. The trading price of our common stock could decline due to any of these risks, and you may lose all or part of your investment. In assessing these risks, you should also refer to the other information contained or incorporated by reference in this prospectus, including our consolidated financial statements and related notes.

Risks Relating to Our Business

We have a history of losses and may never achieve or sustain profitability and may not continue as a going concern.

We have never been profitable and may never become profitable. Since our incorporation in 1998, we have experienced operating losses and negative cash flows for each quarterly and annual period. As of October 31, 2003, we had incurred losses since our incorporation resulting in an accumulated deficit of approximately $422 million. During the fiscal quarter ended October 31, 2003, we had a net loss of approximately $3.4 million. The audit report from KPMG LLP, our independent auditors, relating to our fiscal year 2003 financial statements contains an explanatory paragraph that states that our recurring losses from operations since inception and accumulated deficit, as well as other factors, raise substantial doubt about our ability to continue as a going concern. We anticipate that we will continue to incur net losses in the future. We also have significant fixed commitments, including with respect to real estate, bandwidth commitments, machinery and equipment leases. As a result, we can give no assurance that we will achieve profitability or be capable of sustaining profitable operations. If we are unable to reach and sustain profitability, we risk depleting our working capital balances and our business may not continue as a going concern.

If our available cash is not sufficient to fund our needs, we may need to obtain additional financing, which may not be available on favorable terms, or at all.

As of October 31, 2003, we had approximately $2.9 million of cash and cash equivalents and a working capital deficit of approximately $14.8 million. If we do not complete this offering, or if we do complete this offering and then use a significant portion of the net proceeds we receive to acquire a company, technology or product, we may need to raise additional capital through various other equity or debt financings.

Our projections for cash usage are based on a number of assumptions, including:

- our ability to retain customers in light of market uncertainties and our uncertain future;
- our ability to collect accounts receivables in a timely manner;
- our ability to effectively integrate recent acquisitions and realize forecasted cash savings; and
- our ability to achieve other expected cash expense reductions.

Further, our projected use of cash and business results could be affected by continued market uncertainties, including delays or restrictions in information technology spending by customers or potential customers and any merger or acquisition activity.

In recent years, we have generally financed our operations with proceeds from selling shares of our stock and borrowing funds. There can be no assurance that additional financing will be available on favorable terms, or at all. In addition, even if we find outside funding sources, we may be required to issue securities with greater rights than those currently possessed by holders of our common stock. We may also be required to take other actions that may lessen the value of our common stock or dilute our common stockholders, including borrowing money on terms that are not favorable to us or issuing

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additional equity securities. If we are required to raise money in the future and we experience difficulties doing so, our business and liquidity will be materially adversely affected.

Our financing agreement with Silicon Valley Bank includes various covenants and restrictions that may negatively affect our liquidity and our ability to operate and manage our business.

As of February 2, 2004, we owed Silicon Valley Bank approximately $7.0 million under our amended accounts receivable financing agreement. The accounts receivable financing agreement generally restricts or limits, among other things, our ability to:

- create or incur indebtedness;
- sell, or permit any lien or security interest in, any of our assets;
- enter into or permit any material transaction with any of our affiliates;
- merge or consolidate with any other party, or acquire all or substantially all of the capital stock or property of another party, unless, among other things, the other party is in the same, or a similar line of business as us;
- relocate our principal executive office or add any new offices or business locations;
- change our state of formation;
- change our legal name;
- make investments;
- pay dividends or make any distribution or payment or redeem, retire or purchase our capital stock; and
- make or permit any payment on subordinated debt or amend any provision in any document relating to any subordinated debt.

Further, the accounts receivable financing agreement requires that we maintain EBITDA of at least $1.00 for the quarter ended October 31, 2003 and for each subsequent quarter. The agreement defines EBITDA as earnings before interest, taxes, depreciation and amortization in accordance with generally accepted accounting principles and excluding acquisition-related costs and one-time extraordinary charges.

If we breach our accounts receivable financing agreement with Silicon Valley Bank, a default could result. A default, if not waived, could result in, among other things, us not being able to borrow additional amounts from Silicon Valley Bank and all or a portion of our outstanding amounts may become due and payable on an accelerated basis, which would adversely affect our liquidity and our ability to manage our business.

Our limited operating history with our current operating structure makes it difficult for us and our investors to evaluate our past performance and future prospects.

We have completed a number of acquisitions since December 2002. Until a significant period of time elapses, it will be difficult to determine if we correctly valued these acquired businesses or adequately anticipated all of the demands that our growth will impose on our personnel, procedures and structures, including our financing and reporting control systems and management structure. Our limited operating history with our current structure makes it very difficult for you and us to evaluate or predict our ability to, among other things, retain customers, generate and sustain a revenue base sufficient to meet our operating expenses, and achieve and sustain profitability.

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A significant portion of our revenue comes from one customer and, if we lost this customer, it would have a significant adverse impact on our business results and cash flows.

The New York State Department of Labor represented approximately 21% of our consolidated revenue for the fiscal year ended July 31, 2003 and 15% for the fiscal quarter ended October 31, 2003. The New York State Department of Labor has been a long-term customer of ours, but there can be no assurance that we will be able to retain this customer. Further, there can be no assurance that we will be able to maintain the same level of service to this customer or that our revenue from this customer will not decline or suffer a material reduction in future periods. The New York State Department of Labor is not obligated under our agreement to buy a minimum amount of services from us or designate us as its sole supplier of any particular service. This contract with The New York State Department of Labor, and its funding allowance, expires in June 2005. Further, The New York State Department of Labor has the right to terminate this contract at any time by providing us with 60 days notice. If we were to lose this customer or suffer a material reduction in the revenue generated from this customer, it would have a significant adverse impact on our business results and cash flows.

Atlantic Investors may have interests that conflict with the interests of our other stockholders and as our majority stockholder, can prevent new and existing investors from influencing significant corporate decisions.

Atlantic Investors owns approximately 72% of our outstanding capital stock as of February 20, 2004. Following completion of this offering, Atlantic Investors will own approximately 55% of our outstanding capital stock. In addition, Atlantic Investors holds a note in the principal amount of $3.0 million due upon the earlier to occur of August 1, 2004, and five business days after our receipt of gross proceeds from a financing or a sale of assets of at least $13 million. Atlantic Investors, prior to and after the offering, has the power, acting alone, to elect a majority of our Board of Directors and has the ability to control our management and affairs and determine the outcome of any corporate action requiring stockholder approval, regardless of how our other stockholders may vote, including the election of directors, any merger, consolidation or sale of all or substantially all of our assets, and any other significant corporate transaction. Under Delaware law, Atlantic Investors is able to exercise its voting power by written consent, without convening a meeting of the stockholders, which means that Atlantic Investors could effect a sale or merger of us without the consent of our other stockholders. Atlantic Investors ownership of a majority of our outstanding common stock may have the effect of delaying, deterring or preventing a change in control of us or discouraging a potential acquiror from attempting to obtain control of us, which in turn could adversely affect the market price of our common stock.

Members of our management group also have significant interests in Atlantic Investors, which may create conflicts of interest.

Some of the members of our management group also serve as members of the management group of Atlantic Investors and its affiliates. Specifically, Andrew Ruhan, our Chairman of the Board, holds a 10% equity interest in Unicorn Worldwide Holdings Limited, a managing member of Atlantic Investors. Arthur Becker, our President and Chief Executive Officer, is the managing member of Madison Technology LLC, a managing member of Atlantic Investors. As a result, these NaviSite officers and directors may face potential conflicts of interest with each other and with our stockholders. They may be presented with situations in their capacity as our officers or directors that conflict with their fiduciary obligations to Atlantic Investors, which in turn may have interests that conflict with the interests of our other stockholders.

Acquisitions may result in disruptions to our business or distractions of our management due to difficulties in integrating acquired personnel and operations, and these integrations may not proceed as planned.

Since December 2002, we have acquired ClearBlue Technologies Management, Inc., or CBTM, Avasta, Conxion, selected assets of Interliant and all of the shares of six wholly-owned subsidiaries of ClearBlue

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Technologies, Inc., or CBT, and assumed the revenues and expenses of four additional wholly-owned subsidiaries of CBT as of the date of acquisition. We intend to continue to expand our business through the acquisition of companies, technologies, products and services. Acquisitions involve a number of special problems and risks, including:

- difficulty integrating acquired technologies, products, services, operations and personnel with the existing businesses;
- diversion of management s attention in connection with both negotiating the acquisitions and integrating the businesses;
- strain on managerial and operational resources as management tries to oversee larger operations;
- inability to retain and motivate management and other key personnel of the acquired businesses;
- changes in management and key personnel of acquired businesses may harm relationships with the acquired businesses customers, suppliers and employees;
- exposure to unforeseen liabilities of acquired companies;
- potential costly and time-consuming litigation, including stockholder lawsuits;
- potential issuance of securities in connection with an acquisition with rights that are superior to the rights of holders of our common stock, or which may have a dilutive effect on our common stockholders;
- the need to incur additional debt or use cash; and
- the requirement to record potentially significant additional future operating costs for the amortization of intangible assets.

As a result of these problems and risks, businesses we acquire may not produce the revenues, earnings or business synergies that we anticipated, and acquired products, services or technologies might not perform as we expected. As a result, we may incur higher costs and realize lower revenues than we had anticipated. We may not be able to successfully address these problems and we cannot assure you that the acquisitions will be successfully identified and completed or that, if acquisitions are completed, the acquired businesses, products, services or technologies will generate sufficient revenue to offset the associated costs or other harmful effects on our business.

A failure to meet customer specifications or expectations could result in lost revenues, increased expenses, negative publicity, claims for damages and harm to our reputation and cause demand for our services to decline.

Our agreements with customers require us to meet specified service levels for the services we provide. In addition, our customers may have additional expectations about our services. Any failure to meet customers specifications or expectations could result in:

- delayed or lost revenue;
- requirements to provide additional services to a customer at reduced charges or no charge;
- negative publicity about us, which could adversely affect our ability to attract or retain customers; and
- claims by customers for substantial damages against us, regardless of our responsibility for such failure, which may not be covered by insurance policies and which may not be limited by contractual terms of our engagement.

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Our ability to successfully market our services could be substantially impaired if we are unable to deploy new infrastructure systems and applications or if new infrastructure systems and applications deployed by us prove to be unreliable, defective or incompatible.

We may experience difficulties that could delay or prevent the successful development, introduction or marketing of hosting and application management services in the future. If any newly introduced infrastructure systems and applications suffer from reliability, quality or compatibility problems, market acceptance of our services could be greatly hindered and our ability to attract new customers could be significantly reduced. We cannot assure you that new applications deployed by us will be free from any reliability, quality or compatibility problems. If we incur increased costs or are unable, for technical or other reasons, to host and manage new infrastructure systems and applications or enhancements of existing applications, our ability to successfully market our services could be substantially limited.

Any interruptions in, or degradation of, our private transit Internet connections could result in the loss of customers or hinder our ability to attract new customers.

Our customers rely on our ability to move their digital content as efficiently as possible to the people accessing their Web sites and infrastructure systems and applications. We utilize our direct private transit Internet connections to major network providers, such as Level 3, Internap, WilTel and XO Communications, as a means of avoiding congestion and resulting performance degradation at public Internet exchange points. We rely on these telecommunications network suppliers to maintain the operational integrity of their networks so that our private transit Internet connections operate effectively. If our private transit Internet connections are interrupted or degraded, we may face claims by, or lose, customers, and our reputation in the industry may be harmed, which may cause demand for our services to decline.

If we are unable to maintain existing and develop additional relationships with software vendors, the sales and marketing of our service offerings may be unsuccessful.

We believe that to penetrate the market for hosting and application management services we must maintain existing and develop additional relationships with industry-leading software vendors. We license or lease select software applications from software vendors, including IBM, Microsoft, Micromuse and Oracle. The loss of our ability to continually obtain and utilize any of these applications could substantially weaken our ability to provide services to our customers or require us to obtain substitute software applications that may be of lower quality or performance standards or at greater cost. In addition, because we generally license applications on a non-exclusive basis, our competitors may license and utilize the same software applications. In fact, many of the companies with which we have strategic relationships currently have, or could enter into, similar license agreements with our competitors or prospective competitors. We cannot assure you that software applications will continue to be available to us from software vendors on commercially reasonable terms. If we are unable to identify and license software applications that meet our targeted criteria for new application introductions, we may have to discontinue or delay introduction of services relating to these applications.

Our network infrastructure could fail, which would impair our ability to provide guaranteed levels of service and could result in significant operating losses.

To provide our customers with guaranteed levels of service, we must operate our network infrastructure 24 hours a day, seven days a week without interruption. We must, therefore, protect our network infrastructure, equipment and customer files against damage from human error, natural disasters, unexpected equipment failure, power loss or telecommunications failures, terrorism, sabotage or other intentional acts of vandalism. Even if we take precautions, the occurrence of a natural disaster, equipment failure or other unanticipated problem at one or more of our data centers could result in interruptions in the services we provide to our customers. We cannot assure you that our disaster recovery plan will address all, or even most, of the problems we may encounter in the event of a

disaster or other unanticipated problem. We have experienced service interruptions in the past, and any future service interruptions could:

- require us to spend substantial amounts of money to replace equipment or facilities;
- entitle customers to claim service credits or seek damages for losses under our service level guarantees;
- cause customers to seek alternate providers; or
- impede our ability to attract new customers, retain current customers or enter into additional strategic relationships.

Our dependence on third parties increases the risk that we will not be able to meet our customers needs for software, systems and services on a timely or cost-effective basis, which could result in the loss of customers.

Our services and infrastructure rely on products and services of third-party providers. We purchase key components of our infrastructure, including networking equipment, from a limited number of suppliers, such as IBM, Cisco Systems and F5 Networks. There can be no assurance that we will not experience operational problems attributable to the installation, implementation, integration, performance, features or functionality of third-party software, systems and services. We cannot assure you that we will have the necessary hardware or parts on hand or that our suppliers will be able to provide them in a timely manner in the event of equipment failure. Our ability to obtain and continue to maintain the necessary hardware or parts on a timely basis could result in sustained equipment failure and a loss of revenue due to customer loss or claims for service credits under our service level guarantees.

Our decision to discontinue our practice of obtaining equipment under leases and subsequently renting the equipment to our customers may cause us to lose customers.

We have discontinued our general practice of purchasing or leasing equipment and subsequently renting the equipment to our customers, although we continue to do so in limited circumstances. New customers and current customers seeking to renew their agreements will have to obtain equipment directly from equipment vendors. We may not be successful in attracting new customers who prefer to obtain equipment from their service providers. Current customers may seek a hosting provider who would also rent equipment directly to them to satisfy their equipment needs and may not renew their agreements with us. If we are unable to keep our current customers and attract new customers due to our discontinuation of leasing equipment, our business, financial condition and results of operations could be materially adversely affected.

We could be subject to increased operating costs, as well as claims, litigation or other potential liability, in connection with risks associated with Internet security and the security of our systems.

A significant barrier to the growth of e-commerce and communications over the Internet has been the need for secure transmission of confidential information. Several of our infrastructure systems and application services utilize encryption and authentication technology licensed from third parties to provide the protections necessary to ensure secure transmission of confidential information. We also rely on security systems designed by third parties and the personnel in our network operations centers to secure those data centers. Any unauthorized access, computer viruses, accidental or intentional actions and other disruptions could result in increased operating costs. For example, we may incur additional significant costs to protect against these interruptions and the threat of security breaches or to alleviate problems caused by such interruptions or breaches. Further, we expect to continue to invest in and expend additional financial resources to equip our data centers with enhanced security measures. If a third party were able to misappropriate a consumer s personal or proprietary

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information, including credit card information, during the use of an application solution provided by us, we could be subject to claims, litigation or other potential liability.

Third-party infringement claims against our technology suppliers, customers or us could result in disruptions in service, the loss of customers or costly and time-consuming litigation.

We license or lease most technologies used in the infrastructure systems and application services that we offer. Our technology suppliers may become subject to third-party infringement or other claims and assertions, which could result in their inability or unwillingness to continue to license their technologies to us. We cannot assure you that third parties will not assert claims against us in the future or that these claims will not be successful. Any infringement claim as to our technologies or services, regardless of its merit, could result in delays in service, installation or upgrades, the loss of customers or costly and time-consuming litigation.

We may be subject to legal claims in connection with the information disseminated through our network, which could divert management s attention and require us to expend significant financial resources.

We may face potential direct and indirect liability for claims of defamation, negligence, copyright, patent or trademark infringement and other claims based on the nature and content of the materials disseminated through our network. For example, lawsuits may be brought against us claiming that content distributed by some of our current or future customers may be regulated or banned. In these and other instances, we may be required to engage in protracted and expensive litigation that could have the effect of diverting management s attention from our business and require us to expend significant financial resources. Our general liability insurance may not cover any of these claims or may not be adequate to protect us against all liability that may be imposed. In addition, on a limited number of occasions in the past, businesses, organizations and individuals have sent unsolicited commercial e-mails from servers hosted at our facilities to a number of people, typically to advertise products or services. This practice, known as spamming, can lead to statutory liability as well as complaints against service providers that enable such activities, particularly where recipients view the materials received as offensive. We have in the past received, and may in the future receive, letters from recipients of information transmitted by our customers objecting to such transmission. Although we prohibit our customers by contract from spamming, we cannot assure you that our customers will not engage in this practice, which could subject us to claims for damages.

If we fail to attract or retain key officers, management and technical personnel, our ability to successfully execute our business strategy or to continue to provide services and technical support to our customers could be adversely affected and we may not be successful in attracting new customers.

We believe that attracting, training, retaining and motivating technical and managerial personnel, including individuals with significant levels of infrastructure systems and application expertise, is a critical component of the future success of our business. Qualified technical personnel are likely to remain a limited resource for the foreseeable future and competition for these personnel is intense. The departure of any of our executive officers, particularly Arthur P. Becker, our Chief Executive Officer and President, or core members of our sales and marketing teams or technical service personnel, would have negative ramifications on our customer relations and operations, including adversely affecting the stability of our infrastructure and our ability to provide the guaranteed service levels our customers expect. Any officer or employee can terminate his or her relationship with us at any time. In addition, we do not carry life insurance on any of our personnel. Over the past 18 months, we have had significant reductions-in-force due to redundancies and restructurings resulting from the consolidation of our acquired companies. We have also had a number of departures of several members of senior management due primarily to the change of control of NaviSite on September 11, 2002. In the event future reductions or departures of employees occur, our ability to successfully execute our business

strategy, or to continue to provide services to our customers or attract new customers, could be adversely affected.

The unpredictability of our quarterly results may cause the trading price of our common stock to fluctuate or decline.

Our quarterly operating results may vary significantly from quarter-to-quarter and period-to-period as a result of a number of factors, many of which are outside of our control and any one of which may cause our stock price to fluctuate. The primary factors that may affect our operating results include the following:

- reduction of market demand and/or acceptance of our services;
- oversupply of data center space in the industry;
- our ability to develop, market and introduce new services on a timely basis;
- the length of the sales cycle for our services;
- the timing and size of sales of our services, which depends on the budgets of our customers;
- downward price adjustments by our competitors;
- changes in the mix of services provided by our competitors;
- technical difficulties or system downtime affecting the Internet or our hosting operations;
- our ability to meet any increased technological demands of our customers; and
- the amount and timing of costs related to our marketing efforts and service introductions.

Due to the above factors, we believe that quarter-to-quarter or period-to-period comparisons of our operating results may not be a good indicator of our future performance. Our operating results for any particular quarter may fall short of our expectations or those of stockholders or securities analysts. In this event, the trading price of our common stock would likely fall.

Our common stock could be delisted from Nasdaq if we are unable to comply with Nasdaq s continued listing requirements.

Our common stock currently trades on the Nasdaq SmallCap Market. We have applied for quotation of our common stock on the Nasdaq National Market under the same trading symbol to be effective upon completion of this offering. If our common stock commences trading on the Nasdaq National Market, we must satisfy the continued listing requirements for that market. While we expect to comply with the Nasdaq National Market s initial listing requirements upon completion of this offering, we cannot be sure that we will be able to maintain compliance with the continued listing requirements. A delisting of our common stock from the Nasdaq National Market could materially reduce the liquidity of our common stock and result in a corresponding material reduction in the price of our common stock. In addition, any such delisting could harm our ability to raise capital through alternative financing sources on terms acceptable to us, or at all, and may result in the potential loss of confidence by suppliers, customers and employees.

Risks Related to Our Industry

If the markets for outsourced information technology infrastructure and applications, Internet commerce and communication decline, there may be insufficient demand for our services and, as a result, our business strategy and objectives may fail.

The increased use of the Internet for retrieving, sharing and transferring information among businesses and consumers is developing, and the market for the purchase of products and services over the Internet is still relatively new and emerging. Our industry has experienced periods of rapid growth,

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followed by a sharp decline in demand for products and services, which related to the failure in the last few years of many companies focused on developing Internet-related businesses. If acceptance and growth of the Internet as a medium for commerce and communication declines, our business strategy and objectives may fail because there may not be sufficient market demand for our hosting and application management services.

If we do not respond to rapid changes in the technology sector, we will lose customers.

The markets for the technology-related services we offer are characterized by rapidly changing technology, evolving industry standards, frequent new service introductions, shifting distribution channels and changing customer demands. We may not be able to adequately adapt our services or to acquire new services that can compete successfully. In addition, we may not be able to establish and maintain effective distribution channels. We risk losing customers to our competitors if we are unable to adapt to this rapidly evolving marketplace.

The market in which we operate is highly competitive and is likely to consolidate, and we may lack the financial and other resources, expertise or capability needed to capture increased market share or maintain market share.

We compete in the hosting and application management services market. This market is rapidly evolving, highly competitive and likely to be characterized by over-capacity and industry consolidation. Our competitors may consolidate with one another or acquire software application vendors or technology providers, enabling them to more effectively compete with us. Many participants in this market have suffered significantly in the last several years. We believe that participants in this market must grow rapidly and achieve a significant presence to compete effectively. This consolidation could affect prices and other competitive factors in ways that would impede our ability to compete successfully in the hosting and application management services market.

Further, our business is not as developed as that of many of our competitors. Many of our competitors have substantially greater financial, technical and market resources, greater name recognition and more established relationships in the industry. Many of our competitors may be able to:

- develop and expand their network infrastructure and service offerings more rapidly;
- adapt to new or emerging technologies and changes in customer requirements more quickly;
- take advantage of acquisitions and other opportunities more readily; or
- devote greater resources to the marketing and sale of their services and adopt more aggressive pricing policies than we can.

We may lack the financial and other resources, expertise or capability needed to maintain or capture increased market share in this environment in the future. Because of these competitive factors and due to our comparatively small size and our lack of financial resources, we may be unable to successfully compete in the hosting and application management services market.

The emergence and growth of a market for our hosting and managed application services will be impaired if third parties do not continue to develop and improve Internet infrastructure.

The recent growth in the use of the Internet has caused frequent periods of performance degradation, requiring the upgrade of routers and switches, telecommunications links and other components forming the infrastructure of the Internet. Any perceived degradation in the performance of the Internet as a means to transact business and communicate could undermine the benefits and market acceptance of our services. Consequently, the market for our services will be impaired if improvements are not made to the entire Internet infrastructure to alleviate overloading and congestion.

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Difficulties presented by international economic, political, legal, accounting and business factors could harm our business in international markets.

We operate a data center in the United Kingdom and revenue from our foreign operations accounted for approximately 6% of our total revenues during the first quarter of fiscal year 2004. Although we expect to focus most of our growth efforts in the United States, we may enter into joint ventures or outsourcing agreements with third parties, acquire complementary businesses or operations, or establish and maintain new operations outside of the United States. Some risks inherent in conducting business internationally include:

- unexpected changes in regulatory, tax and political environments;
- longer payment cycles and problems collecting accounts receivable;
- geopolitical risks such as political and economic instability and the possibility of hostilities among countries;
- reduced protection of intellectual property rights;
- fluctuations in currency exchange rates;
- ability to secure and maintain the necessary physical and telecommunications infrastructure;
- challenges in staffing and managing foreign operations;
- employment laws and practices in foreign countries; and
- laws and regulations on content distributed over the Internet that are more restrictive than those currently in place in the United States.

Any one or more of these factors could adversely affect our contemplated future international operations and consequently, our business.

We may become subject to burdensome government regulation and legal uncertainties that could substantially harm our business or expose us to unanticipated liabilities.

It is likely that laws and regulations directly applicable to the Internet or to hosting and managed application service providers may be adopted. These laws may cover a variety of issues, including user privacy and the pricing, characteristics and quality of products and services. The adoption or modification of laws or regulations relating to commerce over the Internet could substantially impair the growth of our business or expose us to unanticipated liabilities. Moreover, the applicability of existing laws to the Internet and hosting and managed application service providers is uncertain. These existing laws could expose us to substantial liability if they are found to be applicable to our business. For example, we provide services over the Internet in many states in the United States and elsewhere and facilitate the activities of our customers in such jurisdictions. As a result, we may be required to qualify to do business, be subject to taxation or be subject to other laws and regulations in these jurisdictions, even if we do not have a physical presence, employees or property in those states.

Risks Related to this Offering

The price of our common stock has been volatile, and may continue to experience wide fluctuations.

Since January 2003, our common stock has closed as low as $1.02 per share and as high as $9.97 per share. The trading price of our common stock has been and may continue to be subject to wide fluctuations due to the risk factors discussed in this section and elsewhere in this prospectus. In addition, in recent years, the stock market has also experienced significant price and volume fluctuations, which have particularly impacted the market prices of equity securities of many companies providing technology-related products and services. The volatility in the stock market often has been

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unrelated to the operating performance of particular companies. Fluctuations in the market price of our common stock may cause you to lose some or all of your investment.

A large number of shares may be sold in the market following this offering, which may depress the market price of our common stock.

In recent years, our common stock has had limited trading activity. We cannot predict the extent to which investor interest in our stock will lead to the development of a more active trading market, how liquid that market might become or whether it will be sustained. As a result, sales of a substantial number of shares of our common stock in the public market following this offering, or the perception that such sales could occur, could cause the price of our common stock to decline. The number of shares of common stock available for sale in the public market is limited by restrictions under federal securities law and under lock-up agreements that the members of our Board of Directors, our executive officers and some of our stockholders have entered into with the underwriters. Those lock-up agreements restrict holders of approximately 22,350,362 shares of our common stock from selling, pledging or otherwise disposing of their shares for a period of 90 days after the date of this prospectus without the prior written consent of Thomas Weisel Partners LLC. However, Thomas Weisel Partners LLC may, in its sole discretion, release all or any portion of the common stock from the restrictions of the lock-up agreements at any time. Upon the expiration of the lock-up agreements, approximately 20,144,612 shares of our common stock previously covered by the lock-up agreements will be eligible for sale into the public market under Rule 144 of the Securities Act.

Anti-takeover provisions in our corporate documents may discourage or prevent a takeover.

Provisions in our certificate of incorporation and our by-laws may have the effect of delaying or preventing an acquisition or merger in which we are acquired or a transaction that changes our Board of Directors. These provisions:

- authorize the board to issue preferred stock without stockholder approval;
- prohibit cumulative voting in the election of directors;
- limit the persons who may call special meetings of stockholders; and
- establish advance notice requirements for nominations for the election of directors or for proposing matters that can be acted on by stockholders at stockholder meetings.

The value of your investment in our common stock will be immediately and substantially diluted because the price you will pay for your shares in the offering is much greater than the tangible book value per share of our common stock.

As of October 31, 2003, we had a negative tangible book value per share of $0.01, which represents the amount of our total tangible assets less our total liabilities, divided by the number of shares of our common stock outstanding. As a result, if you pay $5.00 per share in this offering, your investment will be diluted by approximately $3.96 per share and therefore, valued at only approximately $1.04 per share. In the past, we have issued options and warrants to buy our common stock at prices below the offering price. You will experience further dilution to the extent that additional shares of our common stock are issued upon the exercise of outstanding stock options and warrants.

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FORWARD-LOOKING STATEMENTS

Some of the statements under sections entitled Prospectus Summary, Management s Discussion and Analysis of Financial Condition and Results of Operations and Business and elsewhere in this prospectus and those made from time to time by us through our senior management constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These statements relate to future events or our future financial performance and involve known and may involve unknown risks, uncertainties and other factors that may cause our actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by forward-looking statements including, but not limited to prospects for future market growth. In some cases, you can identify forward-looking statements by terminology such as may, will, should, could, expect, plan, anticipate, intend, believe, e potential, continue, or the negative terms or other comparable terminology. In evaluating these statements, you should specifically consider various factors, including the risks outlined under Risk Factors.

Although we believe that the expectations in the forward-looking statements contained in this prospectus are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. These forward-looking statements are based on our current expectations, and we disclaim any obligation to update these forward-looking statements for subsequent events or to explain why actual results differ unless otherwise required by law. You should not place undue reliance on these forward-looking statements.

USE OF PROCEEDS

We expect to receive approximately $33.7 million from the sale of shares of common stock by us in this offering, or $37.0 million if the underwriters exercise their over-allotment option in full, based on the assumed offering price of $5.00 per share and after deducting the underwriting discounts and commissions and estimated offering expenses that we are to pay. We will not receive any of the proceeds from any sale of shares of common stock by the selling stockholders in this offering.

We intend to use our net proceeds from this offering for the following:

- approximately $3.3 million to repay the outstanding principal and accrued interest under our Loan and Security Agreement dated January 29, 2003 with Atlantic Investors, LLC, which bears interest at a rate of 8% per annum and is due and payable upon the earlier to occur of August 1, 2004 and five business days after our receipt of gross proceeds from a financing or a sale of assets of at least $13 million; and

- approximately $30.4 million for general corporate purposes, including working capital, and potential acquisitions of technologies, products and companies, although we have no current specific plans with respect to the $30.4 million.

Borrowings under the Loan and Security Agreement with Atlantic Investors were used primarily to repay amounts due to Unicorn Worldwide Holdings Limited, for costs associated with our acquisition of Avasta and for working capital. We intend to seek acquisitions of businesses, products and technologies that are complementary to our business, and a portion of our net proceeds from this offering may also be used for such acquisitions. While we engage from time to time in discussions with respect to potential acquisitions, we have no current plans, commitments or agreements with respect to any such acquisitions, and there can be no assurances that any acquisitions will be made.

The amounts and timing of our actual expenditures will depend on numerous factors, including the status of our product development efforts, sales and marketing activities, technological advances, and amount of cash generated or used by our operations. Our management will have considerable discretion in applying the net proceeds of this offering. Our net proceeds of this offering may be used for corporate purposes that do not enhance our results of operations or do not yield a favorable return. Pending the uses described above, we intend to invest our net proceeds in short-term, interest-bearing, investment-grade securities.

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PRICE RANGE OF COMMON STOCK

Our common stock trades on the Nasdaq SmallCap Market under the symbol NAVI. For the period between October 22, 1999, the date of our initial public offering of our common stock, and June 7, 2002, our common stock was quoted on the Nasdaq National Market. The following table sets forth for the periods indicated below the high and low closing sale prices on the Nasdaq National Market and the Nasdaq SmallCap Market, as applicable. All share prices below have been adjusted to reflect the 1-for-15 reverse split of our common stock effected January 7, 2003.

	High	Low
Year Ended July 31, 2002		
First Quarter	$12.30	$2.25
Second Quarter	9.15	3.90
Third Quarter	5.40	3.15
Fourth Quarter	3.90	1.80
Year Ended July 31, 2003		
First Quarter	3.30	1.50
Second Quarter	4.35	1.78
Third Quarter	1.78	1.02
Fourth Quarter	3.60	1.26
Year Ending July 31, 2004		
First Quarter	5.02	2.32
Second Quarter	9.97	4.30
Third Quarter (through March 5, 2004)	6.82	4.39

On March 5, 2004, the last sale price for our common stock as reported by the Nasdaq SmallCap Market was $6.82 per share. As of March 4, 2004, we had 130 holders of record of our common stock.

DIVIDEND POLICY

We have never declared or paid cash dividends on our common stock and do not anticipate declaring or paying any cash dividends on our common stock for the foreseeable future. We expect that we will retain all future earnings to fund the growth and development of our business. We are also restricted from paying any cash dividends on our common stock by the terms of our accounts receivable financing agreement with Silicon Valley Bank, as described in the Liquidity and Capital Resources section of the Management s Discussion and Analysis of Financial Condition and Results of Operations section included later in this prospectus. Any future determination related to dividend policy will be made, subject to the restrictions of the financing agreement with Silicon Valley Bank, at the discretion of our Board of Directors.

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DILUTION

Our net tangible book value as of October 31, 2003 was ($258,000), or ($0.01) per share of common stock. Net tangible book value per share represents the amount of our total tangible assets less our total liabilities, divided by the number of shares of common stock outstanding.

After giving effect to the sale by us of 7,300,000 shares of common stock in this offering at an assumed offering price of $5.00 per share, and after deducting the underwriting discount and commissions and estimated offering expenses payable by us, our adjusted net tangible book value as of October 31, 2003 would have been approximately $33.4 million, or approximately $1.04 per share. This amount represents an immediate increase in net tangible book value of approximately $1.05 per share to our existing stockholders and an immediate dilution in net tangible book value of approximately $3.96 per share to new investors purchasing shares of common stock in this offering at the assumed offering price. We determine dilution by subtracting the adjusted net tangible book value per share after this offering from the amount of cash that a new investor paid for a share of common stock. The following table illustrates this dilution on a per share basis:

Assumed offering price per share		$5.00
Net tangible book value per share as of October 31, 2003	$(0.01)	
Increase per share attributable to new investors	$ 1.05	
Adjusted net tangible book value per share after this offering		$1.04
Dilution in net tangible book value per share to new investors		$3.96

If the underwriters exercise their option to purchase additional shares of our common stock in full in this offering, the net tangible book value per share after the offering would be approximately $1.12 per share, the increase in net tangible book value per share to existing stockholders would be approximately $1.13 per share and the dilution to new investors purchasing shares in this offering would be approximately $3.88 per share.

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CAPITALIZATION

(In thousands)

The following table sets forth our consolidated cash and cash equivalents and capitalization as of October 31, 2003 on an actual basis, and as adjusted to give effect to this offering and the application of the proceeds to us after deducting fees, commissions and other expenses that we will pay and the repayment of approximately $3.3 million of outstanding principal and accrued interest under our Loan and Security Agreement with Atlantic Investors, LLC. You should read this table together with Use of Proceeds, Management s Discussion and Analysis of Financial Condition and Results of Operations and our audited and unaudited consolidated financial statements and the related notes and the other financial information included elsewhere in this prospectus.

	As of October 31, 2003		
	Actual	**Effect of Offering**	**As Adjusted**
		(Unaudited)	
Cash and cash equivalents	$ 2,898	$30,445	$ 33,343
Accounts receivable financing line	9,269		9,269
Current notes payable	1,181		1,181
Current note payable to Atlantic Investors	3,000	(3,000)	
Note to the AppliedTheory Estate	6,000		6,000
Total debt	$ 19,450	$ (3,000)	$ 16,450
Stockholders equity:			
Preferred stock, $0.01 par value. Authorized 5,000 shares; no shares issued or outstanding (actual and as adjusted)			
Common stock, $0.01 par value. Authorized 395,000 shares (actual and as adjusted); issued and outstanding 24,691 (actual); 32,074 (as adjusted)	248	74	322
Accumulated other comprehensive income (loss) (actual and as adjusted)	15		15
Additional paid-in capital	435,934	33,622	469,556
Accumulated deficit	(421,856)		(421,856)
Total stockholders equity	14,341	33,696	48,037
Total capitalization	$ 33,791	$30,696	$ 64,487

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SELECTED CONSOLIDATED FINANCIAL DATA

(In thousands, except per share data)

The following table provides selected consolidated financial data for the five years ended July 31, 2003 and the three months ended October 31, 2003 and 2002. The statements of operations data for each of the three years ended July 31, 2003 and the balance sheet data as of July 31, 2003 and 2002 are derived from our audited consolidated financial statements, which are included elsewhere in this prospectus. The statements of operations data for each of the years ended July 31, 2000 and 1999 and the balance sheet data as of July 31, 2001, 2000 and 1999 shown below are derived from our audited consolidated financial statements, which are not included in this prospectus. The statements of operations shown below for the three months ended October 31, 2003 and 2002 and the balance sheet data as of October 31, 2003 are derived from our unaudited financial statements included elsewhere in this prospectus and, in the opinion of our management, include all adjustments, consisting principally of normal recurring adjustments, necessary for a fair presentation of such information when read in conjunction with our audited financial statements. Our historical results are not necessarily indicative of the results of operations for future periods, and the results of operations for the three months ended October 31, 2003 are not necessarily indicative of the results to be expected for the full year ending July 31, 2004. The following data is qualified in its entirety by and should be read together with Management s Discussion and Analysis of Financial Condition and Results of Operations and our consolidated financial statements and related notes appearing elsewhere in this prospectus.

On August 8, 2003, we completed the acquisition of certain assets and the assumption of certain liabilities of CBT in a business combination accounted for in a manner similar to a pooling-of-interest due to common control ownership. Accordingly, our consolidated financial statements have been restated for all periods prior to the business combination to include CBT s financial results beginning on September 11, 2002, the date on which CBT acquired the controlling interest in us, after the elimination of intercompany balances.

Consolidated Statements of Operations Data:

	Year Ended July 31,					Three Months Ended October 31,	
	2003	2002	2001	2000	1999	2003	2002
						(Unaudited)	
Revenue:							
Revenue	$ 75,281	$ 40,968	$ 66,358	$ 24,870	$ 3,461	$ 23,473	$ 14,561
Revenue, related parties	1,310	18,453	36,368	24,893	7,058		1,310
Total revenue	76,591	59,421	102,726	49,763	10,519	23,473	15,871
Cost of revenue	70,781	67,000	127,155	68,496	20,338	17,924	16,495
Impairment, restructuring and other		68,317	1,930			633	
Total cost of revenue	70,781	135,317	129,085	68,496	20,338	18,557	16,495
Gross profit (deficit)	5,810	(75,896)	(26,359)	(18,733)	(9,819)	4,916	(624)
Operating expenses:							
Product development	950	5,281	14,072	5,197	2,620	348	382
Selling and marketing	5,960	9,703	32,251	22,805	6,888	1,972	1,287
General and administrative	20,207	19,272	33,011	12,270	4,823	4,958	3,677
Impairment, restructuring and other	8,882	(2,633)	8,011			456	147
Total operating expenses	35,999	31,623	87,345	40,272	14,331	7,734	5,493
Loss from operations	(30,189)	(107,519)	(113,704)	(59,005)	(24,150)	(2,818)	(6,117)

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	Year Ended July 31,					Three Months Ended October 31,	
	2003	2002	2001	2000	1999	2003	2002
						(Unaudited)	
Other income (expense):							
Interest income	851	1,060	2,753	2,027	4	64	305
Interest expense	(43,403)	(14,718)	(8,042)	(1,001)	(347)	(609)	(3,940)
Other income (expense), net	(733)	(516)	292	9	(39)	10	(253)
Loss before cumulative effect of change in accounting principle and income tax expense	(73,474)	(121,693)	(118,701)	(57,970)	(24,532)	(3,353)	(10,005)
Income tax expense	(153)						
Loss before cumulative effect of change in accounting principle	(73,627)	(121,693)	(118,701)	(57,970)	(24,532)	(3,353)	(10,005)
Cumulative effect of change in accounting principle			(4,295)				
Net loss	(73,627)	(121,693)	(122,996)	(57,970)	(24,532)	(3,353)	(10,005)
Accretion of dividends on Series C and D convertible redeemable preferred stock					(172)		
Net loss applicable to common shareholders	$(73,627)	$(121,693)	$(122,996)	$(57,970)	$(24,704)	$ (3,353)	$(10,005)
Basic and diluted net loss per common share:							
Before cumulative effect of change in accounting principle	$ (6.32)	$ (22.30)	$ (30.18)	$ (20.57)	$ (55.64)	$ (0.14)	$ (1.60)
Cumulative effect of change in accounting principle			(1.09)				
Basic and diluted net loss per common share(1)	$ (6.32)	$ (22.30)	$ (31.27)	$ (20.57)	$ (55.64)	$ (0.14)	$ (1.60)
Basic and diluted weighted average number of common shares outstanding	11,654	5,457	3,933	2,818	444	24,506	6,270

Consolidated Balance Sheet Data:

As of July 31,					As of October 31, 2003
2003	2002	2001	2000	1999	
					(Unaudited)

Cash and cash equivalents	$ 3,862	$21,842	$ 22,214	$ 77,947	$ 3,352	$ 2,898
Working capital (deficit)	(16,301)	16,516	(9,683)	48,159	(1,355)	(14,751)
Total assets	69,371	53,534	112,266	175,461	21,111	67,592
Long-term obligations	13,577	28,073	69,852	24,988	1,935	13,585
Stockholders equity (deficit)	16,879	8,544	(6,962)	97,474	(4,369)	14,341

(1) As discussed in the notes to our consolidated financial statements, in January 2003 we completed a 1-for-15 reverse stock split of our outstanding shares of common stock. All historical share and per share data have been adjusted for the reverse stock split.

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MANAGEMENT S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis of our financial condition and results of operations should be read together with Selected Consolidated Financial Data and our consolidated financial statements and related notes included in this prospectus. This discussion and analysis contains forward-looking statements that involve risks and uncertainties. Words such as may, will, should, could, expect, plan, anticipate, inte estimate, predict, potential, continue, or similar words are intended to identify forward-looking statements, although not all forward-looking statements contain these words. Although we believe that our opinions and expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements, and our actual results may differ substantially from the views and expectations set forth below. We expressly disclaim any intent or obligation to update any forward-looking statements after the date hereof to conform such statements to actual results or to changes in our opinions or expectations.

Readers are urged to carefully review and consider the various disclosures made by us which attempt to advise interested parties of the factors which affect our business including, but not limited to, those discussed in Risk Factors, Forward-Looking Statements and elsewhere in this prospectus.

Overview

We provide our services to customers typically pursuant to agreements with a term of one to three years and monthly payment installments. As a result, these agreements provide us with a base of recurring revenue. Our revenue increases by adding new customers or additional services to existing customers. Our overall base of recurring revenue is affected by renewals or terminations of agreements with existing customers.

A large portion of the costs to operate our data centers, such as rent, product development and general and administrative expenses, does not depend strictly on the number of customers or the amount of services we provide. As we add new customers or new services to existing customers, we generally incur limited additional expenses relating to telecommunications, utilities, hardware and software costs, and payroll expenses. We have substantial capacity to add customers to our data centers. Our relatively fixed cost base, sufficient capacity for expansion and limited incremental variable costs provide us with the opportunity to grow profitably. However, these same fixed costs present us with the risk that we may incur losses if we are unable to generate sufficient revenue.

In recent years, we have grown through acquisitions of new businesses and have restructured our historical operations. Specifically, in December 2002, we acquired ClearBlue Technologies Management, Inc. (a wholly-owned subsidiary of our majority stockholder at the time of the acquisition), adding application management and development capabilities to our Managed Application Services; in February 2003, we acquired Avasta, adding capabilities to our Managed Application Services; in April 2003, we acquired Conxion, providing key services to our Managed Application Services and Managed Infrastructure Services; in May 2003, we acquired assets of Interliant, forming the core of our Managed Messaging Services; and in August 2003, we acquired assets of CBT (which was our majority stockholder at that time) related to colocation, bandwidth, security and disaster recovery services, enhancing our Managed Infrastructure Services. Prior to September 2002, substantially all of our services were managed application services, and we have added managed infrastructure and managed messaging services since that time. This transformation in our business will result in our recent results being more relevant to an understanding of our business than our historical results. We also expect to make additional acquisitions to take advantage of our available capacity, which will have significant effects on our financial results in the future.

Our acquisitions of CBTM and assets of CBT were accounted for in a manner similar to a pooling-of-interest due to common control ownership. The assets and the liabilities of CBT, CBTM and NaviSite were combined at their historical amounts beginning on September 11, 2002, the date on which CBT

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obtained a majority ownership of NaviSite. Our acquisitions of Avasta and Conxion and selected assets of Interliant were accounted for using the purchase method of accounting and as such, the results of operations and cash flows relating to these acquisitions were included in our Consolidated Statements of Operations and Consolidated Statements of Cash Flows for the fiscal year ended July 31, 2003 from their respective dates of acquisition of February 5, 2003, April 2, 2003 and May 16, 2003.

The audit report on our fiscal year 2003 consolidated financial statements from KPMG LLP, our independent auditors, contains an explanatory paragraph that states that our recurring losses from operations since inception and accumulated deficit, as well as other factors, raise substantial doubt about our ability to continue as a going concern. During fiscal year 2003 and thereafter, we have undergone a significant transition, including all of the acquisitions that are described in this prospectus and a balance sheet restructuring. Included in this transition was a complete turnover of our senior management team and our Board of Directors. While we cannot assure you that we will continue as a going concern, we believe that we have developed and are implementing an operational plan that aligns our cost structure with our projected revenue growth.

Results of Operations

The following table sets forth the percentage relationships of certain items from our Consolidated Statements of Operations as a percentage of total revenue.

	Year Ended July 31,			Three Months Ended October 31,	
	2003	2002	2001	2003	2002
				(Unaudited)	
Revenue:					
Revenue	98.3%	68.9%	64.6%	100.0%	91.7%
Revenue, related parties	1.7	31.1	35.4	0.0	8.3
Total revenue	100.0	100.0	100.0	100.0	100.0
Cost of revenue	92.4	112.8	123.8	76.4	103.9
Impairment, restructuring and other	0.0	115.0	1.9	2.7	0.0
Total cost of revenue	92.4	227.8	125.7	79.1	103.9
Gross profit (deficit)	7.6	(127.8)	(25.7)	20.9	(3.9)
Operating expenses:					
Product development	1.2	8.9	13.7	1.5	2.4
Selling and marketing	7.8	16.3	31.4	8.4	8.1
General and administrative	26.4	32.4	32.1	21.1	23.2
Impairment, restructuring and other	11.6	(4.4)	7.8	1.9	0.9
Total operating expenses	47.0	53.2	85.0	32.9	34.6
Loss from operations	(39.4)	(181.0)	(110.7)	(12.0)	(38.5)
Other income (expense):					
Interest income	1.1	1.8	2.7	0.3	1.9
Interest expense	(56.7)	(24.8)	(7.8)	(2.6)	(24.8)
Other income (expense), net	(1.0)	(0.9)	0.3	0.0	(1.6)
Loss before cumulative effect of change in accounting principle and income tax expense	(96.0)	(204.9)	(115.5)	(14.3)	(63.0)
Income tax expense	(0.2)	0.0	0.0	0.0	0.0
	(96.2)	(204.9)	(115.5)	(14.3)	(63.0)

Loss before cumulative effect of change in accounting principle					
Cumulative effect of change in accounting principle	0.0	0.0	(4.2)	0.0	0.0
Net loss	(96.2)%	(204.9)%	(119.7)%	(14.3)%	(63.0)%

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Comparison of Three Months Ended October 31, 2003 and 2002

Revenue

We derive our revenue primarily from outsourced managed hosting, colocation and managed application services comprised of a variety of service offerings, including providing related professional and consulting services, to middle-market organizations.

Total revenue for the three-month period ended October 31, 2003 increased 48% to approximately $23.5 million from approximately $15.9 million for the three-month period ended October 31, 2002. The overall growth in revenue of approximately $7.6 million was mainly due to revenue resulting from our acquisitions, which contributed approximately $9.1 million in revenue during the quarter ended October 31, 2003. The increased revenue was partially offset by lost customer revenue of $1.6 million, which was primarily the result of a decrease in revenue from related parties of $1.3 million. Revenue from related parties principally consisted of sales of services to CMGI and its affiliates until September 2002 when CMGI sold its equity and debt interests in us to CBT, and then such related party revenue was recorded as revenue. The decrease in related party revenue for the three months ended October 31, 2003 as compared to the three months ended October 31, 2002 was primarily attributable to CMGI s affiliates terminating their relationships with us upon the completion of their contracts. Revenue for the three-month period ended October 31, 2002 includes two months of revenue of CBTM and the acquired subsidiaries from CBT.

Our 48% revenue growth was primarily attributable to the increase in our number of customers derived from our acquisitions. We expect revenue during the three months ended January 31, 2004 to be down slightly from the three months ended October 31, 2003 due to a reduction in prices charged to our largest customer and a one-time revenue item recognized on a cash basis during the three months ended October 31, 2003 from a former customer. We expect our second-half revenues for fiscal year 2004 to be flat to slightly lower than our first-half of fiscal year 2004.

Cost of Revenue and Gross Profit

Cost of revenue consists primarily of salaries and benefits for operations personnel, bandwidth fees and related Internet connectivity charges, equipment costs and related depreciation, and costs to operate our data centers, such as rent and utilities.

Cost of revenue for the three-month period ended October 31, 2003, excluding impairment charges, increased 9% to approximately $17.9 million from approximately $16.5 million for the three-month period ended October 31, 2002. The increase in the cost of revenue of $1.4 million, net of impairment charges, resulted primarily from costs incurred to deliver the increased revenue.

Gross profit as a percentage of revenue for the three-month period ended October 31, 2003 was 21% as compared to a gross deficit as a percentage of revenue of 4% for the three-month period ended October 31, 2002. Excluding the impairment charge recorded in the three-month period ended October 31, 2003, our gross profit as a percentage of revenue was 24%. This increase was mainly due to reductions in unit costs of Internet connectivity charges, equipment costs and related depreciation and costs to run our data centers as well as our ability to deliver the increase in revenue with no significant increase in overall salary expense. We expect our gross profit as a percentage of revenue to improve moderately during fiscal year 2004.

Operating Expenses

Product Development. Product development expenses consist primarily of salaries and related costs of our employees engaged in product development activities. Product development expenses decreased 9% to approximately $348,000 for the three-month period ended October 31, 2003 from approximately $382,000 for the three-month period ended October 31, 2002. The decrease in product development expenses is primarily related to severance costs recorded in the three-month period ended October 31,

2002, which were not replicated in the three-month period ended October 31, 2003. We expect product development expenses to remain constant as a percentage of revenue during fiscal year 2004.

Selling and Marketing. Selling and marketing expenses consist primarily of salaries and related benefits, commissions and marketing expenses such as advertising, product literature, trade shows, marketing and direct mail programs. Selling and marketing expense increased 53% for the three-month period ended October 31, 2003 to approximately $2.0 million from approximately $1.3 million for the three-month period ended October 31, 2002. The increase of approximately $685,000 resulted primarily from increases in salary and related costs, increases in commission expense corresponding to increases in revenue and increases in marketing program costs. We expect selling and marketing expenses to slightly increase as a percentage of revenue during fiscal year 2004 as we hire additional sales resources.

General and Administrative. General and administrative expenses include the costs of financial, human resources, information technology and administrative personnel, professional services, bad debt and corporate overhead. Also included in the three-month period ended October 31, 2002 are intercompany charges from CMGI for facilities and shared back-office and business development support. These costs were eliminated upon the termination of the Facilities and Administrative Agreement between CMGI and us in September 2002. Excluding the impairment charge, general and administrative expenses increased 35% to approximately $5.0 million for the three-month period ended October 31, 2003 from approximately $3.7 million for the three-month period ended October 31, 2002. The increase of approximately $1.3 million was mainly the result of increases in salary expense of approximately $580,000, bad debt expense of approximately $340,000, utility expense of approximately $300,000, depreciation expense of approximately $290,000 and costs of moving data centers of approximately $125,000 partially offset by decreases in the allocation of expense from CMGI of approximately $250,000 and legal expenses of approximately $160,000. We expect general and administrative expenses to remain constant as a percentage of revenue during fiscal year 2004.

Impairment, Restructuring and Other

Costs associated with abandonment of lease facilities were approximately $1.1 million for the three-month period ended October 31, 2003. These costs are due primarily to abandonment of data center space at our Vienna, Virginia facility, recorded as an increase to cost of sales, and the abandonment of administrative space at our San Francisco, California office, recorded as an increase to general and administrative expenses. We recorded a charge equal to the amount of rent and other direct costs for the period and time the space is expected to remain unoccupied plus the present value of the amount by which the rent paid by us to the landlord exceeds any rent paid to us by a subtenant under a sublease over the remainder of the lease term. A charge of $147,000 was recorded for the three-month period ended October 31, 2002 relating to the restructuring of capital lease agreements.

Interest Income

Interest income decreased 79% to approximately $64,000 for the three-month period ended October 31, 2003 from approximately $305,000 for the three-month period ended October 31, 2002. The decrease is due primarily to lower cash balances during the three-month period ended October 31, 2003 as compared to the three-month period ended October 31, 2002.

Interest Expense

Interest expense decreased 85% to approximately $609,000 for the three-month period ended October 31, 2003 from $3.9 million for the three-month period ended October 31, 2002. The decrease is due primarily to the reduction of the expense related to the beneficial conversion feature and interest on our convertible debt, which was fully converted in fiscal year 2003. During the three-month period ended October 31, 2003, interest expense was incurred based primarily on our outstanding accounts receivable financing agreement with Silicon Valley Bank, our note payable to Atlantic Investors and our

note payable to the AppliedTheory estate. We expect interest expense to decrease based on the anticipated repayment of the note payable to Atlantic Investors with the proceeds from this offering.

Comparison of the Years 2003, 2002 and 2001

Revenue

Total revenue for fiscal year 2003 increased 29% to approximately $76.6 million from approximately $59.4 million in fiscal year 2002. The overall growth in revenue was mainly due to revenue resulting from an increased number of customers gained pursuant to our acquisitions, which contributed $48.7 million in revenue during fiscal year 2003, offset by net lost customer revenue of $31.5 million. Revenue from non-related parties increased by 84% to approximately $75.3 million in fiscal year 2003 from approximately $41.0 million in fiscal year 2002 but was offset by a decline in revenue from related parties. Revenue from related parties decreased by 93% to approximately $1.3 million in fiscal year 2003 from approximately $18.5 million in 2002. Revenue from related parties principally consisted of sales of services to CMGI and its affiliates until September 2002 when CMGI sold its equity and debt interests in us to CBT, and then this related party revenue was recorded as revenue. The decrease in related party revenue for fiscal year 2003 as compared to fiscal year 2002 was primarily attributable to CMGI s affiliates terminating their relationships with us upon the completion of their contracts.

Total revenue for fiscal year 2002 decreased 42% to approximately $59.4 million from approximately $102.7 million in fiscal year 2001. Included in fiscal year 2002 revenue is approximately $2.9 million in non-recurring revenue from early contract termination settlements, primarily from related parties, including $2.4 million from the termination of a web hosting agreement with Engage, Inc. Excluding settlement revenue, total revenue for fiscal year 2002 decreased 45% to approximately $56.5 million from approximately $102.7 million in fiscal year 2001. The decrease in fiscal year 2002 revenue, net of settlement revenue, resulted from a $25.4 million, or 38%, decrease in unaffiliated revenue combined with a $17.9 million, or 49%, decrease in revenue from CMGI and its affiliates.

In fiscal year 2003, one unrelated customer accounted for 21% of our revenue as compared to fiscal year 2002 where one CMGI affiliate accounted for approximately 11% of our revenue and fiscal year 2001 where four CMGI affiliates accounted for approximately 25%, 17%, 15% and 14% of our revenue, respectively.

Cost of Revenue

Cost of revenue, excluding impairment charges, increased 6% to approximately $70.8 million in fiscal year 2003 from approximately $67.0 million in fiscal year 2002. The increase in cost of revenue of $3.8 million, net of impairment charges, resulted primarily from the addition of approximately $14.2 million in cost of revenue from the acquisitions of subsidiaries of CBT netted with a $10.4 million reduction in our cost of revenue. The $10.4 million reduction in our cost of revenue consisted primarily of reductions in depreciation of $11.1 million, equipment lease and related costs of $6.4 million due to restructuring that took place in fiscal year 2002 partially offset by increases in labor costs of $4.0 million, bandwidth costs of $1.6 million and software licenses of $1.4 million related to acquisitions made in fiscal year 2003.

Cost of revenue, excluding impairment charges, decreased 47% to approximately $67.0 million in fiscal year 2002, from approximately $127.2 million in fiscal year 2001. The reduction in cost of revenue of $60.2 million, net of impairment charges, resulted primarily from a $34.7 million reduction in equipment lease and related costs, a $10.0 million reduction in labor costs due to head count reductions, a $9.1 million reduction in consulting fees, a $5.9 million reduction in bandwidth and bandwidth related costs, a $2.9 million reduction in rent costs related to the closing of our original data centers on July 31, 2001, and a $2.9 million reduction in other facility and equipment related costs offset by a $5.2 million increase in depreciation resulting from the purchase of equipment formerly held under operating leases. Included in cost of revenue for fiscal years 2002 and 2001 are impairment charges of $68.3 million and $1.9 million, respectively.

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Impairment, Restructuring and Other

In fiscal year 2002, we recorded a $68.3 million impairment charge related to leased and owned equipment and long-lived assets. The components of this charge are as follows:

As a result of a physical inventory of our customer-dedicated equipment, we recorded an impairment charge of $1.5 million for obsolete equipment and for equipment no longer on hand and identified certain excess assets not in use.

We modified the payment amounts and terms of operating leases with three equipment vendors such that the modified leases qualify as capital leases. One of the resulting capital leases is payable in 24 equal monthly payments of $38,000, starting in December 2001. The second capital lease has total payments of $2.6 million, of which $1.0 million was paid in the second quarter of fiscal year 2002 and $1.6 million was paid in fiscal year 2003. The third capital lease is payable in 28 monthly payments of $4,700 for the first four months and $20,400 for the remaining 24 months, starting in April 2002. The equipment under all resulting capital leases was capitalized at the fair market value of the equipment at the time of the modification, determined to be $1.1 million, which was lower than the present value of the future minimum lease payments based on our estimated incremental borrowing rate of 12%. Because the fair market value of the equipment was less than the consideration given, based on a third-party appraisal, we recorded an asset impairment charge of approximately $1.0 million. In addition, we returned some equipment held under operating leases with one of the above lessors and incurred and paid a breakage fee of $397,000.

We recorded a net $1.9 million charge representing the future estimated remaining minimum lease payments related to certain idle equipment held under various operating leases. The equipment had previously been rented to former customers under operating leases, and upon the loss of the customer, the equipment became idle. Based on our then forecasts, the equipment would not be utilized before the related operating leases expired and/or the equipment became obsolete.

We evaluated the current and forecasted utilization of our purchased software licenses. As a result of this evaluation, during the second quarter of fiscal year 2002, we recorded a $365,000 impairment for software licenses that would not be utilized before the licenses expired and/or became obsolete.

We finalized agreements with various equipment lessors whereby we purchased equipment previously held under operating leases for approximately $42.0 million. The fair market value of the equipment at the time of purchase, based on third-party appraisal, was approximately $14.3 million. As the aggregate fair market value of the equipment, based on third-party appraisal, was less than the aggregate consideration given, we recorded an asset impairment charge of approximately $25.4 million, as a separate component of cost of revenue, in fiscal year 2002.

A number of factors occurring during the fourth quarter of fiscal year 2002 impacted our long-lived assets including both our expected future cash flow generation and our expected utilization of the assets within revised operating plans. These factors included the further deterioration of market conditions within our industry, excess capacity in the industry and in our two data centers, our anticipated data center utilization and our revised business model.

Based on these factors and their impact on current and future projected cash flows, we performed an assessment of the carrying value of our long-lived assets pursuant to SFAS No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of. The conclusion of this assessment was that the decline in market conditions within our industry was significant and other than temporary. In this assessment, we reviewed our long-lived assets, which included property, equipment and goodwill. The carrying amount of goodwill, which totaled $186,000, was considered unrecoverable and was written-off as of July 31, 2002 and was included as a component of general and administrative expense.

In accordance with SFAS No. 121, the measurement of the impairment loss of property and equipment was based on the fair value of the asset, as determined by third-party appraisal. Management determined that the best measure of fair value for the property and equipment was a combination of the market and cost approaches. The cost approach was utilized to determine the fair value of certain computer hardware, leasehold improvements, office furniture and equipment and construction in progress. The cost approach utilizes estimated replacement/reproduction cost, with allowances for physical depreciation and functional obsolescence (i.e. asset utilization). For certain equipment and leasehold improvements, the market approach was used. The market approach typically includes comparing recent sales of similar assets and adjusting these comparable transactions based on factors such as age, condition, and type of sale to determine fair value. Based on the appraised fair value of the property and equipment, we recorded an impairment charge of approximately $38.1 million during the fourth quarter of fiscal year 2002.

Included in the fiscal year 2001 cost of revenue is a charge of approximately $1.9 million related to some of our equipment under operating leases, which had been deemed not to have a future economic benefit to us.

Operating Expenses

Product Development. Product development expenses decreased 82% to approximately $950,000 in fiscal year 2003 from approximately $5.3 million in fiscal year 2002. The decrease in product development expenses is primarily related to reduced headcount and related costs resulting from the decrease in product development personnel in fiscal year 2003 from fiscal year 2002, combined with a reduction in allocated depreciation and equipment rental expense.

Product development expenses decreased 63% to approximately $5.3 million in fiscal year 2002 from approximately $14.1 million in fiscal year 2001. The decrease in product development expenses is primarily related to reduced headcount and related costs resulting from the decrease in product development personnel in fiscal year 2002 from fiscal year 2001, combined with a reduction in outside consulting fees.

Selling and Marketing. Selling and marketing expenses decreased 39% to approximately $6.0 million in fiscal year 2003 from approximately $9.7 million in fiscal year 2002. The decrease of approximately $3.7 million resulted primarily from a reduction in salary and related costs of approximately $2.6 million, a reduction of allocated rent of approximately $800,000 and a reduction in marketing program costs of approximately $300,000.

Selling and marketing expenses decreased 70% to approximately $9.7 million in fiscal year 2002 from approximately $32.3 million in fiscal year 2001. The $22.5 million decrease resulted primarily from a $8.1 million reduction in headcount expenses related to a decrease in sales and marketing personnel, a $6.6 million reduction in marketing programs, advertising and product literature, a $5.2 million reduction in commission expense driven by decreased revenue levels, and a $765,000 reduction in consulting fees.

General and Administrative. General and administrative expenses increased 4.9% to approximately $20.2 million in fiscal year 2003 from approximately $19.3 million in fiscal year 2002. The increase of approximately $935,000 was mainly the result of the addition of approximately $1.3 million in CBT general and administrative expenses offset by a net decrease in expenses of approximately $400,000. The $400,000 is primarily comprised of a reduction in bad debt expense of $2.5 million partially offset by increases in headcount related expenses of $1.2 million, increased accounting and legal fees of $800,000 and increased expense for amortization of intangibles related to the CBTM acquisition during the fiscal year.

General and administrative expenses decreased 42% to approximately $19.3 million in fiscal year 2002 from approximately $33.0 million in fiscal year 2001. The $13.7 million decrease resulted primarily from a $8.3 million reduction in bad debt expense, a $5.1 million reduction in headcount expense related to

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a decrease in general and administrative personnel at July 31, 2002 to 26 from 52 at July 31, 2001, and a $1.7 million reduction in consulting fees. General and administrative expenses also included a $600,000 legal settlement paid to Level 3 to settle a contract dispute regarding colocation space cancelled by NaviSite.

Impairment, Restructuring and Other

Costs associated with impairment, restructuring and abandonment of lease facilities increased to approximately $8.9 million in fiscal year 2003 compared to a reversal of a portion of a previous impairment and restructuring charge of approximately $2.6 million in fiscal year 2002. The increase is due primarily to abandonment of administrative space at our 400 Minuteman Road, Andover, MA facility and the abandonment of administrative space at our La Jolla, CA office and approximately $2.0 million impairment of intangible assets by CBT. We recorded a charge equal to the amount of rent and other direct costs for the period the space is expected to remain unoccupied plus the present value of the amount by which the rent paid by us to the landlord exceeds any rent paid to us by a subtenant under a sublease over the remainder of the lease term.

In July 2001, we announced a plan, approved by our Board of Directors, to restructure our operations and consolidate our data centers, which resulted in a charge of approximately $8.0 million, of which approximately $5.2 million was accrued for as of July 31, 2001. Of the total restructuring charge, approximately $1.8 million was related to employee termination benefits. We terminated 126 employees on July 31, 2001. The restructuring charge also included approximately $6.2 million of costs related to the closing of our two original data centers. The components of the facility closing costs included approximately $3.8 million of estimated lease obligations associated with restoring the facilities to their original condition, and other contractual obligations, to be paid over the term of the respective agreements through 2002, and approximately $2.4 million of write-offs of leasehold improvements, which were recorded as of July 31, 2001. During fiscal year 2002, we were able to favorably renegotiate the facility closing costs. The accrual for the two original data centers was reduced by approximately $1.6 million and the bandwidth termination costs were reduced by approximately $1.0 million. In addition, $63,000 in severance and employee costs were forfeited by former employees. As a result, we reversed approximately $2.6 million in restructuring accrual during fiscal year 2002. As of July 31, 2002, we had completed the restructuring plan and made all related payments.

Interest Income

Interest income decreased 20% to approximately $851,000 in fiscal year 2003 from approximately $1.1 million in fiscal year 2002. The decrease is due primarily to the reduced levels of average cash on hand.

Interest income decreased 62% to approximately $1.1 million in fiscal year 2002, from approximately $2.8 million in fiscal year 2001. The decrease is due primarily to the reduced levels of average cash on hand.

Interest Expense

Interest expense increased 195% to approximately $43.4 million in fiscal year 2003 from approximately $14.7 million in fiscal year 2002. The increase of $28.7 million is due mainly to the non-cash write-off of the unamortized beneficial conversion feature related to the conversion of the $65 million of convertible notes during fiscal year 2003.

Interest expense increased 83% to approximately $14.7 million in fiscal year 2002 from approximately $8.0 million in fiscal year 2001. The increase is due to the interest payable on the $65 million of convertible notes and related beneficial conversion feature amortization.

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Other Income (Expense), net

Other income (expense) increased 42% to approximately ($733,000) in fiscal year 2003 from ($516,000) in fiscal year 2002. This increase is mainly due to increased fees related to the accounts receivable financing agreement with Silicon Valley Bank.

Other income (expense) decreased 277% to ($516,000) in fiscal year 2002 from $292,000 in fiscal year 2001. The decrease is due to the loss on the sale of assets offset by the gain realized on the sale of certain of our Streaming Media assets.

Fiscal Year 2001 Change in Accounting Principle

During fiscal year 2001, we adopted SEC Staff Accounting Bulletin No. 101 Revenue Recognition in Financial Statements, or SAB 101. Under SAB 101, installation fees are recognized over the life of the related customer contracts. Prior to fiscal year 2001, we recognized installation fees at the time the installation occurred. The cumulative effect of the change in accounting principle on all prior years resulted in a $4.3 million increase in net loss for the year ended July 31, 2001 and is reflected as a cumulative effect of change in accounting principle. Revenue for the year ended July 31, 2001 includes $1.5 million that was included in the cumulative effect adjustment. The $1.5 million of fiscal year 2001 revenue was primarily attributable to the recognition of the previously deferred revenue on customers lost during fiscal year 2001.

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Quarterly Results of Operations

(In thousands, except for per share data)

We have prepared the following table on a basis consistent with the audited consolidated financial statements included in this prospectus and, in the opinion of management, this chart includes all adjustments necessary for the fair presentation of such data.

	Three Months Ended								
	Oct. 31, 2003	**July 31, 2003(1)**	**April 30, 2003(1)**	**Jan. 31, 2003(1)**	**Oct. 31, 2002**	**July 31, 2002**	**April 30, 2002**	**Jan. 31, 2002**	**Oct. 31, 2001**
	(Unaudited)								
Revenue:									
Revenue	$23,473	$ 22,341	$ 19,620	$ 18,761	$ 14,561	$ 6,625	$ 9,113	$ 11,747	$ 13,483
Revenue, related parties					1,310	3,126	5,604	3,927	5,796
Total revenue	23,473	22,341	19,620	18,761	15,871	9,751	14,717	15,674	19,279
Cost of revenue	17,924	19,960	17,312	17,014	16,495	11,166	14,150	20,307	21,377
Impairment, restructuring and other	633(7)					37,717(3)	(3,985)(4)	7,226(3)	27,359(5)
Total cost of revenue	18,557	19,960	17,312	17,014	16,495	48,883	10,165	27,533	48,736
Gross profit (deficit)	4,916	2,381	2,308	1,747	(624)	(39,132)	4,552	(11,859)	(29,457)
Operating expenses:									
Product development	348	326	121	121	382	356	1,003	1,945	1,977
Selling and marketing	1,972	2,201	1,429	1,043	1,287	1,834	2,731	2,502	2,636
General and administrative	4,958	6,489	5,023	5,018	3,677	2,729	2,622	7,086	6,835
Impairment, restructuring and other	456(7)	2,608(6)	3,819(7)	2,308(7)	147	(138)	(2,495)(8)		
Total operating expenses	7,734	11,624	10,392	8,490	5,493	4,781	3,861	11,533	11,448
Loss from operations	(2,818)	(9,243)	(8,084)	(6,743)	(6,117)	(43,913)	691	(23,392)	(40,905)
Other income (expense):									
Interest income	64	167	169	211	305	339	389	168	164
Interest expense	(609)	(23,232)(9)	(2,470)	(13,760)(9)	(3,940)	(3,770)	(3,763)	(3,576)	(3,609)
Other income (expense), net	10	376	(919)	61	(253)	(1,186)	639	21	10
Loss before income tax expense	(3,353)	(31,932)	(11,304)	(20,231)	(10,005)	(48,530)	(2,044)	(26,779)	(44,340)
Income tax expense		153							
Net loss	$ (3,353)	$(32,085)	$(11,304)	$(20,231)	$(10,005)	$ (48,530)	$ (2,044)	$(26,779)	$ (44,340)
Basic and diluted net loss per common share(2):	$ (0.14)	$ (1.80)	$ (0.88)	$ (2.07)	$ (1.60)	$ (7.97)	$ (0.35)	$ (4.70)	$ (10.72)
	24,506	17,788	12,845	9,751	6,270	6,092	5,917	5,698	4,138

Basic and diluted weighted average number of common shares outstanding(2)

(1) The three-month periods ended July 31, April 30 and January 31, 2003 have been restated herein to reflect our acquisition of assets of CBT as if the acquisition had taken place on September 11, 2002. This acquisition transpired when both companies were under common control, and therefore, the acquisition is accounted for in a manner similar to a pooling-of-interest.

(2) As discussed in the notes to our consolidated financial statements, in January 2003 we completed a 1-for-15 reverse stock split of our outstanding shares of common stock. All historical share and per share data have been adjusted for the reverse stock split.

(3) Impairment related to valuation of our fixed assets.

(4) Reversal of impaired lease accrual due to change in estimate.

(5) Impairment of assets purchased during buyout of certain operating leases.

(6) Impairment of leased facility and write-off of intangible assets at CBT.

(7) Impairment of leased facility.

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(8) Reversal of fiscal year 2001 restructuring charge due to change in estimate.

(9) Increase in interest expense related to non-cash expense from conversion of our convertible debt.

The following is a reconciliation from the quarterly reported results previously filed on our annual report on Form 10-K and our quarterly reports on Form 10-Q to the results presented herein.

	Three Months Ended								
	July 31, 2003			April 30, 2003			January 31, 2003		
	As reported	CBT Results	Combined(1)	As reported	CBT Results	Combined(1)	As reported	CBT Results	Combined(1)
					(Unaudited)				
Revenue:									
Revenue	$ 18,627	$ 3,713	$ 22,341	$ 15,877	$ 3,743	$ 19,620	$ 14,803	$ 3,958	$ 18,761
Revenue, related parties		81							
Total revenue	18,627	3,794	22,341	15,877	3,743	19,620	14,803	3,958	18,761
Cost of revenue	16,339	3,741	19,960	13,633	3,622	17,312	13,006	3,989	17,014
Impairment, restructuring and other									
Total cost of revenue	16,339	3,741	19,960	13,633	3,622	17,312	13,006	3,989	17,014
Gross profit (deficit)	2,288	53	2,381	2,244	121	2,308	1,797	(31)	1,747
Operating expenses:									
Product development	326		326	121		121	121		121
Selling and marketing	2,197		2,201	1,367		1,429	996	26	1,043
General and administrative	5,836	797	6,489	4,729	323	5,023	4,716	311	5,018
Impairment, restructuring and other	776	1,831	2,608	3,819		3,819	2,308		2,308
Total operating expenses	9,135	2,628	11,624	10,036	323	10,392	8,141	337	8,490
Loss from operations	(6,847)	(2,575)	(9,243)	(7,792)	(202)	(8,084)	(6,344)	(368)	(6,743)
Other income (expense):									
Interest income	155	12	167	157	12	169	200	11	211
Interest expense	(23,216)	(16)	(23,232)	(2,448)	(22)	(2,470)	(13,721)	(39)	(13,760